Modernizing Mortgage Foreclosure Law: A Call for Transparency and an End to the Payment Rule

Matthew M. Heekin, Charlotte School of Law

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MODERNIZING MORTGAGE FORECLOSURE LAW: A CALL FOR TRANSPARENCY AND AN END TO THE PAYMENT RULE

M. Mark Heekin*

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* Assistant Professor of Law at Charlotte School of Law in Charlotte, North Carolina. I would like to thank Professor Bruce Burton, a longtime mentor and good friend, and would like to express my gratitude to Adam R. Thornton for research assistance with this Article.
We have had to contend with the persistent effects of the seizing-up of the financial system, the collapse of housing prices and construction, new financial shocks in Europe and elsewhere, restrictive fiscal policies at all levels of government, and, of course, the enormous blows to output and employment associated with the worst U.S. recession since the Great Depression. Moreover, for the first time since the FOMC [Federal Open Market Committee] began using the federal funds rate as its policy interest rate, that rate is effectively at zero and thus cannot be lowered meaningfully further.¹

I. INTRODUCTION

One scholar has noted that melodrama is right versus wrong, but tragedy is right versus right.² Two parties, both socially essential, have interests that are now in tragic collision: the innocent borrower, the bedrock of the mortgage lending industry, who signed the mortgage note, versus the new holder of the note, whose capital is essential to funding the nation’s lending industry. This tragedy flows from the global financial crisis, which led directly to the foreclosure epidemic, the aftershocks of which the nation continues to face. The global financial crisis arose in great measure due to mortgage lenders bundling millions of mortgage loans, which randomly commingled arrays of toxic subprime mortgages with soundly underwritten “normal” loans.³ It can be debated whether private players or government players were more responsible for the mortgage backed securities (MBS) bubble of toxic mortgage bundles,⁴ but regardless of where the greatest blame lies, America is still sorting out the vast array of defaulted mortgages and

³ See Steven L. Schwarcz, Marginalizing Risk, 89 WASH. U. L. REV. 487, 501 (2012) (“Mortgage lenders . . . dispersed risk on these ‘subprime mortgage loans’ by bundling them together as collateral to partially support the payment of complex asset-backed securities that were sold to banks and other institutional investors.”); see also Hearings: Subprime Mortgage Market Turmoil: Examining the Role of Securitization, U.S. SENATE COMMITTEE ON BANKING, HOUSING, & URB. AFF., http://tinyurl.com/ma8fh5p (Testimony Written and Presented by Kurt Eggert, Professor of Law, Chapman University School of Law); Subprime Mortgage Market Turmoil: Examining the Role of Securitization: Hearing Before the Subcomm. on Sec. and Ins. and Invs. of the Comm. on Banking, Hous., and Urban Affairs, 110th Cong. 17–19 (2007) (testimony of Kurt Eggert, Professor of Law, Chapman University School of Law).
facing the foreclosure dilemmas discussed herein.

The bursting of the derivatives bubble that spawned this epidemic has now revealed a major legal pitfall in foreclosure laws. In America, where foreclosure laws are governed by state case law and statute, there exists a basic uncertainty and lack of uniformity in enforcement of foreclosure laws. This uncertainty introduces an element of indefiniteness regarding legal title to real property, causing a logjam in many states’ economic recovery.

This Article is premised on the problem regarding the traditional legal rule that forces the foreclosing lender to produce the original signed mortgage note to prove that it holds the legal right to foreclose or otherwise enforce remedies against the defaulted debt. This is the so-called “payment rule” of negotiable instruments law. The payment rule, or rules of similar import, is applied in most jurisdictions. The payment rule was designed to eliminate the danger of debtors being required to make double payments on a note, thus allowing a debtor to refuse to make payment where a demand to produce the instrument was not met.

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5 Grant S. Nelson, Confronting the Mortgage Meltdown: A Brief for the Federalization of State Mortgage Foreclosure Law, 37 PESP. L. REV. 583, 587 (2010).
8 See Dasma Invs., LLC v. The Realty Assocs. Fund III, L.P., 459 F. Supp. 2d 1294, 1302 (S.D. Fla. 2006) (holding that “[a] party suing on a promissory note—whether just on the note itself or together with a claim to foreclose on a mortgage securing the note—must therefore be in possession of the original of the note or reestablish the note pursuant to Fla. Stat. § 673.3091. If it is not in possession of the original note, and cannot reestablish it, the party simply may not prevail in an action on the note.”). But see Eaton v. Fed. Nat’l Mortg. Ass’n, 969 N.E.2d 1118, 1131 (Mass. 2012) (holding that, contrary to prior practice, a mortgagee is not required to have possession of the mortgage note to effect foreclosure).
9 See Equity Bank v. Gonsalves, 44 Conn. Sup. 464, 467 (1996) (“As for negotiable instruments, notice to the maker of the transfer of the note is not required. The reason given is that the maker can protect himself by demanding production of the instrument and refusing to pay a party not in possession of it.”); see also Kemp v. Countrywide Home Loans, Inc., 440 B.R. 624, 631 (Bankr. D.N.J. 2010) (“From the maker’s standpoint, therefore, it becomes essential to establish that the person who demands payment of a negotiable note, or to whom
The payment rule, however, does not comport well with modern practices within the mortgage lending industry. Because of the bundling, securitization, and global remarketing of mortgage-backed securities, the normal chain of current ownership of any particular mortgage debt is now often unable to be traced. The well-intended payment rule becomes a destructive obstacle under the current reality of MBS practices. If the modern mortgage industry is to survive—and many believe that its survival is an essential goal of society—and protect the rights of debtors, lenders, investors and all others involved in mortgage enforcement cases, there needs to be a dependable solution to the payment rule problem. This Article demonstrates how many courts have struggled to fix the problem and proposes a more dependable, structural solution to provide certainty in the industry and thereby assist all players in the real estate marketplace.

Judge Hunter, writing both majority and dissenting opinions for the North Carolina Court of Appeals, gives a correct analysis of longstanding precedent in light of society’s critical need for change, changes which would allow the mortgage lending industry to remain

10 Grant S. Nelson & Dale A. Whitman, Real Estate Finance Law 445 (5th ed. 2007) (1951) (“The rule that innocent payment to a mortgagee who has already assigned the mortgage note is ineffective is seriously out of touch with modern practices and should be revised. It ignores important changes that have occurred in the mortgage market in the past few decades. First, it assumes that the note can readily be produced by the mortgagee upon the mortgagor’s request if it has not been assigned or if the mortgagee is the holder’s agent. The expansion of financial institutions, the advent of increased branching in many states, and the widespread assignment of mortgages with the mortgagee or some third party designated as servicer, all make this assumption wholly unrealistic. The note usually resides in a vault, often many miles from the location at which the mortgagor customarily makes payments. Moreover, mortgage payments today are very often made by mailed check or by automatic deduction from the mortgagor’s checking account; these convenient procedures would be frustrated if the mortgagor really needed to inspect the note before each payment. A modern mortgagor who demanded to see the note before each payment would probably be viewed as if he or she had just arrived from Mars. A further change of significance is the advent of computerized recordkeeping of mortgage payments. In earlier times it was customary to record each payment on a ledger printed on the reverse side of the note itself; thus, production of the note was natural and caused no inconvenience. This practice has almost entirely disappeared in favor of separate, usually computer-based, accounting of mortgagors’ payments. The modern practice is more accurate and saves expense for all parties concerned, but the savings would be negated to the extent that production of the physical note were required.”).


viable in an age that is not likely to abandon either the sale of mortgages on the secondary market or mortgage securitization. Could this be America’s tragedy playing out before us?

First, this Article will examine these inconsistent holdings, their implications for mortgage enforcement law, and presents various proposed solutions. In the course of the courts’ struggles throughout the country, some have given disparate, even self-contradictory treatment to the payment rule. There are instances in which a court will issue an opinion, then within a matter of weeks or months issue another opinion, which, explicitly or implicitly, contradicts its earlier opinion on the payment rule issue.13

Second, this Article will examines the monumental shift in state law regarding the enforcement of negotiable instruments, notably as it relates to the payment rule for mortgage notes in mortgage foreclosure cases.14 To illustrate the problem, I will focus on the contrasting examples found in two recent cases from the Court of Appeals of North Carolina, where the court handed down two schizophrenic holdings regarding the payment rule, within weeks of one another, thereby clouding the certainty of foreclosure-derived land titles in North Carolina.15

Third, this Article will offer a new fair and balanced solution to the problem, meeting three essential goals: (i) public transparency in harmony with nearly two centuries of state law recording act policy; (ii) fairness to individual mortgage debtors; and (iii) promoting the certainty and efficiency of the financial industry’s ability to enforce borrowers’ obligations through foreclosure.

Accordingly, Part II provides a brief discussion on the issues that led to the Great Recession in 2008. Part III is a brief overview of negotiable instrument law, persons entitled to enforce negotiable instruments, the payment rule, and also details the use of negotiable instruments in United States commerce with an emphasis on the mortgage lending industry. Part IV first provides an analysis of the Simpson opinion and the dissent in Dobson and then moves onto the

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14 Although deeds of trust are the predominant form of real property security instrument utilized in many states, this paper will use the terms “mortgages” and “mortgage notes” (or “notes”) when referring to security instruments for real property and their accompanying notes.
15 See In re David A. Simpson, P.C., 711 S.E.2d 165; Dobson, 711 S.E.2d 728.
majority opinion in Dobson to assess the state of enforcement of negotiable instruments in North Carolina. It would be difficult to dispute that the Simpson opinion and the dissent in Dobson are consistent with well-settled negotiable instrument law. But did the majority in Dobson come to a conclusion that is necessary for today’s mortgage industry to continue to operate utilizing current mortgage lending practices? Finally, Part V summarizes the analysis and proffers a fast, efficient, readily understood and practical solution to rectify this situation. Rather than torturing case law as the Dobson and Simpson opinions do, a more effective approach is offered.

