William & Mary Business Law Review

Volume 6 | Issue 2 Article 5

The Emperor's New Clothes: How the Judicial System and the Housing-Mortgage Market Have Turned a Blind Eye to the Destruction of the Negotiability of Mortgage Promissory Notes

Roy D. Oppenheim

Jacquelyn K. Trask-Rahn

THE EMPEROR'S NEW CLOTHES: HOW THE JUDICIAL SYSTEM AND THE HOUSING-MORTGAGE MARKET HAVE TURNED A BLIND EYE TO THE DESTRUCTION OF THE NEGOTIABILITY OF MORTGAGE PROMISSORY NOTES*

ROY D. OPPENHEIM**
JACQUELYN K. TRASK-RAHN***

ABSTRACT

This Article examines the common notions of negotiable instruments as they relate to the modern day promissory note in the context of residential mortgage lending. The Article further addresses the destruction of the negotiability of such promissory notes through various undertakings added for the benefit of the banking industry, often to the detriment of a borrower. The use of negotiable instruments commenced in the 1800s in England as a way of ensuring a fluid market between trades as there was no fiat currency system in place. The fundamental purpose behind the concept of negotiability was subsequently abrogated by the modernization of the financial industry, and the creation of a global marketplace for the purchase and sale of promissory notes. Furthermore, the Article discusses

---

** Roy D. Oppenheim is a senior partner at Oppenheim Law, a South Florida law firm focusing on real estate and foreclosure defense law. Mr. Oppenheim is a recognized expert in foreclosure defense, and has been used as a source by major media outlets including the *Wall Street Journal*, *New York Times*, AP, *USA Today*, FOX, NBC, CBS, the BBC and *The Florida Bar News* as well as *The Daily Show* and *60 Minutes*. Mr. Oppenheim has been named in Who's Who in America from 2011 to present, and has been named in the Real Estate Division of Best Lawyers in America from 2009 to present. Mr. Oppenheim graduated cum laude with a B.A. from Princeton University in 1982 and received a J.D. from Northwestern School of Law in 1986. Mr. Oppenheim is a member of the New York and Florida Bars.

*** Jacquelyn K. Trask-Rahn is an associate at Oppenheim Law. Ms. Trask-Rahn graduated with a B.S. from the University of Michigan in 2006 and graduated summa cum laude with a J.D. from Nova Southeastern University Shepard Broad Law Center in 2011. Ms. Trask-Rahn was a Merit Scholar and former Articles Editor for the *Nova Southeastern University Law Review*. Ms. Trask-Rahn is a member of the Florida Bar.

The authors would like to thank Marc Marra and Manuel Serra-Jovenich for their research assistance with this Article.

how the holder in due course doctrine, which limits a borrower's defenses when a promissory note has been transferred from one note holder to another, has created significant abuse to consumers by the financial industry. The abuse of consumers through the holder in due course doctrine remains a problem unchecked by many courts that continue to apply negotiability law to modern day promissory notes in real estate mortgage transactions despite the fact that modern day promissory notes lack any of the tenets of "negotiability" under article 3 of the Uniform Commercial Code. The Article then calls on the judiciary, as theoretically the least political and most impartial branch of government, to find that such promissory notes are no longer negotiable instruments, and therefore must be transferred via assignment pursuant to article 9 of the Uniform Commercial Code. Such a new construct or approach would provide the transparency necessary to protect consumers and preserve defenses to predatory lending by the financial industry.

TABLE OF CONTENTS

INTRODUCTION: "THE EMPEROR'S NEW CLOTHES"

In Hans Christian Andersen's folk story "The Emperor's New Clothes," an arrogant Emperor hires two swindlers that promise him the finest suit from the best fabric, which is invisible to anyone who is either unfit for his position or unusually stupid.[1] The Emperor and his ministers cannot see the cloth themselves, but they pretend that they can because they are too afraid to admit that they are stupid or unfit for their position.[2] When the swindlers report that the suit is finished, they mime dressing the Emperor, who then marches before the people of the great city where he lives.[3] All of the citizens play along with the sham until a child in the crowd blurts out that the Emperor is wearing nothing at all, and the cry is soon taken up by the whole city.[4]

Just as in the fable, the judicial system and housing-mortgage market have been improperly led to believe that mortgage promissory notes, particularly the standard note form approved by the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), are negotiable.[5] Yet, rather than acknowledging that the negotiability of this standard form note (which represents trillions of dollars in commercial paper) has been destroyed by the addition of various terms and contingencies, the judicial system and the housing-mortgage market, like the emperor and his ministers, have turned a blind eye to what is obvious to everyone else.[6]

In fact, the very formation of article 3 of the Uniform Commercial Code (UCC) was nothing more than a strategic plan by lenders and the American

---

[1] HANS CHRISTIAN ANDERSEN, THE EMPEROR'S NEW CLOTHES (Harcourt Brace 1998) (1837).

[2] *Id.*

[3] *Id.*

[4] *Id.*

[5] Roy Oppenheim, *Banks fear courts' ruling on negotiability of promissory notes*, S. FLA. L. BLOG (May 28, 2013), http://southfloridalawblog.com/banks-fear-courts-rulings-on-promissory-notes/, *archived at* http://perma.cc/ZC3K-MNVY.

[6] *Id.* In fact, the Illinois Bankers Association all but begged the Illinois Supreme Court to find the standard mortgage note negotiable, citing the "major practical and public policy consequences" that any determination of the negotiability of these notes will have, including "consequences reaching far beyond the court room and defendants in foreclosure actions." Letter from Bruce Jay Baker, Executive Vice President and General Counsel, Illinois Bankers Association, to Honorable Members of the Mortgage Foreclosure Committee (Apr. 13, 2012), *archived at* http://perma.cc/9UC2-4KLW. In light of the possible ramifications of finding the standard note nonnegotiable, rather than asking the Illinois Supreme Court to apply the law, the IBA instead "respectfully urge[d] the Committee (and the Court) to keep sight of the broader consequences of any decisions it may make in the course of its deliberations." *Id.*

Bankers' Association to destroy the limited traditional requirements of negotiability that originated in the 1700s in England, while preserving the "better than" position given to a holder in due course which undermined any consumer protections that might have existed in the original form of promissory notes.[7] Other notable scholars on this topic have opined that the term "Uniform Commercial Code" is a misnomer, for it should have been called "'the Lawyers and Bankers Relief Act.'"[8]

Since the adoption of article 3 of the UCC, few courts have considered whether mortgage promissory notes are in fact truly "negotiable instruments" under the still somewhat narrow definition of "negotiability" contained in article 3.[9] Instead, courts have presumed their negotiability, leading to the mantra by respected law professor and legal scholar Albert J. Rosenthal that "a negotiable instrument is a negotiable instrument is a negotiable instrument. And a holder in due course is a holder in due course is a holder in due course."[10] Courts and judicial officers, like the emperor and his ministers, fear that truly examining the legal fiction of mortgage promissory notes could only lead to the conclusion that they are not negotiable, thus potentially destroying the negotiability of trillions of dollars in commercial paper. So they turn a blind eye, ignore the application of law, and instead enforce folklore that is perpetuated over and over again, and hope that maybe someone else, like the child in the crowd, is brave enough to blurt out what needs to be said: Fannie Mae and Freddie Mac notes are nonnegotiable.

This Article focuses on the history of negotiability, the changes thereto by the modernization and capitalization of our economy, and the changes to negotiability that have been promulgated by the financial industry. Part II of this Article further addresses how such changes were created in order to promote a lending tool that simultaneously allows lenders to transfer commercial paper without accountability or traceability, while preventing unsophisticated consumers from bringing defenses against any purchaser in the secondary market for fraud and misrepresentations by the initial lenders.[11]

Part IV of this Article further calls on the judiciary to examine the archaic and anarchic system that has developed out of article 3 of the UCC, which no longer has practical application in today's commercial lending.

---

[7] Kurt Eggert, *Held Up In Due Course: Codification and the Victory of Form Over Intent in Negotiable Instrument Law*, 35 CREIGHTON L. REV. 363, 422 (2002).

[8] *Id.*

[9] This Article does not suggest that promissory notes are not "transferrable" through other methods, such as by assignment under article 9 of the UCC. Rather, this Article focuses solely on how mortgage promissory notes are not "negotiable" under the requirements of article 3 of the UCC.

[10] Albert J. Rosenthal, Note*, Negotiability—Who Needs It?*, 71 COLUM. L. REV. 375, 375 (1971).

[11] *See infra* notes 104–201 and accompanying text.

Finally, this Article implores the judiciary to apply the law as it stands, rather than continuing to perpetuate the legal fiction of negotiability that has been ingrained in our judicial system because of public policy concerns and potential "broader consequences" of any decision which refuses to turn a blind eye to the failure of negotiability in mortgage promissory notes.[12] The authors of this Article ask the judiciary, as an impartial and nonpolitical branch of government, to open its eyes, and like the child, speak the naked truth. Further, the authors will provide a pathway that will allow notes to flow freely with transparency, and thus not cause a decline in the liquidity of the transfer of notes backed by mortgages as security, while still preserving the rights of borrowers and the original intent of negotiability.[13]

I. NEGOTIABLE INSTRUMENTS

A. A History of Negotiable Instruments

Negotiable instruments were most relevant in small-scale seventeenth and eighteenth century transactions.[14] An example of early negotiability might involve parties such as "Miner," who sold iron ore to "Blacksmith," who then sold his goods to "Customer" at market. In a world without negotiable instruments, if Blacksmith did not have the funds to purchase ore from Miner, Blacksmith would have to obtain money to pay Miner before purchasing the ore, an often-difficult task in a country without a paper currency system. However, negotiable instruments provided a much more efficient structure where in exchange for the ore, Blacksmith would provide Miner with some instrument promising payment to Miner. Subsequently, Miner could collect the payment from Blacksmith, sell the instrument to another party, or use the instrument to pay for other goods.

The chief advantage of employing negotiable instruments in this type of transaction is that they have the effect of increasing the liquidity of payment by making goods easier to sell.[15] Negotiability enhances commerce by centralizing all rights in the underlying asset (a right of payment in this context) in a single physical document.[16] Negotiability in this context

---

[12] *See infra* notes 242–50 and accompanying text.

[13] *See infra* notes 249–50 and accompanying text.

[14] *See* Ronald J. Mann, *Searching for Negotiability in Payment and Credit Systems*, 44 UCLA L. REV. 951, 956 (1997) (citing JAMES STEVEN ROGERS, THE EARLY HISTORY OF THE LAW OF BILLS AND NOTES: A STUDY OF THE ORIGINS OF ANGLO-AMERICAN COMMERCIAL LAW 94–124 (1995)).

[15] GERALD P. O'DRISCOLL, JR. & MARIO J. RIZZO, THE ECONOMICS OF TIME AND IGNORANCE 194 (1996) ("Liquidity provides economic agents with flexibility, flexibility that lowers cost.").

[16] *See id.*

benefited all parties involved in a transaction because each party knew one another and understood the fiscal saliency of the parties involved.[17] In these simple face-to-face transactions, negotiable instruments greatly enhanced the ease of commerce.[18]

Yet, the codification of the UCC into statutory form has since been lamented by many due to the abundant opportunity for fraud and abuse by makers of promissory notes.[19] In fact, Grant Gilmore, one of the drafters of the original form of the UCC, came to rue the codification of these archaic laws, stating that article 3 of the UCC was "a museum of antiquities—a treasure house crammed full of ancient artifacts whose use and function have long since been forgotten."[20]

The promissory note, a unique form of negotiable instrument, was first used by merchants in England in the 1700s.[21] In the first case to examine the legality of said notes, which were not yet considered legal tender in 1756 England, Lord Mansfield upheld form over intent, such that the interests of the free market were held above the rights of the maker of the note, even in such a case in which the note was stolen and then sold to a bona fide purchaser.[22] In that way, negotiable instruments were used in lieu of a fiat currency system to promote free trade between merchants.[23]

While the promissory note has changed little since the seventeenth century, the world currency systems have grown by leaps and bounds, destroying the need for traditional promissory notes. Today's promissory note "is quite a different instrument, serving different purposes, and the consequences of its negotiability are quite different in impact."[24] Today, the most common

---

[17] John F. Dolan, *Changing Commercial Practices and the Uniform Commercial Code*, 26 LOY. L.A. L. REV. 579, 580 (1993) (stating "merchants knew the signatures of other merchants, knowledge that was essential to the circulation of the payments system's paper").

