66527-8 66527-8

No. 66527-8-I

IN THE COURT OF APPEALS
OF THE STATE OF WASHINGTON
DIVISION I

DONALD AND BETH COLLINGS

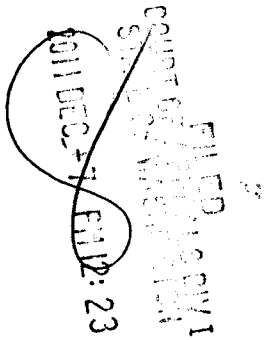
Plaintiffs-Defendants In Intervention-Appellees,

CITY FIRST MORTGAGE SERVICES, LLC

Defendant-Appellant,

U.S. BANK NATIONAL ASSOCIATION AS TRUSTEE
FOR THE GREENPOINT MORTGAGE FUNDING TRUST
MORTGAGE PASS-THROUGH CERTIFICATES,
SERIES 2007-AR1,

Plaintiff In Intervention-Appellant.



**REPLY BRIEF OF APPELLANT
U.S. BANK NATIONAL ASSOCIATION AS TRUSTEE
FOR THE GREENPOINT MORTGAGE FUNDING TRUST
MORTGAGE PASS-THROUGH CERTIFICATES,
SERIES 2007-AR1**

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INTRODUCTION

The Collings commenced their action seeking, among other things, to obtain an order voiding U.S. Bank as Trustee's Deed of Trust as the product of fraud and statutory violations. U.S. Bank as Trustee intervened to defend against such an order. After trial with the advisory jury, disregarding the majority of the jury's findings, the trial court declared the Deed of Trust void and unenforceable; however, the trial court's own findings are not supported by substantial evidence and its conclusions do not support the judgment voiding the Deed of Trust.

In their Brief of Respondents, the Collings ignore the absence of evidence of an assignment upon which the trial court based its finding the Deed of Trust was separated from the Note. Instead, they offer new argument that *City First* split the Note from the Deed of Trust, which still fails to support the judgment as a matter of law. Similarly, the Collings relegate to a *footnote* the absence of evidence of a written lease between the Collings and Loveless, which was clearly key to a number of the trial court's findings and conclusions.

The Collings devote most of their attention to the trial court's erroneous application of the holder in due course doctrine, in which

they demonstrate their (and the trial court's) confusion between the statutory definitions of "holder", "holder in due course," and "beneficiary" under Chapters 61.24, 62A.3 and 62A.9 of the Revised Code of Washington. BR 31-39; CL 22, CP 2155. The holder in due course doctrine, asserted in the negative by the Collings as an affirmative defense, protects a *purchaser* of a loan against charges either *party to the original transaction* may have had against the other. The Collings were not parties to the Loveless Loan; and U.S. Bank as Trustee was not required to establish itself as a holder in due course, although it did without a scintilla of rebuttal evidence from the Collings.

Even if the trial court implicitly concluded U.S. Bank as Trustee is not the holder of the Note, it does not follow from a conclusion of law that a party is not the holder of a negotiable instrument that the security is *voidable*, only that someone else is the holder. This is why even a debtor does not have standing to challenge a creditor's transfer of the loan, a principle vigorously opposed by the Collings, who are not even debtors under the Note and Deed of Trust.

As to the note-split and illegality theories as possible grounds for voiding the Deed of Trust, the Collings can offer only new, half-

hearted argument, as the trial court based its findings in support of its adjudication voiding the Deed of Trust on nonexistent evidence. Conceding U.S. Bank as Trustee's nominal beneficiary of the Deed of Trust, MERS, never assigned the Deed of Trust to itself, as the trial court found in FF 8, CP 2152, the Collings present new argument that City First and Loveless split the Note by agreeing to have MERS serve as the nominal beneficiary or agent of the Deed of Trust at loan origination. This theory fails as a matter of consistent, current Washington law.

Regarding the illegality theory, the trial court did not even issue a finding or conclusion of law regarding illegality. The closest were findings that Loveless "was in material breach of the lease" and that it was a "defect in the Loveless Loan." FF 3, 13 and 14, CP 2152-2153.

After the Collings learned U.S. Bank as Trustee was the owner of the Loveless Loan, rather than City First, their theories of defense against the validity and enforceability of the Loveless Loan, particularly the Deed of Trust, shifted from their product of fraud contention, as they impliedly admitted Loveless's no-cash-back refinance loan six months later was not illegal as the product of fraud

or statutory violations. Instead, the Collings are left to attempt to defend note-split and contract-based illegality theories, neither of which can support the judgment voiding the Deed of Trust.

REPLY TO RESPONDENTS' STATEMENT OF FACTS

The Collings' statement of facts falls badly short of RAP 10.3(a)(5) ("A fair statement . . . without argument"). The Collings' distorted recitation of the facts[1], findings[2], and evidence[3] and tortuous argument that U.S. Bank as Trustee is not the owner or holder of the

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1 At BR 5, the Collings state Loveless "obtained a $52,500 HELOC," and do not even mention the refinance Loveless Loan, nor that both were no-cash-back loans, and then proceed to state the HELOC was in default, citing to Exhibit 11, when Exhibit 11 relates to the Loveless Loan.

2 At BR 8, the Collings represent the trial court found that City First attempted to transfer the Deed of Trust separately from the Note, based upon a citation to 9/16 RP 80-81, 100-103. In the cited provisions of the transcript, Mr. Duclos repeatedly testified U.S. Bank as Trustee owned the Note *and* the Deed of Trust as of July 1, 2007, and that MERS became its nominal beneficiary of the Deed of Trust with its authority, as U.S. Bank as Trustee was and is a MERS member.

3 At BR 13, the Collings represent the Exception Report (Ex. 163), upon which Mr. Duclos based his testimony that U.S. Bank reviewed the Loveless Loan and the Note was endorsed in blank and otherwise free of any deficiencies, listed loans not included in the Mortgage Loan Schedule (Ex. 157). This representation is completely false. On the first page of Exhibit 157, the third loan from the bottom refers to 11910 Weddington St.; that loan is listed on the ninth page of the Exhibit 163 Exception Report at line 18. On the second page of Exhibit 157, the first loan refers to 285 Reflections Drive; that loan is also listed on the ninth page of Exhibit 163 at line 20, two from the Weddington St. loan.

Loveless Loan merely serve to confuse and avoid confrontation of the true issue that the trial court's erroneous findings and conclusions were based in pertinent part on nonexistent evidence, and the findings and conclusions themselves do not support the trial court's adjudication voiding the Deed of Trust.

A. The Collings Fail To Defend Several Key Findings To Which U.S. Bank As Trustee Assigned Error And Argued.

The Collings implicitly admit that no substantial evidence supports two key findings of fact to which U.S. Bank as Trustee assigned error. U.S. Bank as Trustee asserted no evidence supports FF 8 and 19, CP 2152 and 2155, that MERS as the nominal beneficiary for U.S. Bank as Trustee had assigned all the beneficial interest in the Deed of Trust to itself, thereby separating the Note from the Deed of Trust, specifically based upon Exhibit 17, an erroneous foreclosure notice not even issued by MERS and clearly not legally operable as an assignment. BA 29. The Collings did not and could not defend this finding, as no legally operable assignment exists.

The significance of finding FF8, CP 2152 is that without it, the Collings are left to attempt to defend FF 19, CP 2155 by arguing *City First* and Loveless split the Note by agreeing to have MERS serve as

the nominal beneficiary or agent of the Deed of Trust. This was not a finding by the trial court, and it is not the position of Washington courts. Thus, the Collings' attempt to substitute argument for evidence in order to support FF 19, CP 2155 fails, as Washington courts, and other state and district courts in the Ninth Circuit have consistently ruled the parties to a deed of trust may authorize MERS to serve as beneficiary.

B. The Collings Unsuccessfully Try To Defend Other Findings Of Fact To Which U.S. Bank As Trustee Assigned Error And Argued.

U.S. Bank as Trustee showed in its opening brief that no evidence supports FF 2, 3, 13 and 14, CP 2151-2153. These findings indicate that there was a written lease between the Collings and Loveless, a copy of which was in the Loveless Loan origination file and discoverable by U.S. Bank as Trustee "before accepting ownership of the Loveless Loan," which Loveless "material[ly] breached" by the no-cash-back partial refinance with the HELOC, the owner of which the Collings did not sue. Having shifted from their product of fraud contention, the Collings proposed and the trial court adopted findings of a "material breach of the lease" by Loveless which

apparently led to the trial court's adjudication voiding the Deed of Trust. FF 3, CP 2151-2152, J 4, CP 2144.

