MEMORANDUM OF LAW:
MORTGAGE NOTES ARE NOT NEGOTIABLE INSTRUMENTS UNDER THE UNIFORM COMMERICAL CODE AND THEREFORE CANNOT BE TRANSFERRED VIA ENDORSEMENT

INTRODUCTION

1. One of the main issues that surrounds this case (and which should surround nearly every foreclosure action filed in this State), is whether the subject promissory note at issue in the foreclosure case is a negotiable instrument.

2. Unfortunately, issues regarding the negotiability of the note appear to be rarely brought before trial courts' attention. Therefore, both trial and appellate courts in this State have not had the opportunity to consider these issues on their merits.

3. Indeed, a recent law review article published in the Pepperdine Law Review, Professor Dale Whitman identified only forty-two cases decided over the past twenty years in the entire United States in which a decision was "reached on the merits" regarding the negotiability of a mortgage note. *See* Dale A. Whitman, How Negotiability Has Fouled Up the Secondary Mortgage Market, and What to Do About it, 37 Pepp. L. Rv. 737 (2010).

4. Even more shocking, Professor Whitman identified only **two** of those forty-two cases in which a "the court provide[d] a thorough analysis of the negotiability of the note!" *See* Id. at 754.

5. Tracing the case law backwards in Florida, it appears that an analysis of mortgage notes was first articulated by the Fifth District in American Bank of the South v. Rothenberg, 598 So. 2d 289 (Fla. 5th DCA 1992).

6. There, the Court stated that "**the rights of the parties must be determined by the character of the promissory note**. In this case, the promissory note meets the requirements of

section 673.104, Florida Statutes (1991) and is thus a negotiable instrument." Id. at 291. *Bold emphasis added*.

7. Thus, the Rothenberg Court articulated a crucial first step in the analysis of a mortgage promissory note: a decision of whether the **character** of the note at issue is that of a negotiable instrument.

8. Unfortunately, more recent appellate decisions have not mentioned this essential first step, most likely because the character of the promissory note is not being questioned at the trial court level. *See e.g.* Taylor v. Deutsche Bank National Trust Company, 44 So. 3d 618, 622 (Fla. 5th DCA 2010) (merely providing that "a promissory note is a negotiable instrument" without any consideration as to how a promissory note is in fact negotiable); Riggs v. Aurora Loan Services, LLC, 36 So. 3d 932, 933 (Fla. 4th DCA 2010) (providing that "[t]he note was a negotiable instrument subject to the provisions of Chapter 673, Florida Statutes (2008)"); Perry v. Fairbanks, 888 So. 2d 725, 727 (Fla. 5th DCA 2004) (stating that "[a] promissory note is clearly a negotiable instrument within the definition of section 673.1041(1)" without providing an analysis of the statute).

9. Thus, these recent do not address the issue of a note's negotiability because the character of the note was apparently never questioned below.

10. In contexts other than mortgage promissory notes in which the character of the instrument was an issue in the trial court, the Second District has engaged in an examination of the negotiability statute and its application. *See inter alia* discussion regarding GMAC v. Honest Air Conditioning & Heating.

11. Consequently, when the character of the mortgage promissory note is questioned at the trial court level, the gratuitous assertion that "the note is a negotiable instrument" should not be

accepted at face value. Rather, courts should first examine each note at issue to determine whether the note at meets the strict and technical definitions of "negotiable instrument" found in Florida's Uniform Commercial Code.

DEFINITION OF NEGOTIABLE INSTRUMENT

12. Fla. Stat. §673.1041(1) provides the statutory definition of a negotiable instrument.

13. The statute begins by asserting that an instrument is negotiable if it is "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."

14. In addition, the instrument must also meet the three following prerequisites:

a. First, the instrument must be "payable to bearer or to order at the time it is issued or first comes into possession of a holder." §673.1041(1)(a);

b. Second, the instrument must be "payable on demand or at a definite time." §673.1041(b); and

c. Third, the instrument **must 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." §673.1041(c).[1]

15. For purposes of this memorandum, the third prong of the definition is of vital importance because, as Professor Whitman has stated, "The standard note form approved by Fannie Mae and Freddie Mac for use in one-to-four-family residential loans is 1,455 words in length in three pages without signatures, and notes used in loans on commercial properties are commonly several times that size."