II. BACKGROUND

The housing bubble and bust were the proximate causes of the Great Recession that started in 2008, setting off a vicious cycle of falling house prices and surging foreclosures. Although the United States economy is beginning to recover, the recovery is far from robust due to the sluggish real estate market. Buyers, title insurers, lenders making new mortgage loans, and other actors in the post-meltdown real estate market are rightfully circumspect in an environment where courts interpreting state law have set aside foreclosures, even after the foreclosure sale has been conducted, thus introducing an element of uncertainty to land titles. The real estate market cannot return to a state of normalcy until parties who purchase properties out of foreclosure sales have certainty that the foreclosure will not be set aside.

16 Alan S. Blinder & Mark Zandi, How the Great Recession Was Brought to an End, MOODY’S ANALYTICS (July 27, 2010), http://tinyurl.com/8ce5cbn. See also THE FIN. CRISIS INQUIRY COMM’N, THE FINANCIAL CRISIS INQUIRY REPORT: FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE U.S., xvi (2011), available at http://tinyurl.com/44pkjn3 (“While the vulnerabilities that created the potential for crisis were years in the making, it was the collapse of the housing bubble—fueled by low interest rates, easy and available credit, scant regulation, and toxic mortgages—that was the spark that ignited a string of events, which led to a full-blown crisis in the fall of 2008.”).


18 In U.S. Bank Nat’l Ass’n v. Ibanez, the Supreme Judicial Court of Massachusetts held that the foreclosing bank, which was not the original mortgagee, failed to make the required showing that it was the holder of the mortgages at the time of foreclosure, and, as a result, did not demonstrate that the foreclosure sale was valid to convey title to the subject property, and that its request for a declaration of clear title was properly denied by the Land Court. 941 N.E.2d 40, 53 (Mass. 2011).
A. Mortgage and Note Assignments

Mortgagors are typically not provided any notice of an assignment of their mortgage and note, particularly when the servicer to whom payments are made remains the same, leaving mortgagors to fend for themselves in finding out who owns their note and mortgage when an assignment has occurred.19 This is true of many jurisdictions, including North Carolina.20 Professor Dale Whitman points out, however, that if the originating lender sells and assigns the mortgage and accompanying note, but remains the servicer for that mortgage, as is often the case, the law of agency may mollify the harsh effects of the payment rule as it relates to credits for payment.21

B. Foreclosures and Robo-Signing

The problems that have caused foreclosures to be set aside have arisen when foreclosing lenders are not able to produce the original mortgage note when called upon to do so. This inability to track possession of a single document is a manifestation of the bundling and pooling business practices that prevailed prior to the mortgage meltdown. It has also been the Achilles’ heel of many a foreclosing lender. The inability to produce the note has led to the publicization of shameful practices in the mortgage industry, most notably the practice of “robo-signing,”22 which shut down the foreclosures of some of the nation’s largest and most reputable mortgage lenders. Robo-signing allows foreclosures to proceed on questionable affidavits and

19See NELSON & WHITMAN, supra note 10, at 598.
21See Reforming the Law, supra note 7, at 1178–79 (“It is universally agreed that payment to the authorized agent of the note’s assignee will count against the assignee. Thus, if the assignee makes the original mortgagee an agent for collection of the note, a payment made to the mortgagee after the assignment has occurred will be effective and binding on the assignee. Early cases were extremely parsimonious in finding an agency relationship in the absence of a formal agreement, while more recent cases seem to bend over backward to find an agency relationship or an estoppel against the assignee.” (footnotes omitted)).
complicates managing the immense amounts of paperwork associated with the secondary mortgage market.\textsuperscript{23} These practices induced five of the nation’s largest mortgage lenders to enter into an historic thirty–seven billion dollar settlement to help homeowners who had been wronged by their foreclosure practices.\textsuperscript{24} Professor Whitman has noted that many of the practices that contributed to the epidemic, such as the sale of mortgages and their accompanying notes on the secondary market, i.e., mortgage securitization and pooling, are not likely to be abandoned by the mortgage lending industry.\textsuperscript{25}

III. A Brief Summary: Negotiable Instruments, Persons Entitled to Enforce Negotiable Instruments, the Holder Status of Assignees, and the Payment Rule

Negotiable instruments have played a significant role in the evolution of commerce throughout the world. Indeed, negotiable instruments and negotiable instruments law evolved with the advent of commerce. There are some very good articles that detail the evolution of negotiable instruments and negotiable instruments law, so I will reference those, but will not endeavor to try to comprehensively summarize them.\textsuperscript{26} The doctrines involving negotiability have evolved over time. Those in the mortgage industry, even lawyers and judges, sometimes fail to recognize the significance of negotiability and its requirements, causing some to question the need for negotiability in today’s modern world. Indeed, although mortgage notes are viewed as negotiable instruments, they often fail to comply with the formal


\textsuperscript{25}See Negotiability, supra note 11, at 740. (“While the secondary mortgage market has experienced a major hiccup, it is not dead and will not die. We are unlikely to return to a system in which most mortgages are held in portfolio by their originators. Despite the current pause in securitization activity, it makes sense to cure its defects, including those arising from the negotiability doctrines addressed here, so that securitization will operate more effectively when the market returns.”).

\textsuperscript{26}See Ronald J. Mann, Searching for Negotiability in Payment and Credit Systems, 44 UCLA L. REV. 951 (1997); Negotiability, supra note 11.
requirements that would make them negotiable instruments. 27

In considering the origins of negotiable instruments, it is helpful to gain an understanding of the term “negotiable instrument.” Whether an instrument is a negotiable instrument is determined by the form of the instrument when it is drafted. 28 Nothing the maker or the holder does after the instrument is drafted, signed, and delivered will convert a non-negotiable instrument into a negotiable instrument:

To be a negotiable instrument a writing must be signed by the maker or drawer, contain an unconditional promise or order to pay a sum certain in money, contain no other promise, order, obligation or power given by the maker or drawer except as authorized by . . . Article 3, be payable on demand or at a definite time, and be payable to order or to bearer. 29

If an instrument does not comply with the requisite formalities to be considered negotiable, its enforcement is determined by the law of contracts rather than the law of negotiable instruments. 30 Professor Whitman has noted the difficulties in determining whether a note complies with the formal requirements that would make it a negotiable instrument:

[D]etermining whether a note is or is not negotiable is a complicated and potentially difficult process, which requires a review and analysis of all of the note’s terms. The definitions have been broadened and made more complex by successive revisions of Article 3. For example, as noted above, an adjustable rate note would arguably have been nonnegotiable under the prior version of Article 3. So would a note containing a non-recourse clause or a note requiring

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27 See Mann, supra note 26, at 969, 971–72 (“The irrelevance of negotiability to home-mortgage note transactions is best demonstrated by the fact that the standard form of promissory note used for those transactions fails to satisfy the requirements of negotiability. . . . Fannie Mae and Freddie Mac have promulgated a number of standard forms for use in [home-mortgage note] transactions. . . . [T]he Fannie Mae/Freddie Mac forms dominate the market, even for transactions in which the lender does not contemplate an immediate sale to Fannie Mae or Freddie Mac. . . . The most basic of these forms . . . provides as follows: . . . I have the right to make payments of principal at any time before they are due. A payment of principal only is known as a ‘pre-payment.’ When I make a prepayment, I will tell the Note Holder in writing that I am doing so. The italicized sentence of that provision appears to constitute an ‘undertaking . . . to do a[n] act in addition to the payment of money.’ For historical reasons codified in section 3-104(a)(3) of the U.C.C., a promissory note cannot be an instrument if it contains such an undertaking: the rules of negotiability apply only to promises to pay money, not to other, non-monetary undertakings.” (final omission in original) (final alteration in original) (footnote omitted)).

