THE TRUSTEE'S STRONG-ARM POWERS—MORTGAGE CHALLENGES, CLAIMS AND DEFENSES

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A. Introduction

Recent Massachusetts bankruptcy court decisions[1] should serve as pointed reminders that it is imperative for mortgagees to use extreme caution to insure that their mortgages are executed with the proper formalities and that the mortgages are recorded in strict compliance with Massachusetts recording statutes. Otherwise, if the mortgagor files for bankruptcy protection, the mortgagee stands to lose its status as a secured party, leaving the mortgagor with an unsecured claim. The bankruptcy trustee may accomplish this by using his or her strong-arm powers to either avoid the mortgage or invalidate the mortgage and prevent the mortgagee from reforming the defective instrument. The mortgage will then be preserved for the benefit of the bankruptcy estate for an equitable distribution to the unsecured creditors on a pro rata basis.

B. The Trustee's Strong-Arm Power as a Bona Fide Purchaser

Section 544(a)(3) of the Bankruptcy Code grants strong-arm powers to the trustee to avoid certain liens as a hypothetical bona fide purchaser of real property as of the

[1] *See Agin v. Mortgage Electronic Registration Systems, Inc. and Countrywide Home Loans, Inc. (In re Giroux)*, No. 08-1261, 2009 WL 1458173 (Bankr. D. Mass. May 21, 2009), *appeal docketed*, 1:09-cv-10988 (Mass. Dist. Ct. June 10, 2009); *Agin v. South Point, Inc.* (*In re Kurak)*, No. 08-1404, 2009 WL 2171094 (Bankr. D. Mass. July 15, 2009), *appeal docketed*, 1:09-cv-11504 (Mass. Dist. Ct. Sept. 10, 2009).

commencement of the bankruptcy case.[2] The trustee holds the real estate, not as the debtor held the real estate, but with the rights and powers of a bona fide purchaser who bought the real estate from the debtor.[3] The bankruptcy court must look to state law to determine property rights under § 544(a).[4] A bona fide purchaser has been defined in Massachusetts as "[o]ne who buys something for value without notice of another's claim to the property and *without actual or constructive notice* of any defects in or infirmities, claims, or equities against the seller's title."[5] While Massachusetts law states that one cannot be a bona fide purchaser if he had actual notice,[6] under 11 U.S.C. § 544(a) the trustee takes as a bona fide purchaser regardless of any actual knowledge of the trustee.[7] However, the trustee is still subject to constructive notice under Massachusetts law.[8] A party is charged with having constructive notice as a matter of law if the instrument has been properly recorded.[9] Thus, the trustee takes the debtor's real estate on the date of the bankruptcy filing as a bona fide purchaser, subject to all of the properly recorded liens and encumbrances and subject to the debtor's exemption in any equity.

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[2] 11 U.S.C. § 544

> (a) The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may 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, other than fixtures, from the debtor 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, whether or not such a purchaser exists.

[3] *Gray v. Burke* (*In re Coletta Bros. of North Quincy, Inc.*), 172 B.R. 159, 162 (Bankr. D. Mass. 1994).
[4] *Butner v. United States*, 440 U.S. 48, 54 (1979); *Stern v. Continental Assurance Co.* (*In re Ryan)*, 80 B.R. 264, 266 (D. Mass. 1987), *aff'd* 851 F.2d 502 (1st Cir. 1988).
[5] *See Terrill v. Planning Bd. of Upton*, 71 Mass.App.Ct. 171, 175 n.10 (2008) (quoting BLACK'S LAW DICTIONARY 1271 (8th ed. 2004))(emphasis added).
[6] "A conveyance … shall not be valid as against any person, except the grantor or lessor, his heirs and devisees and persons having actual notice of it." MASS. GEN. LAWS ch. 183, § 4 (2003).
[7] 11 U.S.C. § 544(a).
[8] *Gray*, 172 B.R. at 163.
[9] *See* i*d.*

In some circumstances, a mortgage may be recorded under the Massachusetts statutes, but may be invalid for some other reason. Under typical non-bankruptcy circumstances, a mortgagee could reform its mortgage and record it at the registry of deeds.[10] Once a bankruptcy has been filed, however, the trustee may file an adversary proceeding seeking a declaration that the mortgage is invalid. Then the trustee's strong-arm powers under § 544(a) will prevent the mortgagee from reforming the mortgage,[11] leading to the same result—the mortgagee loses the security of the mortgage and the creditors of the bankruptcy estate will yield the benefits.

