MEMORANDUM March 5, 2012

TO: Colleagues

FROM: Thomas A. Cox, Esq.[1]

RE: Comments regarding Negotiability and Articles 3 and 9 of the UCC, and their impact upon foreclosure cases.

I. Introduction[2].

There has been considerable discussion about whether the Fannie Mae/ Freddie Mac Uniform Instrument mortgage loan notes (the "UI Notes")[3] are negotiable. This memorandum addresses those portions of the UI Note that have generated the controversy. It is intended for use by foreclosure defense lawyers only as a starting point for legal analysis of these issues. Understanding Article 3 of the UCC is challenging enough. Still more challenging is the task of applying Article 3 to the lengthy UI Note, which is always accompanied by a mortgage or seventeen or more pages. Magnifying

[1] The author of this memorandum represented financial institutions for many years in the drafting and enforcement of commercial loan obligations, and for the past four years has been involved exclusively in representing homeowners in foreclosure cases. He practices law in the State of Maine, which is a judicial foreclosure state, and where the law is that a foreclosing party must be both the holder and the owner of the note and mortgage in order to foreclose.

[2] The author is indebted to Professor Scott Gould (ret.), who taught negotiable instruments law at the University of Maine School of Law and Rutgers Law School-Newark for a number of years, for patiently helping me to better understand Article 3 and for helping me to refine my analysis in this memorandum. I am also thankful to Professor Neil Cohen, the Director of Research for the Permanent Editorial Board for the Uniform Commercial Code for the privilege of being able to discuss some of these issues with him. The opinions expressed in this memorandum are purely my own and I do not speak for Professor Gould or Professor Cohen. In addition, I am also thankful to George Holler, Esq. who has thought deeply about these issues, brainstormed with me about them, and has generously shared his research.

[3] There are a number of different UI Note forms. For example the UI Note form for a fixed rate note will differ from a UI Note for an adjustable rate note because the later must include terms describing how and when the interest rate must change. This memorandum discusses provisions of the UI Notes that are common to its different versions. The current version of the New York Fixed Rate Note-Single Family-Fannie Mae/Freddie Mac UNIFORM INSTRUMENT is attached to this memorandum as Exhibit A.

that challenge is the indisputable fact that the UI Note would never have passed muster as a negotiable instrument under the law that prevailed over the much of the last two centuries

Any lawyer intending to challenge the negotiability of the UI Note in court cannot rely solely upon this memorandum or any collection of listserv posts or briefs of other lawyers regarding this issue. A challenge to the negotiability of the UI Note can be made responsibly only if Article 3 of the UCC is studied with care, as well as all of the Official Comments for the key Article 3 sections, and some of the key law review articles cited below. In addition, in order to understand these issues and effectively argue them in court, an understanding of the historical development of negotiable instruments law that is provided in some of the law review articles is critical.

Negotiable instruments no longer looks like the "courier[s]s without luggage"[4] they once were, but despite challenges which might be launched against modern, complex mortgage notes, courts are still likely to uphold them as negotiable for two reasons: (1) virtually all of the arguments against the negotiability of UI notes miss the mark under Article 3, and (2) with less than compelling arguments against negotiability, few if any judges are going to rule against negotiability if they realize the consequent evidentiary morass that they will face if resort to proof must be made under UCC Article 9 and the common law.

II. The Old Rules for Determining Negotiability No Longer Apply.

As a sort of legal folklore, many lawyers continue to believe that UCC Article 3 disqualifies promissory notes from being treated as negotiable instruments if: (1) the amount due on the note cannot be determined simply by looking at it, and can only be determined by reference to documents outside of the note; (2) the total amount due on the note can be varied by external factors; (3) the note refers to other documents

---

[4] *Overton v. Tyler*, 3 Pa. 346, 347 (1846). ("[A] negotiable bill or note is a courier without luggage. It is a requisite that it be framed in the fewest possible words, and those importing the most certain and precise contract ... . To be within the statute, it must be free from contingencies or conditions that would embarrass it in its course.")

executed at the same time; and/or (4) other contemporaneously executed documents, such as a mortgage, modify the obligations undertaken in the note by its maker. These notions were not legal folklore when the law of negotiable instruments was in it early developmental stages. Indeed, at the time of Lord Mansfield in the late 1800s, negotiability rules required that a note be for a sum certain determinable within its four corners, that it be payable in a single payment on a date certain or on demand, and that it be free from the affects of agreements outside of its four corners.

When the rules that govern negotiable instruments were first developed, instruments were principally used as money substitutes. The simple rules that determined whether instruments were negotiable and how they could be transferred helped them become the dominant means of paying debts. The purchaser could easily tell if an instrument was negotiable, and if it was, he could take it as a "holder in due course"--free from all but a very few "real" defenses of the drawer or maker--as long as he took it in good faith, for value, and without notice of defects or defenses. The concepts of easy transfer by simple indorsement and transfer of possession, and of HIDC protections, have been preserved as the law of negotiable instruments has been codified in the Uniform Commercial Code. But largely because of maneuvering by the financial industry, the rules that determine whether instruments are negotiable have been changed. As a result, requirements that notes be payable for a sum certain, payable on a single definite date or on demand, and with value determinable from within the four corners of the instrument have gradually been cast aside[5] and what we have been left with is an "absurd and dysfunctional system."[6]

Now, we are left with this reality for mortgage notes:

> [N]o intelligent investor in the modern secondary mortgage market would ever acquire a note without making extremely detailed inquiries about the circumstances of its creation. Doing so would be hardly less than financial

---

[5] Whitman, *How Negotiability Has Fouled Up the Secondary Market, and What to Do About It.*, 37 Pepp. L. Rev. 737, 742 (2010). ("[T]he the modern applications of negotiability are entirely different from the needs it gave rise to satisfy.")

[6] *Id.* at 766.

> suicide. To enumerate some of these concerns, the investor will need to know about - indeed will want assurances concerning - the real estate that secures the note, including: its value, the nature and condition of its improvements, its title, its zoning, and its occupancy. The investor will also wish to know a great deal of information about the borrower: income, employment, credit-worthiness and past payment history, assets, and the like.[7]
>
> [T]he notion that any intelligent secondary market investor would accept a negotiable promissory note in a mortgage transaction as a "courier without luggage" is absurd.[8]

The reason that this historical information is important to us as foreclosure defense lawyers is that, if we try to use the old rationales to try to defeat negotiability, without paying close attention to how the financial industry has turned the elements of negotiability in UCC Article 3 into a set of often inconstant and not very rational rules, such arguments will not likely succeed.

III. Definition of Negotiability.

As a practical matter, in a foreclosure case, a mortgage note is non-negotiable only if a court determines it to be so. What any one of us believes on this issue does not matter, except as a court is persuaded to adopt a position advanced by any one of us.

In analyzing the question of the negotiable status of notes, courts tend to start from a presumption of negotiability.[9] In part, this is driven by the fact that parties seeking to enforce the UI Notes in court almost always do so by attempting to meet the "person entitled to enforce" (hereinafter abbreviated to "PETE") proof requirements of UCC Section 3-301, leaving to counsel for the homeowner the burden of trying to persuade the court that the note is not negotiable.

