

SHOULD THE MORTGAGE FOLLOW THE NOTE?

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Abstract

The law of mortgage assignment has taken center stage amidst foreclosure crisis, robo-signing scandal, and controversy over the Mortgage Electronic Registration System. Yet a concept crucially important to mortgage assignment law, the idea that “the mortgage follows the note,” apparently has never been subjected to a critical analysis in a law review.

This Article makes two claims about that proposition, one positive and one normative. The positive claim is that it has been much less clear than typically assumed that the mortgage follows the note, in the sense that note transfer formalities trump mortgage transfer formalities. “The mortgage follows the note” is often described as a well-established principle of law, when in fact considerable doubt has attended the proposition at least since the middle of the last century.

The normative claim is that it is not clear that the mortgage should follow the note. The Article draws on the theoretical literature of filing and recording to show that there is a case that mortgage assignments should be subject to a filing rule and that “the mortgage follows the note,” to the extent it implies that transferee interests should be protected without filing, should be abandoned.

Whether mortgage recording should in fact be abandoned in favor of the principle “the mortgage follows the note” turns on the resolution of a number of empirical questions. This Article identifies key empirical questions that emerge from its application of principles from the theoretical literature on filing and recording to the specific case of mortgages.

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I. INTRODUCTION

An unprecedented wave of foreclosure litigation over securitized mortgages has thrust the previously obscure issue of mortgage transfer into the spotlight. Securitization involves multiple mortgage transfers,⁰ and homeowners fighting foreclosure have questioned whether foreclosing parties can prove that securitized mortgages were properly transferred.⁰ Mortgage transfer is also a central issue in related investigations and litigation over “robo-signing” and other foreclosure abuses,⁰ and over the propriety of the Mortgage Electronic Registration System.⁰ Apart from foreclosure-related matters, local title recording authorities have attacked the mortgage industry’s practice of not recording mortgage assignments in lawsuits across the country.⁰

⁰ See John Patrick Hunt, Richard Stanton & Nancy Wallace, *Rebalancing Public and Private in the Law of Mortgage Transfer*, 63 AM. U. L. REV. (forthcoming 2013) [hereinafter Hunt, Stanton & Wallace, *Rebalancing Public and Private*].

⁰ For accounts and analysis of the homeowner-lender dispute over mortgage transfer documentation, see, e.g. Nestor M. Davidson, *New Formalism in the Aftermath of the Housing Crisis*, 93 B.U. L. REV. 390, 403-05 (2013); Elizabeth Renuart, *Property Title Trouble in Non-Judicial Foreclosure States: The Ibanez Time Bomb?*, 4 WM. & MARY BUS. L. REV. 111, 131-39 (2013); David A. Dana, *Why Mortgage “Formalities” Matter*, 24 LOY. CONS. L. REV. 505, 514-22 (2012); Douglas J. Whaley, *Mortgage Foreclosures, Promissory Notes, and the Uniform Commercial Code*, 39 W. ST. U. L. REV. 313 (2012); Alan M. White, *Losing the Paper – Mortgage Assignments, Note Transfers and Consumer Protection*, 24 Loy. Cons. L. Rev. 468, 476-83, 489-93 (2012); Dustin A. Zacks, *The Grand Bargain: Pro-Borrower Responses to the Housing Crisis and Implications for Future Lending and Homeownership*, 57 LOY. L. REV. 541, 578-84 (2011)

⁰ See, e.g., Molly Rose Goodman, *The Buck Stops Here: Toxic Titles and Title Insurance* 42 REAL ESTATE L.J. 5 (2013) (describing creation of backdated mortgage assignments); Davidson, *supra* note 2, at 409-11, 427-29 (describing results of HUD Inspector General’s investigation into robo-signed mortgage assignments and \$25 billion national mortgage foreclosure settlement for robo-signing and related abuses).

⁰ See, e.g., John Patrick Hunt, Richard Stanton & Nancy Wallace, *All in One Basket: The Bankruptcy Risk of a National Agent-Based Mortgage Recording System*, 46 U.C. DAVIS L. REV. 1, 18-22 (2012) (describing legal and policy challenges to MERS).

⁰ See, e.g., Motions Hearing Transcript at 81:10-20, *Dallas County v. MERSCORP, Inc.*, No. 3:11-CV-2733-O (N.D. Tex. May 23, 2012) (denying in part motion to dismiss county recorders’ lawsuit seeking recovery based on failure to record mortgage assignments); *Montgomery Cnty., Pa. v. MERSCORP, Inc.*, 904 F. Supp. 2d 436, 454 (E.D. Pa. 2012) (same). *But see, e.g.*, *Plymouth County v. MERSCORP, Inc.*, 886 F. Supp. 2d 1114 (N.D. Iowa 2012) (dismissing county recorder lawsuit).

Mortgage transfer also continues to figure in disputes between parties engaged in mortgage investing.⁰

“The mortgage follows the note” is one of the signature phrases of all these controversies,⁰ and courts have found the phrase persuasive, often without serious analysis of whether it is accurate or whether the rule it reflects is desirable. This Article argues that “the mortgage follows the note” has been a much less well-settled proposition than is often assumed, and that there is a case based on the theoretical literature of filing and recording that the mortgage should *not* follow the note. Whether the mortgage should or should not follow the note depends on the resolution of several empirical questions, and this Article lays out a framework for research to resolve the issue.

⁰ See, e.g., *In re Cedar Funding, Inc.*, 2010 WL 1346365, at *4-*6 (Bankr. N.D. Cal. 2010) (holding that bankruptcy trustee of mortgage originator was permitted to avoid unrecorded assignments of deeds of trust so that general creditors prevailed over putative transferees).

⁰ See, e.g., ASF White Paper at 16 (“When a mortgage note is transferred in accordance with common mortgage loan securitization processes, the mortgage is also automatically transferred to the mortgage note transferee under the UCC and the general common law rule that ‘the mortgage follows the note.’”); Dustin A. Zacks, *Standing in Our Own Sunshine: Reconsidering Standing* 29 QUINNIPIAC L..REV. 551, 577 (2011) (“[I]t is commonplace for banks’ attorneys to ... endlessly repeat[] the mantra that ‘the mortgage follows the note’”).

The Article apparently is the first piece in the law-review literature to offer sustained criticism of the mortgage-follows-the-note rule⁰ and to apply insights from the literature evaluating titling regimes to the peculiarities of mortgages.⁰

What does “the mortgage follows the note” mean? Although the expression is used to stand for several different legal propositions, this Article concentrates on one meaning of the phrase: that note-transfer formalities trump mortgage-transfer formalities such as recording mortgage assignments. When understood in this sense, “the mortgage follows the note” implies that recording mortgage assignments is unnecessary to protect the transferee’s interest. It is this proposition – that the transferee is protected even if it does not record its interest in the mortgage because “the mortgage follows the note” – that the Article examines.

Mortgage finance historically has been understudied relative to its importance,⁰ so the issues raised by the idea that the mortgage follows the note may be unfamiliar. The Article

⁰ The foreclosure crisis has brought forth an outpouring of commentary, largely by practitioners, about whether “the mortgage follows the note” is or is not generally correct as a matter of positive law. The author has not, however, discovered any analysis questioning whether it should be the rule. For arguments that the mortgage follows the note, see Martin C. Bryce et al., *Challenging Progress: County Recorder Lawsuits Against MERS*, 17th Annual Consumer Financial Services Institute, Mat 3-4, 2012; Steven O. Weise, *Setting the UCC Record Straight on Mortgage Loans*, ALI-ABA CLE, April 26-27, 2012; Brett Natarelli & James Golden, *The End of the Beginning in the Battle over MERS*, 65 CONSUMER FIN. L.Q. 400 (2011); Kraetli Q. Epperson, *Case Note: BAC Home Loans – The Mortgage Follows the Note*, 65 CONSUMER FIN. L.Q. 415 (2011); Lawrence A. Young et al., *Foreclosures, Bankruptcy, and the Subprime Crisis*, 63 CONSUMER FIN. L.Q. 49, 57 n.108 (2009). For more skeptical analyses, see Deborah L. Thorne & Ethel Hong Badawi, *Does “The Mortgage Follow the Note”?*, AM. BANKR. INST. J., May 2011, at 54 (reliance on the principle leads to “unpredictable results”); Neil C. Robinson, III, *Into the Matrix: The Future of the Unauthorized Practice of Law in Real Estate Closings Following Matrix Financial Services Corp. v. Frazer*, 63 S.C. L. REV. 1001, 1015 (2012) (same); *Consumer Bankruptcy Panel*, EMORY BANKR. DEV. J. 257, 262-63 (2011); Victoria V. Corder, *Homeowners and Bondholders as Unlikely Allies: Allocating the Costs of Securitization in Foreclosure*, 40 NO. 5 BANKING & FIN. SERVS. POL’Y REP. 19, 23 (2011). For arguments that “the mortgage follows the note” is the right rule, see discussion *infra* Part III

⁰ In previous work, the author has addressed arguments for public mortgage records other than those based on efficiency. See Hunt, Stanton & Wallace, *Rebalancing Public and Private*, *supra* note 1.

⁰ For example, \$13.4 trillion of mortgage debt was outstanding in the United States during the first quarter of 2012. <http://www.federalreserve.gov/econresdata/releases/mortoutstand/current.htm>. By contrast, \$11.1 trillion in Treasury bonds were held by all individuals, corporations, state or local governments, foreign governments, and other entities outside the United States government as of August 3, 2012. http://www.treasurydirect.gov/govt/resources/faq/faq_publicdebt.htm#DebtOwner. Total capitalization of the U.S. stock market as measured by the Wilshire 5000 Total Market Index was \$14.5 trillion on August 8, 2012.

therefore starts with very basic principles and examples, with the author’s apologies to readers for whom such a basic introduction is unnecessary.

When you buy something, you want to make sure you own it. And if you own something, you don’t want someone else to be able to sell it out from under you. These principles often conflict⁰ — what are we to do if A owns property and entrusts it to B, who then “sells” it to C who takes in good faith? Large swathes of commercial and property law are aimed at mitigating the conflict. The law provides rules for determining who owns property when ownership is contested, and it provides different types of rules for different types of property.

Things can get particularly tricky when two different types of property, each subject to different rules, are bundled together. Such is the case for the simple mortgage on a house. It consists of both a promissory note embodying a personal promise to pay (the note) and a security interest in real property that gives the lender rights in that property in case of default (the mortgage).⁰ But the law has different rules for promissory notes and for interests in real property. That can cause complications.

To get the flavor of the problem, consider a simplified (and therefore inaccurate, although suggestive)⁰ version of the law governing ownership of notes and mortgages. Imagine that the law says that if you possess a promissory note, you own it and no one can take it away from you.

⁰ This is sometimes called the conflict between the “nemo dat” principle and the “bona fide purchaser.” On the one hand, no one should be able to convey what she doesn’t own (“nemo dat quod non habet”). On the other, someone who buys in good faith (a “bona fide purchaser”) should be able to own what he paid for. “Nemo dat” promotes security of title and protecting the bona fide purchaser promotes security of exchange. The conflict between the two principles has been resolved in different ways at different times. *See* BENITO ARRUÑADA, INSTITUTIONAL FOUNDATIONS OF IMPERSONAL EXCHANGE 76 (2012) (describing different resolutions of the issue).

⁰ This Article uses the term “mortgage” to refer to any security interest in real property. Even though there are many different types of real property security interests that vary from state to state, such as the deed of trust, contract for deed, etc., it is common to refer to all of them as mortgages. *See, e.g.*, RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES, Introduction, at 3.

⁰ Compare GEORGE E.P. BOX & NORMAN R. DRAPER, EMPIRICAL MODEL-BUILDING AND RESPONSE SURFACES 424 (1987) (“Essentially, all models are wrong, but some are useful.”).

Further imagine that the law has a different rule for real property: It says that you don't own an interest in real property unless you record a document in a local title office stating that the interest has been transferred to you. For a mortgage, the relevant recordable document would be a mortgage assignment.

Now let's assume you want to buy a mortgage from Sarah as an investment. You pay for it and Sarah gives you the promissory note, but you don't record your interest in the mortgage in the title records. Then Sarah wrongfully decides to sell the same mortgage again to someone else, call him Fred. Fred checks the title records, sees that no one else has claimed an interest in the real property, and pays Sarah. Sarah gives Fred an assignment of the mortgage and Fred records it. What happens? Certainly Sarah owes you and/or Fred something after her double dealing. But who owns what and who has to look to Sarah to be made whole? Do you own the note and mortgage because you possess the note? Does Fred own them because he was the first to record his interest in the mortgage? Is it that you own the note and Fred owns the mortgage? Is the last possibility just nonsense?⁰

There are other ways your ownership of the mortgage could be threatened, ways that are less vivid than the double sale above but probably more common. Let's say Larry has lent money to Sarah and she has agreed to put up the note and mortgage as collateral for the loan, before she purports to sell them to you. If Sarah defaults, are you or Larry first in line to get the value of the mortgage? Does it depend on whether Larry recorded his interest in the mortgage or took possession of the note?⁰

⁰ A variant on the idea that separation of mortgage and note is impossible is the proposition that even if they are separated, the noteholder or note owner has an equitable right to get an assignment of the mortgage from the mortgage holder. See Dale A. Whitman, *A Proposal for a National Mortgage Registry: MERS Done Right*, 78 MO. L. REV. (forthcoming 2013) [hereinafter Whitman, *MERS Done Right*], manuscript at 7-8 (arguing that the general rule is that the noteholder can get an equitable assignment of the mortgage when the two instruments are separated).

Or let's say Peter sues Sarah, wins, and gets a judgment against her. Can Peter get his hands on the mortgage, given that you didn't record your interest? Or let's say Sarah goes bankrupt. Now there is a bankruptcy trustee charged with representing Sarah's creditors who stands in the shoes of someone who has a judgment lien on all of Sarah's property⁰ and in the shoes of someone who has made a bona fide purchase of all of Sarah's real property.⁰ Can the trustee reach "your" mortgage? Your note? Such disputes appear rather common,⁰ arising for example in the high-profile bankruptcy of the large subprime mortgage originator New Century Financial.⁰

⁰ The situation described in the text is a conflict over priority in the mortgage. For examples of disputes over priority in mortgage loans, *see, e.g.*, *Landmark Land Co v. Sprague*, 529 F. Supp. 971 (S.D.N.Y. 1981) (dispute over priority in rights to deed of trust among successive purportedly secured lenders); *Bedortha v. Sunridge Land Co.*, 822 P.2d 694 (Or. 1991) (contest over right to receive payments under land sale contract between judgment lienor of vendor and assignee, where land sale contract treated as real estate financing device); *Army Nat'l Bank v. Equity Developers, Inc.*, 774 P.2d 919, 926-31 (Kan. 1989) (contest over priority in mortgage foreclosure proceeds between lender who took security interest in mortgage loan and purported bona fide purchaser of loan); *Security Bank v. Chiapuzio*, 747 P.2d 335 (Or. 1987) (dispute between secured lender who took vendor's interest in land sale contract as collateral and assignee of vendor's interest, where vendor's interest treated as a mortgage); *Prime Fin. Servs. v. Vinson*, 761 N.W.2d 694, 700 (Mich. App. 2008) (dispute over priority between competing secured lenders to mortgage originator where each lender took mortgages and notes as collateral).

