# AVOIDANCE OF DEFECTIVELY NOTARIZED MORTGAGES

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What may appear to be a minor mistake in the notary acknowledgement of a mortgage can expose the mortgage to avoidance by a bankruptcy trustee. In Massachusetts, an improperly notarized mortgage is treated as an unrecorded document which is not effective against third-parties who lack knowledge of the document's existence. McOuatt v. McOuatt, 320 Mass. 410 (1946). This article will reflect on the lessons learned from various cases dealing with defective acknowledgments.

## I. What is an Acknowledgment?

Arising from customary law in England, acknowledgments have been required by law since 1640. See Catlin v. Ware, 9 Mass. 218, 220 n. 1 (1812). Massachusetts law requires that a validly executed acknowledgment be attached to a mortgage as a prerequisite to recording the mortgage in the registry of deeds. In re Bower, 2010 Bankr. LEXIS 3641, at *11 (Bankr. D. Mass. Oct. 13, 2010). An acknowledgment of the signature of at least one of the grantors, made before the officer certifying the acknowledgment, must appear on the mortgage. Mass. Gen. Laws c. 183, § 30.

An "acknowledgment" is the act of witnessing a signatory's indication that he or she signed a document voluntarily for its intended purpose, or as his or her free act and deed. "Standards of Conduct for Notaries Public," Revised Executive Order 455 (04-04), Section 5(d). An acknowledgment is more than a confirmation that a specific person signed a document; rather, it must also confirm that the person intended to act by virtue of his or her signature. Without a proper acknowledgement, the mortgage may not be recorded. Mass. Gen. Laws. c. 183, § 29. If a mortgage without a proper acknowledgement is recorded, the mortgage cannot provide constructive notice to junior lienholders. In re Giroux, 2009 WL 3834002 (D. Mass. Nov. 17, 2009); In re Nistad, 2012 WL 272750 (Bankr. D. Mass. Jan. 30, 2012); In re Bower, 462 B.R. 347 (Bankr. D. Mass. 2012).

## II. Consequences of a Defective Acknowledgment

### A. Avoidance of the Mortgage

The consequences of a defective notarization on a mortgage are significant. Under the "strong-arm powers" established in Section 544(a) of the Bankruptcy Code ("Code"), a trustee can avoid any transfer of property of a debtor, or obligation incurred by a debtor, if that transfer or obligation would be avoidable by a bona fide purchaser of real property from the debtor. A bona fide purchaser is one who purchases without knowledge of defects in the mortgage. In other words, a defect in the notarization of a mortgage could mean that a creditor holding a fully secured claim could have its claim converted to a general unsecured claim.

Section 554(a)(3) of the Code states in relevant part that: "[t]he trustee shall have, as of the commencement of the case…the rights and powers [to]…avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by— . . . (3) a bona fide purchaser of real property… against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser and has perfected such transfer at the time of the commencement of the case…." Pursuant to § 544(a)(3), the trustee holds, as of the commencement of the case, the status of a bona fide purchaser of real property. See In re Coletta Bros. of North Quincy, Inc., 172 B.R. 159, 164 (Bankr. D. Mass. 1994). Section 554(a)(3) also allows the trustee to invalidate unperfected security interests. In re Sullivan, 387 B.R. 353, 357 (B.A.P. 1st Cir. 2008). Thus, the trustee is empowered to avoid a mortgage — which is materially defective under Massachusetts state law — by virtue of his status as a hypothetical bona fide purchaser.

"It is well established law in Massachusetts that a defectively acknowledged mortgage cannot be legally recorded, and if recorded the mortgage does not, as a matter of law, provide constructive notice to future purchasers." In re Bower, 2010 Bankr. LEXIS 3641, at *18. In situations where a mortgage contains a material defect, it is incapable of giving notice of its existence to a trustee as a hypothetical bona fide purchaser pursuant to 11 U.S.C. § 544(a)(3). As such, the trustee can avoid the mortgage through the "strong-arm powers" vested in him or her pursuant to 11 U.S.C. § 544(a)(3).