To date, out of millions of mortgages using the UI Note undergoing court scrutiny, there are very few judicial decisions where the issue of negotiability of the UI Note has even been raised or discussed. On November 14, 2012, the Permanent Editorial Board

---

[7] *Id.* at 743-744.

[8] *Id.* at 746.

[9] See Whitman, *id.* at 755.

for the Uniform Commercial Code released its Report on Application of the UCC to Selected Issues Relating to Mortgage Notes (the "PEB Report"), but explicitly avoided any discussion of the whether the UI Notes are negotiable[10].

The definition of negotiability is set forth in the UCC in Section 3-104 as follows[11]:

§ 3-104. NEGOTIABLE INSTRUMENT.

(a) Except as provided in subsections (c) and (d), "negotiable instrument" means an unconditional promise or order to pay a fixed amount of money, with or without interest or other charges described in the promise or order, if it:

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

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

(3) does not state any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment of money, but the promise or order may contain (i) an undertaking or power to give, maintain, or protect collateral to secure payment, (ii) an authorization or power to the holder to confess judgment or realize on or dispose of collateral, or (iii) a waiver of the benefit of any law intended for the advantage or protection of an obligor.

In order to prove that it is a party entitled to enforce a negotiable instrument, i.e. a PETE, that party must meet one of the three alternative proof requirements of Section 3-301, which provides as follows:

---

[10] See PEB Report, footnote 13. Professor Cohen states that the scope of the PEB Report was limited to the identification and explanation of key provisions of Articles 3 and 9 and purposely avoided discussion of the application of those provisions to evidentiary issues.

[11] An assertion has been made that "Article 9 trumps Article 3.," but that simply is not correct if the focus is on determining whether a note is negotiable. Article 3 alone controls "whether the note is negotiable." 6 Hawkland & Laurence, UCC Series §3-106:6 (Rev. Art.3). The provision of Section 3-106 stating that Article 9 controls where there is a conflict between Articles 3 and 9, only comes into play where a note is used as security or possibly as a security agreement and only affects competing claims to the instrument. *Id.* See below, Section VI captioned The Intersection of Articles 3 and 9.

> § 3-301. PERSON ENTITLED TO ENFORCE INSTRUMENT.
>
> "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 Section 3-309 or 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.

In order to prove that it is a "holder", a PETE must meet the proof requirement of UCC Section 1-201(b)(21)(A)[12] as follows:

> (21) "Holder" means: (A) the person in possession of a negotiable instrument that is payable either to bearer or to an identified person that is the person in possession; . . .

Otherwise, if the PETE is a nonholder in possession, it must prove that it is in possession of the note and has the rights of a holder. UCC §3-301(ii).[13]

IV. Determining Negotiability from the Four Corners of the UI Note.

"The intent of the maker once had an integral role in the development of negotiable instruments law."[14] Assertions have been made that the standard Pooling & Servicing Agreement evidences an intent of the parties to UI Note transactions to have the UI Notes treated as non-negotiable, and that such intent may be used to argue against the negotiable status of the UI Note in court proceedings. As Professor Eggert notes, however, "[w]hen negotiable instruments law was codified, the role of intent was stripped out of the law . . ."[15] It is now the law that "[n]egotiability is determined from

---

[12] In states that have not adopted the latest amendments to Article 1, their section numbers for this definition will be different.

[13] For the purposes of this memorandum, subpart (iii) of Section 3-301 dealing primarily with lost notes is ignored.

[14] Eggert, *Held Up in Due Course: Predatory Lending, Securitization, and the Holder in Due Course Doctrine*, 35 Creighton Law Review 503, 508 (2002).

[15] *Id.*

the four corners of the note."[16] Thus, an examination is required of each portion of the UI Note where a negotiability issue can arise and any contrary intent of the parties revealed in other documents is immaterial.

A. Second paragraph of Section 1 of the UI Note.

The portion of the UI Note where a negotiability issue is first raised is in the second paragraph of Section 1 of the UI Note. The argument appears to be that this paragraph creates an impermissible burden of proof beyond what UCC §3-301 otherwise requires for a PETE. This paragraph of the UI Note is as follows:

> I understand that the Lender may transfer this Note. The Lender or anyone who takes this Note by transfer and who is entitled to receive payments under this Note is called the "Note Holder."

The argument seems to be that this paragraph adds a requirement that a transferee of the note prove that it "is entitled to receive payments under this Note." Or, the argument may be that since the word "transfer"[17] as used, this paragraph imposes an additional burden upon the PETE to prove that the note was delivered "for the purpose of giving the person receiving the right to enforce the instrument." (See §3-203(a) regarding transfers of notes.) It is unlikely that a court would adopt either of these arguments.

The first sentence of the quoted paragraph is merely a declarative statement that is an acknowledgement by the maker that a transfer of the note may occur-it is not an undertaking of the maker to do anything. Since UCC §3-203 expressly allows for a transfer of a negotiable instrument, this sentence cannot be read to add anything to the note that destroys negotiability. The second sentence again is simply a declarative statement that defines the term "Note Holder" as used throughout the remainder of the note. Neither of these sentences contains words of promise or undertaking, nor words

---

[16] 5 Hawkland & Lawrence, UCC Series §3-104.3(Rev Art 3)

[17] Technical legal phrases may be presumed to have been used in their technical sense. *Wolfe v. Schuster*, 591 S.W.2d 926 10 A.L.R. 4th 888 (Tex. Civ. App. Dallas 1979).

conditioning the promises and undertaking that appear elsewhere. Both could be removed from the UI Note and the rights and obligations of the parties to it would not change in any respect. A court is not likely to rule that the second paragraph of Section 1 of the UI Note adds any additional proof burden for a PETE, or that it makes other promises in the note conditional, or that it takes an otherwise negotiable note out of negotiable status. There is no court decision addressing this provision of the UI Note.

B. Variable interest rate provisions in Section 2 of the UI note.

Occasionally, questions have been raised as to whether the inclusion of a variable interest rate provision in a note renders it non-negotiable. UCC §3-112(b) disposes of this issue with its statement that interest on a negotiable note may be stated as a "fixed or variable rate," and that the note "may require reference to information not contained in the instrument." This provision makes clear that a note can be negotiable even when the amount due cannot be determined from the four corners of the instrument, as, for example, when it includes a reference to an external source to determine the interest rate, such as LIBOR.

Parenthetically, to the extent that a UI Note form is used that provides for the addition of accruing interest (at a fixed or variable rate) to the principal amount of the note, one court has held that the note does cease to be a promise to pay "a fixed amount of money" within the meaning of Section 3-104, and it is therefor non-negotiable. [18]

C. Usury Savings Clause.

This clause[19] appears in Paragraph 5 of the fixed rate UI Note and Paragraph 6 of the adjustable rate UI Note and provides that, if the stated interest rate exceeds the

---

[18] *Cf Heritage Bank v. Bruha,* 283 Neb. 263 (2/10/12), footnotes 8-12.