29 Id.; see also N.C. GEN. STAT. § 25-3-104(a) (LEXIS through 2013 Sess.).
30 Gillespie, 280 S.E.2d at 740.
payment of insurance premiums on the security property. Despite these expansions of negotiability, the concept is not unlimited, and it is obvious that not every note used in a mortgage transaction is negotiable.\footnote{Negotiability, supra note 11, at 748–49 (footnotes omitted).}

Historically, mortgages were held in the originating mortgage lender’s portfolio of mortgage loans\footnote{See id. at 738, 740.} and, when finally paid in full, the originating lender would record a satisfaction of mortgage in the land records of the county that is the situs of the mortgaged property and send the original mortgage note to the mortgagor. Today, most mortgages are sold in secondary mortgage markets and the mortgage, along with its accompanying note, is assigned (or “negotiated” in the case of negotiable instruments) to the buyer who is the new holder.\footnote{Id. at 738 (“In this era, it is a relatively rare mortgage that is held in portfolio for its full term by the originating lender. Instead, the vast majority of mortgages are either traded on the secondary market to an investor who will hold them, or to an issuer (commonly an investment banker) who will securitize them. Securitization refers to the practice of issuing securities based on pools of underlying mortgages. The securities may be ‘participation certificates,’ each of which represents a small fractional share of ownership in the underlying mortgage pool. More commonly, however, the securities are, in effect, bonds that are collateralized by the pool of mortgages. The advantage of the latter approach is that there may be many classes of bonds carrying different payment schemes and different priorities, collateralized by a single pool of mortgages.” (footnotes omitted)).}

It is long-standing negotiable instruments law that a negotiable instrument may only be enforced by one who has the right to bring an enforcement action against an obligor, i.e. a “person entitled to enforce.”\footnote{See N.C. GEN. STAT. § 25-3-301 (LEXIS through 2013 Sess.).} North Carolina General Statutes section 25-3-301 defines “person entitled to enforce” a negotiable instrument.\footnote{Id. (“‘Person entitled to enforce’ an instrument means (i) the holder of the instrument, (ii) a nonholder in possession of the instrument who has the rights of a holder, or (iii) a person not in possession of the instrument who is entitled to enforce the instrument pursuant to G.S. 25-3-309 or G.S. 25-3-418(d). A person may be a person entitled to enforce the instrument even though the person is not the owner of the instrument or is in wrongful possession of the instrument.”).} For purposes of this Article, section 25-3-301(i) is crucial because it describes a “holder of the instrument” as one of the persons entitled to enforce a negotiable instrument.\footnote{Id.}

The “holder” of an instrument includes “[t]he person in possession of a negotiable instrument that is payable either to bearer or to an identified person that is the person in possession.”\footnote{Id. § 25-1-201(b)(21)(a); see also Econo-Travel Motor Hotel Corp. v. Taylor, 271 S.E.2d 54, 57 (N.C. 1980).} In addition, a
“person” for purposes of enforcement of a negotiable instrument is defined as “an individual, corporation . . . or any other legal or commercial entity.” Thus, “[i]t is the fact of possession which is significant in determining whether a person is a holder, and the absence of possession defeats that status.” Furthermore, possession is an essential element to a holder’s right to enforce a negotiable instrument and, absent possession of a properly indorsed note, a party is not entitled to enforce the note against the maker. Indorsement, either to the order of a particular party, or in blank, which makes the instrument bearer paper, along with transfer of possession are both required for the negotiation of a negotiable instrument, which gives a transferee rights as a person entitled to enforce that negotiable instrument. It is critical that the party entitled to enforce the note prove that they are the holder. It is not enough that they simply profess to be the holder.

The payment rule has a long history in United States negotiable instruments law. Its origins can be traced to interpretations of the holder in due course doctrine in negotiable instruments law. The

38 N.C. GEN. STAT. § 25-1-201(b)(27) (LEXIS).
40 See id.
41 N.C. GEN. STAT. § 25-3-203(b) (LEXIS) (“Transfer of an instrument, whether or not the transfer is a negotiation, vests in the transferee any right of the transferor to enforce the instrument . . . .”).
42 Liles v. Myers, 248 S.E.2d 385, 387 (N.C. Ct. App. 1978) (“The requirement that this plaintiff prove her status as a holder of the note is distinguishable from a requirement that she allege that status in her pleadings.”).
43 Reforming the Law, supra note 7, at 1176–77 (“In the United States, the payment rule has been an intrinsic component of the law of negotiable notes since negotiability began to receive uniform statutory recognition. The 1990 version of UCC Article 3, currently in effect, governs negotiable instruments. Article 3 is widely understood as adopting the payment rule, although the logic of its language is fairly convoluted. Three different sections must be read together. Section 3-602 provides that an instrument is paid ‘to the extent payment is made . . . to a person entitled to enforce the instrument.’ Under UCC section 3-301, ‘person entitled to enforce’ an instrument means (with certain exceptions not here relevant) either ‘the holder of the instrument’ or ‘a nonholder in possession of the instrument who has the rights of a holder.’ Thus, section 3-301 ties the enforcement right to possession of the paper. Finally, UCC section 3-203(a) provides that ‘[a]n instrument is transferred when it is delivered by a person other than its issuer for the purpose of giving to the person receiving delivery the right to enforce the instrument.’ Rather oddly, Article 3 never overtly states what seems to be its well-accepted premise: that payment can be made only to the person with possession of the instrument. The previous version of Article 3 was similarly silent on that precise point. Nevertheless, virtually all those who deal with Article 3 read it as if section 3-602 said ‘only,’” (alteration in original) (omission in original) (footnotes omitted)).
44 Id. at 1177 (“Some decisions reason that the payment rule stems from the holder in due course doctrine. They assert that since ‘payment’ is a personal defense and hence cannot be raised against a holder in due course, only such holders are entitled to make the payor pay
payment rule requires that once a negotiable instrument has been transferred to an assignee who then becomes a holder, the maker of the instrument who makes payment on the instrument to anyone other than that assignee does so at his or her own peril. The maker’s errant payment is not binding on the assignee unless the party who received the payment forwards it to the assignee. This is so even if the maker of the instrument has no knowledge of its transfer. Therefore, the maker can become liable for double payment after the transfer of the signed note to a new holder. The payment rule was articulated clearly by the Court of Appeals of North Carolina in Liles v. Myers:

Prior to being entitled to a judgment against the defendant, the plaintiff was required to establish that she was holder of the note at the time of this suit. This element might have been established by a showing that the plaintiff was in possession of the instrument and that it was issued or endorsed to her, to her order, to bearer or in blank. It is essential that this element be established in order to protect the maker from any possibility of multiple judgments against him on the same note through no fault of his own. If such proof were not required, the plaintiff could negotiate the instrument to a third party who would become a holder in due course, bring a suit upon the note in her own name and obtain a judgment in her favor. Thereafter, the holder in due course could bring suit upon the note and possibly also obtain a judgment against the defendant.

IV. ANALYSIS OF THE OPINIONS IN SIMPSON AND DOBSON

In Roman mythology, Janus is the god of many things, but particularly of beginnings, endings and transitions. He symbolized change, such as the progress from past to future and from one condition to another. He was often depicted with a double-faced head to enable him to see into the past with one face and into the future with the other again. However, this view reflects a misunderstanding of the holder in due course doctrine. The sort of ‘payment’ to which this doctrine refers is payment made before the transfer of the instrument, which is not the type of payment with which we are concerned. It is not the holder in due course doctrine, but the ‘reified obligation’ concept embodied in the sections of Article 3 quoted above, that imposes the payment rule for negotiable notes. A ‘person entitled to enforce,’ who is required to possess the note, has the benefit of the payment rule whether or not he or she is ‘in due course.’ (footnotes omitted).
simultaneously. Despite this extraordinary power, Janus would be hard-pressed to effectively predict the outcome of mortgage foreclosure cases applying the payment rule.

To illustrate this difficulty, this Article will focus on two contrasting cases decided by the Court of Appeals of North Carolina in 2011: In re David A. Simpson P.C.\(^{51}\) and Dobson v. Substitute Trustee Services, Inc.\(^{52}\) The Simpson court upheld the traditional approach to the payment rule.\(^{53}\) Then, within weeks, the same appellate court undercut nearly two centuries of established commercial law with its holding in Dobson.\(^{54}\)

A. The Court of Appeals of North Carolina’s Inconsistent Application of the Payment Rule

On May 3, 2011, Judge Robert N. Hunter, Jr.’s\(^{55}\) opinion in Simpson upheld the traditional application of the payment rule.\(^{56}\) A short two weeks later the majority in Dobson departed from its application of the payment rule in Simpson, although Judge Hunter’s dissent remained consistent with his earlier opinion in Simpson.\(^{57}\) Since then, this same court has shifted away from Dobson and handed down opinions consistent with its earlier affirmation of traditional negotiable instruments law. In re Bass and In re Yopp both show that this court has again turned its focus back to the traditional treatment of the payment rule.\(^{58}\) The facts antecedent to each of these cases vary to some extent.

\(^{51}\) In re David A. Simpson, P.C., 711 S.E.2d 165 (N.C. Ct. App. 2011).


\(^{53}\) In re David A. Simpson, P.C., 711 S.E.2d at 171.

\(^{54}\) Dobson, 711 S.E.2d at 731.


\(^{56}\) See In re David A. Simpson, P.C., 711 S.E.2d 165, 172 (N.C. Ct. App. 2011) (“Without a determination of who has physical possession of the Note, the trial court cannot determine, under the UCC, the entity that is the holder of the Note.”).

\(^{57}\) See Dobson v. Substitute Tr. Servs., Inc., 711 S.E.2d 728, 736–37 (N.C. Ct. App. 2011) (Hunter, J., dissenting) (“I find no competent evidence in the record from which this Court could determine that Wells Fargo is the holder of Dobson’s note. Neither of the affidavits provided by Defendants, nor the answer provided by Wells Fargo allege possession of the instrument. Thus, Defendants have failed to present competent evidence sufficient to establish a genuine issue of material fact to survive Plaintiff’s Motion for Summary Judgment.”).

but in each case, the Court of Appeals of North Carolina was called upon
to review issues related to the payment rule found in negotiable
instruments law. It seems clear that this schizophrenic court was
struggling to achieve changes necessary to save the mortgage lending
industry, in the absence of legislative action.

Comparing the majority’s approach in *Dobson* to the traditional
approach taken by Judge Hunter in *Simpson*, along with his dissent in
*Dobson*, there is a stark distinction between the two approaches. This
Article will examine some potential explanations for this departure in
*Dobson*. But whatever the explanation may be, uncertainty regarding the
payment rule is the precise evil that must be remedied to allow stability
and fairness to all players in the mortgage marketplace.