[1] §673.1041(c) does provide three exceptions to the general rule that the promise or order must not contain any instruction or undertaking other than the payment of money. These exceptions are: (1) an undertaking or power to give, maintain, or protect collateral to secure payment; (2) an authorization or power to the holder to confess judgment or realize or dispose of collateral; and (3) a waiver of the benefit of any law intended for the advantage or protection of an obligor.

16. Inextricably imbedded within those 1,455 words are a host of undertakings and instructions by the person promising or ordering payment to do some act in addition to the payment of money.

17. By the clear statutory definition once one promise or undertaking is found, the character of the note cannot said to be negotiable.

18. Finally, if the note is not a negotiable instrument, it is not subject to transfer or enforcement pursuant to Fla. Stat. §673, *et seq.* Stated another way, the act of endorsing and transferring a mortgage promissory note is a nullity because endorsement and delivery only effectuates a transfer of a **negotiable** instrument. If an instrument is non-negotiable, it must be transferred pursuant to general contract law.

INSTRUCTIONS OTHER THAN THE PAYMENT OF MONEY

I. GMAC v. HONEST AIR CONDITIONING

19. In GMAC v. Honest Air Conditioning & Heating, Inc., 933 So. 2d 34 (Fla. 2d DCA 2006), the Second District concluded that "the trial court erred in finding that the [retail installment sales contract] was a negotiable instrument." Id. at 35.

20. There, the Court was confronted with a retail installment sale contract (hereinafter "RISC") entered into between GMAC and Honest Air for the purchase of an automobile. Id.

21. The Court noted that the RISC created certain instructions or undertakings in both the "person promising" to pay and the creditor ordering payment, including: (1) an instruction onto the debtor to not remove the vehicle from the United States; (2) an instruction onto the debtor to reimburse advances made by the creditor in payment of repair or storage bills; and (3) an instruction onto the creditor to dispose of the collateral in certain ways following repossession. Id. at 37.

22. **Most notable to our purposes here, the Second District noted that the RISC required the debtor to pay fees for late payment or dishonored checks**. Id.

23. Ultimately, the Second District held that these obligations "bring the RISC within the exclusionary language of section 673.1041(1)(c), which provides that a negotiable instrument 'does not state any other undertakings' in addition to the payment of money." Id.

24. The Court reasoned that this must be so because "[a] negotiable instrument should be 'simple, certain, unconditional, and subject to no contingencies. As some writers have said, it must be a courier without luggage.'" Id. (*citing* Mason v. Flowers, 91 Fla. 224, 107 So. 334, 335 (Fla. 1926)).

II. Instructions other than the payment of money contained in the subject note

25. A mere cursory glance at the ten page promissory note at issue here clearly reveals that the note contains instructions or undertakings on both the debtor promising payment and creditor ordering payment.

26. To begin, clause 8, entitled "Late Charge", obligates the debtor to pay a late charge if any sum payable under the note is not paid when due. This is directly on point to the Second District's conclusion in Honest Air that the obligation in the RISC requiring the debtor to pay late fees rendered the instrument non-negotiable.

27. Additionally, clause 5, entitled "Prepayment; Defeasance", obligates the debtor to send written notice to the creditor if it elects to prepay any portion of the unpaid principal balance due under the note. Professor Whitman noted that over a dozen years ago Professor Ronald Mann concluded that such words brought mortgage promissory notes within purview of the Uniform

Commercial Code's equivalent of §673.1041(1)(c) which rendered the subject notes non-negotiable.[2]

28. These clauses, in addition to the various other obligations the subject note requires, are clearly instructions or undertakings on either the debtor promising payment or the creditor ordering payment which bring the note within the "exclusionary language" of §673.1041(1)(c) and thus make the note non-negotiable.

INCORPORATING THE TERMS OF THE MORTGAGE INTO THE TERMS OF THE NOTE

29. Additional consideration should be given to the consequences of incorporating the terms of a mortgage agreement into the terms of a mortgage promissory note.