[19] LOAN CHARGES
If a law, which applies to this loan and which sets maximum loan charges, is finally interpreted so that the interest or other loan charges collected or to be collected in connection with this loan exceed the permitted limits, then: (a) any such loan charge shall be reduced by the amount necessary to reduce the charge to the permitted limit; and (b) any sums already collected from me which exceeded permitted limits will be refunded to me. The Note Holder may choose

statutory rate under the laws of the jurisdiction controlling the note, and if excess interest is paid by the maker as a result, then the excess interest payments must be refunded to the maker or applied in reduction of principal. The argument against negotiability that has been made here is that it, with this clause in place, the note no longer meets the "fixed amount" requirement of UCC §104.

"[L]anguage referring to usury statutes . . . does not destroy an instrument's negotiability."[20] [21] There are no reported decisions dealing with the UI Note variation of the usury savings clause. The traditional usury savings clause limited a specified note rate to being no higher than the usury rate, while the UI Note clause takes this a step further by allowing a holder to credit excess interest collected against the principal amount of the note. A court is likely to rule that, under the usury savings clause of the UI Note, the amount of principal payment to which the maker obligates himself **remains fixed** and that the savings clause merely allows for **a credit** against that fixed amount, just as monthly installment payment would result in a credit against that amount. Thus, a court is not likely to rule that the usury savings clause of the UI Note destroys negotiability. There are no court decisions construing this clause of the UI Note.

D. The Prepayment Provisions of the UI Note.

It is this provision[22] of the UI Note that provides perhaps only, and certainly the strongest, basis to argue against its status as a negotiable instrument. The UI Note forms

---

> to make this refund by reducing the Principal I owe under this Note or by making a direct payment to me. If a refund reduces Principal, the reduction will be treated as a partial Prepayment.

[20] 5 Hawkland & Lawrence, UCC Series §3-104.7(Rev Art 3)

[21] Purported conditions on an otherwise negotiable instrument that merely reflect other provisions of the law do not vitiate negotiability. *Triffin V. Dillabough*, 552 Pa. 550, 716 A.2d 605 (1998). See Am. Jur. 2nd Bills & Notes §77.

[22] BORROWER'S RIGHT TO PREPAY

> 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 "Prepayment." When I make a Prepayment, I will tell the Note Holder in writing that I am doing so. . .

that do not prohibit prepayments all contain the statement by the maker that "[w]hen I make a prepayment, I will tell the Note Holder in writing that I am doing so." Professor Mann devoted a substantial portion of a law review article to an argument against negotiability of the UI Note based upon this provision.[23] His position was acknowledged without criticism or disagreement in an article by Professor Cohen in 2007[24], and with some serious skepticism by Professor Whitman in a third article in 2010.[25]

Mann's argument is that this provision constitutes "an act 'in addition to the payment of money'" in violation of the language of UCC §3-104(a)(3). This issue and Mann's argument were squarely addressed recently in *In re Walker,* 2012 WL 443014 (Bankr. E.D. PA, 2/13/12) and were rejected after an analysis of the Mann and Whitman law review articles and a review of three court decisions addressing this issue.[26] The court, in *Walker,* quoted a New Jersey trial court decision as being the proper analysis where it said:

> The right of defendants, under the note, to prepay part of the principal does not constitute an "additional undertaking or instruction" that adversely affects the negotiability of the note. Quite the opposite, the right of prepayment is a voluntary option that defendants may elect to exercise solely at their discretion. Indeed, such an allowance confers a benefit, not a burden, upon defendants, who can freely choose to decline the

---

[23] Mann, *Searching For Negotiability in Payment and Credit Systems,* 44 UCLA Law Rev. 951, 968-973 (1997). (Professor Mann was a member of the Permanent Editorial Board for the UCC at the time that it promulgated the 2002 amendments to Article 3.)

[24] Cohen, *The Calamitous Law of Notes*, 68 Ohio St. L. J. 16 1631 (2007) ("As Mann noted, mortgage notes that follow the standard FNMA/FHLMC multi-state form contain a non-monetary undertaking that disqualifies them from negotiable status under UCC Section 3-104(a)(3)").

[25] Whitman, *id.* at 749 ("It is uncertain whether his [Mann's] conclusion is correct; there is no case authority interpreting this aspect of the clause . . . This phraseology obviously contemplates that a clause governing the right of prepayment may be inserted without impairing the note's negotiability, and, in opposition to Mann's conclusion, one might argue that the quoted language requiring written notice of a prepayment by the borrower is merely a natural and logical extension of the privilege of providing for prepayment in a negotiable note.")

[26] Two months earlier this argument was similarly rejected by the Wisconsin Bankruptcy Court in *In re Edwards*, 2011 WL 6754073 (Bankr. W.D. WI, 12/23/11). ("The ability of the debtor to avail himself of additional favorable payment options or receive compensation in the event of accounting errors does not destroy the negotiability of the instrument.")

> opportunity. The fact that defendants must notify the lender in the event they opt for prepayment imposes no additional liability on them and is not a condition placed on defendants' promise to pay. Rather, *notification is simply a requirement of the exercise of the right of prepayment which, as noted, defendants are free to reject.* This requirement does not render the note in issue non-negotiable. (Emphasis by the court.)[27]

An alternative argument regarding this prepayment notice argument is to assert that that the provision violates the "four corners of the note" principle because it forces one to look outside of the note to determine whether and when prepayment notices were given and how that affects the amount due. This approach is almost certain to fail, because the modern version of Article 3 already contains a number of provisions requiring an examination of records outside of the note to determine the amount due, as discussed in Section V, 3rd paragraph below.

George Holler, Esq.[28] of Connecticut has done an excellent analysis of these issues and has concluded that Professor Mann's approach is correct and that the *Walker, Edwards* and *Gouda* courts are wrong. George has generously posted his research and has authorized me to post it along with this memorandum. But, while George's research and analysis that support his view that this provision renders the note non-negotiable is sound, his argument is sophisticated and must be presented with care. It will be a challenge to persuade a judge to take the time to understand it, and, in light of developing adverse precedent, it is increasingly unlikely that a judge will accept this argument even if it is skillfully presented. I urge you to read George's memorandum, the law review article by Professor Mann and the *Walker* case in order to form your own opinion, and in order to make the non-negotiability argument as effectively as possible if you decide to pursue it in any of your cases.

---

[27] *In re Walker, id.,* quoting *HSBC Bank USA, N.A. v. Gouda,* 2010 WL 5128666, at *2–3 (N .J. Super. App. Div. Dec. 17, 2010).

[28] He can be contacted at georgetholleriv@gmail.com

E. The "Obligations of Persons Under This Note" Provision.

This provision[29] appears in Paragraph 8 of the fixed rate UI Note and paragraph 9 of the variable rate UI Note. The issue being raised regarding this portion of the UI Note has not been clearly articulated. This section deals almost entirely with defining the scope of parties other than the original maker, such as guarantors, sureties and indorsers. Under UCC §3-104, it is the nature and extent **the maker's** promises that determines whether the not is negotiable. This paragraph of the UI Note does not add to or condition any of the promises of the maker. For this reason, a court is unlikely to construe Paragraph 8 as destroying negotiable status. There is no court decision construing this provision of the UI Note.