*Dobson* has already been cited as precedent in cases where a party,
not in possession of the original note, sought to enforce such note. For
example, in the following cases citing to *Dobson*, the enforcing party
was not required to produce the original note when the enforcing party’s
status as the holder of the note was in question: *FDIC v. Cashion*[^59] and
*Mullis v. First Charter Bank*[^60] from the Western District of North
Carolina, and *Wells Fargo Bank v. Stratton Jensen, LLC*[^61] and
*Howard*

[^59]: *FDIC v. Cashion*, Civ. No. 1:11cv72, 2012 WL 1098619, at *4 (W.D.N.C. Apr. 2, 2012) ("Contrary to the Defendant’s argument, however, production of the original Note is not the only manner in which holder status can be proved.").

[^60]: *Mullis v. First Charter Bank*, No. 5:12-CV-00090-RLV-DSC, 2013 WL 3899888, at *5 (W.D.N.C. July 29, 2013) ("Plaintiffs’ additionally plead that 'Defendant’s ability to retain right, title and interest to the property cannot be maintained without the original note.' *Dobson v. Substitute Trustee Services, Inc.* establishes that, in North Carolina, arguing that a defendant has 'not proven that it is the holder of the note because it failed to produce the original note' is 'unavailing.' Specifically, North Carolina ‘[c]ourt[s] [have] held that where there is no evidence that photocopies of a note or deed of trust are not exact reproductions of the original instruments, a party need not present the original note or deed of trust . . . .’ Here, Defendants have produced a signed photocopy, and the Plaintiffs have put forth no evidence tending to suggest that the copy is not an exact reproduction. Because current North Carolina case law refutes Plaintiffs’ suggestion that the original Note must be produced in order for Defendants to assert a legal interest in the Property, Plaintiffs have failed to state a claim upon which relief may plausibly be granted. Therefore, this claim shall likewise be dismissed.” (alterations in original) (omission in original) (citations omitted)).

[^61]: *Wells Fargo Bank v. Stratton Jensen, LLC*, 2012 UT App 40, ¶ 3, 273 P.3d 383 ("Further, Wells Fargo demonstrated that based upon the undisputed material facts, it was entitled to judgment as a matter of law. Jensen raised two primary issues that he believed precluded summary judgment. First, he argued that Wells Fargo did not demonstrate that it was a holder in due course because it had failed to produce the original note. Jensen has not cited any single jurisdiction that has adopted this ‘show-me-the-note’ argument, and we are aware of none. On the contrary, courts have generally concluded that ‘where there is no evidence that photocopies of a note or deed of trust are not exact reproductions of the original instruments, a party need not present the original note or deed of trust and may establish that it..."
v. PNC Mortgage\textsuperscript{62} from the Court of Appeals of Utah. As more courts cite to \textit{Dobson} when interpreting the payment rule, there is a very real danger that disparate treatment of the payment rule will continue to be applied by the courts. While courts struggle with the payment rule in its present form, other holdings may develop that echo and enlarge \textit{Dobson}, giving more uncertainty to fundamental property ownership issues.

\textbf{B. In re David A. Simpson, P.C.}

Rex Gilbert executed an adjustable rate note, secured by a deed of trust, on real property located in Hyde County, North Carolina, on May 5, 2006.\textsuperscript{63} The note was in favor of First National Bank of Arizona and the deed of trust identified First National Bank of Arizona as the lender and Matthew J. Ragaller as trustee.\textsuperscript{64} In 2008, Gilbert defaulted.\textsuperscript{65} In March 2009, a substitution of trustee was recorded with the Hyde County Register of Deeds, which substituted David A. Simpson, P.C. as trustee for Ragaller, and identified Deutsche Bank Trust Company Americas as Trustee for Residential Accredit Loans, Inc. Series 2006-QA6 ("Petitioner") as the holder of the note and the secured party under the deed of trust.\textsuperscript{66}

The substitute trustee filed a notice of foreclosure hearing with the Hyde County Clerk of Superior Court on March 12, 2009.\textsuperscript{67} The foreclosure hearing was held June 2, 2009, after which the clerk entered an order allowing the foreclosure, finding in part that the Petitioner was the holder of the note.\textsuperscript{68} The order was appealed to the Hyde County Superior Court, which held a \textit{de novo} hearing.\textsuperscript{69} At the hearing a

\begin{footnotesize}
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\item \textsuperscript{62}Howard v. PNC Mortg., 2012 UT App 19, ¶ 3, 269 P.3d 995 ("Howard asserts that the district court erred in dismissing several of his claims because PNC Mortgage could not demonstrate that it was a holder in due course of the note. Specifically, Howard argues that PNC Mortgage must produce the original note, not a photocopy, to support its claim that it is now the holder of the note. However, courts have generally concluded that \textquote{where there is no evidence that photocopies of a note or deed of trust are not exact reproductions of the original instruments, a party need not present the original note or deed of trust and may establish that it is the holder of the instruments by presenting photocopies of the note or deed of trust.}.")
\item \textsuperscript{63}In re David A. Simpson, P.C., 711 S.E.2d at 167.
\item \textsuperscript{64}Id.
\item \textsuperscript{65}Id.
\item \textsuperscript{66}Id.
\item \textsuperscript{67}In re David A. Simpson, P.C., 711 S.E.2d at 167.
\item \textsuperscript{68}Id. at 168.
\item \textsuperscript{69}Id.
\end{itemize}
\end{footnotesize}
certified copy of the note and deed of trust executed by Gilbert were admitted into evidence, along with two affidavits.\textsuperscript{70} The first affidavit attested to the validity of Gilbert’s debt under the note and the second attested that Petitioner was the current owner and holder of the note.\textsuperscript{71} Petitioner also introduced the original note and an allonge.\textsuperscript{72} The allonge contained a series of indorsements, the final indorsement being to Deutsche Bank Trust Company Americas as Trustee.\textsuperscript{73} At trial, Gilbert argued that Petitioner had not produced sufficient evidence to establish that it was the holder of the note.\textsuperscript{74} The trial court held, however, that Petitioner was the current holder of the note.\textsuperscript{75}

On appeal, Gilbert argued that the Petitioner had not produced sufficient evidence to establish that it was the holder of the note.\textsuperscript{76} “Establishing that a party is the holder of the note is essential to protect the debtor from the threat of multiple judgments on the same note.”\textsuperscript{77} That distinction is a conclusion of law, however, not a finding of fact. Judge Hunter went on to distinguish the two,\textsuperscript{78} reasoning that the trial court had relied on information contained in affidavits by the Petitioner as conclusions of law.\textsuperscript{79} Petitioner argued that it had provided competent evidence of its holder status by its production of the original note and the allonge at the de novo hearing.\textsuperscript{80} It also claimed that “this evidence plainly evidences the transfers’ of the [n]ote to Petitioner.”\textsuperscript{81}

Despite the foreclosing substitute trustee’s production of the note and allonge at trial, the court held that the record lacked competent evidence that the substitute trustee was the lawful owner and holder of

\textsuperscript{70} Id.
\textsuperscript{71} In re David A. Simpson, P.C., 711 S.E.2d at 168.
\textsuperscript{72} Id.
\textsuperscript{73} Id.
\textsuperscript{74} Id.
\textsuperscript{75} Id.
\textsuperscript{76} Id. at 169 (“We note the trial court classified multiple conclusions of law as ‘findings of fact.’ We have previously recognized ‘[t]he classification of a determination as either a finding of fact or a conclusion of law is admittedly difficult.’ Generally, ‘any determination requiring the exercise of judgment or the application of legal principles is more properly classified a conclusion of law.’ Any determination made by ‘logical reasoning from the evidentiary facts,’ however, ‘is more properly classified a finding of fact.’ When this Court determines that findings of fact and conclusions of law have been mislabeled by the trial court, we may reclassify them, where necessary, before applying our standard of review.’” (alteration in original) (citations omitted)).
\textsuperscript{77} Id.
\textsuperscript{78} Id. at 170.
\textsuperscript{79} Id. at 171.
\textsuperscript{80} Id. at 169.
\textsuperscript{81} Id.
the note at the time it sought to enforce the note, stating that the Petitioner’s affidavit alleged no facts as to who possessed the note. The court disregarded the conclusion of law in the affidavit that Petitioner was the owner and holder of the note. Thus, Judge Hunter’s opinion for the court concluded that there was not sufficient competent evidence to establish that the Petitioner was the holder of the note.

C. Dobson v. Substitute Trustee Services, Inc.

Linda Dobson and her husband executed a note and deed of trust in favor of Equivantage, Inc., on July 31, 1996, secured by real property located in Duplin County, North Carolina. Equivantage assigned the note and deed of trust to Wells Fargo Bank Minnesota, N.A., in September 2001, after which Dobson defaulted. In September 2007, Substitute Trustee Services, Inc. (STS) filed a foreclosure action in Duplin County. The Clerk of Superior Court entered an order dismissing the foreclosure and finding that “[t]here was insufficient evidence that [Dobson] was in default under the terms of the [d]eed of [t]rust.” Wells Fargo appealed this dismissal to Duplin County Superior Court on October 29, 2007. On November 1, 2007, Dobson filed a complaint against Wells Fargo, STS, Equivantage, and a servicing company seeking relief, including a preliminary and permanent injunction against the foreclosure proceedings.

