

DEFECTIVE REAL ESTATE DOCUMENTS: WHAT ARE THE CONSEQUENCES?

John C. Murray*

Editors' Synopsis: This Article discusses recent case law regarding whether a recorded but defectively executed or acknowledged mortgage may be deemed valid, whether it imparts constructive notice to, and is entitled to priority over, subsequent judgment creditors and lienholders with validly executed and recorded documents, and particularly, whether a trustee in bankruptcy may avoid the defectively executed mortgage. This Article also addresses the impact of errors in the indexing of real estate documents, the title insurer's liability if the mortgage is deemed invalid because of a defect in it or the underlying note, and whether improperly executed documents should be reformed or deemed invalid.

I. INTRODUCTION	368
II. CASES AND STATUTES UPHOLDING VALIDITY OF DEFECTIVE DOCUMENTS	369
A. The <i>Schwab</i> Decision.....	369
B. The <i>Rothacre</i> and <i>Potter</i> Decisions	370
C. Colorado Statutory Law	371
D. Tennessee Statutory and Case Law.....	372
III. OHIO CASE AND STATUTORY LAW ON DEFECTIVE MORTGAGES	380
A. The <i>Jones</i> Decision	380
B. The <i>Odita</i> Decision.....	382
C. The <i>Kovacs</i> Decision	383
D. Other Recent Ohio Decisions.....	384
IV. OTHER STATE AND FEDERAL DECISIONS DENYING EFFECTIVENESS OF DEFECTIVE MORTGAGE DOCUMENTS	386
A. The <i>Alpine Bank</i> Decision	386
B. The <i>Bucholz</i> Decision	387
C. The <i>Stubbs</i> Decision	387
D. The <i>Rogan</i> Decision.....	388

* Vice President-Special Counsel, First American Title Insurance Company, Chicago, Illinois; B.B.A. 1967, University of Michigan; J.D. 1969, University of Michigan. The author expresses his appreciation to Mark Lee, senior underwriter and counsel with First American Title Insurance Company in Memphis, Tennessee, for his assistance with this article.

E. The <i>Schlarman</i> Decision.....	389
F. The <i>Fisher</i> Decision.....	389
G. The <i>Williams</i> Decision.....	390
V. RECENT DECISIONS ON INDEXING ERRORS (NEW YORK AND OTHER STATES)	391
A. The <i>Coco</i> Decision.....	391
B. The <i>Reiber</i> Decision	392
C. The <i>First Citizens</i> Decision	393
D. Decisions of Other Courts on Misindexed Documents.....	394
VI. TITLE INSURER LIABILITY BASED ON DEFECTIVE DOCUMENTS.....	395
A. The <i>Citicorp Savings</i> Decision	395
B. The <i>McHenry Savings Bank</i> Decision	397
C. The <i>First Federal Savings and Loan</i> Decision	398
D. The <i>Bank of Miami Beach</i> Decision	399
E. The <i>JDC(America)</i> Decision.....	400
VII. DEFECTS INVOLVING EXECUTION OF, OR PARTIES NAMES IN, DOCUMENT	401
A. The <i>Enderle</i> Decision	401
B. The <i>Ethridge</i> Decision	402
C. The <i>Yates</i> Decision	403
D. The <i>In re Head Grading</i> Decision	404
E. The <i>Hooper</i> Decision.....	405
VIII. CONCLUSION	406

I. INTRODUCTION

A flurry of recent case law addresses the issue of whether, notwithstanding a defective execution or acknowledgment (or other defect), a recorded document is still effective for the purpose of imparting constructive notice to other lienholders and judgment creditors who have properly recorded their interests without any defect. The resolution of this issue is extremely important to mortgage lenders, mortgage brokers, issuers and holders of securitized mortgages, and title insurance companies. Resolution of the issue is also critical to determining priorities when a bankruptcy proceeding is filed by or against the mortgagor. Section 544(a) of the Bankruptcy Code (the so-called *Astrong-arm* provision that enables the trustee to invoke state law remedies) provides that, at the commencement of the case, the trustee has the rights of a bona fide purchaser of real property, without regard to any knowledge of the trustee or any creditor, and may avoid an unperfected transfer of land.¹ Furthermore, the trustee generally is deemed to lack notice of a properly recorded, but otherwise defective, mortgage.² But the trustee cannot otherwise avoid a transfer after being put on constructive notice or inquiry of a properly recorded prior claim.³ Applicable state law determines the bankruptcy trustee's status as a bona fide purchaser, pursuant to section 544(b) of the Bankruptcy Code.⁴ Recent case law, both state and federal, generally upholds strict compliance with state law regarding the validity of defective recorded documents and whether they provide sufficient notice to third parties, but some notable

¹ See *In re Sandy Ridge Oil Co.*, 807 F.2d 1332, 1335 (7th Cir. 1986) (Section 544(a) states that a trustee shall be able to avoid an encumbrance that would be voidable by a bona fide purchaser without regard to any knowledge of the trustee or any creditor. The natural interpretation of this language is that actual knowledge of the encumbrance will never prohibit a trustee from invoking ' 544(a)(3).@).

² See, e.g., *Stern. Cont= Assurance Co. (In re Ryan)*, 851 F.2d 502, 508 (1st Cir. 1988) (A[a]n improperly witnessed mortgage does not provide constructive notice.@).

³ See, e.g., *McCannon v. Marston*, 679 F.2d 13, 16B17 (3d Cir. 1982) (holding bankruptcy trustee to constructive/inquiry notice).

⁴ See, e.g., *Owen-Ames-Kimball Co. v. Mich. Lithographing Co. (In re Mich. Lithographing Co.)*, 997 F.2d 1158, 1159 (6th Cir. 1993) (AState law governs who may be a bona fide purchaser.@); *JMJ Bldg. Co. of Cal. v. Bankers Trust Co. (In re MJM Bldg. Co.)*, 250 B.R. 437, 440 (Bankr. M.D. Fla. 2000) (AState law . . . determines who may qualify as a bona fide purchaser.@).

exceptions exist, based on the specific facts of the case and applicable state law.

II. CASES AND STATUTES UPHOLDING VALIDITY OF DEFECTIVE DOCUMENTS

Relatively few reported cases expressly uphold the validity of a defectively executed or acknowledged mortgage. These cases generally involve either special facts or the application of specific state statutes.

A. The *Schwab* Decision

In *Schwab v. GMAC Mortgage Corp.*,⁵ the Third Circuit held that, under Pennsylvania law, the fact that the notary public's embossed seal was not visible in the acknowledgment on the document filed in the county recorder of deeds office did not affect the lien of a mortgage.⁶ The plaintiff, a Chapter 7 trustee, filed an adversary action to avoid a mortgage owned by the defendant mortgagee because the copy of the mortgage in the recorder's office did not contain the embossment of the notary public who had acknowledged the execution. The bankruptcy court entered summary judgment in favor of the mortgagee. On appeal, the United States District Court for the Middle District of Pennsylvania affirmed the bankruptcy court's ruling.⁷ The trustee then appealed the ruling of the district court. The Third Circuit noted that the original mortgage had been lost, and the copy on record did not reveal whether the notary public's embossment had been applied to the original document.⁸

The trustee relied on title 57, section 158 of the Pennsylvania Consolidated Statutes Annotated, which requires a notary public to have an official seal in the form of a rubber stamp and that the seal be placed near the notary's signature on the document in a manner capable of photographic reproduction.⁹ But the statute further requires that documents bear a legibly embossed impression, which need not be capable of photographic reproduction.¹⁰ Despite the requirement of an embossed seal, the Third Circuit determined that the Pennsylvania Legislature considered the recording of a deed or mortgage to be adequate notice to the public when

⁵ 333 F.3d 135 (3d Cir. 2003).

⁶ *See id.* at 138.

⁷ *See id.* at 137.

⁸ *See id.*

⁹ *See* 57 PA. STAT. ANN. ' 158 (West Supp. 2007).

¹⁰ *See id.* ' 158(b).

the acknowledgment includes only the rubber stamp seal that is visible on the copy of the document.¹¹ The Third Circuit therefore held that the fact that the notary public's embossed seal was not visible in the acknowledgment on the document filed in the county recorder of deeds office did not affect the mortgage lien.¹²

B. The *Rothacre* and *Potter* Decisions

¹¹ *Schwab*, 333 F.3d at 138.

¹² *See id.*

In *Kendrick v. Rothacre (In re Rothacre)*,¹³ the bankruptcy court held that where a mortgage only attached the description of the property as an exhibit, the bankruptcy trustee could not avoid the mortgage as a fatal defect under section 446.060(1) of the Kentucky Revised Statutes because the description could be found by using information on the face of the mortgage and by reference to extrinsic evidence.¹⁴ The Second Circuit in *Mortgage Lenders Network, USA v. Sensenich (In re Potter)*¹⁵ held that, in accordance with certification of the issue to the Vermont Supreme Court, recording of a foreclosure complaint and issuance of a foreclosure decree provided constructive notice to purchasers of the mortgage and made the mortgage and foreclosure decree binding on subsequent purchasers, even though no one witnessed the recorded mortgage.¹⁶

C. Colorado Statutory Law

A defective acknowledgment will not cause a document to be invalid in Colorado. Further, an unacknowledged or defectively acknowledged instrument that is properly recorded constitutes notice to all persons or classes of persons claiming any interest in said property.¹⁷ The statute may also be helpful because it provides that a defectively acknowledged (or unacknowledged) instrument that has been of record for 10 years is deemed properly acknowledged.¹⁸

The following is a posting by Professor Dale Whitman to the DIRT listserv moderated by Professor Patrick Randolph at the University of Missouri-BKansas City Law School, replying to a post by a Colorado attorney whose lender client was (rightfully) concerned about the effectiveness of its mortgage, which had not been notarized in the presence of the mortgagor. Professor Whitman, while not interpreting the aforementioned Colorado statute, makes the point that even if the

¹³ 326 B.R. 398 (Bankr. E.D. Ky. 2005).

¹⁴ See *id.* at 401. KY. REV. STAT. ANN. ' 446.060(1) (LexisNexis 1999) states that AWhen the law requires any writing to be signed by a party thereto, it shall not be deemed to be signed unless the signature is subscribed at the end or close of the writing.@ The bankruptcy trustee contended that only the pages of the Mortgage that appeared before the debtors= signatures could be considered in making a determination that the Mortgage did or did not provide constructive notice to third parties and that the legal description that followed the signatures was of no consequence.

¹⁵ 393 F.3d 97 (2d Cir. 2004).

¹⁶ See *id.* at 98.

¹⁷ COLO. REV. STAT. ' 38-35-106(1) (2006).

