

**UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF OHIO
WESTERN DIVISION AT DAYTON**

In re:	*	
		Case No. 02-38219
Brian F. and Patricia K. Madden,	*	
		Chapter 7
Debtors.	*	
		Judge William A. Clark
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John Paul Rieser, Trustee,	*	Adv. Pro. No. 04-3012
Plaintiff,	*	
v.	*	
Household Realty Corporation, et al.,	*	
Defendants.	*	

**MEMORANDUM DECISION
GRANTING THE MOTION OF PLAINTIFF JOHN PAUL RIESER FOR SUMMARY
JUDGMENT AND DENYING THE MOTION OF DEFENDANT HOUSEHOLD
REALTY CORPORATION FOR SUMMARY JUDGMENT**

Dated at Dayton, Ohio this 2nd Day of June, 2005:

This matter is before the court on cross motions for summary judgment. The motions were filed on April 14, 2005, [Adv. Doc. #s 54, 55], and responses filed by the plaintiff, Chapter 7 trustee John Paul Rieser (“Trustee”), on May 4, 2005, [Adv. Doc. # 56], and the defendant, Household Realty Corporation (“Household”), on May 11, 2005 [Adv. Doc. # 57].

The court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 157 and 1334 and the standing general order of reference entered in this district. This matter is a core proceeding pursuant to 28 U.S.C. § 157(b)(2). The following decision is determined in accordance with Fed. R. Bankr. P. 7056.

Based on the evidence set forth in the Joint Stipulation of Material Facts Between the Parties, [Adv. Doc. # 53], the motions, and the responses, the court finds that summary judgment is appropriate and is granted to the Trustee. Household’s cross motion for summary judgment is denied.

I. Factual Background

The issue before the court involves the priority of the liens on real property located at 124 Bronwood Street in New Lebanon, Ohio (the “Property”). The Debtors acquired title to the Property by warranty deed in May 2000. Although not directly addressed in the stipulations, the court has inferred, and the stipulations support, that the Debtors originally granted Countrywide a mortgage and first priority lien on the Property.

In June 2001, the Debtors refinanced the original mortgage. In doing so, the Debtors obtained two loans from Household. The first loan was in the amount of \$98,902.09 and the second was a home equity line of credit in the amount of \$15,000.00. A major portion of the

first loan was used to pay off Countrywide and the remainder of the money loaned was distributed to various smaller creditors.

The loans were secured by two mortgages which ostensibly granted Household a first and second mortgage on the Property. The mortgages were recorded with the Montgomery County Recorder's Office on June 19, 2001. The first mortgage, securing the \$98,902.09 loan (hereinafter referred to as the "First Mortgage"), was executed by debtor Brian Madden, but not executed by Patricia Madden. The second mortgage, securing the line of credit was executed by both Debtors.

The Debtors filed for bankruptcy on October 30, 2002. As of December 2003, the two mortgages identified are the only liens of record on the Property.

II. Summary Judgment Standard

The appropriate standard for a motion for summary judgment is found in Fed. R. Civ. P. 56(c) and is incorporated by reference in Fed. R. Bankr. P. 7056. Rule 56(c) states in part that a court must grant summary judgment to the moving party if:

the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.

Fed. R. Bankr. P. 7056(c); *see also Celotex Corp. v. Catrett*, 477 U.S. 317, 322, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986). In order to prevail, the moving party, if bearing the burden of persuasion at trial, must establish all the elements of its claim. *See Celotex*, 477 U.S. at 331; *R.E. Cruise, Inc. v. Bruggeman*, 508 F.2d 415, 416 (6th Cir. 1975). All inferences drawn from the underlying facts must be viewed in a light most favorable to the party opposing the motion. *See Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 586-88, 106 S.Ct. 1348, 89 L.Ed. 202 (1986).

In the present matter, the parties have stipulated to the material facts and the court cannot conceive of any other facts necessary for a decision. This matter is ripe for summary judgment.

III. Discussion

The sole issue before the court is whether the Trustee, using the strong arm powers granted by 11 U.S.C. § 544, can avoid Household's First Mortgage on the Property because Debtor Patricia Madden failed to sign the recorded version of that document.

A. Legal Framework

Section 544(a) provides that the trustee in bankruptcy has the rights of a bona fide purchaser for value and may avoid any transfer of real property that is voidable by such a purchaser. 11 U.S.C. § 544(a)(3). The extent of the rights of a bona fide purchaser for value is determined by the law of the state in which the property is located. *See Owen-Ames-Kimball Co. v. Mich. Lithographing Co. (In re Mich. Lithographing Co.)*, 997 F.2d 1158, 1159 (6th Cir. 1993).

