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New Jersey Courts Place Roadblocks On Lenders' Ability To Enforce Mortgage Documents

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New Jersey courts have started clamping down on lenders' ability to enforce mortgage documents by raising concerns when the lender cannot establish that it possesses the original note at the time a foreclosure action is commenced or that it is a holder in due course under the Uniform Commercial Code ("UCC"). Two recent decisions, one from the New Jersey Superior Court, Chancery Division, General Equity Part, Atlantic County, and a second from the United States Bankruptcy Court for the District of New Jersey, elucidate this change in judicial mood. The teachings of these decisions, which are discussed herein, are that lenders and their counsel need to determine and be sure of certain facts before they start an action to enforce mortgage documents. The failure to take the simple steps discussed in this article could result in such action being substantially delayed or never getting off the ground.

In *Bank of New York v. Raftogianis*, ___ N.J. Super. ___, 2010 N.J. Super. Unpub LEXIS 2316 (N.J. Super. Ct. Ch. Div. June 29, 2010), the Hon. W.C. Todd, P.J. Ch., issued a lengthy and scholarly opinion addressing many issues relating

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to foreclosure litigation, including the applicability of the UCC, how the Mortgage Electronic Registration System ("MERS") operates, and the impact on foreclosures of the securitization or pooling of mortgages. In fact, the opinion could be viewed as a treatise on these subjects.

In *Raftogianis*, the lender, American Home Acceptance, Inc, loaned \$1,380,000 to the defendant-borrower, which loan was secured by a mortgage on real property and that identified the mortgagee as MERS as nominee for American Home Acceptance. By contrast, the accompanying promissory note, which was secured by the mortgage, was payable to American Home Acceptance. In trying to avoid foreclosure, the defendant-borrower argued that the note and mortgage had been "separated" because the note was payable to American Home Acceptance whereas the mortgage was in favor of MERS as nominee, and therefore

those documents were not enforceable. The court disagreed. It found that American Home Acceptance never intended to separate the note and the mortgage, and that MERS was involved only "to permit the recording of the mortgage in a way that would facilitate subsequent transfers through MERS without the recording of additional documents." (Slip op. at 24). Additionally, the court rejected the argument that MERS was a necessary party to the foreclosure, concluding instead that MERS was just an agent or "straw man" for the lender by relying upon a recent decision the Supreme Court of Kansas, *Landmark Nat'l Bank v. Kesler*, 216 P.3d 158 (Kan. 2009). (Slip op. at 25-26). Thus, even though the note was payable to the American Home Acceptance while the mortgage was in favor of MERS as the nominee, the court concluded that American Home Acceptance remained the owner of both the note and mortgage until the loan was securitized at a later date.

The court then addressed American Home Acceptance's argument that it was entitled to foreclose even though it could not establish that it physically possessed the note. The court rejected this argument. The court held that "[i]t was entirely appropriate to require plaintiff to establish it did have the right to enforce the note and mortgage." (Slip op. at 30). The court then discussed what the proper remedy should be when a plaintiff, after the litigation has commenced, could not establish that it was the proper party in interest at the time the complaint was filed. The court held that such a determination would need to be made on a case-by-case basis after considering the length of the pending litigation. The court did note, however, that in actions involving a nego-

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tiable note, a lender should be able to establish that it physically possessed the original note at the time the complaint was filed.

With respect to specific circumstances presented in *Raftogianis*, the court held a trial to determine whether the lender was in physical possession of the original note as of the date the complaint was filed. The court determined that the lender bore the burden of proof on that issue by a preponderance of the evidence. Ultimately, the court ruled that the lender had not carried its burden and dismissed the complaint without prejudice subject to refile along with a certification on personal knowledge confirming that the lender is in possession of the original note as of the date the new action is filed and providing the physical location of the note and the name of the individual or entity in possession. (Slip op. at 44-45).

