

NEW JERSEY COURT ON THE UCC AND STANDING TO FORECLOSE

A recent decision from the Appellate Division --[Bank of New York v. Ukpe](#) -- is the latest in an ever-growing body of case law addressing this issue from seemingly every conceivable angle.

Defendants applied for a mortgage from Countrywide Home Loans, Inc. ("CHL"). They claimed that they told the broker that they could not afford a monthly payment over \$1,000 and were assured by the broker that the monthly payment would not exceed this amount. However, at the closing, they learned that the monthly payment would be almost \$1,500 per month. They alleged that the broker told them not to worry because they could refinance the loan a few months after closing. Nonetheless, two years later, after several unsuccessful attempts to refinance the loan, Defendants defaulted.

Defendants' note was made "payable to lender," and the mortgage, after it was recorded, was held by Mortgage Electric Recording System ("MERS") as nominee for the lender. Shortly after being recorded, the mortgage was securitized along with other mortgages. As part of this process, several entities entered into a "Pooling and Servicing Agreement" ("PSA"). Under the PSA, CHL was identified as a "seller," CWABS, Inc. was identified as the "depositor" and "master servicer," and the Bank of New York ("BNY") was identified as the "trustee." Under the PSA, the CHL and the other "sellers" transferred the mortgages to CWABS, Inc., which then transferred them to BNY, which held the mortgages for the benefit of the investors in the newly-created security. The PSA also required the original mortgage notes to be endorsed in blank and delivered to BNY.

Defendants claimed, among other things, that BNY lacked standing to foreclose because it was not a holder in due course. The trial court rejected this claim and the Appellate Division affirmed.

First, the Appellate Division held that the mortgage note was a negotiable instrument. Under the UCC, a negotiable instrument is one that (1) is made payable to bearer or to order, and (2) does not include any undertaking other than the paying of money. When a negotiable instrument is transferred, the transferee has the right to enforce it. Moreover, when a negotiable instrument is endorsed "in blank," like Defendants' mortgage note, it is

payable to the bearer and may be negotiated by transfer of possession. Accordingly, Defendants' mortgage note was a "negotiated instrument."

Second, the Appellate Division held that BNY was a holder in due course. The court explained that one who takes an instrument generally does so subject to the claims and defenses that the maker had against the originator. However, the holder in due course rule is an exception to this general rule, which shields from liability an innocent, bona fide purchaser of an instrument who takes the instrument in good faith and for value. There is, however, an exception to this exception. A party cannot be a holder in due course -- and thus cannot enjoy the protections that this status affords -- if it knew about, controlled, or participated in the underlying transaction. In *Upke*, the trial court explained this concept further:

“[T]he doctrine is generally applicable only when the parties are involved in such an unusually close relationship that the transferee should have known that the underlying transaction was somehow suspect. That may occur when the transferee was created by the transferor to handle the transactions in question. It may also occur when the transferee somehow controls the actions of the transferor or is intimately involved in the structuring or processing of the underlying transactions.”

But, both the trial court and the Appellate Division held that this exception to the exception did not apply to CHL and BNY. Specifically, the Appellate Division held:

“[I]t is clear beyond dispute that [BNY] was not created by CHL for the purpose of this transaction. Moreover, there was nothing in the documents executed at closing that would have indicated to plaintiff that a mortgage broker make false representations to defendants Also, nothing in the record supports that [BNY] played any role whatsoever in structuring Defendants' mortgage obligations.”

Accordingly, the Appellate Division concluded that BNY was a holder in due course and had standing to foreclose. This decision is good news for lenders who continue to face ever-evolving challenges from residential borrowers to their standing to foreclose.