The Collings could not defend these findings, although they attempted to do so in a footnote, which inaccurately states Mrs. Collings testified they signed Exhibit 5 and that it was in "City First's loan file." RB 4, n. 1; 9/15 RP 39 (she did not testify she signed it or that it was in City First's loan file). First, whether or not a written lease was in the purchase loan file is irrelevant to the issues between the Collings and U.S. Bank as Trustee, because there was no evidence of any lease being in the Loveless Loan file. Second, Exhibit 5 was an unsigned attachment to an e-mail to the Collings *after* the close of escrow. Third, the only evidence concerning a copy of a lease in any of the three loan origination files was Ms. Russett's testimony that only the unrelated Exhibit 34 had been placed in the loan origination file for the *purchase* loan. 9/16 RP 9-10; Ex. 34.

The evidence established there was no executed lease at the close of escrow and no signed or unsigned lease between Loveless and the Collings in the loan origination file for the purchase loan. There was no executed lease introduced into evidence at trial, no testimony concerning execution of a lease and no evidence at trial

concerning a lease in the Loveless Loan origination file, although the Collings had the opportunity to inquire of GMAC's Mr. DiCicco, but did not.

The significance of FF 2, 3, 13 and 14, CP 2151-2153 is that it enabled the trial court to conclude U.S. Bank as Trustee was not a holder in due course, (CL 22, CP 2155), inapplicable to the facts of this case, or a bona fide purchaser (CL 24, CP 2155), inapplicable because of the absence of finding or conclusion that the *Loveless Loan*, as opposed to the HELOC, was void as the product of an illegality.

The Collings impliedly concede the falsity of FF 16, CP 2154, that "there is no evidence that the deed of trust was transferred from MERS to U.S. Bank for any value," when they argue the trial court was "free to discredit" it. RB 43. Notably, FF 16, CP 2154 contradicts FF 12, 2153, which acknowledges MERS, was the nominal beneficiary of the Deed of Trust. The holder of a secured obligation would not pay its nominal beneficiary or agent for an assignment of the security. Even if the trial court were to "discredit" U.S. Bank as Trustee's evidence that the GreenPoint Mortgage Funding Trust acquired the Loveless Loan in exchange for $420,000 by its investor-

beneficiaries (9/16 RP 63-67, Exh. 156 at 56), it would still be entitled to the statutory presumption it gave value for the transfer under RCW 62A.3-303(a)(2) (instrument is transferred for value if the transferee acquires a security interest in the instrument).

The significance of FF 16 is that it enabled the trial court to conclude U.S. Bank as Trustee was not a holder in due course (CL 22, CP 2155), inapplicable to the facts of this case, or a bona fide purchaser (CL 24, CP 2155), inapplicable because of the absence of finding or conclusion that the *Loveless Loan*, as opposed to the HELOC, was void as the product of an illegality.

REPLY ARGUMENT

A. The Trial Court Erred In Finding The Note Was Split From The Deed Of Trust As A Basis For Voiding The Deed Of Trust, Where There Is No Evidence Of An Assignment Of The Deed Of Trust From MERS As Nominee To Itself, And The Collings' New Argument That City First Split The Note From The Deed Of Trust By Designating MERS As The Nominal Beneficiary Fails As A Matter Of Law.

The Collings' attempt to defend FF 19, CP 2155 with new argument that *City First* and Loveless split the Note by agreeing to have MERS serve as the nominal beneficiary or agent of the Deed of Trust. The Collings' reference to Bain is a red herring. Bain is not relevant to any issue in this action, because there is no issue here

whether or not MERS can serve as the beneficiary under the Deed of Trust under the Washington Deed of Trust Act (DTA), that is, whether or not MERS may nonjudicially foreclose in its name. MERS is no longer the nominal beneficiary of U.S. Bank as Trustee's Deed of Trust. This is not a foreclosure action, and MERS along with the trustee were involuntarily dismissed from this case after contested law and motion.

The Collings' attempt to create evidence to support FF 19, CP 2155 fails, as Washington courts, and other state and district courts in the Ninth Circuit have consistently ruled the parties to a deed of trust may authorize MERS to serve as beneficiary. This issue has been repeatedly raised and rejected by Washington courts. See e.g. Rhodes v. HSBC Bank USA N.A., 2011 WL 3159100 (W.D. Wash. July 26, 2011); St. John v. Northwest Trustee Services, Inc., 2011 WL 2009902 (W.D. Wash. May 23, 2011); Daddabbo v. Countrywide Home Loans, Inc., 2010 WL 2102485 (W.D. Wash. May 20, 2010); Cebrun v. HSBC Bank USA, N.A., 2011 WL 321992 (W.D. Wash. Feb. 2, 2011) and Vawter v. Quality Loan Service Corp. of Washington, 707 F.Supp.2d 1115 (W.D. Wash. 2010). As in Rhodes, Loveless agreed in the Note and Deed of Trust that MERS had the

authority to act as the nominal beneficiary under the Deed of Trust. Rhodes v. HSBC Bank USA N.A., 2011 WL 3159100 at *4.

The recent case of In re Reinke, 2011 WL 5079561 (Bankr. W.D. Wash. Oct. 26, 2011) provides relevant analysis. In Reinke, the court responded to the plaintiff's contentions that 1) MERS could not be the beneficiary under the deed of trust because it never had an interest in the notes and 2) when MERS assumed its role as the nominee for the beneficiary under the deed of trust, the deed of trust was effectively separated from the note, rendering the note unsecured. Like the Collings, the plaintiff cited to the Peterson article and the case of Landmark Nat'l Bank v. Kessler, 289 Kan. 528, 216 P.3d 158 (2009). Id. at *6; BR 7, n. 2, and 28.

The Reinke court concluded there is nothing inherent in the use of MERS as nominee under a deed of trust which irreparably splits the note from a deed of trust so as to render the note unsecured. Id.

> Section 5.4 of the Restatement states two generally recognized principles: (i) a transfer of an obligation secured by a mortgage also transfers the mortgage, unless the parties agree otherwise; and (ii) a mortgage may only be enforced by, or on behalf of, a person who is entitled to enforce the obligation the mortgage secures. The Restatement recognizes that if a

> negotiable note is involved, the Uniform Commercial Code governs transfer or negotiation of the note. These principles [are] followed in Washington state. RCW 61.24.005(2). See also, Fidelity & Deposit Co. of Maryland v. Ticor Title Ins. Co., 88 Wash. App. 64, 943 P.2d 710 (1977); In re Jacobson, 402 B.R. 359 (Bankr. W.D. Wash. 2009).

Id.

The Reinke court also pointed out the recent Ninth Circuit case of Cervantes v. Countrywide Home Loans, Inc., 656 F.3d 1034 (9th Cir. 2011), supports its conclusion that the role of MERS as nominee under a deed of trust does not irreparably split the note from the deed of trust so as to render the note unsecured. Reinke, 2011 WL 5079561 at *6. On the question whether MERS' status as nominee under the deed of trust resulted in an impermissible separation of the note from the mortgage, the Cervantes court concluded:

> Further, the notes and deeds are not irreparably split: the split only renders the mortgage unenforceable if MERS or the trustee, as nominal holders of the deeds, are not agents of the lenders.

Id. at *7, citing Landmark Nat'l Bank v. Kesler, 289 Kan. at 540, 216 P.3d at 167.

The Reinke court also concluded that the Landmark case did not support the plaintiff's contention that the notes were unsecured.

Id. Under Kansas law, the assignment of any mortgage "shall carry with it the *debt* thereby secured. Kan.Stat.Ann. § 58-2323." Id. (citation omitted) (emphasis added). "The Kansas statute therefore is in direct conflict with the applicable Washington statutes and the Restatement. See RCW 61.24.005(2); RCW 62A.3-301."

The Collings do not and cannot defend U.S. Bank as Trustee's assertion that no evidence supports FF 8 and 19, CP 2152 and 2155, that MERS as the nominal beneficiary for U.S. Bank as Trustee assigned all the beneficial interest in the Deed of Trust to itself, thereby separating the Note from the Deed of Trust. BA 29. The Collings could not defend this finding, as no such assignment exists.

Based upon the above authorities, the Collings' note-split argument fails, as a matter of law. It follows, their argument that U.S. Bank as Trustee did not acquire any interest in the Deed of Trust until July 2009, when MERS assigned the supposedly split Deed of Trust to U.S. Bank as Trustee also fails.[4] BR 31. To the extent the trial court voided the Deed of Trust based upon a nonexistent assignment

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4 *See* Report of the Permanent Editorial Board for the Uniform Commercial Code, *Application of the Uniform Commercial Code to Selected Issues Relating to Mortgage Notes,* 12, (Nov. 14, 2011).

of the Deed of Trust by MERS as nominee to MERS itself, this court should reverse.