[18] *Id.* The use of negotiable instruments also became more prevalent as trade increased between Europe and the colonies in America, and the civil notary public acted as both a witness to such documents, as well as a mediator if any such negotiable instrument was dishonored upon presentment or demand. Pedro A. Malavet, *Counsel for the Situation: The Latin Notary, a Historical and Comparative Model*, 19 HASTINGS INT'L & COMP. L. REV. 389, 427 (1996). Thus, the use of negotiable instruments is more closely tied to countries that currently use a civil law system than those which utilize a common law system like the United States. *Id.* The history of the negotiable instrument therefore strongly suggests that promissory notes could, and should, be "adjudicated" outside the common law judicial system for the purposes of effectuating commerce.

[19] Eggert, *supra* note 7, at 365−66.

[20] Grant Gilmore, *Formalism and the Law of Negotiable Instruments*, 13 CREIGHTON L. REV. 441, 460−61 (1979).

[21] Rosenthal, *supra* note 10, at 377−78.

[22] Miller v. Race, (1758) 97 Eng. Rep. 398 (K.B.) 402.

[23] *See id.*

[24] Rosenthal, *supra* note 10, at 378.

use of promissory notes is by purchasers of real property for any unpaid amount due on the purchase price.[25] However, due to the vast growth of technology, promissory notes are now traded in large bundles on a whim between lenders, making them no better than glorified baseball cards being traded in international markets.[26]

In today's society, our modern technological advancements can process an infinite number of transactions in a matter of moments, on a global scale.[27] As such, the existence of a tangible negotiable document does not aid parties to a transaction in simplifying or streamlining their business dealings.[28] Our culture has outgrown the benefits that negotiability once provided.[29] The result has been a staggering increase in lenders promulgating instruments, which they claim are negotiable, but which are absolutely nonnegotiable under applicable law, as discussed in more detail below.[30] The globalization of the economy has removed the personal interaction between a maker and a note holder as originally intended when the doctrine of negotiable instruments arose in seventeenth-century England, and has made the negotiation of promissory notes an area of commerce that is rampant with fraud and other consumer abuse at the hands of financial institutions.[31]

B. What Is a "Negotiable Instrument?"

UCC section 3-104(a) provides the statutory definition of a negotiable instrument, stating that an instrument is negotiable if it is "an unconditional promise or order to pay a fixed amount of money, with or without interest or other charges described in the promise or order."[32]

In addition, the instrument must also meet the three following prerequisites. First, the instrument must be "payable to bearer or to order at the time it is issued or first comes into possession of a holder."[33] Second, the instrument must be "payable on demand or at a definite time."[34] Third, the instrument must not "state any other undertaking or instruction by the person

---

[25] *See* Oppenheim, *supra* note 5.

[26] DAVID P. TWOMEY & MARIANNE M. JENNINGS, ANDERSON'S BUSINESS LAW AND THE LEGAL ENVIRONMENT STANDARD VOLUME 602 (22d ed. 2013).

[27] *Global Presence*, VISA, http://usa.visa.com/about-visa/our-business/global-presence.jsp (last visited Mar. 26, 2015), *archived at* http://perma.cc/BB5V-K9BW.

[28] Dolan, *supra* note 17, at 591–92; *see also* Mann, *supra* note 14, at 986–90.

[29] Rosenthal, *supra* note 10, at 378–79.

[30] *See* Oppenheim, *supra* note 5.

[31] DEP'T OF HOUS. & URBAN DEV. & FED. RESERVE BD., JOINT REPORT TO CONGRESS, TRUTH IN LENDING ACT AND THE REAL ESTATE PROCEDURES ACT 7 (Fed. Reserve Bd. 1998).

[32] U.C.C. § 3-104(a) (2002); *see also* FLA. STAT. § 673.1041(1) (2014).

[33] U.C.C. § 3-104(a)(1) (2002); *see also* FLA. STAT. § 673.1041(1)(a).

[34] U.C.C. § 3-104(a)(2) (2002); *see also* FLA. STAT. § 673.1041(1)(b).

promising or ordering payment to do any act in addition to the payment of money."[35] UCC section 3-104(a)(3) provides three exceptions to the general rule that the promise or order must not contain any instruction or undertaking other than the payment of money.[36] These exceptions are: (i) an undertaking or power to give, maintain, or protect collateral to secure payment; (ii) an authorization or power to the holder to confess judgment or realize or dispose of collateral; and (iii) a waiver of the benefit of any law intended for the advantage or protection of an obligor.[37] None of these exceptions apply here.

By clear UCC definition, once an additional promise or undertaking is identified, the character of the note cannot be said to be negotiable and the note is not subject to transfer or enforcement pursuant to UCC article 3.[38] The act of endorsing and transferring a mortgage promissory note with such additional promise or undertaking is a nullity, because endorsement and delivery only effectuates a transfer of a negotiable instrument.[39] If an instrument is nonnegotiable, it must be transferred pursuant to general contract law.[40]

C. The "Holder in Due Course" Doctrine

A "holder in due course" is defined by the UCC section 3-302 as:

> [T]he holder of an instrument if: (1) the instrument when issued or negotiation to the holder does not bear such apparent evidence of forgery or alteration or is not otherwise so irregular or incomplete as to call into question its authenticity; and (2) the holder took the instrument (i) for value, (ii) in good faith, (iii) without notice that the instrument is overdue or has been dishonored or that there is an uncured default with respect to payment of another instrument issued as part of the same series, (iv) without notice that the instrument contains an unauthorized signature or has been altered, (v) without notice of any claim to the instrument described in Section 3-306, and (vi) without notice that any party has a defense or claim in recoupment described in Section 3-305(a).[41]

Under the holder in due course doctrine, a subsequent holder of a promissory note who takes said note in good faith for value and without notice of

---

[35] U.C.C. § 3-104(a)(3) (2002); *see also* FLA. STAT. § 673.1041(1)(c).
[36] U.C.C. § 3-104(a)(3) (2002).
[37] *Id.*; *see also* FLA. STAT. § 673.1041(1)(c).
[38] *See* U.C.C. § 3-104(a)(3) (2002).
[39] *Id.*
[40] Ingram v. Earthman, 993 S.W.2d 611, 624 (Tenn. Ct. App. 1998) ("If the note is a negotiable instrument, the parties' rights are governed by Article 3 of the Uniform Commercial Code; if it is nonnegotiable, we must look to the common law of contracts to define the parties' rights and remedies.").
[41] U.C.C. § 3-302 (2002).

any apparent forgery or defenses is protected from such defenses in the event that the holder is forced to enforce collection efforts for the debt against the note maker.[42] "The cutting off of defenses upon transfer to a holder in due course has long been considered the central element of negotiable instruments."[43] Notably, while this doctrine protects financial institutions who purchase promissory notes and other negotiable instruments on the secondary market, the doctrine also puts the uneducated or financially unsophisticated members of the population at incredible risk of predatory lending practices.[44] Most lenders who engage in such practices generally sell the promissory notes immediately after a deal closes, often on the same day the note is signed.[45] The holder in due course doctrine cuts off what are termed "personal defenses," which include defenses such as (1) less than full competence; (2) misrepresentations regarding the contents of the documents being signed; and (3) undue influence.[46] On the other hand, the holder in due course doctrine preserves what are termed "real defenses" such as (1) infancy; (2) duress; (3) lack of legal capacity; (4) illegality of the transaction; (5) discharge in bankruptcy; and (6) fraud regarding the nature of the instrument.[47]

During the real estate boom, subprime lending focused on exploiting areas that would give rise to personal defenses, such as misrepresenting the terms of the loan, misrepresenting a borrower's income in order to qualify for a loan, and many other unsavory practices by the loan originator.[48] Of course, any defense that a borrower could have raised based on such practices was then immediately destroyed by an almost instantaneous transfer of the note to a bona fide purchaser who obtained holder in due course status. This practice was used so often that at times the note was actually sold to a secondary purchaser before it was even signed by the borrower.[49]

The holder in due course doctrine is the proverbial coup for financial institutions, as it allows them to have their cake and eat it too.[50] The doctrine eviscerates the greatest risk inherent in the secondary mortgage market: the

---

[42] *See id.*

[43] Eggert, *supra* note 7, at 375.

[44] *Id.*

[45] *Id.* at 375–76. In the authors' legal practice involving defense of mortgage foreclosures, it is extremely common to see an assignment of mortgage dated the same day as the execution of the promissory note, or even instructions to the recording office on the mortgage indicating that the recorded mortgage should be returned to a secondary financial institution who has purchased the rights to the loan before the pen is even put to paper on the loan documents.

[46] *Id.*

[47] *Id.* at 375.

[48] *Id.* at 365.

[49] *Id.*

[50] *See* U.C.C. § 3-305 (2002).

risk that the originating lender participated in some fraud or deception in procuring the note from the maker.[51] The greatest risk to a purchaser on the secondary market is that a maker will have some defense to the allegation of debt owed to the holder.[52] However, distinguished scholars have noted that advancements such as securitization of notes and mortgages have diminished the applicability of the holder in due course doctrine such that "its legitimate purposes have disappeared."[53]

D. The Comeback of the Promissory Note

While the use of promissory notes and other negotiable instruments decreased steadily after the creation of a fiat monetary system based on paper currency in the late nineteenth century, the promissory note started to make a comeback following the codification of negotiable instruments law.[54] In 1896, Uniform Law Commissioners passed the Uniform Negotiable Instruments Law, which led to a rapid increase in lending from banks and small finance companies to poorer, less educated merchants and workers.[55] While such lending was risky due to the high chance of default, lenders used promissory notes to ensure payment tied in some manner to collateral backing the loans, which led to the development of the modern secured transaction in which a maker executes both a promissory note and mortgage securing it to some real or personal property in order to guarantee repayment of the debt.[56] Kurt Eggert, Assistant Professor at Chapman University School of Law wrote in his article *Held Up in Due Course: Codification and the Victory of Form over Intent in Negotiable Instruments Law*:

> Instead of trusting to the good name of borrowers or indorsers or to the guarantee provided by the acceptors of bills, these lenders began to trust in collateral. The lenders became intent on securing the loans with real or personal property so that they could turn to the security should the borrowers default. The lenders' need to rely on security caused them to change the form of promissory notes completely. Instead of the simple, straightforward instruments used from before the time of Lord Mansfield, which were drafted by hand and easily understood by all parties to them, the notes used by 1900 had grown, in Grant Gilmore's words, to

---

[51] Grant Gilmore, *The Good Faith Purchase Idea and the Uniform Commercial Code: Confessions of a Repentant Draftsman*, 15 GA. L. REV. 605, 607 (1981).
[52] *Id.*
[53] Eggert, *supra* note 7, at 377.
[54] *See* Amasa M. Eaton, *The Negotiable Instruments Law: Its History and Its Practical Operation*, 2 MICH. L. REV. 260, 264 (1904).
[55] *Id.*
[56] Grant Gilmore, *The Commercial Doctrine of Good Faith Purchase*, 63 YALE L.J. 1057, 1070 (1954).

> "monstrous size." This size was necessary to allow the drafters to address all of the new concerns that their need for security added.[57]

Once lenders began taking collateral to secure the repayment of the debt owed under a promissory note, lenders became concerned with various other issues such as collection of the collateral after default, care and maintenance of the collateral, insurance regarding the collateral, and accelerating the lender's rights to full repayment of a debt upon default by the maker.[58] These concerns led to a fundamental breakdown in the rule most inherent to the structure of a promissory note: that it employs the least number of words possible.[59] Instead, notes began to morph into much longer and more complex lending instruments, often containing various additional provisions and undertakings by the maker, creating the legal fiction that more language was better.[60]

E. Lincoln National Bank v. Perry*: A Prediction of the Future of Promissory Notes*

Today's promissory notes bear little resemblance to the promissory notes of seventeenth-century England.[61] In *Lincoln National Bank v. Perry*, the Eight Circuit Court of Appeals, with remarkable foresight into the future of promissory notes in the commercial context, forewarned of the risk of fraud and deception to makers if financial institutions were allowed to continue to include burdensome and complex language in promissory notes.[62] The case involved a promissory note that had been negotiated by specific endorsement to two subsequent holders prior to the initiation of the suit.[63] In defense to the suit on the promissory note, the defendants pled multiple defenses, including violation of the state constitution, fraud in the inducement, and failure of consideration.[64]

---

[57] Eggert, *supra* note 7, at 401–02.

[58] *Id.* at 410.

[59] Overton v. Tyler, et al., 3 Pa. 346, 346 (1846).

[60] Lincoln Nat'l Bank v. Perry, 66 F. 887, 894 (8th Cir. 1895) (citing Bank v. Armstrong, 25 Minn. 530, 530 (1879); South Bend Iron Works v. Paddock, 15 P. 574, 574 (Kan. 1887); Bank of Carroll v. Taylor, 25 N.W. 810, 810 (Iowa 1885); Smith v. Maryland, 13 N.W. 852, 852 (Iowa 1882); Killam v. Schoeps, 26 Kan. 310, 310 (1881)).

