Exhibit 1

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Reconsidering the Application of the Holder in Due Course Rule to Home Mortgage Notes

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I. INTRODUCTION

Securitization of residential home loans dramatically changed the operation of the home mortgage market.[1] Historically, most home loans were originated, serviced, and held by a bank.[2] Today, origination and servicing functions are commonly executed by separate entities that do not own the loan.[3] The recent turmoil in the home mortgage market has enlivened discussion of the "assignee liability" of the owners of home mortgage loans, arising from the activities of the originators of home mortgage loans.

One recurring topic in these discussions is the holder in due course rule. Embodied in state statutory adaptations of Article 3 of the Uniform Commercial Code (UCC), this rule insulates some assignees from borrowers' claims and defenses to payment. Generally, a holder in due course under U.C.C. § 3-302 is a person who acquires a home mortgage note for value, in good faith, without notice that it is overdue, dishonored, or that any person has any claim or defense. A holder in due course is protected by U.C.C. § 3-305 from most claims and defenses that mortgage borrowers can assert to avoid paying on the note.

This paper reviews the legislative history of these sections and the underlying concept of negotiability.[4] The paper then turns to the current requirements holders of mortgage loans must satisfy in order to assert holder in due course status under U.C.C. § 3-302 and obtain the protections offered by U.C.C. § 3-305.[5] The paper also addresses other legislative developments, court decisions, and contemporary debate related to assignee liability. Finally, it concludes that it is time to reevaluate the policy justifications offered in support of the application of the holder in due course rule to home mortgage notes.

This paper uses the term "assignee liability" in a general way to mean that the assignee, holder, transferee, or purchaser of a note or loan may be held liable for legal claims against the original lender. The term "home mortgage note" refers to a promissory note that arises from the purchase or refinance of a one-to-four-family dwelling in which the borrower resides and that is secured by a mortgage on that dwelling. A home mortgage note does not include promissory notes that have been made in connection with the purchase of goods or services from a merchant, such as the purchase of vinyl siding or windows for a residence because a Federal Trade Commission rule already abrogates holder in due course protection for these promissory notes.

The legislative history of the UCC contains little consideration of the policy justifications for negotiability and the holder in due course rule. The drafters focused on the form and efficiency of negotiable instruments rather than the rationale for them. The original common-law justification of negotiability established by Lord Mansfield in the 1700s was as a money substitute, but this rationale was no longer relevant when the UCC was promulgated in the early 1950s, given the many methods of payment then available in the financial system. While the UCC drafters did not explicitly justify negotiability as promoting the availability of credit and reducing its cost, the availability of inexpensive credit is the primary justification for negotiability offered in contemporary discussions of negotiability and the holder in due course rule.

Over time, the protection afforded to holders in due course was limited by law outside the UCC. Beginning in the 1940s, some state courts limited the application of the holder in due course rule in consumer goods transactions for public policy reasons. By the mid-1970s, 40 states had enacted laws limiting holder in due course protection in consumer goods transactions. In 1975, the Federal Trade Commission promulgated a rule preserving consumer claims and defenses in consumer goods and services transactions.

Other laws outside the UCC limited holder in due course protection in real estate transactions. In 1968, the Truth in Lending Act created limited assignee liability in most consumer credit transactions, including residential mortgage transactions, for violations of its disclosure requirements. In 1994, the Home Ownership and Equity Protection Act required additional disclosures for high-cost mortgage loans. It also prohibited prepayment penalties and other abusive provisions. It essentially abrogated the holder in due course rule for high-cost mortgage loans by subjecting assignees of such loans to all claims and defenses the borrower could assert against the original lender. Subsequently, 32 states enacted laws with their own definition of high-cost or covered mortgage loans. Twenty-three of these states provide for some form of assignee liability that limits the protections available to holders in due course. These abrogations of holder in due course were based on public policy considerations such as the superior ability of assignees to bear the risk of loss, enhancing market efficiency, and the knowledge gap between assignees and consumers.

This paper argues that historical changes in the policy justifications for negotiable instruments, the parties to negotiable instruments, and the structure of the home mortgage market call for a reconsideration of the application of the holder in due course rule to home mortgage notes. While this paper does not make policy recommendations, it does identify the elimination or limitation of the holder in due course rule as a possible means to improve market efficiency by re-aligning the incentives of assignees of home mortgage notes with those of the originators and brokers of home mortgage notes. This possibility suggests additional lines of inquiry for further research: the evaluation of the consequences of eliminating or limiting the holder in due course rule, using the tools of economic theory and empirical study.

II. HOLDER IN DUE COURSE

The most legally significant aspect of negotiability is protecting a holder in due course from claims and defenses a borrower may assert with respect to payment of an instrument. Protecting a holder in due course departs from the usual rule for contracts under which the assignee "stands in the shoes" of the assignor.[6] In other words, the rights and obligations of the assignor are transferred to the assignee and defenses to contractual obligations that were good against the assignor are also good against the assignee.[7] However, an assignee that qualifies as a holder in due course acquires rights superior to those of the assignor. To acquire these preferential rights, a person must meet the requirements of U.C.C. § 3-302. These requirements will be discussed after reviewing the legislative history of the holder in due course rule.

A. Legislative History

The principles of negotiability and the holder in due course rule that are incorporated into the UCC originally derive from English common law and statutes. The first United States codification of such principles was the Uniform Negotiable Instruments Law, which states adopted in the early 1900s. Nearly half a century later, work began on Article 3 of the UCC, which defined and determined the rules governing negotiable instruments.

1. English Law

The holder in due course rule has its roots in English common law. In the landmark case of *Miller v. Race*, decided in 1758, Lord Mansfield cut off all claims of ownership that conflicted with a bona fide purchaser's claim. Lord Mansfield stated the commercial considerations underlying his decision:

> [Bank notes] are not goods, not securities, nor documents for debts, nor are so esteemed: but are treated as money, as cash, in the ordinary course and transaction of business, by the general consent of mankind; which gives them the credit and currency of money, to all intents and purposes...
>
> ....
>
> A bank-note is constantly and universally, both at home and abroad, treated as money, as cash; and paid and received, as cash; and it is necessary, for the purposes of commerce, that their currency should be established and secured.[8]

In *Peacock v. Rhodes*, Lord Mansfield held that "a holder, coming fairly by a bill" takes it free of all personal defenses that could be asserted against the original party.[9] As in *Miller*, Lord Mansfield sought to protect the use of negotiable instruments as currency.[10] These cases established bills of exchange and bank notes as a substitute for money at a time when England did not have an official paper currency and coins were in short supply.[11] Bank of England notes did not become legal tender until 1833.[12]

These decisions were codified in the Bills of Exchange Act of 1882 (Exchange Act).[13] Lord Mansfield's "holder coming fairly by a bill or note"[14] became a "holder in due course" in the Exchange Act. Section 29 of the Exchange Act set forth the requirements for holder in due course status. They are quite similar to the requirements in the modern UCC.[15] The rights of a holder in due course were codified in section 38 of the Exchange Act and are strikingly similar to the protection offered under the modern UCC. Section 38 stated that a holder in due course "holds the bill free from any defect of title of prior parties as well as from mere personal defenses available to prior parties among themselves, and may enforce payment against all parties liable on the bill."[16]

2. Original Act

The first codification of negotiable instrument law in the United States was the Uniform Negotiable Instruments Law (Original Act). The National Conference of Commissioners on Uniform State Laws (NCCUSL) proposed the Original Act in 1896.[17] The Original Act was similar to the Exchange Act.[18] The Original Act was adopted by all states and territories of the United States in the early 1900s.[19]

Section 52 of the Original Act set forth the requirements of a holder in due course.[20] They are similar to both the Exchange Act and the modern UCC. All three require a bill to be complete on its face and that the holder take it in good faith, for value, and without notice that it is overdue, dishonored, that there is defect in title of the negotiator, or that the instrument had any infirmity.[21] Under the Original Act holders in due course take instruments "free from defect of title of prior parties, and free from defenses available to prior parties among themselves."[22]

3. Drafts of Article 3

In 1944, NCCUSL and the American Law Institute (ALI) agreed to draft a new commercial code.[23] On April 10, 1946, the ALI published UCC, Tentative Draft No. 1—Article 3 along with comments and notes.[24] This was the first preliminary draft of Article 3 of the UCC that was available to the general public.[25]

a. Scope of Coverage

The drafters of the UCC felt that the most significant shortfall of the Original Act was its attempt to cover all negotiable instruments.[26] Unlike the Exchange Act, the Original Act governs all negotiable instruments.[27] Governing all negotiable instruments under one act created many problems, and critics of the act voiced their concerns. When criticism of the Original Act increased, NCCUSL responded by clarifying what instruments were to be treated as negotiable.[28] Postclarification critics continued to claim that the Original Act was ill suited to deal with problems presented by debt securities.[29] Critics also argued that the rigid requirements of the Original Act hampered the adoption of investment instruments.[30]

Another common condemnation of the Original Act was that its inflexibility left courts no room to recognize new types of short-term instruments that businesses may find desirable to treat as negotiable.[31] This was not a strong criticism of the Original Act. The drafters explained that no new type of instrument was pressed for recognition as negotiable between the adoption of the Original Act and the publication of the first draft of the UCC.[32]

b. No Other Promise

During ALI members' discussion of the tentative draft of Article 3 a new requirement for negotiable instruments received significant attention—that negotiable instruments contain no other promise, order, obligation, or power except as authorized by Article 3.[33] Anticipating this reaction, William L. Prosser stated in his opening remarks that Article 3 was designed to be a "tight statute."[34] Not all instruments treated as negotiable at the time Article 3 was drafted were intended to be covered by the Article.[35] Prosser explained there were good reasons for each of the requirements of negotiability and that they all must be met.[36] For this reason the drafters rejected "negotiability by contract," as a "highly undesirable thing."[37]

c. Narrowing Negotiability

The drafters believed the narrow scope of Article 3 was justified in light of the broad range of instruments covered by other articles.[38] Both investment instruments and documents of title were made negotiable by other articles.[39] The drafters recognized that numerous notes in circulation would not be negotiable under the UCC.[40] In order to alter that outcome, they considered writing a provision in the Code that would allow courts or other statutes to declare instruments negotiable.[41] This was quickly dismissed by the drafters because it reduced the utility of Article 3.[42]

Article 3, § 1 of Tentative Draft No. 1 defines the scope of the Article by describing which instruments were negotiable.[43] Most of the section's wording mirrors the Original Act.[44] Tentative Draft No. 1, however, narrowed the definition of "instrument."[45] Article 3 required that negotiable instruments contain a promise to pay a sum certain in money and no other promise, order, obligation, or power other than those authorized by Article 3.[46]

The conference proceedings from the 1946 Annual Meeting of the ALI illustrate that narrowing negotiability was not a warmly received change. The ALI members in attendance questioned whether instruments that had been customarily treated as negotiable would still be negotiable under Article 3.[47] They protested that the narrow scope of Article 3 would create significant commercial opposition to the act.[48] The drafters did not budge, insisting that promises other than those to pay a specified sum of money would make a note nonnegotiable.[49]

Narrowing the scope of negotiability was undeniably intentional. The drafters explicitly stated that their intention was to "clean up" negotiable instruments because they were becoming increasingly longer.[50] The drafters sought to eliminate "cluttered paper containing additional promises or orders."[51] While any instrument that met the requirements could be negotiable, the drafters believed that their definition was commonly satisfied only by "bills, checks, promissory notes, and certificates of deposit."[52] Thus the purpose of narrowing the scope of negotiability was to ensure that negotiable instruments were short, simple to identify, and easy to understand.

The drafters believed that narrowing negotiability would benefit the market. The change made it less likely that borrowers would have their defenses cut off by a holder in due course without knowing it.[53] It also made it easier for lending institutions to determine whether notes were negotiable so they could rediscount them.[54] The drafters touted the advantages of "certainty, simplicity, and predictability," deeming these to far outweigh "all that can be said in favor of permitting the contracts or practices of special groups to elevate" nonnegotiable paper.[55]

During the ALI members' discussion of "cluttered paper," Prosser described his conversations with bankers, noting incongruous views of negotiability within the same bank:

> I have done a good deal of talking to bankers in Minneapolis, which admittedly is not representative of the entire country, but I find a curious divided personality upon the part of bankers.
>
> The loan desk and the collection man and the attorney who is charged with enforcing collections, are all in favor of getting as much into the paper as possible, and they are not interested in negotiability. They say frankly that if the clause is in the negotiable instrument and it has the sanctity of the negotiable instrument attached to it, you can show it to the debtor and say, "You signed it, whether you know it or not," and he is thereby deferred from litigation and his attorney is deferred from contesting the case, and that is not true if you have the clause in a collateral agreement.
>
> On the other hand, the discount desk, the man who is called upon to take the instrument and loan money on it, and unfortunate counsel who has to look at it and determine whether it is negotiable (which is the position that I myself have been in), indulge in profanity about the whole business and want the paper cleaned up and simplified.[56]

The drafters' plan to clean up commercial paper was to have lenders take simple promissory notes that stated that they were made pursuant to a collateral agreement.[57] The collateral agreement would contain all of the clauses and disclaimers that, at the time, were in notes.[58] So long as the note was not subject to the collateral agreement, the agreement would pose no threat to the note's negotiability.

Typically, instruments and documents drawn and issued simultaneously are construed as one document in the hands of the original payee. The drafters intended instruments to be "couriers without luggage," able to pass to a holder in due course free from the other documents.[59] Thus, as long as the note operates independently of the collateral agreement, the note may still be negotiable.

It was thought that using a combination of note and collateral agreement would promote market efficiency because any lender who rediscounted a note would only need to study the collateral agreement once to determine if every "cleaned up" note made by the lender was negotiable.[60] During the 1946 ALI meeting Prosser explained that lengthy notes were frequently treated as negotiable, causing difficultly for lenders and their legal counsel.[61] Even after careful study of lengthy notes, counsel frequently could not give a decisive opinion as to the note's negotiability.[62]

This explanation received mixed reactions. Generally, members thought that cleaning up negotiable paper was a good and necessary plan to enable negotiable instruments to pass through the market with ease.[63] However, there was fear that the proposed changes would eliminate the negotiable status of many instruments in circulation in 1946 that were treated as negotiable.[64] ALI members suggested that mortgages attached to real estate, automobiles, chattel mortgages, conditional sales agreements, and bailment leases would no longer be negotiable.[65]

The drafters agreed that those instruments might not be negotiable under Article 3, but they believed those documents would be covered by the chattel security article, which they were still drafting.[66] The drafters were not persuaded to relax the scope of Article 3 to comport to either custom or practice.

4. Official Versions and State Adoptions

In 1951, the UCC drafting process culminated in the adoption of the 1952 Official Text by the ALI and NCCUSL. In 1953, Pennsylvania became the first state to formally adopt the UCC.[67] Most other states followed suit. New York, however, referred the UCC to the New York Law Revision Commission (Commission) for study and recommendation.[68] The Commission held public hearings.[69] In 1955, the Commission published a section-by-section analysis of the 1952 Official Text.[70] The following year, the Commission issued its final report, with extensive suggestions for revision of the UCC.[71]

The Commission substantially influenced the 1957 Official Text of the UCC.[72] For instance, the 1952 Official Text included a provision describing good faith as "including observance of reasonable commercial standards of any business in which the holder may be engaged."[73] The

Commission argued that this language created an objective test for good faith inconsistent with New York law. They sought to maintain a subjective test for good faith based on the honesty in fact of the holder of a negotiable instrument without the additional requirement that a holder act in accord with reasonable commercial standards.[74] The 1957 Official Text deleted the reasonable commercial standards clause, making it easier for a holder to qualify as a holder in due course.[75]

5. Expansion in Application of Holder in Due Course Rule

In the 1990s the drafters expanded the universe of negotiable instruments under the UCC in response to uncertainty about whether holder in due course protection applied to variable rate loans. Variable rate loans allowed creditors to engage in more complicated risk-based pricing than with their fixed-rate counterparts. This resulted in credit being extended to individuals who were previously "priced out" of credit markets. Borrowers that defaulted on these variable-rate notes attacked the notes' negotiability in an attempt to prevent note holders from asserting status as holders in due course. These borrowers claimed that variable interest rates prevented notes from stating a sum certain as required by U.C.C. § 3-104.

Under the pre-1990 revisions of Article 3, courts were split on whether notes payable at a rate of interest that could not be determined on the face of the note did not state a "sum certain."[76] Many courts held that variable interest rates prevented notes from being negotiable, in whole or in part.[77] Others held that variable interest rates did not prevent a note from being negotiable.[78] The drafters of the 1990 revisions settled this conflict by rejecting court decisions that held that variable-rate notes did not state a sum certain.[79] This rejection is codified in modern U.C.C. § 3-112(b), which expressly authorizes negotiable instruments to use variable interest rates in calculating the amount due on the note.

6. Historical Policy Justifications

Although negotiability and holder in due course are key components of the UCC, there was little discussion of policy justifications for these provisions in the comments and notes to UCC drafts and the transcripts of ALI proceedings. As described above, the drafters' stated purpose was to narrow the scope of negotiability by drafting a "tight statute" to "clean up" negotiable paper and eliminate "cluttered paper" from the realm of negotiability.[80]

The holder in due course section, § 40 of Tentative Draft No. 1, was never discussed at the 1946 meeting. Instead, the focus was on how other sections would prevent someone from achieving holder in due course status.[81] These discussions illustrate that the drafters believed that the benefit or advantage of negotiability is the note holder's ability to cut off claims and defenses to an instrument. Thus, while negotiability and holder in due course are separate legal terms, the two are closely connected. The primary advantage of holding a negotiable instrument is the potential to become a holder in due course of that instrument.

The only justifications given for cleaning up negotiable paper were encouraging its efficient use and promoting its painless circulation. As recounted above, the drafters sought to relieve the "difficulty," "trouble," and "headaches" banks and their legal counsel had in determining whether instruments were negotiable.[82] They considered as negotiable only "simple promises or orders without complications which are intended by the maker to circulate."[83]

In the late 1940s and early 1950s the drafters did not question the fundamental existence of negotiability or the holder in due course rule. They viewed their mission as updating the Original Act and resolving court conflicts. Grant Gilmore, a member of the drafting staff from 1948 to 1952, described the drafting of Article 3 as the Original Act "doubled in spades or negotiability *in excelsis*."[84] Commenting on Llewellyn's reverence for Lord Mansfield, Gilmore said: "As a general rule, anything—including negotiability—which was good enough for Lord Mansfield was good enough for Llewellyn."[85]

The drafters' reference to *Miller v. Race* in support of the negotiation of an instrument with good title to a holder in due course documents their pronegotiability stance.[86] Gilmore appreciated Lord Mansfield's legal ingenuity in establishing bills and notes as a supplement to official currencies. At the same time, Gilmore criticized the drafters of the UCC for failing to account for changes in the commercial environment: "[T]ime seems to have been suspended, nothing has changed, the late twentieth century law of negotiable instruments is still a law for clipper ships and their exotic cargoes from the Indies."[87]

B. U.C.C. § 3-302

Despite the murky policy justifications of the UCC drafters, the holder in due course rule is the most common shield used to defend against assignee liability. In order to acquire the status of a holder in due course, a person must meet the requirements of U.C.C. § 3-302(a), which reads as follows:

> Subject to subsection (c) and Section 3-106(d), "holder in due course" means the holder of an instrument if:
>
> (1) the instrument when issued or negotiated 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 was 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).