B. The Collings Fail To Address U.S. Bank As Trustee's Point That The Trial Court Made No Finding Or Conclusion That The Loveless Loan Was Voidable As The Product Of The Collings' Contract Claim Against Loveless For Entering Into The HELOC, And Thus The Bona Fide Purchaser Doctrine Never Became Applicable.

At trial, the Collings did not even attempt to prove the Loveless Loan, one of two no-cash-back loans that together refinanced Loveless's purchase loan, was voidable as the product of fraud or statutory violation. The trial court's key findings and conclusions, based on a nonexistent lease, did not support an adjudication voiding the Deed of Trust. The closest finding to an illegality was the trial court's finding that Loveless materially breached a lease agreement with the Collings by defying their HELOC prohibition. FF 3, CP 2151-52. However, the trial court seemingly favored the Collings with an *assumption* the Deed of Trust was voidable.

In their Respondents' Brief, the Collings offer bare conclusion that the trial court voided the Deed of Trust as the product of equity skimming despite the absence of a single finding or conclusion suggesting this. BR 48-49. Rather, the trial court's assumption of an

adjudication that the Deed of Trust was voidable improperly shifted the burden to U.S. Bank as Trustee to prove it was a bona fide purchaser.

As discussed in U.S. Bank as Trustee's opening brief, the trial court made multiple erroneous findings based upon an assumption there was a lease in the Loveless Loan origination file. BR 36-42. Specifically, the trial court found there was a written lease between the Collings and Loveless, a copy of which was in the Loveless Loan origination file and discoverable by U.S. Bank as Trustee "before accepting ownership of the Loveless Loan," which Loveless "material[ly] breached" with the HELOC. FF 2, 3, 13 and 14, CP 2151-2153. The Collings do not address U.S. Bank as Trustee's assertion there was no executed lease at the close of escrow, no signed or unsigned lease between Loveless and the Collings in the loan origination file for the purchase loan, no executed lease introduced into evidence at trial and no testimony concerning execution of a lease, except to misrepresent the testimony of Mrs. Collings (BR 4, n. 1 [9/15 RP 39).

Instead, the Collings cite cases applying the bona fide purchaser doctrine which are distinguishable on the basis of their

facts. In Huber v. Coast Inv. Co., Inc., 30 Wn. App. 804, 638 P.2d 609 (1981), cited by the Collings, the homeowner quitclaimed real property to an individual, who entered into an agreement with a business association, who intended the agreement would operate as an equitable lien on the property. After the individual quitclaimed the property back to the homeowner, the business associate asserted an equitable lien against the property reacquired by the homeowner. The court found the business associate had no legal interest in the property, but merely an agreement for contingent benefits. Id. at 811.

In Peoples Nat'l Bank of Washington v. Birney's Enterprises, Inc., 54 Wn. App. 668, 775 P.2d 466 (1989), also cited by the Collings, a creditor was not a bona fide purchaser, due to inquire into the tenant's visible possession, and thus took subject to a tenant's right of possession under an unrecorded 20-year lease. Id.

These cases are inapplicable, as U.S. Bank as Trustee had neither an unperfected lien on the property nor a claim to right of possession. U.S. Bank as Trustee had a perfected Deed of Trust, which secured repayment of the Loveless Loan, which refinanced the purchase loan for an amount less than the purchase loan in which the

Collings acquiesced. Further, U.S. Bank as Trustee did not by virtue of its Deed of Trust claim a right of possession.

1. If The Trial Court Had Found Or Concluded That The Loveless Loan Was Voidable As The Product Of Illegal Equity Skimming, As Newly Argued By The Collings, U.S. Bank As Trustee Would Undeniably Be Found A Bona Fide Purchaser, Because It Could Not Have Had Notice Of Something The Collings Did Not Suspect.

As discussed in U.S. Bank as Trustee's opening brief, the Collings did not suspect they had any claim against Loveless until July 2008, when they learned the property was in foreclosure. BA 39-42. If the issue was whether U.S. Bank as Trustee could have discovered that the Collings suspected they had an equity skimming claim against Loveless when the Loveless Loan was transferred to it in February 2007, the answer is no. Under Scandinavian American Bank v. Johnson, 63 Wash. 187, 115 P. 102 (1911), U. S. Bank as Trustee would be entitled to the protection of the bona fide purchaser doctrine.[5] Id. at 190.

In sum, the conclusion of law that U.S. Bank as Trustee was not a bona fide purchaser because it failed to discover a nonexistent

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5 At BA 24, 27-28 and 41, U.S. Bank as Trustee discussed the issue of value, and the Collings' argument it was required to "pay cash" is incorrect as a matter of law. BR 42-43.

lease was not only erroneous it was also irrelevant, given the trial court's failure to make a finding or conclusion that the *Loveless Loan*, as opposed to the HELOC, was voidable as the product of an illegality.

C. The Collings' Standing As The New Owners Of The Property Did Not Confer Standing To Challenge The Transfer Of The Loveless Loan To U.S. Bank As Trustee, Which Even Loveless Lacked Standing To Do.

Instead of acknowledging the legal presumptions that U.S. Bank as Trustee was entitled to as the possessor of the bearer Note, the trial court erroneously allowed the Collings to challenge the transfer of the Loveless Loan to U.S. Bank as Trustee, where the majority rule is that even debtors do not have standing to do so. BA 17-20. There may not even be a minority position, because the cases the Collings cited regarding standing to assert a claim in equity do not confer standing to do what Loveless, as the debtor, would have had no legal standing to do.

The case of Johnson v. Novastar Mortgage, Inc., 698 F.Supp.2d 463 (D.N.J. 2010), cited by the Collings, is distinguishable on the facts. There, the homeowner entered into a sale-and-leaseback with her daughter. The daughter took out a mortgage loan

and the former homeowner received $20,000. As the funds ran out, the former homeowner pursued another loan from the same broker. This time the broker arranged for an investor to purchase the property. The investor took out a loan, which was made by the lender without regard to whether the investor had the ability or intent to pay. The former homeowner attended the closing; the investor did not. The former homeowner made monthly payments directly to the lender. On the basis of these facts, the court ruled the former homeowner could pursue claims against the lender. Self-evidently, this case does not support the Collings' argument they have standing to challenge the validity and enforceability of the Loveless Loan on the basis of its transfer to U.S. Bank as Trustee, where the majority rule is that even Loveless, as the debtor, would not have had standing. For the same reasons, the Collings lacked standing to challenge the validity and enforceability of the Loveless Loan on the basis of the transfer of ownership to U.S. Bank as Trustee under the securitization agreements, because they are not the debtors.

D. U.S. Bank As Trustee Was Not Required To Prove Its Authority To Nonjudicially Foreclose To Defend The Collings' Unproven Claim That The Loveless Loan Was Voidable As The Product Of An Illegality.

The Collings call on U.S. Bank as Trustee to establish it owns the Loveless Loan under the DTA and Article 3 of the Uniform Commercial Code, as codified in Washington at Chapter 62A.3 of the Revised Code of Washington. BR 31-44. U.S. Bank as Trustee had the original Note present at trial, and exhibit 151, which consists of the Note, the self-authenticating allonge with indorsement in blank on the back, is a true and correct copy. 9/16 RP 34-35, 38, 77, Ex. 151. The Collings contend the trial court concluded U.S. Bank as Trustee is not a holder of the Note, which is inaccurate. BR 10, 33, CL 22, CP 2155. The trial court clearly found U.S. Bank as Trustee to be the owner of the Loveless Loan in February 2007, more than two years before the Collings' dispute with Loveless arose. See e.g. 9/20 RP 36-37 ("The Court: I understand you [U.S. Bank as Trustee] are the owner. I understand you are the owner."); FF 13, 14, CP 2153 ("before accepting ownership of the Loveless Loan" . . . "U.S. Bank had a duty to inquire as early as February 2007 . . .").

The Collings' argument focuses on the fact that the Note had been specially endorsed to GreenPoint, but GreenPoint did not date the indorsement, and did U.S. Bank as Trustee establish the indorsement was GreenPoint's. BR 36; FF 8, CP 2152. U.S. Bank

as Trustee discussed these findings in its opening brief, particularly the fact the GreenPoint was a party to the February 1, 2007, securitization of the Loveless Loan. BA 21-26. Additionally, the trial court's record includes the Affidavit of Michael Najewicz of GreenPoint in Support of U.S. Bank as Trustee's Summary Judgment Motion. CP 2034-2044. Thus, there was simply no evidence to suggest that anyone besides U.S. Bank as Trustee holds the Note or otherwise owns the Loveless Loan.

The Collings' Brief of Respondents devotes nearly ten pages to their argument U.S. Bank as Trustee would be unable to nonjudicially foreclose, because it is not the holder of the Note. Not only is this argument irrelevant to the true issue in this case whether or not the Collings established and the trial court concluded or found on the basis of substantial evidence (which they did not) that the Deed of Trust was void or voidable, but the Collings' own legal conclusion is erroneous as a matter of law.

