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What NJ Justices Got Right In Lost Promissory Notes Ruling

Even today, with all the benefits of digital document storage and reproduction, lawyers and their clients must occasionally spare a thought for the power of an original, physical document. This is particularly true of promissory notes, which, under the Uniform Commercial Code, are usually transferred by possession.

But even the best of us will misplace something on occasion, and there is a split of authority concerning what happens when a noteholder loses a note and sells or assigns its rights under the lost note to a new party.

The New Jersey Supreme Court, like many courts before it across the U.S., recently confronted this question and found that rights under a lost note are assignable both by statute and common law, a result that was both legally sound and commercially sensible.[1]

The UCC, as Originally Drafted, and as Amended

As originally drafted in 1990, Section 3-309(a) of the UCC provided that:

> A person not in possession of an instrument is entitled to enforce the instrument if: (i) the person was in possession of the instrument and entitled to enforce it when the loss of possession occurred, (ii) the loss of possession was not the result of a transfer by the person or a lawful seizure, and (iii) the person cannot reasonably obtain possession of the instrument because the instrument was destroyed, its whereabouts cannot be determined, or it is in the wrongful possession of an unknown person or a person that cannot be found or is not amenable to service of process.

New Jersey adopted this provision in 1995.[2] Read literally, and in isolation, the first subpart suggests that only the party that lost the note can enforce it, making lost notes or the rights under them unsaleable.

However, rights under lost notes from all over the country are commonly sold, accompanied by affidavits setting out the terms of the original notes and stating that they are lost.[3] A 1997 federal court decision first called that practice into doubt.

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In Dennis Joslin Co. LLC v. Robinson Broadcasting Corp.,[4] the court recognized that there did not "appear to be a logical reason to distinguish between a person who was in possession at the time of the loss and one who later comes into possession of the rights to the note," but nevertheless held that the text of Section 3-309(a) of Washington, D.C.'s UCC precluded enforcement of a lost note by any person other than one who was in possession at the time of the loss.[5]

Since Dennis Joslin, courts have fractured on the proper interpretation of Section 3-309(a). Some courts agreed that Section 3-309(a) limited enforcement of a lost note to only the circumstances it delineated. Others relied on the common law doctrine of assignment[6] to reach the opposite conclusion.[7]

Others avoided the result in Dennis Joslin by looking to the equitable principle of unjust enrichment.[8] One even looked to UCC Section 3-203, addressing transfer of an instrument by delivery, to permit enforcement.[9]

The issue became even more complicated in 2002, when the UCC itself was amended in response to Dennis Joslin. The revised Section 3-309(a) expressly recognized the enforcement rights of one who acquired ownership of the instrument from the party who lost it.[10]

Some courts treated their state's refusal to adopt the 2002 amendment as support for the Dennis Joslin position.[11] Others simply held that Dennis Joslin was the wrong result under the pre-2002 language.[12]

Since New Jersey had not amended its version of Section 3-309, this was the body of conflicting law though which the New Jersey Supreme Court had to navigate.

The Beginning of Investors Bank v. Torres

In 2005, Javier Torres signed a promissory note for $650,000, and gave a mortgage as security. In September 2008, he entered into a loan modification agreement with CitiMortgage Inc. that reaffirmed the loan documents, reduced the interest rate, and extended the loan's maturity date. He then defaulted under the modified terms in 2010.

While CitiMortgage lost the original note, in October 2013, it executed a lost-note affidavit, attaching a copy of the original note. Thereafter, CitiMortgage assigned the mortgage loan to Investors Bancorp Inc., which commenced a mortgage foreclosure action in 2015. In opposing Investors Bank's foreclosure efforts, Torres' main contention was that Investors Bank could not foreclose on the basis of a lost-note affidavit.

The trial court disagreed, but it did require Investors Bank to indemnify Torres against any future claim on the lost note by any other party, as contemplated by UCC Section 3-309(b). Torres appealed.

The intermediate New Jersey appellate court affirmed all of the trial court's rulings, finding that:

> [U]nder New Jersey's version of 3-309 a person who was both in possession of a note and entitled to enforce it when the loss occurred may enforce that note and may transfer that right to another; a subsequent transferee need only prove "the terms of the instrument and the person's right to enforce the instrument" as required by subsection (b). [13]

The intermediate appellate court grounded this decision, in part, on the common law doctrine of assignment,[14] and also on the equitable doctrine of unjust enrichment. It found that accepting Torres' argument "would not only deprive plaintiff of the benefit of its bargain with [CitiMortgage], it would also allow defendant to stay in the mortgaged premises and continue to ignore his obligations to pay principal, interest, taxes and insurance premiums."[15]

Torres then sought discretionary review in the New Jersey Supreme Court, which granted his request.

The New Jersey Supreme Court Got It Right

Torres' argument to the New Jersey Supreme Court was straightforward: Section 3-309(a) sets out the criteria for enforcing a lost note, and Investors Bank did not meet them.