This section contains two prerequisites and six requirements that must be met to obtain status as a holder in due course. Section 3-302 also contains three exceptions to holder in due course status that are relevant in the context of home mortgage notes.

1. Prerequisites to Holder in Due Course Status

The prerequisites are, first, that the person be a holder; and, second, that the person hold an instrument.

a. Instrument

An "instrument" is defined by U.C.C. § 3-103(b) as a "negotiable instrument."[88] A negotiable instrument is defined by U.C.C. § 3-104(a) as "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" that also meets the other requirements in the section.[89]

b. Holder

The holder of an instrument is defined as someone who is either in possession of an instrument payable to bearer[90] or, if the instrument is payable to an identified person, the identified person in possession.[91] For example, the standard notes used by Fannie Mae and Freddie Mac require the borrower to pay an identified person.[92] Thus, to be a holder of standard Fannie Mae and Freddie Mac notes, the person in possession of the instrument must satisfy two conditions: the note had to have been indorsed by the prior holder and it had to have been delivered to the person in possession. This process is referred to as "negotiation,"[93] and it has been recognized as necessary for a person to assert holder in due course status.[94] In order to indorse a note, the current holder of the note must sign either the instrument itself or on an allonge (a paper so firmly affixed to the note that it becomes part of the note).[95]

The text of the UCC suggests that mere assignment of an instrument is not sufficient to make the assignee a holder. This is because when an instrument is assigned, it is not necessarily indorsed to the assignee. Courts have supported this interpretation. In a bankruptcy proceeding, one court held that assignment alone does not make the note owner a holder in the absence of indorsement and delivery to the person currently in possession.[96] Other courts have held that when the indorsements are on another paper not firmly affixed to the note itself, there has been no valid indorsement.[97] A few courts have even held that indorsement on an allonge affixed to the note is not sufficient when there is room to place the indorsement on the note itself.[98]

2. Exceptions to Holder in Due Course Status

There are three exceptions to holder in due course status relevant in the context of secondary market lenders purchasing home mortgage notes. First, U.C.C. § 3-302(c) states that a person cannot become a holder in due course of an instrument as long as that instrument was taken outside the ordinary course of business unless the predecessor in interest was a holder in due course.[99] As noted in comment 5 to U.C.C. § 3-302, this section is intended to cover situations where a purchaser takes an instrument under unusual circumstances. The implication is that holder in due course status is only meant to protect ordinary, regularly occurring transactions.[100]

Second, U.C.C. § 3-302(b) discusses the situation where the holder of the instrument in question has notice that a party's obligation to pay has been discharged, but not through an insolvency proceeding.[101] As a general rule, mere discharge of the obligor is not a defense to holder in due course status.[102] However, if the holder took the instrument with notice of the obligor's discharge, that discharge is effective against the holder.[103]

Finally, U.C.C. § 3-302(g) subjects instruments to any law limiting status as a holder in due course in particular classes of transactions. This includes the Federal Trade Commission rule preserving consumer claims and defenses in consumer goods and services transactions, discussed below.

3. Protection Gained by Achieving Holder in Due Course Status

Becoming a holder in due course affords the holder significant protection from legal defenses of the obligor and any other claims to the instrument. Holders in due course are not subject to any defenses discussed in Article 3 besides those listed in U.C.C. § 3-305(a)(1), discussed below.[104]

Moreover, holders in due course are not subject to claims in recoupment or any defenses to simple contracts that are not mentioned in U.C.C. § 3-305(b).[105] Such defenses include failure of consideration, fraud in the inducement, breach of warranties, misrepresentation, mistake, unjust enrichment or violations of unfair or deceptive acts and practices, and predatory lending statutes to the extent that they do not nullify the obligation. Finally, a holder in due course takes an instrument free and clear of all other claims of ownership of the instrument.[106]

Section 3-305(b) makes the right of a holder in due course to enforce an instrument, subject to the enumerated defenses in listed in U.C.C. § 3-305(a)(1). The first subsection establishes infancy as a defense obligors may assert against a holder in due course, but only to the extent that it is a defense to a simple contract.[107] According to the comment, the policy behind this defense is to protect the infant, even at the expense of occasional loss to an innocent purchaser.[108] This limiting language recognizes that the effectiveness of infancy as a defense to a simple contract varies from jurisdiction to jurisdiction.[109]

The second subsection establishes a group of defenses effective against a holder in due course when the note is signed by an adult with knowledge of the note's terms. It makes defenses of duress, lack of legal capacity, or illegality of the transaction effective against a holder in due course.[110] This section covers a broad range of possible defenses,[111] while still giving power to individual jurisdictions to determine what will be included.[112] These defenses are limited because they are only good against a holder in due course to the extent that they completely nullify the obligation of the obligor. This is especially apparent in the duress defense, where an instrument signed at the point of a gun is void, while one signed under threat to prosecute the son of the maker for theft may merely be voidable.[113]

The third subsection establishes another defense effective against a holder in due course: fraud that induced the obligor to sign the instrument with neither knowledge nor reasonable opportunity to learn of its character or its essential terms.[114] The language "with neither knowledge nor reasonable opportunity to learn of its character or its essential terms" is extremely limiting, allowing a very narrow spectrum of fraud claims.[115] The theory of the defense is that the signature on the instrument is ineffective because the signer did not intend to sign such an instrument at all.[116] This defense also extends to an instrument signed with knowledge that it is a negotiable instrument, but without knowledge of its essential terms. However, it is only available when the obligor had no reasonable opportunity to discover the terms of the note.[117] This defense will likely never arise in the context of home mortgage loans because of federal disclosure statutes.[118]

The fourth and final subsection establishes discharge in insolvency proceedings as a defense effective against a holder in due course.[119] Insolvency proceedings are defined in Article 1 of the UCC[120] and include bankruptcy whether or not the debtor is insolvent.[121]

5. Shelter Rule

Even if an assignee does not qualify as a holder in due course, the assignee may derive some protection from a prior holder in due course pursuant to U.C.C. § 3-203(b). The shelter rule vests the rights of the transferor to enforce an instrument in the transferee of the instrument.[122] This is true even when the instrument was not properly negotiated to the new holder.[123] Thus, if the transferor was a holder in due course, the transferee of the instrument can assert status as a holder in due course so long as the transferee did not engage in any fraud or illegality affecting the instrument.[124]

6. Modern Policy Justifications

Modern policy justifications for negotiability and the holder in due course rule differ from those offered by Lord Mansfield. Lord Mansfield established negotiability and protected good faith purchasers of bank notes and bills of exchange to satisfy the need for currency and facilitate commerce. Bank notes and bills supplemented the inadequate money supply. Today, bills and promissory notes are no longer needed as a money substitute to pay debts. Current financial systems provide many means of payment, including paper money, checks, wire transfers, and other means of electronic payment. Therefore, the policy supporting negotiability offered by Lord Mansfield is no longer relevant.

Although modern courts and commentators sometimes pay tribute to Lord Mansfield, their rationales for negotiability and the holder in due course rule differ from Lord Mansfield's. The Supreme Court of Appeals of West Virginia considered the availability of consumer credit in the context of a claim that the assignee of an automobile note was liable to the borrower for fraud committed by the note's originator:

> Credit, for better or worse, is the lifeblood of our consumer economy. The need to make credit more readily available was a driving force behind the creation of the *Uniform Commercial Code* as well as the great strides made earlier by Lord Mansfield at the end of the 18th century and transplanted wholesale into our law in the 19th century. The ability of negotiable commercial paper to flow nationwide without regard to local conditions allows all business, no matter how small or remote, access to nationwide capital

> markets. The main reason for this free flow of commercial paper is the "holder in due course" provisions contained in W.Va. Code 46-3-305 that permit a purchaser who, in good faith, purchases a negotiable instrument and gives value for it without notice of any defense against it or claim to the instrument, to take the instrument free from virtually all defenses.[125]

One commentator summed up the rationale for negotiability as follows: "The availability of relatively inexpensive credit, which our society depends on, is in large part the result of the principle of negotiability."[126]

Today, promoting the availability of credit and reducing the cost of credit are the primary policy justifications for negotiability and the holder in due course rule. In early 2008 New York legislators proposed laws to subject assignees of nonconventional mortgage loans to claims and defenses borrowers could assert against the originating lender. During hearings on the proposed legislation, the president of the Mortgage Bankers Association testified:

> MBA respectfully submits that the extension of [assignee liability]... will in all likelihood eliminate massive volumes of lending... and clearly curtail access to much needed credit for a large segment of borrowers in New York.... The MBA wants to underscore the importance of innovation in making credit opportunities available to consumers. MBA believes that borrower choice lowers costs and should be protected. The imposition of overreaching standards risks undermining our hard won gains in the areas of homeownership and reaching underserved borrowers. It will take away consumer choice as well as access to affordable mortgage credit.[127]

Other policy reasons used to support the negotiability and protection of holders in due course include encouraging commerce,[128] facilitating the flow of capital,[129] reducing transaction costs,[130] maintaining liquidity,[131] increasing certainty,[132] and promoting product innovation.[133] However, increasing the availability of credit and decreasing the cost of credit are the dominant policy reasons offered in contemporary debate to support negotiability and holder in due course.

III. OTHER LAWS LIMIT HOLDER IN DUE COURSE PROTECTION

Despite the rationales espoused in support of the holder in due course rule, laws outside the UCC limit the protection afforded holders in due course. This originally occurred in the context of consumer goods through state court decisions and rulemaking by the Federal Trade Commission. Subsequent federal legislation established assignee liability for violations of disclosure requirements for most consumer credit transactions. More recently, federal legislation imposed assignee liability for high-cost mortgage loans. Today, states and courts have taken a more active role in allowing claims and defenses to be asserted against assignees of home mortgage notes.

A. Consumer Goods Transactions

1. State Court Decisions and Legislation

Beginning in the 1940s, state courts responded to perceived inequities arising out of the application of the holder in due course rule to consumer goods transactions. Some courts refused to apply the holder in due course rule on public policy grounds. In *Mutual Finance Company v. Martin*, the Florida Supreme Court concluded "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."[134]

Other courts reached equitable results within the parameters of the holder in due course rule. In *Commercial Credit Company v. Childs*, the Arkansas Supreme Court denied holder in due course status because the assignee of note was:

> [S]o closely connected with the entire transaction... that it can not be heard to say that it, in good faith, was an innocent purchaser of the instrument for value before maturity... Rather than being a purchaser of the instrument after its execution it was to all intents and purposes a party to the agreement and instrument from the beginning.[135]

Similarly, in *Morgan v. Reasor Corporation*, the California Supreme Court held that a finance company did not qualify as a holder when it possessed "knowledge of facts sufficient to put a reasonable man on... notice that a violation of [law] was a likelihood if not a certainty."[136] The court also stated policy reasons underlying the "closely connected" rationale for setting aside the holder in due course rule: "To the extent that the finance company has a close association with the seller, it is in a better position to discover and police the legality of the seller's contracts with the buyer."[137]

Finally, some courts focused on the technical requirements of holder in due course status. In *Geiger Finance Co. v. Graham*, the Georgia Court of Appeals denied an assignee holder in due course status, holding that a retail installment contract was not a negotiable instrument and allowed the defense of failure of consideration to be raised. The court saw the danger of treating conditional sales contracts as negotiable instruments in consumer transactions:

> 'Conditional sales contracts are invariably written by sellers and finance companies for sellers and finance companies. They are often printed in unconscionably small type and presented to the buyer as a mere formality. * * * The seller is usually justified in believing either that the buyer will not read the contract at all or will not understand it if he does wade through it. Even were the buyer to read and comprehend the avalanche of legal consequences which would greet any default on his part, * * * on the installment plan he must sign one conditional sales contract or another, and they are all pretty much alike. It is against this background that we must view the plight of (a buyer) who staggers into a contract which could make him liable to pay the full price * * * to a finance company, with which he has not dealt directly, even though the vendor sells him a defective article' (or fails to perform the service). 'The average citizen, and particularly the financially unimportant, (is) no more likely to know the law of negotiable paper * * * than the holding in Shelly's Case.'[138]

The court supported its holding by explaining the policy reasons behind protecting holders in due course:

> [T]he courts need not stand impotent while two-page, finely printed 'contracts' are circulated as freely as currency. While Justice Gibson's famous 'courier without luggage' may be an unobtainable ideal for most notes, allowing him to carry a bag or two does not mean that one who trucks furniture from place to place is a 'courier,' no matter what else he might legitimately be. The protections offered a holder in due course were evolved by merchants, bankers and lawyers to facilitate the rapid flow of true commercial paper. The drafters of the U.C.C. (and our legislature by its adoption) were careful to limit the type of instrument which would carry the powerful magic of negotiability under Article 3. Although theoretically possible, a retail installment contract, or conditional sale-contract (or a writing of this nature by whatever name) is not usually a note as defined in [U.C.C. § 3-104]. Where there is any doubt, the presumption is against negotiability.[139]

While courts were finding reasons to nullify holder in due course status in consumer goods transactions, legislatures were passing consumer protection laws. By 1975, 40 states had enacted laws limiting holder in due course in consumer goods and services transactions.[140] Some of these state statutes render holder in due course principles inapplicable to the vast majority of consumer credit sales. Other state statutes preserve consumer defenses against a creditor raised during a specified period of time after the purchase of financed consumer goods or services.

2. FTC Holder Rule

In 1975, the Federal Trade Commission (FTC) promulgated its rule preserving consumer claims and defenses (FTC Holder Rule), based on its authority to prohibit unfair or deceptive acts or practices.[141] At the time the FTC Holder Rule was passed, credit sellers of consumer goods commonly used retail installment sales contracts.[142] Such contracts would either be sold as instruments or used as security for lines of credit. Purchasers became holders in due course, shielded from any defenses that may have arisen in the underlying consumer goods transaction.[143] The FTC found it was unfair when sellers arranged consumer credit such that it separated a buyer's duty to pay from a seller's duty to perform as promised.[144]

The primary policy consideration behind the FTC Holder Rule was the optimal distribution of costs associated with seller misconduct in credit sale transactions.[145] The FTC believed that reallocating the cost of seller misconduct to creditors who were financing the sales of consumer goods would decrease seller misconduct because creditors would police the practices of sellers.[146] Even without policing, creditors were viewed as better able to bear the risk of seller misconduct.[147]

In this context, the FTC viewed the holder in due course rule as abnormal:

> The rule is directed at what the [FTC] believes is an anomaly...
>
> ....
>
> While the principles articulated in *Miller v. Race* have validity in commercial exchanges and transfers, their application to consumer credit sales is anomalous. Consumers are not in the same position as banks, bond issuers, or shippers of freight; nor are they in an equivalent position to vindicate their rights as a payee. The considerations which underpin the laws of negotiability have little or no application in consumer transactions...
>
> ....
>
> The insulation obtained by creditors in consumer transactions is the product of an inappropriate application of legal principles developed by and for merchants and bankers.[148]

Characterization of the holder in due course rule as an anomaly supports the FTC's conclusion that abrogation of consumer claims and defenses is unfair to consumers. The FTC Holder Rule eliminates the anomaly by nullifying holder in due course status in consumer goods transactions. Thus the rule ties the buyer's duty to pay to the seller's duty to perform even when the right to receive payment from the buyer is assigned.

Debate over the FTC Holder Rule prompted predictions of dramatic reductions in the availability of consumer credit to purchase goods and services. Federal Reserve Chairman Arthur Burns predicted the consumer-credit business would be "seriously disrupted" by the FTC Holder Rule.[149] However, these predictions were overstated. Two UCC experts concluded that the FTC Holder Rule "caused some adjustments in the market, largely unseen, but it surely has not had the catastrophic impact upon consumer market that some predicted."[150] The FTC reached a similar conclusion when it reviewed the impact of its rule in the early 1990s.[151]

B. Truth in Lending Act

Even before the FTC Holder Rule, Congress recognized that consumers often could not easily comparison shop for credit. Congress expanded consumer protection to reach most consumer credit transactions by enacting the Truth in Lending Act (TILA) in 1968. Congress declared that TILA's purpose was to enhance economic stability, strengthen competition, and avoid the uninformed use of credit.[152] The Department of Housing and Urban Development (HUD) and the Board of Governors of the Federal Reserve System (Board) stated that "TILA is intended to promote informed use of consumer credit by requiring disclosures about its terms and cost."[153] TILA requires lenders to disclose the finance charge[154] on the loans as well as the annual percentage rate (APR).[155]

Prior to TILA, lenders were able to advertise loan rates that were calculated via one of several methods.[156] Each of these methods significantly changes the cost of credit, despite the same interest rate being advertised.[157] Thus, prior to TILA, there was no meaningful way for consumers to shop and compare loans. The reason TILA requires firm, comparable quotes is because they promote shopping and competition.[158] This implements TILA's stated purpose of strengthening the informed use of credit.[159]

TILA provides for assignee liability, though the liability is very limited. Two conditions must be satisfied before an assignee is liable. First, the violation alleged against an assignee must be a TILA violation. TILA does not subject assignees to claims and defenses arising under other statutes or out of common law, including those that may be raised in predatory lending contexts, such as fraud, failure of consideration, and misrepresentation.

Second, the TILA violation must be apparent on the face of the disclosure statement. If the documents for a loan in violation of TILA are filled out incorrectly (or fraudulently), there would be no violation apparent on the face of the disclosure statement.[160] This limited assignee liability arguably encourages loan-shopping while staying consistent with Board and HUD recommendations, which state that substantive protections do not "unduly [interfere] with the flow of credit, [create] unnecessary creditor burden, or [narrow] consumers' options in legitimate transactions."[161]

C. Real Estate Transactions

Reports of abusive lending practices became more frequent in the 1990s and early 2000s.[162] Federal and state governments responded by passing legislation that created assignee liability. Unlike previous legislation, these statutes focused on abrogating the protections offered by the holder in due course rule in home mortgage loan transactions.

1. Home Ownership and Equity Protection Act

The Home Ownership and Equity Protection Act of 1994 (HOEPA) amends TILA and strictly regulates certain nonpurchase-money, high-cost mortgage loans.[163] HOEPA prohibits potentially abusive terms in high-cost mortgage loans and requires additional disclosures to accompany such loans.[164]

In order to ensure that the "high-cost mortgage market policed itself," the Senate imposed assignee liability for violations of HOEPA.[165] Home mortgage loans are sold to secondary market lenders on a regular basis. Recognizing this fact, the Senate realized one unscrupulous lender had the ability to "cause havoc" on the lending community as a whole.[166] Providing assignee liability halts the flow of capital to such lenders.[167] Anticipating critics of expanded assignee liability, the Senate noted that HOEPA is meant to mirror the FTC Holder Rule, which did not "significantly restrict the flow of consumer credit or interfere with the securitization of auto loans."[168]

HOEPA adopted two assignee liability schemes, one based on strict liability and one based on negligence.[169] If the loan violates HOEPA, the borrower is given the right to rescind the loan.[170] This right runs against assignees of the loan and is a strict liability standard because it requires no proof of conduct besides holding a loan that violates HOEPA.[171] The assignee would be strictly liable simply for holding a loan that violates HOEPA. However, the only remedy available under this strict liability scheme is rescission. Damages of any kind are not available.

