Real Property Law Section

The Real Estate Mortgage Follows the Promissory Note Automatically, Without an Assignment of Mortgage

The Lesson of *BAC Home Loans*

By Kraettli Q. Epperson

This article concerns whether an assignment of a real estate mortgage is required by Oklahoma law. There is a recent 2010 Oklahoma Court of Civil Appeals case that provides the answer to this specific question (the "*BAC* case").[1] The simple and clear answer is "No." As stated by the Oklahoma Supreme Court, and quoted in the *BAC* case: "The indorsement and delivery of the note carries with it the mortgage without any formal assignment thereof."[2] Stated in an informal way: the tail follows the dog. Consequently, no formal assignment of a mortgage is necessary and, consequently, no recording of the assignment of a mortgage is required, in order for the owner of the note to enforce both the note and the related mortgage.

Over the last few years, several challenges in courts around the country have arisen to the use of Mortgage Electronic Registration Systems Inc. (MERS) as a nominee (*i.e.*, limited agent) taking the real estate mortgage for a named (*i.e.*, disclosed) principal, meaning the lender, with the lender advancing the funds and holding the promissory note.[3] Due to the desire of the lender to ensure that the lien of its mortgage is ahead of other lenders or creditors taking lien interests after the execution of its mortgage, such lender will promptly — out of self-interest — file its mortgage of record with the local county clerk to give third persons "constructive notice" of its lien.[4] However, the county clerk provides such recording as a public service, and there is no statutory obligation for a lender to file its mortgage.[5] By the same token, there is no statutory duty to file an assignment of mortgage. If the lender chooses to take advantage of this recording service, or to use the court system to foreclose the mortgage lien, then it must pay the statutory mortgage tax when it files its mortgage, or at least by the time it files a foreclosure.[6] On the other hand, due to its sovereign immunity, the county clerk has no liability for failing to properly record and index the instruments filed by any person.[7] There are several statutes which make it clear that once a person files a document which purports to convey a fee simple interest, when in fact the conveyance is meant to only convey a mortgage lien on the real property, then an explanatory instrument must accompany such earlier filing, and, in the absence of such clarifying recording, the public can take the initial document at face value as a fee simple conveyance.[8]

In the event that the loan is paid off or refinanced — which occurs in the majority of situations — the mortgage is simply released of record by one of four parties: the original lender, the current person entitled to enforce the note, or MERS on behalf of either the original or subsequent holder of the note, and everyone is satisfied, including the title examiner.[9]

However, as the total number of defaulting borrowers has increased dramatically over the last few years (since the current recession began in 2008), the result is that the absolute number of borrowers who are choosing to fight their foreclosures has also increased.

The borrowers' defenses come in many forms: 1) some are substantive issues (*e.g.*,

demanding full credit for all payments made); 2) others are pre-suit procedural in nature (*e.g.*, insisting on notice of default and an opportunity to cure), and 3) others arise in the lawsuit concerning mixed legal/factual issues (*e.g.*, does the plaintiff have standing, as the current holder of both the note and mortgage).

One issue in the third category which has arisen in regard to the use of MERS is the following: When 1) MERS takes the real estate mortgage as the nominee (*i.e.*, limited agent) for the lender (which lender advances the funds and holds the note), and 2) the secured note is thereafter indorsed to a subsequent holder, does there need to be an assignment of mortgage to the new holder of the note, in order for the new holder of the note to be legally allowed to sue the debtor to simultaneously enforce the promissory note and foreclose the real estate mortgage?

While there may be other unanswered questions in Oklahoma about the use of MERS as a nominee/agent/mortgagee, this article leaves such issues for others to address. Instead, this article focuses solely on the "assignment of mortgage" issue, namely: ***If** the note is indorsed and thereby transferred to another person, **then** is it necessary for the mortgage to be assigned in writing to the subsequent holder, with such assignment filed of record, before the later holder of the note has the ability both to enforce the note and to foreclose such mortgage?*

A promissory note is a negotiable instrument covered under Oklahoma's Uniform Commercial Code,[10] and the Permanent Editorial Board for the Uniform Commercial Code issued a report concerning the "Application of the Uniform Commercial Code to Selected Issues Relating to Mortgage Notes," dated Nov. 14, 2011. Such report was issued because "[a]lthough the UCC provisions are settled law, it has become apparent that not all courts and attorneys are familiar with them. ... The Permanent Editorial Board for the Uniform Commercial Code 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 on real property." (page 1) This report directly addresses our "assignment of mortgage" issue (at page 12): "What if a note secured by a mortgage is sold..., 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." On that same page, the report continues by noting "the UCC is unambiguous: the sale of a mortgage note...not accompanied by a separate conveyance of the mortgage securing the note does not result in the mortgage being severed from the note." This report condemns in strong language a recent state court case from Massachusetts — which reflects a minority trend — which cites "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' subsequent enactment of UCC §9-203(g) on those precedents."