⁰ 11 U.S.C. § 544(a)(1)-(2)

⁰ 11 U.S.C. § 544(a)(3).

⁰ For examples of situations where a bankruptcy trustee seeks to reach imperfectly transferred mortgages, *see, e.g.*, *In re First T.D. & Inv., Inc.*, 253 F.3d 520, 524 (9th Cir. 2001) (bankruptcy trustee of real estate investment company not permitted to avoid investors' security interest in mortgages because security interest was perfected); *In re Maryville Sav. & Loan Corp.*, 743 F.2d 413 (6th Cir. 1984) (dispute over whether lender who took assignment of deeds of trust could recover deeds of trust from bankrupt debtor; issue was whether lender's interest in deeds of trust was perfected); *In re Staff Mortg. & Inv. Corp.*, 625 F.2d 281 (9th Cir. 1980) (bankruptcy trustee of buyer and seller of mortgages permitted to avoid investors' security interest in mortgages because security interest was not perfected); *In re Allen*, 134 B.R. 173 (9th Cir. B.A.P. 1991) (issue of material fact as to whether bankruptcy trustee could avoid assignment of deed of trust because issue of fact existed as to whether assignee had perfected its interest); *In re Cedar Funding, Inc.*, 2010 WL 1346365, at *4-*6 (Bankr. N.D. Cal. 2010) (holding that bankruptcy trustee of mortgage originator was permitted to avoid unrecorded assignments of deeds of trust); *In re SGE Mortg. Funding Corp.*, 278 B.R. 653, 655-56 (Bankr. M.D. Ga. 2001) (contest over mortgages between lender who took mortgages as collateral and purchaser of mortgages in originator bankruptcy); *In re Kennedy Mortg. Co.*, 17 B.R. 957 (Bankr. D.N.J. 1982) (contest between secured lender who took mortgages as collateral and unsecured creditors in originator's bankruptcy); *Prime Fin. Servs. v. Vinson*, 761 N.W.2d 694, 700 (Mich. App. 2008) (mortgage assignment did not render perfected mortgage investor's security interest in note).

⁰ *See* Robert S. Friedman & Eric R. Wilson, *The Legal Fallout from the Subprime Crisis*, 124 BANKING L.J. 420 (2007) (detailing claim of Alaska Seaboard Partners, L.P. that because New Century Financial sold Alaska certain loans, the loan proceeds were not property of the New Century bankruptcy estate).

You of course might be inclined to ignore all this. You might trust Sarah and might decide it's not worth your time and energy to think through the consequences of her possible fraud or bankruptcy. But mortgage financiers and dealers do worry about these problems, and they have for a long time. As this Article demonstrates, there is a persistent anxiety about what people who buy mortgages or lend against them have to do to make sure their interests are protected.

The issue is all the more important because mortgages in the United States are so often financed by securitization. Securitization entails creating large pools of mortgages, which requires the original lender to transfer the mortgages into the pool, usually through a series of intermediate steps. So each mortgage is transferred several times. Investors who buy mortgage-backed securities want to be sure that the trusts that are supposed to own the mortgage pools actually do own them. So the problem of making sure ownership interests are protected when transferred recurs repeatedly for each mortgage.

Industry practice during the securitization boom of the 2000s was *not* to record mortgage assignments. Apparently, this was a change from standard practice in earlier periods.⁰ The previously unnoticed practice of not recording mortgage assignments has become quite controversial in the foreclosure crisis as the mortgage securitization industry's conduct has come under intense scrutiny.

No one claims that the mortgage securitization industry recorded mortgage assignments in the 2000s. Instead, the argument is that recording or not recording mortgage assignments is

⁰ At least as late as the 1990s, it was still common to record mortgage assignments at least in some situations. See Dale A. Whitman, *Digital Recording of Real Estate Conveyances*, 32 J. MARSHALL L. REV. 227, 241 (1999) (mortgage assignments are among the "twenty or thirty form documents that account for the vast bulk of real estate recordings").

irrelevant as long as the note is transferred correctly, because “the mortgage follows the note.”⁰ This “mellifluous phrase”⁰ has found favor in the courts; those that recite the phrase follow it far more often than they reject it.⁰ The expression can have several meanings, all of which elevate certain note-related rules relative to mortgage-related rules.

Specifically, “the mortgage follows the note” can mean that the transferee can enforce a properly transferred note regardless of any defects in the transfer of the mortgage. It can mean that an attempted transfer, negotiation, or assignment of the note presumptively should be understood as an attempted transfer of the mortgage. It can mean that the statute of limitations on the note and not the mortgage governs enforcement by foreclosure.⁰ Or it can mean that the party who owns the note automatically owns the mortgage, regardless of any mortgage-related

⁰ See, e.g., *Merritt v. Bartholick*, 36 N.Y. 44, 45 (1867) (“a transfer of the mortgage without the debt is a nullity, and no interest is acquired by it”); *Bank of New York v. Silverberg*, 86 A.D.3d 274, 926 N.Y.S.2d 532, 536 (2011) (N.Y. App. Div. 2011) (collecting New York cases following *Merritt*); *HSBC Bank USA, N.A. v. Taher*, No. 9320/09, 2011 WL 2610525 (N.Y. Sup. July 1, 2011); *In re Veal*, 450 B.R. 897, 909 (9th Cir. B.A.P. 2011); *In re Macklin*, No. 10-44610-E-7, 2011 WL 2015520 (Bankr. E.D. Cal. May 19, 2011); *In re Doble*, No. 10-11296-MM13, 2011 WL 1465559 (Bankr. S.D. Cal., April 14, 2011); *Elvin v. Wucetich*, 157 N.E. 243, 244-45 (Ill. 1927) (“It has often been decided that a mortgage cannot exist as an independent security in the hands of one person while the note it is given to secured belongs to another”); *In re Tucker*, 441 B.R. 638, 641 (Bankr. W.D. Mo. 2010) (“Effectively, the note and the deed of trust are inseparable.”). A search in the ALLCASES database on Westlaw on May 23, 2012 on the phrase “the mortgage follows the note” returned 111 results, 73 of which are from 2007 on. The court using the phrase followed the rule in all but three cases.

⁰ Adam J. Levitin, Written Testimony Before the House Fin. Servs. Comm., Nov. 18, 2010, at 21.

⁰ Massachusetts may be the only jurisdiction that has clearly rejected the proposition outright. See *In re Marron*, 455 B.R. 1, 6 (Bankr. D. Mass. 2011) (“Massachusetts, unlike many other states, does not subscribe to the theory that the “mortgage follows the note”) (citing *U.S. Bank v. Ibanez*, 941 N.E.2d 40, 54 (Mass. 2011); *Barnes v. Boardman*, 149 Mass. 106, 114 (1889)). *Id.* at *6 n.7 (“[T]he MERS phenomenon has created a national Massachusetts-like model where the legal and beneficial ownership of mortgages has been separated. Courts in states which do not permit the separation of ownership of notes and mortgages understandably find this a challenge which may account for some of the inconsistency in decisional authority...”).

⁰ See William Schwartz, *The Holocaust: Does Time Heal All Wrongs?*, 20 CARDOZO L. REV. 433, 436 (1998).

rules such as real property recording laws that might give a contrary result.⁰ This Article focuses on the last of these possible meanings.

The Article first demonstrates, in Part II, that although “the mortgage follows the note” is often stated as though it were a settled proposition of law, there has been uncertainty since the drafting and enactment of the Uniform Commercial Code in the middle of the last century about whether transferring the note according to the rules for notes was enough to transfer the mortgage in a way that would be good against subsequent claimants. Uncertainty persists even though the 1999 revisions to the Code’s official text adopt the mortgage-follows-the-note principle, because the Code’s interaction with other law is unclear.

Second, the Article questions whether “the mortgage follows the note” is the right rule. Part III analyzes justifications that have been proffered for the rule, finding them all wanting. Some older cases that have become widely cited of late rely on formalistic rhetoric about the metaphysical unity of mortgage and note rather than substantive argument. Such reasoning can be rejected out of hand. More recently, commentators have justified “the mortgage follows the note” on the grounds of party intent and efficiency. The Article argues that the intent of transacting parties is an insufficient basis for the rule because the rule affects the interests of third parties, and that the efficiency argument relies on the use of a practice (inspecting and taking possession of notes), that is both ineffective under current law and inconsistent with recent commercial reality.

More generally, the theoretical case for primacy of the note and against mortgage recording is unclear, as Part IV indicates. A rich literature addresses whether filing and recording

⁰ See Shaun Barnes, Kathleen G. Cully, and Steven L. Schwarcz, *In-House Counsel’s Role in the Structuring of Mortgage-Backed Securities*, 2012 WISC. L. REV. 521, 524 n.7 (2012) (U.C.C. §9-203(g) providing for automatic perfection of interest in mortgage with perfection of interest in note “codified [the] common law rule”).

regimes are appropriate or inappropriate for different types of property and different transactions, but scholars working on mortgages generally have not exploited its insights. Drawing on this body of work, the Article identifies several characteristics of real-property mortgages that suggest that recording is appropriate. For example, mortgages are identified with specific parcels of real property and have a relatively long life. Other characteristics of mortgages suggest that recording is unnecessary: mortgages apparently are rarely stolen, for example.

The literature on filing and recording also helps identify empirical questions that are crucial to deciding whether mortgage assignments should be covered by a recording rule or not. These questions include how frequently the typical mortgage is transferred and what cost savings can be achieved by digitizing the recording system. Ultimately, whether mortgages should or should not be covered by a recording rule probably depends on the outcome of these empirical inquiries.

Why is this important, given that the mechanics of mortgage transfer is a fairly technical subject? First, mortgage transfer is a subject of significant practical importance. It attracted much attention from scholars and practitioners when the U.C.C. was enacted and has continued to do so over the intervening decades. Second, there is an opportunity for action. Attention is focused on reforming mortgage securitization in the interest of all parties involved at the same time that technology is eroding the advantage of “the mortgage follows the note.” There is an opportunity to recognize and assert the importance of public mortgage records by rejecting a rule that the mortgage follows the note and adopting a recording rule, assuming that the outcome of empirical research supports doing so.

II. THE PERSISTENT ANXIETY

At least since the drafting of the Uniform Commercial Code, there has been uncertainty about whether a party taking an assignment of a mortgage needs to record its interest in the official title records in order to make sure that that interest is protected from competing claims. Although the 1999 amendments to Article 9 of the Code make it reasonably clear that the Code itself provides that “the mortgage follows the note,” they do not in themselves resolve the potential conflict between the Code and real-property law.

The discussion here focuses on protection of the assignee’s ownership interest, not on the important but distinct question whether failure to record mortgage assignments affects the ability to enforce the mortgage.⁰ A number of state statutes seem to require expressly that parties record mortgage assignments in order to use nonjudicial foreclosure,⁰ and much has been written by courts and commentators about the effect of these statutes, as well as the effect of the standing and real party in interest doctrines, on mortgage enforcement and foreclosure. Indeed, most cases embracing the proposition that “the mortgage follows the note” deal with foreclosure.⁰ Thus, judicial statements that recording is not needed for effective “transfer” can be understood as referring to transfer of the right to enforce the mortgage, not transfer of an ownership interest

⁰ Ownership of a promissory note and the right to enforce the note are clearly understood to be two different things, see Permanent Editorial Board for the U.C.C., *Application of the Uniform Commercial Code to Selected Issues Relating to Mortgage Notes*, Nov. 14, 2011, at 8 (“The rules that determine whether a person is a person entitled to enforce the note do not require person to be the owner of the note, and a change in ownership of the note does not necessarily bring about a concomitant change in the identity of the person entitled to enforce the note. This is because the rules that determine who is entitled to enforce a note and the rules that determine whether the note, or an interest in it, have been effectively transferred serve different functions.”); *In re Veal*, 450 B.R. 897, 912 (9th Cir. B.A.P. 2011) (“[O]ne can be an owner of a note without being a ‘person entitled to enforce.’”). Commentators do not always strictly observe this distinction when writing about mortgages.

⁰ For a sampling of caselaw on mortgage assignment and enforceability, see *Wells Fargo Bank v. Marchione*, 887 N.Y.S.2d 615 (N.Y. App. Div. 2009) (no standing to foreclose without mortgage assignment); *Wells Fargo Bank v. Byrd*, 897 N.E.2d 722 (Ohio App. 2008) (no standing to foreclose absent note and mortgage assignment); *Morgan v. HSBC Bank*, 2011 WL 3207776 (Ky. App. July 29, 2011) (ownership of mortgage must be proven separately from ownership of note); *Wells Fargo Bank, N.A. v. Lupori*, 8 A.3d 919 (Pa. Super. 2010) (foreclosure failed where no mortgage chain asserted).

that will defeat competing claims to the mortgage.⁰ Although some of what is said here may be relevant to enforcement of the mortgage, enforcement is not the focus of the discussion. Instead, the Article focuses on the unsettled⁰ question of ownership of the mortgage.

Although 1999 revisions to the U.C.C. purported to “adopt[] the traditional view that the mortgage follows the note,”⁰ in fact from the time states first considered Article 9 of the U.C.C. in the 1950s,⁰ there has been uncertainty over the scope of the Code’s coverage of real property interests such as mortgages. Despite changes to the language of the U.C.C.’s official comments in 1964, confusion continued to reign until the amendments adopted in 1999. The U.C.C. governed transfer of promissory notes from its inception,⁰ but whether the Code also governed

⁰ None of the 111 cases using the phrase “the mortgage follows the note” dealt with a mortgage ownership contest. Almost all of them dealt with disputes over mortgage enforceability. *See also* MERSCORP HOLDINGS, INC LAW DEPARTMENT, CASE LAW OUTLINE: 1ST QUARTER 2012 7-193 (April 2012) (187-page compilation of foreclosure cases, many of them addressing “mortgage follows the note” issues). This contrasts with the relatively small number of cases dealing with mortgage ownership disputes discussed below.

⁰ *See, e.g.*, *Bates v. MERS, Inc.*, 2011 WL 1304486 (D. Nev, March 30, 2011), at *3 n.1.

⁰ Compare *In re Shuster*, 784 F.2d 883 (8th Cir, 1986) (real property recording statute and not U.C.C. governed perfection of lien on “contract for deed,” an instrument the court treated the same as a mortgage); *In re Maryville Savings Bank*, 743 F.2d 314 (6th Cir. 1974) (assignee had perfected security interest in deed of trust and not in note); *In re Bristol Assocs.*, 505 F.2d 1056, 1061 (3d Cir. 1974) (“[w]here a promissory note and mortgage together become the subject of a security interest, only that portion of the package unrelated to the real property” is covered by U.C.C. Article 9 filing and perfection rules); *In re Ivy Properties, Inc.*, 109 B.R. 10, 12-13 (Bankr. D. Mass. 1989) (following “most courts” in applying state recording law to security interest in mortgage) with *In re Kennedy Mortgage Co.*, 17 B.R. 957, 962 (Bankr. D.N.J. 1982) (“[I]t is not necessary under the Uniform Commercial Code or the Bankruptcy Code or State Statutes for an assignee of a mortgage to record the assignment of the mortgage in order to have a secured status”).

⁰ U.C.C. § 9-308 cmt. 6.