¹⁸ See *id.* ' 38-35-106(2).

acknowledgment of the instrument is defective, and therefore deemed not properly recorded under Colorado law, it remains valid and enforceable as between the parties to the document:

The notarization (literally, acknowledgment) does appear to have been improper, since the signatory is supposed to appear before the notary, and that didn't happen here. But so what? I'm not sure about Colorado, but in most states acknowledgment is necessary, not for validity of the instrument, but only for recordation. So someone might conclude that the deed of trust was not properly recorded, or was not entitled to be recorded. Again, so what? Recording is unnecessary between the parties, and is relevant only if the trustor under the deed of trust later made or suffered a junior lien or other junior encumbrance on the property. If that didn't happen (and it appears from your facts that it didn't), then whether the deed of trust was recorded properly, or indeed recorded at all, is completely irrelevant. The third party bidder in this case has rights that derive from a prior lienor, not one subsequent to your client's lien. Moreover, it is likely that the third party bidder had a title report on the property showing your client's lien, and therefore had actual knowledge of it when bidding. I don't think the supposed error in the acknowledgment has any legal relevance at all. Of course, I would have to revise my opinion if the redemption statute in Colorado allows redemption only by persons whose interests are properly recorded.¹⁹

D. Tennessee Statutory and Case Law

Tennessee generally has been lenient to holders of mortgages and other legal documents that contain defective acknowledgments. The following is an excerpt from comments by Bert Rush, Senior Vice President at First American Title Insurance Company:

The Tennessee Supreme Court has held that a certificate of acknowledgment . . . which fails to state that the notary has

¹⁹ Posting of Dale Whitman, WhitmanD@missouri.edu, to <http://dirt.umkc.edu> (Sept. 24, 2002) (edited version of posting on file with author).

identified the signing party may nevertheless be sufficient under Tennessee law.

. . . [I]n recent years we've seen a flurry of cases from Tennessee concerning defective [acknowledgments]. In 2000, the Tennessee Supremes held that a deed of trust recorded without a notary's seal was void Later, in 2002, the Supreme Court held that [an acknowledgment] containing a false statement about appearance of a signing party, who in fact did not appear but whose signature was supplied under a power of attorney, was invalid.²⁰

*In re Akins*²¹ concerned the following facts: Ronald L. Akins, Sr., borrowed \$175,000 from Community Trust & Banking Company, giving a deed of trust against property in Bradley County, which was promptly recorded. The certificate of acknowledgment recited in part: AI, Tammy Bentley, a Notary Public of the county and state first above written, do hereby certify that Ronald L. Akins, unmarried, personally appeared before me this day and acknowledged the execution of the foregoing instrument.²² Later, Akins filed Chapter 7 bankruptcy and a trustee was appointed. The trustee filed an adversary proceeding seeking to invalidate the deed of trust under section 544 of the Bankruptcy Code.²³

In his complaint, the trustee claimed the deed of trust was not perfected, and thus was avoidable, because the certificate of acknowledgment did not adequately demonstrate the notary's knowledge of the identity of the person appearing before her.²⁴ In other words, the acknowledgment did not contain a recital such as Awith whom I am personally acquainted (or proved to me on the basis of satisfactory evidence)@ or Ato me known to be

²⁰ Posting of Bert Rush to <http://firstam.com/landsakes/html/email/102203notr.html> (Oct. 22, 2003). The case referred to in the first sentence of the above quotation is *Limor v. Fleet Mortg. Group (In re Marsh)* 12 S.W.3d 449 (Tenn. 2000). The case referred to in the last sentence of the above quotation is *Lemeh v. EMC Mortg. Corp. (In re Crim)*, 81 S.W.3d 764 (Tenn. 2002).

²¹ 87 S.W.3d 488 (Tenn. 2002).

²² *In re Akins*, 87 S.W.3d at 490.

²³ *See id.* Section 544, otherwise known as the Atrustee avoiding power,@ allows a trustee or debtor-in-possession to avoid an interest in the debtor's real property that is not perfected as of the commencement of bankruptcy by giving the trustee rights of a hypothetical judgment lien creditor or bona fide purchaser as to the debtor's property as of the date of commencement of the bankruptcy. *See* 11 U.S.C. ' 544 (2004).

²⁴ *In re Akins*, 87 S.W.3d at 491.

the person(s) described in and who executed the foregoing instrument.²⁵
The trustee argued section 66-22-107(a)B(b) of the Tennessee Code
required such recital.²⁶

²⁵ *Id.* at 492.

²⁶ *See id.*

The bankruptcy court certified the question of whether the certificate was valid to the Tennessee Supreme Court. The supreme court held the certificate valid, finding that it satisfied a substantial compliance test for acknowledgments embodied in section 66-26-113, and also that it passed an intent test set forth in section 66-22-114(b) of the Tennessee Code.²⁷

The court began its analysis by acknowledging older Tennessee cases, which interpreted substantial compliance language of section 66-22-113 to make a statutorily prescribed "magic words" . . . practically indispensable to a certificate of acknowledgment.²⁸ Under these cases, almost any missing recital could be fatal. But the court noted that the legislature relaxed the requirements beginning in 1983, first by amending sections 66-22-106 and 66-22-107(a) of the Tennessee Code to permit identification of signing parties by various forms of satisfactory evidence (such as a government issued passport or driver's license);²⁹ then by adding a subsection (d) to section 66-22-106, saying that "A(n) officer who has taken an acknowledgment pursuant to this section shall be presumed to have operated in accordance with the provisions of this chapter";³⁰ and later (in 1987) by enacting section 66-22-114(b) to provide that no specific form or wording shall be required for a certificate (the intent test).³¹

In light of these changes, the court gave the substantial compliance language of section 66-22-113 a new slant. Mainly, courts now must presume that a notary's actions are regular so long as essential requirements appear to have been satisfied. In this case, the court said, it can reasonably be inferred that Mr. Akins was in some way known to the notary because she included the word "unmarried" in the certificate.³² This identification, said the court, satisfies the substantial compliance test.³³

Likewise, the court said that the certificate of acknowledgment, taken together with the signature of Mr. Akins over his typewritten name, is sufficient to show his intent to acknowledge his signature on the deed of trust. This evidence satisfies the intent test of section 66-22-114(b). With

²⁷ See *id.* at 496.

²⁸ *Id.* at 493.

²⁹ See *id.* at 494.

³⁰ *Id.* (quoting TENN. CODE ANN. ' 66-22-106(d) (2004)).

³¹ See *id.* at 495.

³² *Id.*

³³ *Id.*

that, the court returned the case to the bankruptcy court for further proceedings.³⁴

³⁴ *See id.* at 496.

In re Akins is a valuable decision because the court's reasoning and interpretation of statutes may be applied to many other situations involving defective certificates of acknowledgment. The decision promotes certainty and reliability of land records in the Volunteer State. As the court stated, to rule otherwise would put form over substance.³⁵

The same result should obtain in other states, although statutes elsewhere may be less helpful than they proved to be in Tennessee. In states with weak statutes, bringing about legislative changes would be a worthwhile project for land title and state bar associations.

Tennessee statutory law contains specific acknowledgment forms, which experienced attorneys in Tennessee generally recommend using for documents to be recorded in Tennessee. Even though there may be case law to support an argument that a particular nonconforming acknowledgment is sufficient, using the statutory forms likely avoids having to make the argument.

³⁵ *Id.* at 495.

However, in *Gregory v. Ocwen Federal Bank (In re Biggs)*,³⁶ the Sixth Circuit held that, where the debtors executed a deed of trust to a creditor that omitted the debtors' names on the acknowledgment form, the deed of trust was invalid.³⁷ The court ruled that the creditor could not satisfy the intent test under section 66-26-114(b) of the Tennessee Code because the notary named no one in the certificate of acknowledgment, and the court could not determine who, if anyone, intended to acknowledge the signatures on the deed of trust.³⁸ The court noted that section 66-26-114(b) requires only that a certificate of acknowledgment clearly evidence the signer's intent to authenticate, acknowledge or verify a document; the intent at issue goes to the person or persons named in the acknowledgment, not the notary.³⁹ The Sixth Circuit agreed with the lower courts that a deed of trust that did not name the parties acknowledging their signatures met neither the substantial compliance nor the intent test (under the respective statutory provisions set forth above), and thus was invalid.⁴⁰ In so holding, with respect to the substantial compliance test, the court stated that it addresses the unintentional omission of *words* by the officer taking an acknowledgment, not the unintentional omission of the *names* of the acknowledging individuals.⁴¹ As for the intent test, the court held that when no one is named in the certificate of acknowledgment, it cannot be determined who, if anyone, intended to acknowledge the signatures on the

³⁶ 377 F.3d 515 (6th Cir. 2004).

³⁷ *See id.* at 519.

³⁸ *See id.* at 520B21.

³⁹ *Id.* at 521 (quoting *In re Akins*, 87 S.W.3d at 495).

⁴⁰ *See id.* at 519B21.

⁴¹ *Id.* at 519 (quoting *In re Akins*, 87 S.W.3d at 493).

deed of trust.⁴² The court stated that A[f]ar from being a finicky exaltation of form over substance, the requirement that the grantors' names appear on the acknowledgment is essential to giving the acknowledgment statute the modest substance that the Tennessee legislature thought it deserved.⁴³

⁴² *Id.* at 521.

⁴³ *Id.* at 520.

In *In re Bushee*,⁴⁴ the creditor bank moved for relief from the bankruptcy automatic stay so that it could foreclose its mortgage lien on the debtors' residence held in tenancy by the entirety.⁴⁵ The trustee sought to avoid the lien due to a faulty acknowledgment of one debtor's signature.⁴⁶ The debtor husband's signature was properly acknowledged on the deed of trust, but his wife's signature did not contain a complete acknowledgment clause.⁴⁷ Furthermore, the notary had witnessed the document on a line reserved for a debtor's signature.⁴⁸ The trustee argued that when the party to an improperly acknowledged deed of trust filed for bankruptcy, it placed in issue the validity of the creditor bank's lien against her interest in the real property.⁴⁹ The bankruptcy court considered a number of cases involving faulty acknowledgments under Tennessee law and decided that the language contained in the certificate of acknowledgment of the wife's signature substantially complied with the statutory forms, but it did not clearly evidence her intent to authenticate and acknowledge her signature on the deed of trust.⁵⁰ The defect in the acknowledgment meant that, as to the trustee, the creditor bank's lien was perfected only as to the husband's survivorship interest and not as to the parties' fee simple interest in the tenancy by the entirety. The court found that the trustee's interest held through the debtor wife was superior to the creditor's interest.⁵¹ The trustee therefore could partially avoid the mortgage lien, but the creditor bank could foreclose its lien encumbering the survivorship interest of the debtor husband as burdensome and insubstantial, and the trustee had to abandon that survivorship interest.⁵²

In response to the increasing frequency of avoided transfers in Tennessee because of defective notary acknowledgments, the Tennessee legislature enacted savings statutes in 2005, one of which states as follows:

The unintentional omission by the clerk or other officer of any words in a certificate of an acknowledgment, or

⁴⁴ 319 B.R. 542 (Bankr. E.D. Tenn. 2004).

⁴⁵ *See id.* at 544.

⁴⁶ *See id.*

⁴⁷ *See id.* at 545.

⁴⁸ *See id.*

⁴⁹ *See id.* at 546.

⁵⁰ *See id.* at 548B51.

⁵¹ *See id.* at 551.