HOEPA also makes assignees of "high-cost" loans subject to all claims and defenses that the consumer could assert against the originating lender.[172] It expands on the previous assignee liability under TILA because it subjects assignees to all claims and defenses, not merely those arising under TILA or HOEPA.[173] However, assignees will not be liable under HOEPA if they demonstrate "that a reasonable person exercising ordinary due diligence could not determine, based on the documentation required by [HOEPA], the itemization of the amount financed and other disclosure disbursements, that the [loan was a high-cost loan.]"[174] Thus, assignees that intentionally or negligently purchase high-cost HOEPA loans will be liable for non-HOEPA claims and defenses.

Under the HOEPA's negligence theory of liability, recovery is limited based on the claim or defense asserted. Recovery against assignees for HOEPA violations is limited to statutory damages.[175] Recovery for all non-HOEPA claims and defenses is limited to the amount of the indebtedness plus the amount paid by the consumer in connection with the transaction.[176] Thus it is possible that a successful HOEPA suit that also involves a non-HOEPA claim will relieve borrowers of everything owed on the loan and result in statutory damages.

The applicability of HOEPA's assignee liability provisions is limited in two ways. First, HOEPA does not apply to purchase-money mortgages.[177] This limitation exists because at the time HOEPA was passed, evidence indicated that high-rate lenders were using nonpurchase-money mortgages to strip equity from low-income homeowners.[178]

Second, HOEPA only applies to "high-cost" home mortgages.[179] "High-cost" mortgages are defined using price triggers. If the cost of credit exceeds those triggers, HOEPA applies to the loan. Thus loans can be made at high rates while avoiding HOEPA coverage.[180] Although HOEPA triggers were lowered in 2001, they can still be avoided by pricing credit just below the triggers.[181] Thus, despite HOEPA expanding assignee liability beyond TILA, the reach of HOEPA protection is significantly limited.

By its explicit terms, HOEPA only applies to certain nonpurchase-money, high-cost mortgage loans. However, the Board has the authority under HOEPA to prohibit acts or practices in connection with all mortgage loans if the Board finds the practice to be unfair, deceptive, or designed to evade HOEPA.[182] The Board has acknowledged this authority: "The act provides that the Board shall prohibit practices... [i]n connection with all mortgage loans if the Board finds the practice to be unfair, deceptive, or designed to evade HOEPA."[183] The Board recently exercised this authority by prohibiting several practices with respect to all credit secured by a consumer's principal dwelling, but it did not alter the application of the holder in due course rule to such credit.[184]

2. State Mini-HOEPA Laws

Many state[185] legislatures further expanded assignee liability through the enactment of mini-HOEPA laws. These state laws create categories of "high-cost" or "covered" mortgages similar to HOEPA. Many of these laws make certain categories of home-mortgage-note assignees liable on the notes. Numerous states cite reasons for enacting these regulations that are similar to the policy justifications for HOEPA itself.[186] States still feel that aspects of the home-mortgage-loan industry are under-regulated, the borrowers at the most risk are offered little protection, and further regulation is necessary for economic stabilization.[187]

Twenty-three of the 32 states with mini-HOEPA laws provide assignee liability on covered loans. Nonetheless, there is significant variation among assignee liability provisions. These variations fall into two categories: (1) the universe of loans covered by the law and (2) the extent to which holder in due course is abrogated. Over three-fourths of the mini-HOEPA laws cover more loans than HOEPA, which expands the reach of their assignee liability provisions relative to HOEPA. Most states have expanded HOEPA coverage by lowering the equivalent of their "rate trigger," the "points and fees trigger," or both. Some states expand the definition of what needs to be included in calculating the APR or total points and fees. Over one-fifth of the statutes do not expand coverage at all.

The extent of holder in due course abrogation varies in numerous ways. Just over half of the state laws create the same broad assignee liability as HOEPA, usually with a similar "due diligence" safe harbor. Many of these "HOEPA" states add a new dimension to assignee liability by restricting the amount of time in which claims may be affirmatively asserted by borrowers as an original action. The remaining state laws limit assignee liability to all claims and defenses arising under the chapter of the state law. Some of those "TILA" states limit assignee liability to select violations arising under the chapter.

IV. CONCLUSION

This paper raises a fundamental policy question: Is there reason to support the continuing availability of holder in due course protection for assignees of home mortgage notes? The answer to this question can be approached from a number of perspectives, including historical, economic, social, and political. This paper approaches the answer from the historical perspective.

It is important to recognize that the holder in due course rule departs from the usual rule for assignment of contracts under which the assignee "stands in the shoes" of the assignor. Under ordinary circumstances, the claims and defenses of the obligor of a home mortgage note that are valid against the assignor are valid against the assignee. However, an assignee who qualifies as a holder in due course acquires rights superior to those of an assignor. Most claims and defenses valid against the assignor of a home mortgage note are not valid against a holder in due course. There should be good public policy reasons to support this departure from ordinary contract law.

This historical overview suggests three reasons to reconsider the application of the holder in due course rule to home mortgage notes. First, the policy justifications for the rule have changed. Lord Mansfield established the rule to allow bank notes and bills of exchange to act as money substitutes in an economy without paper money when coin was in short supply. With this special status notes and bills could be used as a means of payment rather than solely as a means of funding credit transactions. There is no need for notes to act as a currency substitute in modern financial systems with their many efficient means of payment. Today, financial institutions use notes exclusively as a means of funding credit transactions rather than as currency substitutes. Thus the public policy reasons that once supported this rule no longer support a deviation from normal contract law.

Second, the parties to negotiable instruments changed due to the advent of consumer lending.[188] The 18th-century obligors of negotiable notes and bills were commercial parties. Those parties regularly issued negotiable notes knowing they circulated. Thus Mansfield established the holder in due course rule assuming that the parties to relevant transactions would be on relatively equal footing. Today consumers are mortgage note obligors. Consumers make notes on rare occasions to facilitate large purchases with little or no knowledge that the notes will circulate or understanding that circulation results in a loss of rights against the holders of the notes.

Commercial parties possess greater knowledge, bargaining power, and financial resources than consumers. Lawyers who draft home mortgage notes are quite cognizant of the meaning and consequences of the negotiable instruments drafted for their institutional clients. As the court observed in *Geiger*, the average home mortgage borrower is unlikely to know the law of negotiable paper.[189] Both the *Geiger* and *Martin* courts looked to additional differences between the parties—the consumer's lack of bargaining power and financial resources in financed transactions—to impose assignee liability.[190] Because the parties to home mortgage notes are on unequal footing, the basic assumptions underpinning the creation of the holder in due course rule do not support its application in this context.

Finally, the structure of the mortgage market has changed. The holder in due course rule was not utilized under the unified model of mortgage lending where a single lender solicited, underwrote, originated, funded, serviced, and retained home mortgage loans. Today the rule often applies because the multi-lender model divides these functions among many parties and home mortgage notes are frequently sold. In this new market the holder in due course rule discourages investigation of originator compliance with the law. The less assignees investigate, the less likely they are to discover a default, fraud, misrepresentation, or violation of law that would prevent them from becoming holders in due course. The holder in due course rule should be reconsidered because it operates in new markets and misaligns incentives.

The holder in due course rule has been eliminated in comparable consumer markets. The market for consumer goods and services operates with multiple parties performing specialized functions. Reports of abuses in this market caused the FTC to promulgate its rule preserving consumer claims and defenses in consumer goods and services finance transactions. The primary policy consideration behind the FTC Holder Rule was the optimal distribution of costs associated with seller misconduct in credit sale transactions.[191] Reallocating the cost of seller misconduct to creditors gives them incentive to police sellers.[192] Similar dynamics in the market for high-cost mortgages led the Congress to enact HOEPA.[193]

The reasoning supporting both the FTC Holder Rule and HOEPA can be applied to the broader consumer mortgage market. A number of the commentators call for abrogation of the holder in due course rule for home mortgage notes.[194] Even Federal Reserve Chairman Bernanke testified before a congressional committee in 2007 that a clearly delineated and limited expansion of assignee liability "might prove a useful adjunct" to other methods of addressing the problems in the home mortgage market.[195]

The primary conclusion that can be drawn from the historical review of assignee liability is that it is time to reconsider the application of the holder in due course rule to home mortgage notes. The policy justifications for negotiable instruments have changed. The parties to negotiable instruments have changed. The structure of the home mortgage market has changed.

These historical changes suggest the need for further analysis of the application of the holder in due course rule to home mortgage notes through the lens of economic theory and empirical study. In particular, further analysis is necessary of the economic incentives created by changes in market function, participants, and structure, as well as evaluation of the empirical research into the impact of state laws that expanded assignee liability on the cost and availability of credit. With those tools it would be possible to make a recommendation to policy makers regarding the continuing appropriateness of holder in due course protection for assignees of home mortgage notes.

NOTES

1. See Jacobides, Mortgage Banking Unbundling: Structure, Automation and Profit, 61 Mortgage Banking 28, (2001) (describing the recent changes in the structure of the mortgage lending industry); Eggert, Held up in Due Course: Predatory Lending, Securitization and the Holder in Due Course Doctrine, 35 Creighton L. Rev. 503, 552 (2002) (describing the atomization of the home mortgage lending market); Engel and McCoy, Turning a Blind Eye: Wall Street Finance of Predatory Lending, 75 Fordham L. Rev. 2039, 2045 (2007) (discussing the advent of securitization and explaining how securitization of home mortgage loans is accomplished); Peterson, Predatory Structured Finance, 28 Cardozo L. Rev. 2185, 2191-214 (2007) (describing the evolution of home mortgage markets).

2. See Peterson, Predatory Structured Finance, 28 Cardozo L. Rev. 2185, 2191-214 (2007).

3. See Peterson, Predatory Structured Finance, 28 Cardozo L. Rev. 2185, 2191-214 (2007).

4. This "legislative history" includes the common law and statutory predecessors to the UCC, public and initially confidential drafts of the UCC, discussions among the drafters at their meetings, the comments of drafters in legal publications and publications of the New York Law Revision Commission.

5. See Appendix A for 1990 version of U.C.C. §§ 3-302 and 3-305. The discussion of these sections is based on the 1990 version of Article 3 because it is most widely adopted version. Lawrence, Lawrence's Anderson on the Uniform Commercial Code Local Code Variations vii (3d ed. West 2007) (1994). All states except New York have adopted the 1990 amendments to Article 3. Lawrence, Lawrence's Anderson on the Uniform Commercial Code Local Code Variations vii (3d ed. West 2007) (1994).

6. 9 Corbin et al., Corbin on Contracts §§ 47.1 et seq., 51.1 (Joseph M. Perillo ed., rev. ed. Lexis 1993); Farnsworth, Farnsworth on Contracts §§ 11.1, 11.8 (3d ed. Aspen Publishers 2004). Rights and obligations under contracts may be assigned to other parties. Restatement Second, Contracts §§ 316 et seq.

7. These rights include property rights. An assigned claim of ownership is no greater in the hands of an assignee than it is of the assignor. This rule protects the obligor on the contract by ensuring assignment does not materially increase the obligor's risk. Restatement Second, Contracts §§ 316 et seq.

8. Miller v. Race, 1 Burr. 452, 457, 459, 97 Eng. Rep. 398, 401, 402A (K.B. 1758). The full text of this case is provided in Appendix B. See generally Nyquist, A Spectrum Theory of Negotiability, 78 Marq. L. Rev. 897, 955-961 (1995) (describing in detail the facts, procedure, counsel arguments, and opinion of the court), Rogers, The Early History of the Law of Bills and Notes (1995), and James Oldman, The Mansfield Manuscripts and the Growth of English Law in the Eighteenth Century (Chapel Hill and London 1992).

9. Peacock v. Rhodes, 2 Doug. 633, 636, 99 Eng. Rep. 402, 403 (K.B.1781).

10. "The holder of a bill of exchange, or promissory note, is not to be considered in the light of an assignee of the payee. An assignee must take the thing assigned, subject

to all the equity to which the original party was subject. If this rule applied to bills and promissory notes, it would stop their currency." Peacock v. Rhodes, 2 Doug. 633, 636, 99 Eng. Rep. 402, 403 (K.B.1781).

11. William H. Lawrence, Understanding Negotiable Instruments and Payment Systems 7 (Lexis 2002) (citation omitted):

> Throughout all of the eighteenth century, England did not have any official paper currency, and several denominations of gold and silver coins were in short supply. Increasing mercantile activities forced merchants to adopt money substitutes. Consequently, drafts and notes came to be circulated widely through several hands before ultimately being presented for payment or acceptance. Lord Mansfield decided two major cases that helped assure the acceptability of instruments as money substitutes. His rulings that a holder of a negotiable instrument who acquires it in good faith and for value takes free of the claim of a prior owner of the instrument state the fundamental principle of negotiability.

Eggert, Held Up in Due Course: Codification and the Victory of Form Over Intent in Negotiable Instrument Law, 35 Creighton L. Rev. 363, 391 (2002) (citation omitted):

> Negotiable bills and notes were critical to the expanding English and American economies because there was not sufficient currency in circulation to give substance to all of the transactions of those economies. There was no issuance of paper money that was legal tender until the time of the Civil War, and before then, the only legal tender currency was specie, or coins made of precious metals. It was the importance of this use as currency that convinced the common law judges to give bills and notes the various aspects of negotiability so as to maximize their transferability.

See also Gilmore, Formalism and the Law ofNegotiable Instruments, 13 Creighton L. Rev. 441, 447-48, 452 (1979); Sinclair, Codification of Negotiable Instruments Law: A Tale of Reiterated Anachronism, 21 U. Toledo L Rev, 625, 634-35 (1989); Miller and Harrell, The Law of Modern Payment Systems and Notes 2-3 (2d ed. 1992).

12. William H. Lawrence, Understanding Negotiable Instruments and Payment Systems 7 (Lexis 2002).

13. Bills of Exchange Act, 1882, 45 & 46 Vict. C. 61, §§ 29, 38 (1882). See Appendix A.

14. Peacock v. Rhodes, 2 Doug. 633, 636, 99 Eng. Rep. 402, 403 (K.B. 1781).

15. Compare U.C.C. § 3-302 (1990) and Bills of Exchange Act, 1882, 45 & 46 Vict. C. 61, § 29 (1882). See Appendix A.

16. Bills of Exchange Act, 1882, 45 & 46 Vict. C. 61, § 38(2) (1882). See Appendix A.

17. For discussion of the minor role played by negotiability in case law preceding the adoption of the Uniform Negotiable Instruments Law, see Rogers, The Myth of Negotiability, 31 B.C. L. Rev. 265 (1990).

18. Commercial Code Comments and Notes to Tentative Draft No. 1—Article 3, 7 (American Law Institute 1946), reprinted in 2 Uniform Commercial Code: Drafts 317 (Elizabeth Slusser Kelly ed. 1984). Uniform Negotiable Instruments Law (1896), even parroted some of the language of the Bills of Exchange Act. Compare Bills of Exchange Act, 1882, 45 & 46 Vict. C. 61, § 38(2) (1882). to Uniform Negotiable Instruments Law § 57 (1896).

19. Commercial Code Comments and Notes to Tentative Draft No. 1—Article 3, 7 (American Law Institute 1946), reprinted in 2 Uniform Commercial Code: Drafts 317 (Elizabeth Slusser Kelly ed. 1984).

20. Uniform Negotiable Instruments Law § 52 (1896). See Appendix A.

21. See Uniform Negotiable Instruments Law § 52 (1896), Bills of Exchange Act, 1882, 45 & 46 Vict. C. 61, § 29 (1882), and U.C.C. § 3-302 (1990). See Appendix A.

22. Uniform Negotiable Instruments Law § 57 (1896). See Appendix A.

23. Schnader, A Short History of the Preparation and Enactment of the Uniform Commercial Code, 22 U. Miami L. Rev. 1, 3 (1967).

24. Commercial Code Comments and Notes to Tentative Draft No. 1—Article 3, 5 (American Law Institute 1946), reprinted in 2 Uniform Commercial Code: Drafts 315 (Elizabeth Slusser Kelly ed. 1984).

25. It was used by the Reportorial Group during their successive conferences over the preliminary drafts of Article 3. It was also used during the review of the Proposed Tentative Draft submitted by the Reportorial Group to the Council of the American Law Institute (ALI) at its meeting on March 19-22, 1946. The Reporters for the drafts were William Prosser, Karl Llewellyn, and Soia Mentschikoff. Commercial Code, Proposed Tentative Draft No. 1—Article 3, reprinted in 2 U.C.C. Confidential Drafts 365 (Elizabeth Slusser Kelly & Ann Puckett eds. 1995).

26. 1946 ALI Annual Meeting Proceedings, discussion of Commercial Code, Tentative Draft No. 1—Article 3, printed in 23rd A.L.I. Proc. 95-96 (1946), and Commercial Code Comments and Notes to Tentative Draft No. 1—Article 3, 7 (American Law Institute 1946), reprinted in 2 Uniform Commercial Code: Drafts 317 (Elizabeth Slusser Kelly ed. 1984) (discussing the problems encountered under the Original Act).

27. 1946 ALI Annual Meeting Proceedings, discussion of Commercial Code, Tentative Draft No. 1—Article 3, printed in 23rd A.L.I. Proc. 95-96 (1946), and Commercial Code Comments and Notes to Tentative Draft No. 1—Article 3, 7 (American Law Institute 1946), reprinted in 2 Uniform Commercial Code: Drafts 317 (Elizabeth Slusser Kelly ed. 1984) (discussing the problems encountered under the Original Act). The Exchange Act only governed bills of exchange, checks, and promissory notes per Bills of Exchange Act, 1882, 45 & 46 Vict. C. 61, §§ 3, 73, 89 (1882). See Appendix A.

28. Commercial Code Comments and Notes to Tentative Draft No. 1—Article 3, 8 (American Law Institute 1946), reprinted in 2 Uniform Commercial Code: Drafts 318 (Elizabeth Slusser Kelly ed. 1984). The Commissioners promulgated separate acts covering bills of lading and warehouse receipts, which made it clear that documents of title were not to be included among negotiable instruments. Commercial Code Comments and Notes to Tentative Draft No. 1—Article 3, 8 (American Law Institute 1946), reprinted in 2 Uniform Commercial Code: Drafts 318 (Elizabeth Slusser Kelly ed. 1984). Similarly, they proposed the Uniform Stock Transfer Act to clarify that stock certificates were not negotiable instruments. Commercial Code Comments and Notes to Tentative Draft No. 1—Article 3, 8 (American Law Institute 1946), reprinted in 2 Uniform Commercial Code: Drafts 318 (Elizabeth Slusser Kelly ed. 1984).