⁰ The process of revising and combining preexisting uniform commercial laws into an integrated code began in 1940. Robert Braucher, *The Legislative History of the Uniform Commercial Code*, 58 COLUM. L. REV. 798, 799 (1958). A complete draft appeared in 1949. *Id.* at 800. The Code was revised through the 1950s, *id.* at 804. Pennsylvania was the first to adopt, in 1953, Allen R. Kamp, *Downtown Code: A History of the Uniform Commercial Code 1949-1954*, 49 BUFF. L. REV. 359, 381 (2001), and others followed starting in 1957. Braucher, *supra*, at 804. At least by 1970, all states but Louisiana had adopted the Code. *See Books for Bankers*, 87 BANKING L.J. 1123 (Dec. 1970) (describing adoption by all states but Louisiana).

⁰ 1 GRANT GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 14.1, at 439 (1965) (describing rules under original U.C.C. for perfection of interests in “instruments” by possession).

mortgages – in other words, whether note formalities trumped mortgage formalities, that is, whether the mortgage followed the note – was unclear.

The magisterial *American Law of Property* stated in 1952 that “although a mortgage debt is a chose in action, yet, where the subject of the security is land, the mortgagee is treated as having ‘an interest in the land’ and priorities are governed by the rules applicable to interests in land.”⁰ The treatise also made it clear that recording act provisions specifically were relevant to priority of interests in land.⁰

As an indication of the backdrop against which the Code was adopted, in 1956, an article in the *University of Pennsylvania Law Review* observed that there were several potential ways for a type of interim mortgage financier known as a warehouse lender to perfect its security interest in mortgages, and recognized potential risks from all of them except the most conservative, “recording an assignment and taking possession of all the mortgage documents.”⁰

As initially drafted, the Code contained two potentially conflicting provisions, one (Section 9-104(j)) providing that Article 9 does not apply to “the creation or transfer of an interest in real estate,”⁰ another (Section 9-102(3)) near-impenetrably stating, “the application of this Article to a security interest in a secured obligation is not affected by the fact that the

⁰ See GEORGE OSBORNE, 4 AMERICAN LAW OF PROPERTY §16.119, at 281 (1952).

⁰ Osborne explains that the first-in-time-first-in-right principle for subsequent assignments applies “[i]f unaffected by recording act provisions” and that the competing rule that a subsequent assignee can protect itself against prior claims by inquiring of the debtor and giving notice of the assignment “does not apply where recordation of assignments is provided for – and the recording acts of practically all states, at least permissively, do so provide.” *Id.* at 281-82. This discussion is especially important because Osborne apparently subscribed to the “indissoluble unity” theory of mortgage and note. See discussion *infra*.

⁰ Murdoch K. Goodwin, *Mortgage Warehousing – a Misnomer*, 104 U. PA. L. REV. 494, 506 (1956). “Mortgage warehousing,” as described in Goodwin’s article, is a practice that involves the interim financier appointing an employee of the originating mortgage company receiving the financing to serve as “custodian” and hold the mortgage documents on behalf of the interim financier. *Id.* at 495-96.

⁰ U.C.C. §9-104(j) (original)

obligation is itself secured by a transaction or interest to which this Article does not apply.”⁰ An Official Comment to the original U.C.C. provided that Article 9 did not apply to the creation of mortgages but did apply to the security interest in a mortgage created when the note and mortgage were pledged as collateral.⁰

No less an authority than Grant Gilmore recognized the turmoil here, stating that § 9-102(3) “confusingly undercuts” § 9-104(j) and does so in “somewhat obscure language.”⁰ Gilmore notes that “no statutory solution is provided” to “the question [of] the possible effect of §9-102(3) in a state where transfers of mortgages are required to be recorded in the real property records.”⁰

In 1963, Peter Coogan, a “prominent participant in the development of the UCC”⁰ echoed the popular view: the Code “will have no effect on mortgages which cover land and land alone,”⁰ but “if a note secured by a mortgage is used as collateral in another transaction, the Code applies to the pledge of the note and the mortgage whether or not some recording under real estate law is required for the assignment of the mortgagee’s interest in the mortgage.”⁰ Thus they

⁰ U.C.C. § 9-102(3) (original).

⁰ U.C.C. § 9-102 cmt. 4 (1959 version). The original comment stated:

“An illustration of Subsection (3) is as follows:

The owner of Blackacre borrows \$10,000 from his neighbor, and secures his note by a mortgage on Blackacre. This Article is not applicable to the creation of the real estate mortgage. However, when the mortgagee in turn pledges this note *and mortgage* to secure his own obligation to X, this Article is applicable to the security interest thus created in the note *and the mortgage*. Whether the transfer of the collateral for the note, i.e., the mortgagee’s interest in Blackacre, requires further action (such as assignment of the mortgagee’s interest) is left to real estate law. See Section 9-104(j).” (emphasis added)

⁰ 1 GILMORE, *supra* note 33, § 10.6, at 311 (1965).

⁰ *Id.*

⁰ Jonathan C. Lipson, *Secrets and Liens: The End of Notice in Commercial Finance Law*, 21 Emory Bankr. Dev. L.J. 421, 424 n.8 (2005).

⁰ Peter F. Coogan & Albert L. Clovis, *The Uniform Commercial Code and Real Estate Law: Problems for Both the Real Estate Lawyer and the Chattel Security Lawyer*, 38 IND. L.J. 535, 548 (1963).

⁰ Coogan & Clovis, *id.*, at 548-59.

embraced the possibility that recording could be required to perfect a security interest in mortgages.

Coogan acknowledged the ambiguity again in a 1965 article in the *Harvard Law Review*. The article reports that New York title companies argued that the new UCC *would* cover mortgages and require filing of a UCC financing statement (in addition to delivery and assignment of the mortgage).⁰ Although the authors dubbed the title companies' position "unduly fearful,"⁰ the dispute illustrates the confusion over whether Article 9 covered mortgages. The same authors expressed their view that "assignment of the note carries with it *as a matter of law* the security interest in the collateral for the note,"⁰ although they acknowledged that "[t]his conclusion may not be free from doubt," because it is "inconsistent with the practice of real estate lawyers"⁰ stemming from "express state statutory provisions for recording assignments of real estate mortgages."⁰

Although Comment 4 to Section 9-102 was amended in 1966⁰ so that it addressed only the creation of security interests in notes, not mortgages,⁰ this did not resolve the question of applicability of the recording statutes to transfer of a mortgage. The Comment continued to state

⁰ See Peter F. Coogan et al., *The Outer Fringes of Article 9: Subordination Agreements, Security Interest in Money and Deposits, Negative Pledge Clauses, and Participation Agreements*, 79 HARV. L. REV. 229, 270 (1965).

⁰ Coogan et al., *supra* note 44, at 271.

⁰ Coogan, *supra* note 44, at 271.

⁰ Coogan, *supra* note 44, at 272.

⁰ Coogan, *supra* note 44, at 272.

⁰ See Jan Z. Krasnowiecki et al., *The Kennedy Mortgage Co. Bankruptcy Case: New Light Shed on the Position of Mortgage Warehousing Banks*, 56 AM. BANKR. L.J. 325, 332 n.22 (1982) (arguing that many sources erroneously put the date at 1962).

⁰ Krasnowiecki et al., *supra* note 49, at 331-32.

that Article 9 “leaves to other law the question of the effect on the rights under the mortgage ... of recording or non-recording of an assignment of the mortgagee’s interest.”⁰

The Comment, as revised, embraces the possibility that different regimes could cover the mortgage and the note. And the weight of authority from 1966 to 1999 appears to have been that different regimes did cover mortgage and note, with “the mortgage follows the note” being one of several potentially applicable rules. In re *Bristol Associates, Inc.*, decided by the Third Circuit in 1974, is instructive. There, the court observed that “[w]here a promissory note and mortgage together become the subject of a security interest, only that portion of the package unrelated to the real property is now covered” by Article 9.⁰

In 1976, a commentator writing in the *Colorado Law Review* concluded after a thorough review of the drafting of the Code and comments that “mortgages as liens on real estate are always excluded from Code coverage, although the obligation secured by the mortgage does fall within the scope of Article 9.”⁰ The commentator stated that this “seems correct because the mortgage generally represents nothing more than a lien on land,”⁰ and apparently assumed that perfection of an interest in a mortgage would be governed by real property recording law.⁰

⁰ Krasnowiecki et al., *supra* note 49, at 332.

⁰ In re *Bristol Assocs., Inc.*, 505 F.2d 1056, 1061 (3d Cir. 1974). *Bristol Associates* dealt with whether Article 9 covered the assignment of a lease as collateral for a loan, so the court’s observation about the note may be dicta. Nevertheless, the proposition that real property recording was relevant to the assignment of mortgage and note for security apparently was the leading position.

⁰ Comment, *An Article 9 Scope Problem – Mortgages, Leases, and Rents as Collateral*, 47 U. COLO. L. REV. 449, 464 (1976).

⁰ Comment, *supra* note 53, at 464.

⁰ The author did not directly address whether mortgages were covered by real property recording laws, but assumed this was the case for leases because a lease is “to a limited extent” an “interest in lands.” Comment, *supra* note 53, at 464. recommending that the U.C.C. provide a perfection rule “because of gaps in the state recording acts.” *Id.*

In 1978, the Florida Court of Appeals held that a security interest in a mortgage was governed by the Florida real property recording statute and not the Uniform Commercial Code, pointing to the general practice of the Florida banking industry and a sense that “chaos would result” if lenders who took mortgages as collateral had to make U.C.C. filings.⁰

In 1979, a note in the *Columbia Law Review*⁰ by a future Cravath partner and securitization pioneer⁰ observed that the “convoluted history” of Article 9 had “understandably” created confusion in courts “that have had to confront the question of the law applicable to security interests in mortgages.”⁰ The author concluded that the best solution was to “hav[e] the mortgage follow the note in priority disputes. Article 9 should be applied to determine which party has a prior claim to the note; the right to the mortgage should always vest in the same party.”⁰

The recession of the early 1980s brought the issue to the fore, as there were a number of bankruptcies of mortgage originators who had received bridge financing from “warehouse lenders” and had pledged mortgages and notes as collateral. Because the warehouse lenders at least arguably constructively possessed the notes through custodians but typically did not record

⁰ Rucker v. State Exch. Bank, 355 So. 2d 171, 174 (Fla. Dist. Ct. App. 1978). This was not an ownership contest case; instead the court held that the borrower, who paid the assignor of the mortgage and not the assignee after a mortgage was assigned in a recorded assignment, was bound by the state of the real property record. The borrower had paid the wrong party (the assignor), so the assignee could foreclose on her property. *Id.* at 174.

⁰ Gregory M. Shaw, *Security Interest in Notes and Mortgages – Determining the Applicable Law*, 79 COLUM L. REV. 1414 (1979).

⁰ See <http://www.cravath.com/gshaw/> (accessed December 16, 2013).

⁰ *Id.* at 1417.

⁰ Shaw, *supra* note 57, at 1432. Krasnowiecki et al. object to Shaw’s analysis because he argues that Article 9 covers “all facets of transactions using mortgages and notes as collateral,” *id.* at 1427, but does not adequately explain why, if Article 9 applies, the mortgage follows the note, as Article 9 at that time had no provision to that effect. Krasnowiecki et al., *supra* note 49, at 333 n.22.

assignments of the mortgages, these cases “provide[d] an acid test of the steps which are necessary to perfect an interest in the mortgage.”⁰

As Jan Krasnowiecki (then a law professor at the University of Pennsylvania) and his co-authors wrote at the time, “a number of commentators have expressed concern that something more” than taking possession of the note “may be required to perfect a security interest in the note *and* mortgage.”⁰ The authors concluded that nothing more should be required, because the statutes calling for mortgage recording were drafted to deal with the “mortgagor’s world,” that is to say people contemplating transactions with the borrower in the underlying land.⁰ These people include purchasers of the land. The authors concluded that the real property statutes had no application to the “mortgagee’s world,” populated by the people who were contemplating purchasing the mortgage from the mortgagee or lending to the mortgagee on the strength of the mortgage as collateral.⁰

The “different worlds” argument had a mixed reception in the courts. The case that occasioned their article, *In re Kennedy Mortgage Co.*,⁰ was consistent with Krasnowiecki’s reasoning, and another case decided 19 years later, *In re SGE Funding Corp.*⁰ explicitly followed his analysis. In the latter case, the court concluded that a mortgage broker’s unrecorded assignment of its interest in promissory notes and mortgages to its funders would be governed by

⁰ Krasnowiecki et al., *supra* note 49, at 339.

⁰ Krasnowiecki et al., *supra* note 49, at 329.

⁰ The authors provided only very sparse authority for this proposition – two or three older cases.

⁰ Krasnowiecki et al., *supra* note 49, at 334.

⁰ 17 B.R. 957 (Bankr. D.N.J. 1982). *See also* Landmark Land Co. v. Sprague, 529 F. Supp. 971, 976-77 (S.D.N.Y. 1981) (“authority from various jurisdictions is divided” but “[t]he more compelling view” is that article 9 governs both note and mortgage when note is assigned as security), *rev’d on other grounds*, 701 F.2d 1065 (2d Cir. 1982).

⁰ 278 B.R. 653 (Bankr. M.D. Ga. 2001).

the UCC's rules and not the recording statutes because it took place in the "mortgagee's world,"⁰ while the "purpose and intent of the recording statutes are to protect those in the "mortgagor's world."⁰

Other decisions at least implicitly rejected the two-worlds hypothesis. For example, In *re Maryville Savings & Loan Corp.*⁰ held expressly that it is necessary "to analyze the security interest created in the promissory note separately from the interest created in the deed of trust"⁰ and that "the U.C.C. does not supersede the law in this state *with respect to liens upon real estate.*"⁰ The result was that a bank that had recorded an assignment of deeds of trust but had not taken possession of the notes had a perfected interest in the deeds of trust but not in the notes.⁰ In 1989, a bankruptcy court in Massachusetts found that "[m]ost courts" had adopted a "bifurcated approach" under which Article 9 governed the promissory notes and other law governed the mortgage.⁰

And the dispute continued up until adoption of the 1999 amendments. For example, a 1989 article contended that because a "deed of trust or real estate mortgage represents an interest

⁰ 278 B.R. at 662.

⁰ *Id.*. The court in *SGE* relied heavily on *In re Kennedy Mortgage Co.*, 17 B.R. 957 (Bankr. D.N.J. 1982), which was also the basis of Krasnowiecki's article. *See supra* note 49.

⁰ 743 F.2d 413 (6th Cir. 1984).

⁰ *Id.* at 415.

⁰ 743 F.2d at 416 (emphasis in original).

⁰ 743 F.2d at 416-17. In a clarification, the court explained that the debtor's bankruptcy trustee received the proceeds of the notes, but that the bank "might" be entitled to the proceeds of foreclosure on the deeds of trust. 760 F.2d 119, 121. *See also In re Bristol Assocs.*, 505 F.2d 1056 (3d Cir. 1974).