Investors Bank had the more complex argument. It maintained that Section 3-309(a) did not expressly prohibit assignment; it was simply silent on the subject of assignment. In light of that silence, Investors Bank argued that the court had to interpret Section 3-309(a) in a way that was consistent with equity, the common law doctrine of assignment, and two New Jersey statutes - one concerning the assignability of contractual rights in general,[16] and one concerning the assignment of mortgages in particular.[17]

The New Jersey Supreme Court agreed with Investors Bank that Section 3-309(a) "is silent regarding the rights of an assignee," and that the state Legislature did not intend "to displace New Jersey's statutes and common law on assignments, or to nullify assignments of mortgages that are valid and enforceable under that law."[18]

While the court was careful to disclaim any reliance on the equitable doctrine of unjust enrichment,[19] it did seem to be influenced by the unfairness of barring "a foreclosure action - notwithstanding the defendant's failure over decades to make mortgage payments," depriving "assignees of their bargained-for rights," and "confer[ring] a windfall" on defaulting mortgagors. [20]

Conclusion

In the end, the result in this case was a sensible one. Everyone's agreements - Torres' with CitiMortgage and CitiMortgage's with Investors Bank - are enforced; nobody gets anything for free; and mortgage notes governed by New Jersey law can be bought, sold, pledged or securitized using either an original note or a lost-note affidavit.

Borrowers in this situation also remain protected against the threat of double liability by the requirements of Section 3-309(b). But what probably made the difference was neither abstract fairness nor commercial sense, but rather provisions peculiar to New Jersey law. In the absence of a general assignment statute, things could well have been different.

Both transactional lawyers working on deals involving promissory notes, and litigators trying to enforce them need to remain vigilant about which state's law governs, which version of Section 3-309(a) a particular state has enacted, and each state's position - if it has one - on the post-Dennis Joslin split.[21]

In the somewhat longer term, it would behoove jurisdictions that have not yet adopted the 2002 amendment to Section 3-309(a) to do so. This would eliminate the need for parties to litigate the question of statutory interpretation raised by the 1990 text in order to resolve what should be simple cases.

It would also promote the UCC's own goals: "to (1) simplify, clarify, and modernize the law governing commercial transactions; (2) to permit the continued expansion of commercial practices through custom, usage, and agreement of the parties; and (3) to make uniform the law among the various jurisdictions."[22]

[1] Investors Bank v. Torres, ---A.3d ----, ---N.J. ---, 2020 WL 3550701 (2020).N.J.S.A. 12A:3-309(a).

[2] N.J.S.A. 12A:3-309(a).

[3] See UCC § 3-309(b), describing the proof requirement.

[4] 977 F. Supp. 491 (D.D.C. 1997).

[5] Id. at 494-95.

[6] Section 1-103(b) of the UCC provides that principles of law and equity can "supplement" the UCC's terms, unless those principles are "displaced" by particular UCC provisions.

[7] E.g., YYY Corp. v. Gazda, 761 A.2d 395, 401 (N.H. 2000).

[8] E.g., Nat'l Loan Investors, LP. v. Joymar Assocs., 767 So. 2d 549, 551 (Fla. 3d Dist. Ct. App. 2000) ("We see no reason why this right of enforcement cannot be assigned when recognizing such a right would prevent defendants in foreclosure actions from receiving a windfall.").

[9] Bobby D. Assocs. v. DiMarcantonio, 751 A.2d 673, 676 (P a. Super. Ct. 2000).

[10] UCC § 3-309(a)(l)(B) (2002).

[11] E.g., Fannie Mae v. Hicks, 35 N.E.3d 37 (Oh. 8th Dist. Ct. App. 2015).

[12] E.g., Atl. Nat'l Trust, LLC v. McNamee, 984 So. 2d 375 (Ala. 2007).

[13] Investors Bank v. Torres, 457 N.J. Super. 53, 60 (App. Div. 2018).

[14] Id. at 61-62.

[15] Id. at 62-63.

[16] N.J.S.A. 2A:25-1 ("All contracts for the sale and conveyance of real estate ... and all choses in action arising on a contract shall be assignable, and the assignee may sue thereon in his own name.").

[17] N.J.S.A. 46:9-9 ("All mortgages on real estate in this State, and all covenants and stipulations therein contained, shall be assignable at law by writing, whether sealed or not, and any such assignment shall pass and convey the estate of the assignor in the mortgaged premises, and the assignee may sue thereon in his own name.").

[18] Torres, ---A.3d at ---, --- N.J. at ---, 2020 WL 3550701, at *12.

[19] Id. at *15 n.3.

[20] Id. at *13.

[21] There are also some intermediate positions. For example, Connecticut allows an assignee of a lost promissory note to foreclose in equity but not to bring an action at law. See Seven Oaks Enters., L.P. v. Devito, 198 A.3d 88, 97 n.11 (Conn. App. 2018).

[22] UCC § 1-103(a).