30. This is an extremely critical discussion with respect to the boarder implications of the Florida foreclosure crisis because foreclosing lenders have appeared to blend the two documents into one when instituting foreclosing actions.

31. More to the point, even if this Court determines that the note is negotiable, incorporating the terms of the mortgage into the terms of the note for purposes of a judicial foreclosure severs this negotiability because the mortgage contains numerous instructions and undertakings other than the payment of money.

32. Such instructions generally include: (1) the requirement that the debtor obtain property insurance; (2) the requirement that the debtor assign rents and profits which arise from the property to the creditor; and (3) the requirement that the creditor send the debtor a notice of intent to accelerate and right to cure prior to instituting a foreclosure action.

[2] It should be noted that both the clause requiring late payment and the clause requiring written notice of intent to prepay exist in the standard Fannie mortgage note for residential properties; thus, the analysis done here is equally applicable to an analysis to be done during foreclosures of residential mortgages.

33. In fact, in Holly Hill Acres Ltd. v. Charter Bank of Gainesville, 314 So. 2d 209, 211 (Fla. 2d DCA 1975), the Court distinguished between a note which provided that it was "secured by a mortgage" from one which stated that the terms of the mortgage were incorporated into the note holding that the later was clearly non-negotiable.

34. It is therefore wholly unclear how, even if the note is considered negotiable, negotiation could transfer rights and interests in the non-negotiable mortgage.

REQUIREMENT TO SHOW AGENCY RELATIONSHIP IN CERTAIN CIRCUMSTANCES IF NOTE DEEMED NEGOTIABLE

35. A final consideration should be given to the case which the foreclosing plaintiff claims to be the holder who is acting on behalf of some other entity.

36. Negotiation occurs only where there is a transfer of a negotiable instrument. *See* Fla. Stat. §673.2011.

37. A negotiable instrument is "transferred" "when it is delivered by a person other than the issuer for the person of giving to the person receiving delivery the right to enforce the instrument." Fla. Stat. §673.2031(1).

38. The transfer requirement of §673.2031(1) becomes extremely important in the situation where foreclosing plaintiffs plead they are the "holder" authorized to bring this action on behalf of the "owner."

39. In these cases, foreclosing plaintiffs often identify themselves, either in their pleadings or at a trial on the merits, as "servicers" of the mortgage note.

40. These servicers, however, are not actually holders of the mortgage notes pursuant to the Uniform Commercial Code.

41. Negotiation, as previously stated, requires both the transfer of an instrument and the instrument's delivery. Florida recognizes "constructive" delivery of negotiable instruments in

which an entity need not be in actual possession of the note in order to be a holder. *See e.g.* Lawyers Title Ins. Co. v. Novastar Mortg., Inc., 862 So. 2d 793, 798 (Fla. 4th DCA 2003).

42. In the case of a servicer, constructive delivery of the note is actually made to the true owner of the debt pursuant to a written contract. **The servicer, then, is merely the agent of the owner, who is the true holder of the note through constructive delivery**.

43. "The existence of an agency relationship is ordinarily a question to be determined by a jury in accordance with the evidence adduced at trial." Orlando Executive Park, Inc. v. Robbins, 433 So. 2d 491, 494 (Fla. 1983).

44. "The essential elements of an actual agency relationship are: (1) acknowledgment by the principal that the agent will act for him or her, (2) the agent's acceptance of the undertaking, and (3) control by the principal over the actions of the agent." Robbins v. Hess, 659 So. 2d 424, 427 (Fla. 1st DCA 1995) (*citing* Goldschmidt v. Holman, 571 So. 2d 422, 424 n.5 (Fla. 1990)).

45. Consequently, when a defendant-debtor questions the validity of a servicer's right to pursue a cause of action for foreclosure, the servicer must prove the agency relationship between itself and the true owner of the debt by evidence adduced at trial.

CONCLUSION

46. Based upon the authorities cited, *supra*, it is respectfully submitted that the subject promissory note is non-negotiable.