⁵² *See id.* at 553.

probate of any deed or other instrument, shall in nowise vitiate the validity of the deed, . . . but the same shall be good and valid to all intents and purposes, if the substance of the authentication required by law is in the certificate.⁵³

⁵³ TENN. CODE ANN. ' 66-26-113 (Supp. 2006). See also TENN. CODE ANN. ' 66-26-114(b). The statute sets forth the intent test as follows:

Any certificate clearly evidencing intent to authenticate, acknowledge or verify a document shall constitute a valid certificate of acknowledgment for purposes of this chapter and for any other purposes for which such certificate may be used under the law. It is the legislative intent that no specific form or wording be required in such certificate and that the ownership of property, or the determination of any other right or obligation, shall not be affected by the inclusion or omission of any specific words. *Id.*

In *Mostoller v. Equity One, Inc. (In re Hickman)*,⁵⁴ the bankruptcy trustee sought to avoid, pursuant to section 544(a) of the Bankruptcy Code, a deed of trust to Equity One, Inc. (Equity One) encumbering the real property of the debtors based on an allegedly defective acknowledgment in the deed of trust. The deed of trust, in the amount of \$51,472, was dated September 22, 2004 and recorded on September 24, 2004. The trustee asserted that omission of the debtors' names in the acknowledgment on the deed of trust violated Tennessee statutory and Sixth Circuit authority, making the lien avoidable. Equity One argued that the applicable Tennessee recording statutes had been amended to have retroactive effect, therefore curing any defect in the acknowledgment. The court found that under Tennessee law as it existed in 2004 (when the deed of trust was executed and acknowledged), Tennessee operated under the substantial compliance standard, whereby an acknowledgment was nonetheless valid as long as it complied in either substance or intent with the certificate of acknowledgment form requirements of applicable Tennessee law.⁵⁵

The court, after citing and describing the holdings in the Tennessee cases mentioned above, noted that in 2005 the Tennessee General Assembly amended section 66-24-101 of the Tennessee Code by adding subsections (e) and (f), to be effective on June 6, 2005.⁵⁶ Subsection (e) provides that the county register may refuse to register any interest unless it is properly acknowledged or proved under otherwise applicable Tennessee law.⁵⁷ If the instrument conveys any interest in real property, including any lien on the property, any such instrument not so acknowledged, approved, or validly registered will nonetheless be deemed validly registered under applicable statutory requirements, and all interested parties will be deemed to be on constructive notice of the contents of the instrument.⁵⁸ Subsection (f) provides that subsection (e) applies to instruments of record after June 6, 2005, but if the relative priorities of conflicting claims to real estate were established at a time prior to June 6, 2005, the law applicable to such claims at such time determines their priority.⁵⁹

⁵⁴ No. 06-3163, 2007 WL 1306473 (Bankr. E.D. Tenn., May 2, 2007).

⁵⁵ See TENN. CODE ANN. ' 66-22-107 (2004).

⁵⁶ See *In re Hickman*, 2007 WL 1306473, at *3.

⁵⁷ See Tenn. Code Ann. ' 66-24-101(e) (Supp. 2006).

⁵⁸ See *id.*

⁵⁹ See *id.* ' 101(f). Subsections (e) and (f) of section 66-24-101 read as follows:

(e) Unless an instrument is acknowledged or proved, as provided in chapter 22 of this title, or other applicable law:

(1) The county register may refuse to register or note the instrument for registration; and

(2) If the instrument conveys any interest in real property, including any lien on the property, no purchaser shall be required to accept delivery of the instrument. If, however, an instrument not so acknowledged or proved is otherwise validly registered, the instrument shall be deemed to be validly registered for the purposes of ' ' 66-26-102 and 66-26-103, and in full compliance with all statutory requirements set forth in ' 66-22-101, and all interested parties shall be on constructive notice of the contents of the instrument.

(f) Subsection (e) shall apply to all instruments of record on or after June 6, 2005. However, if the relative priorities of conflicting claims to real property were established at a time prior to June 6, 2005, the law applicable to such claims at such time shall determine their priority.

Id. ' 101(e)B(f).

The court ruled that the 2005 amendments to section 66-24-101 applied to defeat the trustee's avoidance claim and that Equity One's deed of trust was deemed to be validly registered. The court noted that subsection (f) provides that subsection (e) applies to all instruments *of record* on or after [June 6, 2005].⁶⁰ According to the court, A[s]uch language compels a retroactive application of the statute to any and all instruments that have been recorded on or before June 6, 2005.⁶¹ Therefore, the court reasoned, because the trustee succeeded to her rights under section 544 of the Bankruptcy Code on the date the debtors filed their Chapter 7 bankruptcy proceeding (March 2, 2006) she could not avoid the Equity One deed of trust, which had been accepted and recorded by the register of deeds on September 24, 2004.⁶² The court held that, in this case, the trustee's status as a judgment lien creditor was subject to the provisions of section 66-24-101(f), and she may not avoid Equity One's >validly recorded= Deed of Trust on the basis that it was improperly acknowledged.⁶³

As noted above, in *In re Bushee*, which was decided prior to the 2005 amendments to section 66-24-101 of the Tennessee Code, the court held that the spouse's acknowledgment was defective and therefore the lien attached only to a survivorship interest of the spouse with a correct acknowledgment.⁶⁴

Combining the *Bushee* and *Hickman* decisions, it seems that perhaps the only remaining issue in Tennessee is: if the deed of trust is executed by both spouses, yet only one of the signatures is acknowledged (somehow completely omitting the other acknowledgment) and it is recorded, does the lien attach only to a survivorship interest?

The *Hickman* case also makes clear that, if not for the strong desire of bankruptcy trustees and debtors-in-possession to avoid mortgage liens and

⁶⁰ *In re Hickman*, 2007 WL 1306473, at *4.

⁶¹ *Id.*

⁶² *See id.*

⁶³ *Id.*

⁶⁴ *See In re Bushee*, 319 B.R. 542, 551 (Bankr. E.D. Tenn. 2004).

make additional money available for unsecured creditors of the bankruptcy estate, many of these cases would never have been litigated. What about equitable issues? After all, in many of these cases the mortgagee disbursed the money to the mortgagor-debtor, and the parties treated the transaction as a valid secured loan for a substantial period of time. But as bankruptcy practitioners know, the number of payments or length of time between mortgage origination and the borrower=s bankruptcy are not relevant to the operation of section 544 of the Bankruptcy Code.

As noted elsewhere in this Article, the existence of this power and the willingness and incentive of the trustee or debtor-in-possession to wield it (the amount of the trustee=s compensation often depends on the amount of money brought into the estate for distribution to creditors) make it extremely important for secured lenders to ascertain that the documents evidencing their security interests in borrowers= collateral are properly executed, filed, and recorded to avoid subsequent perfection or priority challenges.

III. OHIO CASE AND STATUTORY LAW ON DEFECTIVE MORTGAGES

A number of recent Ohio cases address the effect of a defective mortgage, perhaps as a result of Ohio=s adoption of special legislation specifically designed to address this issue. These cases have all held that defective documents fail to impart constructive notice to third parties under applicable Ohio law.

A. The *Jones* Decision

In *Boberschmidt v. Society National Bank (In re Jones)*,⁶⁵ one of the debtors, Michael N. Jones, filed an affidavit (apparently in connection with the state foreclosure proceedings) stating that he and his wife had signed the mortgage to the lender, Key Bank (Key), at their home with no witnesses or notarization of their signatures, and returned it to Key by regular mail. The Seventh Circuit noted that the mortgage, upon recording, contained the signatures of two witnesses, a completed acknowledgment, and the notary=s seal.⁶⁶ Key did not dispute or contradict these facts. Key also did not dispute the finding of the bankruptcy court that because of these actions,

⁶⁵ 226 F.3d 917 (7th Cir. 2000).

⁶⁶ *See id.* at 919.

Key=s mortgage had not been properly perfected under applicable Ohio law.⁶⁷

⁶⁷ *See id.* at 921. Under section 5301.01 of the Ohio Code, the mortgagor must sign the mortgage in the presence of two witnesses, and a notary public or certain designated public officials must acknowledge it. *See* OHIO REV. CODE ANN. ' 5301.01 (LexisNexis 2004 & Supp. 2007).

Key argued, however, that even if the mortgage was defective under Ohio law, the foreclosure sale and the distribution of the sale proceeds prevented avoidance of the sale as a preferential transfer under section 547 of the Bankruptcy Code. Key also asserted that no transfer had occurred under section 547(b), and that Key had not received more than its entitlement under the debtors' Chapter 7 bankruptcy proceeding.⁶⁸ The Seventh Circuit ruled that the foreclosure sale of the debtors' residence, the confirmation of the sale, the order of distribution of the sale proceeds, and the payment of the proceeds to Key (all within the statutory preference period) clearly constitute a transfer of the Debtors' interest in property.⁶⁹ The Seventh Circuit also stated that, the fact that the transfer was made pursuant to a state court judgment rather than voluntarily does not alter our analysis.⁷⁰

The Seventh Circuit dismissed the argument that, as a secured creditor, Key was entitled to the foreclosure sale proceeds of its security in the Chapter 7 bankruptcy proceeding. The court held that because it had already ruled that the trustee could relitigate the validity of the mortgage and because Key's mortgage was concededly an unperfected interest and therefore unenforceable against the trustee as an unsecured creditor, Key was entitled only to its proportionate share of the available proceeds of the bankruptcy estate.⁷¹ The court relied on Ohio law for the proposition that Key's security interest was unperfected at the time of the debtors' bankruptcy filing, which would permit the trustee to avoid the security interest. According to the court, Key Bank does not dispute the finding that it held an unperfected security interest based on the fact that the mortgage was defective under OHIO REV. CODE ANN. ' 5301.01, nor does it contend that the foreclosure proceedings served to perfect its interest.⁷²

⁶⁸ See *In re Jones*, 226 F.3d at 920.

⁶⁹ *Id.* at 921.

⁷⁰ *Id.*

⁷¹ See *id.* at 921B22.

⁷² *Id.* at 921.

Many states have statutes similar to Ohio's regarding the necessity for witnesses and notarizations of the signatures of the parties to an instrument conveying an interest in real property. But as the Seventh Circuit noted, in the absence of fraud, an instrument which fails to satisfy ' 5301.01 is nevertheless valid between the parties to the instrument.⁷³ In January 2002, Ohio enacted clarifying legislation to correct perceived deficiencies in a new law that eliminated the requirement for two witnesses on recordable documents. The new law contained a confusing requirement that statutory form documents be signed under penalty of perjury. The corrective legislation removed the penalty of perjury language from the new law and made no changes to the standard Ohio acknowledgment forms.⁷⁴

B. The *Odita* Decision

In *Mortgage Electronic Registration Systems v. Odita*,⁷⁵ the Ohio Court of Appeals, in a lien-priority dispute between two mortgage lenders, ruled that a later mortgage had priority even though the mortgagee under that mortgage had actual notice of the first mortgage because the signature of one of the mortgagors was not properly notarized in the previously recorded mortgage (the original mortgage was executed and notarized showing the president of the corporate borrower in his individual capacity, and not as the president of the borrower).⁷⁶ The Ohio appellate court, reversing the trial court, held that under section 5301.25 of the Ohio Code, the recording of a defectively executed mortgage did not establish a lien with priority over subsequently recorded mortgages properly executed in accordance with the provisions of section 5301.01, even where a subsequent mortgage was executed with actual knowledge of the prior defectively executed mortgage.⁷⁷ The court further ruled that the exception in section 5301.25, regarding knowledge of the existence of an unrecorded prior mortgage, applied only to situations where the prior unrecorded mortgage was properly executed and valid.⁷⁸ Therefore, a subsequent mortgagee with

⁷³ *Id.* at 920 (citation omitted) (quoting *Basil v. Vincello*, 553 N.E.2d 602 (Ohio 1990)).

⁷⁴ See OHIO REV. CODE ANN. ' 5302.05 and ' 5302.12 (LexisNexis 2004) (statutory warranty deed and statutory mortgage form no longer require signature to be signed under penalty of perjury).