This UCC report's answer is consistent with the law of Oklahoma, as such law is expounded in the *BAC* case: the real estate mortgage follows the note automatically.[11]

The *BAC* case involves a summary judgment by the trial court granting judgment on a promissory note along with ordering foreclosure of a real estate mortgage. Although the appellate court remands the case, such remand is solely due to the unanswered question as to whether the plaintiff, BAC, currently holds the note. What is significant is that the remand is not for the purpose of determining the holder of the mortgage, because the appellate court clearly holds, quoting an Oklahoma Supreme Court case, that: *"The indorsement and delivery of the note carries with it the mortgage without any formal assignment thereof."*[12] To reach this conclusion, the appellate court discusses the holdings in four cases from other states dealing with the concepts related to MERS.[13] In addition, it relies on several Oklahoma UCC statutes.[14] Ultimately, it bases its position on three earlier precedential Oklahoma Supreme Court cases.[15] In addition, in order to educate itself on the nature and history of the MERS system, the appellate court reviewed a then-upcoming law review article discussing MERS.[16]

The facts of the *BAC* case reflect omissions in the paperwork supporting the endorsement of the note and the assignment of the real estate mortgage, existent when the petition for foreclosure is initially filed. These initial errors included, as shown on the copy of the note

attached to the petition, the omission of the name of the new holder of the note, although the initial lender (American Home Mortgage) had its assistant secretary place her initials on the stamp which was intended to show the endorsement from American Home Mortgage, the initial lender, to a subsequent note holder. The name of the new note holder was left blank. When the motion for summary judgment was filed, the plaintiff, BAC Home Loans Servicing LP f/k/a Countrywide Home Loans Servicing LP (hereinafter BAC), attached a copy of the note showing the name "Countrywide Document Custody Services, a division of Treasury Bank, N.A." stamped in the indorsement space that had been left blank in the copy attached to the petition. But an endorsement to BAC was still lacking.

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In the mortgage assignment, MERS, "as Nominee for American Home Mortgage" assigned the mortgage to Countrywide Home Loans Servicing LP. The assignment was undated but signed by "Kimberly Dawson, 1st Vice President" for MERS. The acknowledgment attached to the assignment was undated but signed by Regina McAninch as a notary public in the state of Texas. A file-stamp by the county clerk of Rogers County, Oklahoma, appeared on the mortgage document but not on the mortgage assignment.[17] BAC attached to the motion for summary judgment a copy of the mortgage assignment identical to the one attached to the petition except that it was dated April 20, 2009, and bore the file-stamp of the Rogers County clerk showing it was filed of record on July 16, 2009.[18]

When the lender's motion for summary judgment was filed, the trial court found that all of the essential errors had been corrected.

There was one particularly important initially missing fact which the trial court ruled was satisfied at the time of its consideration of the lender's motion for summary judgment. The trial court apparently heard oral argument and saw documentary evidence — presumably the back side of the note — which document was not included in the appellate record.[19]

The trial court granted summary judgment to BAC, the foreclosing lender, holding the plaintiff had proven it was the current holder of the promissory note, and the real estate mortgage.

The debtor appealed.

The appellate court stated: "BAC attached a copy of the note showing the name 'Countrywide Document Custody Services, a division of Treasury Bank, N.A.' stamped in the indorsement space that had been left blank in the copy attached to the petition. The copy of the note attached to the motion also contained upside-down and backwards text in the area of the indorsement, suggesting the page had additional indorsements on the back, but the attachment does not include a copy of the back of the page."[20]