⁰ *In re Ivy Properties, Inc.*, 109 B .R. 10, 12-13 (Bankr. D. Mass. 1989). Although the court determined that "[r]ecording of mortgage assignments does not appear to be necessary under the wording of the Massachusetts statute governing recording of real property interests," *id.* at 13-14, what is relevant here is that the court analyzed the issue under state recording law.

in real estate,” Article 9 “does not apply,” so “real estate recording requirements must be satisfied.”⁰

The *Restatement (Third) of Property: Mortgages*, which appeared in 1997, does not purport to address successive assignments of a mortgage and thus did not take a position on whether the mortgage follows the note in that context. The comments to the *Restatement* call the subject “complex” and expressly defer to “other bodies of law, including the recording acts and the Uniform Commercial Code, that are beyond the scope of this Restatement.”⁰ As of 1997, real-estate-oriented treatises continued to recommend that the mortgage assignment be recorded, at least when the note and mortgage were to serve as collateral for a loan to the mortgagor: *Powell on Real Property* reminded practitioners that “it is always important to record the document creating the real estate interest – in this case the assignment,”⁰ and that “for unchallenged protection, the new lender should take possession of the note serving as security and should also record the assignment of the mortgage.”⁰

As late as 1998, when the 1999 amendments were being discussed, Professor Grant Nelson argued that the view that “the mortgage simply follows the note” is “the better view, and the one that is receiving growing acceptance,”⁰ although he recognized that the position that “a

⁰ Keith Meyer, *A Potpourri of Agricultural U.C.C. Issues: Attachment, Real Estate-Growing Crops and Federalization*, 12 *HAMLIN L. REV.* 741, 752 (1989).

⁰ RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES § 5.4 cmt. d.

⁰ See 4 MICHAEL ALAN WOLF, *POWELL ON REAL PROPERTY* § 37.27[2], at 37-178 (2011). Although this treatise bears a 2011 copyright date, the introduction to the chapter on mortgages states that the 1997 revision was prepared by Anne Copps of Albany, New York, and does not refer to any later revisions. *Id.* at 37-1.

⁰ *Id.*

⁰ Grant S. Nelson, *The Contract for Deed as a Mortgage: The Case for the Restatement Approach*, 1998 *B.Y.U. L. REV.* 1111, 1157-58 (1998).

security interest in the mortgage must be perfected under state recording act principles” has been taken by “some commentators” and “a few cases.”⁰

The intent to adopt the “mortgage follows the note” rule in the 1999 UCC amendments seems reasonably clear, at least to those versed in the revisions’ counterintuitive nomenclature conventions. Section 9-203(g) provides, “the attachment of a security interest in a right to payment or performance” – that is, a security interest in the note – “is also attachment of a security interest in the security interest, mortgage, or other lien” securing the note.⁰ Section 9-308(e) provides, “Perfection of a security interest in a right to payment or performance also perfects a security interest in a security interest, mortgage, or other lien on personal or real property securing the right.”⁰ Thus, a security interest in a mortgage is attached and perfected along with the security interest in the accompanying note. Although the language about “security interest[s]” on its face seems to cover only security transactions and not outright transfers, the UCC uses the term “security interest” to include a buyer’s ownership interest.⁰

The comments to the 1999 amendments further suggest that the drafters’ intent in making the changes was to codify “the mortgage follows the note.” The commentary on Section 9-308 reads, “Section 9-203(g) adopts the traditional view that the mortgage follows the note; i.e., the transferee of the note acquires the mortgage as well.”⁰ Commentary on Section 9-203 likewise states, “Subsection (g) codifies the common-law rule that a transfer of an obligation secured by a

⁰ Nelson, *supra* note 77, at 1157.

⁰ U.C.C. § 9-203(g).

⁰ U.C.C. § 9-308(e).

⁰ See generally Permanent Editorial Board for the Uniform Commercial Code, *Report of the Permanent Editorial Board for the Uniform Commercial Code: Application of the Uniform Commercial Code to Selected Issues Relating to Mortgage Notes*, *supra* note 26, at 8-12.

⁰ U.C.C. §9-308 cmt. 6.

security interest or other lien on personal or real property also transfers the security interest or lien.”⁰

Thus, it is generally believed that the 1999 amendments purported to adopt the “mortgage follows the note” principle.⁰ Such a purpose certainly seems consistent with the revisions’ overall intent to make it easier to create and perfect security interests.⁰ Nevertheless, the revisions were enacted against an unclear background, as commentators explaining the revisions noted⁰ and as some of the comments implicitly recognize. For example, the official commentary provides, “[t]his Article rejects cases such as *In re Maryville Savings & Loan Corp.*,”⁰ the case holding that security interests in promissory notes must be analyzed separately from security interests in deeds of trust. Such statements suggest that the proposition that the mortgage follows the note was nonobvious enough to need clarifying.

There was no clear rule that the mortgage follows the note,⁰ despite the arguments of many commentators that this was the correct or preferable rule and despite the comments’ statement that this was the “traditional” and “common-law” view. Indeed, one might interpret

⁰ U.C.C. § 9-203 cmt. 9.

⁰ See, e.g., JULIAN B. McDONNELL & JAMES CHARLES SMITH, SECURED TRANSACTIONS UNDER THE U.C.C. § 16.09 (2011).

⁰ See Julian B. McDonnell, *Is Revised Article 9 a Little Greedy?*, 104 COM. L.J. 241, 241-42 (1999) (“The U.C.C. specialists devoutly believe in secured credit. With appropriate fanfare, they have introduced changes designed to make it easier for financiers to create and perfect security interests in the many different contexts in which secured financing is used ... It is as though U.C.C. specialists identified with secured creditors as the Clients, the Good Guys ...”).

⁰ W. Rodney Clement, Jr. & Baxter Dunaway, *Revised Article 9 and Real Property*, 36 REAL PROP. PROB. & TR. J. 511, 537 (2001).

⁰ U.C.C. § 9-109, Official Comment 7. U.C.C. § 9-109 cmt. 7 asserts that it is “implicit” in § 9-109(b) that “one cannot obtain a security interest in a ... mortgage on real property that is not also coupled with an equally effective security interest in the secured obligation”). Given that §9-109(b) simply provides that Article 9 applies to security interests in the note even if it is secured by a mortgage, the proposition in the comment does not seem apparent, “implicit” as it may be.

⁰ At least one contemporaneous commentator did call the proposition that the mortgage follows the note the “general rule.” See Joshua Stein, *Special Forms of Collateral*, 418 PLI/Real 907, 924 (1997).

the enactment as necessary to resolve confusion rather than as simply stating a pre-existing rule. The comment to the revision that the Article now “rejects cases such as *In re Maryville*”⁰ suggests as much.

Now that the U.C.C. apparently *does* contain a “mortgage follows the note” rule, why does this background matter? It remains unclear how the U.C.C. interacts with other laws,⁰ so the U.C.C. revisions have not conclusively resolved the issue. Although some U.C.C. commentators implicitly have treated the U.C.C. as supreme and treated the question simply as one of interpreting the Code,⁰ Massachusetts has declined to follow the “mortgage follows the note” principle⁰ despite its adoption of the U.C.C.⁰ Most states have not addressed how the U.C.C.’s mortgage-follows-the-note provisions interact with their recording laws,⁰ and it appears that few states actually amended their real-property recording statutes to cede primacy to the U.C.C.⁰ Given the ambiguity about the interplay between the U.C.C. and other law, knowing the history puts the 1999 amendments in appropriate context, showing that they reflected a win for one side in a long-running contest rather than an enactment of long-established principles. This

⁰ In any event, perhaps the comment should be understood as applying only to Article 9 security interests in mortgages, as opposed to interests taken a bona fide purchaser under the Bankruptcy Code.

⁰ See, e.g., Alvin C. Harrell, *Impact of Revised UCC Article 9 on Sales and Security Interests Involving Promissory Notes and Payment Intangibles*, 55 CONS. FIN. L.Q.R. 144, 148 (2001) (“There is ... some inevitable interplay (and potential for conflict) between the claims of the holder of a negotiable instrument under UCC Articles 3 and 9, and potentially competing claims under a recorded assignment of the mortgage pursuant to real property law.”).

⁰ See, e.g., G. Ray Warner, *Real Estate Transactions Under Revised Article 9*, 19-JUN AM, BANKR. INST. J. 14, 30 (2000).

⁰ See *U.S. Bank N.A. v. Ibanez*, 941 N.E.2d 40, 53-54 (Mass. 2011). *Ibanez* involved standing to enforce a mortgage, not ownership of the mortgage, the main subject here.

⁰ See Stephen S. Kudenholdt et al., *The Massachusetts Supreme Judicial Court Foreclosure Decisions: The Impact on the Securitization Documentation Process*, 129 BANKING L.J. 195 (2011).

⁰ See Hunt, Stanton & Wallace, *supra* note 1.

⁰ *Id.*

conclusion, together with the observation that the U.C.C. drafting and adoption process may not equally represent all relevant interests,⁰ suggests is worth reconsidering whether “the mortgage follows the note” is a good rule.

III. THE EVOLVING BASIS FOR “THE MORTGAGE FOLLOWS THE NOTE”

Given that the 1999 revisions to the Code purported to “codif[y] the common-law rule”⁰ that the mortgage follows the note, it is worthwhile to explore the explanations that have been given for the proposition.⁰ Earlier statements of the rule rely on a formalistic approach, but more recently commentators such as Grant Nelson and Dale Whitman have put forth a more convincing justification: “the security is worthless in the hands of anyone except a person who has the right to enforce the obligation; it cannot be foreclosed or otherwise enforced. Hence, separating the security and the obligation is ordinarily foolish, since it will leave one person with an unsecured debt and the other with a security instrument that cannot be enforced.”⁰

A. *The Formalistic “Justification”*

Explanations why “the mortgage follows the note” often proceed as follows.⁰ (1) the note and mortgage are two distinct things, the former embodying a personal promise to pay and the

⁰ See, e.g., Edward J. Janger, *Predicting When the Uniform Law Process Will Fail: Article 9, Capture, and the Race to the Bottom*, 83 IOWA L. REV. 571, 631-32 (1998) (uniform law drafting process “unduly constricts” number of represented groups, among other problems); Kamp, *supra* note 32.

⁰ U.C.C. §9-203(g) cmt. 9.

⁰ Although the focus of this Article is ownership of the note and mortgage, this section draws on statements about the mortgage-follows-the-note rule that were made in disputes over enforcement of the mortgage.

⁰ *Id.* at 387-88.

⁰ GRANT S. NELSON & DALE A. WHITMAN, *REAL ESTATE FINANCE LAW* § 5.27, at 385-389 (5th ed. 2007); 4 MICHAEL ALAN WOLF, *POWELL ON REAL PROPERTY* § 37.27, 37-177 to 37-181 (2000) (pertinent section revised 1997); *RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES* §5.4 (1997); GEORGE OSBORNE, 4 *AMERICAN LAW OF PROPERTY* § 16.107, at 253-54 (1952).

latter embodying the right to sell real property to satisfy the debt in case of default on the note;⁰ (2) but the note can be enforced without the mortgage but not vice versa;⁰ (3) therefore, the mortgage is a “worthless piece of paper” without the note;⁰ (4) therefore, the mortgage is “subsidiary” or “incident” to the note;⁰ (5) therefore, “transfer” of the note automatically

⁰ See OSBORNE, *supra* note 95, at 253 (“The mortgagee of real property has two things, the personal obligation and the interest in the realty securing that obligation.”); NELSON & WHITMAN, *supra* note 95 §5.27 at 385 (“This twofold character of the rights of the mortgagee must be kept in mind when transfers by the mortgagee are considered.”); WOLF, *supra* note 75 § 37.27[2], at 37-178 (“It must be remembered that the mortgagee has two interests,” the debt and the security interest); RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES §5.4 cmt. a (recognizing separate existence of mortgage and note: “It is conceivable that on rare occasions a mortgagee will wish to disassociate the obligation and the mortgage, but that result should follow only upon evidence that the parties to the transfer so agreed.”).

⁰ WOLF, *supra* note 75 § 37.23, at 37-145 (“The underlying note, bond, or debt could be collected in many ways” other than foreclosure); NELSON & WHITMAN, *supra* note 95 §5.27 at 387 (“in the hands of anyone except a person who has the right to enforce the obligation,” mortgage “cannot be foreclosed or otherwise enforced”); RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES §5.4 cmt. a (“When the right of enforcement of the note and the mortgage are split, the note becomes, as a practical matter, unsecured.”); *id.* cmt. b (“If the full obligation is transferred without the mortgage, the effect of such a transfer ... is to make it impossible to foreclose the mortgage.”); *id.* cmt. e (“[I]n general a mortgage is unenforceable if it is held by one who has no right to enforce the secured obligation.”).

⁰ See OSBORNE, *supra* note 95, at 261 (“The mortgage interest as distinct from the debt is not a fit subject of assignment. It has no determinate value.”); NELSON & WHITMAN, *supra* note 95 §5.27 at 387 (“security is worthless” if separated from the note); WOLF, *supra* note 75 §37.27[2], at 37-178 (“worthless piece of paper”); RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES §5.4 cmt. b (mortgage split from note is “practically a nullity”).

⁰ OSBORNE, *supra* note 95, at 253 (“The obligation, however, is correctly regarded as the principal thing with the mortgage attached to it in an extremely important, but subsidiary, capacity.”); NELSON & WHITMAN, *supra* note 95 § 5.27, at 387 (same); WOLF, *supra* note 75 § 37.27[2], at 37-178 (citing *Merritt v. Bartholick*, 36 N.Y. 44 (1867)); RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES §5.4 (policy of avoiding separation of mortgage and note “is sometimes justified on the ground that ‘all the authorities agree that the debt is the principal thing and the mortgage an accessory,’” (quoting *Carpenter v. Longan*, 83 U.S. 271 (1872))).

transfers the mortgage;⁰ (6) and also, whoever can establish ownership of the note establishes ownership of the mortgage.⁰

Older authorities tended to take a formalistic approach, starting at Step 4 with little explanation and deducing from the mortgage's "incident" status that the mortgage follows the note in one way or another. Both *Carpenter v. Longan*⁰ and *Merritt v. Bartholick*,⁰ 19th-century Supreme Court cases rescued from relative obscurity by the foreclosure crisis,⁰ are in this mold. *Carpenter* dealt with whether the assignee of a mortgage securing a negotiable promissory note⁰ could enforce the mortgage even though the mortgage was not separately assigned.

Acknowledging "a considerable discrepancy in the authorities upon the question presented,"⁰ the U.S. Supreme Court found that no separate assignment was necessary because the mortgage was

⁰ OSBORNE, *supra* note 95, at 255 ("From the fundamental principle just noted, that the one and only function of the mortgage is to be security for the obligation, it follows that the transfer of the obligation will carry with it the mortgage as an inseparable incident of it."); NELSON & WHITMAN, *supra* note 95 §5.27, at 387 ("The security is virtually inseparable from the obligation unless the parties to the transfer expressly agree to separate them"); WOLF, *supra* note 75 § 37.27[2] ("Where ... the mortgagee has 'transferred; only the underlying debt or obligation, this partial act carries to the assignee (in equity) also the security interest even where there has been no formal assignment or delivery of the security interest or instrument."); RESTATEMENT (THIRD) OF PROPERTY § 5.4(a) ("A transfer of an obligation secured by a mortgage also transfers the mortgage unless the parties to the transfer agree otherwise"); *id.* cmt. a ("[I]t is almost always sensible to keep the mortgage and the right of enforcement of the obligation it secures in the hands of the same person.").