### B. Preservation of the Mortgage

Section 551 of the Code automatically preserves for the benefit of the bankruptcy estate any transfer avoided under 11 U.S.C. § 544. As the court in In re Carvell explained, preservation "simply puts the estate in the shoes of the creditor whose lien is avoided. It does nothing to enhance (or detract from) the rights of that creditor viz-a-viz other creditors." In re Carvell, 222 B.R. 178, 180 (B.A.P. 1st Cir. 1998). The purpose of 11 U.S.C. § 551 is to allow a trustee to preserve the avoided interest for the bankruptcy estate so that junior interest holders do not benefit from the avoidance to the detriment of the bankruptcy estate and its creditors. In re Nistad, 2012 Bankr. LEXIS 367, at *20.

## III. Examples of Defective Acknowledgements

Defects in an acknowledgment can occur for a variety of reasons. For instance, a notary must witness the signatory signing the mortgage. If the notary is not present, the acknowledgment is defective and the mortgage is deemed unrecordable. Allen v. Allen, 86 Mass. App. Ct. 295 (Mass. App. Ct. 2014). Two other common examples of defective acknowledgments are as follows:

### 1. Failure to Properly Identify Signatory

Defective acknowledgments can occur as a result of the failure to identify the signatory. This is true even where the acknowledgment is located directly below the signature lines of the mortgage itself. In the case of In re Giroux, for instance, the

acknowledgement at issue omitted the debtor's name. 2009 Bankr. LEXIS 3429 (Bank. D. Mass. May 21, 2009). As a result, the bankruptcy court found that "the acknowledgement attached to the mortgage executed by the Debtor … cannot be construed to satisfy the requirements of Massachusetts law. Although the notary witnessed the Debtor's signature, that alone is not enough." Id. at *31. Since the notary acknowledgment in Giroux was defective because it omitted the debtor's name, the court concluded that it did not provide constructive notice to a subsequent purchaser for value. Id. at *34.

Similarly, in the case of In re Bower, the bankruptcy court found that the absence of the debtor's identity from a certificate of acknowledgement was a material defect that rendered it impossible to infer that the notary had ascertained that it was the debtor who appeared before her. 2010 Bankr. LEXIS 3641 (Bank. D. Mass. Oct. 13, 2010). The court in Bower cited Giroux and held that the omission of the debtor's name constituted a material defect. Id. at *19. As a result, the mortgage was incapable of giving constructive notice to a subsequent purchaser for value. Id.

Lastly, in the case of In re Nistad, the acknowledgment at issue mistakenly contained the name of third-parties instead of the debtors' names. 2012 Bankr. LEXIS 367 (Bankr. D. Mass. Jan. 30, 2012). The bankruptcy court in Nistad adopted the court's holding in Bower and held that although the inclusion of third-party names in the identification clause of an acknowledgement was distinguishable from Bower, where the acknowledgment at issue omitted the debtor's name entirely, the "very purpose of the Acknowledgment has been similarly undermined." Id. at *12-13. As such, the court in Nistad held that the inclusion of third-party names in the acknowledgment constituted a material defect, thereby rendering the mortgage incapable of providing constructive notice. Id.

**2. Failure to Include Language that Acknowledgment was Signed "Voluntarily" or as One's "Free Act and Deed"**

Under Massachusetts law, a notary acknowledgement that cannot permit an inference that the notary "obtain[ed] satisfactory evidence of the Debtor's identity" and "ascertain[ed] that his [or her] signature on the mortgage was ***voluntarily affixed***" is patently defective and renders the instrument ineligible for recording and ineffective for constructive notice purposes. In re Giroux, 2009 Bankr. LEXIS 3429 at *31 (Bankr. D. Mass. May, 21, 2009) (emphasis added), aff'd, 2009 U.S. Dist. LEXIS 106872 (D. Mass. Nov. 17, 2009); see also In re Nistad, 2012 Bankr. LEXIS 367 (Bankr. D. Mass. Jan. 30, 2012); In re Bower, 2010 Bankr. LEXIS 3641. "[T]he Supreme Judicial Court [has] signaled its adherence to a stringent requirement, namely that a grantor or mortgagor expressly state to the notary that the execution of the instrument was his or her free act and deed." In re Giroux, 2009 Bankr. LEXIS 3429 at *28.

