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Subsequent Purchasers Liable for Mortgage Lien Despite Mortgage Satisfaction Piece

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Whenever real estate is purchased, the buyer should obtain title insurance to protect his or her interest in the property. As part of procuring title insurance, the public records are reviewed to determine what liens, if any, encumber the property. Any such liens are then identified and paid in full and satisfied at closing. The reason for this is simple: When the property is transferred to the buyer at closing, the title insurer guarantees that the buyer now owns the property free and clear from any such liens.

In *Ingomar Limited Partnership v. Current*, the U.S. District Court for the Middle District of Pennsylvania recently found that subsequent purchasers were liable for a mortgage lien against the property when the title insurer had mistakenly concluded that the mortgage was previously satisfied of record.

In the late 1990s, a married couple borrowed money from Ingomar's predecessor-in-interest. The loan was collateralized by adjacent properties they jointly owned. The smaller parcel included their residence. The other, larger parcel consisted of unimproved land. The mortgage document contained separate legal descriptions of each parcel along with their respective tax identification numbers.

Since the married couple had believed that the mortgage lien attached only to the small parcel, they were surprised to discover that the mortgage lien attached to both parcels when they applied for a loan to construct a new home on the large parcel.

When the husband attempted to contact the mortgage holder at the time, he was advised that the mortgage lender had filed for bankruptcy and its assets were being managed by a third party provider. After a series of communications with the third party provider, the married couple received a copy of a satisfaction piece bearing the tax parcel identification number for the large parcel and stating that the "[m]ortgage has been fully paid or otherwise discharged and that upon the recording hereof said Mortgage shall be and is hereby fully and forever satisfied and discharged." The postal address used for

both the small and large parcels appeared in the satisfaction piece and was the same address that appeared in the note executed by the married couple. The satisfaction piece incorrectly referenced the deed book and page number at which the mortgage was recorded.

The married couple ceased making payments under the underlying promissory note after receiving the satisfaction piece. Because the postal address used for both parcels appeared in the satisfaction piece, they reasoned that the mortgage was released on both parcels, thus extinguishing their monetary obligations under the note. In spite of repeated written and oral demands by the mortgage holder at the time to repay the note, they refused to do so because of the alleged satisfaction of the mortgage.

After receiving notice of foreclosure, the married couple sold the small parcel to two individuals and used the net sale proceeds to build a new home on the large parcel. The purchasers of the small parcel arranged for a title search before purchasing the small parcel. The title search located the existence of the mortgage lien and the satisfaction piece. The married couple never disclosed to the purchasers that they had failed to satisfy the note in full.

After title to the small property was transferred, an amended satisfaction piece was recorded by the mortgage holder at the time that corrected the reference to the deed book and page where the previous mortgage was recorded. A revocation of the satisfaction piece followed thereafter and stated that the mortgage had not been satisfied and had been released in error.

After Ingomar acquired the note and mortgage, it filed suit in federal district court against the subsequent purchasers, among others, to obtain a declaratory judgment that they purchased their property subject to the mortgage lien.

Both parties then filed motions for summary judgment. In support of their motion and in opposition to Ingomar's motion, the subsequent purchasers argued that the declaratory judgment action should be dismissed as time-barred and because they acquired their property as bona fide purchasers.

They first argued that Ingomar's claim was barred by the statute of limitations.

In Pennsylvania, there is no uniformly applicable limitations period for a declaratory judgment action. Rather, such an action is instead governed by the time-bar rules applicable to the underlying substantive claim. As such, the federal district court pointed out that "declaratory judgment proceedings seeking relief at law must be filed within the statute of limitations applicable to a claim asserting legal rights underlying the declaratory judgment action."

The federal district court was unimpressed by the subsequent purchasers' attempt to redress the equitable claim in the language of negligence. They reasoned that the case hinged upon their alleged failure to perform a reasonable title search of the small parcel. As such, damage to the validity of the mortgage lien allegedly resulted from this negligence and was time-barred by the applicable two-year limitations period.

The federal district court instead found that "an action seeking declaratory relief to establish real property rights is not governed by a limitations period but by the equitable doctrine of laches."

In doing so, the federal district court emphasized that Ingomar did not seek recovery for negligence committed by the subsequent purchasers but rather sought declaratory judgment that the mortgage lien was satisfied in error and remained attached to the small parcel.

As an aside, the federal district court refused to consider whether the doctrine of laches served as a potential bar to Ingomar's claim because the subsequent purchasers never raised that affirmative defense during litigation.

The federal district court next discussed whether the subsequent purchasers had bona fide status.

"A buyer of property qualifies as a bona fide purchaser if the buyer 'pays valuable consideration, has no notice of the outstanding rights of others, and acts in good faith.' A buyer who qualifies as a bona fide purchaser receives title to the property unencumbered by any previously existing interests."

"A buyer may receive notice of 'the outstanding rights of others' through two methods. First, proper recordation of an interest places subsequent buyers on constructive notice of prior interests, preventing them from attaining status as bona fide purchasers. Second, actual notice of a preexisting interest will prevent a buyer from claiming rights as a bona fide purchaser regardless of whether the interest is recorded."

The subsequent purchasers based their bona fide status on their lack of actual knowledge of the mortgage lien at the time of closing and their reasonable reliance on the title search, which disclosed its satisfaction.

The federal district court disagreed with the subsequent purchasers' assertion that they were bona fide purchasers of the small parcel because the satisfaction piece incorrectly referenced the deed book and page where the mortgage appeared and contained only the tax parcel identification number for the large parcel.

Because of these discrepancies between the parcels identified in the mortgage lien and the parcel referenced in the satisfaction piece, the federal district court believed that the subsequent purchasers were placed on notice of potential encumbrances to the title to the small parcel and thus they were not entitled to bona fide purchaser status.

In a footnote, the federal district court insinuated that the title insurer dropped the proverbial ball by failing to invest the potential pre-existing interest and that the subsequent purchasers may have a right of action against their title insurer for its failure to discover Ingomar's prior interest.

LESSONS LEARNED

The federal district's holding in *Ingomar* is rather harsh but not surprising. Buyers obtain title insurance for a reason, which is to protect themselves from claims of pre-existing liens. In *Ingomar*, the federal district court admonished the title insurer for its lack of detail and attention during the real estate transaction and, in essence, suggested that the subsequent purchasers should seek legal redress

against the title insurer, as opposed to the mortgage holder, which now had a valid lien against their property.

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