⁰ OSBORNE, *supra* note 95, at 253 ("[T]he security is inseparable from the obligation and ... whoever can establish his priority of claim to the obligation gets with it the security interest in the land provided it is still in existence."); NELSON & WHITMAN, *supra* note 95 §5.27, at 387 ("Ordinarily, whoever can establish a claim to the obligation automatically gets with it the security interest in the land, provided it is still in existence."). Although the *Restatement (Third) of Property: Mortgages* does not expressly state this position, possibly because it also embraces the proposition that "the note follows the mortgage" unless otherwise agreed, RESTATEMENT (THIRD) OF MORTGAGES § 5.4(b), declining to follow substantial authority holding that assignment of the mortgage without the note is a nullity. See *id.* Reporters' Note.

⁰ *Carpenter v. Longan*, 83 U.S. 271 (1872)

⁰ *Merritt v. Bartholick*, 36 N.Y. 44 (1867).

⁰ *Carpenter* has been cited 64 times in judicial opinions since 2007, the same number of times it was cited from 1911 to 2007. *Merritt* has been cited 19 times since late 2009, as many times as it had been cited from 1943 to 2009.

⁰ The negotiable character of the promissory note was critical. *Id.* at 273 ("The case is a different one from what it would be if ... the note was non-negotiable.").

⁰ *Id.* at 275.

not a “choses in action,” such as an assignable contract right, but rather an “accessory”⁰ or “incident”⁰ to the note. The court noted that the mortgage “can have no separate and independent existence” so that the mortgage stood in a “dependent and incidental relationship” to the note, which “takes the case out of the rule applied to choses in action.”⁰ The court closed its discussion with the Latin maxim: *Accessorium non ducit, sequitur principale*:⁰ “The accessory does not lead, but follows, the principal.”

In *Merritt v. Bartholick*, the issue was whether the delivery of a mortgage without an assignment or delivery of the note created an interest in the note. The New York Court of Appeals started from the premise that “a mortgage is but an incident to the debt which it is intended to secure,”⁰ and immediately arrived at the “logical conclusion” that “a transfer of the mortgage without the debt is a nullity, and no interest is acquired by it.”⁰ But perhaps delivery of the mortgage took the note with it? The court viewed the question as one of party intent,⁰ but refused to find that delivery of the mortgage signaled intent to transfer the note. After all, “the legal maxim is, *the incident shall pass by the grant of the principal, but not the principal by the grant of the incident*,”⁰ and concluding that the note followed the mortgage “would be to reverse the maxim, and make the principal follow the incident.”⁰

⁰ *Id.* at 275.

⁰ *Id.* at 274.

⁰ *Id.* at 275.

⁰ *Id.* at 45.

⁰ *Merritt v. Bartholick*, 36 N.Y. at 45.

⁰ *Id.* at 45.

⁰ *Id.* at 45.

⁰ *Id.* (emphasis in original).

⁰ *Id.* at 46.

These courts found that consequences followed directly from the mortgage's status as an "incident," "accessory," or "subsidiary": In *Carpenter*, the court held no separate assignment was required for enforceability because the mortgage was an "incident" of a negotiable note. In *Merritt*, the court found that the mortgage's "accessory" status implied that mortgage and note cannot be split, and found that the note did not follow the mortgage because of a maxim triggered by the mortgage's status as incident.

Although these formalistic opinions produced bright-line rules that are conveniently quoted by lawyers trying to win cases, they seem rather arbitrary. The closest either case comes to explaining why the mortgage is an "incident" is the statement in *Carpenter* that "when the note is paid, the mortgage expires."⁰ But logic, even supported by Latin maxims, is not enough to get to the conclusions in *Carpenter* and *Merritt*. The fact that the mortgage ceases to exist when the note is paid does not imply "logically" that they cannot be separated when they both do exist.⁰ As applied to ownership of mortgage and note, even if the law should try to keep mortgage and note together, that premise does not imply as a matter of logic that it is the note regime rather than the mortgage regime that determines who owns the mortgage-and-note package.

⁰ *Carpenter*, at 275.

⁰ See, e.g., RESTATEMENT (THIRD) OF PROPERTY: TRUSTS § 5.4 cmt. a ("When the right of enforcement of the note and the mortgage are split, the note becomes, as a practical matter, unsecured."). It might be argued that courts should be reluctant to conclude that mortgage and note are separated because the mortgage is "worthless" if held by anyone other than the note holder. But the argument that separation renders the mortgage worthless obviously fails in jurisdictions where the mortgage can be enforced without the note. See, e.g., *Hogan v. Wash. Mut. Bank*, 277 P.3d 781, 783-84 (Ariz. 2012) (foreclosing trustee under deed of trust did not have to prove entitlement to enforce note because "the note and the deed of trust are ... distinct instruments that serve different purposes") Moreover, if the note is unsecured when separated from the mortgage and secured when united with the mortgage, then the mortgage would seem to have value to the note owner equal to the difference between the value of the secured note and the value of the unsecured note. Thus, the argument that the mortgage is "worthless" if held by someone other than the noteholder appears invalid.

B. *The Party-Intent Justification*

Beguiling as the purely logical approach reasoning from the inherent nature of mortgage and note may have been to 19th-century jurists, the approach does not, and cannot, explain *why* a rule that the mortgage follows the note is a good one. Grant Nelson and Dale Whitman, both in their real estate finance treatise⁰ and in the latest *Restatement of Mortgages*, for which Whitman was Reporter,⁰ offer a more substantive defense of the rule, one based on the intent of the parties. Other commentators have also endorsed the intent-based approach.⁰

As Nelson and Whitman explain:

The security is virtually inseparable from the obligation unless the parties to the transfer agree to separate them. The reason is that the security is worthless in the hands of anyone except a person who has the right to enforce the obligation; it cannot be foreclosed or otherwise enforced. Hence, separating the security and the obligation is *ordinarily foolish*, since it will leave one person with an unsecured debt and the other with a security instrument that cannot be enforced.⁰

This explanation differs from the older approach because it posits that mortgages *can* be separated from notes if the parties clearly intend to do so,⁰ but that parties ordinarily do not intend to split mortgage and note because separating the two renders the mortgage

⁰ NELSON & WHITMAN § 5.27, *supra* note 95, at 385-389.

⁰ RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES §5.4 (1997).

⁰ See OSBORNE, *supra* note 95, at 261-62 (criticizing finding that note does not follow mortgage on ground that transferor's intention in assigning mortgage presumably is to transfer the debt); *see also* Letter from Prof. Alan M. White to Permanent Editorial Board for the U.C.C., May 27, 2011, at 2 (meaning of the common-law "mortgage follows the note" principle codified in U.C.C. is "unless the parties express a contrary intent, a contract to sell notes is treated as including a sale of any corresponding mortgages").

⁰ NELSON & WHITMAN, *supra* note 95, at 387-88 (emphasis added); *accord* RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES §5.4 cmt. a ("The essential premise of this section is that it is nearly always sensible to keep the mortgage and the right of enforcement of the obligation it secures in the hands of the same person. This is so because separating the obligation from the mortgage results in a practical loss of efficacy of the mortgage.").

⁰ RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES §5.4 cmt. a ("It is conceivable that on rare occasions a mortgagor will wish to disassociate the obligation and the mortgage, but that result should follow only upon evidence that the parties to the transfer so agreed."); NELSON & WHITMAN *supra* note 95, at 388 (in "very rare" circumstances parties might agree to separate mortgage and note, leaving the retained note unsecured).

unenforceable. Thus the court should presume that the parties intend to keep mortgage and note together. Of course, the premise that separation leads to unenforceability does not hold where foreclosure plaintiffs have succeeded in arguing that a mortgage or deed of trust *can* be enforced independently without proof of any right to enforce the note.⁰

Adopting the party-intent approach also would change older law about the effect of assignment of a mortgage without the note. When the mortgagee assigns the mortgage and does not assign the note, under the party-intent approach the note follows the mortgage “[e]xcept as otherwise required by the Uniform Commercial Code.”⁰ This is justified, again, on the sensible ground that the parties probably intend to keep mortgage and note together.⁰ The proposed rule departs from the older approach of *Merritt*, which demanded affirmative proof of intent to transfer the note in order to overcome the maxim that the incident follows the principal.

Nelson and Whitman’s approach certainly makes sense on its terms and improves on the formalistic approach. But the “essential premise” that parties want to keep mortgage and note together so that they can be enforced does not answer the question of ownership.⁰ If A and B are in an ownership contest over a note and mortgage, each is likely to want to get both, but that does not tell us whether A or B should win. It does not tell us whether the note regime or the

⁰ See, e.g., Hogan, *supra* note 117. For a thorough discussion of this issue, see Dale A. Whitman, *Foreclosing on Nothing: The Curious Problem of the Deed of Trust Foreclosure Without Entitlement to Enforce the Note*, 66 ARK. L. REV. 21 (2013). In another example of enforcement of the mortgage without ability to enforce the note, a mortgagor apparently can foreclose on a mortgage even when the personal obligation has been discharged in bankruptcy. See LYNN M. LOPUCKI & ELIZABETH WARREN, *SECURED CREDIT: A SYSTEMS APPROACH* 504 (7th ed. 2012).

⁰ RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES §5.4(b). The qualification reflects the fact that Article 3 of the Uniform Commercial Code imposes strict rules on how the right to enforce a negotiable note may be transferred. NELSON & WHITMAN, *supra* note 95, at 396; RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES § 5.4 cmt. b.

⁰ RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES §5.4(b) cmt. b (“The objective of this rule, as noted above, is to keep the obligation and the mortgage in the same hand unless the parties wish to separate them.”); NELSON & WHITMAN, *supra* note 95, at 395-96 (“the preferable rule is to presume ... intent [to transfer note with mortgage] in the absence of contrary proof.”).

mortgage regime should determine whether A or B wins, only that the two instruments should not be split.⁰

Nelson and Whitman do have a preference as between A and B: they prefer note possession over the recording statutes as the basis for deciding the contest. This is in keeping with their emphasis on the intent of the transacting parties. Nelson and Whitman suggest that failure to record mortgage assignments is likely to result from inadvertence,⁰ so that attaching consequences to the failure to record is likely to frustrate party intent.

The intent test is an improvement over the formalistic approach because it does not rely on unexplained legal fictions. However, the intent of parties to a mortgage transaction is not the only thing that matters where property interests are concerned because of the interests of third parties who may eventually want to transact in the mortgage,⁰ and possibly the public interest more generally.⁰ Consider the double sale of the Introduction: Even if it was quite clear that

⁰ The Uniform Commercial Code treats the right to enforce and ownership as separate issues for promissory notes and mortgages. This is widely understood to be the case for promissory notes. See Permanent Editorial Board, *supra* note 26, at 8-9 (person entitled to enforce note may not be the same as note owner). The U.C.C. expressly treats mortgage ownership as conceptually separate from note ownership. See U.C.C. §§ 9-203(g), 9-308(e) (attachment and perfection of security interest in note results in attachment and perfection of security interest in mortgage). The Code also implicitly treats mortgage ownership and mortgage enforcement as separate issues, because it has provisions governing mortgage ownership but leaves the issue of mortgage enforceability to other law. See U.C.C. §.9-308 cmt. 6 (“Article 9 does not determine who has the power to release a mortgage of record.”); Permanent Editorial Board, *supra* note 26, at 1 (“[A]s to both substance and procedure, the enforcement of real estate mortgages by foreclosure is the province of a state’s real property law.”). Despite the Code’s recognition that the property interest in the mortgage is conceptually separate from that in the note, commentators have questioned whether this is meaningful. See, e.g., Coogan et al., *supra* note 44, at 272

⁰ Perhaps a Solomonic approach is called for: let the instruments be split and let one party buy the instrument from the other. To the author’s knowledge this has not been tried.

⁰ RESTATEMENT (THIRD) OF MORTGAGES § 5.4 cmt. a (“Ideally, a transferring mortgagee will make th[e] intent [to keep mortgage and note united] plain by executing to the transferee both an assignment of the mortgage and an assignment, indorsement, or other appropriate transfer of the obligation. But experience suggests that, with fair frequency, mortgagees fail to document their transfers so carefully. This section’s purpose is generally to achieve the same result even if one of the aspects of the transfer is omitted.”).

⁰ See, e.g., LOPUCKI & WARREN, *supra* note 123, at 282 (“[T]he mere fact that prior liens exist does not itself ensure that the prospective lender will be able to discover them or to obtain needed information about them.”).

⁰ For a discussion of the importance of the public interest in mortgage records, see Hunt, Stanton & Wallace, *Rebalancing Public and Private*, *supra* note 1.

Sarah the seller intended to transfer the mortgage to the first buyer (you) when you bought it, if the second buyer (Fred) has no way of finding this out he can be deceived.

C. *The Efficiency Justification*

Party intent is an incomplete basis for resolving ownership contests, but commentators who go beyond the essentialist argument also defend “the mortgage follows the note” on the ground that the rule provides an efficient way for buyer to check whether the seller really owns what it’s selling. Looking to note possession arguably is a simple and efficient test of ownership, especially when contrasted with the alternative of recording mortgage assignments.

Simply put, the argument goes that a purchaser shouldn’t buy a mortgage unless the seller can produce the note. And if the seller can produce the note, the buyer shouldn’t be put to the trouble of checking title records.⁰ The reason put forth is that the buyer can inquire into note possession: “The transfer of possession of the note affords a simple and efficient mechanism for perfecting a security interest simultaneously in both documents.”⁰

Yet going around inspecting and taking delivery of physical pieces of paper may be only slightly more efficient than recording mortgage assignments in local title offices.⁰ Perhaps a 19th-century solution⁰ based on the reification of commercial rights into paper instruments is a

⁰ JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 30-7, at 49 (4th ed. 1995) (mortgage-follows-the-note test “at least with respect to sophisticated persons, protects subsequent parties who will necessarily ask to see the negotiable instrument”); NELSON & WHITMAN, *supra* note 95, at 402 (mortgage-follows-note rule is “simple to follow” and avoids the necessity of the secured pledgee’s taking multiple precautions”); Krasnowiecki, *supra* note 49, at 338 (“Surely it is not too much to ask [persons seeking to acquire rights in the mortgage] to inquire where the note is.”).

⁰ Nelson, *Contract for Deed*, *supra* note 77, at 1158.

⁰ See Dale A. Whitman, *How Negotiability Has Fouled up the Secondary Mortgage Market, and What To Do About It*, 37 PEPP. L. REV. 737, 768 (2010) (produce-the-note system “turned out to be highly unsatisfactory in a national market because of the extreme inconvenience of moving many millions of notes around the nation”).

little better than 17th-century vintage paper title records,⁰ but neither one tracks 21st century business practice. Perhaps the best evidence of this proposition is the fact that promissory notes apparently were not inspected or delivered as a matter of course in the years leading up to the foreclosure crisis.⁰ Although the idea that taking possession is easier than recording may have been a sound justification for the mortgage-follows-the-note rule at one time, the justification does not seem to track recent practice.

Moreover, the possession-based argument does not fully track current law. It is clear under the U.C.C. that a party may possess a note without owning it free and clear of security interests.⁰ A note owner can sell or give a security interest in a promissory note to a lender, and the purchaser's or secured party's interest in the note and mortgage is perfected automatically, without filing or transfer of possession.⁰ That means that the seller can hold on to the note and display it to others, and there will be no indication that the note has been sold or is subject to a security interest. Although the first lender or purchaser apparently would lose out to a second

⁰ See, e.g., JAMES STEVEN ROGERS, *THE END OF NEGOTIABLE INSTRUMENTS: BRINGING PAYMENT SYSTEMS OUT OF THE PAST* xiv (2012) (the "usual view" that "existing law works well for the traditional paper-based system of checks and promissory notes" is "unfounded" and "much of the trouble with current law of payment systems comes from the fact that U.C.C. Articles 3 and 4 are anachronistic").