[61] *See Promissory Note Example*, SAMPLE NOTE, http://www.samplenote.org/types/promissory-note-example (last visited Mar. 26, 2015), *archived at* http://perma.cc/V98Q-E28R; *see Manuscripts and Special Collections*, THE UNIVERSITY OF NOTTINGHAM, http://www.nottingham.ac.uk/manuscriptsandspecialcollections/researchguidance/accounting/cashsubstitutes.aspx (last visited Mar. 26, 2015), *archived at* http://perma.cc/H82P-GRR2.

[62] *Perry*, 66 F. at 887–95.

[63] *Id.* at 887–90.

[64] *Id.* at 889–90.

Thus, due to the defenses raised, all of which were "personal defenses" cut off by the holder in due course doctrine, the court was first required to consider whether the promissory note was in fact a negotiable instrument and thus subject to transfer by endorsement alone.[65] In finding that the note was not negotiable due to the complex language and various undertakings included therein, the court noted:

> It will be observed that there is embodied in the note an agreement to the effect that if there shall be any depreciation, prior to the maturity of the note, in the collateral deposited to secure its payment, then the payee or any holder may call for such further security, as he deems satisfactory, and, if the same is not furnished within two days, may proceed at once to sell the collateral.
> ...
> It frequently happens that notes discounted by banks contain a statement that certain securities have been deposited as collateral to secure their payment, together with a stipulation authorizing a sale of such securities, in a certain manner, at the maturity of the paper, if it is not then paid. Such recitals and stipulations do not render the time or fact of payment, nor the amount to be paid at maturity, in the least degree uncertain; and for that reason it is generally held that they do not impair the negotiability of a note that is, in other respects, so drawn as to satisfy the requirements of the law merchant.
> ...
> It is manifest, however, that an important element of certainty is destroyed by a collateral agreement *appended to a note which may cause a payment to be made thereon of an uncertain sum at an uncertain time before maturity*, and thus render the amount payable at maturity somewhat less than the amount specified on the face of the paper.
> ...
> It has accordingly been held in several well considered cases that stipulations of that nature embodied in a promissory note will impair its negotiability.[66]

The court, in considering the terms of the subject promissory note and the holdings of other similar cases, determined that the note was not negotiable, and in so holding stated:

> We are forced to concur in the view taken by these cases,—that the negotiability of a promissory note ought not to be upheld when it contains an agreement authorizing the holder in a certain contingency to demand such further collateral security as he deems satisfactory, and if it is not furnished, to sell the original collateral and to apply the proceeds in payment of the paper before it had become due. Under existing decisions permitting negotiable notes to contain a stipulation authorizing the sale

[65] *Id.* at 890.
[66] *Id.* at 892−93 (emphasis added).

> at maturity of collateral securities, and, in some states, authorizing the insertion of an agreement to pay exchange and attorney's fees, as well as a warrant to confess judgment, *such instruments have already been burdened with all of the luggage which they can conveniently carry.* Furthermore, as notes and bills are designed to circulate freely, and to take the place of money in commercial transactions, sound policy would seem to dictate that they should be in form as concise as possible, and that the obligation assumed by the maker or makers should be expressed in plain and simple language.[67]

The court further cautioned:

> It is easy to foresee that, if parties are permitted to burden negotiable notes with all sorts of collateral engagements, *they will frequently be used for the purpose of entrapping the inexperienced and the unwary into agreements which they had no intention of making, against which the law will afford them no redress*. We hold, therefore, that the note in suit was a nonnegotiable instrument.[68]

F. How the System of Promissory Notes Has Become Defunct in Modern Times

While the use of promissory notes and other negotiable instruments made sense when people lived in the same geographical area, their ability to remain useful in a global marketplace has significantly diminished.[69] As Ronald Mann wrote in his article *Searching for Negotiability in Payment and Credit Systems*:

> [T]imes have changed and with them the size and interrelations of our economy, as well as the state of information technology. In this modern age of multiple and rapid transactions in a national and perhaps global market, negotiability's emphasis on the physical document is a hindrance rather than a benefit. In many transactions, transporting a document from buyer to seller is no longer a simple matter of pushing a piece of paper across a table. Furthermore, even if the buyer and the seller meet face-to-face, the financial institution on whom the instrument is drawn commonly is located at a distance from one or both of the parties to the underlying transaction. The frequent need to transport the document thousands of miles is a much more common problem now than it was in the era when our country was founded.[70]

Promissory notes are still commonly used to finance the purchase of real property; however, their use has actually become much more harmful than beneficial given the ability to easily forge signatures, stamp "endorsements,"

[67] *Id*. at 894 (emphasis added).
[68] *Id.* (emphasis added).
[69] Mann, *supra* note 14, at 961−62.
[70] *Id.*

and robo-sign allonges to give the illusion of compliance with the antiquated rules of negotiability.[71] The doctrine of the "holder in due course," which destroys many of the maker's defenses to such fraud, has left the consuming public at risk of being subject to the continued mercy of financial institutions, often without any ability to fight back once a promissory note has been negotiated.[72] In addition, while note makers in seventeenth-century England were very familiar with the ins and outs of negotiation and transfer of negotiable instruments,[73] as Judge Summers stated today, "'the average citizen, and particularly the financially unimportant, [is] no more likely to know the law of negotiable paper ... than the holding in Shelley's Case.'"[74]

Moreover, the complex division of ownership and servicing rights for loans backed by promissory notes are a far cry from the original idea of promissory notes in which the person collecting payments was the actual party to whom a debt was owed, and the person who maintained physical possession of the note.[75] The modern system of dividing beneficial and legal rights under promissory notes makes it nearly impossible for a note maker to determine whom it actually owes a debt to, and leaves the maker open to multiple claims by various parties on the same debt.[76] The concept of transferring rights by physically transferring commercial paper inherent in the laws of negotiability is no longer applicable.[77] While notes used to be transferred from one holder to another by physical transfer of the document, as contemplated by the laws of negotiability, in modern times physical documents are rarely transferred beyond a document storage facility even when the right to collect on the debt is sold from one financial institution

---

[71] Roy Oppenheim, *Robosigning Settlement Proves Sky Was Falling! Chicken Little Was Right!*, S. FLA. LAW BLOG (Feb. 10, 2012), http://southfloridalawblog.com/robosigning-settlement-proves-sky-was-falling-chicken-little-was-right/, *archived at* http://perma.cc/XY6A-87MS.

[72] Thomas Erskine Ice, *Negotiating the American Dream: A Critical Look at the Role of Negotiability in the Foreclosure Crisis*, 86 FLA. B. J. 8 (2012).

[73] Eggert, *supra* note 7, at 366 ("[N]egotiability and its primary effects were once understood by the people who created negotiable instruments and [who] by and large intended to create those instruments and be bound by those effects. Because of this knowledge and intent by the instruments' makers, the law of negotiable instruments developed and worked fairly efficiently given the primitive financial system available. As the knowledge of negotiable instruments declined and as those instruments came to be created by many who have no idea of the nature or legal effects of negotiability, this efficiency has diminished alarmingly. Negotiable instrument law and the financial industry have come to assign the risk of fraud, theft and deception in such a way as to increase and encourage deceptive practices.").

[74] Geiger Fin. Co. v. Graham, 182 S.E.2d 521, 523 (Ga. Ct. App. 1971) (quoting Buffalo Indus. Bank v. DeMarzio, 296 N.Y.S. 783, 785 (City Ct. 1937), *rev'd*, 6 N.Y.S.2d 568 (Sup. 1937)).

[75] Mann, *supra* note 14, at 961−62.

[76] *Id.*

[77] *Id.* at 962.

to another.[78] Documents are rarely transferred by endorsement until such time as they are removed from a document storage warehouse for presentment if a debt is not paid.[79]

G. Predatory Lending Practices Resulting from the Holder in Due Course Doctrine

Given the rampant abuse of consumers due to the growth of predatory lending practices that led to the Great Recession, the court's prediction in *Lincoln National Bank* was extremely accurate.[80] During the 1920s and into the 1930s, consumer credit lending increased exponentially, leading to a massive scale increase in the use of promissory notes as a method of financing consumer transactions.[81] While in seventeenth-century England parties were generally both makers and holders of negotiable instruments, and thus had clear knowledge of the rules of both sides of the instruments, makers in the first part of the twentieth century by and large were consumers who had never been holders of negotiable instruments, and who had little knowledge as to the ramifications of executing a promissory note.[82] Promissory notes were prepared by financial institutions and contained complex and diverse undertakings, including the requirement of collateral, the payment of expenses and attorneys' fees, prepayment penalty clauses, and all other sorts of "luggage," which flew in the face of traditional tenets of negotiability.[83]

The potential to make massive amounts of money, combined with a comparative low level of risk to lenders, led to a rapid growth of unethical lending practices while personal defenses against the original lenders disappeared upon transfer.[84] During the peak of predatory lending in consumer transactions, consumers bought cars that were never delivered or that could not be driven, household appliances that failed to function, and innumerable other goods and services that were sub-par or nonexistent.[85] Moreover, consumers entered into said notes completely unaware that once the loan was transferred, their right to sue on the basis of the quality of the good or service, or for

---

[78] *Id.*

[79] *Id.* at 970.

[80] Lincoln Nat'l Bank v. Perry, 66 F. 887, 894–95 (8th Cir. 1895).

[81] Simon D. Norton, *The Cause of the Banking Crises of the 1920's*, THE WORLD FIN. REV., http://www.worldfinancialreview.com/?p=2446 (last visited Mar. 26, 2015).

[82] *See* ALFRED W. BAYS, THE UNIFORM NEGOTIABLE INSTRUMENTS ACT WITH QUESTIONS, PROBLEMS AND FORMS 38 (Callaghan & Co. 1911).

[83] Eggert, *supra* note 7, at 399−400, 403, 414−15.

[84] William C. Jones, *Finance Companies as Holders in Due Course of Consumer Paper*, 1958 WASH. U. L. REV. 177, 180 (1958).

[85] *See* Promulgation of Trade Regulation Rule and Statement of Basis and Purpose, 40 Fed. Reg. 53,506, 53,509−14 (Nov. 18, 1975).

fraudulent misrepresentations used to induce them to enter into the promissory notes, would be lost forever under the holder in due course doctrine, which obliterated personal defenses.[86]

"Faced with consumers burdened with worthless automobiles, household appliances, or home improvements and lenders who claimed holder in due course status, courts sought ways to ameliorate the most pernicious effects of the holder in due course doctrine in consumer transactions."[87] Often, courts would do so by finding that the promissory notes at issue were not negotiable instruments, and thus the consumers would still be permitted to raise defenses that otherwise would be destroyed under the holder in due course doctrine.[88]

In the early 1950s, the UCC was being drafted to replace its predecessor treatises and statutes.[89] However, while its drafters originally intended to include additional protections for consumers (including limiting the holder in due course doctrine to commercial transactions with more sophisticated borrowers), due to pressure from special interest groups largely comprised of financial institutions and other lenders, none of these protections made it into the UCC that was eventually adopted and codified by most states.[90] Instead, remarkably, the drafters of the UCC cowed to these special interests and further *expanded* the definition of negotiability to allow for the inclusion of additional terms in promissory notes without destroying the negotiability thereof.[91]

The Federal Trade Commission (FTC) finally got involved to reduce the victimization of consumers by promulgating the Holder in Due Course Rule, which was intended to stymie the rampant victimization of consumers through predatory lending practices.[92] The FTC's Holder in Due Course Rule, which applies to all consumer retail installment contracts, requires credit

---

[86] Geiger Fin. Co. v. Graham, 182 S.E.2d 521, 523 (Ga. App. 1971).

[87] Eggert, *supra* note 7, at 416.

[88] Eggert, *supra* note 7, at 416.

[89] *Uniform Commercial Code*, CORNELL UNIV. L. SCH., http://legal-dictionary.thefreedictionary.com/Uniform+Commercial+Code (last visited Mar. 26, 2015), *archived at* http://perma.cc/GH7D-F2S4; *see also Uniform Commercial Code*, REFERENCE FOR BUS., http://www.referenceforbusiness.com/management/Tr-Z/Uniform-Commercial-Code.html (last visited Mar. 26, 2015), *archived at* http://perma.cc/86Y9-NSU4.

[90] Gregory E. Maggs, *Karl Llewellyn's Fading Imprint on the Jurisprudence of the Uniform Commercial Code*, 71 U. COLO. L. REV. 541, 545−52 (2000); Edward L. Rubin, *The Code, the Consumer, and the Institutional Structure of the Common Law*, 75 WASH. U. L. Q. 11, 13−14 (1997); Lary Lawrence, *Misconceptions About Article 3 of the Uniform Commercial Code: A Suggested Methodology and Proposed Revisions*, 62 N.C. L. REV. 115, 147−48 (1983).

[91] Lawrence, *supra* note 90, at 119−21.