⁷⁵ 822 N.E.2d 821 (Ohio Ct. App. 2004).

⁷⁶ See *id.* at 822, 828.

⁷⁷ See *id.* at 826, 828.

⁷⁸ See *id.* at 826.

actual knowledge of a prior defectively executed mortgage had priority. The appellate court further held that the trial court erred in permitting reformation, which was not an available remedy for a defectively executed mortgage.⁷⁹

C. The *Kovacs* Decision

⁷⁹ See *id.* at 830.

In *Kovacs v. First Union Home Equity Bank (In re Huffman)*,⁸⁰ the Sixth Circuit held that the three mortgages at issue were not properly witnessed and, thus, under former section 5301.01 of the Ohio Code,⁸¹ the bankruptcy trustee would have been entitled to avoid them.⁸² In the process, the Sixth Circuit determined that subsequent changes in Ohio law did not validate the execution of the mortgages.⁸³ Section 5301.234, which was in effect at the time the mortgages were executed and later repealed, provided that the recording of a mortgage was constructive notice to all persons.⁸⁴ However, the Sixth Circuit reasoned that because section 5301.234 was unconstitutional due to its violation of the one-subject rule under the Ohio constitution, it did not bar the trustee from avoiding the mortgages.⁸⁵ Therefore, the law in effect at the time the cases started was the repealed version of section 5301.01 (enacted after the mortgages were executed), which required the presence of two witnesses at the signing of the mortgages.⁸⁶ Under the amended version of section 5301.01 (enacted after the mortgages were executed), a mortgage executed prior to the amendment's effective date is presumed valid even if not attested by two witnesses, unless the mortgagor's signature thereon was obtained by

⁸⁰ 369 F.3d 972 (6th Cir. 2004).

⁸¹ See OHIO REV. CODE ANN. § 5301.01 (repealed 2002).

⁸² See *In re Huffman*, 369 F.3d at 974.

⁸³ See *id.* at 977.

⁸⁴ See *id.* at 974.

⁸⁵ See *id.* at 976.

⁸⁶ See *id.* at 976B77.

fraud.⁸⁷ Moreover, the recording of the mortgage in the office of the county recorder is constructive notice of the instrument to all persons.⁸⁸

⁸⁷ See OHIO REV. CODE ANN. ' 5301.01(B)(1)(a) (LexisNexis 2004 & Supp. 2007).

⁸⁸ See *id.* ' 5301.01(B)(1)(b).

The Sixth Circuit, despite its express retroactive application, determined that the amended version of section 5301.01 did not save the mortgages because the statute could not apply retroactively to impair the trustee's vested rights.⁸⁹ The court found that only properly executed mortgages take priority over a bona fide purchaser under Ohio law.⁹⁰ The former section 5301.01 required the presence of two witnesses at the signing of any mortgage. The Sixth Circuit noted that the three mortgages at issue were not properly witnessed and, thus, under the former law the trustee would be entitled to avoid them.⁹¹ The question was whether subsequent changes in Ohio law validated the execution of the mortgages. The Sixth Circuit held that the amended version of section 5301.01, though retroactive by its terms, could not apply retroactively to impair the bankruptcy trustee's vested rights.⁹² The statute specifically protects vested rights; section 5301.01(B)(2) states that section 5301.01(B)(1) does not affect any accrued substantive rights or vested rights that came into existence prior to [the effective date of this amendment.]⁹³

D. Other Recent Ohio Decisions

⁸⁹ See *In re Huffman*, 369 F.3d at 977.

⁹⁰ See *id.* at 974 (citing OHIO REV. CODE ANN. ' 5301.25 (LexisNexis 2004 & Supp. 2007)).

⁹¹ *Id.*

⁹² See *id.* at 977.

⁹³ *Id.* (quoting ' 5301.01(B)(2)). See also *Suhar v. Burns (In re Burns)*, 322 F.3d 421, 427 (6th Cir. 2003) (The Trustee properly avoided the mortgage for being improperly witnessed. Ohio Revised Code ' 5301.234, which prior to its repeal provided recorded mortgages an irrebuttable presumption of validity, does not govern this case, which involves a bankruptcy petition filed before the short-lived ' 5301.234 became effective.@).

Several other recent Ohio bankruptcy cases also have addressed the issue of the validity of defective mortgages and have permitted the bankruptcy trustee to void the lender=s security interest. *Monnie v. Field (In re Bross)*⁹⁴ concluded that a bankruptcy trustee could avoid a mortgage that the court found defective because the executing debtor did not sign it.⁹⁵ The fact that the debtor had initialed the bottom of each page of the document was irrelevant and did not constitute substantial compliance under section 5301.01 of the Ohio Code. The court found that because the mortgage was not signed, the debtor=s intention to execute the mortgage was not manifest.⁹⁶ In *Field v. Wheeler (In re Wheeler)*,⁹⁷ both the debtor and her husband signed the mortgage, but the notary did not certify the acknowledgment of the debtor=s signature.⁹⁸ The court granted summary judgment to the bankruptcy trustee to void the debtor=s interest in the property, finding that the mortgage did not substantially comply with section 5301.01 and that the defectively executed mortgage did not provide actual or constructive notice to subsequent bona fide purchasers because the notary public did not certify the acknowledgment of the debtor=s signature.⁹⁹ *Resiser v. Household Realty Corp. (In re Madden)*¹⁰⁰ ruled that the bankruptcy trustee could avoid the defendant=s first mortgage because the debtor had failed to sign the recorded version.¹⁰¹ Under Ohio law, a defectively executed mortgage was invalid on its face and not entitled to recordCa recorded mortgage would be treated as though it had not been recorded. The court refused to reform the document in favor of mortgage holder.¹⁰² In *Porter Drywall Co. v. Haven, Inc. (In re Haven, Inc.)*,¹⁰³ the mortgage was properly witnessed, but the signature page containing witnesses= signatures as well as the acknowledgment was replaced by the signature page from the Construction Loan Agreement when the instrument

⁹⁴ No. C-1-06-172, 2006 U.S. Dist. LEXIS 57449 (S.D. Ohio Aug. 16, 2006).

⁹⁵ *See id.* at *14B15.

⁹⁶ *See id.* at *14.

⁹⁷ No. 1:05-CV-805, 2006 U.S. Dist. LEXIS 38733 (D. Ohio June 12, 2006).

⁹⁸ *See id.* at *1B3.

⁹⁹ *See id.* at *10.

¹⁰⁰ No. 02-38219, 2005 Bankr. LEXIS 2908 (Bankr. S.D. Ohio June 7, 2005).

¹⁰¹ *See id.* at *11.

¹⁰² *See id.* at *13.

¹⁰³ No. 04-8058, 2005 Bankr. LEXIS 541 (B.A.P. 6th Cir. Apr. 7, 2005).

was recorded.¹⁰⁴ The court ruled that the mortgage recording was invalid, stating that, A[a]n improperly notarized instrument is >improperly executed= within the meaning of Section 5301.25(A) of the Ohio Revised Code.¹⁰⁵ *Menninger v. First Franklin Financial Corp. (In re Fryman)*¹⁰⁶ held that only properly executed mortgages take priority over a bona fide purchaser under Ohio law.¹⁰⁷ *Simon v. Chase Manhattan Bank (In re Zaptocky)*¹⁰⁸ held that the trustee, standing in the shoes of a hypothetical bona fide purchaser, could avoid a defective mortgage that was not signed in the presence of two witnesses as required by Ohio law at the time the mortgagor filed for bankruptcy; the defectively executed but recorded mortgage did not constitute constructive notice to third parties, including bona fide purchasers.¹⁰⁹

Based on these recent Ohio cases, it appears that the concept of Aactual notice@ with respect to record matters has virtually vanished in OhioCand perhaps with respect to any off-record matters as well, such as an unrecorded contract for sale or ground lease or rights of parties in possession.

IV. OTHER STATE AND FEDERAL DECISIONS DENYING EFFECTIVENESS OF DEFECTIVE MORTGAGE DOCUMENTS

Several other state and federal courts, in addition to those in Ohio, have recently issued rulings holding that defective mortgage documents do not impart constructive notice to third parties for recording purposes.

A. The Alpine Bank Decision

¹⁰⁴ *See id.* at *4B5.

¹⁰⁵ *Id.* at *11 (citing *Mortg. Elec. Registration Sys.*, 822 N.E.2d at 825).

¹⁰⁶ 314 B.R. 137 (Bankr. S.D. Ohio 2004).

¹⁰⁷ *See id.* at 138.

¹⁰⁸ 250 F.3d 1020 (6th Cir. 2001).

¹⁰⁹ *See id.* at 1027B28.

For example, in *Alpine Bank v. Moreno (In re Moreno)*,¹¹⁰ the plaintiff bank filed an adversary proceeding against the Chapter 7 trustee, the debtors, and others, seeking to prevent the trustee from avoiding the bank=s deed of trust pursuant to section 544 of the Bankruptcy Code¹¹¹ and seeking a declaratory judgment that its deed of trust was a valid and perfected lien on a hotel.¹¹² The bank and trustee submitted cross motions for summary judgment.¹¹³

The court held that the trustee could avoid the bank=s admittedly defective lien on the hotel because the actual owner of the property did not execute the deed of trust.¹¹⁴ As a result, there was no security interest or adequate chain of record title created and the trustee was not on constructive notice of the bank=s deed of trust.¹¹⁵ Moreover, the court found that the trustee was not on inquiry notice given that the defective execution of the deed of trust was not enough to Aexcite the attention@ of a title searcher.¹¹⁶ The court ruled that there was no equitable reason to allow the deed of trust to create a valid security interest in the hotel because, as a banking institution with some experience in the area of securing loans, the bank was properly responsible for complying with applicable statutes.¹¹⁷

¹¹⁰ 293 B.R. 777 (Bankr. D. Colo. 2003).

¹¹¹ See 11 U.S.C. § 544 (2004).

¹¹² See *In re Moreno*, 293 B.R. at 780.

¹¹³ See *id.*

¹¹⁴ See *id.* at 785.

¹¹⁵ See *id.*

¹¹⁶ *Id.* at 783 (citing *Burman v. Richmond Homes, Ltd.*, 821 P.2d 913, 919 (Colo. Ct. App. 1991)).

¹¹⁷ See *id.* at 784B85.

The court reasoned that because the owner of the hotel did not sign the deed of trust, the deed was outside of the chain of title via the grantor-grantee indices. As a consequence, the trustee could avoid the bank's purported lien for the benefit of the bankruptcy estate. The court denied the bank's motion for summary judgment and entered declaratory judgment in favor of the trustee. The purported transfer of any interest in the hotel property by way of the bank's deed of trust was avoided and preserved for the estate.¹¹⁸

B. The *Bucholz* Decision

In *In re Bucholz*,¹¹⁹ the mortgagor signed the mortgage, and a staff notary subsequently acknowledged it outside of the mortgagor's presence.¹²⁰ The court ruled that the mortgagee violated the New Jersey recording statutes because the mortgage was not executed in the presence of a notary public.¹²¹ The court noted that a defectively notarized mortgage may not be recorded and, even if recorded, does not constitute a perfected lien with priority over properly perfected liens.¹²² The court stated that a mortgage which has been inadvertently recorded with a defective acknowledgment does not serve as notice to a subsequent purchaser or encumbrancer and does not provide constructive notice of the security interest.¹²³ The court disallowed the creditor's claim as secured because the recorded mortgage was invalid, did not provide notice to third parties, and failed to perfect the security interest.¹²⁴

¹¹⁸ See *id.* at 785.