Washington is not a show-me-the-note state. See e.g., St. John v. Northwest Trustee Services, Inc., 2011 WL 2009902 at *2 (citations omitted); Wallis v. Indymac Federal Bank, 717 F.Supp.2d 1195, 1200 (W.D. Wash. 2010) (citation omitted). There is no

statutory requirement to produce the promissory note to nonjudicially foreclose. A lender's possession of the note endorsed in blank means that it may foreclose in its own name. Corales v. Flagstar Bank, FSB. __ F.Supp.2d __, 2011 WL 4899957, *4 (W.D. Wash Oct. 14, 2011) (citation omitted).

The "beneficiary" under the DTA is the "holder of the instrument or document evidencing the obligations secured by the deed of trust . . ." In re Reinke, 2011 WL 5079561, at *10; RCW 61.24.005(2). A "holder" with respect to a negotiable instrument is defined as the person in possession if the instrument is payable to bearer. Id.; RCW 62A.1-201(20). Once endorsed in blank, a negotiable instrument can be negotiated by transfer of possession alone. Id. at 11. The DTA does not require than an assignment of a deed of trust be recorded in advance of the commencement of nonjudicial foreclosure. Id. at 10.

In Reinke, the plaintiff argued the indorsement was undated and that the servicer, rather than the owner of the note, was foreclosing. "Washington law does not require that indorsements be dated." Id. at 11. Further, the Reinke court noted that, even though undated, the indorsements on the subject note followed a natural

progression from the initial payee to the blank indorsement. Accordingly, the court found the subject note was indorsed in blank when it was purchased by the owner.

The Collings also misstate the trial court's findings in representing U.S. Bank as Trustee failed to show the allonge was physically attached to the Note. BR 35. Not only was the affixation of the allonge not a subject of the trial court's findings, but the *only* evidence regarding the allonge shows that it was stapled to the Note when Mr. DiCicco procured the Note from U.S. Bank for production in this case. 9/16 RP 35. The Collings cite the case of In re Weisband, 427.B.R. 13 (Bankr. Ariz. 2010) as a case in which an endorsement which was found not to be affixed. In Weisband, the servicer moved for relief from the automatic bankruptcy stay. The loan had been securitized and the securitization documents showed, as here, the holder of the note was the trustee for the trust. However, the servicer produced a special endorsement (to itself), on a separate sheet of paper and there was no evidence that it had been stapled or otherwise attached to the note. Further, the court noted that the special endorsement to the servicer was completely inconsistent with the securitization of the note into the trust. The court found the

servicer did not have standing to move for relief from stay. Id. at * 4 and fn. 4. Accordingly, Weisband is inapplicable to the facts and findings in this case.

Here, all the evidence shows that U.S. Bank as Trustee is the holder of the bearer Note, that the Note and Deed of Trust were transferred and delivered to it in February 2007 and that GreenPoint, to which City First transferred the Note by means of the self-authenticating allonge, does not challenge the transfer of the Loveless Loan to U.S. Bank as Trustee. If the issue in this case was may U.S. Bank as Trustee nonjudicially foreclose under the DTA by virtue of the power of foreclosure set forth in the Deed of Trust, the answer would be yes.

E. There Is No Authority For An Award Of Attorneys Fees Between U.S. Bank As Trustee And The Collings.

The Collings are not parties to the Loveless Loan. Even if they were, enforcement of the Loveless Loan was not in issue. Rather, U.S. Bank as Trustee intervened to defend its interests in the Deed of Trust against what was supposed to be a common law claim that the Deed of Trust was voidable as the product of fraud or statutory

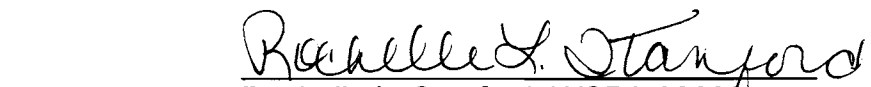
violations. Accordingly, there is no authority for attorneys' fees as requested by the Collings.

F. Conclusion.

For the reasons set forth in the Brief of Appellant and this Reply Brief, this Court should reverse and remand with instructions to issue an order declaring the validity and enforceability of the Loveless Loan by U.S. Bank as Trustee and dissolving the permanent injunction.

RESPECTFULLY SUBMITTED this 5th day of December, 2011.

PITE DUNCAN, LLP



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APPENDIX A

REPORT OF THE PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE

APPLICATION OF THE UNIFORM COMMERCIAL CODE TO SELECTED ISSUES RELATING TO MORTGAGE NOTES

NOVEMBER 14, 2011

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PREFACE

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." 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 Report of the Permanent Editorial Board is such an articulation, addressing the application of the Uniform Commercial Code to issues of legal, economic, and social importance arising from the issuance and transfer of mortgage notes. A draft of this Report was made available to the public for comment on March 29, 2011, and the comments that were received have been taken into account in preparing the final Report.

REPORT OF THE PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE

APPLICATION OF THE UNIFORM COMMERCIAL CODE TO SELECTED ISSUES RELATING TO MORTGAGE NOTES

Introduction

Recent economic developments have brought to the forefront complex legal issues about the enforcement and collection of mortgage debt. Many of these issues are governed by local real property law and local rules of foreclosure procedure, but others are addressed in a uniform way throughout the United States by provisions of the Uniform Commercial Code (UCC).[1] Although the UCC provisions are settled law, it has become apparent that not all courts and attorneys are familiar with them. In addition, the complexity of some of the rules has proved daunting.

The Permanent Editorial Board for the Uniform Commercial Code[2] has prepared this Report in order to further the understanding of this statutory background by identifying and explaining several key rules in the UCC that govern the transfer and enforcement of notes secured by a mortgage[3] on real property. The UCC, of course, does not resolve all issues in this field. Most particularly, as to both substance and procedure, the enforcement of real estate mortgages by foreclosure is primarily the province of a state's real property law (although determinations made

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[1] The UCC 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. This Report is based on the current Official Text of the UCC. Some states have enacted some non-uniform provisions that are generally not relevant to the issues discussed in this Report. Of course, the enacted text of the UCC in the state whose law is applicable governs. See note 6, *infra*, regarding the various different versions of Article 3 of the UCC in effect in the states.

[2] In 1961, the American Law Institute and the Uniform Law Commission, the organizations that jointly sponsor the UCC, 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."

[3] This Report, like Article 9 of the UCC, uses the term "mortgage" to include a consensual interest in real property to secure an obligation whether created by mortgage, trust deed, or the like. See UCC § 9-102(a)(55) and Official Comment 17 thereto and former UCC § 9-105(1)(j). This Report uses the term "mortgage note" to refer to a note secured by a mortgage, whether or not the note is a negotiable instrument under UCC Article 3.

pursuant to the UCC are typically relevant under that law). Accordingly, this Report should be understood as providing guidance only as to the issues the Report addresses.[4]

Background

Issues relating to the transfer, ownership, and enforcement of mortgage notes are primarily governed by two Articles of the UCC:

- In cases in which the mortgage note is a negotiable instrument,[5] Article 3 of the UCC[6] provides rules governing the obligations of parties on the note[7] and the enforcement of those obligations.
- In cases involving either negotiable or non-negotiable notes, Article 9 of the UCC[8] contains important rules governing how ownership of those notes may be transferred, the effect of the transfer of ownership of the notes on the ownership of the mortgages securing those notes, and the right of the transferee, under certain circumstances, to record its interest in the mortgage in the applicable real estate recording office.

This Report explains the application of the rules in both of those UCC Articles to provide guidance in:

- Identifying the person who is entitled to enforce the payment obligation of the maker[9] of a mortgage note, and to whom the maker owes that obligation; and

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[4] Of course, the application of the UCC rules to particular factual circumstances depends on the nature of those circumstances. Facts raising legal issues other than those addressed in this Report can result in different rights and obligations than would be the case in the absence of those facts. Accordingly, this Report should not be read as a statement of the total legal implications of any factual scenario. Rather, the Report sets out the UCC rules that are common to the transactions discussed so as to provide a common basis for understanding the application of those rules. The impact of non-UCC law that applies to other aspects of such transactions is beyond the scope of this Report.

[5] The requirements that must be satisfied in order for a note to be a negotiable instrument are set out in UCC § 3-104.

[6] Except for New York, every state (as well as the District of Columbia, Puerto Rico, and the United States Virgin Islands) has enacted either the 1990 Official Text of Article 3 or the newer 2002 Official Text (the latter having been adopted in ten states as of the date of this Report). Unless indicated to the contrary all discussions of provisions in Article 3 apply equally to both versions. Much of the analysis of UCC Article 3 in this Report also applies under the older version of Article 3 in effect in New York, although many section numbers differ. The Report does not address those aspects of New York's Article 3 that are different from the 1990 or 2002 texts.