29. Commercial Code Comments and Notes to Tentative Draft No. 1—Article 3, 8 (American Law Institute 1946), reprinted in 2 Uniform Commercial Code: Drafts 318 (Elizabeth Slusser Kelly ed. 1984). See also 1946 ALI Annual Meeting Proceedings, discussion of Commercial Code, Tentative Draft No. 1—Article 3, printed in 23rd A.L.I. Proc. 96 (1946).

30. The criticism that the Original Act suppressed the use of securities came to a head in President and Directors of Manhattan Co. v. Morgan, 242 N.Y. 38, 150 N.E. 594 (1926). In *Manhattan*, the court held that interim certificates requiring the delivery of bonds were not negotiable because they were not payable in money (as required by

§ 1 of the Original Act). Commercial Code Comments and Notes to Tentative Draft No. 1—Article 3, 8 (American Law Institute 1946), reprinted in 2 Uniform Commercial Code: Drafts 318 (Elizabeth Slusser Kelly ed. 1984). This holding resulted in the passage of the Hofstander Act of 1926, 8 N.Y. Personal Property Law §§ 260-62 (1926, repealed 1964), which was geared towards dealing separately with investment instruments. Commercial Code Comments and Notes to Tentative Draft No. 1—Article 3, 8 (American Law Institute 1946), reprinted in 2 Uniform Commercial Code: Drafts 318 (Elizabeth Slusser Kelly ed. 1984).

For additional discussion of the Original Act's inability to properly deal with investment, see Aigler, Recognition of New Types of Negotiable Instruments 24 Col. L. Rev. 563 (1924); Beutel, Negotiability by Contract, 28 Ill. L. Rev. 205 (1933).

31. Commercial Code Comments and Notes to Tentative Draft No. 1—Article 3, 9 (American Law Institute 1946), reprinted in 2 Uniform Commercial Code: Drafts 318 (Elizabeth Slusser Kelly ed. 1984).

32. Commercial Code Comments and Notes to Tentative Draft No. 1—Article 3, 9 (American Law Institute 1946), reprinted in 2 Uniform Commercial Code: Drafts 318 (Elizabeth Slusser Kelly ed. 1984). The drafters noted that the vast majority of cases that arose in which a party unsuccessfully argued an instrument was negotiable had dealt exclusively with "old and familiar" instruments rather than new or innovative ones. The comments cite three such situations. First, conditional sales contracts containing provisions stating that "in the hands of any assignee for value they are to be treated as negotiable instruments" have been held not negotiable. See, e.g., Motor Contract Co. v. Van Der Volgen, 162 Wash. 449, 298 P. 705, 79 A.L.R. 29 (1931); American Nat. Bank of San Francisco v. A.G. Sommerville, Inc., 191 Cal. 364, 216 P. 376 (1923); Malas v. Lounsbury, 193 Wis. 531, 214 N.W. 332 (1927). Second, neither custom nor contract will make a savings deposit book negotiable. Ornbaun v. First Nat. Bank, 215 Cal. 72, 8 P.2d 470, 81 A.L.R. 1146 (1932). Finally, the statement "This note is negotiable" will not make an otherwise nonnegotiable promissory note negotiable. Moore v. Vaughn, 167 Miss. 758, 150 So. 372 (1933). Commercial Code Comments and Notes to Tentative Draft No. 1—Article 3, 9 (American Law Institute 1946), reprinted in 2 Uniform Commercial Code: Drafts 318 (Elizabeth Slusser Kelly ed. 1984).

33. Commercial Code, Tentative Draft No. 1—Article 3 § 1, reprinted in 2 U.C.C. Confidential Drafts 97 (Elizabeth Slusser Kelly & Ann Puckett eds. 1995).

34. 1946 ALI Annual Meeting Proceedings, discussion of Commercial Code, Tentative Draft No. 1—Article 3, printed in 23rd A.L.I. Proc. 98 (1946). Similar sentiments were expressed privately by the drafters prior to presenting the Article to members of the ALI. U.C.C. Article 3, Third Preliminary Draft § 1 Comment 2 (February, 1946), reprinted in 2 U.C.C. Confidential Drafts 162 (Elizabeth Slusser Kelly & Ann Puckett eds. 1995).

35. Commercial Code Comments and Notes to Tentative Draft No. 1—Article 3, 10 (American Law Institute 1946), reprinted in 2 Uniform Commercial Code: Drafts 320 (Elizabeth Slusser Kelly ed. 1984); UCC Article 3, U.C.C. Article 3, Third Preliminary Draft § 1 Comment 2 (February, 1946), reprinted in 2 U.C.C. Confidential Drafts 162 (Elizabeth Slusser Kelly & Ann Puckett eds. 1995). For instance, stocks, bonds, and investment paper were intended to be treated under Article V. See 1946 ALI Annual Meeting Proceedings, discussion of Commercial Code, Tentative Draft No. 1—Article 3, printed in 23rd A.L.I. Proc. 96 (1946).

36. 1946 ALI Annual Meeting Proceedings, discussion of Commercial Code, Tentative Draft No. 1—Article 3, printed in 23rd A.L.I. Proc. 98 (1946). The drafters seemed to share this feeling, stating "There is good reason to limit negotiability, which cuts off valid defenses to a personal contract, to simple promises or orders without

complications which are intended by the maker to circulate." Comments and Notes to Draft No. 1 § 1 Comment 1 (March, 1946) reprinted in 2 U.C.C. Confidential Drafts 407 (Elizabeth Slusser Kelly & Ann Puckett eds. 1995).

37. 1946 ALI Annual Meeting Proceedings, discussion of Commercial Code, Tentative Draft No. 1—Article 3, printed in 23rd A.L.I. Proc. 97 (1946). The exact words used by Prosser were:

> We have carefully considered the contentions that have been advanced that it should be possible to open up the field of negotiable paper to instruments which declare themselves to be negotiable. The so-called "negotiability by contract" in our drafting group became, I think, "negotiability by sesame," [laughter] the reference being sufficiently obvious. We have considered that possibility and have come to the conclusion that it is a highly undesirable thing. If anything were done in this Article to open the door to a rule that any piece of paper may become negotiable by declaring itself to be so, then every conditional sale, every chattel mortgage, every pledge agreement, every debtor's piece of paper that is made or executed in this country, is going to contain a provision declaring, "This instrument is negotiable."

1946 ALI Annual Meeting Proceedings, discussion of Commercial Code, Tentative Draft No. 1—Article 3, printed in 23rd A.L.I. Proc. 97 (1946).

38. U.C.C. Article 3, Third Preliminary Draft § 1 Comment 2 (February, 1946), reprinted in 2 U.C.C. Confidential Drafts 162 (Elizabeth Slusser Kelly & Ann Puckett eds. 1995).

39. U.C.C. Article 3, Third Preliminary Draft § 1 Comment 2 (February, 1946), reprinted in 2 U.C.C. Confidential Drafts 162 (Elizabeth Slusser Kelly & Ann Puckett eds. 1995). Modern Articles 7 and 8 deal with investment instruments and documents of title, respectively.

40. U.C.C. Article 3, Third Preliminary Draft § 1 Comment 2 (February, 1946), reprinted in 2 U.C.C. Confidential Drafts 162 (Elizabeth Slusser Kelly & Ann Puckett eds. 1995).

41. U.C.C. Article 3, Third Preliminary Draft § 1 Comment 2 (February, 1946), reprinted in 2 U.C.C. Confidential Drafts 162-63 (Elizabeth Slusser Kelly & Ann Puckett eds. 1995).

42. U.C.C. Article 3, Third Preliminary Draft § 1 Comment 2 (February, 1946), reprinted in 2 U.C.C. Confidential Drafts 162-63 (Elizabeth Slusser Kelly & Ann Puckett eds. 1995). The comment reads, in part:

> The drafting group can see no point whatever in setting up requirements for negotiability in this Article, and excluding from it the kind of paper which we are agreed should not be negotiable under it, if we leave the back door open and such paper can still be held negotiable apart from the statute by any court which it sees fit—the only prerequisite being that it does not meet our requirements as laid down in this article.

U.C.C. Article 3, Third Preliminary Draft § 1 Comment 2 (February, 1946), reprinted in 2 U.C.C. Confidential Drafts 162-63 (Elizabeth Slusser Kelly & Ann Puckett eds. 1995).

43. Commercial Code Comments and Notes to Tentative Draft No. 1—Article 3, 7 (American Law Institute 1946), reprinted in 2 Uniform Commercial Code: Drafts 317 (Elizabeth Slusser Kelly ed. 1984).

44. Commercial Code Comments and Notes to Tentative Draft No. 1—Article 3, 7 (American Law Institute 1946), reprinted in 2 Uniform Commercial Code: Drafts 317 (Elizabeth Slusser Kelly ed. 1984).

45. Compare Uniform Negotiable Instruments Law § 1 (1896), to Commercial Code Comments and Notes to Tentative Draft No. 1—Article 3, § 1 (American Law Institute 1946). See Appendix A.

46. Commercial Code Comments and Notes to Tentative Draft No. 1—Article 3, 12-13 (American Law Institute 1946), reprinted in 2 Uniform Commercial Code: Drafts 322-23 (Elizabeth Slusser Kelly ed. 1984) (explaining the intent behind adding the words "and no other promise, order, obligation or power").

47. For instance, the first question was whether the new negotiability requirements affected the negotiability of a collateral note. See 1946 ALI Annual Meeting Proceedings, discussion of Commercial Code, Tentative Draft No. 1—Article 3, printed in 23rd A.L.I. Proc. 100 (1946).

48. Beutel vocalized that the narrowing of negotiability would create a lot of commercial opposition to the Act. See 1946 ALI Annual Meeting Proceedings, discussion of Commercial Code, Tentative Draft No. 1—Article 3, printed in 23rd A.L.I. Proc. 104 (1946).

49. Prosser responded to such criticisms saying, "It is our contention that if an instrument promises to pay one hundred dollars and also deliver a horse, that it is not a negotiable instrument." See 1946 ALI Annual Meeting Proceedings, discussion of Commercial Code, Tentative Draft No. 1—Article 3, printed in 23rd A.L.I. Proc. 113 (1946). See also U.C.C. Article 3, Third Preliminary Draft § 1 Comment 1 (February, 1946), reprinted in 2 U.C.C. Confidential Drafts 161-62 (Elizabeth Slusser Kelly & Ann Puckett eds. 1995) (discussing the importance of the requirements of negotiability).

50. 1946 ALI Annual Meeting Proceedings, discussion of Commercial Code, Tentative Draft No. 1—Article 3, printed in 23rd A.L.I. Proc. 98-99 (1946). Comments from the members present at the 1946 ALI conference were that notes that were multiple pages long were too long. 1946 ALI Annual Meeting Proceedings, discussion of Commercial Code, Tentative Draft No. 1—Article 3, printed in 23rd A.L.I. Proc. 260 (1946).

51. U.C.C. Article 3, Third Preliminary Draft § 1 Comment 2 (February, 1946), reprinted in 2 U.C.C. Confidential Drafts 162 (Elizabeth Slusser Kelly & Ann Puckett eds. 1995).

52. Prosser was repeatedly questioned regarding which instruments were considered negotiable. Some opponents of the narrow Article 3 said it was a change in established common law. Prosser responded:

> Certainly the intent is to cover all [negotiable instruments]. I think we have.
>
> The result is, I believe, to limit negotiability to bills, checks, promissory notes, and certificates of deposit. If there is anything else that meets the requirements, I am perfectly willing to have it negotiable. We believe those to be the only instruments to meet the requirements.

See 1946 ALI Annual Meeting Proceedings, discussion of Commercial Code, Tentative Draft No. 1—Article 3, printed in 23rd A.L.I. Proc. 104 (1946). See also U.C.C. Article 3, Third Preliminary Draft § 1 Comment 1 (February, 1946), reprinted in 2 U.C.C. Confidential Drafts 161 (Elizabeth Slusser Kelly & Ann Puckett eds. 1995).

53. Commercial Code Group No. 1, Comments and Notes to Council & Commercial Law Acts Section, Draft No. 1—Article III—Commercial Paper Sections, 3 (March 1946), reprinted in 2 U.C.C. Confidential Drafts 407 (Elizabeth Slusser Kelly & Ann Puckett eds. 1995) ("All the requirements of negotiability have good reason behind them; and when they are departed from it is an indication of advantage taken of the debtor").

54. See 1946 ALI Annual Meeting Proceedings, discussion of Commercial Code, Tentative Draft No. 1—Article 3, printed in 23rd A.L.I. Proc. 257 (1946).

55. See Commercial Code Group No. 1, Comments and Notes to Council & Commercial Law Acts Section, Draft No. 1—Article III—Commercial Paper Sections § 1 Comment 1 (March 1946), reprinted in 2 U.C.C. Confidential Drafts 40 (Elizabeth Slusser Kelly & Ann Puckett eds. 1995).

56. 1946 ALI Annual Meeting Proceedings, discussion of Commercial Code, Tentative Draft No. 1—Article 3, printed in 23rd A.L.I. Proc. 257 (1946).

57. 1946 ALI Annual Meeting Proceedings, discussion of Commercial Code, Tentative Draft No. 1—Article 3, printed in 23rd A.L.I. Proc. 254-55 (1946).

58. 1946 ALI Annual Meeting Proceedings, discussion of Commercial Code, Tentative Draft No. 1—Article 3, printed in 23rd A.L.I. Proc. 254-55 (1946). Of course, if the note was made subject to the collateral agreement, these clauses and disclaimers could not include provisions that made a note nonnegotiable by the terms of § 1 of the Code. See also, U.C.C. Article 3, Third Preliminary Draft § 1 Comment 2 (February, 1946), reprinted in 2 U.C.C. Confidential Drafts 162 (Elizabeth Slusser Kelly & Ann Puckett eds. 1995).

59. U.C.C. Article 3, Third Preliminary Draft §§ 47 Comment to subsec. (c) (February, 1946), reprinted in 2 U.C.C. Confidential Drafts 349 (Elizabeth Slusser Kelly & Ann Puckett eds. 1995). The drafters acknowledged that there is some difficulty determining when the note and the mortgage are legally "divorced," especially when both the note and mortgage are acquired by a purchaser. 2 U.C.C. Confidential Drafts 350 (Elizabeth Slusser Kelly & Ann Puckett eds. 1995). They adopted the phrase "courier without luggage" from Overton v. Tyler, 3 Pa. 346, 347, 1846 WL 4875 (1846).

60. The notes themselves could be simple form documents requiring little if any review.

61. 1946 ALI Annual Meeting Proceedings, discussion of Commercial Code, Tentative Draft No. 1—Article 3, printed in 23rd A.L.I. Proc. 254-55 (1946). Professor Llewellyn stated:

> We are aware that notes frequently regarded by lawyers and bankers as negotiable run into difficulty when presented anywhere for rediscount, because counsel for the outfit asked to rediscount them are frequently unable to give a decisive opinion, (certainly not without careful study of each individual instrument, and that careful study takes its due measure of time), unable to give an opinion as to whether the paper is negotiable or it is not negotiable.
>
> ....
>
> It has seemed to us that there is a line of banking practice available to bankers considerably more convenient to the bankers than their present form, and vastly more useful to the commercial community at large. That line of practice consists in taking a simple promissory note from your customer when you make him a loan, the promissory note simply stating, "Given pursuant to collateral agreement," and then putting in the collateral agreement all the clauses, and you only have to sign the collateral agreement once to handle ten years of banking transactions.

See also 1946 ALI Annual Meeting Proceedings, discussion of Commercial Code, Tentative Draft No. 1—Article 3, printed in 23rd A.L.I. Proc. 98-99 (1946). Prosser described the notes he considered lengthy, stating:

> [T]he thing we are trying to exclude here is the promissory note which is so cluttered up with additional obligations, promises, undertakings, powers,

> authorizations to do this, that, and the other, waivers of this, that or the other, that when it is submitted to counsel for a bank, and counsel for a bank is asked to determine whether it is negotiable or not, he cannot tell. Specifically, the type of thing we are aiming at you will find in this pamphlet entitled, "Comments and Notes," the larger one of the two before us today, at page 53, where you will find for upwards of a page and a half, something drawn in the form of a promissory note which I would like very much to have you all read.

In light of modern practices, it is interesting that the drafters considered a promissory note a page and a half to be inordinately long.

62. 1946 ALI Annual Meeting Proceedings, discussion of Commercial Code, Tentative Draft No. 1—Article 3, printed in 23rd A.L.I. Proc. 98-99 (1946). See also 1946 ALI Annual Meeting Proceedings, discussion of Commercial Code, Tentative Draft No. 1—Article 3, printed in 23rd A.L.I. Proc. 254 (1946).

63. See 1946 ALI Annual Meeting Proceedings, discussion of Commercial Code, Tentative Draft No. 1—Article 3, printed in 23rd A.L.I. Proc. 257-61 (1946). (discussing the reasons for cleaning up negotiable instruments). Prosser discussed the hesitation of Federal Reserve Banks to discount many notes that were currently being treated as negotiable by other banks:

> At the present time there is very little rediscounting of notes going on in the Federal Reserve System, and none is anticipated in the immediate future although they say that they never can tell. The attitude of the Federal Reserve Board is that they would look with very great sympathy upon any attempt to clean up the paper and simplify it, but they do not feel that they are in any position to take any active measures of their own at the present time because they have very little of this paper before them.

1946 ALI Annual Meeting Proceedings, discussion of Commercial Code, Tentative Draft No. 1—Article 3, printed in 23rd A.L.I. Proc. 257-58 (1946).

64. 1946 ALI Annual Meeting Proceedings, discussion of Commercial Code, Tentative Draft No. 1—Article 3, printed in 23rd A.L.I. Proc. 260 (1946).

65. 1946 ALI Annual Meeting Proceedings, discussion of Commercial Code, Tentative Draft No. 1—Article 3, printed in 23rd A.L.I. Proc. 260 (1946). Mr. Beutel's comments demonstrate this concern:

> This business of cleaning up instruments involves all sorts of things. Mr. Llewellyn is modest when he says they are "that long." I have seen them pages long, purporting to be negotiable, and many of them are. In real estate, in selling and mortgaging houses, they do the same trick.
>
> ....
>
> Therefore, if we "clean up," as we say, this banking and commercial paper, we ought to have a provision some place else in our Commercial Code to very carefully cover the transferability of these instruments, because they deal with them in the market just like they deal with checks and drafts. Just try to mortgage a house and get a non-negotiable mortgage note, and see the row you have.

1946 ALI Annual Meeting Proceedings, discussion of Commercial Code, Tentative Draft No. 1—Article 3, printed in 23rd A.L.I. Proc. 260-61 (1946).