G. The "Uniform Secured Note" Provision.

This provision[30] appears in Paragraph 10 of the fixed rate UI Note and Paragraph 11 of the variable rate UI Note. The provision references a mortgage made concomitantly with the note. "A separate agreement does not affect the negotiability of an

[29] OBLIGATIONS OF PERSONS UNDER THIS NOTE

> If more than one person signs this Note, each person is fully and personally obligated to keep all of the promises made in this Note, including the promise to pay the full amount owed. Any person who is a guarantor, surety or endorser of this Note is also obligated to do these things. Any person who takes over these obligations, including the obligations of a guarantor, surety or endorser of this Note, is also obligated to keep all of the promises made in this Note. The Note Holder may enforce its rights under this Note against each person individually or against all of us together. This means that any one of us may be required to pay all of the amounts owed under this Note.

[30] The initial portion of this Section follows, with the two subparagraph quotes from the mortgage left out for the sake of brevity:

UNIFORM SECURED NOTE

> This Note is a uniform instrument with limited variations in some jurisdictions. In addition to the protections given to the Note Holder under this Note, a Mortgage, Deed of Trust, or Security Deed (the "Security Instrument"), dated the same date as this Note, protects the Note Holder from possible losses which might result if I do not keep the promises which I make in this Note. That Security Instrument describes how and under what conditions I may be required to make immediate payment in full of all amounts I owe under this Note. Some of those conditions are described as follows: . . .

instrument."[31] The "inclusion [in a note] of a provision granting a security interest in collateral will not defeat negotiability"[32] because UCC Section 3-104(a)(3) explicitly provides that negotiability is not destroyed if the note contains an "an undertaking or power to give, maintain or protect collateral to secure payment" and because Section 3-106(b)(1) explicitly states that a promise is not made conditional "by **reference** to another writing for a statement of rights with respect to collateral . . ."[33] (emphasis added). If this paragraph of the note had included a statement **incorporating** the mortgage, or a statement that the obligations of the maker of the note are **conditioned** upon performance of the obligations of the mortgagee under the mortgage, then the UI Note would indeed be non-negotiable. As discussed in Section II of this memorandum, there is little remaining logic for the continuation of this kind of semantic distinction in Article 3 for mortgage notes, but that is what the drafters have left us and to the courts to deal with.

As an example of how the financial industry has rendered the rules of negotiability illogical, UCC Section 3-104(3) allows a negotiable note to contain provisions referencing a mortgage and requiring a party to "protect" mortgaged property, but nullifies negotiability if the note requires the maker to insure it[34], on the

---

[31] 5 Hawkland & Lawrence, UCC Series §3-104.3(Rev Art 3)

[32] *Id.* at §3-104.12

[33] Official Comment 2 to Section 3-106 states:

> Many notes issued in commercial transactions are secured by collateral … it may be convenient not to include a statement concerning collateral, prepayment, or acceleration in the note, but rather to refer to an accompanying loan agreement, security agreement or mortgage for that statement. Subsection (b)(i) allows a reference to the appropriate writing for a statement of these rights. For example, a note would not be made conditional by the following statement: "This note is secured by a security interest in collateral described in a security agreement dated April 1, 1990 between the payee and maker of this note. Rights and obligations with respect to the collateral are [stated in] [governed by] the security agreement." The bracketed words are alternatives, either of which complies.

[34] "A duty to pay taxes, insurance or the like destroys the negotiability of the instrument." 6 Hawkland & Laurence, UCC Series §3-104:7, *Massey Ferguson Credit Corp. v. Bice*,11 U.C.C. Rep.

theory that the cost of insurance would run against the requirement that the note be for a "fixed amount,"[35] while illogically ignoring the reality that protecting a residential property equally requires payments of money.

The argument that has been made against the negotiable status of the UI Note focuses on the language that it uses to reference the mortgage securing it. This language appears in the final section of the UI Note captioned "Uniform Secured Note." That section recites that there is a mortgage securing the note and describes under what conditions acceleration may occur. It then quotes two of those provisions—the due- on-sale-clause of the mortgage and the corresponding notice of "immediate payment in full" clause--that usually appear in Paragraph 15 of the mortgage

This language of the UI Note appears to be crafted to be only a "reference" to the mortgage, and appears to be drawn so as not to make payment of the note "conditional" upon the terms of the mortgage. The use of the word "conditions" in this portion of the UI Note is only referring to conditions stated in the mortgage and is not used in a manner that conditions payment of the note upon the mortgage.

Some have argued that the use of the phrase "[s]ome of those conditions are described as follows", with the accompanying quotation of two of the paragraphs from the mortgage, constitutes more than a reference to the mortgage and in fact does incorporate the mortgage into the note. Others argue that this language structure in the UI Note, by using the phrase "some of those conditions" and then quoting only two of them compels an examination of the mortgage to determine its other "conditions" that are not quoted in the UI Note. However UCC §3-106(b) expressly states that negotiability is not destroyed by "a reference to another writing with respect to collateral, prepayment or acceleration." These

---

Serv. 2d 116, 450 N.W.2d 435 (S.D. 1990), *P&K Marble v. La Paglia*, 9 U.C.C. Rep. Serv. 2d 966, 147 N.Y.S. 2d 682, 147 A.D. 2d 804(1989)

[35] *Id.* Note, however, that it is perfectly fine for <u>the mortgage</u> to require insurance without affecting negotiability of the note.

arguments are not likely to be persuasive to a judge. If the quotations of two paragraphs of the mortgage had not been included in the note, then there would be little room to argue that the remaining language is anything more than a permissible reference to the mortgage. It is difficult to argue that the quotation of those two paragraph somehow changes the analysis.

Courts are likely to rule that the drafters of the UI Note did not go beyond making a reference to the mortgage and that they did not actually incorporate the mortgage or make the maker's obligation to pay the note conditioned upon the provisions of the mortgage. It thus seems unlikely that that a court will hold that this language of the UI Note destroys negotiability. Moreover, there is no case law on this provision of the UI Note to the contrary.

V. Affects on Negotiability of Agreements Outside of the Note.

A. The obligations arising under the UI Note can be modified by the mortgage without negotiability being destroyed.

It is in regard to this concept that major misunderstandings have developed that lead to mistaken assertions the provisions in the mortgage securing the UI Note can destroy the note's status as a negotiable instrument. Article 3 of the UCC expressly contemplates that there will be other loan documents executed contemporaneously with a negotiable note, and even that those other agreements may contain provisions that would destroy negotiability had they been included in the note. Section 3-117 provides as follows:

> §3-117 OTHER AGREEMENTS AFFECTING INSTRUMENT.
>
> Subject to applicable law regarding exclusion of proof of contemporaneous or previous agreements, the obligation of a party to an instrument to pay the instrument may be modified, supplemented, or nullified by a separate agreement of the obligor and a person entitled to enforce the instrument, if the instrument is issued or the obligation is incurred in reliance on the agreement or as part of the same transaction giving rise to the agreement. To the extent an obligation is modified, supplemented, or nullified by an

> agreement under this section, the agreement is a defense to the obligation.[36]

A judge must look only within the four corners of a UI Note to determine whether it is negotiable, and is not permitted by Article 3 to consider how a contemporaneous mortgage modifies or supplements those provisions in determining the negotiable status of the note.

