UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF KENTUCKY
FRANKFORT

IN RE:

RICKY J. DORSEY, SR. **KAREN A. DORSEY**	**CASE NO. 11-30829**
DEBTORS	
J. JAMES ROGAN, TRUSTEE	**PLAINTIFF**
VS.	**ADVERSARY NO. 12-3010**
VANDERBILT MORTGAGE & FINANCE, INC., et al.	**DEFENDANTS**

ORDER DENYING MOTION TO ALTER, AMEND OR VACATE

This matter is before the Court on Vanderbilt Mortgage & Finance, Inc.'s ("Vanderbilt") Motion to Alter, Amend or Vacate [Doc. 36] (the "Motion to Alter"), the opposition brief [Doc. 38] filed by the Trustee thereto, and Vanderbilt's reply [Doc. 39]. The Motion to Alter addresses the Memorandum Opinion [Doc. 33] and related Order [Doc. 34]. The Motion to Alter requests relief pursuant to Federal Rule of Civil Procedure 59(e), made applicable and supplemented by Federal Rule of Bankruptcy Procedure 9023(e). A hearing was held on June 27, 2013.

The Motion to Alter raises two arguments: (1) The Assignment[1] vested in Vanderbilt the right to enforce the Note; and (2) the language in the Mortgage creates an obligation to pay the lender on par with the Note. Neither argument is persuasive.

A motion pursuant to Rule 59(e) looks to correct a clear error of law, account for newly discovered evidence or an intervening change in the controlling law, or to otherwise prevent manifest injustice. *GenCorp, Inc. v. Am. Int'l Underwriters,* 178 F.3d 804, 834 (6th Cir. 1999). Vanderbilt's arguments do not raise any issue of manifest injustice.

[1] Capitalized terms not otherwise defined herein have the meaning given in the Memorandum Opinion.

The Motion to Alter also does not present newly discovered evidence or a change in the law. Attached to the Motion to Alter is information from the internet provided "for the sole purpose of clarifying the relationship of" Equity One, Inc., Popular Financial Holdings and Popular Financial Services, LLC. Mot. Alter 3, n. 1. This purpose does not suggest the information is newly discovered evidence and is insufficient to make the attachment part of the record.

Regardless, Popular Financial Services, the payee of the original Note, was not a party to the Purchase Agreement or Bill of Sale and the information attached to the Motion to Alter that explains the relationship of Popular Financial Services to the Transferor Parties is no help. The attachments indicate Popular Financial Services was still a separate legal entity from any of the Transferor Parties and those parties could not hold or enforce the Note without some evidence of transfer of those rights.

Therefore, Vanderbilt's arguments only seek to correct what it perceives as a legal error. There was no legal or other error that requires correction. The arguments are addressed here and supplement and confirm the findings and conclusions in the Memorandum Opinion and Order.

1. <u>Summary of Memorandum Opinion and Order</u>.

The Memorandum Opinion recognized Vanderbilt holds the Mortgage, which is properly perfected. The Memorandum Opinion also determined the Trustee could not avoid the Mortgage through his rights as a hypothetical judicial lien creditor. Therefore, a holder or a person in possession of the Note with the rights of a holder are the only entities entitled to enforce the Note and receive the proceeds from the Real Property upon enforcement of the security interest represented by the Mortgage.[2]

[2] At the hearing, counsel for Vanderbilt conceded that Vanderbilt was not a "holder." *See* KY. REV. STAT. ANN. § 355.1-201(u).

Vanderbilt, as assignee of MERS, may assert whatever rights the mortgagee or Nominee has under the Mortgage. A mortgagee may enforce the security interest that is the basis for the mortgage. That does not mean, however, that the mortgagee is entitled to the proceeds of the note, payment of which is secured by the mortgage.

Showing it is entitled to enforce the Mortgage does not prove Vanderbilt is entitled to the proceeds of the underlying Note when the Real Property is sold. The Complaint demanded that Vanderbilt prove not only its rights in the Mortgage, but also the Note. Vanderbilt did not prove it had the right to enforce the Note for the reasons set out in the Memorandum Opinion, and as further discussed herein. Therefore, the Memorandum Opinion and Order stand.