The trial court heard cross motions for summary judgment. Wells Fargo presented the following evidence before the trial court to establish that it was the holder of the note:

1. an affidavit by the vice president of loan documentation of Wells Fargo, which states that “[t]he owner and holder of the [n]ote and indebtedness is[] Wells Fargo;”
2. an affidavit by a default litigation specialist with Wells Fargo.

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82 Id. at 174. “Whether Deutsche Bank Trust Company Americas as Trustee for Residential Accredit Loans, Inc. Series 2006–QA6 is the owner and holder of the Note and Deed of Trust is a legal conclusion that is to be determined by a court of law on the basis of factual allegations.” In re David A. Simpson, P.C., 711 S.E.2d at 173.
83 Id. at 174.
84 See id.
86 Id.
87 Id.
88 Id. (alterations in original).
89 Dobson, 711 S.E.2d at 729.
90 Id.
91 Id. at 729–30.
Fargo, which states that “Wells Fargo is the present and current holder of the [n]ote;” (3) a photocopy of the original note; and (4) a photocopy of the document assigning the note to “Norwest Bank Minnesota,” which is “now known as Wells Fargo.” 92

The trial court denied the Defendants’ motion for summary judgment and granted Dobson’s motion for summary judgment in part, concluding that, as a matter of law, Wells Fargo failed to present sufficient evidence that it was a holder of the note and the amount due on the note. 93 The trial court entered an order that would permanently enjoin the Defendants “from foreclosing upon, or taking any steps of any nature to cause the foreclosure of the [d]eed of [t]rust . . . until such a time as Defendants can establish that they are the owner and holder of the [n]ote[,] and the amount owed by [Dobson].” 94

On appeal, the Court of Appeals of North Carolina reversed the trial court holding and remanded for further proceedings. 95 Judge Linda Stephens wrote the majority opinion in which she addressed the issues related to the summary judgment ordered by the trial court, as well as the issues related to negotiable instruments law and the payment rule. 96 She held that at the summary judgment stage, Wells Fargo had presented sufficient evidence that it was the holder of the note, 97 the amount owed on the note, 98 and that it was erroneous for the trial court, as a matter of law, to conclude that the evidence presented by Wells Fargo was insufficient. 99

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92 Id. at 730 (alterations in original).
93 Dobson, 711 S.E.2d at 730, 732.
94 Id. at 730 (alterations and omission in original).
95 Id. at 732.
96 See id. at 729–32.
97 See Dobson, 711 S.E.2d at 732. “Despite this evidence establishing Wells Fargo as the holder of the note, Dobson argues on appeal—and successfully argued before the trial court—that Wells Fargo has not proven that it is the holder of the note because it failed to produce the original note. This argument is unavailing.” Id. at 730.
98 Id. at 731 (“As for whether Defendants presented sufficient evidence to establish the amount owed by Dobson on the note, the record contains evidence of the note itself, a 2002 modification of the note, the deed of trust, records of Dobson’s payments and modifications of Dobson’s payment schedule from bankruptcy proceedings, and computer printouts of Defendants’ records of Dobson’s payments and charges from January 2000 to February 2009. This evidence, taken in the light most favorable to Defendants, is sufficient to establish the amount owed by Dobson under the note.”).
99 Id. at 732 (“Accordingly, we hold that the trial court erred by granting summary judgment for Dobson based on the court’s erroneous conclusions that, as a matter of law, Defendants failed to present sufficient evidence to show the amount owed by Dobson under the note and to show that Wells Fargo is the holder of the note. We note that this holding should be viewed in the context of summary judgment, and should not be interpreted as
In dissent, Judge Hunter reached an opposite conclusion, which is not surprising, considering that he had written the Simpson opinion just two weeks earlier. In the opening paragraph of his dissent, he stated, “I conclude Dobson has met her burden, demonstrating that Wells Fargo failed to present competent evidence sufficient to establish a genuine issue of material fact that it is the holder of Dobson’s promissory note, an essential element of Defendants’ claim. Therefore, I respectfully dissent.” Judge Hunter’s dissent sprung from three particular points of departure from Stephens’ majority opinion:

Thus, my disagreement with the majority’s decision is threefold. First, I conclude that our case law has established a narrow exception whereby an alleged holder may establish possession of a negotiable instrument without producing the original instrument, but that exception does not apply to the instant case. Second, I am concerned the majority’s decision will be construed to permit an alleged holder of a negotiable instrument to establish it is in possession of an instrument merely by producing photocopies of the instrument. Third, I conclude Defendants have failed to produce competent evidence sufficient to establish that Wells Fargo is in possession of Dobson’s promissory note. Without such evidence, Wells Fargo cannot establish it is the holder of the Note.

Hunter’s analysis of the exception to the requirement that the foreclosing lender produce the original note was created in In re Helms and later applied in In re Adams. His analysis showed that this narrow exception was not applicable in Dobson. Next, he

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100 See In re David A. Simpson, P.C., 711 S.E.2d 165, 171–72 (N.C. Ct. App. 2011) (reasoning that even if the original note was produced, along with physical possession, there must be evidence that the note was indorsed to the party presenting the note with the purpose of giving that party the right to enforce the instrument).

101 Dobson, 711 S.E.2d at 732 (Hunter, J., dissenting).

102 Id. at 732–33 (Hunter, J., dissenting).

103 284 S.E.2d 553, 554 (N.C. Ct. App. 1981) (“The rationale behind the ‘best evidence’ rule is that the original instrument best identifies its own contents. When the opposing party, however, admits that the documents shown him are correct copies of the original, the original need not be produced.” (citations omitted)).

104 693 S.E.2d 705, 710 (N.C. Ct. App. 2010) (“Because respondents do not dispute that the photocopies are ‘correct copies’ of the original instruments, we conclude that Deutsche Bank . . . was not required to present the original Note and Deed of Trust at the foreclosure hearing to establish that it was in possession of these instruments.”).

105 711 S.E.2d at 734 (Hunter, J., dissenting) (“Here, Dobson contests the authenticity of

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expressed concern that the majority’s holding would allow future parties to establish possession of the note by producing a mere photocopy of the note.\textsuperscript{106} Finally, Judge Hunter opined that Wells Fargo had not put on sufficient evidence that it was in possession of Dobson’s note.\textsuperscript{107}

1. Was the Dobson court seeking to modernize foreclosure laws?

The decision in Dobson allowed a purported holder of a negotiable instrument to proceed with foreclosure against a homeowner without first establishing the right to enforce the instrument as the holder.\textsuperscript{108} This is contrary to the requirements set forth in North Carolina General Statutes section 25-3-301, which defines a “person entitled to enforce” a negotiable instrument. There are three ways in which a person may qualify as the person entitled to enforce a negotiable instrument: (1) as a holder of the instrument, (ii) as a non-holder in possession of the instrument who has the rights of a holder, or (iii) as a person not in possession of the instrument who is entitled to enforce the instrument pursuant to sections 25-3-309 or 25-3-418(d).\textsuperscript{109} Under traditional law, the “holder” of an instrument is “[t]he person in possession of a negotiable instrument that is payable either to bearer or to an identified person that is the person in possession.”\textsuperscript{110} “It is the fact of possession which is significant in determining whether a person is a holder, and the absence of possession defeats that status.”\textsuperscript{111}

Accordingly, in Dobson, to enforce the promissory note, Wells
Fargo was obligated to present evidence of possession. Wells Fargo presented the following evidence before the trial court: (1) an affidavit by its vice president of loan documentation, which stated that the owner and holder of the note is Wells Fargo (Williams Affidavit); (2) an affidavit by a default litigation specialist with Wells Fargo, which stated that Wells Fargo is the present and current holder of the note (Robinson Affidavit); (3) a photocopy of the original note; and (4) a photocopy of an assignment to Norwest Bank Minnesota, which is now known as Wells Fargo.\textsuperscript{112} Even if these affidavits were properly admitted, as discussed below, they contained mere conclusory statements that the owner and holder of the note was Wells Fargo.

According to \textit{Connolly}, Wells Fargo had to prove it was the holder by showing that it was in possession of the note, because possession is the cornerstone of determining whether or not a person is the holder and therefore entitled to enforce the note.\textsuperscript{113} Furthermore, the Williams Affidavit stated that Dobson’s note had been assigned to “Equivantage Home Equity Loan Trust, 1997–1.”\textsuperscript{114} This was not the same indorsement shown on the photocopy of the note, nor was it the same trust to which Wells Fargo claimed the note was presently assigned to: “Equivantage Home Equity Loan Trust 1996–4.”\textsuperscript{115} The fact that the note was assigned to a different trust demonstrates the potential for multiple suits on the same promissory note where possession of the note may be established merely by producing a photocopy of the note.\textsuperscript{116} \textit{Liles v. Myers} contemplated such a scenario and stated that an alleged holder “could negotiate the instrument to a third party who would become a holder in due course, bring a suit upon the note in her own name and obtain a judgment in her favor.”\textsuperscript{117}

If \textit{Dobson} is interpreted to permit a party seeking to foreclose under a power of sale, to establish possession of the promissory note by means other than production of the original note, as feared by the dissent, the UCC requirements defining the holder as the person entitled to enforce the note, embodied in North Carolina General Statutes section 25-1-201(b)(21), will become a nullity. As a result, parties could cite to \textit{Dobson} as precedent that they are able to put forth conclusory affidavits, which state that they are the holders of the note, without any proof of

\textsuperscript{113}See \textit{Connolly}, 306 S.E.2d at 125.
\textsuperscript{114}Dobson, 711 S.E.2d at 734.
\textsuperscript{115}Id. at 734–35.
\textsuperscript{116}Id. at 735.
\textsuperscript{117}Id. at 735 (quoting Liles v. Myers, 248 S.E.2d 385, 387 (N.C. Ct. App. 1978)).
actual possession of the instrument they are seeking to enforce.