Notwithstanding the provisions of Section 3-117, it has been asserted that provisions in the mortgage, which appear to change or supplement provisions of the UI Note, make the note non-negotiable. For example, the assertion has been made that Uniform Covenant 2 of the Uniform Mortgage, which has an application of payments provision more detailed than that in the UI Note, and which also includes a provision for application of payments to an escrow account, destroys negotiability. It is argued that negotiability is destroyed because the mortgage provisions force one to look outside of the UI Note document to determine how much is due on the note. This argument is likely to fail[37] for two reasons. Contrary to the rules for negotiable instruments existing before the modern era, there is no provision in Article 3 that states that a note is rendered non-negotiable if one must look outside of the four corners of the instrument to determine the amount of principal due on it. A court would likely uphold the negotiability of a UI Note as long as there is a reasonable means to determine its value, even if beyond the four corners of the document.

---

[36] This last sentence of §3-117 can be confusing. In the mortgage context, it means that if there is a provision in a mortgage modifying or conditioning the maker's obligation to pay on the note, the maker may assert that as a defense when the other party to the note asserts a claim on the note. This defense will not apply to a holder in due course, (*see* 6 Hawkland & Laurence, UCC Series §§3-117:1through 3-117:3) except for the fact that any party claiming HIDC status with respect to the note is likely to also be an assignee of the mortgage such that the supplemental provision will bind that party by virtue of its mortgage assignee status

[37] This argument was rejected without analysis in *In re Edwards*, 2011 WL 6754073 (Bankr. W.D. WI, 12/23/11). ("The ability of the debtor to avail himself of additional favorable payment options or receive compensation in the event of accounting errors does not destroy the negotiability of the instrument.")

Article 3 contains a number of provisions that allow a note to be called negotiable even where resort must be made to documents outside of the instrument to determine the amount due. Section 3-104(a), allowing for interest bearing notes, makes it likely that resort will be needed to outside records to determine the amount of interest accrued. Section 3-112 makes resort to outside records a certainty by allowing a variable interest rate where "reference to information not contained in the instrument" may be required, such a LIBOR on adjustable rate mortgage. Section 104(a) also allows a note to include a provision for "other charges", such as late fees, the amount of which will again require resort to outside records to determine. Section 3-108(b) allows a note to be payable on multiple dates, such 360 months as with a 30 year mortgage loan, meaning again that resort to outside documents will normally be required to determine the number of payments actually made. With all of these "modern" rules relating to negotiability and the need for reference to outside documents, it is unlikely that a judge will rule that the enhanced application of payments provisions of Covenant 2 of the mortgage require a potential buyer of a UI Note to do more by way of outside records examination than is already contemplated by the above referenced provisions of Article 3.

Another example of an assertion being improperly made that a provision of the mortgage destroys the negotiable status of a UI Note arises out of Covenant 14 of the mortgage. It is asserted that "Uniform Covenant 14 [of the mortgage], by expressly justifying the borrower in withholding a portion of the stated principal amount of the note, or by demanding a credit on the stated amount due, creates such an express condition [as prohibited by UCC §3-106(a)(i)]". The assertion that this provision in the mortgage creates a condition **in the note** is fundamentally wrong. The mortgage provision does not change or condition the note. Rather, it creates a condition in a document **separate from the note**. Even if a condition of the mortgage said that the maker's obligation to pay the note would terminate if the sun came up the following day, that would not destroy the negotiability of the note, **because that condition is not in the note.** UCC §3-117 expressly allows a mortgage to have a provision that provides that an obligation to pay the note is "nullified". Such a nullification (or modification)

provision does not destroy negotiability of the note because it does not appear within the four corners of the note. It is binding upon the maker and payee, but not upon a holder in due course, since an HIDC is not charged with knowledge of conditions stated in an agreement separate from the note.[38]

B. The PSA does not "trump" the Article 3 rules relating to negotiable notes.

Assertions have been made that agreements by persons not parties to the note and made outside of the note, such as Pooling and Servicing Agreements and related documents, or other conduct of the parties to those documents, can change a note from a negotiable instrument into a non-negotiable note. The assertion is repeatedly made that the provisions of the PSA trump the negotiability rules of Article 3, but there is no support for this position in the UCC.

Proponents of the argument that the PSA trumps Article 3's application to a note rely upon the provisions of UCC §1-302(a), which read as follows:

> § 1-302. Variation by Agreement.
>
> (a) Except as otherwise provided in subsection (b) or elsewhere in [the Uniform Commercial Code], the effect of provisions of [the Uniform Commercial Code] may be varied by agreement.

The term "agreement" as used here means "the bargain of the parties in fact." UCC §1-201(3). The term "party" as used here is a person that has engaged in a transaction. UCC §1-201(26). Thus, a note can be varied **only by the parties to it—**the maker on the one hand and the payee (or a successor PETE), on the other.[39] A PSA is not an agreement that can make an otherwise negotiable note non-negotiable, because the maker of the note is not a party to the PSA or any of

[38] 6 Hawkland & Laurence, UCC Series §3-117:1 ("A provision in an agreement stating that an instrument is a sham, if not against public policy will be given effect."). See also *id* at §3-117:2.

[39] If the note is held by a holder who is not the owner, then it seems to me that it would have to be the holder who would be the other party to any amendment of the note. For example §3-108(b)(iii) gives to a holder of negotiable instrument the right to extend its time of payment.

its related documents. The fact that the PSA has a detailed set of rules on how a note coming into the trust must be transferred **between parties to the trust**, does not affect in any respect the terms or character of that note (that is **between the maker and the payee**) or the rights or obligations of its maker. The maker is simply not a party to the PSA or its related documents. Even if the parties to the PSA agree among themselves not to treat the note as negotiable if one of them goes to court with possession of the note and the requisite indorsements, then any agreement by that PETE in a separate agreement, such as the PSA, will not prevent a court from treating that party as the PETE under Sections 3-301 and 3-308 in an action against the maker.[40]

While not always considered from this perspective, Article 3 of the UCC in fact provides certain and significant protections to the maker of a negotiable note. Article 3 provides a set of rules, which make it easy to determine whether the party seeking to enforce the note has the right to do so, and which protect a maker from potential double liability on a note. Those rules protect the maker by making it simple for him to know that, when he pays a party possessing the note with PETE status, the debt is discharged and the maker is protected against any other claims being made against him on the note. Thus, if a maker is sued on a negotiable note by a PETE (UCC §3-301) and the note is produced in court (UCC §3-308(b)) by the PETE, the maker of the note will be protected against any claim to liability on the note by any other person. (UCC §3-602). These protections cannot be taken away from the maker **unless he *agrees* to have them taken away at the time that he signs the note**. (UCC §3-117). Because the maker **is not** a party to the PSA or any of its affiliated documents, nothing in those

[40] The PSA issues sometimes are raised when the note is not properly indorsed: i.e. indorsed to another party or not indorsed at all (including unattached allonges). This would fall under 3-203(b), specifically Official Comment 2, which states that because the transferee's rights are derivative they must be proved—the presumption under 3-308 does not apply since the transferee is not a holder.

documents contains any agreement of the maker of a negotiable note to surrender the protections afforded to the maker under Article 3 or to change the note into a non-negotiable contract to pay money.