2. The Assignment Did Not Grant Any Rights in the Sale Proceeds to Vanderbilt.

a. The Note and the Mortgage Convey Different Rights.

Vanderbilt characterizes this dispute in what it describes as the "split note category." Vanderbilt asserts the law allows Vanderbilt, as the assignee of MERS (the Nominee and mortgagee), to enforce the Mortgage for the benefit of Vanderbilt. The Memorandum Opinion and Order are not so simply characterized. The analysis does not split the Note and the Mortgage; the Memorandum Opinion recognizes the operative documents gave different rights to each party.

Two separate parties had rights under the Note and the Mortgage when they were created. Popular Financial Services was the "Lender" in the Note; MERS was not a party. Popular Financial Services was the "Lender" under the Mortgage; MERS was the "Nominee" and mortgagee. If the Note had transferred to Vanderbilt in 2008 as asserted, the separation of rights would still have existed. Then, when MERS assigned the Mortgage to Vanderbilt through the Assignment, the separation would have ended because Vanderbilt succeeded to the rights of the Lender, the Nominee and the mortgagee under the Mortgage and it would have held the Note.

The Memorandum Opinion concluded, however, that the Note was not transferred to Vanderbilt in 2008, at least by the Purchase Agreement, Bill of Sale or any other evidence in the record. Therefore, there is still a separation of the rights granted by the Note and the Mortgage. Vanderbilt has MERS' rights as Nominee and mortgagee under the Mortgage, but it has not received the rights of Popular Financial Services pursuant to the Note or Mortgage, so it is not the "Lender" under the Note or the Mortgage.

The separation of rights in the Note and the Mortgage matters because the ability to enforce the security interest does not equate to the right to payment of the underlying secured obligation.

b. Allowing Vanderbilt to Enforce the Mortgage Would Not Change the Result.

Vanderbilt relies on *Royal v. First Interstate Bank* (*In re Trierweiler*), 484 B.R. 783 (B.A.P. 10th Cir. 2012), but the ruling does not conflict with the Memorandum Opinion. It is first recognized that *Royal* involved a note endorsed in blank, which does not exist here. Still, like here, the Tenth Circuit BAP determined the trustee could not use its rights as a bona fide purchaser to avoid the mortgage.

Royal may support Vanderbilt's ability to enforce the Mortgage as the assignee of MERS. The Court could allow Vanderbilt, as assignee of MERS, to pursue the rights of the Nominee and mortgagee under the Mortgage. As argued by Vanderbilt, these rights might even include the right to enforce the security interest evidenced by the Mortgage (*i.e.*, foreclose).[3] This, however, does not give Vanderbilt the right to the proceeds of the sale of the collateral.

Once the Real Property is liquidated, the proceeds must go to pay the secured obligation, *i.e.*, the Note. Vanderbilt's rights as Nominee and mortgagee do not allow it to ignore the law and distribute the proceeds to Vanderbilt absent proof Vanderbilt is a holder or a nonholder in

[3] Allowing a separate action by Vanderbilt is not necessary, as this adversary proceeding gives it a full and fair opportunity to enforce whatever rights it would have if Vanderbilt had initiated the action. *See infra* at Section 3.b.

possession of the Note *with the rights of a holder*. See KY REV. STAT. ANN. § 355-3-301(1) and (2) (emphasis supplied). Vanderbilt, as Nominee and mortgagee must follow the same UCC analysis the Court undertook in the Memorandum Opinion that precludes delivery of the sale proceeds to Vanderbilt as payment on the Note. Mem. Op. 9-13.[4] Therefore, even if the Court would allow Vanderbilt to enforce the Mortgage, this Court would still control distribution of the proceeds of the sale of the collateral – the Real Property.[5]

c. Vanderbilt's Authority to Enforce the Mortgage is in Question.