⁰ See RUFFORD G. PATTON & CARROLL G. PATTON, 1 *PATTON ON LAND TITLES* § 6 (2d ed. 1957) (documenting colonial recording acts in early 17th century); *id.* § 67 (grantor-grantee (name) indices "originated with the recording system").

⁰ See e.g., Whitman, *How Negotiability Has Fouled up the Secondary Mortgage Market*, *supra* note 133, at 758 ("While delivery of the note might seem a simple matter of compliance, experience during the past several years has shown that, probably in countless thousands of cases, promissory notes were never delivered to secondary market investors or securitizers and, in many cases, cannot presently be located at all."); *In re Kemp*, 440 B.R. 624, 628 (Bankr. D.N.J. 2010) (recounting testimony of Countrywide employee that it was "customary for Countrywide to maintain possession of the original note and related loan documents" and not to deliver them to buyers, and that the note in question in the case "to her knowledge, never left the possession of Countrywide").

⁰ Permanent Editorial Board, *supra* note 26, at 8-9.

⁰ U.C.C. §§ 9-203(b)(1), (3) (security interest attaches to collateral when value given and debtor has signed a security agreement that reasonably describes the collateral); § 9-309(4) (security interest arising from sale of a promissory note is perfected upon attachment).

lender or purchaser who actually took possession of the note,⁰ unsecured lenders or other parties evaluating the owner's creditworthiness would not have any way of knowing that the note was encumbered. Given that mortgage note transferees apparently did not take possession of the notes, there does seem to be at least some risk of deception here.

IV. EVALUATING FILING SYSTEMS FOR REAL PROPERTY MORTGAGES

The justifications proffered for the mortgage-follows-the-note rule are all incomplete, so it makes sense to step back and consider from a broader perspective what rule is appropriate for resolving mortgage ownership contests. The mortgage-follows-the-note rule is one possible answer to a more general question: How should we decide who wins property ownership contests? Should it be the person who possesses the property (a "possession rule")? Should it be the person who was first received an assignment of the property from the previous owner without any further formalities being required (an "automatic perfection" rule)?⁰ Or should there be a public recording system, with priority depending on when interests are recorded (a "recording rule")?⁰ Legal scholars have framed questions about proof-of-ownership questions broadly, creating a substantial literature that addresses what types of property and transactions⁰ are best

⁰ See U.C.C. § 9-330(d).

⁰ Cf. Baird & Jackson, *Possession and Ownership: An Examination of the Scope of Article 9*, 35 STAN. L. REV. 175, 187 (1983) (argument that transaction parties "should be able to allocate ownership rights between themselves as they please ... loses force when at stake are the rights of a third party who asserts a competing claim to the property.").

⁰ The U.C.C. provides for filing as the principal way of protecting interests in many types of personal property. Real-property statutes provide for recording as a way of protecting interests in real property. Although the U.C.C. filing and real-property recording systems are different, see, e.g., Jonathan C. Lipson, *Secrets and Liens: The End of Notice in Commercial Finance Law*, *supra* note 42, at 446-47 ("The UCC-1 financing statement is most decidedly not a property recordation device, as might be found in the real property or intellectual property context" because it provides only "inquiry notice"). Nevertheless, the discussion here focuses on their commonalities rather than their differences. It seeks to establish that there is a case for some type of filing or recording system.

⁰ Douglas Baird & Thomas Jackson, *Information, Uncertainty, and the Transfer of Property*, 13 J. LEGAL STUD. 299, 303-04 (1984) ("The desirability of a particular kind of filing system turns on the type of property it is to cover.").

fitted for recording rules and what types are best left to possession or automatic-perfection rules.⁰ It appears that scholars working in this area have not considered the peculiarities of mortgages as a property type and that, conversely, the scholarly conversation about mortgage assignment recording so far has not drawn systematically on insights from the general literature on filing and recording.⁰

This Part introduces these literatures to one another by using criteria from the broader literature on filing and recording to evaluate whether mortgages should be covered by a filing rule, a possession rule, or an automatic-perfection rule. The results are inconclusive at this stage

⁰ See generally BENITO ARRUÑADA, *INSTITUTIONAL FOUNDATIONS OF IMPERSONAL EXCHANGE: THEORY AND PRACTICE OF CONTRACTUAL REGISTRIES* (2012); Thomas E. Plank, *Article 9 of the UCC: Reconciling Fundamental Property Principles and Plain Language*, 68 *BUS. LAW.* 439 (2013) [hereinafter Plank, *Reconciling Fundamental Property Principles and Plain Language*]; Thomas E. Plank, *Assignment of Receivables Under Article 9: Structural Incoherence and Wasteful Filing*, 68 *OHIO ST. L.J.* 231 (2007) [hereinafter Plank, *Wasteful Filing*]; Lipson, *supra* note 42; Steven L. Schwarcz, *Towards a More Centralized Perfection System for Cross-Border Receivables Financing*, 20 *U. PA. J. INT’L ECON. L.* 455 (1999); 21 *EMORY BANKR. DEV. L.J.* 421 (2005); Peter A. Alces, *Abolish the Article 9 Filing System*, 79 *MINN. L. REV.* 679 (1995); James J. White, *Revising Article 9 to Reduce Wasteful Litigation*, 26 *Loy. L. Rev.* 823 (1993); Douglas G. Baird, *Security Interests Reconsidered*, 80 *VA. L. REV.* 2249 (1994); Alan Schwartz, *A Theory of Loan Priorities*, 18 *J. LEGAL STUD.* 209 (1989); Charles W. Mooney, Jr., *The Mystery and Myth of “Ostensible Ownership” and Article 9 Filing: A Critique of Proposals to Extend Filing Requirements to Leases*, 39 *ALA. L. REV.* 683 (1988); Dan S. Schechter, *Judicial Lien Creditors Versus Prior Unrecorded Transferees of Real Property: Rethinking the Goals of the System and Their Consequences*, 62 *S. CAL. L. REV.* 105 (1988); Douglas Baird & Thomas Jackson, *Information, Uncertainty, and the Transfer of Property*, 13 *J. LEGAL STUD.* 299 (1984); Douglas Baird & Thomas Jackson, *Notice Filing and the Problem of Ostensible Ownership*, 12 *J. LEGAL STUD.* 53 (1983); Douglas Baird & Thomas Jackson, *Possession and Ownership: An Examination of the Scope of Article 9*, 35 *STAN. L. REV.* 175 (1983); Corwin W. Johnson, *Purpose and Scope of Recording Statutes*, 47 *IOWA L. REV.* 231 (1962); John Hanna, *The Extension of Public Recordation*, 31 *COLUM. L. REV.* 617 (1931).

⁰ See, e.g., James M. Davis, *Paper Weight: Problems in the Documentation and Enforcement of Transferred Mortgage Loans, and a Proposal for an Electronic Solution*, __ *AM. BANKR. L.J.* (forthcoming 2013); Nestor M. Davidson, *New Formalism in the Aftermath of the Housing Crisis*, 93 *B.U. L. REV.* 389 (2013); Hunt, Stanton & Wallace, *Rebalancing Public and Private*, *supra* note 1; Donald J. Kochan, *Certainty of Title: Perspectives After the Mortgage Foreclosure Crisis on the Essential Role of Effective Recording Systems*, 66 *ARK. L. REV.* 267 (2013); Whitman, *MERS Done Right*, *supra* note 14; John Patrick Hunt, Richard Stanton & Nancy Wallace, *All in One Basket: The Bankruptcy Risk of a National Agent-Based Mortgage Recording System*, 46 *U.C. DAVIS. L. REV.* 1 (2012); Dale A. Whitman, *A National Mortgage Registry: Why We Need It and How to Do It*, 45 *U.C.C.L.J. NO. 1*, Art. 1 (2013); David A. Dana, *Why Mortgage “Formalities” Matter*, 24 *LOY. CONS. L. REV.* 505 (2012); Alan M. White, *Losing the Paper – Mortgage Assignments, Note Transfers and Consumer Protection*, 24 *LOY. CONS. L. REV.* 468 (2012); Tanya Marsh, *Foreclosures and the Failure of the American Land Title Recording System*, 111 *COLUM. L. REV. SIDEBAR* 19 (2011); Christopher L. Peterson, *Two Faces: Demystifying the Mortgage Electronic Registration System’s Land Title Theory*, 53 *WM. & MARY L. REV.* 111 (2011) [hereinafter Peterson, *Two Faces*]; Christopher L. Peterson, *Foreclosure, Subprime Mortgage Lending, and the Mortgage Electronic Registration System*, 78 *U. CIN. L. REV.* 1359 (2010); Gerald Korngold, *Legal and Policy Choices in the Aftermath of the Subprime and Mortgage Financing Crisis*, 60 *S.C. L. REV.* 727 (2009).

– there appears to be a colorable case for any of the three rules⁰ – but the analysis helps structure further empirical inquiry by identifying questions that should be addressed. The analysis also should help advance the discussion of mortgage recording by taking a step back and drawing on insights that were developed before debates over particular contemporary mortgage-industry practices became all-consuming.

The existing literature on filing and recording focuses on the interests of parties who transact or may transact in the kind of property under discussion. Analysis based solely on the interests of contracting parties is incomplete because there are probably significant public benefits (and public costs) to public filing and recording systems. For example, these systems may create significant value to third parties by aggregating information and making it public, as discussed in previous work.⁰ Moreover, the replacement of the public mortgage recording system with a private one based on the decisions of participants in the mortgage industry may raise questions of democratic governance.⁰ The public dimension of public recording systems is undoubtedly important. Nevertheless, a limited analysis based on transacting-party interests may lead to interesting conclusions. For example, if it turns out that mortgage recording is justified based solely on the interests of transacting parties, then there is no need to invoke benefits to nontransacting parties or democratic norms to defend the system. And the transacting-parties

⁰ The law could also provide for a combination of the three rules: for example, the U.C.C. provides that interests in a promissory note can be perfected by filing, by possession, or, for sale transactions, automatically. See 1 JASON H.P. KRAVITT ET AL., *SECURITIZATION OF FINANCIAL ASSETS* § 6.03[B], at 6-33 Tbl. 6-1 (2d ed 2009 & Supp. 2011). For simplicity, the Article focuses on the use of a filing rule as opposed to a possession or automatic perfection rule.

⁰ See generally Hunt, Stanton & Wallace, *Rebalancing Public and Private*, *supra* note 1.

⁰ See Peterson, *Two Faces*, *supra* note 144, at 155.

framework, limited as it may be, does underlie a significant body of scholarship.⁰ This analysis here seeks to take its place within that body of scholarship.

A. *Criteria for Usefulness of Filing Systems and Preliminary Application to Mortgages:
Automatic v. Notorious Perfection*

The analysis of what formalities are appropriate for mortgage transfer can proceed in two stages. First, should the law condition protection on any form of notice to third parties, or should whatever is enough to make the transfer effective between transferor and transferee also be enough to protect the transferee against third parties? In other words, should the law have a system of “notorious” or “automatic” perfection? This section addresses that question. The following section assumes for the sake of argument that notorious perfection is appropriate and addresses whether notoriety should be achieved by possession or by filing or recording.

1. Cost of Making Interest Notorious

The cost of making an interest in property notorious is important in deciding whether to adopt a system of notorious perfection.⁰ It appears that the cost and inconvenience of recording mortgage assignments⁰ and taking possession of mortgage notes⁰ led the mortgage industry to

⁰ See sources cited *supra* note 143.

⁰ See Hanna, *supra* note 143, at 627 (citing “added expense” as a reason for not requiring recording of assignments of accounts); Plank, *Wasteful Filing*, *supra* note 143, at 261-62 (citing costs of making filings and searching filing systems as reasons not to require filing for transfers of receivables); White, *supra* note 143, at 830 (citing filing cost savings as one justification for proposal to allow secured creditors to achieve priority in bankruptcy over lien creditors without perfection (typically accomplished by filing)).

⁰ See Whitman, *MERS Done Right*, *supra* note 14., at 37-38 (listing 10 steps necessary for recording mortgage assignments and arguing that the system is too expensive and cumbersome)

⁰ See Dale A. Whitman, *How Negotiability Has Fouled up the Secondary Mortgage Market, and What To Do About It*, 37 PEPP. L. REV. 737, 768 (2010) (referencing “extreme inconvenience of moving many millions of notes around the nation”).

stop observing either practice.⁰ Thus, it appears that the industry views both filing and possession as too expensive for the benefits they provide under current law. Of course, a system that reduced the cost or increased the benefit of possession and/or filing might result in a different calculus.

The most obvious way that the cost of notoriety might be reduced is through digitization.⁰ Although electronic title recording has been adopted in many jurisdictions and continues to spread,⁰ the cost and inconvenience of recording mortgage assignments may still be high in large parts of the country.⁰ Thus, it is unsurprising that proposals exist to create a national mortgage registry,⁰ to create a national electronic mortgage-and-note registry,⁰ to create a national electronic note registry,⁰ and/or to upgrade local mortgage recording capabilities.⁰ Although all these proposals involve public records of mortgage ownership and thus are akin to a recording or

⁰ See Whitman, *MERS Done Right*, *supra* note 14., at 22-23 (arguing that at least some participants in the secondary mortgage market stopped recording mortgage assignments as early as 1986); White, *supra* note 144, at 475 (“There is evidence that, especially during the subprime lending boom of 2004-2007, notes were neither endorsed nor delivered.”).

⁰ See Hunt, Stanton & Wallace, *Rebalancing Public and Private*, *supra* note 1 (arguing that digitization of title records holds out the possibility of reducing cost while providing public benefits of public records).

⁰ *Id.* (discussing spread of electronic recording).

⁰ See Whitman, *MERS Done Right*, *supra* note 14., at 37-38 (discussing filing fees for mortgage assignments and describing payment of recording fees as “a particular burden”).

⁰ See Hunt, Stanton & Wallace, *Rebalancing Public and Private*, *supra* note 1 (describing for national registry to track mortgage ownership).

⁰ See Whitman, *MERS Done Right*, *supra* note 14, at 47-68 (describing proposal for national registry). Whitman’s proposal is to “declare unambiguously that the mortgage and note cannot be separated,” *id.* at 47, and to track the right to enforce the note (and thus the mortgage), but not to track ownership of the note and mortgage. *Id.* at 49-51; White, *supra* note 144, at 498-99 (describing proposal to “combine the note and mortgage into a single instrument, with the full image of the instrument and all later modifications to its parties or terms updated in a single electronic registry”).

⁰ See Davis, *supra* note 144, at 74-87 (describing proposal for national registry tracking right to enforce, and ownership of, electronic mortgage notes). We use the term “electronic note” for accessibility; the technical term is “transferable record.” *Id.* at 4.