2. Were the *Helms* and *Adams* rules overextended in *Dobson*?

As Judge Hunter noted, there are certain exceptions to the obligation that the party seeking to enforce the note be required to produce the note. Two cases that highlight those exceptions are: *In re Helms* and *In re Adams*.118

In 1981, the Court of Appeals of North Carolina, in *Helms*, rejected the application of the “best evidence” rule, stating “[w]hen the opposing party . . . admits that the documents shown [to] him are correct copies of the original, the original need not be produced.”119 The court later applied *Helms* in the 2010 case of *Adams*, stating that when the debtor did not dispute that the photocopies of the note and deed of trust were the “correct copies” of the originals, the party claiming to be the holder of the instruments did not need to produce the originals to establish possession of the instruments.120 Thus, the court in *Adams* “applied the exception, created in *Helms*, to the requirement that the party seeking to foreclose must produce the original note to establish that it is in possession of the instrument—when the opposing party concedes the photocopies are correct copies of the instrument.”121 The parties in *Helms* and *Adams* did not dispute the validity of the photocopies of the instruments and therefore neither foreclosing party was required to present the originals at the foreclosure hearing to establish that they were in possession of the instruments.122 This exception in cases where the parties do not dispute the accuracy of the photocopies furthers the policy behind the foreclosure by power of sale statute, North Carolina General Statutes section 45-21.16, which is designed to provide a more efficient and less expensive procedure than judicial foreclosure.123

The *Dobson* court applied this narrow exception despite the fact that Dobson contended in her brief and an affidavit that she “cannot confirm the authenticity of the copy of the [n]ote produced by the

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119 *In re Helms*, 284 S.E.2d at 554 (citations omitted).
120 *In re Adams*, 693 S.E.2d at 710.
121 *Dobson*, 711 S.E.2d at 733 (Hunter, J., dissenting).
122 *In re Adams*, 693 S.E.2d at 710 (stating that “[m]ere possession” does not suffice to prove ownership or holder status (alteration in original) (quoting Econo-Travel Motor Hotel Corp. v. Taylor, 271 S.E.2d 54, 57 (N.C. 1980)); *In re Helms*, 284 S.E.2d at 554.
123 See *In re Helms*, 284 S.E.2d at 555.
Defendants." 124 The majority opinion acknowledged that Dobson did not admit that the photocopy of the note was the correct copy. 125 Thus, Dobson did actually dispute that the photocopy of the note was a true and correct copy of the original in both her brief and her affidavit, therefore, the Helms exception should have been inapplicable. The majority in Dobson, however, held Dobson’s “dispute” of the authenticity of the note as “insufficient to cast doubt on Defendants’ evidence that Wells Fargo is the holder of the note . . . .” 126 The Dobson court does not provide guidance as to what evidence would be sufficient to “cast doubt,” nor does it state where this “doubt” requirement originates. 127 As stated above, neither of the mortgagors in Helms or Adams contested the authenticity of the photocopies of the original instruments and the court did not set forth any further requirement—other than requiring the opposing party to concede that the copies are accurate depictions of the originals in order for the exception to apply. 128 The exception should not have been applied in Dobson because the opposing party did not concede that the copies were accurate depictions of the original instrument. By allowing this exception to apply in a case where the opposing party did not concede that the photocopies were the correct copies of the instrument, the Court of Appeals of North Carolina allowed the exception to swallow the rule. This is an unsettling result when one considers “that foreclosure under a power of sale is not favored in the law, and its exercise ‘will be watched with jealousy.’” 129

3. Did the Dobson court get into the forest and lose sight of the trees?

A power of sale foreclosure requires that the clerk of court find a “valid debt of which the party seeking to foreclose is the holder . . . .” 130 The holder of an instrument under North Carolina law, for foreclosure actions under a power of sale, is “[t]he person in possession of a negotiable instrument that is payable either to bearer or to an identified

124 Dobson, 711 S.E.2d at 731 (alteration in original).
125 Id.
126 Id.
127 See id.
128 See In re Adams, 693 S.E.2d 705, 710 (N.C. Ct. App. 2010); In re Helms, 284 S.E.2d at 554–55.
130 N.C. GEN. STAT. § 45-21.16(d)(i) (LEXIS through 2013 Sess.).
person that is the person in possession.” Generally, “any determination requiring the exercise of judgment or the application of legal principles is more properly classified a conclusion of law.” The determination of holder status requires the application of legal principles set forth in North Carolina General Statutes section 25-1-201(b)(21), and therefore, is a conclusion of law. Affidavits may be considered to show that a party is entitled to a judgment as a matter of law, however, “statements in affidavits as to opinion, belief, or conclusions of law are of no effect.” Following this well-established law, the court in Simpson disregarded the statement from a GMAC official who stated that the lender was the “owner and holder” of the note and deed of trust, as it was a conclusion of law.

The Williams Affidavit and the Robinson Affidavit, on which the Dobson majority relied, were similar to the affidavit of the GMAC officer in Simpson because both affidavits made conclusory statements that Wells Fargo was the holder of the note. Therefore, the Dobson court erroneously relied upon both the Williams and the Robinson affidavits when it found the affidavits to be sufficient evidence to show that, as a matter of law, Wells Fargo was the holder of the note. The Dobson majority did not attempt to define the term “holder,” nor did it address the corresponding statute in its analysis. The Dobson court fundamentally accepted as true all the statements found in both affidavits, and allowed them to stand in place of the legal analysis necessary to find a “holder.” Considering “foreclosure under a power of sale is not favored in the law” the Dobson court’s acceptance of facts in the affidavits in lieu of reasoned analysis seems to give unprecedented deference to lenders. As Dobson becomes accepted precedent, the

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131 Id. § 25-1-201(b)(21)(a); see also Econo-Travel Motor Hotel Corp. v. Taylor, 271 S.E.2d 54, 57 (N. C. 1980).
134 Id. at 730 (quoting S.B. Simmons Landscaping & Excavating, Inc. v. Boggs, 665 S.E.2d 147, 152 (N.C. Ct. App. 2008) (“Summary judgment is proper when, viewed in the light most favorable to the nonmovant, ‘the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that any party is entitled to a judgment as a matter of law.’”).
135 Id. at 734; see also Speedway Motorsports Int’l Ltd. v. Bronwen Energy Trading, Ltd., 707 S.E.2d 385, 395 n.2 (N.C. Ct. App. 2011) (rejecting a party’s contention that the court must accept as true all statements found in the affidavits in the record, stating, “our standard of review does not require that we accept a witness’ characterization of what ‘the facts’ mean.”).
136 In re David A. Simpson, P.C., 711 S.E.2d at 173.
willingness of courts to accept similar affidavits may become common practice.

4. Was the Dobson majority merely peeved with the trial court?

The Court of Appeals incorporated part of the transcript of the summary judgment hearing from the trial court: “I just don’t like this mess. It’s confusing. It’s imprecise. I think probably the best thing to do is to let the Court of Appeals worry with it. . . . [H]opefully the folks up at Raleigh will be a lot smarter than I am and can figure this thing out. I am just not comfortable with the facts at all.”

In its opinion remanding to the trial court, the Court of Appeals said that there should be “meaningful consideration of the evidence, which apparently the trial court was loath to provide. Based on the foregoing, we remand ‘to let’ the trial court ‘worry with it.’” With this pointed language, the trial court and the Court of Appeals embody quarrelsome siblings, with the trial court being the younger sibling complaining that the load is too heavy, and the Court of Appeals being the elder sibling determined to make the younger one do its fair share of the work. The Court of Appeals made it clear that it would not allow the trial court to pass on serving its duty as finder of fact in the instant case. Although the Dobson majority may not have meant these words as an affront to the trial court, that is what they most certainly portray to this reader.

It could be argued that part of the Court of Appeal’s willingness to reverse this judgment and remand for trial was based on the fact that it was not going to allow the trial court to pass the matter up, since most likely there would be a later appeal, and have the Court of Appeals act as a quasi-trier of fact. The Dobson majority even stated that if the trial court, in a later proceeding beyond the summary judgment stage, were to find the Defendant’s evidence unavailing, it could “conclude that [the] Defendants failed to present evidence such that a permanent injunction is appropriate.” Borrowers should be able to rely on the trial court, as a trier of fact, to ascertain whether a lender’s evidence passes muster to survive summary judgment. Allowing lenders to survive the summary judgment stage results in substantial burdens to low-income homeowners, who are subsequently faced with costly litigation against sophisticated lenders’ counsel with substantial resources, in fights to

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138 Dobson, 711 S.E.2d at 732 n.2.
139 Id. at 732.
140 Id.
keep their homes.