¹¹⁹ 224 B.R. 13 (Bankr. D.N.J. 1998).

¹²⁰ See *id.* at 17.

¹²¹ See *id.* at 22.

¹²² See *id.* at 21.

¹²³ *Id.* at 22 (citation omitted).

¹²⁴ See *id.* at 29.

C. The *Stubbs* Decision

In *Stubbs v. Chase Manhattan Mortgage Corp. (In re Stubbs)*,¹²⁵ the mortgage did not include in the acknowledgment the name of the mortgagor as a person who appeared before the notary public.¹²⁶ The mortgagor and the bankruptcy trustee argued that although the creditors' security interest was recorded, the mortgage failed to provide constructive notice because of the defective acknowledgment. As a result, the creditors' interest was subordinate to the rights of a hypothetical bona fide purchaser.¹²⁷ The court permitted the plaintiffs to avoid the lien under section 544(a)(3) of the Bankruptcy Code.¹²⁸ Under Indiana law,¹²⁹ the mortgage could not be recorded because of the improper acknowledgment, and thus it provided no constructive notice under section 32-21-4-1 of the Indiana Code.¹³⁰

Indiana requires strict compliance with its recording statute. According to the court, to be proper under section 32-21-2-7 of the Indiana Code, the acknowledgment had to state the name of the person who appeared before the notary public.¹³¹ The court reasoned that the most critical part of the

¹²⁵ 330 B.R. 717 (Bankr. D. Ind. 2005), *aff=d*, No. 2:05-CV-439, 2006 U.S. Dist. LEXIS 57267 (N.D. Ind. Aug. 14, 2006).

¹²⁶ *See id.* at 722.

¹²⁷ *See id.* at 723.

¹²⁸ *See id.* at 731.

¹²⁹ *See* IND. CODE ANN. ' 32-21-2-3 (LexisNexis 2002).

¹³⁰ *See In re Stubbs*, 330 B.R. at 725B26.

¹³¹ *See id.* at 729.

acknowledgment therefore was missing.¹³² As a result of avoiding the lien, the court held that the value of the lien position of the creditors inured to the benefit of the debtor=s bankruptcy estate pursuant to section 551 of the Bankruptcy Code.¹³³ The court allowed the plaintiffs to avoid the creditors= lien, entered a default judgment against a nonresponding creditor, and ordered that the lien interests of the creditors be preserved for the benefit of the bankruptcy estate.¹³⁴

D. The *Rogan* Decision

¹³² *See id.* at 730.

¹³³ *See id.* at 731.

¹³⁴ *See id.* at 732.

In *Rogan v. America=s Wholesale Lender (In re Vance)*,¹³⁵ the bankruptcy trustee argued that the mortgage executed by the debtors was voidable because it was defective under applicable Kentucky law involving proper notarizations.¹³⁶ The bankruptcy court agreed with the trustee and ruled that the mortgage was not a recordable instrument capable of providing constructive notice to the trustee.¹³⁷ But the district court found that the deficient, but recorded, mortgage was sufficient to provide either actual or inquiry notice under Kentucky law.¹³⁸ The Sixth Circuit rejected the district court=s ruling and agreed with the bankruptcy court, holding that the notary failed to include the necessary statutory information in its certification and therefore failed to comply with Kentucky law (which the court held was applicable in this case).¹³⁹ According to the Sixth Circuit, in Kentucky, a defective acknowledgment of a mortgage that is recorded cannot provide *constructive notice* of a mortgage. Therefore, it also cannot provide protection from a bankruptcy trustee=s status as a hypothetical bona fide purchaser lacking actual knowledge, which is conferred upon the trustee by federal bankruptcy law.¹⁴⁰

E. The *Schlarman* Decision

In another recent Kentucky case, *Schlarman v. SunTrust Mortgage, Inc. (In re Helvey)*,¹⁴¹ the bankruptcy court permitted the trustee to avoid the mortgage company=s mortgage lien on certain real property owned by the debtor.¹⁴² The trustee successfully argued and the mortgage company admitted that the certificate of acknowledgment following the signature of the Debtor is defective in that the name of the mortgagor, the name of the county, and the date of acknowledgment are left blank, and that the mortgage therefore was not acknowledged properly in accordance with Kansas law.¹⁴³ The trustee specifically referred to the holding of the Sixth Circuit in *In re Vance* in support of its argument. The bankruptcy court found that the mortgage at issue here is in fact identical to the mortgage

¹³⁵ No. 02-6537, 2004 U.S. App. LEXIS 7171 (6th Cir. Ky. April 8, 2004).

¹³⁶ *See id.* at *2.

¹³⁷ *See id.* at *2B3.

¹³⁸ *See id.* at *3.

¹³⁹ *See id.* at *4.

¹⁴⁰ *Id.* at *6.

¹⁴¹ No. 05-24181, 2006 Bankr. LEXIS 1619 (Bankr. E.D. Ky. Aug. 2, 2006).

¹⁴² *See id.* at *8.

¹⁴³ *Id.* at *3.

addressed in *Vance*.¹⁴⁴ It therefore concluded that because the mortgage in the case before it was defective under the standard enunciated by the Sixth Circuit in *Vance* and contained the identical defects, the subject mortgage was defectively acknowledged and insufficient to put the Trustee on notice.¹⁴⁵

F. The *Fisher* Decision

¹⁴⁴ *Id.* at *7.

¹⁴⁵ *Id.* at *8.

In *Fisher v. Advanta Finance Corp. (In re Fisher)*,¹⁴⁶ the bankruptcy court permitted the trustee to avoid the mortgage after determining that the mortgage's acknowledgment was invalid because the notary did not confront the debtor, did not confirm that she was the person subscribing her name, and did not confirm that the debtor executed the documents willfully.¹⁴⁷ Furthermore, the court held that the notary's acknowledgment of the mortgage subsequent to the debtor's signature and outside her presence violated state law and was evidence of fraud.¹⁴⁸ The court found that an acknowledgment is a prerequisite for recordation with the Recorder of Deeds,¹⁴⁹ and noted that an acknowledgment is a formal declaration before an authorized public official, by the person who executed the instrument, that such instrument is his or her voluntary and willful act or deed.¹⁴⁹ The court did note, however, that a deed is valid, as between the actual parties, without the acknowledgment or recordation.¹⁵⁰

G. The *Williams* Decision

In *Williams v. Wells Fargo Financial Mississippi 2, Inc. (In re Rick's Auto Outlet of Monticello, LLC)*,¹⁵¹ the debtor limited liability company (LLC), owned certain real property.¹⁵² As described in the case:

A married couple, who were members of the LLC, subsequently executed a deed of trust on property they owned as individuals and on property owned by the LLC. The deed of trust was signed by them individually, and the acknowledgment identified them individually but not as members of the LLC, and in fact contained no mention of the LLC.¹⁵³

Mississippi has a statute describing the appropriate form of acknowledgment for limited liability companies,¹⁵⁴ but that acknowledgment form was not used on this deed of trust. The trustee argued the acknowledgment on the deed of trust was improper under applicable

¹⁴⁶ 320 B.R. 52 (Bankr. E.D. Pa. 2005).

¹⁴⁷ *See id.* at 64.

¹⁴⁸ *See id.*

¹⁴⁹ *Id.* at 63.

¹⁵⁰ *Id.*

¹⁵¹ 327 B.R. 650 (B.A.P. 8th Cir. 2005).

¹⁵² *See id.* at 651.

¹⁵³ *Id.* at 651B52.

¹⁵⁴ *See* MISS. CODE ANN. § 89-3-7 (Supp. 2006).

state law and the deed was therefore avoidable.¹⁵⁵ The Eighth Circuit Bankruptcy Appellate Panel concurred, finding that the acknowledgment contained none of the elements required by section 89-3-7 of the Mississippi Code on behalf of the LLC.¹⁵⁶ According to the court:

¹⁵⁵ See *In re Rick=s Auto Outlet of Monticello, LLC*, 327 B.R. at 652.

¹⁵⁶ See *id.*

[N]othing in the signature block or acknowledgment would put a third party on notice that they were executing it on behalf of the LLC. The debtor is not referenced in the signature block or the acknowledgment; there is no signature on the debtor=s behalf; and there is no indication whatsoever in any part of the document that the individuals were authorized to act on the debtor=s behalf.¹⁵⁷

The court stated further that A[e]ven with a liberal interpretation, this deed and acknowledgment does not provide notice that the individuals who signed it were acting on behalf of the LLC. An instrument that has not been properly acknowledged does not constitute notice to creditors or subsequent purchasers.¹⁵⁸

V. RECENT DECISIONS ON INDEXING ERRORS (NEW YORK AND OTHER STATES)

Indexing errors also may cause a mortgage to be deemed defective and therefore not constitute notice to third parties.

A. The *Coco* Decision

For example, under New York law a purchaser is Acharged with constructive notice of all matters which are in the record.¹⁵⁹ In *Coco v. Ranalletta*,¹⁶⁰ the mortgagor, Richard A. Ranalletta, executed a mortgage that contained a misspelling of his last name as ARanaletta. The defective mortgage was recorded. A subsequent mortgagee recorded its mortgage against the property, with the mortgagor=s name spelled correctly.¹⁶¹

¹⁵⁷ *Id.* at 653.

¹⁵⁸ *Id.*

¹⁵⁹ *Young v. Farmingdale Food Market, Inc. (In re Lasercard Reprographics, Ltd.)*, 106 B.R. 793, 802 (Bankr. S.D.N.Y. 1989).

¹⁶⁰ 733 N.Y.S.2d 849 (Sup. Ct. 2001), *aff=d*, 759 N.Y.S.2d 274 (App. Div. 2003).

¹⁶¹ *See id.* at 850.

The holder of the defective mortgage later filed a foreclosure action against Mr. Ranalletta, and the subsequent mortgagee challenged the priority of the defective mortgage.¹⁶² The holder of the defective mortgage argued (among other things) that utilization of the county=s computerized indexing system, which included an option for a phonetic search, might have revealed the prior mortgage with the incorrect spelling of the debtor=s name.¹⁶³ But the New York appellate court affirmed the decision of the trial court, which ruled that the misspelled name of the mortgagor in the prior mortgage resulted in the recording of that mortgage being outside the chain of title, thus failing to constitute constructive notice under the recording statute.¹⁶⁴ The subsequent mortgage recorded under the correctly spelled name of the debtor therefore had priority over the prior mortgage.¹⁶⁵ The appellate court noted that there is no evidence to suggest actual knowledge of this lien on the part of FHB Funding Corp.¹⁶⁶ The appellate court also stated that

constructive notice may not be premised upon an incorrectly indexed instrument, whether the error was committed by the clerk or induced by one of the parties. In any event, the misspelling of the mortgagor=s name, in the pending case, was not an error, on the part of the County Clerk, but rather, the parties to the mortgage.¹⁶⁷

¹⁶² *See id.* at 851.

¹⁶³ *See id.* at 853.

¹⁶⁴ *See id.* at 854.

¹⁶⁵ *See id.*

¹⁶⁶ *Id.* at 851.

¹⁶⁷ *Id.* at 852B53.