In Ohio, a bona fide purchaser for value is a purchaser who “takes in good faith, for value, and without actual or constructive knowledge of any defect.” *Terlecky v. Beneficial Ohio, Inc. d/b/a Beneficial Mortgage Co. of Ohio (In re Little Key)*, 292 B.R. 879, 883 (Bankr. S.D. Ohio 2003) (citing *Shaker Corlett Land Co. v. City of Cleveland*, 139 Ohio St. 3d 66, 68, 41 N.E. 2d 243 (1942)). “[A] bona fide purchaser for value is bound by an encumbrance upon land only if he has constructive knowledge of the encumbrance.” *Id.* (quoting *Tiller v. Hinton*, 19 Ohio St. 3d 66, 68, 482 N.E. 2d 946, 949 (1985)). But, “a ‘purchaser will be charged with knowledge of a previous encumbrance upon real property when he has knowledge of facts which would induce a prudent person to make an inquiry by which he would have or could have obtained knowledge of

a prior encumbrance.” *Id.* (quoting *Thames v. Asia’s Janitorial Service, Inc.*, 81 Ohio App. 3d 579, 587, 611 N.E. 2d 948, 953 (1992)).

In this case, the Trustee argues that § 544 allows him to take precedence over Household with respect to Patricia Madden’s mortgaged interest in the Property because Patricia Madden’s failure to sign the First Mortgage to Household created a defect in the mortgage of which the Trustee had no knowledge. In support of this argument, the Trustee cites the Ohio statute of conveyances which states that a “mortgage ... shall be signed by ... the mortgagor” and a mortgage “of any interest of a married person in real property shall be signed, acknowledged, and certified.” O.R.C. §§ 5301.01(A), 5301.04. The Trustee also notes that the Ohio statute provides specific instances when a defect in a mortgage will not affect the validity of the document, but none of those instances include the failure of the mortgagor to sign the document. *See* O.R.C. § 5301.71. Finally, the Trustee points out that although the Ohio state legislature has recently amended the applicable sections of the Ohio Revised Code and, in doing so significantly relaxed some of the rigid requirements of the law regarding the signatures of witnesses to a mortgage, none of those amendments addressed the failure of the mortgagor to execute the document.¹

¹ The court notes the plethora of case law regarding the amendments to the Ohio Revised Code. The controversy arose when bankruptcy trustees began attempting to trump the mortgagees in bankruptcy citing defective mortgages because the proper witness procedures had not been followed. The bankruptcy courts, following Ohio statutory law, ruled that the mortgages were defective and the trustees prevailed. In 1999, the Ohio legislature reacted by amending the Ohio Revised Code to include language stating that a recorded mortgage was irrebuttably presumed to be properly executed regardless of any actual or alleged defect in the witnessing of the mortgage. The added section, O.R.C. § 5301.234, was immediately challenged and later found to be unconstitutional. *In re Huffman*, ___ F.3d ___, 2005 WL 1163098 at *3 (6th Cir. May 18, 2005). In response, the Ohio legislature amended O.R.C. § 5301.01(B) to include similar language in 2002. Although not applicable in this case, at least one court has read the newly amended § 5301.01 broadly enough to find that “under Ohio Revised Code § 5301.01(B) a defectively executed mortgage, which is properly recorded, places a bona fide purchaser on constructive notice of the encumbrance, and can not be avoided by a bankruptcy trustee under § 544(a)(3) unless the bankruptcy trustee’s rights have already vested.” *In re Baker (Buzulencia v. TMS Mortgage, Inc., et al.)*, 300 B.R. 298, 305 (Bankr. N.D. Ohio 2003). As the Trustee has argued in this case, however, the amendments to the Ohio Revised Code were focused on the failure of the document to be properly witnessed and not the mortgagor’s failure to execute the document.

In response to the Trustee's arguments, and apparently wary of the limitations of Ohio Revised Code § 5301.01(B), Household argues that even though the First Mortgage is clearly defective on its face, Household still retains its position under the defective document because of the doctrine of subordination. According to Household, equitable subordination permits a mortgage to attach to property where the mortgagee intended both the husband and wife to sign the mortgage, but due to an error, one party's signature was missing. See *E.M. Calhoun v. Bahram Heidari*, 2003 WL 21804830 at *3 (Ohio App. July 29, 2003).

In the *E.M. Calhoun* case, a husband and wife owned a piece of property in which the husband had granted a mortgage to ABN AMRO Mortgage Group, Inc ("ABN"). After ABN's mortgage had been granted and recorded, another bank, later succeeded in interest by Calhoun, obtained and recorded a judgment against the property. The ABN mortgage, however, was only executed by the husband because of a mistake by the title company. Thus, Calhoun argued that his later recorded interest was superior to ABN's as to the wife's interest in the property.

The Ohio Court of Appeals for the Fourth District in Gallia County held that ABN's interest included the wife's undivided one-half interest in the property based on the doctrine of equitable subordination even though the wife had not signed the mortgage itself. The court cited the syllabus of an Ohio Supreme Court opinion which held that "a third party who, with its own funds, satisfies and discharges a prior first mortgage on real estate, upon express agreement with the owner that it will be secured by a first mortgage on that real estate, is subrogated to all of the rights of the first mortgagee in that real estate." *E.M. Calhoun v. Bahram Heidari*, 2003 WL 21804830 at *4 (quoting *Federal Union Life Ins. Co. v. Deitsch*, 127 Ohio St. 505, 189 N.E. 440 (1934)). Thus, the court of appeals held that the doctrine of equitable subordination corrects the

defect in the mortgage instrument and transfers all of the property interest to the mortgagee if the parties so intended.

