



Transfer of Promissory Note

- If the note is a “negotiable instrument,” then it is governed by UCC Article 3
- Is transferee of the note a “holder in due course” (HIDC)?
 - HIDC takes it free of maker’s personal defenses (e.g., failure of consideration) [UCC § 3-305(b)]
 - HIDC takes the note subject to maker’s “real” defenses [UCC § 3-305(a)]



Holder in Due Course [§ 3-305]

- To be a holder in due course of a negotiable promissory note, one must
 - Pay value to acquire the note
 - Take the note in “good faith”
 - Take it “without notice” that the note is/has been (a) overdue or dishonored, (b) forged or altered, (c) claimed by another party, or (d) subject to defenses



Nonnegotiable Promissory Note

- If note is not a negotiable instrument, its enforcement is governed by common law of contracts
 - In that case, assignee takes the note subject to all real and personal defenses of the maker
 - Thus, if the note is nonnegotiable, Lynch can’t collect from Mitchell (assuming, of course, that Mitchell’s defense is a valid defense)

Problem 4: Consumer Credit

- October 2007: Uphoff signs contract w/Quickie Aluminum Siding to install aluminum siding on his home for \$5,700
 - Uphoff signs note (\$5,700 + 15% interest) and mortgage on his home
 - Quickie assigns note to Roosevelt Bank for \$5,500 cash
- January 2008: After first two payments, Uphoff stops making payments when siding begins falling off the house
- Can Roosevelt enforce note/mortgage?



- If note is nonnegotiable, Roosevelt took note subject to Uphoff’s defense for breach of warranty/failure of consideration
- If note is negotiable, and UCC HIDC rules apply, then if Roosevelt is a HIDC, Roosevelt would be able to enforce the note against Uphoff, despite his failure of consideration defense against Quickie
 - Note: If Roosevelt has previously purchased notes from Quickie and similar problems arose in those transactions, this may be “reason to know” of Uphoff’s defense, even absent actual knowledge

UCCC § 3.404(1)

- “With respect to a consumer credit sale or consumer lease, an assignee of the rights of the seller or lessor is subject to all claims and defenses of the consumer against the seller or lessor arising from the sale or lease of property or services, notwithstanding that the assignee is a holder in due course of a negotiable instrument”
 - Thus, Roosevelt would take the note/mortgage subject to Uphoff’s defense

FTC Rule

- Consumer credit contract (\$25,000 or less) must say: "NOTICE. ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED WITH THE PROCEEDS HEREOF."
 - Assignee of note with this legend can't be a HIDC under Article 3
 - It is an "unfair trade practice" to enter into consumer credit contract without this notice



Problem 4

- What if the note Uphoff signed to Quickie DID NOT contain the notice required by the FTC Rule?
 - Suppose also that the home is located in a state that has not adopted UCCC
- Can Roosevelt now claim to be a HIDC and enforce the note w/out regard to Uphoff's defense?



Problem 4

- Violation of FTC rule subjects Quickie to fines, but does not invalidate the note under state law
- Thus, Roosevelt can be a HIDC, unless the state has adopted a statute that would deny Roosevelt HIDC status

Mo. Rev. Stat. § 408.405

The rights of a holder or assignee of an instrument ... which evidences the obligation of a natural person as buyer, lessee or borrower in connection with the purchase or lease of consumer goods or services, are subject to all defenses and setoffs of the debtor arising from or out of such sale or lease ..., only as to amounts then owing and as a matter of defense to or setoff against a claim by the holder or assignee; provided, however, with respect to goods only, the rights of the debtor under this section ... must be so asserted within 90 days after receipt of the goods."