With respect to the capability of the county's computerized system to produce an optional phonetic search, the appellate court noted that the applicable New York statute, section 316 of the Real Property Law,¹⁶⁸ only provides that the mortgagor-mortgagee list be maintained in alphabetical order.¹⁶⁹ The court then reasoned that, if a phonetic search were required, Auncertainty would be introduced into the recording and searching of land titles and liens.¹⁷⁰

B. The *Reiber* Decision

¹⁶⁸ See N.Y. REAL PROP. LAW ' 316 (McKinney 2006).

¹⁶⁹ *Coco*, 733 N.Y.S. 2d at 853.

¹⁷⁰ *Id.*

The *Coco* opinion should be compared with *Reiber v. Option One Mortgage Corp. (In re Hojnoski)*,¹⁷¹ in which the mortgagor-debtor correctly signed the mortgage, but her name was misspelled and the county clerk indexed the mortgage under the misspelled name.¹⁷² The mortgagee later filed a Correction Affidavit correcting the spelling error, but the clerk mistakenly indexed this document as affecting property in a different town.¹⁷³

The mortgagor filed bankruptcy, and the trustee argued that the mortgage was avoidable under bankruptcy law because neither the recorded mortgage nor the Correction Affidavit constituted constructive notice of the mortgage=s existence.¹⁷⁴ The federal district court sided with the mortgagee.¹⁷⁵ The court affirmed the bankruptcy court=s holding that, given what a hypothetical record searcher would have found with respect to the property, it would have been reasonable to make an inquiry about the nature of the Correction Affidavit, regardless of its designation as relating to property in another town, and that such inquiry would have led to the discovery of the mortgage and the lien on the property.¹⁷⁶

The court acknowledged that under New York law a misspelled name will take a conveyance outside the chain of title, but distinguished this case from the *Coco* decision, stating, A[T]he question here, though, is whether the Correction Affidavit sufficed to remedy the misspelling of plaintiff=s last name, or whether the error concerning the name of the town in which the property is located rendered the Correction Affidavit ineffective in that regard.¹⁷⁷ The court agreed with the reasoning of the bankruptcy court on this issue, stating:

[U]nder the factual circumstances of this case, given what a hypothetical record searcher would have found with respect to the Property, it would have been reasonable to make an inquiry about the nature of the Correction Affidavit, regardless of its designation as relating to property in the Town of Erwin. That inquiry would have

¹⁷¹ 344 B.R. 28 (W.D.N.Y. 2006).

¹⁷² *See id.* at 29.

¹⁷³ *See id.*

¹⁷⁴ *See id.* at 29B30.

¹⁷⁵ *See id.* at 34.

¹⁷⁶ *See id.*

¹⁷⁷ *Id.* at 33.

led to the discovery of the mortgage and the lien on the
Property.¹⁷⁸

C. The *First Citizens* Decision

¹⁷⁸ *Id.* at 34.

In *First Citizens National Bank v. Sherwood*,¹⁷⁹ Mr. Turrell, as Trustee for Ms. Van Noy, executed a mortgage in favor of Mr. Sherwood. This mortgage was properly recorded, but the recorder's office made an error by indexing the mortgage under the name AVan Noy@ and not ATurrell,@ who was the actual mortgagor. First Citizens later bought the property from Turrell but was not aware of the existing mortgage because it was misindexed under the name AVan Noy.@ In a quiet title action, the trial court concluded that First Citizens was not on notice of the misindexed prior mortgage.¹⁸⁰ On appeal, a Pennsylvania Superior Court held that documents may provide constructive notice if, through reasonable diligence, a subsequent searcher would discover them.¹⁸¹ This predictive analysis depended on whether means other than an index search were available, such as electronic records. However, the Pennsylvania Supreme Court reversed.¹⁸²

The supreme court concluded that the plain meaning of title 21, section 357 of the Pennsylvania Statutes Annotated is that the recording of a written instrument such as a mortgage gives subsequent purchasers constructive notice of the mortgage. All that is required is proper recording. The court also noted that title 16, section 9853, which provides that proper indexing shall be notice to all persons of the recording of an instrument, does not create a negative inference that a subsequent purchaser *per se* lacks notice on the grounds that the mortgage is improperly indexed. The court also noted that even if the indexing statute could be interpreted as requiring proper indexing in order to impart constructive notice, the general recording statute, title 21, section 357, which only requires recording as creating

¹⁷⁹ 879 A.2d 178 (Pa. 2005).

¹⁸⁰ *See id.* at 179.

¹⁸¹ *First Citizens Nat=l Bank v. Sherwood*, 817 A.2d 501 (Pa. Super. Ct. 2003), *rev=d* 879 A.2d 178 (Pa. 1985).

¹⁸² *See First Citizens*, 879 A.2d at 182.

constructive notice, would still be controlling as it is the more recently enacted statute.¹⁸³ Two justices issued a strong dissent.

D. Decisions of Other Courts on Misindexed Documents

¹⁸³ *See id.* at 181.

Maryland courts also have found no constructive notice when the mortgage is misindexed.¹⁸⁴ But Florida courts have held that misindexing is not fatal.¹⁸⁵ The Washington D.C. courts too have found that misindexing does not automatically indicate that there cannot be constructive notice.¹⁸⁶ Some states have held that the party filing the notice is not responsible for another=s indexing and recording mistakes or omissions.¹⁸⁷

VI. TITLE INSURER LIABILITY BASED ON DEFECTIVE DOCUMENTS

Case law has been inconsistent regarding a title insurer=s liability to an insured mortgage lender where the mortgage is deemed to be invalid and unenforceable because of a defect in the underlying note or mortgage. A court must determine liability by taking a close look at the specific facts of each case, the insuring provisions of the ALTA Loan Policy (along with the policy exclusions and exceptions, including the measure of damages and the options available to the insurer to Acure@ a loss), as well as the Areasonable expectations@ of the insured party. The relatively few courts that have decided this issue have reached different conclusions based on their own interpretation of the applicable policy provisions as well as the specific facts of the case.

A. The *Citicorp Savings* Decision

¹⁸⁴ See *Waicker v. Banegura*, 745 A.2d 419, 423B25 (Md. 2000); *Greenpoint Mortg. Funding, Inc. v. Schlossberg, Inc.*, 888 A.2d 297, 317B18 (Md. 2005).

¹⁸⁵ See *Anderson v. N. Fla. Prod. Credit Ass=n*, 642 So. 2d 88, 89B90 (Fla. Dist. Ct. App. 1994).

¹⁸⁶ See *Harris v. Md. Nat=l Bank (In re Harris)*, 183 B.R. 657, 659B60 (D.D.C. 1995).

¹⁸⁷ See *Preece v. Hardin*, 69 S.W.2d 361, 361B62 (Ky. Ct. App. 1934); *Guaranty State Bank of Fort Worth v. La Hay*, 224 P. 189, 189B90 (Okla. 1924); *Sykes v. Keating*, 118 Mass. 517, 519B20 (1875).

In *Citicorp Savings of Illinois v. Stewart Title Guaranty Co.*,¹⁸⁸ the title company issued an ALTA Loan Policy to the lender in the amount of \$27,000 insuring against loss sustained due to A[t]he invalidity or unenforceability of the lien of the insured mortgage upon [said estate].¹⁸⁹ Sometime later, the lender learned that the borrower had been declared incompetent many years earlier. The title company and the guardian for the incompetent borrower then arranged for transfer of title by quitclaim deed in exchange for a payment of \$1,550.91 (the amount of the original down payment on the property).¹⁹⁰ Accepting this agreement, the probate court transferred the property to the title insurer. The title insurer then tendered the deed to the lender, which refused to accept it, claiming that under the title policy it was entitled to \$27,000 in damages due to the unenforceability of the mortgage lien. The lender then filed an action for breach of the policy.¹⁹¹

The Seventh Circuit Court of Appeals noted in its decision that there were two issues (as raised in the District Court below): whether the policy was breached and whether tendering the deed cured that breach.¹⁹² The court also noted that any ambiguity in the contract would be construed against the insurer and stated that the policy language was indeed ambiguous as applied to the facts in this case.¹⁹³ According to the court, A[a]s a practical matter, [the lender] would not have extended \$27,000 credit to [the borrower] on the basis of a voidable mortgage. . . . In May 1979 [when the note and mortgage were executed], [the lender=s] lien was unenforceable, regardless of whether the guardian *later* ratified it.¹⁹⁴ The court therefore held that the title insurer breached the policy=s guarantee of the mortgage=s enforceability at the time of the issuance of the policy and that the title insurer=s tender of the deed in lieu of damages was an imperfect substitute for damages in this case.¹⁹⁵ By the time the title insurer tendered the deed the land may have been worth much less due to

¹⁸⁸ 840 F.2d 526 (7th Cir. 1988).

¹⁸⁹ *Id.* at 528.

¹⁹⁰ *Id.*

¹⁹¹ *See id.*

¹⁹² *See id.*

¹⁹³ *See id.* at 529.

¹⁹⁴ *Id.* at 530.

¹⁹⁵ *Id.*

changes in market value.¹⁹⁶ The court ruled that the insurer A should therefore bear any risk of market value decline in the property after that time.¹⁹⁷ The court further stated that A[t]ender does not remove the fact that that no money would have changed hands but for [the title insurer=s] mistake.¹⁹⁸ The court remanded the case with directions to grant the lender summary judgment in the amount of \$27,000, while noting that A[the title insurer] is of course free to sell the property to mitigate its losses.¹⁹⁹

¹⁹⁶ *Id.*

¹⁹⁷ *Id.*

¹⁹⁸ *Id.* at 531.

¹⁹⁹ *Id.*

In a vigorous dissent, Judge Coffey argued that the majority refused to allow the insurer to remove a defect in the title, as explicitly provided in the policy, by establishing the lien of the insured mortgage. Judge Coffey further argued that that language of the policy was not ambiguous and clearly gave the insurer the right to clear title by delivering to the insured a valid deed to the mortgaged real property. He also pointed out that the lender still had the right to foreclose on the mortgage and noted that because under Illinois law the mortgage was only Avoidable²⁰⁰ by the guardian and not void, the contract could not have been void from its inception as the majority had asserted. He further noted that he would have remanded the case for a determination of whether the guardian's participation in the transfer of title to the title insurer amounted to a ratification of the contract.²⁰⁰

B. The *McHenry Savings Bank* Decision

²⁰⁰ See *id.* at 531B33.

In *McHenry Savings Bank v. Pioneer National Title Insurance Co.*,²⁰¹ the Illinois appellate court, agreeing with the decision of the majority in *Citicorp Savings*, ruled in favor of the insured. The court held that the bank could recover damages against the title insurer even though the title insurer had established, as a result of separate litigation, an equitable mortgage in favor of the insured lender that enabled it to recover the amount of funds disbursed to the borrowers plus costs. The court found that the judgment did not provide the lender with any interest on its loan to the borrowers, which it would have otherwise been entitled to under a valid mortgage in a foreclosure proceeding.²⁰² Therefore, the court ruled that the establishment of an equitable mortgage did not give the insured a valid and enforceable lien as required under subparagraph 7(a) of the Terms and Conditions of the loan policy.²⁰³ According to the court, A[t]o interpret subparagraph 7(a) otherwise would be to render the language as to the mortgage lien superfluous. Moreover, such an interpretation would allow [the title insurer] to escape liability under its policy even though it expressly insured against the invalidity and unenforceability of the mortgage lien.²⁰⁴ The court rejected the title insurer's argument that the insured was not entitled in any event to a recovery in excess of \$56,000, which was the liability limit of the policy.²⁰⁵ The court stated that based on the record before it, the extent of the insured's actual loss was impossible to determine and that even though the insured has a foreclosure judgment for \$59,019.17, [the insured] has received only fee simple title to the mortgaged property. The record does not indicate whether the property has been sold or what the present value of the property is.²⁰⁶ The court therefore remanded the case to the trial court to determine what actual loss, if any, the insured had suffered as a result of the invalid mortgage lien.²⁰⁷

C. The *First Federal Savings and Loan* Decision

²⁰¹ 540 N.E.2d 357 (Ill. App. Ct. 1989).