[7] In this Report, such notes are sometimes referred to as "negotiable notes."

[8] Unlike Article 3 (which has not been enacted in its modern form in New York), the current version of Article 9 has been enacted in all 50 states, the District of Columbia, and the United States Virgin Islands. Some states have enacted non-uniform provisions that are generally not relevant to the issues discussed in this Report (but see note 31 with respect to one relevant non-uniformity). A limited set of amendments to Article 9 was approved by the American Law Institute and the Uniform Law Commission in 2010. Except as noted in this Report, those amendments (which provide for a uniform effective date of July 1, 2013) are not germane to the matters addressed in this Report.

[9] A note can have more than one obligor. In some cases, this is because there is more than one maker (in which case they are jointly and severally liable; see UCC § 3-116(a)). In other cases, there may be an indorser. The obligation

- Determining who owns the rights represented by the note and mortgage.

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.[10] Moreover, these rules displace any inconsistent common law rules that might have otherwise previously governed the same questions.[11]

This Report does not, however, address all of the rules in the UCC relating to enforcement, transfer, and ownership of mortgage notes. Rather, it reviews the rules relating to four specific questions:

- Who is the person entitled to enforce a mortgage note and, correspondingly, to whom is the obligation to pay the note owed?
- How can the owner of a mortgage note effectively transfer ownership of that note to another person or effectively use that note as collateral for an obligation?
- What is the effect of transfer of an interest in a mortgage note on the mortgage securing it?
- May a person to whom an interest in a mortgage note has been transferred, but who has not taken a recordable assignment of the mortgage, take steps to become the assignee of record in the real estate recording system of the mortgage securing the note?[12]

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of an indorser is different from that of a maker in that the indorser's obligation is triggered by dishonor of the note (see UCC § 3-415) and, unless waived, indorsers have additional procedural protections (such as notice of dishonor; see UCC § 3-503)). These differences do not affect the issues addressed in this Report. For simplicity, this Report uses the term "maker" to refer to both makers and indorsers.

[10] Subject to limitations on the ability to affect the rights of third parties, the effect of these provisions may be varied by agreement. UCC § 1-302. Variation by agreement is not permitted when the variation would disclaim obligations of good faith, diligence, reasonableness, or care prescribed by the UCC or when the UCC otherwise so indicates (see, *e.g.*, UCC § 9-602). But the meaning of the statute itself cannot be varied by agreement. Thus, for example, private parties cannot make a note negotiable unless it complies with UCC § 3-104. See Official Comment 1 to UCC § 1-302. Similarly, parties may not avoid the application of UCC Article 9 to a transaction that falls within its scope. See *id.* and Official Comment 2 to UCC § 9-109.

[11] UCC § 1-103(b). As noted in Official Comment 2 to UCC § 1-103:

> 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. 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. 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.

[12] The Report does not discuss the application of common law principles, such as the law of agency, that supplement the provisions of the UCC other than to note some situations in which the text or comments of the UCC identify such principles as being relevant. See UCC § 1-103(b).

Question One – To Whom is the Obligation to Pay a Mortgage Note Owed?

If the mortgage note is a negotiable instrument,[13] Article 3 of the UCC provides a largely complete set of rules governing the obligations of parties on the note, including how to determine who may enforce those obligations and, thus, to whom those obligations are owed. The following discussion analyzes the application of these rules to that determination in the context of mortgage notes that are negotiable instruments.[14]

In the context of mortgage notes that have been sold or used as collateral to secure an obligation, the central concept for making that determination is identification of the "person entitled to enforce" the note.[15] Several issues are resolved by that determination. Most particularly:

(i) the maker's obligation on the note is to pay the amount of the note to *the person entitled to enforce the note*,[16]

(ii) the maker's payment to *the person entitled to enforce the note* results in discharge of the maker's obligation,[17] and

(iii) the maker's failure to pay, when due, the amount of the note to *the person entitled to enforce the note* constitutes dishonor of the note.[18]

Thus, a person seeking to enforce rights based on the failure of the maker to pay a mortgage note must identify the person entitled to enforce the note and establish that that person has not been paid. This portion of this Report sets out the criteria for qualifying as a "person entitled to enforce" a mortgage note. The discussion of Question Two addresses how ownership of a mortgage note may be effectively transferred from an owner to another person.

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[13] See UCC § 3-104 for the requirements that must be fulfilled in order for a payment obligation to qualify as a negotiable instrument. It should not be assumed that all mortgage notes are negotiable instruments. The issue of the negotiability of a particular mortgage note, which requires application of the standards in UCC § 3-104 to the words of the particular note, is beyond the scope of this Report.

[14] Law other than Article 3, including contract law, governs this determination for non-negotiable mortgage notes. That law is beyond the scope of this Report.

[15] The concept of "person entitled to enforce" a note is not synonymous with "owner" of the note. See Official Comment 1 to UCC § 3-203. A person need not be the owner of a note to be the person entitled to enforce it, and not all owners will qualify as persons entitled to enforce. Rules that address transfer of ownership of a note are addressed in the discussion of Question 2 below.

[16] UCC § 3-412. (If the note has been dishonored, and an indorser has paid the note to the person entitled to enforce it, the maker's obligation runs to the indorser.)

[17] UCC § 3-602. The law of agency is applicable in determining whether a payment has been made to a person entitled to enforce. See *id.*, Official Comment 3. Note that, in states that have enacted the 2002 Official Text of UCC Article 3, UCC § 3-602(b) provides that a maker is also discharged by paying a person formerly entitled to enforce the note if the maker has not received adequate notification that the note has been transferred and that payment is to be made to the transferee. This amendment aligns the protection afforded to makers of notes that have been assigned with comparable protection afforded to obligors on other payment rights that have been assigned. See, *e.g.*, UCC § 9-406(a); Restatement (Second), Contracts § 338(1).

[18] See UCC § 3-502. See also UCC § 3-602.

UCC Section 3-301 provides only three ways in which a person may qualify as the person entitled to enforce a note, two of which require the person to be in possession of the note (which may include possession by a third party that possesses it for the person)[19]:

- The first way that a person may qualify as the person entitled to enforce a note is to be its "holder." This familiar concept, set out in detail in UCC Section 1-201(b)(21)(A), requires that the person be in possession of the note and either (i) the note is payable to that person or (ii) the note is payable to bearer. Determining to whom a note is payable requires examination not only of the face of the note but also of any indorsements. This is because the party to whom a note is payable may be changed by indorsement[20] so that, for example, a note payable to the order of a named payee that is indorsed in blank by that payee becomes payable to bearer.[21]
- The second way that a person may be the person entitled to enforce a note is to be a "nonholder in possession of the [note] who has the rights of a holder."
    - How can a person who is not the holder of a note have the rights of a holder? This can occur by operation of law outside the UCC, such as the law of subrogation or estate administration, by which one person is the successor to or acquires another person's rights.[22] It can also occur if the delivery of the note to that person constitutes a "transfer" (as that term is defined in UCC Section 3-203, see below) because transfer of a note "vests in the transferee any right of the transferor to enforce the instrument."[23] Thus, if a holder (who, as seen above, is a person entitled to enforce a note) transfers the note to another person, that other person (the transferee) obtains from the holder the right to enforce the note even if the transferee does not become the holder (as in the example below). Similarly, a

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[19] See UCC § 1-103(b) (unless displaced by particular provisions of the UCC, the law of, *inter alia*, principal and agent supplements the provisions of the UCC). See also UCC § 3-420, Comment 1 ("Delivery to an agent [of a payee] is delivery to the payee."). Note that "delivery" of a negotiable instrument is defined in UCC § 1-201(b)(15) as voluntary transfer of possession. This Report does not address the determination of whether a particular person is an agent of another person under the law of agency and the agency law implications of such a determination.

[20] "Indorsement," as defined in UCC § 3-204(a), requires the signature of the indorser. The law of agency determines whether a signature made by a person purporting to act as a representative binds the represented person. UCC § 3-402(a); see note 12, supra. An indorsement may appear either on the instrument or on a separate piece of paper (usually referred to as an *allonge*) affixed to the instrument. See UCC § 3-204(a) and Comment 1, par. 4.

[21] UCC Section 3-205 contains the rules concerning the effect of various types of indorsement on the party to whom a note is payable. Either a "special indorsement" (see UCC § 3-205(a)) or a "blank indorsement" (see UCC § 3-205(b)) can change the identity of the person to whom the note is payable. A special indorsement is an indorsement that identifies the person to whom it makes the note payable, while a blank indorsement is an indorsement that does not identify such a person and results in the instrument becoming payable to bearer. When an instrument is indorsed in blank (and, thus, is payable to bearer), it may be negotiated by transfer of possession alone until specially indorsed. UCC § 3-205(b).