Without the language "voluntarily for its intended purpose" or "signed as his/her free act and deed," or similar language to that effect, the notarization does not confirm that the signatory acknowledged the document before the notary, and the mortgage is unrecordable. For instance, in the case of In re Shubert, the Bankruptcy Court held that

the notarization at end of a mortgage, which provided merely that the debtor/mortgagor had appeared before the notary public and proven her identity by means of a Massachusetts driver's license, but with no indication that she was executing the mortgage as her free and voluntary act, was not proper notarization under Massachusetts law. 535 B.R. 488 (Bankr. D. Mass. 2015); But see In re Greater Love Tabernacle Church of Boston, Massachusetts, 2015 Bankr. LEXIS 2784 (Bankr. D. Mass. Aug. 21, 2015) (finding notary certificate unambiguous and not defective under Massachusetts law where certificate stated that the signer personally appeared before the notary and "acknowledged the foregoing instrument to be his free act and deed").

Nonetheless, even if the notarization does contain the language "voluntarily for its intended purpose" or "signed as his/her free act and deed," or similar language to that effect, there may still be a problem if the mortgage is signed by a person who acted in a representative capacity. The Bankruptcy Appellate Panel case of In re Kelley, for instance, dealt with a mortgage that was executed and acknowledged by an attorney-in-fact, rather than the individuals for whom he was acting. 498 B.R. 392 (B.A.P. 1st Cir. 2013). In Kelley, the Bankruptcy Appellate Panel determined that "a review of the language of this acknowledgement does not justify a conclusion that [the attorney-in-fact] ever said anything to the one who made out the certificate of acknowledgement to indicate that the Mortgage was the voluntary act of the Debtors." Id. The fatal flaw identified by the Bankruptcy Appellate Panel in Kelley was that the language of the acknowledgement "fail[ed] to unequivocally express that the execution of the Mortgage was the ***free act and deed of the [grantors]***." Id. at 400 (emphasis supplied).

It is important to note, however, that not every error in a notarization renders a mortgage unrecordable. For instance, when an acknowledgment fails to disclose the method used to identify the signatory to the notary, the mortgage can still be recorded. Other failures, such as a failure to maintain a record of the acknowledgment in a separate ledger, or a failure to make a copy of the signatory's identification, should not affect recordation.

## IV. Understanding the Traverse decision

A bankruptcy trustee's job is to liquidate assets for the benefit of the bankruptcy estate. While the avoidance and preservation of an improperly notarized mortgage are steps toward liquidation, the trustee must still liquidate the mortgage. In most cases, the holder of the mortgage will agree to make a cash settlement to retain its secured position. But what if the former mortgage holder is satisfied with being an unsecured creditor? What can the trustee do to maximize the value of the mortgage he now holds?

In 2014, the Court of Appeals for the First Circuit issued its decision in In re Traverse, 753 F.3d 19 (1st Cir. 2014), *cert denied*, 135 S. Ct. 459 (2014), limiting a Chapter 7 trustee's ability to sell a debtor's home that is subject to an avoided mortgage. In Traverse, the trustee avoided an unrecorded mortgage and preserved the mortgage for the benefit of the estate. The trustee then sought to sell the real estate pursuant to 11 U.S.C. § 363(a). The trustee planned to use the sale proceeds to first

pay the bankruptcy estate the amount due on the avoided and preserved mortgage and then pay any remaining amount to the debtor pursuant to her valid homestead.

The lower courts held that the trustee could sell the real estate, but the Court of Appeals disagreed. The Court recognized the trustee's power under Section 363 to sell real estate, but it also recognized the debtor's right to insulate real estate from creditors pursuant to her homestead exemption. The Court stated that the trustee's avoidance powers only preserved the value of the avoided mortgage for the bankruptcy estate's benefit. It did not give the trustee any right to sell the real estate. The Court determined that since the debtor was making her payments under the note that was secured by the mortgage, the trustee, in his new role as mortgagee, had no right to foreclose on the mortgage.

The Traverse Court also held that although preservation of a mortgage can promise a bankruptcy estate a benefit from the sale of a home, it does not follow that "the preserved mortgage creates 'equity' for the estate." In re Traverse, 753 F.3d at 29-30. The Court stated that bankruptcy courts have defined "equity" for purposes of justifying a sale as "the value remaining for unsecured creditors above any secured claims and the debtor's exemption." Id. at *29. The Court noted that the debtor's claimed homestead exemption leaves no residual equity for her unsecured creditors and, as such, concluded that the trustee may either claim the first proceeds of a voluntary sale or wait to exercise the rights of a mortgage holder in the event of a default.