The two recent Massachusetts bankruptcy cases discussed below demonstrate the importance of using strict formalities in the execution and acknowledgement of mortgages. Due to errors in the execution of the loan documents, the mortgagees in these cases lost their secured status to the bankruptcy trustee, allowing the bankruptcy estate to reap the benefits. On the other hand, if the mortgagees had insured proper execution and recording of their mortgages, they would have retained their secured positions.

C. The Recent Massachusetts Bankruptcy Court Decisions

(1) Mortgage Avoidance - *Agin v. Mortgage Electronic Registration Systems, Inc. and Countrywide Home Loans, Inc. (In re Giroux)*[12]

On June 28, 2008, Matthew H. Giroux ("Giroux") filed a chapter 7 bankruptcy petition and schedules, which listed his real property subject to two mortgages held by Countrywide.[13] Countrywide filed a motion in the bankruptcy court for relief from

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[10] *Beach Associates, Inc. v. Fauser*, 9 Mass.App.Ct. 386, 394-95 (1980).
[11] *See Tomsic v. Beaulac* (*In re Beaulac*), 298 B.R. 31, 35 (Bankr. D. Mass. 2003)(quoting *Gen. Builders Supply Co. v. Arlington Coop. Bank*, 359 Mass. 691, 694 (1971)).
[12] *Agin v. Mortgage Electronic Registration Systems, Inc. and Countrywide Home Loans, Inc. (In re Giroux)*, No. 08-1261, 2009 WL 1458173 (Bankr. D. Mass. May 21, 2009), *appeal docketed*, 1:09-cv-10988 (Mass. Dist. Ct. June 10, 2009).
[13] *Id*. at *1.

automatic stay to foreclose on the first mortgage.[14] In response, the trustee filed a complaint to avoid the mortgage pursuant to 11 U.S.C. § 544.[15] The trustee argued that the mortgage contained a material defect and therefore could be avoided by him.[16]

The alleged defect was that the acknowledgement clause of the mortgage in question did not specifically refer to Giroux as the person who appeared before the notary public.[17] Giroux signed the mortgage in the presence of a witness who was the same person as the notary public.[18] However, the acknowledgement did not specifically state that Giroux signed and acknowledged the mortgage as his free act and deed; rather the clause left a blank line where Giroux's name should have been.[19]

In support of his claim, the trustee relied on MASS. GEN. LAWS ch. 183, § 30, which provides that a deed or other instrument requires an acknowledgement by one or more grantor or the attorney executing it, and MASS. GEN. LAWS ch. 183, § 29, which states that a deed shall not be recorded without an acknowledgement or proof of its due execution.[20] The purpose for requiring an acknowledgement is that it provides evidence of the legitimacy of the execution of the instrument when it is offered for recording.[21] Without the requisite acknowledgment, the trustee argued that the instrument contained a material defect and should not have been recorded.[22] Because the materially defective mortgage in this case was recorded improperly, it did not provide constructive notice to the trustee who stood in the

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[14] *Id*.
[15] *Id*.
[16] *Id*.
[17] *Id*.
[18] *Id*.
[19] *Id*.
[20] *Id*. at *1-*2.
[21] *Id*. at *2 (citing *McOuatt v. McOuatt*, 320 Mass. 410, 413-14 (1946)); *Gordon v. Gordon*, 8 Mass.App.Ct. 860, 862 (1979).
[22] *Agin v. Mortgage Electronic Registration Systems, Inc. and Countrywide Home Loans, Inc. (In re Giroux)*, No. 08-1261, 2009 WL 1458173, at *2 (Bankr. D. Mass. May 21, 2009), *appeal docketed*, 1:09-cv-10988 (Mass. Dist. Ct. June 10, 2009).

position as a hypothetical bona fide purchaser at the commencement of Giroux's bankruptcy case.[23] Thus, the trustee asserted his right to prevent Countrywide from curing the defect and avoid the mortgage under the strong-arm provision.[24]

On the other hand, Countrywide argued that the mortgage was not defective because the document identified Giroux as the mortgagor and, although the clause left a blank, the language in the clause indicated that the signer acted of his own free act and deed.[25] Countrywide, therefore, argued that the mortgage complied with the law and should not be avoided.[26]