[22] See Official Comment to UCC § 3-301.

[23] UCC § 3-203(b).

subsequent transfer will result in the subsequent transferee being a person entitled to enforce the note.

- Under what circumstances does delivery of a note qualify as a transfer? As stated in UCC Section 3-203(a), a note is transferred "when it is delivered by a person other than its issuer for the purpose of giving to the person receiving delivery the right to enforce the instrument." For example, assume that the payee of a note sells it to an assignee, intending to transfer all of the payee's rights to the note, but delivers the note to the assignee without indorsing it. The assignee will not qualify as a holder (because the note is still payable to the payee) but, because the transaction between the payee and the assignee qualifies as a transfer, the assignee now has all of the payee's rights to enforce the note and thereby qualifies as the person entitled to enforce it. Thus, the failure to obtain the indorsement of the payee does not prevent a person in possession of the note from being the person entitled to enforce it, but demonstrating that status is more difficult. This is because the person in possession of the note must also demonstrate the purpose of the delivery of the note to it in order to qualify as the person entitled to enforce.[24]

- There is a third method of qualifying as a person entitled to enforce a note that, unlike the previous two methods, does not require possession of the note. This method is quite limited – it applies only in cases in which "the person cannot reasonably obtain possession of the instrument because the instrument was destroyed, its whereabouts cannot be determined, or it is in the wrongful possession of an unknown person or a person that cannot be found or is not amenable to service of process."[25] In such a case, a person qualifies as a person entitled to enforce the note if the person demonstrates not only that one of those circumstances is present but also demonstrates that the person was formerly in possession of the note and entitled to enforce it when the loss of possession occurred and that the loss of possession was not as a result of transfer (as defined above) or lawful seizure. If the person proves those facts, as well as the terms of the note, the person is a person entitled to enforce the note and may seek to enforce it even though it is not in possession of the note,[26] but the court may not enter judgment in favor of the

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[24] If the note was transferred for value and the transferee does not qualify as a holder because of the lack of indorsement by the transferor, "the transferee has a specifically enforceable right to the unqualified indorsement of the transferor." See UCC § 3-203(c).

[25] UCC § 3-309(a)(iii) (1990 text), 3-309(a)(3) (2002 text). The 2002 text goes on to provide that a transferee from the person who lost possession of a note may also qualify as a person entitled to enforce it. See UCC § 3-309(a)(1)(B) (2002). This point was thought to be implicit in the 1990 text, but was rejected in some cases in which the issue was raised. The reasoning of those cases was rejected in Official Comment 5 to UCC § 9-109 and the point was made explicit in the 2002 text of Article 3.

[26] To prevail the person must establish not only that the person is a person entitled to enforce the note but also the other elements of the maker's obligation to pay such a person. See generally UCC §§ 3-309(b), 3-412. Moreover, as is the case with respect to the enforcement of all rights under the UCC, the person enforcing the note must act in good faith in enforcing the note. UCC § 1-304.

person unless the court finds that the maker is adequately protected against loss that might occur if the note subsequently reappears.[27]

Illustrations:

1. Maker issued a negotiable mortgage note payable to the order of Payee. Payee is in possession of the note, which has not been indorsed. Payee is the holder of the note and, therefore, is the person entitled to enforce it. UCC §§ 1-201(b)(21)(A), 3-301(i).
2. Maker issued a negotiable mortgage note payable to the order of Payee. Payee 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).
3. Maker issued a negotiable mortgage note payable to the order of Payee. Payee sold the note to Transferee and gave possession of it to Transferee for the purpose of giving Transferee the right to enforce the note. Payee did not, however, indorse the note. 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. This is because the note was transferred to Transferee and the transfer vested in Transferee Payee'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).
4. Same facts as Illustrations 2 and 3, except that (i) under the law of agency, Agent is the agent of Transferee for purposes of possessing the note and (ii) it is Agent, rather than Transferee, to whom actual physical possession of the note is given by Payee. In the facts of Illustration 2, Transferee is a holder of the note and a person entitled to enforce it. In the context of Illustration 3, Transferee is a person entitled to enforce the note. Whether Agent may enforce the note or mortgage on behalf of Transferee depends in part on the law of agency and, in the case of the mortgage, real property law.
5. Same facts as Illustration 2, except that 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). If Transferee brings an action on the note against Maker, Transferee must establish the terms of the note and the elements of Maker's obligation on it. The court may not enter judgment in favor of Transferee, however, unless the court finds that Maker 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).

[27] See *id.* UCC § 3-309(b) goes on to state that "Adequate protection may be provided by any reasonable means."

Question Two – What Steps Must be Taken for the Owner of a Mortgage Note to Transfer Ownership of the Note to Another Person or Use the Note as Collateral for an Obligation?

In the discussion of Question One, this Report addresses identification of the person who is entitled to enforce a note. That discussion does not address who "owns" the note. While, in many cases, the person entitled to enforce a note is also its owner, this need not be the case. The rules that determine whether a person is a person entitled to enforce a note do not require that person to be the owner of the note,[28] and a change in ownership of a note does not necessarily bring about a concomitant change in the identity of the person entitled to enforce the note. This is because the rules that determine who is entitled to enforce a note and the rules that determine whether the note, or an interest in it, have been effectively transferred serve different functions:

- The rules that determine who is entitled to enforce a note are concerned primarily with the maker of the note, providing the maker with a relatively simple way of determining to whom his or her obligation is owed and, thus, whom to pay in order to be discharged.
- The rules concerning transfer of ownership and other interests in a note, on the other hand, primarily relate to who, among competing claimants, is entitled to the economic value of the note.

In a typical transaction, when a note is issued to a payee, the note is initially owned by that payee. If that payee seeks either to use the note as collateral or sell the note outright, Article 9 of the UCC governs that transaction and determines whether the creditor or buyer has obtained a property right in the note. As is generally known, Article 9 governs transactions in which property is used as collateral for an obligation.[29] In addition, however, Article 9 governs the sale of most payment rights, including the sale of both negotiable and non-negotiable notes.[30] With very few exceptions, the same Article 9 rules that apply to transactions in which a payment right is collateral for an obligation also apply to transactions in which a payment right is sold. Rather than contain two parallel sets of rules – one for transactions in which payment rights are collateral and the other for sales of payment rights – Article 9 uses nomenclature conventions to apply one set of rules to both types of transactions. This is accomplished primarily by defining the term "security interest" to include not only an interest in property that secures an obligation

[28] See UCC § 3-301, which provides, in relevant part, that "A person may be a person entitled to enforce the instrument even though the person is not the owner of the instrument . . . ."

[29] UCC § 9-109(a)(1).

[30] With certain limited exceptions not germane to this Report, Article 9 governs the sale of accounts, chattel paper, payment intangibles, and promissory notes. UCC § 9-109(a)(3). The term "promissory note" includes not only notes that fulfill the requirements of a negotiable instrument under UCC § 3-104 but also notes that do not fulfill those requirements but nonetheless are of a "type that in ordinary business is transferred by delivery with any necessary indorsement or assignment." See UCC §§ 9-102(a)(65) (definition of "promissory note") and 9-102(a)(47) (definition of "instrument" as the term is used in Article 9).

but also the right of a buyer of a payment right in a transaction governed by Article 9.[31] Similarly, definitional conventions denominate the seller of such a payment right as the "debtor," the buyer as the "secured party," and the sold payment right as the "collateral."[32] As a result, for purposes of Article 9, the buyer of a promissory note is a "secured party" that has acquired a "security interest" in the note from the "debtor," and the rules that apply to security interests that secure an obligation generally also apply to transactions in which a promissory note is sold.

Section 9-203(b) of the Uniform Commercial Code provides that three criteria must be fulfilled in order for the owner of a mortgage note effectively to create a "security interest" (either an interest in the note securing an obligation or the outright sale of the note to a buyer) in it.

- The first two criteria are straightforward – "value" must be given[33] and the debtor/seller must have rights in the note or the power to transfer rights in the note to a third party.[34]
- The third criterion may be fulfilled in either one of two ways. Either the debtor/seller must "authenticate"[35] a "security agreement"[36] that describes the note[37] or the secured party must take possession[38] of the note pursuant to the debtor's security agreement.[39]

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[31] See UCC § 1-201(b)(35) [UCC § 1-201(37) in states that have not yet enacted the 2001 revised text of UCC Article 1]. (For reasons that are not apparent, when South Carolina enacted the 1998 revised text of UCC Article 9, which included an amendment to UCC § 1-201 to expand the definition of "security interest" to include the right of a buyer of a promissory note, it did not enact the amendment to § 1-201. This Report does not address the effect of that omission.) The limitation to transactions governed by Article 9 refers to the exclusion, in cases not germane to this Report, of certain assignments of payment rights from the reach of Article 9.