V. THE MERS ENTANGLEMENT

Justice Louis D. Brandeis famously stated, “Sunlight is said to be the best of disinfectants; electric light the most efficient policeman.”\(^{141}\) In that statement, Brandeis espoused transparency and openness. One has to wonder if sunlight shining on mortgage records would have provided enough transparency to prevent the murky confusion of mortgage ownership created by the Mortgage Electronic Registration System (MERS), a private registry of vital mortgage information.\(^{142}\) In both practical and legal terms, the privately owned and operated MERS nullified the centuries-old principle of American law: protecting innocent parties involved in land transactions.\(^{143}\) As the great John Cribbet once observed, “In the United States the recording system has furnished . . . a permanent record which can be examined by anyone wishing to buy land or lend money on it . . . .”\(^{144}\) The cornerstone of America’s legal tradition of transparency of landholding interests has been the establishment of a public recording act in each state, which protects all parties owning or dealing in any interest in land.\(^{145}\)

Whereas the traditional method of recordation helped to identify the actual current lender of mortgage financing, MERS impedes this search. MERS established a private electronic recording system to expedite the quick-profit, high-velocity bundling of mortgage backed securities, including a plethora of toxic loans created by sloppy or commission-drunken underwriters, into a dizzying variety of “tranches”\(^{146}\) for sale on

\(^{141}\) LOUIS D. BRANDEIS, OTHER PEOPLE’S MONEY AND HOW THE BANKERS USE IT 92 (N.Y.C., Frederick A. Stokes Co. 2d prtg. 1914).


\(^{143}\) See id. at 4, 10.


\(^{145}\) See CRIBBET & JOHNSON, supra note 144.

\(^{146}\) Tranches, INVESTOPEDIA, http://www.investopedia.com/terms/t/tranches.asp (last visited Nov. 30, 2014) (“Tranche is a term often used to describe a specific class of bonds within an offering wherein each tranche offers varying degrees of risk to the investor. For example, a CMO [(Collateralized Mortgage Obligation)] offering a partitioned MBS portfolio might have mortgages (tranches) that have one-year, two-year, five-year and 20-year
global securities markets. To expedite the haste of bundling, frequently MERS was used as a nominee to hold the mortgage loans in its name, which would short-circuit the pedestrian state recording acts and careful negotiable instrument requirements.\textsuperscript{147}

Upon the bursting of this mortgage bundling bubble, it was discovered that the fast and sloppy MERS frequently could not identify and locate the actual holders of the bundled mortgage notes.\textsuperscript{148} This failure, when linked to negotiable instruments law, as discussed earlier, obscured the actual legal ownership of the mortgage debt and the rights of the lender under the mortgage security to seek remedies pursuant to state foreclosure laws, thereby ensnaring the entire foreclosure process. Before focusing on MERS and the entanglement it created, it is helpful to examine the shortcomings of the public land title records that facilitated the creation of MERS.

There has been insufficient change in the land title records system, which has been in use America since colonial times.\textsuperscript{149} At that time, a paper recording and indexing system was state of the art, but that system has largely gone unchanged even though technology has improved exponentially. An effective land title records system should: (1) review instruments that grant an interest in land for compliance with formal requirements, (2) record those instruments, (3) index the recorded maturities. It can also refer to segments that are offered domestically and internationally.”).\textsuperscript{147}

\textsuperscript{147} See Dale A. Whitman, A Proposal for a National Mortgage Registry: MERS Done Right, 78 MO. L. REV. 1, 1, 39 (2013) [hereinafter Proposal] (discussing the use of MERS to alleviate the inconveniences of repeatedly recording mortgage assignments); see also NELSON & WHITMAN, supra note 10, at 625; see generally id. at 529–701 and accompanying footnotes.

\textsuperscript{148} See Liddell & Liddell, Jr., supra note 22, at 383.

\textsuperscript{149} Tanya Marsh, Foreclosures and the Failure of the American Land Title Recording System, 111 COLUM. L. REV. SIDEBAR 19, 20–21 (2011) (“Little has changed since colonial days in the process by which title is recorded. There are over 3,000 local recording systems where holders of an interest in real estate can register that interest. For centuries, deeds, mortgages, easements, and leases were hand-transcribed into books. Indexes were created as finding guides to locate the transcriptions. Some counties used multiple index books—one for deeds, one for mortgages, and one for miscellaneous records. In most American recording offices, computers are now used to digitize new records and maintain the indexes, although some smaller and more rural counties continue to use physical books for indexing. Still, many counties that digitize their records and index on a computer maintain the fiction of a paper-based system by referring to the location of a document by ‘book’ and ‘page’ numbers. There are two methods of indexing land title records: the tract index and the grantor/grantee index. The tract index uses a legal description of the relevant land as its organizing principal. The grantor/grantee index uses the names of the parties to a conveyance as its organizing principal. Indexes normally include the following fields of information: names of the parties, type of conveyance, recording date, short legal description, and reference to the location of the document.” (footnotes omitted)).
instruments in a logical manner, and (4) make the indexes and recorded instruments available and searchable to the public to ensure transparency in land title records. A paper system was sufficient in colonial America, however, with the growth in population and land area, along with the number and complexity of transactions, our country has outgrown the paper system. The securitization of mortgages exacerbated the problem and brought with it the need for a more expeditious and cost-effective system to track changes in ownership of mortgages. In response, in the early 1990s, mortgage industry participants created MERS. Even before the foreclosure epidemic of 2008, owners of mortgages

150 See Dean Arthur R. Gaudio, Electronic Real Estate Records: A Model for Action, 24 W. NEW ENG. L. REV. 271, 272–73 (2002) (“For that era of history, paper technology was more than adequate. But as years unfolded, the document records multiplied. At first they increased as a simple result of the accumulation of time and the resulting accumulation of transfers. In the period of a hundred or more years, many transfers of real estate, accompanied by various liens and probates of estates, would be recorded. This growth began to increase because conveyances became more frequent, financing became more common and parcels were being subdivided, resulting in even more conveyances. As a consequence, the first innovation in the recording system became necessary—the index. The index served as a starting point for a title examiner to begin his or her search. Earlier index systems were based on the names of the grantor and grantee. Later systems were based on the individual parcels of land and became more prevalent as history progressed.”).


152 Id. at 1368–69 (“Given the venerable and uninterrupted legacy of land title recording acts, it is interesting that [the] first fundamental change to the American public land title recording systems in over three hundred years was not initiated by publicly elected leaders. Instead, the Mortgage Electronic Recording System was conceived of and created by a tight-knit group of powerful mortgage industry insiders. In October of 1993, a task force of mortgage finance companies released a ‘white paper’ at an annual convention of mortgage bankers. The paper suggested that an electronic book entry system of tracking mortgage loans would be better for the mortgage lending industry than the legal system of county recording offices. The paper encouraged comments from the real estate finance industry, leading to the formation of a steering committee affiliated with the Mortgage Bankers Association of America (MBA). The MBA is a trade association supported through dues paid by mortgage lending companies that conducts public relations for the industry. The MBA retained Ernst & Young, an accounting firm, to study the feasibility of developing MERS. In addition to studying the technological and financial hurdles, the accounting firm also conducted telephone interviews with mortgage loan originators, servicers, warehouse lenders, custodians, assignment processors, and employees at Fannie Mae and Freddie Mac. The accountants’ primary conclusion was that that [sic] the finance industry could save a lot of money by deciding not to pay the fees that local governments require to record mortgage assignments.” (footnotes omitted)); see also Our Business, MERS, http://www.mersinc.org/about-us/our-business (last visited Nov. 30, 2014) (“MERSCORP Holdings, Inc. is a privately held corporation that owns and manages the MERS® System and all other MERS® products. It is a member-based organization made up of thousands of lenders, servicers, sub-servicers, investors and government institutions.”).
in the secondary market whose transfers were registered under MERS were warned by leading experts in mortgage law that they “must continue, as in the past, to ensure that they get possession of the notes they buy.” This was true because MERS is merely a “nominee” and “does not become the holder of the promissory notes.” MERS has been a significant cause of confusion and uncertainty, which fueled the foreclosure epidemic that led to the Great Recession.

Prior to the creation of MERS, mortgage assignments were recorded in the public land title records in the county where the mortgaged land was located—the same office in which the mortgage itself was recorded. With the advent of the sale of mortgages on the secondary market and mortgage securitization, a mortgage may be transferred over and over again many times during its life. Therefore, the process of recording assignments of mortgages in the county land records office came to be viewed by many in the mortgage industry as too time consuming and costly, which led to the creation of MERS.

Much has been written in court opinions and articles by practitioners and scholars on the problems spawned by MERS. To truly appreciate the confusion and uncertainty introduced onto the mortgage lending and foreclosure stage by MERS, however, one would have to look no further than the situation encountered by Eugene D. Kline and his wife, Patricia, reported in the New York Times.

The Klines owned real property in Ohio encumbered by a first and a second mortgage originated by different mortgage lenders. The Klines were delinquent on payment on both mortgages. Wells Fargo,

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153 See NELSON & WHITMAN, supra note 10, at 625; id. at 625–26 (“MERS does not become the holder of the promissory notes that represent the loans in question. Thus, secondary market investors must continue, as in the past, to ensure that they get possession of the notes they buy. But they do not have to worry about obtaining and recording successive assignments in local recorders’ offices as loans are traded.”).

154 Id. at 625.

155 See NELSON & WHITMAN, supra note 10, at 624–25.

156 See supra note 152.


159 Id.

160 Id.
as trustee for the mortgage-backed security in which the first mortgage was bundled, needed to name the holder of the second mortgage in the foreclosure action, so it requested that information from MERS, as nominee for the second mortgagee.\textsuperscript{161} MERS indicated that WMC Mortgage was the holder of the second mortgage encumbering the Klines’ property.\textsuperscript{162} WMC confirmed that they were indeed the holder of the second mortgage,\textsuperscript{163} so Wells Fargo foreclosed, joining WMC in the suit.\textsuperscript{164} Two years after the foreclosure of the Klines’ property, it was revealed that at the time of the foreclosure, WMC did not hold the second mortgage.\textsuperscript{165} The second mortgage was actually held the entire time by the very same mortgage-backed securities trust that held the Klines’ first mortgage.\textsuperscript{166} All parties involved—Wells Fargo, WMC, the Klines and the courts—relied on the incorrect mortgage ownership information provided by MERS.\textsuperscript{167} Since both Wells Fargo and WMC were members of MERS, it seems like they should have been able to access the MERS registration records and determine ownership of the Klines’ second mortgage.