The court determined that the mortgage was defective because applicable law requires a notary public to recite both the evidence relied upon to establish the identity of the signer, and that the signer executed the mortgage as his free act and deed.[27] Although defective, the court next considered whether the mortgage was *materially* defective so as to be incapable of providing constructive notice to the bona fide purchaser—the trustee. Persuaded by Sixth Circuit case law,[28] the court found that the mortgage was, in fact, materially defective.[29]

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[23] *Id*.
[24] *Id*. at *3.
[25] *Id*.
[26] *Id*.
[27] *Id*. at *4.
[28] *Id*. (citing *Burden v. CIT Group/Consumer Fin., Inc., et al* (*In re Wilson*), No. 07-6447, 2009 WL 723197 (6th Cir. Mar. 19, 2009); *Gregory v. Ocwen Fed. Bank* (*In re Biggs*), 377 F.3d 515 (6th Cir. 2004); *Countrywide Home Loans, Inc. v. Gardner* (*In re Henson*), 391 B.R. 210 (B.A.P. 6th Cir. 2009); *Select Portfolio Servs., Inc,.et al. v. Burden* (*In re Trujillo)*, 378 B.R. 526, 537 (B.A.P. 6th Cir. 2007); *MG Investments et al. v. Johnson* (*In re Cocanougher*), 378 B.R. 518 (B.A.P. 6th Cir. 2007); *Greenpoint Credit, LLC v. Gigandet* (*In re Chandler*), No. 3:05-1564, 2005 WL 3263331 (M.D. Term. Nov. 30, 2005); *Drown v. Countrywide Home Loans, Inc.* (*In re Peed*), 403 B.R. 525 (Bankr. S.D. Ohio 2009); *Sensenich v. Countrywide Home Loans, Inc.* (*In re Willis*), No. 07-1008, 2008 WL 444547, at *7 (Bankr. D. Vt. Feb. 15, 2008)).
[29] *Agin v. Mortgage Electronic Registration Systems, Inc. and Countrywide Home Loans, Inc. (In re Giroux)*, No. 08-1261, 2009 WL 1458173, at *6 (Bankr. D. Mass. May 21, 2009), *appeal docketed*, 1:09-cv-10988 (Mass. Dist. Ct. June 10, 2009).

Adopting the Sixth Circuit's reasoning, the court recognized that the policy behind the requirement of a recorded and valid acknowledgement is to substantiate the identity of the instrument's signer, which is necessary for a "fraud-free system" to enable a "free market."[30] The requirement instills confidence in buyers and sellers of real property.[31] Absent such an acknowledgement, others cannot be certain who, if anyone acknowledged the instrument or whether the instrument was signed as a free act and deed.[32]

Although the name of the mortgagor may have been set forth elsewhere in the instrument, and therefore logically should have been the name listed in place of the blank in the acknowledgement clause, this was insufficient to *confirm* the signature.[33] The court, therefore, rejected the notion that substantial compliance with relevant law could cure the deficient acknowledgement or eliminate the requirement.[34] The court also rejected the idea that the acknowledgement requirement could be overcome by the mortgagor's intent.[35] Since intent is specific to the person who is acknowledging, if that person is not named in the acknowledgement, it is impossible to substantiate his or her intent.[36] Consequently, the court held that the mortgage was both materially and patently defective, and should not have been accepted for recording.[37]

Pursuant to 11 U.S.C. § 544(a)(3), the trustee has the rights and powers of a bona fide purchaser as defined by state law,[38] and under Massachusetts law, a mortgage that is defective when recorded does not provide constructive notice to a bona fide purchaser for

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[30] *Id*.
[31] *Id*.
[32] *Id*.
[33] *Id*. at *7 (emphasis added).
[34] *Id*.
[35] *Id*.
[36] *Id*.
[37] *Id*. at *9.
[38] *Id*. at *10.

value.[39] An unrecorded deed is valid only against the grantor, his heirs and devisees, and persons having actual knowledge pursuant to MASS. GEN. LAWS ch. 183, § 4.[40] While Countrywide did claim that the trustee had actual knowledge of the mortgage's validity,[41] the court stated that any personal knowledge of the mortgage's validity would not be imputed to the bankruptcy estate because, according to 11 U.S.C. § 544(a), the trustee is bestowed the strong-arm power without regard to actual knowledge.[42] Therefore, the court concluded that the trustee could avoid the mortgage pursuant to 11 U.S.C. § 544(a)(3), recover and preserve for the benefit of the estate the value of the mortgage lien pursuant to 11 U.S.C. §§ 550(a) and 551.[43]