Problem 4: Missouri Statute

- Uphoff could assert defense vs. Roosevelt
- However, Uphoff can't recover any payments he already made
- Also, if his defense is based on the quality of the siding (rather than its installation), Uphoff must raise that defense w/in 90 days after siding is installed [Mo. Rev. Stat. § 408.405]



Mortgage Follows the Note

- Suppose A loans \$50,000 to B; B signs a note and grants a mortgage on B's land
- Can A sell the note to X, but keep the mortgage on B's land?
 - No; "the mortgage follows the note"
 - Mortgage has no legal significance apart from the obligation that it secures
 - Mortgage also passes to X by operation of law (even w/out written assignment of mortgage)



Problem 1

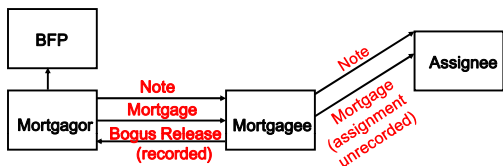
- Horizon Mortgage Co. took, recorded mortgage (securing \$150K loan to Mitchell)
- Horizon has now sold mortgage note to Stearns Bros. (an investment bank), which will pool it w/other mortgages and issue MBS
- If “the mortgage follows the note,” why might Stearns Bros. still insist upon a separate document assigning the mortgage?



Why Get/Record Assignment?

- (1) If assignee has to foreclose on the mortgage, assignee will need to record evidence of assignment to be able to establish proper chain of title to the land
- (2) If assignee doesn't record assignment, assignee could be subject to risk of being defrauded

Fraud Risk



- If assignee does not record mortgage assignment, mortgagee could collude with mortgagor to issue bogus release/satisfaction
- This would not bind assignee, but assignee's interest could be extinguished by the recording act, if the mortgagor later conveyed land to a BFP



Securitization

- Owner of mortgages places them in a “pool,” and then issues securities, often (but not necessarily) bonds, which are sold to investors
 - On behalf of issuer, trustee collects payments from mortgagors, and then uses those payments to pay P&I payments to bondholders



Securitization: Rationale

- Benefit to investors: can get benefit of diversified (through pooling of mortgages) and/or flexible real estate-backed investment
- Benefit to lenders: lenders can obtain more \$\$ to make loans in capital markets (not just from bank deposits, insurance premiums, or pension contributions)
- Benefit to borrowers: greater supply of mortgage capital should result in lower rates



- Suppose that Stearns Bros. does obtain a written assignment of the mortgage. Can you think of any reason why Stearns Bros. might not record it?
 - Cost of recording assignment ≈ \$25
 - If Stearns Bros. is putting 2,000 mortgages into the securitization pool, cost of recording assignments = \$50,000!
 - Instead, it may choose to hold the assignments and only record those where loan goes into default

Securitization Problem

- Mitchell gets mortgage loan from Bank
 - He'd been promised 6% interest rate
 - At closing, note's language said 8%; when Mitchell complained, Bank told him he didn't qualify for 6% rate (this was a lie)
 - Mitchell signed the note
- Bank sold loan to FreddieMac, which placed loan into a pool held by special purpose entity (SPE) and issues MBS
- Mitchell makes payments based on 6% interest rate; can SPE declare him in default and foreclose the mortgage?

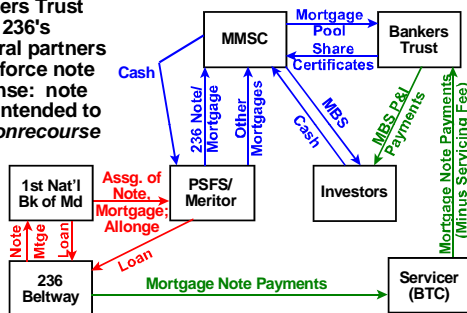


Securitization Problem

- If Mitchell's note was negotiable and the SPE is HIDC of that note, then SPE can enforce that note according to its terms (8%) w/out regard to Mitchell's defense
- By contrast, if Mitchell's note was not negotiable (or if SPE is not a HIDC), Mitchell could raise his defense

Bankers Trust v. 236 Beltway

- Bankers Trust sues 236's general partners to enforce note
- Defense: note was intended to be *nonrecourse*



Bankers Trust v. 236 Beltway

- Held: note was not negotiable, because it didn't contain an unconditional promise to pay a "sum certain"
 - Note had a variable interest rate (so amount due could not be determined solely by reference to Note)
- Thus, Bankers Trust took the note subject to all personal defenses of maker



Bankers Trust

- Case was decided under former Art. 3
- Today, revised Art. 3 provides that an adjustable rate note can still be a negotiable instrument
- If revised Art. 3 had been in effect at the time, would case have been resolved in favor of Bankers Trust?