²⁰² See *id.* at 360.

²⁰³ This provision of the ALTA Loan Policy provides that the title insurer will not be liable under the policy if it cures any defects in the title, establishes the title, or establishes the lien of the insured mortgage, as insured.²⁰⁴ *Id.*

²⁰⁴ *Id.*

²⁰⁵ See *id.* at 361.

²⁰⁶ *Id.*

²⁰⁷ *Id.*

But, in *First Federal Savings and Loan Association of Fargo, North Dakota v. Transamerica Title Insurance Co.*²⁰⁸ (with facts similar to *Citicorp Savings*), the Colorado Federal District Court agreed with the dissent in *Citicorp Savings* and, finding no ambiguity in the policy language, ruled that the title insurer did not breach any of its obligations under the title policy by refusing to defend the insured where the insured was ultimately granted a special warranty deed establishing title to the property with no defects.²⁰⁹ The insured had sued the insurer for breach of contract based on a lawsuit in which a ground lease for the property was found to be void.²¹⁰ The court held that where, as in this case, the insurer ultimately established title to the property, there was no breach of contract.²¹¹ The court determined that the only real issue was whether the title insurer established title within a reasonable period of time, and the court noted that A[t]here is simply no evidence that the state court litigation [to establish title to the property] took an unreasonable amount of time.²¹² Therefore, the court ruled that because the title insurer had established title to the property pursuant to paragraph 7(a) of the AConditions and Stipulations@ of the loan policy,²¹³ the insured had no claim under the

²⁰⁸ 793 F.Supp. 265 (D. Colo. 1992).

²⁰⁹ See *id.* at 269B70.

²¹⁰ See *id.* at 266B68.

²¹¹ See *id.* at 269.

²¹² *Id.*

²¹³ This provision of the ALTA Loan Policy provides, in pertinent part, that the title insurer has satisfied its obligations under the policy if it Aestablishes the title . . . within a reasonable time after receipt of such notice.@ *Id.* at 268.

policy.²¹⁴ As the court noted, A[a] title insurance policy does not guarantee title or the enforceability of a mortgage lien, but is instead a contract of indemnity.²¹⁵

D. The *Bank of Miami Beach* Decision

²¹⁴ *See id.* at 270.

²¹⁵ *Id.*

In *Bank of Miami Beach v. Fidelity and Casualty Co. of New York*,²¹⁶ the Florida Supreme Court held that where the signatures on the mortgage were genuine but the signatures on the mortgage note were forged, the title company had no liability to the insured.²¹⁷ In this case, the insured lender had instituted a foreclosure action against the borrower.²¹⁸ After settling the foreclosure action, the lender filed suit against the title company seeking indemnification for its losses under a Guarantee of Validity of Mortgage (or title guarantee) it obtained from the title insurer.²¹⁹ The title guarantee guaranteed to the mortgagee that the mortgage constitutes a valid mortgage lien on the property described in said mortgage, subject to only such encumbrances, liens, and other objections as are shown in schedule B hereof.²²⁰ According to the Florida Supreme Court, the only issue in the case (as determined by the appellate court) was: Does an invalid mortgage note render a mortgage lien invalid so as to subject the insurer on a title insurance contract which guaranteed the validity of the mortgage lien to liability for breach of contract? [Our] answer: No.²²¹ The Florida Supreme Court agreed with the ruling of the appellate court, stating that a mortgage lien and a mortgage debt are two entirely different legal concepts or

²¹⁶ 239 So.2d 97 (Fla. 1970).

²¹⁷ See *id.* at 100.

²¹⁸ See *id.* at 98.

²¹⁹ The *Bank of Miami Beach* case was originally decided by the Florida Third District Court of Appeals in 1968, two years before virtually universal adoption of the initial ALTA Loan Policy by the title insurance industry.

²²⁰ *Id.*

²²¹ *Id.*

>species=.@²²² The court noted that a title policy insures only the title to the real estate, not the debt, and does not guarantee that the mortgaged property is worth the amount of the debt or that the mortgage debt will be paid. The court therefore ruled that the forged note was *not* a covered risk (the court also noted that in spite of the fact that the note was forged, because of another circumstance, the mortgage was still a valid lien on the property).²²³

E. The *JDC(America)* decision

²²² *Id.* at 99.

²²³ *See id.* at 99B100.

In *Lawyers Title Insurance Corp. v. JDC (America) Corp.*,²²⁴ the Eleventh Circuit Court of Appeals held that the title insurer had no duty to defend a claim that the insured's mortgage was unenforceable due to the insured mortgagee's status as a partner in a joint venture for which the mortgaged property was held in trust.²²⁵ This was so, according to the court, because of the unambiguous exclusion in the mortgagee's policy of title insurance for matters created, suffered, assumed or agreed to²²⁶ by the insured, which exclusion applied to the claims of the lender because the claims involved actions of the insured in entering into various relationships with the borrower. The court further held that the provision of the policy providing coverage against the invalidity and unenforceability of the insured mortgage did not apply because the provision insures against defects in the mortgage itself, but not against problems arising from or related to the underlying debt,²²⁷ and noted that A[t]he defenses asserted by [the insured] on behalf of the joint venture . . . all explicitly related to the effect of the parties' relationship on the collectability of the debt underlying the mortgage rather than the validity of the mortgage itself.²²⁷ Further,

[A] mortgage lien and a mortgage debt are two entirely different legal concepts or species. A provision guaranteeing that the mortgage constituted a valid mortgage lien might be held to cover a loss resulting from fraud, mistake, duress, or misrepresentation in the procurement of the mortgage. At a point that is not

²²⁴ 52 F. 3d 1575 (11th Cir. 1995).

²²⁵ See *id.* at 1583B84.

²²⁶ *Id.* at 1580, n.9.

²²⁷ *Id.* at 1583.

presented nor decided here; but such a guarantee of the validity of the mortgage *lien* cannot and should not be construed as guaranteeing that the insurer has made a careful investigation of the origin of the mortgage *debt* and guarantees its payment or validity. If such coverage is contemplated, the policy should specifically so provide.²²⁸

VII. DEFECTS INVOLVING EXECUTION OF, OR PARTIES NAMED IN, DOCUMENT

Several cases have dealt with the issue of whether the technical legal formalities of drafting and executing notes and/or mortgages (such as the proper designation of parties, the inclusion of a party's name in the document, or proper dates in the documents) have been complied with under applicable state law and whether, if such errors or omissions exist, the document(s) should be declared invalid and unenforceable or reformed and given effect based on the parties' intentions. The decisions rendered in this area are not consistent and vary according to the jurisdiction and the facts of each case.

A. The *Enderle* Decision

²²⁸ *Id.* at 1582 (quoting *Bank of Miami Beach v. Fidelity & Casualty Co. of N.Y.*, 239 So. 2d 97, 99 (Fla. 1970)). *See also* *Gerrold v. Penn Title Ins. Co.*, 637 A.2d 1293, 1295 (N.J. Super. Ct. App. Div. 1994) (holding that mortgagor's failure to deliver loan proceeds to mortgagor, which resulted in failure of consideration, was not covered risk under an invalidity clause in title policy).

In *In re Foreclosure of Deed of Trust of Enderle*,²²⁹ the Enderles executed a deed of trust on their property to secure a loan made to a third party, the Tants. The Enderles deed of trust erroneously stated that it was given to secure the payment of a debt of \$ 225,000 owed by the Enderles (and not the Tants) to the bank.²³⁰ Because there was no reference in the deed of trust to show it was security for the debt owed by the third party, the Tants, the court ruled it was an invalid deed of trust and the trustee could not foreclose the property.²³¹ The court acknowledged that a mortgage to secure the debt of a third party may be valid, but stated, As the Bank admits, the Enderles are not indebted to the Bank, and because the alleged Enderle debt is the one referenced in the deed of trust, the . . . trustee was without authority to foreclose.²³²

²²⁹ 431 S.E.2d 549 (N.C. Ct. App. 1993).

²³⁰ *See id.* at 550.

²³¹ *Id.*

²³² *Id.*

Interestingly, the court also noted that A[w]e do not address the issue, because it is not raised, of whether, because the deed of trust may fail to express the true intent of the parties, it should be reformed.²³³ The attorneys for the bank never raised the issue of mutual mistake in their pleadings or sought reformation of the document, which is certainly unusual, and perhaps inexplicable, as the court indicated it may well have entertained that argument had it been raised.²³⁴

B. The *Ethridge* Decision

²³³ *Id.*

²³⁴ See also *Putnam v. Ferguson*, 502 S.E.2d 385, 388 (N.C. Ct. App. 1998) (following reasoning of court in *Enderle*, and holding that where deed of trust identified one individual as debtor, while promissory note was executed by two different individuals, the deed of trust did not properly identify obligation secured and was invalid).

In a somewhat harsh decision, *Ethridge v. Tierone Bank*,²³⁵ the deed of trust designated only the husband (though noting that he was married) as the borrower, despite the fact that both the husband and wife held title to the property as tenants by the entirety.²³⁶ The Missouri Supreme Court held that the mortgage lien was invalid as to the wife=s interest in the property even though she initialed each page of the deed of trust and signed her name below the signature line and signed a separate Asettlement statement@ listing her as borrower.²³⁷ The court found that the language of the mortgage was unambiguous and that the intent of the parties should be determined solely by the terms of their contract.²³⁸ According to the court, A[a] deed by only one of two tenants by the entirety conveys nothing.@²³⁹ The court refused reformation of the deed of trust, reasoning that the evidence showed the deed of trust was always between David Ethridge and the lender and that his wife, Mary, was not a party to the deed of trust. The court also found that there was no scrivener=s error.²⁴⁰ The court stated that A[h]ere there was no mistake as to the parties= intent. There is no clear, cogent, and convincing evidence that it was Mary Ethridge=s intent to grant a lien to the lender or that there was a mistake in drafting the deed of trust. The doctrine of reformation cannot be applied.@²⁴¹ The court also rejected the lender=s argument that the doctrine of equitable estoppel applied, because A[t]here is no evidence that Mary Ethridge engaged in any false or misleading conduct.@²⁴² Finally, the court rejected the lender=s assertion that the doctrine of equitable subrogation should apply in this case to place it in the position of the prior lienholder (the deed of trust involved a refinancing of the Ethridges= home). The court noted, again, that there was no fraud on the part of Mary Ethridge that caused the lender=s loss and reasoned that the mere fact that she benefited from the discharge of the prior loan did not per se require a finding of equitable subrogation on behalf of the new lender.²⁴³ The court noted that it would not relieve the lender from its own negligence,

²³⁵ 226 S.W.3d 127 (Mo. 2007).

²³⁶ *See id.* at 129.