(2) Declaring the Mortgage Invalid and Preventing of Reformation - *Agin v. South Point, Inc. (In re Kurak)*[44]

On May 21, 2008, Debra A. Kurak ("Kurak") filed for chapter 7 bankruptcy protection.[45] She listed ownership of real estate that was subject to a lien for which she had no contractual liability.[46] South Point, Inc. ("South Point") filed a motion for relief from automatic stay to enforce its rights under the note and first mortgage.[47] In turn, the trustee filed an adversary proceeding against South Point challenging the validity of the mortgage as pertaining to Kurak and seeking a determination that South Point could not reform the mortgage in light of the trustee's strong-arm powers under 11 U.S.C. § 544(a).[48]

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[39] *Id*. (citing *Graves v. Graves*, 72 Mass. (1 Gray) 391 (1856)).
[40] *Id*. at *11.
[41] *Id*.
[42] *Id*.
[43] *Id*.
[44] *Agin v. South Point, Inc. (In re Kurak)*, No. 08-1404, 2009 WL 2171094 (Bankr. D. Mass. July 15, 2009), *appeal docketed*, 1:09-cv-11504 (Mass. Dist. Ct. Sept. 10, 2009).
[45] *Id*. at *1.
[46] *Id*.
[47] *Id*.
[48] *Id*.

The trustee's challenge to the validity of the mortgage focused on Kurak's execution of the mortgage.[49] Some of the pertinent facts are as follows. The real estate closing occurred at Kurak's home, which she co-owned with Manuel Lopes ("Lopes"), who did not file for bankruptcy.[50] The closing attorney took the signed mortgage back to his office and made three copies.[51] It is undisputed that Kurak signed the mortgage in the presence of a notary public and initialed each page, as did Lopes.[52]

Questions occurred when two different versions of the same mortgage came to light. In one version (hereinafter the "First Version"), the first page of the mortgage did not list Kurak as a borrower; only Lopes was listed as a borrower in the First Version. [53] The signature page of the First Version was executed by Kurak above the word "witness," that was typed in separately and the word "borrower" was crossed out.[54] Lopes executed as a borrower.

A second version of the mortgage was recorded with the registry of deeds (hereinafter the "Second Version").[55] The first page of the Second Version identified both Lopes and Kurak as the borrowers, but Kurak's name appeared in a different typeface than Lopes' name.[56] On the signature page, both Lopes and Kurak signed over the word "borrower."[57] Apparently after the closing, the attorney's assistant faxed a signed copy of the mortgage to South Point, which asked that Kurak's name be added to the first page as a "borrower."[58] The closing attorney guessed that South Point's office crossed out the word "borrower" and

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[49] *Id*.
[50] *Id*. at *2.
[51] *Id*.
[52] *Id*. at *3.
[53] *Id*. at *1. The term "borrower" was defined as a mortgagor in the security instrument. *Id*.
[54] *Id*.
[55] *Id*. at *2.
[56] *Id*.
[57] *Id*.
[58] *Id*. at *3.

typed in the word "witness" on the signature page of the First Version of the mortgage because that did not appear on the recorded mortgage or the copy that was at the attorney's office.[59]

Even though Kurak signed the mortgage in the presence of a notary public and initialed each page, the predicament in this case is that, when Kurak signed the mortgage, she was not a defined borrower.[60] The court analyzed the issue of whether the alteration of the mortgage after its execution, to add Kurak's name as a borrower, was a material alteration.[61]

The trustee argued that the mortgage was invalid as to Kurak because the attorney's office altered the document after its execution.[62] A mortgage is a contract, and to determine the terms of the contract one must look at its four corners, absent extringent evidence.[63] Therefore, the trustee argued that, at the time of the mortgage's execution, it was simply a mortgage from Lopes to South Point—not a mortgage from Lopes and Kurak.[64] Adding Kurak to the first page as a "borrower" after she signed the mortgage could not expand the scope of the mortgage to something it was not.[65]

It is a well-established policy that "titles to real estate should not be held hostage to disputes over the parties' intention."[66] It is vital that society has confidence that instruments are not binding until they have been formally executed and, once executed, they will not be altered or controlled by parol evidence.[67] Of significant importance, the court found that

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[59] *Id*.
[60] *Id*. at *4.
[61] *Id*.
[62] *Id*.
[63] *Id*.
[64] *Id*.
[65] *Id*.
[66] *Id*. at *7.
[67] *Id*. (quoting *Burns v. Lynde*, 88 Mass. (1 Allen) 305, 312 (1863)).