Now, Household asks this court to follow the holding of the *E.M. Calhoun* case and find that Household received both of the Debtors' interests in the Property because the parties intended that Household step into the shoes of former first mortgagee Countrywide.

In response to Household's argument, the Trustee seeks to differentiate between the doctrines of legal and conventional subordination and argues that conventional subordination, which is the doctrine applied by Household in this case, does not apply to a bona fide purchaser for value. The trustee cites the language of another Ohio State Supreme Court case, *Straman v. Rehtine*, 58 Ohio St. 443, 51 N.E. 44 (1898). Paragraph 1 of the syllabus in *Straman* states:

Where money is loaned under an agreement that it shall be used in the payment of a lien on real estate, and it is so used, and the agreement is that the one who so loans the money shall have a first mortgage lien on the same lands to secure his money, and through some defect in the new mortgage, or oversight as to other liens, the money cannot be made on the last mortgage, the mortgagee has a right to be subrogated to the lien which was paid by the money so by him loaned, when it can be done without placing greater burdens upon the intervening lien holders than they would have borne if the old mortgage had not been released, *but not as against a bona fide lien holder who acquired his lien after the release of the old mortgage, without notice of such agreement and payment.*

(emphasis added). The Trustee also points to the dissent in the *E.M. Calhoun* case which stated that “[g]enerally, subrogation will not be allowed if the rights of an intervening lien holder, such as a bona fide purchaser without notice, would be prejudiced.” *E.M. Calhoun*, 2003 WL 21804830 at *6.

B. Analysis

After a lengthy review of the case law presented by the parties, including the unpublished *E.M. Calhoun* opinion and the Ohio State Supreme Court opinions, this court simply will not rule

that an unsigned mortgage is valid against a trustee in bankruptcy.² Although the doctrine of equitable—or conventional—subordination applies to situations such as this where a third party pays another parties’ debt and then steps into the shoes of the original creditor, the court will not apply that principal to cure a mortgage defect as obvious and blatant as the failure of the mortgagor to sign the document. In addition, application of subordination principles simply is not proper as against a bona fide purchaser without notice and for value, such as the Trustee in this case.

Instead of following the law as interpreted by the *E.M. Calhoun* court, this court is swayed by the reasoning of the Ohio Court of Appeals for the Tenth District in the more recent, and published, opinion in *Mortgage Electronic Registration Systems v. Odita*, 159 Ohio App. 3d 1, 822 N.E. 2d 821 (Ohio Ct. App. 2004). In that case, the appeals court decided that a recorded, defectively executed mortgage did not have priority over a later recorded mortgage even though the subsequent mortgagee had knowledge of the defective mortgage. In deciding as such, the court reviewed Ohio law regarding mortgages and stated that “[a] defectively executed mortgage is not entitled to record, and even if it is recorded, the defective mortgage is treated as though it has not been recorded.” *Mortgage Electronic Registration Systems*, 159 Ohio App. 3d at 5.

In addition, the appeals court determined that the trial court should not reform a mortgage that was defective because the mortgagor’s signature was not acknowledged by a notary. In doing so, the court found that the process of reforming an written document “presupposes the existence of a valid instrument,” and that “a court of equity cannot validate or give life to an invalid instrument, as to do so would require the court to re-execute an improperly executed instrument and create a new agreement.” *Id.* at 11.

² The court notes that although unpublished state appellate court opinions are often used as guidance in the federal courts, those opinions are generally disfavored and serve little precedential value under the rules of the Sixth Circuit set forth by the Court of Appeals. *See* Sixth Circuit Local Rule 28(g).

Accordingly, this court finds that Patricia Madden's failure to execute the First Mortgage makes that instrument invalid on its face. The court will not now reform the document in order to ensure that Household has priority over the Trustee. As stated by the court of appeals in *Mortgage Electronic Registration Systems*, "where a statute such as R.C. 5301.01 requires certain formalities for the execution of an instrument, a court of equity under its power of reformation cannot supply these formalities to validate a defectively executed instrument." *Id.* at 11-12 (quoting *Delfino v. Paul Davies Chevrolet, Inc.*, 2 Ohio St. 2d 282, 209 N.E. 2d 194 (1965)).

The court will not reform the defectively executed First Mortgage and allow Household to step into the shoes of the prior first mortgagee under the doctrine of equitable subordination. The First Mortgage was defective as to Patricia Madden's mortgaged interest in the Property and has no priority over the Trustee, who stands as a bona fide purchaser for value under Ohio law. The Trustee has priority as to Patricia Madden's interest in the Property.

IV. Conclusion

The Trustee's motion for summary judgment is granted. Household's cross motion for summary judgment is denied.

It is so ordered.

cc:

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