Nothing said in the preceding paragraph diminishes the argument that parties to the PSA may contract, **among themselves and that as between themselves**, to create special rules in addition to those in the UCC that govern how ownership of a note is to be transferred **among themselves**, even to the point of agreeing among themselves that transfers among themselves by indorsement alone are not sufficient. However, even if the transfer rules of a PSA are violated as among the parties to the PSA, if one of the parties to that PSA ends up with possession of the note indorsed in blank or to that party, that party becomes the holder entitled enforce the note against the maker pursuant to §§3-301 and 3-308.[41]

As between the holder and the maker, it doesn't matter whether the holder got possession of the note after the closing date of the PSA, or in a manner that violates the REMIC provisions or other requirements of the PSA. Other parties to, or beneficiaries of, the PSA, such as investors, (or even the IRS) may have legitimate complaints for damages or other claims resulting from violations of the PSA. But breach of a condition of the PSA by the holder does not affect negotiability of the underlying instrument or affect the maker's payment obligation. The note maker's sole legally cognizable and appropriate expectation is that he cannot be required to do something beyond what the express terms of the note require of him, and that he will have the protections afforded him under Article 3 when he pays, or judgment is entered in favor of, a PETE.

---

[41] This is a major point of controversy and goes to standing issues---(1) the standing of the purported PETE to seek judicial enforcement of the note, and (2) the standing of the note obligor to raise issues as to how the PETE got the note. These issues are discussed further in Section VII below.

Another argument that has been made with respect to the PSA provisions is that "the Sponsors, the Sellers and the Depositors . . . do not treat residential mortgages as completely sold due to the continuing repurchase obligations arising out of [the early payment default] representations and warranties." The argument goes on to assert that "[t]hese conditions render the notes non-negotiable under Section 3-302(a)(2)(iii) and (a)(2)(vi) of the UCC." To the extent that this argument is an assertion that, as to the maker, negotiability status is destroyed, this argument fails for two reasons. First, and as discussed above, because the maker of note is not a party to the PSA, this means that these provisions simply cannot render the note non-negotiable. Second, the referenced provisions of Section 3-302 do not relate at all to negotiability issues, rather, they address holder-in-due-course issues. There simply is nothing in Section 3-302 that affects the status of a note as a negotiable instrument or that could render a negotiable note non-negotiable.

VI. The Intersection of Article 3 and Article 9.

Article 9 of the UCC applies to **every note**, negotiable and non-negotiable. UCC §9-102(47). Section 9-203(b) spells out how the ownership of any note, negotiable or non-negotiable, is sold. Article 9 is also the only source of law about whether, between the transferee and transferor an ownership interest in the note has been transferred to the transferee. For our foreclosure defense work, it is critically important to understand that Article 9 does not provide the rules about how the enforcement of a note against its maker by an assignee. The rules in § 9-406(a)-(c) concerning whom, as between the assignor and assignee, the obligor must pay do not apply to promissory notes. (They apply only to accounts, chattel paper, and payment intangibles.) While § 9-607(a)(1) allows the assignee to notify a maker to pay the assignee, § 9-607(e) and the italicized language in comment 6 to § 9-607 makes it clear that subsection (a) has no effect on the identification of the party to whom the payment obligation is owed. The result is that

common law contract rules, rather than Article 9, determine what proof is required of a party seeking enforcement of a non-negotiable note. [42]

However, if the note is negotiable, then Article 3 is the **exclusive source** of law on how it is enforced, and Article 9 will have nothing to do with that issue. It is only with negotiable notes under Article 3 that there can be a party other than the owner of the note who has the right to enforce it (leaving aside issues relating to agents). When the owner of a negotiable note and its holder are different parties, it is the **holder** of the note, to the complete exclusion of the **owner**, who has the right to enforce the note,[43] and Article 9 will have no application to enforcement rights relating to that note.

Some of the confusion around the interplay between Articles 3 and 9 may arise out of the fact that they use some of the same key words, but use them in fundamentally different ways. For example, in Article 3, the term "'instrument' means a negotiable instrument," UCC §3-104(b), while in Article 9 "'instrument' means a negotiable instrument or any other writing that evidences a right to the payment of a monetary obligation and is of a type that in ordinary course of business is transferred by delivery with any necessary indorsement or assignment."[44] (UCC §9-102(47)). Similarly, in Article 3, the word "transfer" means delivery "by a person other than its issuer for the purpose of giving to the person receiving delivery the right to enforce the instrument" (UCC §3-203(a), but in Article 9, the use of the word "transfer" refers to the transfer of ownership of a note. [45] (UCC §9-203(g)).

---

[42] One of the few sets of rules in Article 9 that has an impact on whether an assignee can enforce a note against the maker are the rules in §§ 9-406 and 9-408 that override some anti-assignment clauses, but I think that such clauses are rare or non-existent in mortgage notes.

[43] The classic and most current example of how "holdership" and ownership of a negotiable note are separated is seen in the conduct of Fannie and Freddie. The notes that they own are foreclosed by servicers, in the names of the servicers because Fannie and Freddie claim to make the servicers the holders of their notes during foreclosure.

[44] This language allows the Article 9 definition to pick up non-negotiable notes, but not regular-old loan contracts and other contractual obligations for the payment of money.

[45] See also PEB Report at Page 8.

It has been asserted that, upon the sale of any type of a note, the right to enforce the note will thereafter always be determined by Article 9. This simply is not correct. As stated in the PEB Report

> The rules that determine whether a person is a person entitled to enforce a note do not require that person to be the owner of the note, and a change in ownership of a note does not necessarily bring about a concomitant change in the identity of the person entitled to enforce the note.[46]

Again, if the note is negotiable, Article 3 is the exclusive source of law on how it is enforced and is never overridden by Article 9 as to determination of enforcement rights. If the note is non-negotiable, then Article 9 and the common law of contracts control its enforcement.

