

IMPROPERLY RECORDED DEFECTIVE MORTGAGE AVOIDED

“*Great cases...make bad law*” declared Supreme Court Justice Oliver Wendell Holmes Jr. in his dissenting opinion in the *Northern Securities* antitrust case of 1904. One of the most oft-quoted phrases any aspiring lawyer will hear in law school, this maxim stands for the proposition that decisions in cases of great importance from a public or social perspective make a poor basis upon which to construct a general law. Although an otherwise innocuous adversary bankruptcy proceeding (*Daren A. Messer, et al. v. JPMorgan Chase Bank, NA (In re Messer)*, Adv. Pro. No. 13-2448) can hardly be called a matter of high social importance, it did result in the United States Bankruptcy Court for the Southern District of Ohio certifying two novel questions of state law for consideration by the Ohio Supreme Court that “could potentially affect tens of thousands of [mortgages]” in Ohio. The Ohio Supreme Court has not yet ruled on this matter, but given the implications I felt it worth putting on people’s radar at this time.

In a nutshell, the questions can be summarized as follows: O.R.C. §5301.01 requires that all mortgages be acknowledged in the presence of a notary, and further provides that the recording of said mortgage shall operate as constructive notice of its existence to all persons. In other words, you can’t “avoid” a properly-recorded mortgage – whether as a bankruptcy trustee, as a junior creditor or as a good faith purchaser for value – simply because you did not have actual notice of the existence of that mortgage. This concept forms the foundation upon which the public land records system is constructed. Conversely, documents that are improperly recorded – whether by virtue of a simple defect such as a missing acknowledgement, or if that document was not entitled to be recorded under O.R.C. §317.08 – do not operate as constructive notice, and could be avoided by a person taking an interest in the subject property without actual knowledge of the existence of that instrument.

O.R.C. §1301.401, passed into law in December of 2012, seems to flip this structure on its head by declaring that anyone challenging the validity or effectiveness of a “public record” (such as those documents to which O.R.C. §317.08 refers) shall be “considered to have discovered [i.e., have actual knowledge] of that record as of the time that the record was first...tendered to a county recorder for recording.” Simply put, by challenging the validity of a defectively executed mortgage, the challenging party is then deemed by

operation of law to have actual knowledge of the existence of the mortgage and its terms, retroactive to the date upon which that instrument was created. In other words, this statute appears to do away with the question of whether an improperly acknowledged mortgage could provide the basis for constrictive notice, and instead says that the law will assume that a party will be deemed to have had actual knowledge of that instrument, whether or not that was true at the time, should they later dare to challenge its effectiveness under the ordinary constructive notice scheme.

So back to Justice Holmes. Here we have a situation where the Bankruptcy Court declined to make a decision because the conflict between these two statutory schemes was apparently a case of first impression in Ohio, and declining to follow the lender's interpretation of O.R.C. §1301.401 could negatively affect the noted "tens of thousands" of mortgages in Ohio even if only "1%" of the millions of Ohio mortgages were executed improperly. As someone who routinely practices in the areas of real estate finance and foreclosure, I wouldn't be surprised to discover that the 1% figure cited by the court is rather conservative. On the other hand, upholding O.R.C. §1301.401 as written would seem to wholly eviscerate O.R.C. §5301.01's requirement that mortgages be acknowledged, provided the county recorder accepts that instrument for recording. So the Ohio Supreme Court is basically being asked to balance the enforceability of "tens of thousands" of mortgages with the longstanding principle that mortgages must be acknowledged to be recorded and enforceable. *Good cases make bad law—indeed.*