[32] UCC §§ 9-102(a)(28)(B); 9-102(a)(72)(D); 9-102(a)(12)(B).

[33] UCC § 9-203(b)(1). UCC § 1-204 provides that giving "value" for rights includes not only acquiring them for consideration but also acquiring them in return for a binding commitment to extend credit, as security for or in complete or partial satisfaction of a preexisting claim, or by accepting delivery of them under a preexisting contract for their purchase.

[34] UCC § 9-203(b)(2). Limited rights that are short of full ownership are sufficient for this purpose. See Official Comment 6 to UCC § 9-203.

[35] This term is defined to include signing and its electronic equivalent. See UCC § 9-102(a)(7).

[36] A "security agreement" is an agreement that creates or provides for a security interest (including the rights of a buyer arising upon the outright sale of a payment right). See UCC § 9-102(a)(73).

[37] Article 9's criteria for descriptions of property in a security agreement are quite flexible. Generally speaking, any description suffices, whether or not specific, if it reasonably identifies the property. See UCC § 9-108(a)-(b). A "supergeneric" description consisting solely of words such as "all of the debtor's assets" or "all of the debtor's personal property" is not sufficient, however. UCC § 9-108(c). A narrower description, limiting the property to a particular category or type, such as "all notes," is sufficient. For example, a description that refers to "all of the debtor's notes" is sufficient.

[38] See UCC § 9-313. As noted in Official Comment 3 to UCC § 9-313, "in determining whether a particular person has possession, the principles of agency apply." In addition, UCC § 9-313 also contains two special rules under which possession by a non-agent may constitute possession by the secured party. First, if a person who is not an agent is in possession of the collateral and the person authenticates a record acknowledging that the person holds the collateral for the secured party's benefit, possession by that person constitutes possession by the secured party. UCC § 9-313(c). Second, a secured party that has possession of collateral does not relinquish possession by delivering the collateral to another person (other than the debtor or a lessee of the collateral from the debtor in the ordinary course of the debtor's business) if the delivery is accompanied by instructions to that person to hold possession of the collateral for the benefit of the secured party or redeliver it to the secured party. UCC § 9-313(h).

- Thus, if the secured party (including a buyer) takes possession of the mortgage note pursuant to the security agreement of the debtor (including a seller), this criterion is satisfied even if that agreement is oral or otherwise not evidenced by an authenticated record.
- Alternatively, if the debtor authenticates a security agreement describing the note, this criterion is satisfied even if the secured party does *not* take possession of the note. (Note that in this situation, in which the seller of a note may retain possession of it, the owner of a note may be a different person than the person entitled to enforce the note.)[40]

Satisfaction of these three criteria of Section 9-203(b) results in the secured party (including a buyer of the note) obtaining a property right (whether outright ownership or a security interest to secure an obligation) in the note from the debtor (including a seller of the note).[41]

Illustrations:

6. Maker issued a mortgage note payable to the order of Payee.[42] Payee borrowed money from Funder and, to secure Payee's repayment obligation, Payee and Funder agreed that Funder would have a security interest in the note. Simultaneously with the funding of the loan, Payee gave possession of the note to Funder. Funder has an attached and

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See also Official Comment 9 to UCC § 9-313 ("New subsections (h) and (i) address the practice of mortgage warehouse lenders.") Possession as contemplated by UCC § 9-313 is also possession for purposes of UCC § 9-203. See UCC § 9-203, Comment 4.

[39] UCC §§ 9-203(b)(3)(A)-(B).

[40] As noted in the discussion of Question One, payment by the maker of a negotiable note to the person entitled to enforce it discharges the maker's obligations on the note. UCC § 3-602. This is the case even if the person entitled to enforce the note is not its owner. As between the person entitled to enforce the note and the owner of the note, the right to the money paid by the maker is determined by the UCC and other applicable law, such as the law of contract and the law of restitution, as well as agency law. See, e.g., UCC §§ 3-306 and 9-315(a)(2). As noted in comment 3 to UCC § 3-602, "if the original payee of the note transfers ownership of the note to a third party but continues to service the obligation, the law of agency might treat payments made to the original payee as payments made to the third party."

[41] For cases in which another person claims an interest in the note (whether as a result of another voluntary transfer by the debtor or otherwise), reference to Article 9's rules governing perfection and priority of security interests may be required in order to rank order those claims (and, in some cases, determine whether a party has taken the note free of competing claims to the note). In the case of notes that are negotiable instruments, the Article 3 concept of "holder in due course" (see UCC § 3-302) should be considered as well, because a holder in due course takes its rights in an instrument free of competing property claims to it (as well as free of most defenses to obligations on it). See UCC §§ 3-305 and 3-306. With respect to determining whether the owner of a note has effectively transferred a property interest to a transferee, however, the perfection and priority rules are largely irrelevant. (The application of the perfection and priority rules can result in the rights of the transferee either being subordinate to the rights of a competing claimant or being extinguished by the rights of the competing claimant. See, *e.g.*, UCC §§ 9-317(b), 9-322(a), 9-330(d), and 9-331(a).)

[42] For this Illustration, as well as Illustrations 7-11, the analysis under UCC Article 9 is the same whether the mortgage note is negotiable or non-negotiable. This is because, in either case, the mortgage note will qualify as a "promissory note" and, therefore, an "instrument" under UCC Article 9. See UCC §§ 9-102(a)(47), (65).

enforceable security interest in the note. UCC § 9-203(b). This is the case even if Payee's agreement is oral or otherwise not evidenced by an authenticated record. Payee is no longer a person entitled to enforce the note (because Payee is no longer in possession of it and it has not been lost, stolen, or destroyed). UCC § 3-301. Funder is a person entitled to enforce the note if either (i) Payee indorsed the note by blank indorsement or by a special indorsement identifying Funder as the person to whom the indorsement makes the note payable (because, in such cases, Funder would be the holder of the note), or (ii) the delivery of the note from Payee to Funder constitutes a transfer of the note under UCC § 3-203 (because, in such case, Funder would be a nonholder 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).

7. Maker issued a mortgage note payable to the order of Payee. Payee borrowed money from Funder and, in a signed writing that reasonably identified the note (whether specifically or as part of a category or a type of property defined in the UCC), granted Funder a security interest in the note to secure Payee's repayment obligation. Payee, however, retained possession of the note. Funder has an attached and enforceable security interest in the note. UCC § 9-203(b). If the note is negotiable, Payee remains the holder and the person entitled to enforce the note because Payee is in possession of it and it is payable to the order of Payee. UCC §§ 1-201(b)(21)(A), 3-301(i).
8. Maker issued a mortgage note payable to the order of Payee. Payee sold the note to Funder, giving possession of the note to Funder in exchange for the purchase price. The sale of the note is governed by Article 9 and the rights of Funder 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). This is the case even if the sales agreement was oral or otherwise not evidenced by an authenticated record. If the note is negotiable, Funder is also a person entitled to enforce the note, whether or not Payee indorsed it, because either (i) Funder is a holder of the note (if Payee indorsed it by blank indorsement or by a special indorsement identifying Funder as the person to whom the indorsement makes the note payable) or (ii) Funder is a nonholder in possession of the note (if there is no such indorsement) who has obtained the rights of Payee 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).
9. Maker issued a mortgage note payable to the order of Payee. Pursuant to a signed writing that reasonably identified the note (whether specifically or as part of a category or a type of property defined in the UCC), Payee sold the note to Funder. Payee, however, retained possession of the note. The sale of the note is governed by Article 9 and the rights of Funder as buyer constitute a "security interest." UCC § 1-201(b)(35). The security interest is attached and is enforceable. UCC § 9-203(b). If the note is negotiable, Payee remains the holder and the person entitled to enforce the note (even though, as between Payee and Funder, Funder owns the note) because Payee is in

possession of it and it is payable to the order of Payee. UCC §§ 1-201(b)(21)(A), 3-301(i).

Question Three – What is the Effect of Transfer of an Interest in a Mortgage Note on the Mortgage Securing It?

What if a note secured by a mortgage is sold (or the note is used as collateral to secure an obligation), but the parties do not take any additional actions to assign the mortgage that secures payment of the note, such as execution of a recordable assignment of the mortgage? UCC Section 9-203(g) explicitly provides that, in such cases, the assignment of the interest of the seller or other grantor of a security interest in the note automatically transfers a corresponding interest in the mortgage to the assignee: "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." (As noted previously, a "security interest" in a note includes the right of a buyer of the note.)