²³⁷ *See id.* at 129, 134.

²³⁸ *See id.* at 132B33.

²³⁹ *Id.* at 132.

²⁴⁰ *See id.*

²⁴¹ *Id.* at 133.

²⁴² *Id.*

²⁴³ *See id.* at 134.

stating that A[t]he lender prepared the deed of trust that inaccurately described the property as being solely owned by David Ethridge. Mary Ethridge is not at fault for the errors committed by the lender or her late husband. Equitable subrogation cannot be applied.²⁴⁴ In a vigorous dissent by Judge Limbaugh, he argued that the case presented a clear example of a mutual mistake for which reformation was the proper remedy to give effect to the true intent of the parties (for example, that Mary Ethridge clearly intended to be bound by the provisions of the deed of trust) and prevent an unjustified windfall to Mary Ethridge simply because of a scrivener=s error. He pointed out that she had voluntarily signed the deed of trust after initialing each page and had also signed the loan settlement statement.²⁴⁵

C. The *Yates* Decision

In *Yates v. Dixie Fire Insurance Co.*,²⁴⁶ the North Carolina Supreme Court ruled that a deed omitting the names of the grantors before the designation A[p]arties of the first part,@ but concluding, A[i]n witness whereof the said parties of the first part have hereunto set their hands,@ followed by the signatures of the grantors, was valid.²⁴⁷ The court found that A[i]t was not necessary that the names of the grantors should be set out

²⁴⁴ *Id.*

²⁴⁵ *See id.* at 135B37.

²⁴⁶ 92 S.E. 356 (N.C. 1917).

²⁴⁷ *Id.* at 358.

in the first line of the deed when they are designated by the final clause and by their signatures thereunder.²⁴⁸ The court also noted that the clerk of the court certified that the grantors personally appeared before him and acknowledged the execution of the foregoing deed of conveyance.²⁴⁹

D. The In re *Head Grading* Decision

²⁴⁸ *Id.* at 358B59.

²⁴⁹ *Id.* at 359. *See also* Prudential Ins. Co. of America v. Hunt, 175 S.E. 130 (N.C. 1934) (holding that the deed was not defective where evidence showed that intention of parties was clear though grantee's name did not appear in blank provided for it at one place in deed). *Cf.* Joiner v. Firemen's Ins. Co. of Newark, N.J., 6 F.Supp. 103 (M.D. N.C. 1934), where the court described the *Yates* ruling as obsolete and, with respect to the intention of the parties, stated that it does not permit antiquated technicalities to override the plainly expressed intention of the grantor, and does not regard as very material the part of the deed in which such intention is manifested. *Id.* at 104. The court held that a deed signed by the husband under his wife's name and under seal, and acknowledged by him as grantor, was sufficient evidence of his assent to conveyance of her property, as required by statute in New Jersey at that time. *See id.* at 104B05.

In *In re Head Grading Co.*,²⁵⁰ the North Carolina bankruptcy court held that a deed of trust (dated July 28, 1998), which was purportedly given as security for a promissory note, did not properly identify the debt that it secured and was unenforceable after the debtor filed for relief under Chapter 7 of the Bankruptcy Code, even though the date in the note was only *one day later* than the date in the deed of trust.²⁵¹ Even the bankruptcy court acknowledged that A[t]he actual note presented and held by Mrs. Head, which refers to the two parties to the deed of trust and to the amount referenced in the deed of trust, is dated July 29, 1998.²⁵² The court ruled that ANorth Carolina law requires deeds of trust to specifically identify the debt referenced therein,²⁵³ but the court did note that in those cases, the deed of trust referenced the wrong obligor of the debt owed. In this case, there is no issue regarding the parties involved with respect to the debt owed and the security given. However, there is an issue regarding the date stated in the deed of trust and the date on the note produced.²⁵⁴

²⁵⁰ 353 B.R. 122 (Bankr. E.D.N.C. 2006).

²⁵¹ *See id.* at 122B24.

²⁵² *Id.* at 123.

²⁵³ *Id.* The court specifically mentioned *Enderle*, *supra* note 229, and *Putnam*, *supra* note 234, in support of its decision.

²⁵⁴ *Id.* at 124.

Even though the dates in the note and deed of trust differed by only one day and the court acknowledged that the deed of trust likely was meant to identify the note dated one day later, the court stated that Ait did not properly and specifically identify the obligation secured.²⁵⁵ The court reasoned that Aclarity and certainty in lien perfection requirements would be lost@ if the rule were not strictly adhered to.²⁵⁶ This seems like an absurd and especially harsh result, because the intention of the parties was clear, the scrivener=s error could easily be cured by reforming the instrument to match the clear intent of the parties, and no third parties were involved.

E. The *Hooper* Decision

²⁵⁵ *Id.* See also *Walston v. Twiford*, 105 S.E.2d 62, 64 (N.C. 1958) (holding that because the deed of trust did not properly identify the obligation secured it is invalid).

²⁵⁶ *In re Head Grading Co.*, 353 B.R. at 124.

But, in *In re Foreclosure of Hooper*,²⁵⁷ the North Carolina Court of Appeals affirmed (without publishing an opinion) the trial court's ruling, which upheld the validity of the foreclosure of a deed of trust that was dated November 10, 1995. The deed of trust purported to secure a \$150,000 debt obligation as evidenced by a Promissory Note of even date herewith, the terms of which are incorporated by reference.²⁵⁸ There was no promissory note dated November 10, 1995, but the trial court found the trustee had the right to foreclose instead on a note dated January 10, 1996. The trial court allowed the holder of the note and deed of trust to testify that his intention was that the note would be secured by the deed of trust. The trial court concluded that because in this case the same party executed both the note and the mortgage, the borrower could not set up a lack of knowledge defense, as could a true third party; if there were no \$150,000 debt, the borrower would not have executed the \$150,000 deed of trust. The trial court also noted that the note and the deed of trust, though not specifically referring to each other, each: (1) established an indebtedness from the borrower to the lender in the amount of \$150,000; (2) called for a due date of the final payment on April 1, 1999; and (3) was executed by the borrower, Eugene N. Hooper in favor of Robert B. Patterson, trustee. The court further noted that no other promissory note was offered by the defendant as the note for which the deed of trust was the security.²⁵⁹ The court likely agreed with the holding of the dissenting opinion in *Putnam v. Ferguson*,²⁶⁰ that as between the parties, an exact degree of accuracy is required in the description of the debt secured by a mortgage, since it is sufficient if the debt secured is capable of identification and the amount thereof is ascertainable.²⁶¹ The trial court found that in this case there was no ambiguity²⁶² and seemed to permit the introduction of parol evidence, because the testimony of both plaintiff and defendant was offered, not to vary or contradict the terms of the promissory note and deed of trust, but to

²⁵⁷ 541 S.E.2d 524 (2000) (unpublished table decision).

²⁵⁸ Brief of Plaintiff-Appellee at *ii, *In re Foreclosure of Hooper*, No. COA99-1342, 2000 WL 34253626 (N.C. Ct. App. March 10, 2000).

²⁵⁹ See *id.* at *3B4.

²⁶⁰ 502 S.E.2d 386.

²⁶¹ *Id.* at 388 (quoting 54A AM.JUR.2D *Mortgages* ' 80 (1996)).

²⁶² See Brief of Defendant-Appellant at *6, *In re Foreclosure of Hooper*, No. COA99-1342, 2000 WL 34252474 (N.C. Ct. App. Jan. 13, 2000).

identify the promissory note as that intended to be secured by the deed of trust.²⁶³

VIII. CONCLUSION

As evidenced by the cases and statutes discussed in this Article, many states require that an instrument be acknowledged in order to be entitled to recordation, and a few of these even hold that an unacknowledged document is unenforceable against third parties with actual knowledge of the document. A strong incentive for notaries not to sign false acknowledgments or acknowledge documents outside the presence of the parties whose signatures are to be notarized. The purpose of the notarization is two-fold: first, to be sure the parties are who they say they are; and second, to be sure that the execution of the document is their voluntary act and deed. Conscientious notaries ask for identification and will not notarize a document if it is apparent that the signature is under a disability or obvious duress.

²⁶³ See Brief of Plaintiff-Appellee at *8, *In re* Foreclosure of Hooper, No. COA99-1342, 2000 WL 34253626 (N.C. Ct. App. March 10, 2000).

Another reason for caution and carefulness with respect to the correct completion and acknowledgment of a mortgage and related documents is the specter of an adversary claim by the trustee or debtor in possession if a bankruptcy proceeding is subsequently filed by or against the mortgagor. As noted earlier in this Article, the "strong-arm" language of section 544(b) of the Bankruptcy Code²⁶⁴ enables the trustee or debtor in possession to avoid any transfer of an interest of the debtor in property that is avoidable under applicable state law. Section 544 vests a bankruptcy trustee with the rights of a hypothetical lien creditor whose lien was perfected at the time of the filing of the bankruptcy petition. If another creditor who claims a lien against the applicable property has not properly perfected its lien as of the filing of the bankruptcy petition, the trustee or the debtor-in-possession can avoid that creditor's lien, and that creditor then becomes a mere unsecured creditor of the estate. The purpose of section 544 is to arm the trustee with sufficient powers to acquire and evaluate all the property of the estate. The trustee or debtor-in-possession is considered a bona fide purchaser of real property in the bankruptcy estate and may avoid obligations of the debtor that are voidable by such a purchaser. Section 544, as well as sections 547 and 548 of the Bankruptcy Code, also avoids one creditor being given favored treatment by a debtor, to the detriment of debtor's other creditors, on the eve of bankruptcy. This occurs when a debtor gives title to property, or a security interest therein, to one creditor just before filing bankruptcy, thus, forsaking all others. In response, the drafters of the Bankruptcy Code created remedies to avoid unperfected security interests as of the commencement of bankruptcy (section 544), preferential transfers not supported by new value (assets) received by the debtor immediately prior to bankruptcy (section 547), and fraudulent transfers by the debtor, within two years of the date of filing, with the intent to defraud creditors or while the debtor was insolvent and without reasonably equivalent value (assets) being received by the debtor (section 548). (Section 548(a)(1) of the Bankruptcy Code was amended in 2005 to extend the "reach back" period or avoidance of fraudulent transfers from one year to two years.²⁶⁵) While the drafters of the Bankruptcy Code created a few "safe harbor" defenses to the operation of these sections, pre-bankruptcy payments by the debtor are not among

²⁶⁴ See 11 U.S.C. § 544(b) (2004).

²⁶⁵ See The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (2005). This statute was enacted into law on April 20, 2005 and applies to all bankruptcy cases filed on or after October 17, 2005 (with limited exceptions as to certain provisions).

them. Again, the true purpose of these statutory provisions is not to cancel the debt (although that is often the result), but is instead to treat all creditors equally and fairly with respect to access to the debtor's assets.

Finally, the enactment of savings statutes, which provide (whether under a substantial compliance test or otherwise) that defectively executed or performed acknowledgments will not cause a recorded document to be deemed defective and will nonetheless constitute notice to third parties, should be encouraged. Such legislation, which local and state bar associations should be encouraged to promote, provides certainty and reliability of land records and elevates substance over form, making life easier for title insurers. It also cures the unintended effect of lack of notice that defective acknowledgments receive in bankruptcyCwhich presently permits trustees and debtors-in-possession to avoid entire liens and encumbrances based on legal technicalities that differ among the states.