[92] Rubin, *supra* note 90, at 37.

instruments to include language stating that any holder takes the instrument subject to any defenses that could be asserted against the original seller.[93]

When the FTC promulgated its Holder in Due Course Rule, it focused specifically on consumer goods transactions, due to the great risk to consumers in contracts in which the debt was separated from the actual goods sold, thereby splitting product warranties from the debt obligations.[94] The FTC, after a plethora of decisions from various state courts allowing consumers to raise defenses against assignees, promulgated its Holder in Due Course Rule because of unfair outcomes that resulted from the division of these debt obligations and product warranties, which resulted in consumers being forced to pay a debt to an assignee even when the product financed from the seller was defective.[95]

Notably, before the Holder in Due Course Rule, a purchaser of goods would purchase a product from the original seller under a retail installment contract, which required the purchaser to make payments over a period of time. The seller would then assign the debt in exchange for immediate payment and the assignee would continue to collect payments on the debt. However, problems arose when the product purchased had a defect, or when some other type of fraud arose in the underlying consumer goods transaction between the purchaser and seller. Under the holder in due course doctrine, the purchaser was required to continue to pay the assignee for the faulty or defective product and seek redress from the original seller, who often had gone out of business or had no financial incentive to correct the problem, having already received payment from the assignee.[96] Worse, the purchaser could not even assert the defective nature of the product as a defense to any suit brought by the assignee to collect on the debt.

As a result of the unfair consequences of such a rule, various state courts began allowing borrowers to assert defenses against the assignee despite the holder in due course doctrine for public policy reasons.[97] In 1953, the

---

[93] Michael F. Sturley, *The Legal Impact of the Federal Trade Commission's Holder in Due Course Notice on a Negotiable Instrument: How Clever Are the Rascals at the FTC?*, 68 N.C. L. REV. 953, 969−72 (1990).

[94] Preservation of Consumers' Claims and Defenses, 40 Fed. Reg. 53,506, 53,510 (Nov. 18, 1975) (The FTC findings stated that "[t]he record contains over fourteen thousand indications of foreclosures of asserted claims and defenses in credit sale transactions. There are over one hundred cases represented by consumer histories provided spontaneously for this proceeding—both in written submissions and oral testimony at public hearings.").

[95] *Id.*

[96] *See* Promulgation of Trade Regulation Rule and Statement of Basis and Purpose, *supra* note 85, at 53,511.

[97] Mark. B. Greenlee & Thomas J. Fitzpatrick IV, *Reconsidering the Application of the Holder in Due Course Rule to Home Mortgage Notes*, 41 No. 3 UCC L. J. ART 2 (Winter 2009).

Florida Supreme Court in *Mutual Finance Co. v. Martin* allowed a borrower to assert defenses against an assignee seeking to collect on a debt it had purchased, holding that "the finance company is better able to bear the risk of the dealer's insolvency than the buyer and in a far better position to protect his interests against unscrupulous and insolvent dealers."[98]

However, the FTC's Holder in Due Course Rule does not apply to the financing of real estate, and thus leaves homebuyers open to the same rampant abuse that the FTC curtailed in invoking the Holder in Due Course Rule.[99]

H. The FTC's Holder in Due Course Rule Does Not Apply to Mortgage Notes and Thus Upholding the Rules of Negotiability Is Especially Important in Order to Protect Unsophisticated Borrowers

Consumer groups have long fought for an extension of the FTC's Holder in Due Course Rule for residential mortgage loans, but have been largely unsuccessful. The failure to procure a similar rule in residential mortgage loans is based on the premise that the underlying policy reasons for the Holder in Due Course Rule do not exist with regard to residential mortgage loans because the home purchased is not subject to any warranty by the lending institution providing funding for its purchase.[100]

In 1994, consumer groups were partially successful in getting legislation passed to protect borrowers from predatory lending practices in relation to high-cost mortgage refinancing through the enactment of the Home Ownership and Equity Protection Act of 1994 (HOEPA).[101] However, HOEPA does not protect borrowers obtaining purchase money mortgages, even if predatory lending practices are involved, and instead is strictly limited to nonpurchase money, high-cost mortgage loans.[102] In addition, the remedy under HOEPA is limited to rescission of the transaction and does not provide for monetary damages suffered by the borrower.[103]

As a result of the limited application of the Holder in Due Course Rule and HOEPA, the true gatekeeper between fraudulent practices by financial institutions and the consuming public in relation to purchase money mortgage transactions remains the strict requirements of negotiability. However,

---

[98] Mut. Fin. Co. v. Martin, 63 So. 2d 649, 653 (Fla. 1953).

[99] *Staff Guidelines on Trade Regulation Rule Concerning Preservation of Consumers' Claims and Defenses (Holder in Due Course Rule)*, FED. TRADE COMM'N 1, 9 (May 4, 1976), *available at* http://perma.cc/5ME3-J8CJ.

[100] Greenlee & Fitzpatrick, *supra* note 97, at 9.

[101] Home Ownership and Equity Protection Act of 1994, Pub. L. No. 103-325, 108 Stat. 2190 (codified as amended at 15 U.S.C. § 1637 *et. seq.* (2007), 12 C.F.R. § 226.32 (2007)).

[102] *Id.*; *see also* Greenlee & Fitzpatrick, *supra* note 97, at 16.

[103] Home Ownership and Equity Protection Act of 1994, *supra* note 101.

because courts have continued to relax these strict requirements in favor of financial institutions, the already limited protections that borrowers had have been effectively stripped, leaving them open and vulnerable to predatory lending practices with little redress against financial institutions.

II. COURTS MUST CONSIDER THE TERMS OF A PROMISSORY NOTE IN ORDER TO DETERMINE IF IT IS TRULY A "NEGOTIABLE INSTRUMENT"

Although many courts assume that all promissory notes are negotiable simply by virtue of being called a "promissory note," some courts have recognized that a mortgage promissory note must be analyzed to determine whether the character of the note at issue is that of a negotiable instrument.[104] However, all too often in foreclosure actions, courts refuse to address the issue of the negotiability of mortgage promissory notes.[105] Instead, courts supply blanket statements that all notes are negotiable instruments without any real inquiry into the truth of such statements.[106] This baseless claim that all notes are negotiable instruments can no longer be accepted at face value under the "broad brush" with which the law of negotiable instruments has been painted.[107] Courts must do their duty to first examine the note to determine whether it meets the definition of a "negotiable instrument."[108]

---

[104] Felin Assocs., Inc. v. Rogers, 38 A.D.2d 6, 9 (N.Y. App. Div. 1971) ("It is quite apparent that a note given in a real estate transaction in connection with a mortgage does not fall into the classification of a negotiable instrument. Certainly, absent affirmative proof this court is not and should not be required to presume that the note was negotiable.") (citing Wright v. Wright, 54 N.Y. 437, 441 (1873); Peterson v. Meyer, 105 Misc. 719, 721 (Cnty. Ct. of N.Y. 1919)); Am. Bank of the S. v. Rothenberg, 598 So. 2d 289, 291 (Fla. Dist. Ct. App. 1992); Ingram v. Earthman, 993 S.W.2d 611, 623-24 (Tenn. Ct. App. 1998) ("If there is any doubt that an instrument is negotiable, the courts generally find that it is nonnegotiable.").

[105] *See* Ice, *supra* note 72, at 13.

[106] Riggs v. Aurora Loan Servs., LLC, 36 So. 3d 932, 933 (Fla. Dist. Ct. App. 2010); *see also* Taylor v. Deutsche Bank Nat'l Trust Co., 44 So. 3d 618, 622 (Fla. Dist. Ct. App. 2010) (stating "a promissory note is a negotiable instrument."); Perry v. Fairbanks, 888 So. 2d 725, 727 (Fla. Dist. Ct. App. 2004) (stating "[a] promissory note is clearly a negotiable instrument within the definition of section 673.1041(1).").

[107] Rosenthal, *supra* note 10, at 375.

[108] *See* Ingram, 993 S.W.2d at 624 ("Whether an instrument is negotiable is a question of law to be determined by the court.") (citing N. Bank v. Pefferoni Pizza Co., 562 N.W.2d 374, 375-76 (Neb. 1997)); Cartwright v. MBank Corpus Christi, N.A., 865 S.W.2d 546, 549 (Tex. Ct. App. 1993); LARY LAWRENCE, LAWRENCE'S ANDERSON ON THE UNIFORM COMMERCIAL CODE, § 3-101:48 (3d ed. 1994); Ford Motor Credit Co. v. All Ways, Inc., 546 N.W.2d 807, 809 (1996).

A. Courts Have Consistently Held That Certain Undertakings Included in Promissory Notes Destroy Their Negotiability

In the course of preparing to write this Article, the authors searched case law from all fifty states to determine what "additional provisions" contained in promissory notes have been held to destroy their negotiability. Various courts across the country that have found mortgage promissory notes negotiable have done so through a broad interpretation of UCC section 3-106(b)(i) and UCC section 3-104(a)(3)(i).[109] On the other hand, the majority of courts that have found mortgage promissory notes negotiable have done so based on the belief that certain provisions in such notes do not adversely affect negotiability.[110]

Unfortunately, most courts engaged in foreclosure "rocket dockets" have little time, resources, or inclination to consider whether the promissory notes being presented by financial institutions are in fact negotiable instruments.[111] In fact, doing so would significantly slow down the pace of such dockets, potentially causing a massive backlog of foreclosures as courts struggle with enforcement of billions of dollars of commercial paper that has been negotiated despite the fact that it is clearly not negotiable as a

[109] U.C.C. § 3-106(b)(i) (2002); U.C.C. § 3-104(a)(3)(i) (2002).

[110] *See* HSBC Bank USA, Nat'l Ass'n v. Gouda, 2010 WL 5128666, at *2−*3 (N.J. Super. Ct. App. Div. Dec. 17, 2010) ("The fact that defendants must notify the lender in the event they opt for prepayment imposes no additional liability on them and is not a condition placed on defendants' promise to pay. Rather, *notification is simply a requirement of the exercise of the right of prepayment which, as noted, defendants are free to reject.* This requirement does not render the note in issue non-negotiable.") (emphasis added); McDonald v. OneWest Bank, FSB, No. 10CV01952, 2012 WL 3137485, at *1 (W.D. Wash. Apr. 12, 2012); Picatinny Fed. Credit Union v. Fed. Nat'l Mortg. Ass'n, No. 09-1295, 2011 WL 1337507, at *7 (D.N.J. Apr. 7, 2011); Mesina v. Citibank, N.A., No. 10-2304 RTL, 2012 WL 2501123, at *1 (Bankr. D.N.J. June 27, 2012) ("[P]aragraph 11 *of the Note* does not render the makers' promise conditional or destroy negotiability. It is the type of reference to collateral, prepayment or acceleration specifically permitted by section 106(b) of the UCC.") (emphasis added); In re Kain, Bankr. No. 08-08404-HB, 2012 WL 1098465, at *1, *5 (Bankr. D.S.C. Mar. 30, 2012) ("Since such *prepayment terms* do not affect the negotiability of a note with regard to it being for a 'sum certain' or an 'unconditional promise,' the Court is not persuaded that the same terms would affect the negotiability of a note on the grounds that it contains an additional promise.") (emphasis added); In re Walker, 466 B.R. 271, 283−84 (Bankr. E.D. Pa. 2012); In re Edwards, Bankr. No. 11-23195, 2011 WL 6754073, at *5 (Bankr. E.D. Wis. Dec. 23, 2011) ("[P]roviding information regarding a prepayment to the lender is not an express condition to payment or subject to 'another writing' within the meaning of the statute, WIS. STAT. § 403.106(1)(a). Therefore, the Note is a negotiable instrument.").