Initially, MERS did not allow mortgagors to search for their own mortgage information. After 2011, MERS claimed that it had reformed its operations to allow borrowers to track ownership of their MERS registered mortgages.\textsuperscript{168} Anecdotal reports would indicate that owners may not be able to find such information from the MERS database.\textsuperscript{169}

\textsuperscript{161} See id.
\textsuperscript{162} Morgenson, supra note 158.
\textsuperscript{163} Id.
\textsuperscript{164} See id.
\textsuperscript{165} Id.
\textsuperscript{166} Id.
\textsuperscript{167} See id.
\textsuperscript{168} See Marsh, supra note 149, at 23.
\textsuperscript{169} Id. (detailing her own inability to locate her own mortgage held by MERS as nominee, Professor Marsh stated: "When the mortgage or portfolio is subsequently sold, the conveyance information is registered in MERS, but no assignment is recorded. For example, my own residential mortgage names MERS as the lender’s nominee. I write my monthly mortgage check to a particular financial services company, but I do not know if that company actually owns my mortgage, or is servicing it on behalf of another lender, or a trust of investors. If I were ever so unlucky as to receive a foreclosure notice, I could not consult the county records to verify if the entity threatening foreclosure actually owns the debt on my home. That information is held only in MERS. Initially, only paid customers of MERS were able to access the information it stores. Perhaps in response to criticism of this lack of transparency, MERS has recently created a system, called MERS Servicer Identification System, which is designed to permit homeowners to discover the identity of their servicer and the investor that owns their loan. Although the new service is a step forward in promoting transparency, it remains problematic. When I searched the system by the address of my home, the system was unable
In April 2011, long after the foreclosure epidemic had erupted, an Interagency Review of foreclosure practices conducted by the Federal Reserve System, Office of the Comptroller of the Currency, and Office of Thrift Supervision revealed some enlightening, although not surprising, findings.\textsuperscript{170} In its assessment of MERS, the Interagency Review reported that significant weaknesses existed. It cited lack of oversight and a lack of quality control checks on MERS by servicers and mortgage lenders, which permitted the deficiencies to develop and go unchecked.\textsuperscript{171} Because many of these servicers were also owners of MERS, it is hard to imagine they could not have instituted changes to make MERS more accountable and transparent. It seems that the watchdogs for our nation’s land title records were snoozing when the proposal was made that MERS would be the sole custodian of important records of rights to ownership of interests in land throughout the United States.

The MERS entanglement has motivated Professor Whitman to seek reform via the creation of a national mortgage registry, in a sense, making “MERS done right.”\textsuperscript{172} Others have decried the problem and grappled for solutions.\textsuperscript{173} This illustrates the seriousness of the problem, which has arisen in part due to the MERS mess. The solutions advocated by this author, however, address reform of negotiable instruments law, not revised methods of mortgage recordings or moving from state recording systems to federal systems.\textsuperscript{174}


\textsuperscript{171} \textit{Id.} at 11 ("Servicers exercised varying levels of oversight of the MERS relationship, but none to a sufficient degree. Several of the servicers did not include MERS in their vendor management programs. In these instances, the servicers failed to conduct appropriate due diligence assessments and failed to monitor, evaluate, and appropriately manage the MERS contractual relationship. Deficiencies included failure to assess the internal control processes at MERS, failure to ensure the accuracy of servicing transfers, and failure to ensure that servicers’ records matched MERS’ records. . . . Examiners also determined that servicers’ quality-control processes pertaining to MERS were insufficient. In some cases, servicers lacked any quality-assurance processes and relied instead on the infrequent and limited audits that MERS periodically conducted. Other deficiencies included the failure to conduct audit reviews to independently verify the adequacy of and adherence to quality-assurance processes by MERS, and the need for more frequent and complete reconciliation between the servicers’ systems and the MERS registry. Several servicers did not include MERS activities in the scope of their audit coverage.").

\textsuperscript{172} See \textit{Proposal, supra} note 147, at 46.

\textsuperscript{173} See Peterson, \textit{supra} note 151; Vance & Bell, \textit{supra} note 157.

\textsuperscript{174} This author agrees that improvements in recording systems for mortgage liens are
VI. PROPOSED PRACTICAL SOLUTIONS

It must be noted that changes to the laws concerning mortgages or negotiable instruments will not come quickly or easily. Many scholars, including Professors Ronald Mann and Dale Whitman, have long called for change to these laws and their accompanying practices. Their calls for change have largely gone unheeded. In failing to act, state legislatures are encouraging, if not downright forcing, the courts to appropriate their lawmaking authority. As noted above, the Court of Appeals of North Carolina in *Dobson* may have been seeking to streamline negotiable instruments law to meet modern marketplace realities, however, more direct approaches are available. Moreover, the courts cannot continue to personify Janus by looking both ways with regard to the payment rule in litigation relating to enforcement of mortgage notes.

One very practical national solution is readily at hand. The state legislatures should render identical debtor protection for all notes, whether secured by real estate mortgages or deeds of trust, to match the protection given to account debtors under Article 9 of the Uniform Commercial Code. This would relieve an obligor from the obligation of trying to ascertain whether the holder of the note had assigned the note without notification to the obligor. Payment to the account creditor by the account debtor does not result in the risks of paying twice to two different persons. Therefore, the burden of proving both actual possession and legal holder status is no longer an element, thus removing the core obstacle under *Liles*. This change would provide certainty in the marketplace.

Another proposed national solution includes the 2002 revision to always worthy of consideration, but under negotiable instruments law the ownership of the mortgage security instrument recorded upon the land follows the ownership of the debt represented by the mortgage note. As discussed above, the danger of double payment by the borrower necessitates the presentment of the original signed note at the time of payment. *See supra* notes 6, 10, and accompanying text.

175 See Mann, *supra* note 26, at 956; *see also Negotiability, supra* note 11, at 766.

176 *See, e.g.,* N.C. GEN. STAT. § 25-9-406(a) (LEXIS through 2013 Sess.) (“Discharge of account debtor; effect of notification.— Subject to subsections (b) through (i) of this section, an account debtor on an account, chattel paper, or a payment intangible may discharge its obligation by paying the assignor until, but not after, the account debtor receives a notification, authenticated by the assignor or the assignee, that the amount due or to become due has been assigned and that payment is to be made to the assignee. After receipt of the notification, the account debtor may discharge its obligation by paying the assignee and may not discharge the obligation by paying the assignor.”).
the Uniform Commercial Code, section 3-602(b), which has only been adopted by a handful of states. This would be a more expedient path to a solution and would relieve state legislatures of having to wordsmith and enact a new statute dedicated to replicating the intent of section 9-406(a).

With either of the foregoing recommendations, the state legislatures should adopt a statute that defines effective notice of the mortgage assignment as requiring written notice to be provided to the borrower. Such a statute should also require that notice of the assignment be recorded properly and in a timely manner in the land title records of the county that is the situs of the mortgaged property.

VII. CONCLUSION

Either of the above recommendations would remove the double-payment threat for all real estate mortgages and deeds of trust, regardless of whether the notes are negotiable or non-negotiable. Further, these legislative solutions to the payment rule would ensure that when a note is assigned, the maker of a mortgage note could safely continue to make payments to the assignor of the note and receive a discharge for those payments until notified to begin paying the assignee of the note.

Absent some action by state legislatures to modernize the archaic

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177 U.C.C. § 3-602(b) (West 2014). One of the more pertinent portions of the National Conference of Commissioners on Uniform State Laws’ 2002 revision to U.C.C. § 3-602 is its paragraph (b), which states:

Subject to subsection (c), a note is paid to the extent payment is made by or on behalf of a party obliged to pay the note to a person that formerly was entitled to enforce the note only if at the time of the payment the party obliged to pay has not received adequate notification that the note has been transferred and that payment is to be made to the transferee. A notification is adequate only if it is signed by the transferor or the transferee; reasonably identifies the transferred note; and provides an address at which payments subsequently are to be made. Upon request, a transferee shall seasonably furnish reasonable proof that the note has been transferred. Unless the transferee complies with the request, a payment to the person that formerly was entitled to enforce the note is effective for purposes of subsection (c) even if the party obliged to pay the note has received a notification under this paragraph.

Id.

178 As of this writing, only Arkansas, District of Columbia, Indiana, Kentucky, Michigan, Minnesota, Mississippi, Nevada, New Mexico, Oklahoma, South Carolina, and Texas have adopted the revised U.C.C. § 3-602, although Massachusetts and New York are considering its enactment. Legislative Fact Sheet – UCC Article 3, Negotiable Instruments and Article 4, Bank Deposits (2002), UNIFORM L. COMMISSION, http://tinyurl.com/o7ekd9f (last visited Dec. 17, 2014).
payment rule, the courts of our nation will continue to struggle to balance the interests of innocent borrowers against those of the assignees who have purchased mortgage loans. The courts may have to continue to play the role of Janus in the mortgage enforcement tragedy playing on the nation’s stage.