The appellate court reversed the summary judgment and remanded it to the trial court for trial explaining: "The record on summary judgment in the present case contains conflicting evidence as to the ownership of the note. The note, in which the Whites promised to pay a sum certain to the order of Lender, is a negotiable instrument pursuant to *12A O.S.2001 §3-104*(a). It may be indorsed specially to be payable to an identified person or it may be indorsed in blank to be payable to bearer. *12A O.S.2001 §3-205*(a) and (b). If the note was indorsed in blank and BAC was in possession of the original note, then BAC was the owner of the note and entitled to bring this action. *12A O.S.2001 §§3-205*(B) and 3-110. The note in the record appears to be indorsed to Countrywide Document Custody Services, a division of Treasury Bank, N.A.; we are unable to determine from the record submitted to us that the instrument was later indorsed in blank and transferred to BAC. Although BAC's attorney represented at hearing the note was indorsed in blank and in BAC's possession, no evidence was entered into the record at the hearing. The hearing consisted of oral argument only on the motions for summary judgment and was not a trial. This appeal comes to us as an accelerated appeal from a summary determination. We must base our review upon the record the parties have actually made and not one which is

theoretically possible. Based on the record before us, we conclude there is a question of fact as to the ownership of the note. Accordingly, we REVERSE the trial court's order granting summary judgment in favor of BAC and REMAND this matter for trial."[21]

It is significant that neither the trial court nor the appellate court expressed any concern about who held an assignment of the real estate mortgage. Instead, the appellate court held:

> "In Oklahoma, ownership of the note is controlling, and assignment of the note necessarily carries with it assignment of the mortgage. *Gill v. First Nat. Bank & Trust Co. of Oklahoma City*, 1945 OK 181, 159 P.2d 717, 719. 'The mortgage securing the payment of a negotiable note is merely an incident and accessory to the note, and partakes of its negotiability. The indorsement and delivery of the note carries with it the mortgage without any formal assignment thereof.' *Prudential Ins. Co. of America v. Ward*, 1929 OK 71, 274 P. 648, 650. Proof of ownership of the note is proof of ownership of the mortgage security. *Engle v. Federal Nat. Mortg. Ass'n*, 1956 OK 176, 300 P.2d 997, 999. Therefore, in Oklahoma it is not possible to bifurcate the security interest from the note. An assignment of the mortgage to one other than the holder of the note is of no effect."[22]

This paragraph 10 from the appellate court decision makes it clear that no assignment of the real mortgage is required in order for the holder of the note to institute and complete the real estate mortgage foreclosure.

It is interesting to note the steps followed by the appellate court in the analysis it followed to reach its final decision. In particular, the appellate court lists and summarizes the holdings of the four out-of-state cases dealing with MERS, and then states:

"Oklahoma law is in accord with these cases."

What does this statement mean?

A review of these four out-of-state cases shows that they held, as summarized by the Oklahoma appellate court (¶9):

> "…MERS lacked any enforceable rights because *there was no evidence MERS owned the promissory note* secured by the mortgage. *Id*. at 167-168. Similarly, appellate Courts in Arkansas, Missouri and Maine have *refused to allow MERS or its assignee to assert rights against the mortgagor because it did not hold the note* secured by the mortgage." (emphasis added)[23]

In other words, the dispositive question is: Who holds the note?

A review of these four out-of-state cases also makes it clear that, as a practical matter, if the subsequent note holder wants to receive notice of a court action being filed, which could impact its mortgage lien, such as the foreclosure of a money judgment or other mortgage, or the conduct of a tax sale, then either the initial note holder (*e.g.*, ABC Bank) or MERS, as nominee/agent/mortgagee for the initial note holder, must sign and file an assignment of mortgage (*i.e.*, from ABC Bank to XYZ Bank). The debtor/mortgagor is protected, by statute, by receiving credit for all payments made to the initial note holder, up until the assignment of mortgage is recorded. Also, the assignee of the mortgage is entitled to recover from the assignor any payments made to such assignor after such assignment is recorded.

Hence, the four rules being stated directly or by implication in this *BAC* case are:

1) any endorsement of a note must be by the holder of the note, and not by MERS (if MERS is the nominee/agent only as to the mortgage); and

2) a subsequent holder of the note automatically holds the real estate mortgage, without the need for the execution (or recording) of an assignment of the mortgage; and

3) a holder of a mortgage who does not also hold the note (or does not hold the express authority to act for the note holder) cannot institute an action to enforce the note; and

4) in order to give the debtors and third parties notice that the mortgage interest is being held by someone other than the initial mortgagee (*e.g.*, being held by XYZ Bank — the later holder of the note — instead of the initial holder, ABC Bank), there must be a recorded assignment of the mortgage by the mortgagee (*e.g.*, by ABC Bank or by MERS as nominee/agent for ABC Bank).

In other words, the execution (and filing) of an assignment of mortgage is not required by statute and is not necessary for the enforcement of the note and the mortgage by whoever is the current holder of the promissory note. Such preparation and filing of an assignment of mortgage would be solely for the benefit of the current note holder for the purpose of giving the debtors and third parties constructive notice of the name of the current holder of the note and mortgage.

