

MEMORANDUM

November 5, 2012

TO: The Honorable Hariett Lansing, Michael Houghton, Esq., John Sebart, Esq.,  
William Breetz, Esq., Teresa Harmon, Esq.

FROM: Thomas A. Cox, Esq.

RE: ULC Foreclosures Committee: Issues relating to the UCC

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**I. Introduction.**

As all of you saw at last week's meeting, there are important issues relating to the UCC that must be considered by the Uniform Law Commission at large and by this Committee itself with respect to the drafting work of the Committee.

At the core of the issue is a combined policy and legal question of whether long-term mortgage notes are negotiable under present law, or whether statutory provisions should be considered that would render such notes non-negotiable. When one looks at the history of negotiable instruments law going back to the days of the law merchant, there simply is no good legal or policy argument to support calling these notes negotiable instruments. George Holler, Esq. did a nice job of laying out those issues.

I have been forced to recognize the reality that the ULC and the PEB are not going to deal with this issue. It is for that reason that I have put before this ULC Committee the position of homeowner advocates that any statute coming out of this Committee should include a provision that provides that, notwithstanding the provisions of UCC §3-305, no party pursuing a residential mortgage foreclosure should be permitted to assert holder in due course status in opposition to any claims or defense asserted by a homeowner. Holder in due course status is created by state law, UCC §3-305, and state law can therefore take that protection away.

Holder in due course status for buyers of mortgage notes is one of the prime causes of the present foreclosure crisis. The ULC and this Committee have said that they want to produce a proposed act that will prevent, or at least minimize the potential for any future similar crisis. If the ULC is serious about that statement, it cannot fail to address that issue in

the work of this Committee. This issue for homeowner advocates is not a bargaining chip or a “throw-away” issue. Rather it is of paramount importance to them and a failure the Committee and the ULC to responsibly address the issue is likely to assure the opposition of consumer groups to any product that the Committee produces.

The FTC eliminated HDC defenses in other consumer lending transactions back in the mid 1970’s<sup>1</sup> with no apparent diminution in the availability of consumer credit. Professor Kurt Eggert published two prescient articles on this topic in 2002.<sup>2</sup> I recently discovered two 2009 articles from the Cleveland Federal Reserve Bank addressing this issue and advocating for the reconsideration of applying holder in due course theories to residential mortgage notes.<sup>3</sup> I am sending those articles to you with this memorandum. The authors of these two articles, Messrs. Greenlee and Fitzpatrick from the Cleveland Federal Reserve, were in attendance at the meetings this past Friday, and the Committee missed a great opportunity to have these gentlemen address the Committee regarding the results of their research and to discuss it with them. I am deeply disappointed in that failure.

Tied to this issue, and arising out of the unwise policy of treating long-term mortgage notes as negotiable instruments is my request that the Committee include a provision mandating that only owners of mortgage loans be allowed to be the foreclosing parties. If negotiability were not in play, this would not even be an issue. Some Committee members appeared to have concerns about whether they could consider such a provision in light of the jurisdiction of the PEB over all issues relating to the UCC. Uncertainty on the part of the Committee about its ability to address this issue is not acceptable.

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<sup>1</sup> Promulgation of Trade Regulation Rule and Statement of Basis and Purpose, [40 Fed. Reg. 53,506](#) (Nov. 18, 1975).

<sup>2</sup> Eggert, *Held Up In Due Course: Codification and the Victory of Form Over Substance in Negotiable Instruments Law*, 35 Creighton L. Rev. 363 (2002) (“Eggert I”), and Eggert, *Held Up in Due Course: Securitization, Predatory Lending and the Holder in Due Course Doctrine*, 35 Creighton L. Rev. 503 (2002) (“Eggert II”).

<sup>3</sup> Greenlee and Fitzpatrick, *Reconsidering the Application of the Holder in Due Course Rule to Home Mortgage Notes*, found at <http://www.clevelandfed.org/research/workpaper/2008/wp0808.pdf>, Fitzpatrick, Littman and Whitaker, *Making Financial Markets Safer for Consumers, Lessons From Consumer Goods Markets and Beyond*, found at [http://www.clevelandfed.org/forefront/2009/12/ff\\_20091216\\_05.cfm](http://www.clevelandfed.org/forefront/2009/12/ff_20091216_05.cfm)

## **II. The Issue.**

From what I have seen so far, it appears to me that this Committee has a hand tied behind its back in considering this holder in due course issue. There appear to be turf issues in play. The ALI representative was present at the meeting to protect its interest in UCC related issues. Members of the Committee have expressed concern about not encroaching upon the turf of the PEB. The Committee Chair has expressed concern about whether this Committee can consider holder in due course issues, without permission of the ULC Scope Committee (although the inclusion in the draft statute, and the lengthy discussion on Saturday afternoon, about changing the rules regarding liens for association dues was far beyond the scope of the Committee's authorization and no Committee member had any concerns about that.)

My concern is threefold. First, we need clarity around the process by which the ULC and the ALI are going to decide whether the Committee is going to be able to consider the holder in due course issue and the ownership issues. Second, we need complete transparency around that process. The ULC and ALI must make certain that consumer advocates have a clear understanding of this process and the opportunity to participate in it. Third, the ULC simply must not refuse to allow this Committee to address the HDC and ownership issues.

It will be the ULC as an institution that will be the proponent of any proposed statute the Committee produces and the ULC finally approves. It is imperative that the ULC not allow turf issues, arising out its internal organization, to limit the ability of this Committee to consider critical issues such as the holder in due course issue. It is not acceptable for the PEB or the ALI to have the ability to prevent this Committee from even considering an issue such as this. I am an outsider to ULC process, so perhaps I am not sufficiently knowledgeable about how the ULC functions. However, my observations so far leave me with deep concern about how this issue is being handled.

I am not sure even who the right person or persons are to address this issue. That is why I have included all of you as recipients. I respectfully request a written response to this memorandum from the appropriate person so that I and other homeowner representatives

will be able to understand how this vital issue will be dealt with by the ULC. Thank you for your consideration of this important matter.