[111] Roy Oppenheim, *Fast-Track Foreclosure Bill: Winners and Losers*, S. FLA L. BLOG (June 12, 2013), http://southfloridalawblog.com/fast-track-foreclosure-bill-winners-and-losers/, *archived at* http://perma.cc/XFG5-VU5R.

matter of law.[112] Instead, most foreclosure court judges, under pressure from the legislative and executive branches of government to move cases and clear dockets, turn a blind eye to the fact that the most common promissory notes being presented by purported "holders in due course" are in fact not negotiable due to the terms and undertakings included in them that ignore the basic tenets of negotiability.[113]

In *GMAC v. Honest Air Conditioning & Heating, Inc.*, the Second District concluded that "the [trial] court erred in finding that the [retail installment sales contract ('RISC')] [was] a negotiable instrument."[114] There, the court was confronted with a RISC entered into between GMAC and Honest Air for the purchase of an automobile.[115]

The Second District noted that the RISC required the debtor to pay fees for late payment or dishonored checks, and held that these obligations "bring the RISC within the exclusionary language of section 673.1041(1)(c), which provides that a negotiable instrument 'does not state any other undertakings' in addition to the payment of money."[116] The court reasoned that this must be so because "[a] negotiable instrument should be 'simple, certain, unconditional, and subject to no contingencies. It must be a courier without luggage.'"[117]

Likewise, in *Geiger Finance Co. v. Graham*,[118] the court found that a retail installment contract for pest control was not a negotiable instrument, as the "note" contained other provisions than simply the promise to repay.[119] Instead, the note included a grant to a holder of the instrument to waive particular defaults or remedies without waiving others, and a purported waiver by the maker of "any defense, counterclaim or cross complaint he could have asserted against the seller."[120] Thus, the court found that the note was clearly not a negotiable instrument, stating that the "intent [underlying the UCC] is that a negotiable instrument carries nothing but the simple promise to pay" and therefore inclusion of additional promises and conditions destroyed its negotiability.[121]

---

[112] *Id.*
[113] *Id.*
[114] Gen. Motors Acceptance Corp. v. Honest Air Conditioning & Heating, Inc., 933 So. 2d 34, 35 (Fla. Dist. Ct. App. 2006).
[115] *Id.*
[116] *Id.* at 37.
[117] *Id.* (citing Mason v. Flowers, 91 Fla. 224, 107 So. 334, 335 (Fla. 1926)); *see also* Ameritrust Co., N.A. v. White, 73 F.3d 1553 (11th Cir. 1996).
[118] 182 S.E.2d 521 (Ga. Ct. App. 1971).
[119] *Id.* at 524.
[120] *Id.*
[121] *Id.*

In *P & K Marble v. LaPaglia*,[122] the court not only declared the note non-negotiable due to additional provisions it contained, but also went on to make a broad assertion that most notes related to the purchase of real property were not negotiable.[123] In doing so, the court opined that:

> [A] note given in connection with a mortgage in a real estate transaction generally is not a negotiable instrument. Indeed, the subject note and mortgage does not fulfill at least one of the requirements of a [negotiable instrument] as contained in UCC 3-104(1)(b) in that it fails to contain an unconditional promise or order to pay a sum certain in money and no other promise except as authorized by UCC article 3. The note and mortgage contains numerous promises, such as to keep the mortgaged property insured, which are not authorized by UCC article 3.[124]

The court in *Felin Associates, Inc. v. Rogers* agreed with this contention, and also that found notes given in connection with a mortgage to secure real property were not negotiable, stating "[i]t is quite apparent that a note given in a real estate transaction in connection with a mortgage does not fall into the classification of a negotiable instrument. Certainly, absent affirmative proof this court is not and should not be required to presume that the note was negotiable."[125]

B. Notice of Prepayment Provision in Mortgage Promissory Note Destroys Its Negotiability

UCC section 3-106 is in place to clarify the terminology "unconditional promise or order" used in the section 3-104 definition of a negotiable instrument. UCC section 3-106(b)(i) states that "a promise or order is not made conditional (i) by a reference to another record *for a statement of rights with respect to collateral, prepayment, or acceleration*."[126]

This section specifically states that a promise is not conditional if there is reference to *another* record for a statement of rights regarding prepayment or acceleration.[127] However, courts have allowed for additional "undertaking[s] or instruction[s] ... in addition to the payment of money[,]" such as notice of prepayment provisions, in the note itself.[128] These courts apparently rely on the language in the official comment for UCC section 3-106, which states that "[a] statement of rights and obligations concerning collateral,

---

[122] 147 A.D.2d 804 (N.Y. App. Div. 1989).
[123] *Id.* at 804–05.
[124] *Id.*
[125] Felin Associates, Inc. v. Rogers, 38 A.D.2d 6, 9 (N.Y. App. Div. 1971).
[126] U.C.C. § 3-106(b)(i) (2002) (emphasis added).
[127] *Id.*
[128] *See* U.C.C. § 3-104(a)(3) (2002).

prepayment, or acceleration does not prevent the note from being an instrument *if the statement is in the note itself*."[129]

The seminal case for the proposition that the existence of a notice of prepayment provision[130] in a mortgage promissory note does not render the note nonnegotiable is *HSBC Bank USA v. Gouda*.[131] In *Gouda*, the makers contended that the requirement of written notice contained in the prepayment provision renders the note nonnegotiable, as it constitutes an "undertaking or instruction" in addition to the payment of money.[132] However, the court disagreed, stating:

> The right of defendants, under the note, to prepay part of the principal does not constitute an "additional undertaking or instruction" that adversely affects the negotiability of the note. Quite the opposite, the right of prepayment is a voluntary option that defendants may elect to exercise solely at their discretion. Indeed, such an allowance confers a benefit, not a burden, upon defendants, who can freely choose to decline the opportunity. The fact that defendants must notify the lender in the event they opt for prepayment imposes no additional liability on them and is not a condition placed on defendants' promise to pay. Rather, *notification is simply a requirement of the exercise of the right of prepayment which, as noted, defendants are free to reject. This requirement does not render the note in issue non-negotiable*.[133]

Such an expansive interpretation of an "additional undertaking or instruction" in the *Gouda* court's holding is often cited.[134] However, it is based on defective reasoning.

The court in *Gouda* proffered as its reasoning that since the prepayment provision "confers a benefit, not a burden" on the defendants, it does not qualify as an "additional undertaking or instruction."[135] It may prove

---

[129] U.C.C. § 3-106 (2002) (emphasis added).

[130] A typical prepayment provision is evidenced in the "FLORIDA FIXED RATE NOTE—Single Family—Fannie Mae/Freddie Mac UNIFORM INSTRUMENT." The prepayment provision states, "I have the right to make payments of Principal at any time before they are due. A payment of Principal only is known as a 'Prepayment.' When I make a Prepayment, I will tell the Note Holder in writing that I am doing so. I may not designate a payment as a Prepayment if I have not made all the monthly payments due under the Note."

[131] 2010 WL 5128666 (N.J. Super. Ct. App. Div. Dec. 17, 2010).

[132] *Id.* at *2.

[133] *Id.* at *3 (emphasis added).

[134] Picatinny Fed. Credit Union v. Fed. Nat'l Mortg. Ass'n, No. 09-1295, 2011 WL 1337507, at *2 (D.N.J. Apr. 7, 2011); *In re* Verity, Bankr. No. 10-20880 (DHS), Adv. No. 10-02373, 2012 WL 3561669, at *7 (Bankr. D.N.J. Aug. 16, 2012); *In re* Mesina v. Citibank, NA., No. 10-2304 (RTL), 2012 WL 2501123, at *2 (Bankr. D.N.J. June 27, 2012); *In re* Kain, Bankr. No. 08-08404-HB, Adv. No. 10-80047-HB, 2012 WL 1098465, at *5 (Bankr. D.S.C. Mar. 30, 2012); *In re* Walker, 466 B.R. 271, 283−84 (Bankr. E.D. Pa. 2012).

[135] *See Gouda*, 2010 WL 5128666 at *3.

true that a maker is free to reject such a prepayment provision. It may also prove true that such a provision stands to benefit a maker. However, it is equally true that the notice requirement of a prepayment provision in a mortgage promissory note places an additional undertaking or instruction on the maker, especially if the maker chooses to prepay on the note.

The drafters of the UCC state that to be negotiable, an instrument must not contain an additional "undertaking or instruction by the person promising or ordering payment to do an act in addition to the payment of money."[136] Nowhere does article 3 state that the additional undertaking or instruction must be a *burden*, as the court in *Gouda* suggests.[137]

C. Courts Have Held that Mortgage Promissory Notes Are Negotiable Even Where There Is Not a "Fixed Amount of Money" Due

In order for a note to qualify as a negotiable instrument, the note needs to remain unconditional by meeting the "sum certain" requirement.[138] In other words, to be considered a negotiable instrument, the note must have contained a fixed amount of money to be repaid when executed by the maker.[139]

> To meet the fixed principal amount [or "sum certain"] requirement of the Uniform Commercial Code's definition of negotiable instrument, the fixed amount generally must be determinable by reference to the instrument itself *without any reference to any outside source*. If reference to a separate instrument or extrinsic facts is needed to ascertain the principal due, the sum is not certain or fixed.[140]

However, despite this unambiguous requirement, courts have twisted the legal construct in such a fashion as to make a contortionist proud by allowing references outside the four corners of a negotiable instrument to determine the instrument's adjustable interest rate.[141]

In *In re Kain*, the maker signed a note containing an interest-only adjustable rate.[142] The note provided for an initial fixed yearly rate that eventually changed to an adjustable rate.[143] Upon foreclosure, the maker challenged the negotiability of the note.[144] In addition to the plaintiff's claim that the note

---

[136] *See* U.C.C. § 3-104(a)(3) (2002).
[137] *Id.*; *Gouda*, 2010 WL 5128666, at *3.
[138] *See* U.C.C. § 3-104(a) (2002).
[139] *Id.*
[140] Heritage Bank v. Bruha, 812 N.W.2d 260, 263 (Neb. 2012) (emphasis added).
[141] *See, e.g.*, *In re* Kain, Bankr. No. 08-08404-HB, Adv. No. 10-80047-HB, 2012 WL 1098465, at *6 (Bankr. D.S.C. Mar. 30, 2012).
[142] *Id.* at *2.
[143] *Id.*
[144] *Id.* at *4.

was nonnegotiable under *Gouda*, the maker also argued that the note was nonnegotiable because the adjustable interest rate prohibits the note from having a "sum certain," therefore destroying the note's negotiability and preventing the holder bringing the foreclosure action from having holder in due course status.[145] The court referenced UCC article 3 in determining whether an adjustable interest rate disallows for "sum certain," rendering the subject note a nonnegotiable instrument.[146] The court stated that "even when executed simultaneously with a mortgage, a note remains subject to the provisions of Article 3."[147]

Specifically, the court addressed the adjustable rate's relation to the "sum certain" requirement.[148] Additionally, the court made reference to article 3's list of instances in which the "sum certain" requirement was not defeated, even though the amount payable was not explicitly stated in the four corners of an instrument.[149] The court in *In re Kain* held that "[t]he statutory language permitted parties to look beyond the four corners of a note to determine interest without destroying its negotiability."[150] Thus, the court denied the maker's claim that an adjustable interest rate bars a promissory note from being negotiable.[151]

Other significant cases finding a promissory note that references information outside the document negotiable are *Cashen v. Integrated Portfolio Management, Inc.*[152] and *Amberboy v. Societe de Banque Privee*.[153] The court in *Cashen* held that the inclusion of externally determined interest rates into the reading of a note does not render it a nonnegotiable instrument.[154] The court in *Amberboy* spoke directly on the "sum certain" requirement, stating "the sum certain requirement is not defeated even though the amount payable is not explicitly stated on the instrument."[155] The court's rationale for declaring the "sum certain" requirement met was that an adjustable rate note containing a variable interest rate, which can be readily accessed by a simple

---

[145] *Id.* at *6.

[146] *Id.* at *6–7.

[147] *Id.* at *4 (citing Northwestern Bank v. Neal, 248 S.E.2d 585, 586 (1987)). In regard to a note's interest rate, U.C.C. article 3 provides that in order for a note to remain negotiable with an adjustable interest rate, the computation of interest "must be one which can be made from the instrument itself without reference to any outside source." *See* U.C.C. § 3-106 (2002).

[148] *Id.* at *6.

[149] *Id.*

[150] *Id.* at *7.

[151] *Id*.

[152] No. 08-CV-268, 2008 WL 4976210, at *2 (N.D. Ill. Nov. 20, 2008).

[153] 831 S.W.2d 793 (Tex. 1992).

[154] *Cashen*, 2008 WL 4976210 at *3.