It is not even clear if Vanderbilt may enforce the Mortgage under these facts. Vanderbilt, as Nominee and mortgagee under the Mortgage, must take instruction from the Lender. The quoted language from the *Royal* decision cited in the Motion to Alter provides in part: "'In other words, as nominee for the lender and its successors and assigns, MERS is a limited agent. That agency relationship is addressed in the MERS membership rules which require MERS to comply with the instructions of the holder of the Note.'" Mot. Alter 5 (quoting 484 B.R. at 791-92).

Popular Financial Services has not appeared and Vanderbilt is not the "Lender" under the Mortgage, so it is not clear what entity has provided instructions to Vanderbilt to enforce the Mortgage. No party has raised authority in this manner and resolution is not necessary to this decision.

d. Vanderbilt Is Not Entitled to the Proceeds of Sale of the Collateral Subject to the Mortgage.

As recognized in the Memorandum Opinion, Kentucky law prevents action on the Mortgage if the underlying debt is not proven. *See Rogan v. Litton Loan Serv., L.P. (In re Collins)*, 456 B.R. 284 (B.A.P. 6th Cir. 2011) (cited extensively in the Memorandum Opinion).

[4] Available at *Rogan v. Vanderbilt Mortg. & Fin., Inc. (In re Dorsey)*, ___ B.R. ___, 2013 WL 1909497, *5-8 (Bankr. E.D. Ky. May 6, 2013).

[5] *See infra* Section 3.a. (addressing duplicate payment).

The BAP in *Collins* recognized a well-settled proposition that: "Under Kentucky law, without evidence of debt, there is no valid, enforceable mortgage." *Id.* at 294; *see also* Mem. Op. 8. While there is a valid note, there is no proof in the record that the party seeking to enforce the Note has any rights thereunder.

Vanderbilt's discussion of the "split note" concept seems to arise from its desire to find relevance in the Mortgage. Ownership of the Note is the real problem in this case. The BAP in *Collins* recognized that a challenge of this nature was better presented as an objection to the claim because the obligation and security interest do exist. *Id.* at 296.

Posturing the dispute as an objection to the claim, *i.e.*, a creditor's failure to prove a right to payment, more clearly shows the issue is not with the existence, perfection or enforcement of the Mortgage, but the Note.[6] The analysis is slightly different from *Collins*, but *Collins* is clearly applicable. In *Collins*, the BAP considered the enforceability of the debts alleged by two different creditors.

As to the first creditor's debt, on remand, this Court was instructed to determine which party held the mortgage on the date the bankruptcy petition was filed and to then determine whether that party could "establish a proper chain of title of the note to establish its right to payment." *Id.* at 297.

As to the second, the BAP found that the trustee had presented a plausible claim for relief where the bank failed to present the note evidencing the debt owed to the bank. *Collins*, 456 B.R. at 295. The BAP provided:

> [I]n the absence of evidence of a note, the second mortgage of which GMAC Mortgage claims to be a beneficial owner and entitled to enforce is subject to attack by the trustee as a hypothetical judicial lien creditor. *See First Nat'l Bank of Boston v. Larson (In re Kennedy Mortg. Co.)*, 17 B.R. 957, 965 (Bankr. D.N.J.

[6] The Trustee did request such relief in the Complaint. Paragraph A, page 4, provides in part: "Defendants Vanderbilt and Popular Financial Services, LLC could not enforce payment of any indebtedness secured by the October 13, 2006 mortgage … ."

> 1982) ("Without the manifestation of the debt, usually evidenced by a note ... the mortgage instrument itself is subject to attack. The lien of a mortgage is regarded as no greater than the actual debt secured.").
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> ...
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> [T]he important point in this proceeding is that the trustee's complaint alleges that *there is no evidence of indebtedness to GMAC Mortgage*. The trustee's allegation, although perhaps inarticulate, is that GMAC Mortgage is not the holder of the note.... *If the trustee is able to prove the facts alleged in his complaint, then as a judicial lien creditor, the trustee would have priority over a creditor who is unable to prove an enforceable mortgage on the date of filing*.

In re Collins, 456 B.R. 284, 295-96 (B.A.P. 6th Cir. 2011) (footnote omitted) (emphasis supplied). That is exactly what the Trustee has proven here. The *Collins* analysis applies to prevent enforcement of the Mortgage because there is no party that may enforce the underlying debt at the time the holder of the Note or a nonholder in possession of the Note with the rights of a holder must step forward.