VII. Why Judges Will Not Want to Accept Non-negotiability Arguments.

A practical challenge presented by any argument against negotiability is that it asks a judge to surrender the simple proof required when treating a note as an Article 3 negotiable instrument in exchange for a complex, time consuming, and document-intensive search for proof when enforcement rights are rooted in Article 9 and the common law of contracts. A judge dealing with an action to enforce a negotiable note need only be satisfied that the plaintiff is entitled to enforce it. The note, itself, may be self-authenticating (see, e,g., F.R.Evid. 902(d)). On the other hand, a judge dealing with a non-negotiable note will be faced with a voluminous PSA, a mortgage loan schedule, a mortgage loan purchase agreement and possibly other documents needed to prove ownership, and the (probably contested) testimony of the multiple witnesses that may be needed to authenticate those documents. The length of time required for a judge to try a non-negotiable note case will be far longer than for a simple negotiable note case. Further, a judge will know that if he establishes a precedent of determining that the UI Note is non-negotiable, he will have vastly increased the workload of his judicial system for all future foreclosure cases. While these more complex and time consuming proof burdens are exactly what foreclosure defense counsel would like to impose on the other

---

[46] *Id.*

side, it seems likely that a judge will be very resistant to take this step in the absence of clear and convincing proof that the UI Note is non-negotiable.

VIII. Standing Issues.

Standing challenges have been made as to the rights of trustees of securitized trusts to sue on improperly acquired notes and mortgages. Corresponding standing issues have arisen as to whether note obligors even have the right to challenge the standing of the trustees.

There was a major effort by members of this listserv some time ago to develop a standing defense based upon the assertion that conveyance of a loan into a securitized trust after the closing date of the trust and/or through assignments and indorsements that did not meet the specific requirements of the PSA and related REMIC rules resulted in a failure of the trustee to actually acquire ownership of and/or the right to enforce the note. This effort has not been successful.

In an unpublished decision by the Sixth Circuit Court of Appeal in *Livonia Properties v. Farmington Road*, 2010 U.S. App. LEXIS 22764, the court held that an obligor on a negotiable note "does not have standing to raise that flaw to challenge the [enforcing party's] chain of title," stating that "a litigant who is not a party to an assignment lacks standing to challenge that assignment. Nick Wooten, Esq. attempted to make a more sophisticated standing argument in *U.S. Bank v. Congress* that went to trial in Alabama with a well-prepared expert witness supporting his standing defense. Nick's argument was that New York trust law, which governs almost all securitized trusts, left a trustee with no legal power to acquire an asset unless the acquisition occurred through strict compliance with the trust's governing documents, meaning that a trustee could not own the note and could not have standing to attempt to enforce such an obligation. Unfortunately, the Alabama trial court rejected this defense.[47]

---

[47] *US Bank v. Congress*, 01-CV-2009-901113.00 (Cir. Ct Jeff. Cty., Alabama, 2/23/11). ("Therefore it is clear that the party entitled to enforce the note does not have to be the owner of that note. U.S. bank was the 'holder' of the Congress note and therefore it had the legal right to foreclose on the Congress property.")

In *In re Correia,* 452 B.R. 319, 2011 Bankr. LEXIS 2461, the 1st Circuit BAP again rejected this defense stating that a note obligor, who is not a third party beneficiary of a PSA, lacks "standing to object to any breaches of the terms of the PSA."[48] One of the most recent cases coming to this conclusion is *In re Walker*, 2012 WL 443014 (Bankr., E.D. PA, 2/13/12) where the court cataloged in footnotes 28 and 29 over twenty trial and bankruptcy court decisions reaching the same or similar conclusions. So far, it appears that the only reported decision that has really discussed the issue[49] and left the door open to a consideration of the PSA and New York trust law standing defense is *In re Doble*, 2011 Bankr. LEXIS 1449 (S.D. CA, 4/14/11), but that court did not fully sustain the defense saying that the debtor's complaint was insufficient to establish it. *Id* at *38 and fn. 21.

It is unlikely that any court inclined to construe the UI Note as negotiable will be willing to consider the PSA and New York trust law standing defenses. UCC §3-301 is simple in its requirements for the proof required to be a PETE. Article 3 is not concerned with proof of ownership of the note or how the PETE got the note. More importantly, there is certainty under Sections 3-308 and 3-602 that if the court enters judgment after proof of PETE status, the homeowner is completely protected from liability to any other party who might attempt to make a claim on the note.

---

[48] For another recent and similar ruling, see in *In re Edwards*, 2011 WL 6754073 (Bankr. W.D. WI, 12/23/11). ("The debtor was neither a party to the pooling or servicing agreements nor a potential third party beneficiary of those agreements, so his standing to challenge the assignments is lacking. Aside from the fact that the debtor is without standing to seek relief for violations of the Pooling and Servicing Agreement, those alleged violations are irrelevant to Deutsche Bank's standing to enforce the Note under the Uniform Commercial Code . . .")

[49] In *Horace v. LaSalle Bank*, CV 08-362 (Cir. Ct., Alabama, March 25, 2011) the court expressed surprise "to the point of astonishment" that LaSalle did not comply with the terms of its own PSA or with New York trust law. It even held that the homeowner was a third party beneficiary of the PSA and went on to permanently enjoin LaSalle from foreclosing and entered judgment against it. Certainly this case is helpful support for this defense, but as a lower level court decision with no written analysis, it is of limited utility. The same result supporting the standing defense was reached in *Hendricks v. U.S. Bank*, Case No. 10-849-CH (Mich., Washtenaw Cty. Tr. Ct., June 6, 2011) in a decision where there was a good written analysis of the issue. Again the fact that this is an unreported lower level trial court decision makes it of limited utility as precedent.

The developing body of case law against the PSA standing argument is now sufficiently voluminous to lead to the conclusion that it is unlikely that courts are going to adopt it. Lawyers who contemplate making of this argument in the face of this precedent, and the other arguments raised in this memorandum, should consider with care whether doing so might damage the credibility of the client's case on other stronger issues. The New York trust law argument developed by Nick Wooten is exceedingly difficult to present (see *In re Doble, id.)*, and probably requires expert witness support. Again, the making of that argument without such support will likely weaken a party's credibility on other issues.

IX. Conclusion.

"[D]eciding whether a complex promissory note is negotiable is a process fraught with frustration and the possibility of error, and that the predictability of such cases is low."[50] Despite the numerous arguments that have been advanced against negotiability of the UI Note, only one of them, the prepayment notice requirement, appears to have some reasonable support. No court has found that the prepayment clause destroys negotiability, and five courts have held that it does not. Thus, the vitality of that argument is also much in doubt. The enormous burden that a judicial determination of non-negotiability will have upon the judicial system will make judges reluctant to rule against negotiability of the UI note in the absence of a compelling argument to support such a conclusion. That compelling argument does not appear to exist. For so long as we are dealing with notes that our courts consider to be negotiable, Article 9 and the method by which a note possessor came into PETE status are factors with no consequence to our defense of foreclosure cases.

---

[50] Whitman, *id* at 754.

Endnote.

Despite my conclusion that courts are unlikely to treat the UI Note as non-negotiable, I think that is an absurd outcome from a policy perspective. The law review articles of Professors Cohen, Mann and Whitman cited above explain why that is so. The UCC's allowance of holdership for mortgage notes that is separate from ownership, allowed MERS to perpetuate its charade of having its 23,000 bogus vice presidents purportedly make MERS into a "holder for a moment" so as to allow it claim the right to foreclose. That scheme has now been halted by MERS, but a similar one is now being carried on by Fannie Mae and Freddie Mac who force servicers to conceal the identity of the GSE's in foreclosures. They are abusing the holder provisions of Article 3 so as to conceal the reality that the servicers are acting as their undisclosed agents. There is no adequate legal justification for this practice, yet it goes on unchecked. The practice stands on its head the longstanding principal of legal standing—the notion that only a party with a real stake in the outcome should be allowed to bring a lawsuit.