[155] *Amberboy*, 831 S.W.2d at 793.

reference to a bank's published prime rate, is compatible with the UCC's objective of "commercial certainty."[156]

Although one may believe the aforementioned cases make valid arguments for allowing instruments containing adjustable interest rates to remain negotiable, the truth of the matter is that they are the exception rather than the rule. A fixed amount is an *absolute requisite* to negotiability.[157] In the absence of a fixed amount, a subsequent holder cannot ascertain how much it is legally owed under the instrument, and a maker cannot determine how much he or she owes under it.[158] Furthermore, a subsequent holder will be unable to determine a fair purchasing price, thereby defeating the basic purpose for creating negotiable instruments.[159]

The case of *Amberboy v. Societe de Banque Privee* provides guidance for navigating the muddied waters of the negotiability of promissory notes with adjustable interest rates.[160] After discussing the complexity of variable rate notes and sifting through various states' laws on negotiability, the court in *Amberboy* held that a promissory note requiring interest to be charged at a rate that can be determined *only by reference to a bank's published prime rate* is not a negotiable instrument as defined by Texas Uniform Commercial Code.[161] The court in *Amberboy* stated that "[i]n contrast to those cases upholding the negotiability of variable interest rate notes, which involved reference rates that are widely published and readily ascertainable," the interest in the current case could not be "readily determined by reference to a widely published rate."[162] In *Amberboy,* the note required the payment of:

> Interest on the principal amount remaining unpaid hereunder from time to time outstanding, at a rate per annum equal to the lesser of (a) the rate (the "Basic Rate") which is equal to *the sum of the prime interest rate (the "Prime Rate") for short-term loans published by Lender, plus 2 percent (2%) per annum,* which Basic Rate shall be variable and shall be adjusted for the term hereof, effective at the close of business on the day of any such change in the Prime Rate; or, (b) the maximum lawful rate of interest (the "Maximum Rate") permitted by applicable usury laws ....[163]

Further analyzing the variable rate note, the court concluded that under the UCC, the readily ascertainable published rate required to keep the note

156 *Id.* at 796–98.
157 U.C.C. § 3-104(a) (2002); *see also* FLA. STAT. § 673.1041(1) (2014).
158 *Id.*
159 *See id.*
160 *Amberboy*, 831 S.W.2d at 793–804.
161 *Id.* at 793.
162 *Id.* at 803 (Doggett, J., concurring and dissenting).
163 *Id.* (Doggett, J., concurring and dissenting) (citing Ackerman v. FDIC, 930 F.2d 3, 4 (5th Cir. 1991)).

negotiable must amount to a "commercial certainty."[164] A note that is commercially certain allows the note to function akin to money, and therefore allows the instrument to be accepted with a fixed, determinable amount.[165]

The cases *Heritage Bank v. Bruha*[166] and *Ingram v. Earthman*[167] provide further insight into the rationale for ruling an instrument nonnegotiable due to its lack of a fixed amount.[168] In the case of *Heritage Bank*, a note was ruled nonnegotiable based on the fact that it contained language requiring an inquiry outside of the document's four corners to determine the amount owed.[169] In *Heritage Bank*, the Federal Deposit Insurance Corporation (FDIC) sold a promissory note received from a failed bank to Heritage Bank.[170] Heritage brought an action against the maker, who had originally contracted with the failed bank, to collect on the note.[171] The maker argued that Heritage Bank lacked standing to bring a claim on the note because the note was a nonnegotiable instrument due to the absence of a determinable fixed amount.[172] The court then examined the language of the note's promise to pay and variable interest rate, stating:

> The note evidenced a promise to pay "the principal amount of Seventy-five Thousand & 00/100 ($75,000.00) *or so much as may be outstanding*, together with interest on the unpaid outstanding principal balance of each advance." The note stated that it "evidence[d] a revolving line of credit." The note contained a variable interest rate. The rate was subject to change every month and calculated on an index maintained by Sherman County Bank. The interest rate on Bruha's note was 1 percentage point under the percentage on the index at any given time. The initial rate was 7.25 percent, and was later adjusted to 6.75 percent. On default, this interest rate would increase by 5 percentage points.[173]

After examining the note, the court declared the subject note nonnegotiable, concluding:

> Here, the text of the note states that Bruha "promises to pay ... the principal amount of Seventy-five Thousand & 00/100 Dollars ($75,000.00) *or so much as may be outstanding* ...." (Emphasis supplied.) Further, the note states that it "evidences a revolving line of credit" and that Bruha

[164] *Id.* at 796.
[165] *Id.*
[166] 812 N.W.2d 260 (Neb. 2012).
[167] 993 S.W.2d 611 (Tenn. Ct. App. 1998).
[168] *See Heritage Bank*, 812 N.W.2d at 268; *see also Ingram*, 993 S.W.2d at 624.
[169] *Heritage Bank*, 812 N.W.2d at 268.
[170] *Id.* at 266.
[171] *Id.*
[172] *See id.* at 268.
[173] *Id.* at 265 (emphasis added).

> could request advances under the obligation up to $75,000. This fails the "fixed amount of money" requirement of § 3-104(a); one looking at the instrument itself cannot tell how much Bruha has been advanced at any given time .... Stated simply, "[a] note given to secure a line of credit under which the amount of the obligation varies, depending on the extent to which the line of credit is used, is not negotiable ...."[174]

Because the note contained the language "or so much as to be outstanding," one cannot pinpoint how much the maker had been advanced at any given time by looking solely at the instrument.[175] As a result, the instrument was determined to be nonnegotiable and Heritage Bank had no standing to bring a claim against the maker for the note's balance.[176]

Likewise, in the case of *Ingram*, a lender filed suit against a maker on a note to recover an amount due from a personal loan, including interest.[177] The court found the note to be nonnegotiable due to the uncertainty in the note's language regarding the amount of interest to be paid.[178] The court stated:

> [The] note did not satisfy the "sum certain" requirement in Tenn. Code Ann. §§ 47-3-104(1)(b), -106 when it was signed because its interest rate could not be computed "from the instrument itself without reference to any outside source." *See* Tenn. Code Ann. § 47-3-106 cmt. 1. The note provided for interest "[a]t the Bank's 'Prime Rate' plus ___% per year." It also defined the "Bank" as "Frederic B. Ingram" and "Prime Rate" as the "Bank's rate for loans to its most credit worthy customers for 90-day unsecured loans." Thus, the note required Mr. Earthman to pay interest at whatever rate Mr. Ingram charged his most credit worthy customers for ninety-day unsecured loans.
>
> This interest rate provision ... certainly does not permit the calculation of interest from the face of the instrument itself.[179]

In summary, because Mr. Ingram's "Prime Rate" was not based on a readily ascertainable, objective marketplace standard, the calculation of the note's sum required extrinsic criteria.[180] Because there was a necessity to look outside the "four corners" of the document to determine the note's true sum, the note was not for a sum certain and, therefore, was not negotiable.[181]

---

[174] *Id.* at 268.
[175] *Id*.
[176] *Id.*
[177] Ingram v. Earthman, 993 S.W.2d 611, 617 (Tenn. Ct. App. 1998).
[178] *Id.* at 625.
[179] *Id.*
[180] *Id.* at 624–26.
[181] *Id.*

D. Reference or Incorporation of Another Document Into the Note Can Destroy Its Negotiability

It is common practice in drafting promissory notes to make reference to the note being secured by an additional document, such as a mortgage; however, when the reference to another document constructs a condition on the note, courts consider the additional document incorporated into the note.[182] When a condition is conferred onto a note, it is no longer considered a negotiable instrument.[183] It should be noted, however, that the "mere reference" to a document such as a mortgage or security agreement does not automatically render a note nonnegotiable.[184]

The prime example of a note referencing an additional document and maintaining its negotiability can be found in the case of *Cashen v. Integrated Portfolio Mgmt., Inc.*[185] In *Cashen*, the negotiability of a note containing a reference to a security interest was challenged.[186] The court addressed the issue of the security interest, holding that the mere reference to a security agreement in an instrument does not render a note nonnegotiable.[187] The court elaborated on the meaning of a "reference," stating "the promise or order may contain … an undertaking or power to give, maintain, or protect collateral to secure payment," so long as the reference to the security interest does not form a condition upon the note.[188]

Although a mere reference to a security agreement has failed to defeat a note's negotiability, many courts hold that when a mortgage is incorporated into the note rather than merely referenced, the note is no longer negotiable.[189] Promissory notes that *incorporate* the terms of an additional document, through *reference* to said additional document, become "subject to

---

[182] *See* Sims v. New Falls Corp., 37 So. 3d 358, 361 (Fla. Dist. Ct. App. 2010) (holding that the note was governed by Florida law rather than the Georgia choice of law provision in the mortgage specifically because the note only referenced the mortgage and was careful not to expressly incorporate the mortgage for fear of destroying negotiability).

[183] U.C.C. § 3-106(a) (2002).

[184] *Id.* The Fannie/Freddie Note walks a thin line when it comes to this distinction as seen in the amicus curiae brief submitted by the Real Property Probate & Trust Law Section of The Florida Bar in *Sims*, 37 So. 3d at 363−64, wherein the section explained that "[t]he legal reason why the form promissory note is silent as to choice of laws and does not incorporate by reference the terms of the security deed appears to be that the inclusion of such terms could affect the negotiable status of the note."

[185] No. 08-CV-268, 2008 WL 4976210, at *3 (N.D. Ill. Nov. 20, 2008).

[186] *Id.*

[187] *Id.*

[188] *Id.*

[189] *See, e.g.*, Resolution Trust Corp. v. 1601 Partners, Ltd., 796 F. Supp. 238, 240 (N.D. Tex. 1992).

or governed by" another agreement, thereby rendering the promise in the promissory note conditional.[190] Black's Law Dictionary defines "incorporation by reference" as:

> The method of making one document of any kind become a part of another separate document by referring to the former in the latter, and declaring that the former shall be taken and considered as a part of the latter the same as if it were fully set out therein.[191]

When an additional document is incorporated into a note by reference, the additional document is declared a part of the note in which the declaration is made, "as much as if it were set out at length therein."[192] When an additional document is deemed incorporated into a note, the additional document confers any and all of its possible conditions on to the note.[193] When a note is subject to an additional document's conditions via incorporation by reference, the promise contained in that note is then considered conditional, and the note nonnegotiable.[194] The fine-line distinction between a "reference to" and "incorporation of" an additional document in a potentially negotiable instrument is examined in the case of *Resolution Trust Corp. v. 1601 Partners, Ltd.*[195]

In *Resolution Trust Corp.*, a note referencing a deed of trust using the language "the terms, agreements and conditions of [the Deed of Trust] are by reference made a part of this instrument" was held to have crossed the threshold of a mere reference and stripped the note of its negotiability.[196] The court proclaimed:

> Section 3.105(b) of the UCC provides that a promise is not unconditional if the instrument "states that it is subject to or governed by any other agreement." Here, the note states that "the terms, agreements and conditions of [the Deed of Trust] are by reference made a part of this instrument."... Mere reference to a note being secured by a mortgage, of course, is common commercial practice and does not affect the negotiability of the note .... The language within the note ... exceeds the outer bounds of "mere reference," as it explicitly purports to incorporate the terms of the Deed of Trust.[197]

---

[190] *Id.*; U.C.C. § 3-105(b) (2002).

[191] BLACK'S LAW DICTIONARY 907 (Revised 4th ed. 1968).

[192] Booker v. Everhart, 240 S.E.2d 360, 363 (N.C. 1978) (citing Toledo, St. Louis & Kansas City R.R. Co. v. Cupp, 35 N.E. 703, 703 (Ind. App. 1893)); *see also* 17A AM. JUR. 2D *Contracts* § 391 (2013).

[193] *See Resolution Trust Corp.*, 796 F. Supp. at 240.

[194] United States v. Farrington, 172 F. Supp. 797, 797−801 (D.C. Mass. 1959).

[195] *Resolution Trust Corp.*, 796 F. Supp. at 240.

[196] *Id.*; *see also* U.C.C. § 3-105(b) (2002).

[197] *Resolution Trust Corp.*, 796 F. Supp. at 240; *see also* U.C.C. § 3-105(a)−(c) (2002).

The court's examination of the note's language combined substance with semantics.[198] The inclusion of the phrase "made a part of this instrument" effectively incorporated the deed (an additional document) into the note (the original document).[199] As a result, the note was subject to an additional document, thereby completely altering the function and negotiability of the instrument.[200] The deed's incorporation through reference thus extinguished the note's negotiability.[201]

III. The Absence of Negotiability in the Standard Fannie Mae and Freddie Mac Promissory Notes

Fannie Mae and Freddie Mac, the government sponsored enterprises responsible for the largest share of the secondary mortgage market, promulgated a standard form promissory note and mortgage to be used in residential property purchases.[202] This form is an essential requirement for any loan originator who wants to have the possibility of selling the note and mortgage to Fannie Mae or Freddie Mac.[203] If a loan is not originated with these documents, then the originator loses these government entities as possible secondary market purchasers for the loan.[204] Unfortunately, in drafting the form promissory note, its constructors made many inclusions in order to protect a future holder, which render the note nonnegotiable as a matter of law.[205] Professor Ronald Mann stated:

> The irrelevance of negotiability to home-mortgage note transactions is best demonstrated by the fact that the standard form of promissory note used for those transactions fails to satisfy the requirements of negotiability. Because of the strong interest in uniformity in the large securitized

---

[198] *Resolution Trust Corp.*, 796 F. Supp. at 240.

[199] *Id.*

[200] *Id.* at 240–41.

[201] *Id.* at 240.

[202] *Notes and Note Addenda*, FREDDIE MAC, http://www.freddiemac.com/uniform/unifnotes.html (last visited Mar. 26, 2015), *archived at* http://perma.cc/A8QA-LSHG; Mann, *supra* note 14, at 971.

[203] *Notes and Note Addenda*, *supra* note 202; Mann, *supra* note 14, at 971.