An analogous dispute existed in *Simmerman v. Ocwen Financial & Mortgage Services, Inc. (In re Simmerman),* 463 B.R. 47, 59 (Bankr. S.D. Ohio 2011). Citing *Collins,* the bankruptcy court in *Simmerman* determined that a chapter 13 debtor had standing to seek disallowance of a claim when the information attached did not show the right to enforce the note and mortgage. The issue is not the ability to bring a foreclosure action, but the need to show a right to payment of the underlying debt obligation.

Other cases addressing standing issues reached similar conclusions. *See Wells Fargo Bank, N.A. v. Heath,* 280 P.3d 328 (Okla. 2012); *Premier Capital, LLC v. Gavin (In re Gavin),* 319 B.R. 27, 53 (B.A.P. 1st Cir. 2004). In *Gavin,* the debtors argued the creditor did not have standing to pursue a discharge action because it failed to demonstrate it owned the note. *Gavin*, 319 B.R. at 30. Although the creditor proved an assignment to it, the creditor did not prove the assignment to its assignor. Therefore, "Premier failed to produce either evidence of the endorsements required to establish its ownership of the Note or substitute evidence permitted

under applicable state law." *Id.* at 32. The BAP then concluded: "Absent such evidence, Premier has failed to establish title to the Note, and thus has no enforceable obligation against the Debtor. Without an enforceable obligation Premier has no claim …." *Id.*

Similarly, the court in *Wells Fargo Bank, N.A. v. Heath*, determined a bank could not foreclose because it did not have the ability to enforce the Note. The note was not indorsed, so the bank was not a holder at the time the foreclosure action was filed. *Heath*, 280 P.3d at 333, 335; *see also Morgan v. HSBC Bank USA NA*, No. 2009-CA-000597-MR, 2011 WL 3207776 (Ct. App. Ky. July 29, 2011) (in an unpublished decision, the Kentucky Court of Appeals determined the claimant had not proved standing to bring a foreclosure action because it could not prove it was the holder of the note when the foreclosure complaint was filed). Vanderbilt has not provided evidence to show it is the Lender entitled to receive payment under the Note

3. <u>The Mortgage Does Not Give Vanderbilt the Right to Collect the Note</u>.

a. <u>The Result in the Memorandum Opinion Avoids the Risk of Duplicate Payment</u>.

The Memorandum Opinion determined Vanderbilt does not have a right to participate in the proceeds of the sale of the Real Property because it did not prove it was a holder or person in possession of the Note with the rights of a holder. KY REV. STAT. ANN. § 355-3-301. The comparison of this adversary proceeding to a state law foreclosure action remains an apt way to explain the impact of the ruling.

The Trustee is in essence foreclosing on the Real Property through his rights and powers as a hypothetical judicial lien creditor. 11 U.S.C. § 544. The Trustee brought any party that he believed might claim an interest in the Real Property into this adversary proceeding as defendants. *See* Compl. 1. The Complaint requires the Defendants to not only prove the validity of their security interest, if any, but also their right to payment of the underlying claim.[7] Compl.

[7] Again, the second part of this request is really an objection to the underlying claim.

4-5. Vanderbilt addressed the first demand, but not the second. *See Heath*, 280 P.3d at 333, 335-36 (under Oklahoma law, a claimant could not initiate foreclosure if it could not prove its right to enforce the note.)

What happens to the proceeds of the Real Property is not "irrelevant," as asserted by Vanderbilt. Mot. Alter 6. A different result would subject the Debtors to the risk of double payment. *See In re Gavin*, 319 B.R. at 33 (a creditor that did not prove chain of title to the note could not recover without showing the debtor was protected from the risk of duplicate payment); *see also Livonia Props. Holdings, L.L.C. v. 12840-12976 Farmington Rd. Holdings, L.L.C.*, 2010 WL 4275305, at *4 (6th Cir. Oct. 28, 2010) (the court determined the debtor was not at risk of duplicate payment because the creditor *proved* a right to the note based on possession *and* a proper chain of assignment). The Memorandum Opinion applied the provisions of the UCC regarding persons entitled to enforce notes, which provisions protect debtors from multiple payments. Mem. Op. 9-13. The Court has jurisdiction over all Debtors' property, so the Court will make certain the sale proceeds go to the proper party and the Debtors are not at risk of duplicate payment.

b. <u>The Mortgage Does Not Represent an Obligation to Pay the Note</u>.