EXHIBIT A

[Downloaded from eFannieMae website 9/13/2011]

NOTE

______________________________, _____
[Date]

___________________, _________
[City] [State]

____
[Property Address]

1. BORROWER'S PROMISE TO PAY

In return for a loan that I have received, I promise to pay U.S. $________________ (this amount is called "Principal"), plus interest, to the order of the Lender. The Lender is ____. I will make all payments under this Note in the form of cash, check or money order.

I understand that the Lender may transfer this Note. The Lender or anyone who takes this Note by transfer and who is entitled to receive payments under this Note is called the "Note Holder."

2. INTEREST

Interest will be charged on unpaid principal until the full amount of Principal has been paid. I will pay interest at a yearly rate of __________%.

The interest rate required by this Section 2 is the rate I will pay both before and after any default described in Section 6(B) of this Note.

3. PAYMENTS

(A) Time and Place of Payments

I will pay principal and interest by making a payment every month.

I will make my monthly payment on the ____ day of each month beginning on _______________, ____. I will make these payments every month until I have paid all of the principal and interest and any other charges described below that I may owe under this Note. Each monthly payment will be applied as of its scheduled due date and will be applied to interest before Principal. If, on _________________, 20___. I still owe amounts under this Note, I will pay those amounts in full on that date, which is called the "Maturity Date."

I will make my monthly payments at ____ or at a different place if required by the Note Holder.

(B) Amount of Monthly Payments

My monthly payment will be in the amount of U.S. $____________________.

4. BORROWER'S RIGHT TO PREPAY

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 "Prepayment." When I make a Prepayment, I will tell the Note Holder in writing that I am doing so. I may not designate a payment as a Prepayment if I have not made all the monthly payments due under the Note.

I may make a full Prepayment or partial Prepayments without paying a Prepayment charge. The Note Holder will use my Prepayments to reduce the amount of Principal that I owe under this Note. However, the Note Holder may apply my Prepayment to the accrued and unpaid interest on the Prepayment amount, before applying my Prepayment to reduce the Principal amount of the Note. If I make a partial Prepayment, there will be no changes in the due date or in the amount of my monthly payment unless the Note Holder agrees in writing to those changes.

5. LOAN CHARGES

If a law, which applies to this loan and which sets maximum loan charges, is finally interpreted so that the interest or other loan charges collected or to be collected in connection with this loan exceed the permitted limits, then: (a) any such loan charge shall be reduced by the amount necessary to reduce the charge to the permitted limit; and (b) any sums already collected from me which exceeded permitted limits will be refunded to me. The Note Holder may choose to make this refund by reducing the Principal I owe under this Note or by making a direct payment to me. If a refund reduces Principal, the reduction will be treated as a partial Prepayment.

6. BORROWER'S FAILURE TO PAY AS REQUIRED

(A) Late Charge for Overdue Payments

If the Note Holder has not received the full amount of any monthly payment by the end of ________ calendar days after the date it is due, I will pay a late charge to the Note Holder. The amount of the charge will be ____% of my overdue payment of principal and interest. I will pay this late charge promptly but only once on each late payment.

(B) Default

If I do not pay the full amount of each monthly payment on the date it is due, I will be in default.

(C) Notice of Default

If I am in default, the Note Holder may send me a written notice telling me that if I do not pay the overdue amount by a certain date, the Note Holder may require me to pay immediately the full amount of Principal which has not been paid and all the interest that I owe on that amount. That date must be at least 30 days after the date on which the notice is mailed to me or delivered by other means.

(D) No Waiver By Note Holder

Even if, at a time when I am in default, the Note Holder does not require me to pay immediately in full as described above, the Note Holder will still have the right to do so if I am in default at a later time.

(E) Payment of Note Holder's Costs and Expenses

If the Note Holder has required me to pay immediately in full as described above, the Note Holder will have the right to be paid back by me for all of its costs and expenses in enforcing this Note to the extent not prohibited by applicable law. Those expenses include, for example, reasonable attorneys' fees.

7. GIVING OF NOTICES

Unless applicable law requires a different method, any notice that must be given to me under this Note will be given by delivering it or by mailing it by first class mail to me at the Property Address above or at a different address if I give the Note Holder a notice of my different address.

Any notice that must be given to the Note Holder under this Note will be given by delivering it or by mailing it by first class mail to the Note Holder at the address stated in Section 3(A) above or at a different address if I am given a notice of that different address.

8. OBLIGATIONS OF PERSONS UNDER THIS NOTE

If more than one person signs this Note, each person is fully and personally obligated to keep all of the promises made in this Note, including the promise to pay the full amount owed. Any person who is a guarantor, surety or endorser of this Note is also obligated to do these things. Any person who takes over these obligations, including the obligations of a guarantor, surety or endorser of this Note, is also obligated to keep all of the promises made in this Note. The Note Holder may enforce its rights under this Note against each person individually or against all of us together. This means that any one of us may be required to pay all of the amounts owed under this Note.

9. WAIVERS

I and any other person who has obligations under this Note waive the rights of Presentment and Notice of Dishonor. "Presentment" means the right to require the Note Holder to demand payment of amounts due. "Notice of Dishonor" means the right to require the Note Holder to give notice to other persons that amounts due have not been paid.

10. UNIFORM SECURED NOTE

This Note is a uniform instrument with limited variations in some jurisdictions. In addition to the protections given to the Note Holder under this Note, a Mortgage, Deed of Trust, or Security Deed (the "Security Instrument"), dated the same date as this Note, protects the Note Holder from possible losses which might result if I do not keep the promises which I make in this Note. That Security Instrument describes how and under what conditions I may be required to make immediate payment in full of all amounts I owe under this Note. Some of those conditions are described as follows:

> Lender may require immediate payment in full of all Sums Secured by this Security Instrument if all or any part of the Property, or if any right in the Property, is sold or transferred without Lender's prior written permission. If Borrower is not a natural person and a beneficial interest in Borrower is sold or transferred without Lender's prior written permission, Lender also may require immediate payment in full. However, this option shall not be exercised by Lender if such exercise is prohibited by Applicable Law.
>
> If Lender requires immediate payment in full under this Section 18, Lender will give me a notice which states this requirement. The notice will give me at least 30 days to make the required payment. The 30-day period will begin on the date the notice is given to me in the manner required by Section 15 of this Security Instrument. If I do not make the required payment during that period, Lender may act to enforce its rights under this Security Instrument without giving me any further notice or demand for payment.

WITNESS THE HAND(S) AND SEAL(S) OF THE UNDERSIGNED.

______________________________________(Seal)
-Borrower

______________________________________(Seal)
-Borrower

______________________________________(Seal)
-Borrower

[*Sign Original Only*]