While this question has provoked some uncertainty and has given rise to some judicial analysis that disregards the impact of Article 9,[43] the UCC is unambiguous: the sale of a mortgage note (or other grant of a security interest in the note) not accompanied by a separate conveyance of the mortgage securing the note does not result in the mortgage being severed from the note.[44]

It is important to note in this regard, however, that UCC Section 9-203(g) addresses only whether, as between the seller of a mortgage note (or a debtor who uses it as collateral) and the buyer or other secured party, the interest of the seller (or debtor) in the mortgage has been correspondingly transferred to the secured party. UCC Section 9-308(e) goes on to state that, if the secured party's security interest in the note is perfected, the secured party's security interest

[43] *See, e.g.*, the discussion of this issue in *U.S. Bank v. Ibanez*, 458 Mass. 637 at 652-53, 941 N.E.2d 40 at 53-54 (2011). In that discussion, the court cited Massachusetts common law precedents pre-dating the enactment of the current text of Article 9 to the effect that a mortgage does not follow a note in the absence of a separate assignment of the mortgage, but did not address the effect of Massachusetts's subsequent enactment of UCC § 9-203(g) on those precedents. Under the rule in UCC § 9-203(g), if the holder of the note in question demonstrated that it had an attached security interest (including the interest of a buyer) in the note, the holder of the note in question would also have a security interest in the mortgage securing the note even in the absence of a separate assignment of the mortgage. (This Report does not address whether, under the facts of the *Ibanez* case, the holder of the note had an attached security interest in the note and, thus, qualified for the application of UCC § 9-203(g). Moreover, even if the holder had an attached security interest in the note and, thus, had a security interest in the mortgage, this would not, of itself, mean that the holder could enforce the mortgage without a recordable assignment of the mortgage to the holder. Whatever steps are required in order to enforce a mortgage in the absence of a recordable assignment are the province of real property law. The matter is addressed, in part, in the discussion of Question 4 below.)

[44] Official Comment 9 to UCC § 9-203 confirms this point: "Subsection (g) codifies the common-law rule that a transfer of an obligation secured by a security interest or other lien on personal or real property also transfers the security interest or lien." Pursuant to UCC § 1-302(a), the parties to the transaction may agree that an interest in the mortgage securing the note does not accompany the note, but such an agreement is unlikely. See, *e.g.*, Restatement (3d), Property (Mortgages) § 5.4, comment *a* ("It is conceivable that on rare occasions a mortgagee will wish to disassociate the obligation and the mortgage, but that result should follow only upon evidence that the parties to the transfer so agreed.").

in the mortgage securing the note is also perfected,[45] with result that the right of the secured party is senior to the rights of a person who then or later becomes a lien creditor of the seller of (or other grantor of a security interest in) the note. Neither of these rules, however, determines the ranking of rights in the underlying real property itself, or the effect of recordation or non-recordation in the real property recording system on enforcement of the mortgage.[46]

Illustration:

10. Same facts as Illustration 9. 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 Funder's interest in the rights of Payee in the note also constitutes attachment of an interest in the rights of Payee in the mortgage. UCC § 9-203(g).

Question Four – What Actions May a Person to Whom an Interest in a Mortgage Note Has Been Transferred, but Who Has not Taken a Recordable Assignment of the Mortgage, Take in Order to Become the Assignee of Record of the Mortgage Securing the Note?

In some states, a party without a recorded interest in a mortgage may not enforce the mortgage non-judicially. In such states, even though the buyer of a mortgage note (or a creditor to whom a security interest in the note has been granted to secure an obligation) automatically obtains corresponding rights in the mortgage,[47] this may be insufficient as a matter of applicable real estate law to enable that buyer or secured creditor to enforce the mortgage upon default of the maker if the buyer or secured creditor does not have a recordable assignment. The buyer or other secured party may attempt to obtain such a recordable assignment from the seller or debtor at the time it seeks to enforce the mortgage, but such an attempt may be unsuccessful.[48]

Article 9 of the UCC provides such a buyer or secured creditor a mechanism by which it can record its interest in the realty records in order to conduct a non-judicial foreclosure. UCC Section 9-607(b) provides that "if necessary to enable a secured party [including the buyer of a mortgage note] to exercise ... the right of [its transferor]to enforce a mortgage nonjudicially," the secured party may record in the office in which the mortgage is recorded (i) a copy of the security agreement transferring an interest in the note to the secured party and (ii) the secured

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[45] See Official Comment 6 to UCC § 9-308, which also observes that "this result helps prevent the separation of the mortgage (or other lien) from the note." Note also that, as explained in Official Comment 7 to UCC § 9-109, "It also follows from [UCC § 9-109(b)] 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-property mortgage, would be ineffective."

[46] Similarly, Official Comment 6 to UCC § 9-308 states that "this Article does not determine who has the power to release a mortgage of record. That issue is determined by real-property law."

[47] See discussion of Question Three, *supra.*

[48] In some cases, the seller or debtor may no longer be in business. In other cases, it may simply be unresponsive to requests for execution of documents with respect to a transaction in which it no longer has an economic interest. Moreover, in cases in which mortgage note was collateral for an obligation owed to the secured party, the defaulting debtor may simply be unwilling to assist its secured party. See Official Comment 8 to UCC § 9-607.

party's sworn affidavit in recordable form stating that default has occurred[49] and that the secured party is entitled to enforce the mortgage non-judicially.[50]

Illustration:

11. Same facts as Illustration 10. Maker has defaulted on the note and mortgage and Funder would like to enforce the mortgage non-judicially. In the relevant state, however, only a party with a recorded interest in a mortgage may enforce it non-judicially. Funder may record in the relevant mortgage recording office a copy of the signed writing pursuant to which the note was sold to Funder and a sworn affidavit stating that Maker has defaulted and that Funder is entitled to enforce the mortgage non-judicially. UCC § 9-607(b).

Summary

The Uniform Commercial Code provides four sets of rules that determine matters that are important in the context of enforcement of mortgage notes and the mortgages that secure them:

- First, in the case of a mortgage note that is a negotiable instrument, Article 3 of the UCC determines the identity of the person who is entitled to enforce the note and to whom the maker owes its payment obligation; payment to the person entitled to enforce the note discharges the maker's obligation, but failure to pay that party when the note is due constitutes dishonor.
- Second, for both negotiable and non-negotiable mortgage notes, Article 9 of the UCC determines whether a transferee of the note from its owner has obtained an attached property right in the note.
- Third, Article 9 of the UCC provides that a transferee of a mortgage note whose property right in the note has attached also automatically has an attached property right in the mortgage that secures the note.
- Finally, Article 9 of the UCC provides a mechanism by which the owner of a note and the mortgage securing it may, upon default of the maker of the note, record its interest in the mortgage in the realty records in order to conduct a non-judicial foreclosure.

As noted previously, these UCC rules do not resolve all issues in this field. The enforcement of real estate mortgages by foreclosure is primarily the province of a state's real property law, but legal determinations made pursuant to the four sets of UCC rules described in this Report will, in many cases, be central to administration of that law. In such cases, proper application of real property law requires proper application of the UCC rules discussed in this Report.

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[49] The 2010 amendments to Article 9 (see fn. 8, *supra*) add language to this provision to clarify that "default," in this context, means default with respect to the note or other obligation secured by the mortgage.

[50] UCC § 9-607(b) does not address other conditions that must be satisfied for judicial or non-judicial enforcement of a mortgage.

DECLARATION OF SERVICE

The undersigned declares under penalty of perjury, under the laws of the State of Washington, that the following is true and correct:

That on December 5, 2011, I arranged for service of REPLY BRIEF OF APPELLANT U.S. BANK NATIONAL ASSOCIATION AS TRUSTEE FOR THE GREENPOINT MORTGAGE FUNDING TRUST MORTGAGE PASS-THROUGH CERTIFICATES, SERIES 2007-AR1, to the court and to the parties to this action as follows:

Office of the Clerk Court of Appeals - Division 1 One Union Square 600 University Street Seattle, WA 98101 Fax: (206) 389-2613	____ *Fasimile* ____ *Messenger* ____ *U.S. Mail* *XXX Federal Express* ____ *E-Mail*
Howard M. Goodfriend Smith Goodfriend, PS 1109 First Avenue, Suite 500 Seattle, WA 98101 howard@washingtonappeals.com *Counsel for Defendants in Intervention/Respondents*	____ *Fasimile* ____ *Messenger* *XXX U.S. Mail* ____ *Federal Express* *XXX E-Mail*

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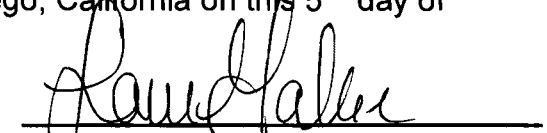
DATED at San Diego, California on this 5th day of December, 2011.



Lauren E. Gabler