

Legal analysis to guide the mortgage industry and protect its interests.

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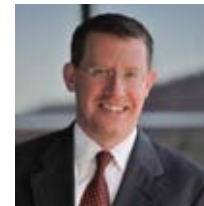
WATERSHED RULING BY 4TH CIRCUIT COURT OF APPEALS UPHOLDS HOLDER RULE IN SECURITIZATION CONTEXT

For the first time, a United States Court of Appeals has expressly confirmed the right of a holder to foreclose a note, even when the loan has been securitized. This watershed decision was issued on May 19, 2011 by the United States Court of Appeals for the Fourth Circuit in *Horvath v. Bank of New York, N.A.* No. 10-1528, ___ F.3d ___, 2011 WL 1892110 (4th Cir. May 19, 2011). This published opinion concerns a note holder's right to foreclose on a mortgage or deed of trust under state law, particularly the negotiable instrument provisions of the Uniform Commercial Code. This is decision signals a victory for the mortgage industry.

John A. Horvath (Horvath) took out a loan with America's Wholesale Lender in October 2006. As part of that transaction, Horvath executed a promissory note and, to secure Horvath's repayment obligations under the note, a deed of trust in favor of America's Wholesale Lender. Mortgage Electronic Registration Systems, Inc. (MERS) was named as the beneficiary in the deed of trust. The loan was subsequently securitized and in 2009 the Bank of New York, N.A. (BNY) came into possession of the note, indorsed in blank. The opinion states that "[a]s a natural consequence of the securitization process, Horvath's note changed hands. As of 2009, [BNY] possessed Horvath's loan note. The deed of trust, however, remained unchanged in Virginia's real estate records." When Horvath subsequently defaulted, the servicer initiated and completed a non-judicial foreclosure.

Horvath sued BNY and other parties in a quiet title action in state court, claiming that the "splitting, selling, trading, and insuring of the pieces of his mortgage had caused the 'the Deeds of Trust [to] split from the Notes and [become] unenforceable.'" Focusing these allegations on the securitization of the loan, Horvath contended that BNY lacked the right to foreclose because it had never been assigned the deed of trust via a publicly recorded document. Horvath

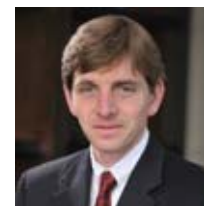
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any other way. If Horvath were correct in asserting that the transfer of a note splits it from the deed of trust, . . . there would be little reason for notes to exist in the first place. One of the defining features of notes is their transferability, . . . but on Horvath's view, transferring a note would strip it from the security that gives it value and render the note largely worthless. This cannot be - and is not - the law.

The Court also held that it was unnecessary under Virginia law for BNY to have recorded a formal assignment of the deed of trust into it prior to foreclosing. A specific Virginia statute provides that an assignee does not have to record an assignment for the transaction to be effective. Although the Court did not specifically address MERS's role in the transaction, it did describe the MERS system as "establishing a consistent beneficiary and thereby further enhancing the ease with which the deed of trust could be transferred." The Court also did not substantially address the timing of the securitization transfers, but very clearly held that securitization did not negate or otherwise impact the enforceability of the note and deed of trust at issue.

The Court's final holding firmly sums up the rationale for affirming BNY's enforcement of the note and underlying deed of trust:

Horvath's briefs are filled with allegations of fraud in the mortgage industry and discussions of the financial crisis that has plagued the country of late. But these seem interposed mainly to distract attention from what in reality is a straightforward commercial case. The court cannot ignore the myriad sources that confirm BNY's authority to take the steps that it did—from the text of the note and deed of trust, to the provisions of the Virginia code, to the centuries of Virginia case law protecting the negotiability of commercial instruments. None of these permits us to grant Horvath undisputed title over his property in return for his default. We thus affirm the judgment of the district court.

The holdings of *Horvath* should be equally applicable in all jurisdictions that have enacted the UCC's provisions in Article 3 regarding negotiable instruments. This case therefore has widespread potential impact as persuasive authority on the note holder's right to enforcement of underlying mortgages or deeds of trust.