66. 1946 ALI Annual Meeting Proceedings, discussion of Commercial Code, Tentative Draft No. 1—Article 3, printed in 23rd A.L.I. Proc. 264-67 (1946). In response to an ALI member's concerns about all the instruments that would not be negotiable under the UCC, Llewellyn stated:

> Concurring with Mr. Beutel in regard to the need of covering them, the Code plans a Chattel Security Article which is the place at which the bulk of this will be handled. We already are and have been for a year and half in our protracted negotiations with the finance companies, which will continue until the chattel security chapter has finished being drafted.

1946 ALI Annual Meeting Proceedings, discussion of Commercial Code, Tentative Draft No. 1—Article 3, printed in 23rd A.L.I. Proc. 264 (1946). This reference was to then-titled Article VII, which has been renumbered as Article 9 today.

67. 13 Pa. Cons. Stat. §§ 1101 to 9507 (1953) (effective July 1, 1954).

68. Schnader, A Short History of the Preparation and Enactment of the Uniform Commercial Code, 22 U. Miami L. Rev. 1, 8 (1967).

69. In 1954 the New York Law Review Commission published transcripts of the hearings and related memoranda and correspondence. See N.Y. Law Review Comm'n, State of New York Law Commission Report: Hearings on the Uniform Commercial Code (1954).

70. N.Y. Law Review Comm'n, State of New York Law Commission Report: Study of the Uniform Commercial Code (1955).

71. N.Y. Law Review Comm'n, State of New York Law Commission Report: Report and Appendices Relating to the Uniform Commercial Code 68 (1956) (concluding the "the Uniform Commercial Code is not satisfactory in its present form and cannot be made satisfactory without comprehensive re-examination and revision").

72. Epstein, Introduction to N.Y. Law Review Comm'n, State of New York Law Commission Report: Hearings on the Uniform Commercial Code (reprint ed. 1980).

73. U.C.C. 1952 Text and Comments Edition § 3-302(1)(b) (1952), reprinted in 16 Uniform Commercial Code: Drafts 325 (Elizabeth Slusser Kelly ed. 1984).

74. N.Y. Law Review Comm'n, State of New York Law Commission Report: Report and Appendices Relating to the Uniform Commercial Code 141 (1956). See also Eggert, Held Up in Due Course: Codification and the Victory of Form Over Intent in Negotiable Instrument Law, 35 Creighton L. Rev. 363, 420-21 (2002).

75. This was eventually changed to a "somewhat less subjective but not fully objective standard" in the 1990 revisions to Article 3. See Eggert, Held Up in Due Course: Codification and the Victory of Form Over Intent in Negotiable Instrument Law, 35 Creighton L. Rev. 363, 533 (2002), and U.C.C. 1-201(a)(20) (1990).

76. A. Alport & Son, Inc. v. Hotel Evans, Inc., 65 Misc. 2d 374, 317 N.Y.S.2d 937, 8 U.C.C. Rep. Serv. 1040 (Sup 1970); Pre-1990 revisions to Article 3 of the U.C.C. § 3-106, Comment 1. The comment also stated that other instruments could be made negotiable by other statutes or judicial decision, granting courts some discretion in how they interpreted variable interest rates.

77. See, e.g., Farmers Production Credit Ass'n v. Arena, 145 Vt. 20, 481 A.2d 1064, 39 U.C.C. Rep. Serv. 245 (1984) (holding a note allowing for future advances of principal and a variable interest rate did not state a sum certain); Northern Trust Co. v. E.T. Clancy Export Corp., 612 F. Supp. 712, 41 U.C.C. Rep. Serv. 1315 (N.D. Ill. 1985) (holding that a note requiring interest to be computed from time to time by referencing a bank's floating prime rate renders the sum payable uncertain and the instrument

nonnegotiable); Taylor v. Roeder, 234 Va. 99, 360 S.E.2d 191, 4 U.C.C. Rep. Serv. 2d 652, 69 A.L.R.4th 1117 (1987) (denying holder in due course status to the holder of a note because the note's variable interest rate prevented it from being negotiable); Centerre Bank of Branson v. Campbell, 744 S.W.2d 490, 5 U.C.C. Rep. Serv. 2d 1403 (Mo. Ct. App. S.D. 1988) (denying holder in due course status to the holder of a note because the note's variable interest rate prevented it from being negotiable); National Union Fire Ins. Co. of Pittsburgh, Pa. v. Tegtmeier, 673 F. Supp. 1269 (S.D. N.Y. 1987).

78. First City Federal Sav. Bank v. Bhogaonker, 715 F. Supp. 1216, 10 U.C.C. Rep. Serv. 2d 873 (S.D. N.Y. 1989); Klehm v. Grecian Chalet, Ltd., 164 Ill. App. 3d 610, 115 Ill. Dec. 662, 518 N.E.2d 187 (1st Dist. 1987); Universal C.I.T. Credit Corp. v. Ingel, 347 Mass. 119, 196 N.E.2d 847, 3 U.C.C. Rep. Serv. 303 (1964).

79. American Law Institute, Progress Report 5 (Apr. 20, 1988) states: "This redraft rejects recent decisions holding variable rate notes nonnegotiable on the ground that there was no sum certain." See also 1988 Annual ALI Conference Proceedings, 65 ALI Proc. 435 (1988), which states:

> We want to make the substance of Article 3 much more relevant to the way in which business is done today... Our redraft is, I think, very much in the mainstream of Anglo-American commercial law, but it does make some major substantive changes. For a very few minutes, let me just mention some of the points that are made in the redraft.
>
> The traditional formal requirements for negotiability have been largely retained, although there is some flexibility. One of the principal matters before the committee right now is how much more flexibility there should be. We, of course, reject the recent holdings that variable interest rate notes are nonnegotiable, and we hope we have solved that particular problem.

80. 1946 ALI Annual Meeting Proceedings, discussion of Commercial Code, Tentative Draft No. 1—Article 3, printed in 23rd A.L.I. Proc. 98, 254 (1946).

81. For example, John M. Slanten asked whether independent promises in notes prevent them from being negotiable, stating: "So there is no purpose to transfer the independent promise, but only the promise to pay. The power of the negotiable instrument is taken away because it contains something else about a different matter?" 1946 ALI Annual Meeting Proceedings, discussion of Commercial Code, Tentative Draft No. 1—Article 3, printed in 23rd A.L.I. Proc. 114 (1946) (Prosser responded that if both promises were delivered at the same time in the paper, the power of a negotiable instrument was lost).

Fredrick Beutel commented on whether he believed Article 3 was intended for the protection of borrowers, stating: "The sections requiring negotiability certainly are [intended for the advantage of the obligor], because they protect the obligor from having his defenses cut off, and if those are not for the benefit and protection of the obligor, I don't know of anything in this act that is." See 1946 ALI Annual Meeting Proceedings, discussion of Commercial Code, Tentative Draft No. 1—Article 3, printed in 23rd A.L.I. Proc. 117 (1946).

Finally, Commercial Code Comments and Notes to Tentative Draft No. 1—Article 3, § 1 Comment 1 (American Law Institute 1946), reprinted in 2 Uniform Commercial Code: Drafts 321 (Elizabeth Slusser Kelly ed. 1984) states: "There is good reason to limit negotiability, which cuts off valid defenses to a personal contract, to simple promises or orders without complications which are intended by the maker to circulate."

82. 1946 ALI Annual Meeting Proceedings, discussion of Commercial Code, Tentative Draft No. 1—Article 3, printed in 23rd A.L.I. Proc. 254, 262 (1946).

83. Commercial Code Comments and Notes to Tentative Draft No. 1—Article 3, § 1 Comment 1 (American Law Institute 1946), reprinted in 2 Uniform Commercial Code: Drafts 321 (Elizabeth Slusser Kelly ed. 1984).

84. Gilmore, Formalism and the Law of Negotiable Instruments, 13 Creighton L. Rev. 441, 461 (1979).

85. Gilmore, Formalism and the Law of Negotiable Instruments, 13 Creighton L. Rev. 441, 460-61 (1979).

86. Commercial Code Comments and Notes to Tentative Draft No. 1—Article 3, 147 (American Law Institute 1946), reprinted in 2 Uniform Commercial Code: Drafts 457 (Elizabeth Slusser Kelly ed. 1984).

87. Gilmore, Formalism and the Law of Negotiable Instruments, 13 Creighton L. Rev. 441, 448 (1979). See also Rubin, Learning From Lord Mansfield: Toward A Transferability Law For Modern Commercial Practice, 31 Idaho L. Rev. 775, 778 (1995) ("[I]t would appear that no lawmaker has thought creatively about negotiable instruments since Mansfield's efforts in the middle of the eighteenth century").

88. U.C.C. § 3-103(b) (1990) (stating "instrument" is defined in § 3-104). U.C.C. § 3-104(b) (1990) (stating "instrument" means "negotiable instrument").

89. U.C.C. § 3-104(a) (1990).

90. U.C.C. § 1-201(5) (1990) defines "bearer" to mean the person in possession of an instrument, document of title, or certificated security payable to bearer or indorsed in blank. A bearer instrument is payable to anyone who holds it because there is no named payee.

91. U.C.C. § 1-201(20) (1990).

92. Notes are available at http://www.freddiemac.com/uniform/unifnotes.html (last visited Oct. 2008) and http://www.efanniemae.com (last visited Oct. 2008). The notes read "FOR VALUE RECEIVED, the undersigned ("Borrower") promises to pay to the order of ____________." The lender originating the loan is written into the space provided.

93. See U.C.C. § 3-201 (1990) (defining negotiation as the transfer of an instrument to a person who becomes the instrument's holder). Subsection (b) states that except for negotiation by a remitter, if an instrument is payable to an identified person, negotiation requires transfer of possession of the instrument and its indorsement by the holder. See also In re Gavin, 319 B.R. 27, 31-32, 53 Collier Bankr. Cas. 2d (MB) 836, 55 U.C.C. Rep. Serv. 2d 641 (B.A.P. 1st Cir. 2004) (holding that Article 3 provides that where a negotiable instrument is payable to an identified person, transfer of ownership of the instrument requires indorsement by the holder, and transfer of possession of the instrument).

94. See SMS Financial, Ltd. Liability Co. v. ABCO Homes, Inc., 167 F.3d 235, 42 Fed. R. Serv. 3d 1214, 37 U.C.C. Rep. Serv. 2d 1200 (5th Cir. 1999) (holding that if a holder other than the maker indorses and transfers possession of a note either voluntarily or involuntarily, it has negotiated the note to the transferee, and made the transferee the note's holder); In re McMullen Oil Co., 251 B.R. 558, 36 Bankr. Ct. Dec. (CRR) 109, 42 U.C.C. Rep. Serv. 2d 507 (Bankr. C.D. Cal. 2000) (denying a bank holder in due course status because the checks at issue in the lawsuit were not negotiated to the bank; thus it was not a holder); Crossland Sav. Bank FSB v. Constant, 737 S.W.2d 19, 4 U.C.C. Rep. Serv. 2d 1479 (Tex. App. Corpus Christi 1987) (holding a valid negotiation is necessary to make a transferee a holder).

95. See, e.g., Crossland Sav. Bank FSB v. Constant, 737 S.W.2d 19, 4 U.C.C. Rep. Serv. 2d 1479 (Tex. App. Corpus Christi 1987).

96. In re Governor's Island, 39 B.R. 417, 39 U.C.C. Rep. Serv. 518 (Bankr. E.D. N.C. 1984) (holding mere assignment of a note without indorsement by the note's previous

owner prevents the note's current owner from being a holder of the note. Without status as a holder, the current owner cannot be a holder in due course).

97. See Adams v. Madison Realty & Development, Inc., 853 F.2d 163, 6 U.C.C. Rep. Serv. 2d 732 (3d Cir. 1988) (holding a note has not been indorsed if indorsements are on separate sheets of paper not physically attached to the note). See also Crossland, 737 S.W.2d 19 (holding indorsements stapled to a bundle of documents that includes the note are not considered indorsements of the note).

98. Pribus v. Bush, 118 Cal. App. 3d 1003, 173 Cal. Rptr. 747, 31 U.C.C. Rep. Serv. 599 (4th Dist. 1981) (holding that allonge may only be used to indorse a note when there is no space on the note itself).

99. The language of U.C.C. § 3-302(c) reads:

> Except to the extent a transferor or predecessor in interest has rights as a holder in due course, a person does not acquire rights of a holder in due course of an instrument taken (i) by legal process or purchase in an execution, bankruptcy, or creditor's sale or similar proceeding, (ii) by purchase as part of a bulk transaction not in ordinary course of business of the transferor, or (iii) as the successor in interest to an estate or other organization.

100. Purchases made outside the ordinary course of business might include bankruptcy purchases or single purchases of an entire portfolio of loans.

101. For example, by paying off the note.

102. Even an obligor whose debt has been discharged and recorded as discharged is not necessarily safe from a holder in due course. U.C.C. § 3-302(b) (1990) (stating that public filing or recording of a document does not of itself constitute notice of a defense, claim in recoupment, or claim to the instrument).

103. The holder would retain holder in due course status and be able to demand payment of the amount of the instrument not yet discharged according to the terms of the instrument.

104. U.C.C. §§ 3-305(b) and 3-305(a)(2) (1990).

105. As long as the claim arose out of the transaction in which the instrument was created. U.C.C. §§ 3-305(b) and 3-305(a)(3) (1990).

106. U.C.C. § 3-306 (1990).

107. U.C.C. § 3-305(a)(1)(i) (1990).

108. U.C.C. § 3-305 Comment 1 (1990).

109. U.C.C. § 3-305 Comment 1 (1990).

110. U.C.C. § 3-305(a)(1)(ii) (1990).

111. U.C.C. § 3-305 Comment 1 (1990) (giving the following examples: "mental incompetence, guardianship, ultra vires acts, lack of corporate capacity to do business, or any other incapacity apart from infancy").

112. U.C.C. § 3-305 Comment 1 (1990) (stating that the applicability of these defenses will vary from jurisdiction to jurisdiction). For instance, illegality of the transaction most commonly arises "as a matter of gambling or usury, but may arise under a variety of statutes." U.C.C. § 3-305 Comment 1 (1990).

113. U.C.C. § 3-305 Comment 1 (1990).

114. U.C.C. § 3-305(a)(1)(iii) (1990). This is often called "real fraud," "essential fraud," or "fraud in factum."

115. U.C.C. § 3-305 Comment 1 (1990) ("The common illustration [of this type of fraud] is that of the maker who is tricked into signing a note in the belief that it is merely a receipt or some other document").

116. U.C.C. § 3-305 Comment 1 (1990). This is an interesting justification because intent to create a negotiable instrument is neither required to create negotiable instruments, nor is it sufficient to make a nonnegotiable instrument negotiable.

117. U.C.C. § 3-305 Comment 1 (1990). When determining what qualifies as a reasonable opportunity, all relevant factors must be taken into account, including the signer's intelligence, education, business experience, and ability to read or understand English. U.C.C. § 3-305 Comment 1 (1990). The nature of representations that were made to the signer, whether the signer had good reason to rely on the representations, the presence of any third person who might read or explain the instrument to the signer, or any other possibility of obtaining independent information, and the apparent necessity, or lack of it, for acting without delay are also relevant when determining what is a reasonable opportunity. U.C.C. § 3-305 Comment 1 (1990).

In a confidential preliminary draft of the UCC, the drafters explained that fraud as a real defense comes down to whether a party was excusably ignorant of what he was signing. The drafters stated that excusable ignorance turns on the facts, citing analysis by Professor Britton in his text on Bills and Notes. Looking only at the signer's intent, Professor Britton classified situations where signers were excusably ignorant as follows:

> The maker intended to sign a paper which would impose no duty on him whatever, such as a receipt.
>
> He intends to sign one imposing a duty other than to pay money.
>
> He intends to sign a contract to pay money, but not an instrument.
>
> He intends to sign a nonnegotiable instrument but not a negotiable one.
>
> He intends to sign a negotiable instrument with different terms.
>
> The factual ignorance of what the maker signs is tied in with the issue of his negligence. For that cases take into account the age of the party, sex, intelligence, business experience, ability to read or to understand English, the representations made to him and his reason to rely on the person making them, and his opportunity to obtain independent information—as where one who cannot read signs without asking a third person present to read the instrument to him. Obviously a general statement of the principle is all that can be made.

U.C.C. Article 3, Third Preliminary Draft §§ 48 Comment to subsec. (c) (February, 1946), reprinted in 2 U.C.C. Confidential Drafts 353-54 (Elizabeth Slusser Kelly & Ann Puckett eds. 1995).

118. The Home Ownership and Equity Protection Act and the Truth in Lending Act require disclosure of a note's material terms. See discussion infra Parts II.B, III.C.1. Compliance with them likely gives borrowers a "reasonable opportunity" to learn the note's character and terms.

119. U.C.C. § 3-305(a)(1)(iv) (1990).

120. U.C.C. § 1-201(22) (1990) ("any assignment for the benefit of creditors or other proceedings intended to liquidate or rehabilitate the estate of the person involved").

121. U.C.C. § 3-305 Comment 1 (1990).

122. U.C.C. § 3-203(b) (1990).

123. U.C.C. § 3-203(b) (1990).

124. U.C.C. § 3-203(b) (1990); Piper v. Goodwin, 20 F.3d 216, 23 U.C.C. Rep. Serv. 2d 466, 1994 FED App. 0098P (6th Cir. 1994); Crossland, 737 S.W.2d 19.

125. One Valley Bank of Oak Hill, Inc. v. Bolen, 188 W. Va. 687, 689, 425 S.E.2d 829 (1992). See also Jones v. Approved Bancredit Corp., 256 A.2d 739, 743, 6 U.C.C. Rep. Serv. 1001 (Del. 1969) ("The divergent line of cases, reflecting an underlying conflict in policy considerations, accords determinative importance to the maintenance of a free flow of credit. These cases protect the finance company from purchaser defenses on the ground that this is an overriding consideration in order to assure easy negotiability of commercial paper and the resultant availability of the rapid financing methods required by our present-day economy").

126. William H. Lawrence, Understanding Negotiable Instruments and Payment Systems 16 (Lexis 2002).

127. Hearing to Evaluate Governor's Program Bill 44 before S. Standing Comm. on Banks, 2008 Leg., 232nd Sess., at 11, 17 (N.Y. May 12, 2008), (prepared testimony of Paul J. Richman, vice president of state government affairs, Mortgage Bankers Association) available at http://www.mortgagebankers.org/files/News/InternalResource/62541_MBATestimonyNYSenateMay12,2008.pdf (last visited Oct. 2008). This bill was eventually passed by the State of New York. Portions of the Act take effect between September 2008 and July 2010. See S.B. S08143-A, 2008 Leg., 232nd Sess. (N.Y. 2008). See also Position Paper of the American Securitization Forum, Assignee Liability in the Secondary Mortgage Market, at 3 (June 2007) available at http://www.americansecuritization.com/uploadedFiles/Assignee%20Liability%20Final%20Version_060507.pdf (last visited Oct. 2008). The paper states, in part:

> [T]he calls for expanded assignee liability—that the secondary subprime mortgage market aids and abets predatory practices by primary lenders and brokers—is substantially overblown. In addition to being largely unnecessary, any federal legislation that would expose secondary market participants to assignee liability that is very high or unquantifiable would have severe repercussions. It would likely cause a contraction and deleterious repricing of mortgage credit, thus harming both prospective subprime borrowers and current borrowers seeking to refinance their existing loans on more favorable terms—especially those borrowers with impending rate increases on their adjustable rate mortgage loans. And this contraction and repricing would occur at precisely the time when the provision of further liquidity, spurred by the willingness of investors to expose themselves to additional risk, is essential to ensuring the financial health of the housing market."