[204] *See Notes and Note Addenda*, *supra* note 202; Mann, *supra* note 14, at 971 (citing GRANT S. NELSON & DALE A. WHITMAN, CASES AND MATERIALS ON REAL ESTATE TRANSFER, FINANCE, AND DEVELOPMENT 213–47 (4th ed. 1992)).

[205] *See, e.g.*, MULTISTATE FIXED RATE NOTE—Single Family—Fannie Mae/Freddie Mac UNIFORM INSTRUMENT, Form 3200 Multistate Mortgage, *available at* http://perma.cc/XQ7M-8Z8V; Roy Oppenheim, *Banks Fear Courts' Ruling on Negotiability of Promissory Notes*, S. FLA. LAW BLOG (May 28, 2013), http://southfloridalawblog.com/banks-fear-courts-rulings-on-promissory-notes/, *archived at* http://perma.cc/X72E-E8JU.

> home-mortgage note transactions, Fannie Mae and Freddie Mac have promulgated a number of standard forms for use in those transactions.
> ...
> Sending a notice certainly is an act "in addition to the payment of money," and the note's language seems to constitute an "undertaking" to perform that act (albeit only on certain conditions). Accordingly, it seems unlikely that the Fannie Mae/Freddie Mac form qualifies as negotiable. Thus, the rules of Article 3 (including its holder-in-due-course protections) do not apply.
> ...
> [T]he preceding paragraphs offer an obvious answer: the benefits of negotiability have no practical significance to the operation of the current system.
> ...
> [I]t is far more sensible to leave negotiability by the wayside in order to pursue the financial advantages promised by access to a large and highly liquid secondary market. Because the home-mortgage note cannot practicably assure the benefits of negotiability, there is no reason why the parties drafting the notes that the system uses should take any great care to ensure that the notes retain technical negotiability. *Furthermore, the absence of negotiability from the most common form of note suggests that the parties that draft those notes in fact do not take care to protect the negotiability of the obligations in question.*[206]

Although it is clear that the form promissory note that Fannie Mae and Freddie Mac use is not negotiable by any definition of negotiability provided under article 3 of the UCC, courts have continued to uphold the legal fiction that these notes are transferable by negotiation.[207] These notes, unlike Pinocchio who wears his lies on his face, continue to hide their true character and are continually permitted to do so due to political pressure and lobbying by financial institutions asking the judicial branch (which is supposed to remain impartial and impassive) to continue to turn a blind eye to this obvious farce.[208] We ask the courts to remain unswayed by this political pressure and to uphold the law.

A. The Fannie Mae and Freddie Mac Form Promissory Notes Contain Numerous Provisions that Destroy Their Negotiability

The third prong of the definition of what constitutes a "promissory note," as well as the case law set forth above regarding the destruction of negotiability, is of fundamental importance because the standard note form approved by Fannie Mae and Freddie Mac contains a host of undertakings and

---

[206] Mann, *supra* note 14, at 971−73 (emphasis added).
[207] *Id.* at 972−73.
[208] CARLO COLLODI, THE ADVENTURES OF PINOCCHIO (Nicolas J. Perella trans., Univ. of Cal. Press 1986).

instructions by the person promising or ordering payment to do some act in addition to the payment of money.[209]

By clear UCC definition, once such an additional promise or undertaking is identified, the character of the note cannot be said to be negotiable and the note is not subject to transfer or enforcement pursuant to UCC article 3.[210] The act of endorsing and transferring a mortgage promissory note with such an additional promise or undertaking is a nullity, because endorsement and delivery only effectuates a transfer of a negotiable instrument.[211] If an instrument is nonnegotiable, it must be transferred pursuant to general contract law.[212]

One such provision that is evidenced in the standard note form approved by the Fannie Mae and Freddie Mac (the "Fannie/Freddie Note"[213]) is for "late charges."[214] Such charges were considered obligations other than the payment of money, which rendered the RISC in *GMAC* nonnegotiable.[215]

Furthermore, the Fannie/Freddie Note contains: (1) the instruction that the lender will deliver or mail to the borrower any changes in the interest rate and monthly payments; (2) the obligation that the borrower tell the lender, in writing, if borrower opts to prepay;[216] (3) the instruction that if applicable law "is finally interpreted" so that the interest charged under the note or other loan charges exceed legal limits, then (a) any such loan charge shall be reduced by the amount necessary to reduce the charge to the permitted limit, and (b) any sums already collected by the lender that exceed permitted limits shall be refunded to the borrower; the instruction that the lender send written notice of default; (4) the instruction entitling the lender to be paid back by the borrower for all costs and expenses; (5) the instruction that the lender send any notices that must be given to the borrower pursuant to the

---

[209] *See* Dale A. Whitman, *How Negotiability Has Fouled Up the Secondary Mortgage Market, and What to Do About It*, 37 PEPP. L. REV. 737, 743 (2010); *see also* Mann, *supra* note 14, at 971−72 ("Sending a notice certainly is an act 'in addition to the payment of money.'").

[210] U.C.C. § 3-104(a) (2002); U.C.C. § 3-106(a)-(d) (2002).

[211] *See* U.C.C. § 3-105 (2002); Mann, *supra* note 14, at 990-91.

[212] Ingram v. Earthman, 993 S.W.2d 611, 624 (Tenn. Ct. App. 1998) ("If the note is a negotiable instrument, the parties' rights are governed by Article 3 of the Uniform Commercial Code; if it is nonnegotiable, we must look to the common law of contracts to define the parties' rights and remedies.").

[213] *See, e.g.*, MULTISTATE FIXED RATE NOTE—Single Family—Fannie Mae /Freddie Mac UNIFORM INSTRUMENT, *supra* note 205.

[214] *Id.*

[215] GMAC v. Honest Air Conditioning & Heating, Inc., 933 So. 2d 34, 37 (Fla. Dist. Ct. App. 2006).

[216] *See* Mann, *supra* note 14, at 971 (citing MULTISTATE FIXED RATE NOTE—Single Family—Fannie Mae/Freddie Mac UNIFORM INSTRUMENT, Form 3200 Multistate Mortgage).

terms of the note by either delivering it or mailing it by first class mail; and (6) the instruction that the borrower send any notices that must be given to the lender pursuant to the terms of the note by either delivering it or mailing it by first class mail.[217]

Additionally, the Fannie/Freddie uniform mortgage instrument (the "Fannie/Freddie Mortgage"[218]) that accompanies the Fannie/Freddie Note often contains a provision that is an express condition on payment, which under UCC section 3-106(a)(i) renders the Fannie/Freddie Note a conditional promise and therefore, under UCC section 3-104(a), nonnegotiable.[219]

Each of these instructions is an additional obligation other than for the payment of money, which renders the Fannie/Freddie Note nonnegotiable. Therefore, any party purporting to be the holder of a negotiable instrument cannot enforce the Fannie/Freddie Note as a negotiable instrument, transferable by endorsement alone.

B. Fannie Mae and Freddie Mac Acknowledge That Their Promissory Note Explicitly Incorporates the Mortgage

In *Sims v. New Falls Corp.*, the court requested an amicus curiae brief of the Real Property Probate & Trust Law Section of the Florida Bar regarding the negotiability of the Fannie/Freddie Note and Mortgage.[220] That brief included an opinion letter from counsel for Fannie Mae and Freddie Mac.[221] In deciding *Sims*, the Third District explicitly reached their conclusions through "application of the guidance received from FNMA/FHLMC[,]" "the drafter of both documents."[222] In the absence of

---

[217] *See, e.g.*, MULTISTATE FIXED RATE NOTE—Single Family—Fannie Mae /Freddie Mac UNIFORM INSTRUMENT, *supra* note 205.

[218] *Id.*

[219] Paragraph 16 of the Fannie/Freddie Mortgage often states in relevant part:

> *Governing Law; Severability; Rules of Construction*. This Security Instrument shall be governed by federal law and the law of the jurisdiction in which the Property is located. All rights and obligations contained in this Security Instrument are subject to any requirements and limitations of Applicable Law. Applicable Law might explicitly or implicitly allow the parties to agree by contract or it might be silent, but such silence shall not be construed as a prohibition against agreement by contract. *In the event that any provision or clause of this Security Instrument or the Note conflicts with Applicable Law, such conflict shall not affect other provisions of this Security Instrument or the Note which can be given effect without the conflicting provision.*

Id. (emphasis added); U.C.C. § 3-106(a)(i) (2002); U.C.C. § 3-104(a) (2002).

[220] Sims v. New Falls Corp., 37 So. 3d 358, 361−62 (Fla. Dist. Ct. App. 2010), *review denied*, 49 So. 3d 747 (Fla. 2010).

[221] *Id.* at 362.

[222] *Id.*

contrary authority, the guidance contained in the letter is authoritative by way of incorporation.[223]

The letter states in relevant part:

> The choice of law provision in the Security Deed was inserted with the expectation that enforcement of the mortgage loan would occur through a foreclosure action in which the Note reflecting the indebtedness and the Security Deed reflecting the security for repayment of that indebtedness would be considered together as an integrated contract and that the choice of law provision in the Security Deed would govern the enforcement of the Note. We intended that if a suit to enforce the Note were maintained separately from an action to foreclose on the property under the terms of the Security Deed, the applicable law would be determined by the choice of law provisions of the forum jurisdiction.[224]

The note and mortgage in question in *Sims* are the standard form Fannie/Freddie "uniform instrument[s]."[225]

Black's Law Dictionary defines "integrated contract" as *"*[*o*]*ne or more writings constituting a final expression* of one or more terms of an agreement."[226] The Fannie/Freddie Note necessarily incorporates the terms of the mortgage, as they must be read together as "a final expression." Therefore, the obligations of the Fannie/Freddie Mortgage incorporated into the Fannie/Freddie Note render the purported Fannie/Freddie Note nonnegotiable,[227] and a holder of the Fannie/Freddie Note cannot claim that it is entitled to enforce the note as the holder of a negotiable instrument.[228]

---

[223] *Id.* at 361−62.

[224] *Id.* at 360−62.

[225] *See generally id*. at 389 n.1 ("The mortgage is entitled 'SECURITY DEED' and bears the following notation at its foot: 'GEORGIA—SECOND MORTGAGE—1/80-FNMA/FHLMC UNIFORM INSTRUMENT.' … An identically worded notation appears at the foot of the promissory note.").

[226] BLACK'S LAW DICTIONARY 880 (9th ed. 2009) (emphasis added).

[227] *See Sims*, 37 So. 3d at 362; *see also* Holly Hill Acres, Ltd. v. Charter Bank of Gainesville, 314 So. 2d 209, 211 (Ct. App. Fla. 1975) (finding a note that incorporated terms of the mortgage nonnegotiable); Trust Corp. v. 1601 Partners, Ltd., 796 F. Supp. 238, 240 (N.D. Tex. 1992) ("The language within the note executed by 1601 Partners, however, exceeds the outer bounds of 'mere reference,' as it explicitly purports to incorporate the terms of the Deed of Trust. Accordingly, the note is not a negotiable instrument under Texas law.").

[228] *See* Jackson v. DeWitt, 592 N.W.2d 262, 267 (Wis. Ct. App. 1999) ("The [retail installment security agreement] RISA is not a negotiable instrument because it contains promises, other than an unconditional promise to pay. For example, Jackson promises to purchase a swimming pool, to grant a security interest in the pool, *and to pay any delinquency charges.*") (emphasis added).

C. The Illinois Bankers Association Claims the Fannie/Freddie Note Must Be Deemed Negotiable Due to Far-Reaching Consequences If It Is Deemed Otherwise

The Illinois Bankers Association (the "IBA") is one of Illinois's foremost government relations associations.[229] As such, when the IBA speaks, government officials listen.[230] The IBA represents banks of all sizes in Illinois, initiates banker-supported legislation, lobbies in support of industry positions, testifies before legislative committees, and prepares and submits comprehensive comment letters on regulatory proposals.[231]

In a recent letter to the Supreme Court Mortgage Foreclosure Committee, the IBA addressed certain "questions of first impression ... [the resolution of which] will have major practical and public policy consequences reaching far beyond the court room and defendants in foreclosure actions."[232] One such question of first impression the IBA references is the "argument[] asserting that many if not most mortgage notes which conform to the fixed requirements of Fannie Mae and Freddie Mac are not negotiable instruments because they contain undertakings and conditions that disqualify them from the definition of 'negotiable' under Article 3 of the Uniform Commercial Code."[233]

In the letter, the IBA does not discuss the veracity of the claim that the Fannie/Freddie Note is nonnegotiable.[234] Instead, the IBA undertakes to inappropriately pressure the Committee into finding the Fannie/Freddie Note negotiable without any evidence to support said contention by stating that the individuals raising concerns about the negotiability of the Fannie/Freddie Note "apparently are not concerned with [the] implications beyond the context of a given lawsuit or class of lawsuits, but the rest of us should be, for obvious reasons."[235] Interestingly enough, the IBA does not further elucidate what those obvious reasons are, in apparent fear of acknowledging the reality of the situation in writing.[236] Instead, the IBA strongly implies that the Fannie/Freddie Note should be found negotiable due to the fact that "Fannie Mae and Freddie Mac together hold over $5.3 trillion in home mortgages, nearly half the entire residential mortgage market in the United

---

229 *Government Relations*, IBA, http://www.ilbanker.com/Government-Relations/ (last visited Mar. 26, 2015), *archived at* http://perma.cc/X57A-DMFW.