⁰ See Hunt, Stanton, and Wallace, *Rebalancing Public and Private*, *supra* note 1 (proposing upgrades of local recording offices with common electronic systems as an alternative to a national registry).

filing system, digitization also can reduce the cost of a possession-like rule because electronic documents can in principle be made unique, as the law of electronic notes recognizes.⁰ A party could be required to have control of a unique electronic document to protect its interest without requiring that the control be made public, thus creating the digital equivalent of a possession rule.⁰

Information is available about the cost to transacting parties of the private mortgage registry known as MERS. MERS has charged a membership fee of \$150 to \$7,500, plus a fee of \$11.95 for each mortgage registration or transfer, and a public registry might not be more expensive for the user.⁰ However, claims about the expense entailed in creating and maintaining a new national electronic system, or for upgrading local systems, are speculative at this time. The expense of the most cost-effective system for achieving notoriety remains a key part of the agenda for future empirical research.⁰

2. Underlying Asset Is Tangible

In fairly recent articles, Professors Steven Schwarcz and Thomas Plank draw essentially opposite conclusions about what tangibility or intangibility of an asset implies about whether the

⁰ See Davis, *supra* note 144, at 76-77 (describing provisions of the Uniform Electronic Transactions Act that provide for use of “authoritative copies” of electronic records as way of establishing “control,” a concept analogous to possession of paper documents).

⁰ Davis recognizes this possibility, *id.* at 76-80, but advocates making the information on the registry publicly available. *Id.* at 83-87.

⁰ See Whitman, *MERS Done Right*, *supra* note 144, at 59. This fee schedule (current as of January 2013) appears to represent an increase in MERS pricing. Earlier research indicated that MERS’ registration fee was \$6.95 and its transfer fee was \$2. See John Patrick Hunt, Richard Stanton & Nancy Wallace, *U.S. Residential-Mortgage Transfer Systems: A Data-Management Crisis*, in HANDBOOK OF FINANCIAL DATA & RISK INFORMATION 85, 114. (Margarita Brose et al. eds., forthcoming 2013).

⁰ Although empirical information about the cost of filing would be desirable, it is important not to be too optimistic. Calls for such investigation apparently have gone unanswered since the early days of the Great Depression. See Hanna, *supra* note 143, at 618 (lamenting, in 1931 article, the fact that “[l]ikewise unavailable are any statistics dealing with the cost of recording and filing systems”).

asset should be subject to a filing or recording requirement. Schwarcz argues that if property is intangible, possession cannot inform a transferee about who owns the property, so a filing system is advisable.⁰ Plank, by contrast, argues that if property is intangible, possession cannot *misinform* a transferee about who owns the property, so a filing system is unnecessary and an automatic perfection rule is advisable.⁰

Apart from the uncertainty over which way tangibility cuts, there is some doubt about whether mortgages are in fact “tangible” to begin with. Goods and real property are tangible by nature, but the same is not true of obligations to pay, which are tangible or not depending on how the law decides to treat them. Whether the obligation is tangible or not depends on whether the obligation is reified – that is, whether the law recognizes some object, such as a negotiable instrument,⁰ as the physical embodiment of the obligation.⁰ There currently is uncertainty about whether the physical notes that describe many mortgage obligations are negotiable,⁰ and thus whether the mortgage is tangible. Moreover, the mortgage industry is experimenting with

⁰ Schwarcz, *supra* note 143, at 460 (“Because receivables are intangible, there is nothing physical to transfer”); *id.* at 463 (“If receivables transfers are not recorded, the assignee has no objective way of determining whether that receivable was previously transferred to a third party.”).

⁰ Plank, *Reconciling Fundamental Property Principles and Plain Language*, *supra* note 143, at 471 (for receivables, “[f]iling is not necessary to cure the ‘ostensible ownership’ problem presented by goods”); Plank, *Wasteful Filing*, *supra* note 143, at 252 (“[U]nlike goods, receivables do not create an ostensible ownership problem” because goods are tangible and receivables are intangible).

⁰ See Kurt Eggert, *Not Dead Yet: The Surprising Survival of Negotiability*, 66 ARK. L. REV. 145, 155-56 (2013) (“The key element of the negotiability transfer system is that the liabilities of the parties to negotiable instruments are ‘reified’ in pieces of paper, that is, the writings become the indispensable embodiments of the liabilities of the parties.”) (quoting James Steven Rogers, *Negotiability As a System of Title Recognition*, 48 OHIO ST. L.J. 197, 200 (1987)).

⁰ See LOPUCKI & WARREN, *supra* note 123, at 330 (“[T]he law can render intangible property tangible simply by recognizing some tangible object as the embodiment of the intangible rights.”); Steven L. Harris & Charles W. Mooney, Jr., *Using First Principles of UCC Article 9 to Solve Statutory Puzzles in Receivables Financing*, 46 GONZ. L. REV. 297, 343 (2010-11) (“By enabling a purchaser of tangible chattel paper to perfect its security interest in a monetary obligation by taking possession of chattel paper, former Article 9 reified in tangible chattel paper what otherwise may have constituted intangible collateral not susceptible of possession.”).

electronic notes that operate within a largely untried legal framework under which the electronic notes reify the obligation and are thus tangible.⁰

Given the uncertainty both about whether mortgages are tangible and about what significance to attach to their tangibility or intangibility, this factor does not clearly weigh in favor of or against automatic perfection for mortgages. However, in the course of arguing that no filing system is appropriate for intangible assets, Plank highlights a related factor that clearly does seem relevant: whether credible information about competing interests in mortgages can be extracted from the transferor without a filing system or a demand for possession of the note.

3. Credible Information About Competing Interests Can Be Extracted from Transferor

At least two authors, Thomas Plank⁰ and Alan Schwartz,⁰ have argued that automatic perfection is appropriate where the prospective transferee can extract credible information about competing interests in property from the transferor in the ordinary course of due diligence for the transaction being contemplated. If there is a credible way of for an acquirer or lender to learn about the existence of competing interests without filing or demanding the physical production

⁰ See Whitman, *supra* note 133, at 749 (“[I]t seems bizarre that the negotiability of the most widely used mortgage note form in the nation, employed in many millions of transactions, is uncertain and that no one has bothered to do anything to clarify it”); Whitman, *MERS Done Right*, *supra* note 14, at 27-28 (“The courts often seem to *assume* that mortgage notes are negotiable ... but only rarely do they actually analyze the note language to determine whether negotiability exists”); Ronald J. Mann, *Searching for Negotiability in Payment and Credit Systems*, 44 UCLA L. REV. 951, 971 (1997) (“[T]he standard form of promissory note used for [home mortgages] fails to satisfy the requirements of negotiability”).

⁰ See Davis, *supra* note 144, at 77-78 (discussing MERS eNote project that relies on framework of Uniform Electronic Transactions Act, which uses the concept of “control” of electronic “transferable records,” analogous to possession of paper negotiable instruments, and which specifies that a party can control a record if a system that ensures the existence of a single authoritative copy of the transferable record).

⁰ See Plank, *Wasteful Filing*, *supra* note 143, at 252 (“Third parties can only determine [the] existence [of an account receivable] by inspecting [the account creditor’s] financial statements, books, and records. By inspecting those financial statements, books, and records, third parties can also determine whether Pierce has assigned the account.”); *Reconciling Fundamental Property Principles and Plain Language*, *supra* note 143, at 471 (same).

⁰ See Schwartz, *supra* note 143, at 220 (“Good debtors could avoid paying the high interest rates that uninformed lenders would charge by informing the lenders that they had little or no prior debt.”).

of specific documents, then the expense of a filing system or possession rule may be unwarranted.

Plank argues that a prospective buyer of intangible assets will extract from the transferor information about any competing interests in the assets as a by-product of the due diligence process that must be undertaken to acquire the assets in the first place. Plank's contention is that if the underlying asset is intangible, such as a contract right to collect on an account receivable, then "a potential purchaser ... can only determine the existence of those receivables by reviewing the records of the debtor."⁰ The value of the receivables depends on "the existence of ... the obligor to whom a loan was made ... and from whom payment is owed."⁰ The same process that verifies the existence of an obligor may "determine whether another prior purchaser has an interest in those receivables."⁰ Hence, there is no need to incur the expense of a filing rule or, presumably, to require the transferee to take possession of an instrument.

Alan Schwartz makes a similar argument in defending a proposal to allow the lender who is first in time to have priority in the debtor's property without taking a security interest or making a filing.⁰ Schwartz's key point is that subsequent takers of property interests can extract a disclosure of previously existing interests from the seller. He argues that this is "as effective [as] ... and cheaper"⁰ than a filing requirement. Specifically, Schwartz argues that the first lender to a company should have priority over all later lenders, even if the subsequent lenders are secured. Schwartz argues that lenders will charge high rates to borrowers that might have

⁰ Plank, *Reconciling Fundamental Property Principles and Plain Language*, *supra* note 143, at 471.

⁰ Plank, *Wasteful Filing*, *supra* note 143, at 267.

⁰ Plank, *Reconciling Fundamental Property Principles and Plain Language*, *supra* note 143, at 471.

⁰ See Schwartz, *supra* note 143, at 218-24. The specific context is priority of loans taken out by operating concerns that later become insolvent. *Id.* at 209.

⁰ See *id.* at 211.

preexisting senior debt, so borrowers have an incentive to disclose the absence of such debt and, Schwartz claims, they can do so credibly by producing tax returns, audited financial statements, or SEC filings.⁰ Imposing a filing system for senior unsecured debt, Schwartz argues, imposes higher administrative and litigation costs.⁰ He would retain filing rules as to buyers of property from the business because they are less likely than lenders to investigate the seller/borrower's financial position and may be less able to evaluate financial disclosures.⁰ As applied to mortgages, Schwartz might argue that buyers will not purchase mortgages for a high price unless the seller can prove that it has not already sold the mortgages to someone else.

Plank's and Schwartz's arguments rightly focus attention on what information the due diligence process for mortgage sales – apart from any use of a filing system or inspecting and taking possession of notes – generates and at what cost. If the relevant information about competing claims would come up in due diligence anyway, and if the information is generated at low cost, then that is a reason not to require filing or possession.

It is questionable whether some of the specific claims made by Plank and Schwartz apply to mortgages. For example, it is unclear that the tax returns, audited financial statements, and SEC filings that Schwartz emphasizes can show that a party has *not* already transferred or given security interests in mortgage loans that the party otherwise appears to own. Mortgages may derive most of their value from the mortgagee's ability to foreclose on the underlying land rather than the mortgagor's personal obligation to pay, so it is unclear that Plank's point that information about the debtor is a natural by-product of due diligence fully applies to mortgages.

⁰ *Id.* at 220-21. Schwartz claims that such disclosure is common in any case because lenders commonly require covenants, such as covenants to maintain a specified ratio of current earnings to fixed charges, that would make no sense if the lender thought the borrower might have significant outstanding debt. *Id.* at 221.

⁰ *Id.* at 222.

⁰ *Id.* at 223.

But these areas of uncertainty only highlight the need for empirical research into the due diligence process for mortgage purchases, what information it produces, and any opportunities for saving money in this process by implementing a clear possession or filing rule for mortgages.

B. Criteria for Choosing Between Notorious Perfection Systems: Filing v. Possession

Assuming that some form of notoriety – either filing or possession – is appropriate for a given type of property in a given type of transaction, the next question is which form of notoriety is appropriate. This Part discusses factors relevant to deciding whether a filing rule or a possession rule is better for mortgage transfers.

1. Factors Favoring a Filing Rule

A number of factors suggest that a filing rule for mortgages makes sense: Real-property mortgages are tied to immobile land and generally are valuable. Under current law, there is some benefit to separating possession and ownership of these assets. There is also a benefit to dividing ownership.

a. Underlying Asset Is Immobile

Property that is immobile can be identified by its location. If the filing system itself is maintained on a location-by-location basis (as with state filing systems under the U.C.C. or local records for real property), the location of the property can be matched with the filing system relatively easily. It is thus said that filing systems are most appropriate for immobile property.⁰

⁰ Baird & Jackson, *Information, Uncertainty, and the Transfer of Property*, *supra* note 143, at 304 (filing system more appropriate for title claims as opposed to just security claims when property is immobile)

A real-property mortgage is tied to a fixed location because it refers to a specific piece of real property. Thus, parties could tell where to make filings for a given mortgage relatively easily. This factor seems to favor a filing system for mortgages.

b. Underlying Asset Is Valuable

The cost of a filing system is more likely to be justified when the property in question is valuable.⁰ For example, Baird and Jackson argue that a filing system for title to real property makes more sense than a filing system for title to goods because parcels of real property typically are more valuable than goods.⁰

Mortgages typically are valuable. For example, the “conforming loan limit,” measuring the size of a “commodity” mortgage on a single-family home, was \$417,000 throughout most of the United States (and higher in the rest of the country) in July 2013.⁰ Although the value of the underlying asset is only part of the relevant cost-benefit analysis for a filing requirement, the value of the underlying asset does help establish a ballpark estimate of the potential loss from the kinds of problems that filing could help avoid. The amount of the average home mortgage is typically of the same order of magnitude as the value of the underlying real property.⁰ Thus, if this factor supports a filing rule for the underlying real property, it seems to support a filing rule for the mortgage.

⁰ Baird & Jackson, *Information, Uncertainty, and the Transfer of Property*, *supra* note 143, at 304 (“Filing systems are comparatively better than possessory systems when the property involved is valuable”).

⁰ *Id.* at 304-05 (arguing that one reason that “[r]eal property is the paradigm of property for which a filing system of title claims is superior” is that the costs of maintaining the recording system “are generally small compared to the relative value of the property involved.”).

⁰ “Conforming Loan Limits,” available at <http://www.fhfa.gov/Default.aspx?Page=185>, accessed July 3, 2013.

⁰ Data from the Federal Housing Finance Administration indicate that the average fixed-rate mortgage issued in 2008 had a principal amount of 69% of the property value. See <http://www.fhfa.gov/Default.aspx?Page=313> (last visited August 8, 2013).

c. Underlying Asset Has Value in Use

When a property's physical use is important, a filing system may be better than a possession-based system because it may be important for a party that does not own the property (or that does not own the property free and clear of all competing interests) to possess the property.⁰ The filing system for security interests in goods allows the owner to continue to possess, say, a drill press, and use the equipment for production, while a lender maintains a security interest in the equipment.

This factor does favor a recording system for mortgages, at least to some extent. Although a mortgage does not have value in use the same way a piece of equipment does, it nevertheless does seem to be the case that it is often convenient to separate possession of the paper records of a mortgage from ownership. For example, securitized mortgage documents are often left in the hands of servicers⁰ or at least transferred to servicers upon foreclosure.⁰

Suggested reforms may eventually reduce the importance of original mortgage documentation for foreclosure,⁰ but for the moment it appears that it is convenient to separate

⁰ See Baird & Jackson, *Information, Uncertainty, and the Theory of Property*, *supra* note 143, at 304; Plank, *Reconciling Fundamental Property Principles and Plain Language*, *supra* note 143, at 471-72 (distinguishing goods from chattel paper and promissory notes on the ground that goods have value in use while "the value of chattel paper and promissory notes depends primarily on the existence of another person who is obligated to make the payments.").

⁰ See White, *supra* note 144, at 474 (reporting Fannie Mae practice of leaving mortgage notes with the servicer). *Cf.* Elizabeth Renuart, *Property Title Trouble in Non-Judicial Foreclosure States*, 4 WM. & MARY BUS. L. REV. 111, 129 (2013) (securitization pooling and servicing agreement "normally identifies a document custodian to take physical possession of the loan notes and mortgages on behalf of the trustee").