128. Western State Bank of South Bend v. First Union Bank & Trust Co. of Winamac, 172 Ind. App. 321, 326-27, 360 N.E.2d 254, 258, 21 U.C.C. Rep. Serv. 159 (1977) ("The purpose of conferring HDC status is to encourage and facilitate the circulation of commercial paper. 'It is sometimes said that the holder in due course doctrine is like oil in the wheels of commerce and that those wheels would grind to a quick halt without such lubrication.'") (citations omitted). But see Rosenthal, Negotiability—Who Needs It?, 71 Colum. L. Rev. 375, 401 (1971) (concluding "today, negotiability, and specifically the protections of holders in due course, are not necessary or even helpful in fostering the flow of commerce").

129. White and Summers, 1 Uniform Commercial Code 693 (3rd ed. 1988) ("the holder-in-due-course doctrine... facilitated the flow of capital from large lenders to the seller to an individual consumer").

130. Maggs, The Holder in Due Course Doctrine as a Default Rule, 32 Ga. L. Rev. 783, 793 (1998) ("Second, and perhaps just as important, the holder is assured that should he acquire HDC status he will not incur high transaction costs in the form of protracted litigation when seeking to enforce the contract").

131. Rogers, The Myth of Negotiability, 31 B.C. L. Rev. 265, 272, 289-90 (1990) (explaining how negotiable instruments became money substitutes instead of means of transferring funds). But see Mann, Searching for Negotiability in Payment and Credit Systems, 44 UCLA L. Rev. 951, 969 (1997) ("Thus, the home-mortgage market has replaced negotiability with more developed liquidity systems—principally devices for pooling and securitizing the underlying notes—that make the home-mortgage note highly liquid").

132. Naimon, Thiesson, and Beal, Assignee Liability in Residential Mortgage Transactions, 19 Rev. of Banking & Fin. Services 89 (Mar. 2003) ("The arguments for the continued existence of the rule remain what they have been for centuries: it produces commercial certainty; enhances lender liquidity; and makes access to capital easier by lowering barriers to entry into the lending market, allowing quantification of risk, and generating competition").

133. Lawrence and Minan, The Effect of Abrogating the Holder-in-Due-Course Doctrine on the Commercialization of Innovative Consumer Products, 64 B.U. L. Rev. 325 (1984) (arguing abrogation of the holder in due course rule discourages product innovation because of increased financing costs associated with assignee assessment of the integrity, finances, and product quality of sellers of innovative consumer goods). See also Hearing to Evaluate Governor's Program Bill 44 before S. Standing Comm. on Banks, 2008 Leg., 232nd Sess., at 17 (N.Y. May 12, 2008), (prepared testimony of Paul J. Richman, vice president of state government affairs, Mortgage Bankers Association) available at http://www.mortgagebankers.org/files/News/InternalResource/62541_MBATestimonyNYSenateMay12,2008.pdf (last visited Oct. 2008) ("MBA wants to underscore the importance of innovation in making credit opportunities available to consumers. MBA believes that borrower choice lowers costs and should be protected. The imposition of overreaching standards risks undermining our hard won gains in the areas of homeownership and reaching undeserved borrowers").

134. Mutual Finance Co. v. Martin, 63 So. 2d 649, 653, 44 A.L.R.2d 1 (Fla. 1953). See also Unico v. Owen, 50 N.J. 101, 232 A.2d 405, 410, 4 U.C.C. Rep. Serv. 542 (1967) ("the financer-creditor is better able to absorb the impact of a single imprudent or unfair exchange").

135. Commercial Credit Co. v. Childs, 199 Ark. 1073, 137 S.W.2d 260, 128 A.L.R. 726 (1940).

136. Morgan v. Reasor Corp., 69 Cal. 2d 881, 73 Cal. Rptr. 398, 447 P.2d 638, 646 (1968) (citation omitted).

137. Morgan, 447 P.2d at 647 n.19 (citation omitted).

138. Geiger Finance Co. v. Graham, 123 Ga. App. 771, 773, 182 S.E.2d 521, 523, 9 U.C.C. Rep. Serv. 598 (1971) (additions in original) (citation omitted).

139. Geiger, 182 S.E.2d at 524-25 (citation omitted).

140. Preservation of Consumers' Claims and Defenses, 40 Fed. Reg. 53,506, 53,508 (Nov. 18, 1975). For a recent list of state laws prohibiting negotiable instruments and/or waiver of defense clauses in various consumer credit sale transactions, see Pridgen and Alderman, Consumer Credit and the Law (2008-2009 Rev. Ed.), at App. 14A.

141. Preservation of Consumers' Claims and Defenses, 40 Fed. Reg. 53,506 (Nov. 18, 1975) (codified in 16 C.F.R. § 433.1 et seq. (2008)). In particular, the FTC said that the holder in due course rule "enables a merchant who engages in disreputable and unethical sales practices to establish and maintain a source of payment which assures him a place in the market, notwithstanding continuing breaches of contract and warranty." Preservation of Consumers' Claims and Defenses, 40 Fed. Reg. 53,506, 53,509 (Nov. 18, 1975).

142. Notes and mortgages in forms other than retail installment contracts were used commonly as well.

143. When passing the final FTC Holder Rule, the FTC stated in its findings 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." Preservation of Consumers' Claims and Defenses, 40 Fed. Reg. 53,506, 53,510 (Nov. 18, 1975).

144. Preservation of Consumers' Claims and Defenses, 40 Fed. Reg. 53,522 (Nov. 18, 1975).

145. Preservation of Consumers' Claims and Defenses, 40 Fed. Reg. 53,522 (Nov. 18, 1975).

146. Preservation of Consumers' Claims and Defenses, 40 Fed. Reg. 53,523 (Nov. 18, 1975).

147. Preservation of Consumers' Claims and Defenses, 40 Fed. Reg. 53,509 (Nov. 18, 1975).

148. Preservation of Consumers' Claims and Defenses, 40 Fed. Reg. 53,507, 53,509 (Nov. 18, 1975).

149. Hershey, Jr., Washington & Business: The Shifting Onus of Consumer Credit, N.Y. Times, Oct. 7, 1976, at 84.

150. White and Summers, Uniform Commercial Code 503 (4th ed. 1995). See also Rubin, Learning From Lord Mansfield: Toward A Transferability Law For Modern Commercial Practice, 31 Idaho L. Rev. 775, 789 (1995) ("What is striking is that the financial community has not been particularly perturbed by the FTC Rule").

151. Termination of Review, 57 Fed. Reg. 28,814 (June 29, 1992) (concluding that "After carefully considering the comments, the Commission believes that they do not present a sufficient basis to conclude that the Holder Rule has had a significant impact on a substantial number of small entities").

152. 15 U.S.C.A. § 1601(a) (2007). The section reads:

> The Congress finds that economic stabilization would be enhanced and the competition among the various financial institutions and other firms engaged in the extension of consumer credit would be strengthened by the informed use of credit. The informed use of credit results from an awareness of the cost thereof by consumers. It is the purpose of this subchapter to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit, and to protect the consumer against inaccurate and unfair credit billing and credit practices.

153. Department of Housing and Urban Development & Federal Reserve Board, joint report to congress, Truth in Lending Act and the Real Estate Procedures Act 7 (Federal Reserve Board 1998).

154. The finance charge is essentially the total cost of credit in dollars, including interest payments, points, origination fees, private mortgage insurance, etc. Items

excluded from the finance charge are fees for credit reports, appraisals, inspection, flood certifications, document preparation, title searches, title insurance, notary fees, recording fees and taxes).

155. The APR is the lump-sum finance charge expressed as an interest rate paid per year over the life of the loan.

156. For instance, interest could be calculated via simple interest, add-on, or discount.

157. Department of Housing and Urban Development & Federal Reserve Board, joint report to congress, Truth in Lending Act and the Real Estate Procedures Act I (Federal Reserve Board 1998).

158. Department of Housing and Urban Development & Federal Reserve Board, joint report to congress, Truth in Lending Act and the Real Estate Procedures Act 12 (Federal Reserve Board 1998) ("The cost of credit from all creditors should be stated comprehensively and uniformly to promote comparison shopping and competition"). See also Department of Housing and Urban Development & Federal Reserve Board, joint report to congress, Truth in Lending Act and the Real Estate Procedures Act 30 (Federal Reserve Board 1998) ("[Encouraging] guaranteed loan prices would have other benefits. It could result in a simpler and more effective disclosure scheme that would facilitate shopping and enhance competition"); Department of Housing and Urban Development & Federal Reserve Board, joint report to congress, Truth in Lending Act and the Real Estate Procedures Act IV (Federal Reserve Board 1998) (discussing the Real Estate Settlement and Procedures Act: "The Board and HUD *recommend* that creditors be required to give consumers more reliable closing cost information to promote shopping and competition") (emphasis in original).

159. See 15 U.S.C.A. § 1601(a) (2007), supra note 152 and accompanying text.

160. For example, a loan with no TILA disclosure statement or a TILA disclosure statement without an APR, Finance Charge, Amount Financed, Total Payments, a Payment Schedule, or Notice to Cancel would be a violation apparent on the face of the document. Improper calculation of Total Payments and Payment Schedule would also be apparent on the face of the document.

161. Department of Housing and Urban Development & Federal Reserve Board, joint report to congress, Truth in Lending Act and the Real Estate Procedures Act 51 (Federal Reserve Board 1998).

162. Department of Housing and Urban Development & Federal Reserve Board, joint report to congress, Truth in Lending Act and the Real Estate Procedures Act 51-57 (Federal Reserve Board 1998); Department of Housing and Urban Development and Department of the Treasury, Curbing Predatory Home Mortgage Lending, a Joint Report 18 (Department of Housing and Urban Development 2000), available at http://www.huduser.org/publications/hsgfin/curbing.html (last visited Oct. 2008); General Accounting Office, GAO-04-280, Consumer Protection: Federal and State Agencies Face Challenges in Combating Predatory Lending, Report to the Chairman and Ranking Minority Member, Special Committee on Aging, U.S. Senate, 23-25 (General Accounting Office 2004), available at http://www.gao.gov/new.items/d04280.pdf (last visited Oct., 2008).

163. Home Ownership and Equity Protection Act of 1994, Pub. L. No. 103-325, 108 Stat. 2190 (codified as amended at 15 U.S.C.A. § 1637 et seq. (2007), 12 C.F.R. § 226.32 (2007)). "High-cost" mortgages are those securing closed-end credit with a principal dwelling (other than a purchase-money mortgage or reverse mortgages). In order to be "high-cost," first-lien mortgages must exceed the rate on comparable treasury securities by 8% (junior-lien mortgages must exceed by 10%), or the total points and fees must exceed the greater of 8% of the loan value or $400. Home Ownership and Equity Protection Act of 1994, Pub. L. No. 103-325, 108 Stat. 2190 (codified as amended at 15 U.S.C.A. § 1637 et seq. (2007), 12 C.F.R. § 226.32 (2007)).

164. Senate Report No. 103-169, at 2 (1994), reprinted in 1994 U.S.C.C.A.N. 1881, 1886 (1994). In particular, the Senate was concerned with "reverse redlining," where communities that had been traditionally denied credit would be targeted for credit that was granted on unfair terms. Senate Report No. 103-169, at 1905 (1994), reprinted in 1994 U.S.C.C.A.N. 1881, 1886 (1994).

165. Senate Report No. 103-169, at 28 (1994), reprinted in 1994 U.S.C.C.A.N. 188, 1912 (1994).

166. Senate Report No. 103-169, at 28 (1994), reprinted in 1994 U.S.C.C.A.N. 188, 1912 (1994). The report reads:

> By imposing assignee liability, the Committee seeks to ensure that the High Cost Mortgage market polices itself. Unscrupulous lenders were limited in the past by their own capital resources. Today, however, with loans sold on a regular basis, one unscrupulous player can create havoc in a community by selling loans as fast as they are originated. Providing assignee liability will halt the flow of capital to such lenders.

Senate Report No. 103-169, at 28, 1912 (1994), reprinted in 1994 U.S.C.C.A.N. 188, 1912 (1994).

167. Senate Report No. 103-169, at 28, 1912 (1994), reprinted in 1994 U.S.C.C.A.N. 188, 1912 (1994).

168. Senate Report No. 103-169, at 28, 1912 (1994), reprinted in 1994 U.S.C.C.A.N. 188, 1912 (1994).

169. This categorization is also discussed in Keyfetz, The Home Ownership and Equity Protection Act of 1994: Extending Liability for Predatory Subprime Loans to Secondary Mortgage Market Participants, 18 Loy. Consumer L. Rev. 151, 176-79 (2005).

170. 15 U.S.C.A. § 1635 (2007) (granting right of rescission that lasts up to three years after the loan closes); 15 U.S.C.A. § 1639(j) (2007) ("Any mortgage containing a provision prohibited by this section shall be deemed a failure to deliver the material disclosures required under this subchapter, for the purpose of section 1635 of this title").

171. 15 U.S.C.A. § 1641(c) (2007).

172. 15 U.S.C.A. § 1641(d)(1) (2007).

173. Under HOEPA a borrower with any claim against the high-cost loan originator would be able to advance that claim or defense against an assignee of the high-cost loan. Under TILA, the borrower would only be able to assert violations of TILA against assignees, not other claims or defenses.

174. 15 U.S.C.A. § 1641(d)(1) (2007). Exactly what is required by this standard is unclear. The court in *Cooper v. First Government Mortg. and Investors Corp.* interprets this to require (1) review of documentation required by TILA, itemization of amount financed, and other disclosure of disbursements; (2) analysis of these items, and (3) whatever further inquiry is objectively reasonable given the results of the analysis. Cooper v. First Government Mortg. and Investors Corp., 238 F. Supp. 2d 50, 56 (D.D.C. 2002). However, the court in *Jenkins v. Mercantile Mortg. Co.* did not discuss the due diligence requirement, but the holding suggested that satisfying it required much less than the *Cooper* court required. Jenkins v. Mercantile Mortg. Co., 231 F. Supp. 2d 737, 746-47 (N.D. Ill. 2002). In *Jenkins*, the original lender had materially altered the documents disclosing the finance charges so that the loan appeared not to be "high cost." Rejecting the argument that the bank should have investigated because the borrower's documents were different than the bank's, the court held that the bank could not be liable because the loan could not be determined to be high cost on the face of the documents (as required by § 1641(a)).

175. 15 U.S.C.A. § 1641(d)(2)(A) (2007) limits recovery to damages per 15 U.S.C.A. § 1640 (2007). Section 1640 limits damages in individual actions for HOEPA violations when the credit extended is closed-end to the sum of: actual damages, the finance charge (not less than $200, not more than $2,000), costs and fees (including attorney's fees), and in the case of material failure to comply with HOEPA (violation of § 1639), an amount equal to the total finance charges and fees paid by the borrower.

176. 15 U.S.C.A. § 1641(d)(2)(B) (2007).

177. Purchase-money mortgages are mortgages securing loans that were used to purchase a house. In other words, HOEPA only applies to loans taken out to refinance.

178. Senate Report No. 103-169, at 22 (1994), reprinted in 1994 U.S.C.C.A.N. 1881, 1906 (1994) ("Evidence before the Committee indicates that some high-rate lenders are using nonpurchase-money mortgages to take advantage of unsophisticated, low-income homeowners").

179. 12 C.F.R. § 226.32(a) (2007).

180. The "trigger" rates can be found in 12 C.F.R. § 226.32(a) (2007). For discussion of the relatively low number of subprime loans that are considered "high-cost" under HOEPA, see Pyle, A "Flip" Look at Predatory Lending: Will the Fed's Revised Regulation Z End Abusive Refinancing Practices? 112 Yale L.J. 1919, 1923 & n.18 (2003); Engel and McCoy, A Tale of Three Markets: The Law and Economics of Predatory Lending, 80 Tex. L. Rev. 1255, 1269 & n.45 (2002); Venkatesan, Abrogating the Holder in Due Course Doctrine in Subprime Mortgage Transactions to More Effectively Police Predatory Lending, 7 N.Y.U.J. Legis. & Pub. Pol'y. 177, 216 & n.223 (2003/2004).

181. HOPEA triggers were reduced by the Federal Reserve Board of Governors from 10% for first-lien mortgages to 8% for the same. It should be noted that the Federal Reserve Board of Governors, as provided by the act, shall prohibit practices either in connection with all mortgage loans (if the Board finds a practice to be unfair, deceptive, or designed to evade HOEPA) or in connection with refinancing mortgage loans (if the Board finds that a practice is associated with abusive lending practices or otherwise not in the interest of the borrower). See 15 U.S.C.A. § 1639(l)(1) to (2) (2007). Thus, the potential for expanded assignee liability under HOEPA for all mortgage loans is a possibility.

182. 15 U.S.C.A. § 1639(l) (2007).

183. Truth in Lending, 66 Fed. Reg. 65,612 (Dec. 20, 2001).

184. The recent amendments to HOEPA require disclosure of certain creditor payments to mortgage brokers, prohibit creditors or mortgage brokers from influencing appraisers to misrepresent home values, and prohibit certain servicer practices. See Truth in Lending, 73 Fed. Reg. 44,603-04 (July 30, 2008).

185. In this section "state" is used to include the District of Columbia.

186. For example, the Maine Consumer Credit Code—Truth-in-Lending has an identical statement of purpose to the federal TILA. It states:

> The legislature finds that economic stabilization would be enhanced and the competition among the various financial institutions and other firms engaged in the extension of consumer credit would be strengthened by the informed use of credit. The informed use of credit results from an awareness of the cost thereof by consumers. It is the purpose of this Article to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit, and to protect the consumer against inaccurate and unfair credit billing and credit card practices.

Me. Rev. Stat. tit. 9-A § 8-102 (1981).

The Arkansas Home Loan Protection Act states, in part, that:

> Abusive lending has threatened the viability of many communities and caused decreases in homeownership
>
> While the marketplace appears to operate effectively for conventional mortgages, too many homeowners find themselves victims of overreaching lenders who provide loans with unnecessarily high costs and terms that are unnecessary to secure repayment of the loan and;
>
> As competition and self-regulation have not eliminated the abusive terms from home-secured loans, the consumer protection provisions of this chapter are necessary to encourage lending at reasonable rates with reasonable terms.

Ark. Code § 23-53-102(a)(7) to (9) (2003).