230 *Id.*

231 *About IBA*, IBA, https://www.ilbanker.com/About/ (last visited Mar. 26, 2015), *archived at* http://perma.cc/X72E-E8JU.

232 Letter from Bruce Jay Baker, *supra* note 6, at 1 (Apr. 13, 2012).

233 *Id.* at 3 (citing Mann, *supra* note 14).

234 *Id.*

235 *Id.*

236 *Id.* at 3–4.

States."[237] Again, the IBA's position offers no real legal support for the contention that the Fannie/Freddie Note is *actually* negotiable.

The IBA's letter confirms that the world's largest financial institutions recognize the problem with the negotiability of the Fannie/Freddie Note. However, rather than correcting this legal fiction and adjusting the form note and mortgage to comply with negotiability requirements, large financial institutions like the IBA hope to avoid this misstep on their part by intimidating the courts and legislature into believing that "the Emperor is wearing clothes."

Despite the fact that "Fannie and Freddie presently are issuing more than 95% of all mortgage-backed securities in the country,"[238] the Fannie/Freddie Note contains numerous promises in addition to the payment of money that are not authorized by article 3.[239] The courts have too often let individuals and banking institutions who believe that "financial services professionals may need to engage in unethical or illegal conduct to be successful" off the hook.[240] When courts continue to let banks escape accountability for their actions, they encourage the dangerous belief that these banks are above the law or too big to jail.[241]

A large part of the courts' willingness to overlook the banking institutions' failure to follow applicable law has stemmed from the underlying rationale that delinquent homeowners deserve to be foreclosed on.[242] In this age of rampant fraud by such banking institutions, however, the courts are quickly changing their tune.[243] More and more each day, our courts and justices are forcing themselves to look past their preconceived prejudices regarding defaulting borrowers in the pursuit of justice.[244] As Justice

---

[237] *Id.* at 3.

[238] Letter from Bruce Jay Baker, *supra* note 6, at 3 (citing Conservator's Report on the Enterprises' Financial Performance, Federal Housing Financing Agency (Third Quarter 2011), at 5) .

[239] *Id.*

[240] Lauren Tapa LaCapara, *Many Wall Street Executives Say Wrongdoing Is Necessary: Survey*, CHI. TRIB.: BUS. (Jul. 10, 2012), *available at* http://perma.cc/7WZU-62AK.

[241] Roy Oppenheim, *Holder: Banks Too Big to Fail and Too Big to Jail*, S. FLA. L. BLOG (Mar. 11, 2013), http://southfloridalawblog.com/holder-banks-too-big-to-fail-and-too-big-to-fail/, *archived* at http://perma.cc/MA9M-USDJ.

[242] *See* Roy Oppenheim, *Nevada Law Makes it Easier for Banks to Foreclose on Delinquent Loans*, S. FLA. L. BLOG (July 18, 2013), http://southfloridalawblog.com/nevada-law-makes-it-easier-for-banks-to-foreclose-on-delinquent-loans/, *archived at* http://perma.cc/QAD6-52AM (showing a developing national trend of legislatures' and courts' presumption of guilt on the foreclosed homeowner, resulting in an unprecedented shifting of the burden of proof onto homeowners).

[243] *See* Spencer v. EMC Mortgage, 97 So. 3d 257, 262 (Fla. 3d Dist. Ct. App. 2012) (Schwartz, J., specially concurring).

[244] *Id.*

Schwartz declared in a recent Florida Third District Court of Appeal ruling involving a borrower who managed to stay in his home for fifteen years without payment after default, "[t]he law is the law. Notwithstanding the distasteful consequences of applying it ... , it must be served."[245]

IV. THE SOLUTION TO THE PROBLEM: HOW ARTICLE 9 AND BASIC CONTRACT LAW CAN REPLACE ARTICLE 3 AND MAINTAIN FLUIDITY OF THE SECONDARY MORTGAGE MARKET WHILE PROVIDING TRANSPARENCY AND PROTECTION TO CONSUMERS

There is an obvious solution to the problem presented by this Article. As the authors opined in the Introduction, the largest problem with negotiability is that there is no transparency to the transaction, and makers are left not knowing to whom their debt is owed. The holder in due course doctrine has left the uninformed and poorer sectors of the market with little recourse to open predatory lending practices and other immoral actions by loan originators. Furthermore, as Professor Eggert stated, case by case litigation favors the financial institutions as it is costly for consumers, and financial institutions can act collectively to shape case law in their favor:

> Case by case litigation, on the other hand, [is] commonly too expensive for the poor consumers who [rely] on consumer credit, giving their lenders a tremendous advantage in litigation because the lenders [can] refuse to settle quickly and then wear down the consumers until the harried borrowers either [drop] the suit or [agree] to terms favoring the lenders. Furthermore, while each borrower [has] only his or her own loan to worry about, lenders, looking out for their long-term interests, [have] a greater incentive to fight for changes that [will] help them. One such strategy would be to settle as much as possible any cases with facts especially unfavorable to lenders, while insisting on trying all cases with facts favorable to lenders. By trying such cases and participating in any appeals, the lenders could hope to shape favorable case law since it would be largely based on cases where the lenders appeared sympathetic or the borrowers unsympathetic.[246]

Unfortunately, most courts side with lenders based on the incorrect belief that lenders are somehow the party more entitled to equity in foreclosure

---

[245] *Id.* The case states, in part:

> Because of the stumbling, bumbling, and general ineptitude of the mortgagee and its representatives, the appellant has managed to remain in the mortgaged premises without payment for over fifteen years after defaulting in 1997. While it therefore pains me deeply to do so, I concur in the reversal of the summary judgment of the foreclosure against her.

Id.

[246] Eggert, *supra* note 7, at 423−24.

actions, and often bend and break rules of procedure and rules of evidence in order to enter judgment in favor of a bank.[247]

In fact, the authors of this Article have appeared before countless trial court judges who have engaged in conduct that is such an egregious violation of the law that it extends into malfeasance, rather than simple judicial error.[248] Interestingly enough, other appellate judges besides Judge Schwartz have come out publicly in stating that the law must be applied equally regardless of the consequences. One such appellate judge made it clear that "the law is not complicated;" and furthermore, that the law must be applied equally in all types of cases regardless of the outcome effected through its application.

The problems of negotiability could be solved simply by removing the tenets of negotiability from real estate transactions and applying basic contract law and the provisions of article 9 of the UCC. Instead of transfer by endorsement, financial institutions would have to transfer by assignment, which requires documents to be dated and notarized, thus providing additional procedural safeguards to consumers. As noted by Professor Neil Cohen in his article *The Calamitous Law of Notes*, most rules regarding transfer by endorsement and negotiability of instruments have become superfluous and could be easily achieved through basic contract law.[249] In considering all of the various rules under article 3 of the UCC as analyzed in this Article, Professor Cohen noted:

---

[247] *See* Oppenheim, *supra* note 242 (showing a developing national trend of legislatures' and courts' presumption of guilt on the foreclosed homeowner, resulting in an unprecedented shifting of the burden of proof onto homeowners).

[248] In these instances, trial judges have clearly stated that they know what the law is, that they are bound to follow it, and if they did so they would have to rule in favor of the borrower. They have then ruled in favor of the lender despite their clear acknowledgement that by doing so they are acting in clear disregard for what the law requires of them. The authors have seen trial courts enter judgments *after acknowledging that the bank's figures in the judgment could not possibly be correct* based simply on the fact that "this is a 2008 case. We are under strict instruction from the Florida Supreme Court to move these cases." Interestingly enough, they are probably under a much stricter oath of office to apply the law. The authors of this Article have also seen judges act in complete disregard of their jurisdictional limits to relieve lenders and their counsel from their legal blunders, including vacating final judgments long after they have been rendered based on incorrect legal descriptions and failure to name necessary parties in the original complaint. In doing so, trial court judges have repeatedly ignored the law in order to make favorable decisions in favor of lenders on the grounds that "if I don't have jurisdiction to grant this motion, then your client gets a free house, and I'm just not ok with that." The authors of this Article have even seen judges vacate a lender's own *voluntary dismissal* of a case on the grounds that the judge was mistaken as to the facts, and the lender, therefore, should somehow be absolved of its own strategic errors.

[249] Neil B. Cohen, Note, *The Calamitous Law of Notes*, 68 OHIO ST. L.J., 161, 165−66 (2007).

> All of the rules mentioned ... are important rules .... Nonetheless, for the most part, they are unnecessary rules. They are unnecessary because with the exception of the good title rules for holders in due course, they could all be created by contract whether or not the document evidencing the undertaking to pay qualifies as a note governed by Article 3 of the UCC. Thus, while the rules may be beneficial, they do not bring about results that could not be brought about, almost as simply, merely by careful drafting of the underlying contract.[250]

In fact, parties can contractually agree to be subject to provisions identical to the holder in due course doctrine, including a waiver of personal defenses. By containing such an express waiver of such rights in the terms of the contract between the parties, the obvious advantage to consumers is that they will be aware of the waiver of their rights to bring defenses, rather than being subjected to a waiver as the result of an obscure and outdated legal doctrine not even referenced in the documents they are signing. Thus, the only actual loss that would be suffered would be the good title to a note for a holder in due course, which has slight value in today's global economy anyhow. Finally, making transfer occur by assignment would require lenders to record the transfer in interest from one lender to another, putting the borrower and the public on notice as to who the rightful beneficiary of the contract is, again lending transparency and accountability to financial institutions. Although Mortgage Electronic Recordation Systems, Inc. ("MERS") arguably tries to do that, it is privately owned and not independent, as it is a registry owned and controlled by the banks (as an internal recordation system) and has been largely discredited by the robo-signing scandal.

CONCLUSION

The remarkable shift in the use of negotiable instruments, and particularly the promissory note, from the late seventeenth century to today exemplifies the need to correct the current system and offer more protection to consumers. The crash of the real estate housing market, which had artificially ballooned due to predatory lending practices, over inflation of property values, and rampant abuse of the public by financial institutions has shone a light on the flaws in our system and the lack of oversight of financial institutions that were permitted to run amuck during times of prosperity. While the FTC saw fit to do away with the holder in due course doctrine by promulgating its Rule with relation to retail installment contracts, the very reasons for that action still exist in the real property lending sector, and the same abuses which the FTC sought to prevent still exist in an area where the stakes are exponentially greater, and the damage limitless.

---

[250] *Id.* at 165−66.

As practicing attorneys in the area of foreclosure defense, the authors of this Article have seen constant abuse by financial institutions against consumers. The authors have also seen a judiciary too overburdened and lacking in resources to address these problems, facing constant political pressure to clear a backlog that was created not by consumers, but by the very financial institutions that now seek equity and redress in their courtrooms. The authors have seen a judiciary that is afraid of its legislative counterpart, which is controlled by funding and legislative directives despite the fact that these branches are supposed to be "equals," and more importantly are supposed to be governed by the separation of powers. Finally, the authors have seen a judiciary that, at least at the trial court level, engages in systemic favoritism of lenders, making it difficult if not impossible for borrowers to mount a legitimate defense.

Financial institutions wave the "holder in due course doctrine" like a mantra, using it to try and defeat claims against every inequitable course of action they have taken, every fraud they have perpetrated, and every Foreclosuregate scandal that they have caused. They hide behind it like an impenetrable wall, the fortress that protects them from public outcry and Occupy Wall Street protestors sick of being abused by financial institutions who are "too big to fail, too big to jail, and too big to nail." If courts were to finally open their eyes, determine that these promissory notes are not negotiable instruments, and apply contract law to these cases, true justice might actually be achieved and the interest of our judicial system will be preserved. It is for this very reason those financial institutions and their lobbyists, such as the Illinois Bankers Association, are fighting tooth and nail to make sure this does not happen. It is for those same reasons, however, that it must be done. As stated so aptly by Judge Leventhal, "the law must not yield to expediency and the convenience of lending institutions."[251] Therefore, the authors of this Article call on the judiciary to uphold the law rather than lore, to force transparency into the mortgage note realm, and protect the interests of the legal system by acknowledging finally that the emperor needs a new wardrobe.

---

[251] Bank of New York v. Silverberg, 926 N.Y.S. 2d 532, 539 (N.Y. App. Div. 2011).