Vanderbilt argues that the Mortgage is sufficient to create an obligation to pay the Note. Essentially, Vanderbilt wants the Court to recognize two negotiable instruments – the Note *and* the Mortgage. Accepting this argument would create a dangerous precedent that would greatly upset existing law dealing with negotiable instruments and secured transactions.

If Vanderbilt's argument succeeds, then any party wishing to collect on a negotiable instrument must only produce a mortgage to receive payment when the collateral is sold. This is contrary to the protections afforded a debtor by the UCC. *See supra* Section 1. The enforcement provisions of the UCC "are designed to provide for the maker a relatively simple way of

determining to whom the obligation is owed and, thus, whom the maker must pay in order to avoid defaulting on the obligation." *Veal v. Am. Home Mortg. Savs., Inc. (In re Veal),* 450 B.R. 897, 912 (B.A.P. 9th Cir. 2011); see also Mem. Op. 9.

The Kentucky cases cited by Vanderbilt, *Prewitt v. Wortham*, 79 Ky. 287 (1881), *Lyons v. Moise's Ex'r.*, 183 S.W.2d 493, 495 (Ky. 1944) and *Hoskins v. Black*, 226 S.W. 384 (Ky. 1920), do not support Vanderbilt's position. *Prewitt* involved the question of whether a five- or fifteen-year statute of limitations applied where there was no evidence of a written obligation to pay. In trying to provide written evidence of the debt so the fifteen-year statute applied, the mortgagee presented the written mortgage as proof. *Prewitt* did not involve a transfer of an obligation to pay and did not reach the issue of who could enforce the covenant to pay if one was still enforceable.

Rather, *Prewitt* determined whether any such covenant was enforceable at all due to the lapse of the five-year statute of limitations based on a contract not in writing. The court concluded that the particular mortgage in that case did not contain a covenant for payment and the debt was barred by the five-year statute. *Prewitt*, 79 Ky. at 290. There was no danger in *Prewitt* of creating a second negotiable instrument and *Prewitt* does not justify such a finding here. Likewise, there was no written note in *Hoskins* and no danger of creating a second negotiable instrument.

Lyons does not remotely support Vanderbilt's argument that a mortgage containing a separate promise to pay constitutes a separate, enforceable contract. Mot. Alter 10. In *Lyons* only one written contract existed. The contract in question was not a mortgage or security instrument. The court was analyzing the contract to determine whether it contained a promise to pay for purposes of applying the five- or fifteen-year statute of limitations. *Lyons*, 183 S.W.2d at

494 (finding that the only issue before the court was which statute of limitations was applicable and that a determination of ownership of the claim was unnecessary to the court's decision).

Further, even if the Mortgage here contains a promise to pay, that promise is made to the "Lender." Vanderbilt was given ample opportunity to, but did not prove that it stepped into the shoes of the "Lender." Treating the Mortgage as a negotiable instrument on par with the Note is not something the law supports and this Court is not willing to stretch the rights granted in the Mortgage to this length. Those changes must come from the legislature.

4. Conclusion.

On this record, Vanderbilt is no different than a stranger to the Note seeking payment thereon. Allowing Vanderbilt to receive the proceeds of a sale of the Real Property is not fair to the Debtors and any legitimate holder of, or person otherwise entitled to enforce, the Note. Vanderbilt has simply not satisfied its burden of proof.

The Motion to Alter is **DENIED**.

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The affixing of this Court's electronic seal below is proof this document has been signed by the Judge and electronically entered by the Clerk in the official record of this case.

Signed By:
Gregory R. Schaaf
Bankruptcy Judge
Dated: Monday, July 01, 2013
(grs)
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