Illinois' Act states "[t]he purpose of this act is to protect borrowers who enter into high-risk home loans from abuse that occurs in the credit marketplace when creditors and brokers are not sufficiently regulated in Illinois. This act is to be construed as a borrower protection statute for all purposes." Ill. Rev. Stat. ch. 815 § 137/5 (2004).

187. See, e.g., Ill. Rev. Stat. ch. 815 § 137/5 (2004); Me. Rev. Stat. tit. 9-A § 8-102 (1981).

188. Gilmore, Formalism and the Law of Negotiable Instruments, 13 Creighton L. Rev. 441, 452 (1979) ("The banks, however, presently began to experiment with the novel idea of lending money to poor people. The idea paid off, no doubt beyond the wildest hopes of its investors—a fact attested to by the appearance, around the turn of the century, of small loan and sales finance companies").

189. Geiger, 182 S.E.2d at 523.

190. The *Geiger* court concluded that "Even where the buyer [does] read and comprehend the avalanche of legal consequences which would greet any default on his part, on the installment plan he must sign one conditional sales contract or another, and they are all pretty much alike." Geiger, 182 S.E.2d at 523. The *Martin* court held 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." Martin, 63 So. 2d at 653. Similarly, the FTC viewed creditors as better able to bear the risk of seller misconduct when it promulgated its rule preserving claims and defenses against financers of consumer goods and services. Preservation of Consumers' Claims and Defenses, 40 Fed. Reg. 53,506, 53,507 (Nov. 18, 1975).

191. Preservation of Consumers' Claims and Defenses, 40 Fed. Reg. 53,523 (Nov. 18, 1975).

192. Preservation of Consumers' Claims and Defenses, 40 Fed. Reg. 53,523 (Nov. 18, 1975).

193. Senate Report No. 103-169, at 28 (1994), reprinted in 1994 U.S.C.C.A.N. 188, 1912 (1994).

194. See, e.g., Eggert, Held up in Due Course: Predatory Lending, Securitization and the Holder in Due Course Doctrine, 35 Creighton L. Rev. 503, 608-09 (2002) ("the problem of predatory lending calls for the elimination of the holder in due course doctrine in all loans secured by the residences of the borrowers"); Engel and McCoy, Turning a Blind Eye: Wall Street Finance of Predatory Lending, 75 Fordham L. Rev. 2039, 2081 (2007) ("Our proposal would impose extensive liability on assignees that failed to adopt the due diligence standards we discuss below and would cap liability

for those assignees that complied with the specifications we outline"); Peterson, Predatory Structured Finance, 28 Cardozo L. Rev. 2185, 2282 (2007) ("growing calls for assignee liability reform are a very positive development in the law"); Forrester, Still Mortgaging the American Dream: Predatory Lending, Preemption, and Federally Supported Lenders, 74 U. Cin. L. Rev. 1303, 1364 ("Creation of assignee liability is one of the most effective means of dealing with predatory lenders"); Sinclair, Codification of Negotiable Instruments Law: A Tale of Reiterated Anachronism, 21 U. Tol. L. Rev. 625, 683 (1990) ("[the holder in due course rule] was probably unnecessary at the turn of the century, and almost certainly unnecessary when the U.C.C. was enacted"); Venkatesan, Abrogating the Holder in Due Course Doctrine in Subprime Mortgage Transactions to More Effectively Police Predatory Lending, 7 N.Y.U.J. Legis. & Pub. Pol'y. 177, 222 (2003/2004) ("The HDC doctrine that currently protects assignees is an anachronism grounded in public policy that is not relevant to the subprime mortgage industry").

195. Legislative and Regulatory Options for Minimizing and Mitigating Mortgage Foreclosures Before H. Fin. Services Comm., 110th Cong. 27 (2007) (statement of Ben S. Bernanke, Chairman, Bd. of Governors, Fed. Reserve Sys.) Responding to a question from Rep. Nydia M. Velazquez after his prepared testimony before the House Financial Services Committee, Chairman Bernanke said:

> With respect to assigning liability, I would say that there may be circumstances where it might prove a useful adjunct to some of these other methods, but I think it is extraordinarily important that we make sure that if that exists, if assignee liability exists, that the rules be very, very clearly delineated, the responsibilities of the investors be very, very clearly delineated, and that there not be some uncapped damages or unspecified damages they would be liable for because if you do that then the investors will simply consider it too risky and they will pull out and simply will not have any investment in this whole sector.

APPENDIX A

Bills of Exchange Act (1882)

Section 3 [Bill of Exchange Defined.]

(1) A bill of exchange is an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a sum certain in money to or to the order of a specified person, or to bearer.

(2) An instrument which does not comply with these conditions, or which orders any act to be done in addition to the payment of money, is not a bill of exchange.

(3) An order to pay out of a particular fund is not unconditional within the meaning of this section; but an unqualified order to pay, coupled with (a) an indication of a particular fund out of which the drawee is to re-imburse himself or a particular account to be debited with the amount, or (b) a statement of the transaction which gives rise to the bill, is unconditional

(4) A bill is not invalid by reason -

(a) That it is not dated;

(b) That it does not specify the value given, or that any value has been given therefore;

(c) That it does not specify the place where it is drawn or the place where it is payable.

Section 29 [Holder in Due Course.]

(1) A holder in due course is a holder who has taken a bill, complete and regular on the face of it, under the following conditions; namely,

(a) That he became the holder of it before it was overdue, and without notice that it had been previously dishonored, if such was the fact:

(b) That he took the bill in good faith and for value, and that at the time the bill was negotiated to him he had no notice of any defect in the title of the person who negotiated it.

(2) In particular the title of a person who negotiates a bill is defective within the meaning of this Act when he obtained the bill, or the acceptance thereof, by fraud, duress, or force and fear, or other unlawful means, or for an illegal consideration, or when he negotiates it in breach of faith, or under such circumstances as amount to a fraud

(3) A holder (whether for value or not), who derives his title to a bill through a holder in due course, and who is not himself a party to any fraud or illegality affecting it, has all the rights of that holder in due course as regards the acceptor and all parties to the bill prior to that holder.

Section 38 [Rights of the Holder.]

The rights and powers of the holder of a bill are as follows:

(1) He may sue on the bill in his own name.

(2) Where he is a holder in due course, he holds the bill free from any defect of title of prior parties as well as from mere personal defenses available to prior parties among themselves, and may enforce payment against all parties liable on the bill:

(3) Where his title is defective (a) if he negotiates the bill to a holder in due course, that holder obtains a good and complete title to the bill, and (b) if he obtains payment of the bill the person who pays him in due course gets a valid discharge for the bill.

Section 73 [Cheques on a Banker.]

A cheque is a bill of exchange drawn on a banker payable on demand. Except as otherwise provided in this part, the provisions of this Act applicable to a bill of exchange payable on demand apply to a cheque.

Section 89(1) [Promissory Notes.]

Subject to the provisions of this part, and except as by this section provided, the provisions of this Act relating to bills of exchange, apply, with the necessary modifications, to promissory notes.

Uniform Negotiable Instruments Law (1896)

Section 1. Form of a Negotiable Instrument

Be it enacted, etc., An instrument to be negotiable must conform to the following requirements:-

(1) It must be in writing and signed by the maker or drawer;

(2) Must contain an unconditional promise or order to pay a sum certain in money;

(3) Must be payable on demand, or at a fixed or determinable future time;

(4) Must be payable to order or to bearer; and,

(5) Where the instrument is addressed to a drawee, he must be named or otherwise indicated therein with reasonable certainty.

Section 52 What Constitutes a Holder in Due Course

A holder in due course is a holder who has taken the instrument under the following conditions: -

(1) That is complete and regular upon its face;

(2) That he became the holder if it before it was overdue, and without notice that it had been previously dishonored, if such was the fact;

(3) That he took it in good faith and for value;

(4) That at the time it was negotiated to him he had no notice of any infirmity in the instrument or defect in the title of the person negotiating it.

Section 53 When Person Not Deemed Holder in Due Course

Where an instrument is payable on demand is negotiated an unreasonable length of time after its issue, the holder is not deemed a holder in due course.

Section 54 Notice Before Full Amount Paid

Where the transferee receives notice of any infirmity in the instrument or defect in the title of the person negotiating the same before he has been paid the full amount agreed to be paid therefore, he will be deemed a holder in due course only to the extent of the amount heretofore paid by him.

Section 57 Rights of a Holder in Due Course

A holder in due course hold the instrument free from any defects of title of prior parties, and free from defenses available to prior parties among themselves, and may enforce payment of the instrument for the full amount thereof against all parties liable thereon.

Section 58 When Subject to Original Defenses

In the hands of any holder other than a holder in due course, a negotiable instrument is subject to the same defenses as if it were non-negotiable. But a holder who derives his title through a holder in due course, and who is not himself a party to any fraud or illegality affecting the instrument, has all the rights of such former holder in respect to all parties prior to the latter.

Section 59 Who Deemed Holder in Due Course

Every holder is deemed prima facie to be a holder in due course; but when it is shown that the title of any person who has negotiated the instrument was defective, the burden is on the holder to prove that he or some person under whom he claims acquired the title as holder in due course. But the last mentioned rule does not apply in favor of a party who became bound on the instrument prior to the acquisition of such defective title.

Uniform Commercial Code, Tentative Draft No. 1— Article 3 (1946)

Section 1. Instruments Included.

(1) Unless otherwise specified "instrument" in this Article means a writing which is negotiable within this Section.

(2) Except as otherwise provided in Article V and Article VI, any writing to be negotiable must

(a) be signed by the maker or drawer;

(b) contain an unconditional promise or order to pay a sum certain in money and no other promise, order, obligation, or power except as authorized by this Article;

(c) be payable on demand or at a definite future time; and

(d) be payable to order or to bearer.

(3) No particular form of words is necessary to an instrument.

Section 40. Holder in Due Course.

A holder in due course is any holder who takes the instrument

(a) for value, in good faith, and without notice that it is overdue, has been dishonored, or is subject to any defense or claim.

Section 42. Good Faith.

Good faith means honesty in fact in the conduct or transaction concerned.

Uniform Commercial Code (1952)

Section 3-302. Holder in Due Course.

(1) A holder in due course is a holder who takes the instrument

(a) for value; and

(b) in good faith including the observance of the reasonable commercial standards of any business in which the holder may be engaged; and

(c) without notice that it is overdue or has been dishonored or of any defense against or claim to it on the part of any person

(2) A payee may be a holder in due course.

(3) A holder does not become a holder in due course of an instrument:

(a) by purchase of it at judicial sale or by taking it under legal process; or

(b) by acquiring it in taking over an estate; or

(c) by purchasing it as part of a bulk transaction not in regular course of business of the transferor.

(4) A purchaser of a limited interest can be a holder in due course only to the extent of the interest purchased.

Uniform Commercial Code (1990)

Section 3-104 Negotiable Instrument.

(a) Except as provided in subsections (c) and (d), "negotiable instrument" means 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, if it:

(1) is payable to bearer or to order at the time it is issued or first comes into possession of a holder;

(2) is payable on demand or at a definite time; and

(3) does not state any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment of money, but the promise or order may contain (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 on or dispose of collateral, or (iii) a waiver of the benefit of any law intended for the advantage or protection of an obligor.

(b) "Instrument" means a negotiable instrument.

Section 3-106. Unconditional Promise or Order.

(a) Except as provided in this section, for the purposes of Section 3-104(a), a promise or order is unconditional unless it states (i) an express condition to payment, (ii) that the promise or order is subject to or governed by another writing, or (iii) that rights or obligations with respect to the promise or order are stated in another writing. A reference to another writing does not of itself make the promise or order conditional.

(b) A promise or order Is not made conditional (i) by a reference to another writing for a statement of rights with respect to collateral, prepayment, or acceleration, or (ii) because payment is limited to resort to a particular fund or source.

(c) If a promise or order requires, as a condition to payment, a countersignature by a person whose specimen signature appears on the promise or order, the condition does not make the promise or order conditional for the purposes of Section 3-104(a). If the person whose specimen signature appears on an instrument fails to countersign the instrument, the failure to counter-sign is a defense to the obligation of the issuer, but the failure does not prevent a transferee of the instrument from becoming a holder of the instrument.

(d) If a promise or order at the time it is issued or first comes into possession of a holder contains a statement, required by applicable statutory or administrative law, to the effect that the rights of a holder or transferee are subject to claims or defenses that the issuer could assert against the original payee, the promise or order is not thereby made conditional for the purposes of Section 3-104(a); but if the promise or order is an instrument, there cannot be a holder in due course of the instrument.

Section 3-109. Payable to Bearer or to Order.

(a) A promise or order is payable to bearer if it:

(1) states that it is payable to bearer or to the order of bearer or otherwise indicates that the person in possession of the promise or order is entitled to payment;

(2) does not state a payee; or

(3) states that it is payable to or to the order of cash or otherwise indicates that it is not payable to an identified person.

(b) A promise or order that is not payable to bearer is payable to order if it is payable (i) to the order of an identified person or (ii) to an identified person or order. A promise or order that is payable to order is payable to the identified person.

(c) An instrument payable to bearer may become payable to an identified person if it is specially indorsed pursuant to Section 3-205(a). An instrument payable to an identified person may become payable to bearer if it is indorsed in blank pursuant to Section 3-205(b).

Section 3-203. Transfer Of Instrument; Rights Acquired By Transfer.

(a) An instrument is transferred when it is delivered by a person other than its issuer for the purpose of giving to the person receiving delivery the right to enforce the instrument.

(b) Transfer of an instrument, whether or not the transfer is a negotiation, vests in the transferee any right of the transferor to enforce the instrument, including any right as a holder in due course, but the transferee cannot acquire rights of a holder in due course by a transfer, directly or indirectly, from a holder in due course if the transferee engaged in fraud or illegality affecting the instrument.

(c) Unless otherwise agreed, if an instrument is transferred for value and the transferee does not become a holder because of lack of indorsement by the transferor, the transferee has a specifically enforceable right to the unqualified indorsement of the transferor, but negotiation of the instrument does not occur until the indorsement is made.

(d) If a transferor purports to transfer less than the entire instrument, negotiation of the instrument does not occur. The transferee obtains no rights under this Article and has only the rights of a partial assignee.

Section 3-302. Holder in Due Course.

(a) Subject to subsection (c) and Section 3-106(d), "holder in due course" means the holder of an instrument if:

(1) the instrument when issued or negotiated 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 that the instrument was 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).

(b) Notice of discharge of a party, other than discharge in an insolvency proceeding, is not notice of a defense under subsection (a) but discharge is effective against a person who became a holder in due course with notice of the discharge. Public filing or recording of a document does not itself constitute notice of a defense, claim in recoupment, or claim to the instrument.

(c) Except to the extent a transferor or predecessor in interest has rights as a holder in due course, a person does not acquire rights of a holder in due course of an instrument taken (i) by legal process or by purchase in an execution, bankruptcy, or creditor's sale or similar proceeding, (ii) by purchase as a part of a bulk transaction not in ordinary course of business of the transferor, or (iii) as the successor in interest to an estate or other organization.

(d) If, under Section 3-303(a)(1), the promise of performance that is the consideration for an instrument has been partially performed, the holder may assert rights as a holder in due course of the instrument only to the fraction of the amount payable under the instrument equal to the value of the partial performance divided by the value of the promised performance.

(e) If (i) the person entitled to enforce an instrument has only a security interest in the instrument and (ii) the person obliged to pay the instrument has a defense, claim in recoupment, or claim to the instrument that may be asserted against the person who granted the security interest, the person entitled to enforce the instrument may assert rights as a holder in due course only to an amount payable under the instrument which, at the time of enforcement of the instrument, does not exceed the amount of the unpaid obligation secured.

(f) To be effective, notice must be received at a time and in a manner that gives a reasonable opportunity to act on it.

(g) This section is subject to any law limiting status as a holder in due course in particular classes of transactions.

Section 3-305. Defenses and Claims in Recoupment.

(a) Except as stated in subsection (b), the right to enforce the obligation of a party to pay an instrument is subject to the following:

(1) a defense of the obligor based on (i) infancy of the obligor to the extent it is a defense to a simple contract, (ii) duress, lack of legal capacity, or illegality of the transaction which, under other law, nullifies the obligation of the obligor, (iii) fraud that induced the obligor to sign the instrument with neither knowledge nor reasonable opportunity to learn of its character or its essential terms, or (iv) discharge of the obligor in insolvency proceedings;

(2) a defense of the obligor stated in another section of this Article or a defense of the obligor that would be available if the person entitled to enforce the instru-

ment were enforcing a right to payment under a simple contract; and

(3) a claim in recoupment of the obligor against the original payee of the instrument if the claim arose from the transaction that gave rise to the instrument; but the claim of the obligor may be asserted against a transferee of the instrument only to reduce the amount owing on the instrument at the time the action is brought.

(b) The right of a holder in due course to enforce the obligation of a party to pay the instrument is subject to defenses of the obligor stated in subsection (a)(1), but it is not subject to defenses of the obligor stated in subsection (a)(2) or claims in recoupment stated in (a)(3) against a person other than the holder.

(c) Except as stated in subsection (d), in an action to enforce the obligation of a party to pay the instrument, the obligor may not assert against the person entitled to enforce the instrument a defense, claim in recoupment, or claim to the instrument (Section 3-306) of another person, but the other person's claim to the instrument may be asserted by the obligor if the other person is joined in the action and personally asserts the claim against the person entitled to enforce the instrument. An obligor is not obliged to pay the instrument if the person seeking enforcement of the instrument does not have rights of a holder in due course and the obligor proves that the instrument is a lost or stolen instrument.

(d) In an action to enforce the obligation of an accommodation party to pay an instrument, the accommodation party may assert against the person entitled to enforce the instrument any defense or claim in recoupment under subsection (a) that the accommodated party could assert against the person entitled to enforce the instrument, except the defenses of discharge in insolvency proceedings, infancy, and lack of legal capacity.

Section 3-306. Claims to an Instrument.

A person taking an instrument, other than a person having rights of a holder in due course, is subject to a claim of a property or possessory right in the instrument or its proceeds, including a claim to rescind a negotiation and to recover the instrument or its proceeds. A person having rights of a holder in due course takes free of the claim to the instrument.

APPENDIX B

MILLER v. RACE, 1 Burr. 452, 97 Eng. Rep. 398 (K.B. 1758).

Miller versus Race. Tuesday, 31st Jan. 1758. Bank notes, though stolen, the property of the person to whom they are paid, without knowledge of the larceny. [See 1 Bos. 649. 4 Durn. 30, 325. 1 Hen. Bl. 318. 3 Durn. 554, and S. C. cited and S. P. adjudged on a bill of exchange, payable to A. or bearer. 3 Burr. 1519.

[S. C. 1 Sm. L. C. (11th ed.) 463. Adopted, *Lichfield Union* v. *Greene,* 1857, 1 H. & N. 889. Referred to, *Crouch v. Credit Foncier,* 1873, L. R. S Q. B. 381 ; *Goodwin v. Robarts,* 1875-76, L. R. 10 Ex. 350 ; 1 App. Cas. 476 ; *London & County Banking Company v. London & River Plate Bank,* 1887-88, 20 Q. B. D. 238 ; 21 Q. B. D. 543.]