In *Kemp v. Countrywide Home Loans, Inc.* (*In re Kemp*), 2010 Bankr. LEXIS 4085 (Bankr. D.N.J. Nov. 17, 2010), the debtor filed an adversary complaint seeking to expunge the proof of claim filed on behalf of Bank of New York by Countrywide Home Loans, Inc. as servicer. The underlying facts were as follows. The debtor, an individual, filed a voluntary petition under Chapter 13 of the Bankruptcy Code. The debtor scheduled ownership in several properties, including one for which the debtor listed Countrywide Home Loans d/b/a "America's Wholesale Lender" as a secured creditor holding first and second mortgages for loans totaling \$209,000. Thereafter, Countrywide Home Loans, Inc., which identified itself as the servicer for the Bank of New York, filed a secured proof of claim in the amount of \$211,202.41. In response, the debtor filed an adversary complaint seeking to expunge the secured proof of claim arguing that the Bank of New York could not enforce the underlying obligation.

The debtor did not dispute that he signed the mortgage documents, which listed Countrywide Home Loans, Inc. as the lender. However, shortly after he signed the mortgage documents, they were securitized or pooled with other loans and sold as a package to the Bank

of New York as Trustee in return for Asset-backed Certificates, Series 2006-8. The pooling agreement provided that a Countrywide-related entity was to deliver and indorse the original mortgage note to the Bank of New York as trustee. However, delivery and indorsement did not occur. Subsequently, MERS, in an apparent effort to cure the failure to deliver and indorse the mortgage note, and as the nominee for America's Wholesale Lender, assigned the debtor's mortgage note to the Bank of New York Trustee for Asset-backed Certificates, Series 2006-8. That assignment was recorded with the county clerk. Critically, at the trial of the adversary proceeding, a lender representative testified that the original mortgage note never left the possession of Countrywide.

The court ruled that the lender's secured proof of claim needed to be expunged for two reasons under New Jersey law. The court noted that the enforcement of a note secured by a mortgage was governed by the UCC because the note is a "negotiable instrument." *N.J.S.A.* 12A:3-104. Under the UCC, a party is entitled to enforce a negotiable instrument if it is "the holder of the instrument, a nonholder in possession of the instrument who has the rights of a holder, or a person not in possession of the instrument who is entitled to enforce the instrument pursuant to 12A:3-309 or subsection d. of 12A:3-418." *N.J.S.A.* 12A:3-301. The court noted that the Bank of New York never had possession of the note because it was not delivered and indorsed and therefore the Bank of New York was not a "holder" under the New Jersey UCC. Also preventing the Bank of New York from becoming a "holder" was that there was not a proper indorsement on the note itself, or an allonge that was executed at the time that the proof of claim was filed. The Bank of New York could not be deemed a "nonholder in possession" because it did not possess the note. Finally, the Bank of New York was not a "non-holder not in possession" because it could not satisfy the requisites of lost, destroyed or stolen instruments or payment or acceptance of the instrument

by mistake under *N.J.S.A.* 12A:3-309 and subsection d. of *N.J.S.A.* 12A:3-418, respectively.

The court also rejected an argument by Countrywide on behalf of the Bank of New York that the recorded written mortgage assignment, which purported to transfer both the note and the mortgage, enabled the new owner, the Bank of New York, to enforce both the note and mortgage. The court held that the recorded assignment of the mortgage did not establish the enforceability of the note, which was governed by the UCC. Said differently, the Bank of New York may have owned the note based on the mortgage assignment but it did not have the right to enforce the note for the reasons set forth above.

"Additionally, this author recommends, if possible, that the plaintiff specifically plead in the foreclosure complaint that the plaintiff possesses the original note as of the date the complaint is dated."

Both *Raftogianis* and *Kemp* are instructive in this age of courts placing greater scrutiny on actions by lenders to enforce their mortgage documents. *Raftogianis* teaches that *before* starting a foreclosure action, the lender and its counsel must establish and satisfy themselves that the lender possesses the original note and can identify the note's actual location and who possesses it. Additionally, this author recommends, if possible, that the plaintiff specifically plead in the foreclosure complaint that the plaintiff possesses the original note as of the date the complaint is dated. Further, *Kemp* teaches that the plaintiff should also be able to establish that it is either a "holder," "nonholder in possession," or "nonholder not in possession" under the New Jersey UCC before commencing an action on mortgage documents. The failure to take these simple steps may result in unnecessary delay and expense.