1. 2011 OK CIV APP 35, 256 P.3d 1014.

2. *Id*. at ¶10.

3. Typical language from a "MERS Mortgage" provides: "'MERS' is Mortgage Electronic Registration Systems, Inc. MERS is a separate corporation that is acting solely as nominee for Lender and Lender's successors and assigns. MERS is the mortgagee under this Security Instrument." "OKLAHOMA — Single Family — Fannie Mae/Freddie Mac UNIFORM INSTRUMENT – MERS Form 3037 1/01 (rev. 12/03)."

4. 25 O.S. §§10-13; 16 O.S. §§15-16; 46 O.S. §§6-7.

5. There is a land recording system, known as the Torrens Title system, which was used in the United States solely in Cook County, Illinois (containing Chicago), whereby the local government kept track of all land titles, and issued a title certificate, like a car title is issued in Oklahoma. However, "Attorneys preferred the fast, efficient title insurance company methods to the slower administrative processes of the Torrens system. Also in the late 1970s the practice of selling mortgages to a secondary market became widespread, but institutional investors would not accept a Torrens certificate as a guarantee of title. In view of the declining use of the Torrens system, in January 1992 the Illinois legislature began the process of phasing it out." (http://encyclopedia.chicagohistory.org/pages/1262.html) The Torrens Title system is not used in Oklahoma.

6. 68 O.S. §1907.

7. *Board of County Com'rs of Tulsa County v. Guaranty Loan & Inv. Corp. of Tulsa Inc*., 1972 OK 78, 497 P.2d 423.

8. 46 O.S. §§8, 10, and 11.

9. Oklahoma Title Examination Standard 24.12.

10. 2011 OK CIV APP 35 at ¶11: "The note...is a negotiable instrument pursuant to 12A O.S.2001§3-104(a). It may be indorsed specially to be payable to an identified person or it may be indorsed in blank to be payable to bearer. 12A O.S. 2001 §3-205(a) and (b)."

11. 12A O.S. §§1-9-607(a)(3) and (a)(5)(b) and 1-9-203(g); the 2001 UCC Comment to 12A O.S. §1-9-203(g) provides: "9. Collateral Follows Right to Payment or Performance. 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. See Restatement (3d), Property (Mortgages) §5.4(a) (1997). See also Section 9-308(e) (analogous rule for perfection)." As explained in the article on MERS at 120, which article is referred to by the *BAC* case appellate court (see footnote 17 below), "Thus, in *Carpenter v. Longan*, the United States Supreme Court announced the classic statement of this rule: 'The note and mortgage are inseparable.... An assignment of the note carries the mortgage with it, while an assignment of the latter alone is a nullity.'" 83 U.S. (16 Wall.) 271, 274 (1872).

12. 2011 OK CIV APP 35 at ¶10.

13. *Id*. at ¶9.

14. *Id*. at ¶11: "The note, in which the Whites promised to pay a sum certain to the order of Lender, is a negotiable instrument pursuant to 12A O.S.2001 §3-104(a). It may be indorsed specially to be payable to an identified person or it may be indorsed in blank to be payable to bearer. 12A O.S.2001 §3-205(a) and (b). If the note was indorsed in blank and BAC was in possession of the original note, then BAC was the owner of the note and entitled to bring this action. 12A O.S.2001 §§3-205(B) and 3-110."

15. *Gill v. First Nat. Bank & Trust Co. of Oklahoma City*, 1945 OK 181, 159 P.2d 717; *Prudential Ins. Co. of America v. Ward*, 1929 OK 71, 274 P. 648; *Engle v. Federal Nat. Mortg. Ass'n*, 1956 OK 176, 300 P.2d 997.

16. *Id*. at ¶8: Christopher L. Peterson, *Two Faces: Demystifying the Mortgage Electronic Registration System's Land Title Theory,* Real Property, Trust and Estate L.J. (forthcoming) (available at http://ssrn.com/abstract=1684729).

17. 2011 OK CIV APP 35 at ¶3.

18. *Id.* at ¶4.

19. *Id.*at ¶6.

20. *Id.* at ¶4.

21. *Id.* at ¶11.

22. *Id.* at ¶10.

23. It should be noted that in several of these out-of-state cases, the ruling which went against MERS did so because its principal has already filed a motion to intervene or to set aside the judgment, and had been turned down. It is logical but not instructive to be told that the principal's agent does not get a "second bite at the apple" when the principal has been rebuffed.

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