It was an action of trover against the defendant, upon a bank note, for the payment of twenty-one pounds ten shillings to one William Finney or bearer, on demand.

The cause came on to be tried before Lord Mansfield at the sittings in Trinity term last at Guildhall, London : and upon the trial it appeared that William Finney, being possessed of this bank note on the 11th of December 1756, sent it by the general post, under cover, directed to one Bernard Odenharty, at Chipping Norton in Oxfordshire ; that on the same night the mail was robbed, and the bank note in question (amongst other notes) taken and carried away by the robber ; that this bank note, on the 12th of the same December, came into the hands and possession of the plaintiff, for a full and valuable consideration, and in the usual course and way of his business, and without any notice or knowledge of this bank note being taken out of the mail.

It was admitted and agreed, that, in the common and known course of trade, bank notes are paid by and received of the holder or possessor of them, as cash ; and that in the usual way of negotiating bank notes, they pass from one person to another as cash, by delivery only and without any further inquiry or evidence of title, than what arises from the possession. It appeared that Mr. Finney, having notice of this robbery, on the 13th December, applied to the Bank of England, "to stop the payment of this note:" which was ordered accordingly, upon Mr. Finney's entering into proper security "to indemnify the bank."

[453] Some little time after this, the plaintiff applied to the bank for the payment of this note ; and for that purpose delivered the note to the

defendant, who is a clerk in the bank : but the defendant refused either to pay the note, or to re-deliver it to the plaintiff. Upon which this action was brought against the defendant.

The jury found a verdict for the plaintiff, and the sum of 21l. 10s. damages, subject nevertheless to the opinion of this Court upon this question—"Whether under the circumstances of this case, the plaintiff had a sufficient property in this bank note, to entitle him to recover in the present action?"

Mr. Williams was beginning on behalf of the plaintiff.—

But Lord Mansfield said, "that as the objection came from the side of the defendant, it was rather more proper for the defendant's counsel to state and urge their objection."

Sir Richard Lloyd, for the defendant.

The present action is brought, not for the money due upon the note ; but for the note itself, the paper, the evidence of the debt. So that the right to the money is not the present question : the note is only an evidence of the money's being due to him as bearer.

The note must either come to the plaintiff by assignment ; or must be considered as if the bank gave a fresh, separate, and distinct note to each bearer. Now the plaintiff can have no right by the assignment of a robber. And the bank cannot be considered as giving a new note to each bearer : though each bearer may be considered as having obtained from the bank a new promise.

I do not say whether the bank can, or cannot stop payment ; that is another question. But the note is only an instrument of recovery.

Now this note, or these goods (as I may call it,) was the property of Mr. Finney, who paid in the money : he is the real owner. It is like a medal which might entitle a man to payment of money, or to any other advantage. And it is by Mr. Finney's authority and request that Mr. Race detained it.

It may be objected, that this note is to be considered as cash "in the usual course of trade." But still, the [454] course of trade is not at all affected by the present question, about the right to the note. A different species of action must be brought for the note, from what must be brought against the bank for the money. And this man has elected to bring trover for the note itself, as owner of the note ; and not to bring his action against the bank for the money. In which action of trover, property can not be proved in the plaintiff : for a special proprietor can have no right against the true owner.

The cases that may affect the present are, 1 Salk. 126, M. 10 W. 3, *Anonymous*, coram Holt, Ch.J at Nisi Prius at Guildhall. There Ld. Ch.

J. Holt held, that the right "owner of a bank bill, who lost it, might have trover against a stranger who found it : but not against the person to whom the finder transferred it for a valuable consideration, by reason of the course of trade which creates a property in the assignee or bearer." 1 Ld. Raym. 738,[1] S. C. In which case the note was paid away in the course of trade : but this remains in the man's hands, and is not[2] come into the course of trade. H. 12 W. 3, B. R. 1 Salk. 283, 284, *Ford v. Hopkins*, per Holt, Ch.J. at Nisi Prius at Guildhall. "If bank notes, Exchequer notes, or million lottery tickets, or the like are stolen or lost, the owner has such an interest or property in them, as to bring an action, into whatsoever hands they are come. Money or cash is not to be distinguished but these notes or bills are distinguishable, and can not be reckoned as cash ; and they have distinct marks and numbers on them." Therefore the true owner may seize these notes wherever he finds them, if not passed away in the course of trade.

1 Strange, 505, H. 8 G. 1, in Middlesex, coram Pratt, Ch.J. *Armory v. Delamirie*, a chimney sweeper's boy found a jewel. It was ruled "that the finder has such a property as will enable him to keep it against all but the rightful owner, and, consequently, may maintain trover."

This note is just like any other piece of property until passed away in the course of trade. And here the defendant acted as agent to the true owner.

Mr. Williams contra for the plaintiff.

The holder of this bank note, upon a valuable consideration has a right to it, even against the true owner.

1st, the circulation of these notes vests a property in the holder, who comes to the possession of it, upon a valuable consideration.

[455] 2dly, this is of vast consequence to trade and commerce ; and they would be greatly incommoded if it were otherwise.

3dly, this falls within the reason of a sale in market-overt ; and ought to be determined upon the same principle.

First—He put several cases, where the usage, course, and convenience of trade, made the law : and sometimes, even against an Act of Parliament. 3 Keb. 444, *Stanley v. Ayles*, per Hale Ch.J. at Guildhall. 2 Strange, 1000, *Lumley v. Palmer* : where a parol acceptance of a bill of exchange was holden sufficient against the acceptor. 1 Salk. 23.

Secondly—This paper credit has been always, and with great reason, favoured and encouraged. 2 Strange, 946, *Jenys v. Fawler et Al'*.

The usage of these notes is, "that they pass by delivery only ; and are considered as current cash ; and the possession always carries with it the property." 1 Salk. 126, pl. 5, is in point.

A particular mischief is rather to be permitted, than a general inconvenience incurred. And Mr. Finney, who was robbed of this note, was guilty of some laches in not preventing it.

Upon Sir Richard Lloyd's argument, a holder of a note might suffer the loss of it, for want of title against a true owner ; even if there was a chasm in the transfer of it through one only out of five hundred hands.

Thirdly—This is to be considered upon the same foot as a sale in market overt.

2 Inst. 713. "A sale in market overt binds those that had right."

But it is objected by Sir Richard, "that there is a substantial difference between a right to the note, and a right to the money." But I say the right to the money will attract to it a right to the paper. Our right is not by assignment, but by law, by the usage and custom of trade. I do not contend that the robber, or even the finder of a note, has a right to the note : but after circulation, the holder upon a valuable consideration has a right.

We have a property in this note : and have recovered the value against the withholder of it. It is not material, what action we could have brought against the bank.

[456] Then he answered Sir Richard Lloyd's cases ; and agreed that the true owner might pursue his property, where it came into the hands of another, without a valuable consideration, or not in the course of trade : which is all that Ld. Ch. J. Holt said in 1 Salk. 284.

As to 1 Strange, 505, he agreed that the finder has the property against all but the rightful owner : not against him.

Sir Richard Lloyd in reply—

I agree that the holder of the note has a special property : but it does not follow that he can maintain trover for it, against the true owner.

This is not only without, but against the consent of the owner.

Supposing this note to be a sort of mercantile cash ; yet it has an earmark by which it may be distinguished ; therefore trover will lie for it. And so is the case of *Ford v. Hopkins*.

And you may recover a thing stolen from a merchant, as well as a thing stolen from another man. And this note is a mere piece of paper ; it may be as well stopped as any other sort of mercantile cash, (as, for instance, a policy which has been stolen). And this has not been passed away in trade ; but remains in the hands of the true owner. And therefore it does not signify in what manner they are passed away, when they are passed away : for this was not passed away. Here the true owner, or his servant (which is the same thing) detains it. And, surely, robbery does not devest the property.

This is not like goods sold in market overt ; nor does it pass in the way of a market overt ; nor is it within the reason of a market overt. Suppose it was a watch stolen : the owner may seize it, (though he finds it in a market overt,) before it sold there. But there is no market overt for bank notes.

I deny the holder's (merely as holder) having a right to the note, against the true owner ; and I deny that the possession gives a right to the note.

Upon this argument on Friday last, Ld. Mansfield then said that Sir Richard Lloyd had argued it so ingeniously, [457] that (though he had no doubt about the matter,) it might be proper to look into the cases he had cited, in order to give a proper answer to them ; and therefore the Court deferred giving their opinion, to this day. But at the same time, Ld. Mansfield said, he would not wish to have it understood in the city, that the Court had any doubt about the point.

Lord Mansfield now delivered the resolution of the Court.

After stating the case at large, he declared that at the trial, he had no sort of doubt, but this action was well brought, and would lie against the defendant in the present case ; upon the general course of business, and from the consequences to trade and commerce : which would be much incommoded by a contrary determination.

It has been very ingeniously argued by Sir Richard Lloyd for the defendant. But the whole fallacy of the argument turns upon comparing bank notes to what they do not resemble, and what they ought not to be compared to, viz. to goods, or to securities, or documents for debts.

Now they are not goods, not securities, nor documents for debts, nor are so esteemed : but are treated as money, as cash, in the ordinary course and transaction of business, by the general consent of mankind ; which gives them the credit and currency of money, to all intents and purposes. They are as much money, as guineas themselves are ; or any other current coin, that is used in common payments, as money or cash.

They pass by a will, which bequeaths all the testator's money or cash ; and are never considered as securities for money, but as money itself. Upon Ld. Ailesbury's[3] will, 900l. in bank-notes was considered as cash. On payment of them, whenever a receipt is required, the receipts are always given as for money ; not as for securities or notes.

So on bankruptcies, they cannot be followed as identical, and distinguishable from money : but are always considered as money or cash.

It is a pity that reporters sometimes catch at quaint expressions that may happen to be dropped at the Bar or Bench ; and mistake their meaning. It has been quaintly said, "that the reason why money can not be followed is, because it has no ear-mark :" but this is not true. The true reason is, upon account on the currency of it : it can not be recovered after it has passed in currency. So, in case of money stolen, the true owner can not recover it, after it has been paid away fairly and honestly upon a valuable and bona fide consideration : but before money has [458] passed in currency, an action may be brought for the money itself. There was a case in 1 G. 1, at the sittings, *Thomas v. Whip*, before Ld. Macclesfield : which was an action upon assumpsit, by an administrator against the defendant, for money had and received to his use. The defendant was nurse to the intestate during his sickness ; and, being alone, conveyed away the money. And Ld. Macclesfield held that the action lay. Now this must be esteemed a finding at least.

Apply this to the case of a bank-note. An action may lie against the finder, it is true ; (and it is not at all denied :) but not after it has been paid away in currency. And this point has been determined, even in the infancy of bank-notes ; for 1 Salk. 126, M. 10 W. 3, at Nisi Prius, is in[4] point. And Ld. Ch. J. Holt there says that it is "by reason of the course of trade ; which creates a property in the assignee or bearer." (And "the bearer" is a more proper expression than assignee.)

Here an inn-keeper took it, bona fide, in his business from a person who made an appearance of a gentlemen. Here is no pretence or suspicion of collusion with the robber : for this matter was strictly inquired and examined into at the trial ; and is so stated in the case, "that he took it for a full and valuable consideration, in the usual course of business." Indeed if there had been any collusion, or any circumstances of unfair dealing ; the case had been much otherwise. If it had been a note for 1000l. it might have been suspicious : but this was a small note for 21l. 10s. only : and money given in exchange for it.

Another case cited was a loose note[5] in 1 Ld. Raym. 738, ruled by Ld. Ch. J. Holt at Guildhall, in 1698 ; which proves nothing for the defendant's side of the question : but it is exactly agreeable to what is laid down by my Ld. Ch. J. Holt, in the case I have just mentioned. The action did not lie against the assignee of the bank-bill ; because he had it for valuable consideration.

In that case, he had it from the person who found it : but the action did not lie against him, because he took it in the course of currency ; and therefore it could not be followed in his hands. It never shall be followed into the hands of a person who bona fide took it in the course of currency, and in the way of his business.

The case of *Ford v. Hopkins*, was also[6] cited : which was in Hil. 12 W. 3, coram Holt Ch. J. at Nisi Prius, at Guildhall ; and was an action of trover for million-lottery tickets. But this must be a very incorrect report of that [459] case : it is impossible that it can be a true representation of what Ld. Ch. J. Holt said. It represents him as speaking of bank-notes, Exchequer-notes, and million lottery tickets, as like to each other. Now no two things can be more unlike to each other, than a lottery-ticket, and a bank-note. Lottery tickets are identical and specific : specific actions lie for them. They may prove extremely unequal in value : one may be a prize ; another, a blank. Land is not more specific, than lottery-tickets are. It is there said, "that the delivery of the plaintiff's tickets to the defendant, as that case was, was no change of property." And most clearly it was no change of the property ; so far, the case is right. But it is here urged as a proof "that the true owner may follow a stolen bank-note, into what hands soever it shall come."

Now the whole of that case turns upon the throwing in bank-notes, as being like to lottery tickets.

But Ld. Ch. J. Holt could never say "that an action would lie against the person who, for a valuable consideration, had received a bank note which had been stolen or lost, and bona fide paid to him :" even though the action was brought by the true owner : because he had determined otherwise, but two years before ; and because bank notes are not like lottery-tickets, but money.

The person who took down this case, certainly misunderstood Lord Ch. J. Holt, or mistook his reasons. For this reasoning would prove, (if it was true, as the reporter represents it,) that if a man paid to a goldsmith 500l. in bank notes, the goldsmith could never pay them away.

A bank-note is constantly and universally, both at home and abroad, treated as money, as cash ; and paid and received, as cash ; and it is necessary, for the purposes of commerce, that their currency should be established and secured.

There was a case in the Court of Chancery,[7] on some of Mr. Child's notes, payable to the person to whom they were given, or bearer. The notes had been lost or destroyed many years. Mr. Child was ready to pay them to the widow and administratrix of the person to whom they were made payable ; upon her giving bond, with two responsible sureties, (as is the custom in such cases,) to indemnify him against the bearer, if the notes should ever be demanded. The administratrix brought a bill ; which was dismissed because she either could not or would not give the security required. No dispute ought to be made with the bearer of a cash-note ; in regard to commerce, and for the sake of the credit of these notes ; [460] though it may be both reasonable and customary, to stay the payment, till inquiry can be made, whether the bearer of the note came by it fairly, or not.

Lord Mansfield declared that the Court were all of the same opinion, for the plaintiff ; and that Mr. Just Wilmot concurred.

Rule—That the postea be delivered to the plaintiff.

1. N.B. In this case, the transferee went to the bank ; and got a new bill in his own name. However, the case turned upon his having the note for a valuable consideration.

2. The fact seems to be quite otherwise.

3. *Popham et Al. v. Bathurst et Al.* in Chancery, 5th November, 1748.

4. V. ante, 454.

5. Ex relatione of another person.

6. V. ante, 454.

7. *Walmsley* against *Child*, 11th December, 1749. [1 Vez. 341. 3 Burr. 1524. 3 Durn. 454.]

APPENDIX C

State	AL	Code Section	Coverage	Liability	Safe Harbor	Offence	Defense
AR	Y	ARK. CODE ANN. § 23-53-105	HOEPA+	TILA	HOEPA	2 Years	-
CA	N	-	-	-	-	-	-
CO	Y	COLO. REV. STAT. § 5-3.5-201	HOEPA+	HOEPA	HOEPA	-	-
CT	Y	CONN. GEN. STAT. § 36a-746g	HOEPA	TILA	-	Loan Term	Loan Term
D.C.	Y	D.C. CODE § 26-1153.05	HOEPA+	HOEPA	HOEPA+	-	-
FL	Y	FLA. STAT. § 494.00793	HOEPA	HOEPA	HOEPA	-	-
GA	Y	GA. CODE. ANN. § 7-6A-6(b)	HOEPA+	HOEPA	HOEPA	1 Year	-
ID	N	-	-	-	-	-	-
IL	Y	815 ILL. COMP. STAT. 137/135(d)	HOEPA+	HOEPA	HOEPA+	5	-
IN	Y	IND. CODE § 24-9-5-1	HOEPA+	HOEPA	HOEPA+	5	-
KS	N	-	-	-	-	-	-
KY	Y	KY. REV. STAT. ANN. 360.100(1)(b), ¶2	HOEPA+	TILA	-	-	-
LA	N	-	-	-	-	-	-
ME	Y	ME. REV. STAT. ANN. tit. 9-A, § 8-209	HOEPA+	TILA	HOEPA	-	-
MD	Y	MD. CODE ANN., COM. LAW §§ 12-311, 12-1007	HOEPA+	TILA	-	-	-
MA	Y	MASS. GEN. LAWS ch. 183C, § 15	HOEPA+	HOEPA	HOEPA+	5	-
MI	N	-	-	-	-	-	-
MN	N	-	-	-	-	-	-
NV	Y	NEV. REV. STAT. § 598D.110	HOEPA	TILA	-	-	-
NJ	Y	N.J. STAT ANN. § 46:10B-27	HOEPA+	HOEPA	HOEPA+	6	-
NM	Y	N.M. Stat. § 58-21A-11	HOEPA+	HOEPA	HOEPA+	6	-
NY	Y	N.Y. BANKING LAW § 6-l(13)	HOEPA+	TILA	-	-	-
NC	Y	N.C. GEN. STAT. § 21-1.1E	HOEPA+	TILA	-	-	-
OH	Y	OHIO REV. CODE ANN. §§ 1349.27, 1349.29	HOEPA	HOEPA	-	3	-
OK	Y	OKLA. STAT. tit. 14A, § 5-203(11)	HOEPA	HOEPA	HOEPA	Loan Term	Loan Term
PA	N	-	-	-	-	-	-
RI	Y	R.I. GEN. LAWS § 34-25.2-7	HOEPA+	HOEPA	HOEPA+	5	-
SC	Y	S.C. CODE ANN. § 37-23-50	HOEPA+	TILA	-	6	-
TN	Y	TENN. CODE ANN. § 45-20-101	HOEPA+	HOEPA	HOEPA+	3	-
TX	Y	TEX. FIN. CODE ANN. § 349.003	HOEPA	TILA	HOEPA+	2	-
UT	N	-	-	-	-	-	-
WI	N	-	-	-	-	-	-

State = Jurisdiction
AL = Assignee Liability
Offence = Time in which borrower may file a claim under the statute
Defense = Time in which borrowers may assert claims or defenses in response to the note holder filing a claim against borrower

Safe Harbor Key
HOEPA – "Ordinary Due Diligence" standard
HOEPA+ – Extra requirements to satisfy due diligence

Coverage Key
HOEPA – Same "high cost loan" triggers as HOEPA, covers same loans as HOEPA
HOEPA+ – Lower "high cost loan" triggers, covers more loans that HOEPA

Liability Key
TILA – Assignee Liability only for violations of the chapter
HOEPA – Assignee Liability for all claims and defenses