⁰ See Dale A. Whitman, *Foreclosing on Nothing: The Curious Problem of the Deed of Trust Foreclosure Without Entitlement to Enforce the Note*, 66 ARK. L. REV. 21, 26 (2013) ("Fannie Mae and Freddie Mac... normally deliver possession of a note to the servicer when it is necessary to foreclose"); *In re Woodberry*, 383 B.R. 373, 375 (Bankr. D.S.C. 2008) (foreclosure action where servicer, not securitization trustee, had possession of note).

⁰ See Whitman, *MERS Done Right*, *supra* note 14, at 69 (proposing that national mortgage registry certificate "would provide all of the documentary evidence necessary to foreclose").

possession of mortgage documentation from mortgage ownership, so this factor seems to favor a filing system for mortgage interests.

d. Divided Ownership of Underlying Asset Important

If it is important to divide ownership of property in time⁰ or via creation of security interests,⁰ a possession rule may not work well. The benefits of a possession rule flow from the idea that only one person at a time may possess the property.⁰ If multiple parties must own different entitlements to the property, then possession cannot usefully identify all the involved parties.

Securitization is all about dividing entitlements to the cash flows of mortgage pools, in that different classes of certificates have different rights to payment – some entitled to interest, others to principal, some entitled to be paid first, others to be paid last, some junior, others senior. Thus, it might seem that the divided-ownership factor clearly supports a filing rule. However, securitization trusts are meant to take ownership of securitized mortgages *in toto*, so in this sense securitization does not rely on dividing ownership in the individual mortgage, except in the sense that holding property in trust does so.

Other mortgage-finance practices do entail the creation of divided ownership in mortgages, specifically a division between a party owning a security interest and a mortgage owner who has given a security interest. For example, it appears common for investors to fund

⁰ Baird & Jackson, *Information, Uncertainty, and the Theory of Property*, *supra* note 143, at 303 (“A possession-based rule, for example, impedes temporal divisions of property”).

⁰ Baird & Jackson, *Information, Uncertainty, and the Theory of Property*, *supra* note 143, at 304 (describing when “filing systems ... will more easily accommodate *title* claims to an asset, and not just security claims”); *id.* at 305; *id.* at 308. Although Article 9 equates a security interest with the interest in a buyer of property, Baird and Jackson distinguish between the two interests, as does this Article.

⁰ See discussion *supra* Part III. C. (describing argument that possession rule for note is efficient because it is easy to check who has an interest by checking possession).

mortgage origination by taking a security interest in the mortgage and/or note from the originator, and this practice apparently has given rise to considerable litigation.⁰ Some evidence suggests that the practice of taking true security interests in mortgages continues to be important,⁰ but empirical research would be helpful to determine just how common it is in the age of securitization.

2. Factors Not Favoring a Filing Rule

Two factors do not favor the use of a filing system. It does not appear that mortgages are likely to be stolen, and a filing system does not seem to describe mortgages better than possession of the mortgage documents themselves.

a. Asset Is Subject to a High Risk of Theft

If property may be stolen, tracing ownership interests in a filing system may help reduce the risk of theft.⁰ Although mortgage fraud of all types certainly is a perennial problem, one that has become even more prominent in the wake of the crisis, outright mortgage theft has not emerged as a major issue to date. Thus, this factor does not support use of a filing system.

⁰ See sources cited *supra* note 18.

⁰ See, e.g., Blake Rubin et al., *Creative Tax Planning for Real Estate Transactions*, SM 034 ALI-ABA 91 (describing dispute over tax treatment of warehouse financing arrangements in which lender takes security interest in mortgage pool); Steven O. Weise, *U.C.C. Article 9: Personal Property Secured Transactions*, 60 BUS. LAW. 1725, 1726 (2005) (describing dispute over warehouse lender had a security interest in mortgage notes).

⁰ Baird & Jackson, *Information, Uncertainty, and the Theory of Property*, *supra* note 143, at 303.

b. Filing Describes Underlying Asset Better Than Possession Does

When possession does not provide a clear guide to what property is actually possessed, as may be the case with real property, a filing system may be more appropriate.⁰ This factor does not seem to support use of a recording system for mortgages, as mortgages typically are most fully defined in the note and mortgage documents. Although a filing system might be able to define mortgages just as well as the underlying documents, the case does seem to be different from that of the real-property filing system, where a metes-and-bounds description based on a survey is likely to be more precise and trustworthy than the owners' own demarcation of their land.⁰ Of course, this criterion is not dispositive – goods are not thought to be affected by the problem of vagueness in possession, but there is a filing system for security interests in goods.⁰

3. Factors That May or May Not Favor a Filing Rule

A number of factors do not clearly favor or disfavor a filing system for mortgages: mortgages have an intermediate life and are frequently transferred in the securitization process but may not be transferred much thereafter.

a. Underlying Asset Is Long-Lived

Long-lived assets are likely to be more appropriate for a filing system.⁰ Short-lived assets incur additional costs from purging the filing system to reflect assets that no longer are in existence. Mortgages typically have long maturities; a common maturity for a residential

⁰ Baird & Jackson, *Information, Uncertainty, and the Theory of Property*, *supra* note 143, at 305 (“[D]escriptions of land may be more precise than possession of it – a fact adverse possession litigation teaches.”)

⁰ Baird & Jackson, *Information, Uncertainty, and the Theory of Property*, *supra* note 143, at 305 & n.14.

⁰ *Id.*

⁰ Baird & Jackson, *Information, Uncertainty, and the Theory of Property*, *supra* note 143, at 304.

mortgage is 30 years.⁰ The actual expected life of a mortgage is much shorter than its maturity because refinancing is common⁰ and because default has become much more common in recent years.⁰ Arguably, the fact that mortgage loans generally amortize over time shortens the average life still further as the typical dollar on a 30-year loan will not remain outstanding for 30 years even if paid as agreed.⁰ Despite all these factors, it appears that the average life of a mortgage loan is at least several years. This is comparable to the average life of a car,⁰ and states maintain filing systems for motor vehicle ownership.⁰

b. Property Interest Is Infrequently Transferred

Filing systems may be more useful for infrequently transferred property because of the cost and inconvenience of making entries in the filing system.⁰ For example, Baird and Jackson argue that very high frequency of transfer is a reason that there is no filing system for money.⁰

⁰ See <http://www.bankrate.com/funnel/mortgages/?prods=1> (viewed Aug. 8, 2013) (mortgage loan rate site listing “30 yr fixed” as the leading option for mortgage maturity).

⁰ See http://ycharts.com/indicators/mortgage_originations_refinancing (viewed Aug. 8, 2013) (indicating that \$357 billion in US mortgages were refinanced in the quarter ending March 31, 2013).

⁰ See Diego Aragon, Richard Peach & Joseph Tracy, *Distressed Residential Real Estate: Dimensions, Impacts, and Remedies* (July 22, 2013) (report of New York Fed staff indicating that the percentage of U.S. properties in foreclosure increased from approximately 0.5% in the first quarter of 2005 to approximately 4% by the first quarter of 2011 before declining to 3-3.5% by mid-2013).

⁰ See Lakhbir Hayre & Robert Young, *Glossary*, in SALOMON SMITH BARNEY GUIDE TO MORTGAGE-BACKED AND ASSET-BACKED SECURITIES 832, 837 (Lakhbir Hayre ed. 2005) (defining “weighted average life” as “a measure of the investment life of a fixed-income security that returns principal over a period of time, rather than in a fixed term at maturity”).

⁰ See Mark Rehtin, *Average age of U.S. car, light truck on road hits record 11.4 years*, Polk says AUTONEWS.COM (Aug. 6, 2013) (accessed August 8, 2013) (reporting that the age of the average vehicle on the road is 11.4 years).

⁰ See LOPUCKI & WARREN, *supra* note 123, at 423-47 (describing operation of state certificate title systems, which are “best regarded as ... filing system[s]”).

⁰ Baird & Jackson, *Information, Uncertainty, and the Theory of Property*, *supra* note 143, at 304.

⁰ *Id.* at 306.

How this factor applies to mortgages is both important and unclear. Certainly, mortgages do not change hands as often as pieces of currency do. However, a securitized mortgage does change hands several times at the beginning of its life. For example, in private-label securitizations of the 2000s, the mortgage would travel from an originator to a “sponsor,” thence to a “depositor,” and finally to a special-purpose vehicle, usually a trust, that holds the mortgage for the benefit of investors.⁰ Once the mortgage reaches the special purpose vehicle, it typically is not transferred.

The need to transfer the mortgage repeatedly in the securitization process meant that observing the practice of recording each mortgage transfer became more expensive and cumbersome.⁰ Thus, it appears that the industry undertook efforts to obviate recording as securitization became more popular. These efforts appear to have included the creation of the Mortgage Electronic Registration System, an arrangement in which a single entity purports to hold legal title to a mortgage as a common agent for multiple principals, obviating recording for transfers between those principals.⁰ Efforts to avoid recording may also have included the amendment of Article 9 of the Uniform Commercial Code to provide for perfection of interests in mortgages without recording.⁰

Thus, it appears that as mortgages came to be transferred more frequently, the industry sought to avoid recording. That in itself can be taken as strong evidence against using a filing system for mortgages. It is not dispositive, however. First, the traditional recording system

⁰ See John Patrick Hunt et al., *All in One Basket: The Bankruptcy Risk of a National Agent-Based Mortgage Recording System*, 46 U.C. DAVIS L. REV. 1 (2012).

⁰ *Id.* at 10-11 (describing large number of mortgage transfers in typical securitization transaction).

⁰ *Id.* at 11 (describing theory of MERS)

⁰ See Hunt, Stanton & Wallace, *Rebalancing Public and Private*, supra note 1 (explaining how revisions to Article 9 of U.C.C. reduced incentives to record mortgage assignments).

could be improved,⁰ for example by being made less expensive through electronic recording.⁰ Second, recording and filing systems make valuable information public; to the extent publicity benefits users outside the mortgage industry, industry participants will not necessarily take this positive externality into account.⁰ Third, if industry efforts to circumvent recording seem to result from the efforts of a relatively small number of powerful players, then these arrangements will not necessarily reflect the interests of all industry participants. Fourth, a recording system may be appropriate for true security interests in mortgages even if recording is not appropriate for transfers.⁰ The fact that the industry moved away from one recording system in the past does not answer the question whether any recording system could be the right answer for industry participants and the public at large. Nevertheless, the fact that many mortgages are transferred frequently certainly is relevant to designing the system.

C. Empirical Agenda for Usefulness of Filing for Mortgages

Even taking account only of the interests of transacting and potentially transacting parties and ignoring any wider public interest that may be served by public records, there seems to be a colorable case for a mortgage recording rule. Mortgages have several characteristics of property for which a filing rule is appropriate: they are tied to a fixed property location and are valuable, and there is some benefit to separating possession from ownership and in subdividing ownership

⁰ See Whitman, *MERS Done Right*, *supra* note 14, at 37-38 (describing “cumbersome” process for recording assignments under traditional approach).

⁰ See Hunt, Stanton & Wallace, *Rebalancing Public and Private*, *supra* note 1.

⁰ See Hunt, Stanton & Wallace, *Rebalancing Public and Private*, *supra* note 1.

⁰ See Plank, *Wasteful Filing*, *supra* note 143, at 262-64 (insisting on difference between security interests and transfers).

interests. At the same time, mortgages are infrequently stolen and are not better described by a filing system than by possession.

What emerges most clearly from examining the factors that emerge from the general literature on filing is that a solid conclusion about whether mortgage recording should be subject to a filing rule requires empirical research. Even if the industry has itself largely abandoned recording, that does not mean that a recording rule is bad idea. After all, the industry that abandoned mortgage recording did not face a clear recording rule; it faced an uncertain regime under which it was unclear whether recording was necessary to protect a transferee's interest.⁰

The cost and burden of using the recording system (and the achievable cost of an improved, electronic, recording system) is the most obvious area for empirical research, given that cost and inconvenience appear to be the main reason the industry abandoned mortgage recording to begin with.⁰ The foregoing discussion of what factors are important in deciding whether to adopt a filing rule can help structure the analysis of cost. Mortgages' high value suggests that the costs of a filing system are likely to be justified, but information about how long mortgages usually last and how often they typically are transferred can help refine this impression.

Another area for empirical research is what information about competing claims to mortgage ownership emerges naturally in the due diligence process and whether the cost of due diligence can be reduced by introducing a clear recording rule. For example, even if due diligence produces high-quality, credible information about competing claims, a recording system may be able to eliminate steps in the process and therefore produce net savings.

⁰ See discussion *supra* Part II

⁰ See Whitman, *MERS Done Right*, *supra* note 14, at 38 (“During the late 1990s and early 2000s, when volumes of secondary market trades increased greatly as a result of widespread securitization, players in the industry simply quit playing by these rules” (referring to mortgage assignment recording rules)).

Finally, empirical research into just how important it is to separate mortgage possession and mortgage ownership could help determine whether a possession rule is truly a workable alternative to recording or automatic perfection. Although anecdotal evidence from recorded cases indicates that taking an interest in a mortgage without taking possession remains relatively common,⁰ it would be helpful to understand just how common the practice really is.

V. CONCLUSION

This Article has shown that it has been unclear for decades whether the mortgage follows the note, that is, whether note-transfer formalities trump mortgage-transfer formalities. Thus, although the 1999 revisions to the U.C.C. purported to codify a well-established common-law rule, they in fact reflected a victory for one side in a long-running struggle. The net effect of the 1999 revisions remains unclear because it is not clear how they interact with pre-existing state title recording statutes, and understanding the state of play when they were enacted should help courts and others charged with evaluating the interplay between these two bodies of law.

The Article also has given some reasons to question whether the mortgage should follow the note. Although it is probably inefficient for different regimes to govern mortgage and note, that does not mean that note formalities – meaning protection of the transferee’s interest without filing – should automatically triumph. None of the justifications conventionally offered for the mortgage-follows-the-note rule is complete: The argument based on metaphysical unity of the two instruments does not tell us which instrument’s rules should prevail; the justification based on party intent does not take into account the interests of third parties, which are crucial to evaluating whether to adopt a recording rule or not; and the justification based on the efficiency of a possession rule does not fully track current law, which provides for perfection without

⁰ See cases cited *supra* note 18.

possession, or match recent practice, in which it appears common to transfer notes and mortgages without transferring possession.

Given that the justifications that have been offered for the mortgage-follows-the-note rule are unsatisfactory, the Article has looked outside the mortgage scholarship to the broader body of scholarly work addressing filing and recording more generally. This literature teaches us that mortgages have several characteristics that suggest a recording rule is appropriate: they are valuable, they are tied to a fixed property location, and ownership in them can usefully be separated from possession. On the other hand, mortgages are easily identified through possession and are not often stolen, suggesting a filing regime is unnecessary.

Ultimately, several empirical issues should be resolved before deciding that a recording rule, a possession rule, or an automatic perfection rule is right for mortgages. First is the cost of recording; relevant sub-inquiries here are the average length of a mortgage's life and how often the typical mortgage is transferred. Additional empirical questions include the extent to which recording duplicates information that would emerge in due diligence anyway and the extent to which parties actually separate mortgage possession and ownership and actually subdivide ownership into different interests.

This Article has sought to shift the conversation about mortgage assignment recording from a debate over positive law to a normative discussion about whether a recording rule is desirable, and has sought to advance that normative debate by identifying empirical issues critical to its resolution. Three years after the robo-signing scandal revealed the shambolic state of mortgage assignment law and practice, it is high time to go back to basics, as this Article suggests, in thinking about what this law and practice should be.