Kurak's name did not precede the granting language in the mortgage.[68] Rather, her name was added without her authority, and the attorney did not obtain and acknowledge her signature after the mortgage was altered.[69] According to common law, an unauthorized alteration of a written instrument by a party or holder voids the instrument, and the person who altered it cannot recover upon it as altered.[70] Therefore, the court held that the mortgage was ineffective to divest property rights from Kurak to South Point and accordingly invalid.[71] Due to the trustee's position as a bona fide purchaser, South Point was prevented from reforming the mortgage.

D. Massachusetts Recording Laws—Other Potential Pitfalls for Mortgagees

(1) Additional Acknowledgment Traps

The above cases do not represent the only problems that may lead to deficient acknowledgements. Provided below are some Massachusetts laws and examples of acknowledgement pitfalls that might result in avoidance of a mortgage by the trustee. In considering the examples below, first and foremost, recall that pursuant to Massachusetts law, a deed[72] shall not be recorded without an acknowledgment or proof of its due execution either endorsed upon or annexed to the deed.[73] Failure to adhere to this law will result in lack of constructive notice to a bona fide purchaser and, as a result, the conveyance will not be valid against the bona fide purchaser.

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[68] *Id*. at *6.
[69] *Id*.
[70] *Id*. at *7.
[71] *Id*. at *8.
[72] "[I]n Massachusetts, the granting of a mortgage vests title in the mortgagee to the land placed as security for the underlying debt. The mortgage splits the title into two parts: the legal title, which becomes the mortgagee's, and equitable title which the mortgagor retains." *Maglione v. BancBoston Mortg. Corp.*, 29 Mass.App.Ct. 88, 89 (1990). In other words, when a mortgagor grants a mortgage, it is actually granting the mortgagee legal title. Therefore, the terms deed and mortgage may be used interchangeably.
[73] MASS. GEN. LAWS ch. 183, § 29.

MASS. GEN. LAWS ch. 183, § 30 prescribes the authorized methods for making acknowledgements and the officers before whom acknowledgements may be made. In Massachusetts, a grantor's acknowledgement may be made before a notary public or justice of the peace.[74] An acknowledgment made outside of the Commonwealth of Massachusetts, but within the United States or any of its states, territories, or districts, may be made in the presence of a justice of the peace, notary public, magistrate, or commissioner appointed by the governor of this Commonwealth.[75] However, if taken by any *other* officer who is legally authorized to take an acknowledgement, a certificate of authority must be attached to the instrument in the form prescribed by MASS. GEN. LAWS ch. 183, § 33.[76] The certificate of authority must have attached to it either a certificate of the secretary of state where the officer resides or a certificate of a clerk of court where the officer resides or where the acknowledgement was made; both certificates must be made under seal.[77] The certificate of authority must state: (i) that said officer is duly authorized to take an acknowledgment in that state, (ii) that the secretary of state or clerk of court is well acquainted with the grantor's handwriting, and (iii) that the officer believes the grantor's signature to be genuine.[78] Massachusetts law is also specific as to which officers may take an acknowledgement outside of the United States, its territories and districts.[79] Finally, those who sign an instrument under their powers of attorney must also comply with the acknowledgement and recording laws discussed herein.[80]

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[74] MASS. GEN. LAWS ch. 183, § 30(a).
[75] MASS. GEN. LAWS ch. 183, § 30(b).
[76] *Id*. (emphasis added).
[77] MASS. GEN. LAWS ch. 183, § 33.
[78] *Id*.
[79] MASS. GEN. LAWS ch. 183, § 30(c).
[80] MASS. GEN. LAWS ch. 183, § 32.

The foregoing acknowledgement statutes provide ample opportunity for a lax mortgagee to make a serious error which could lead to the trustee avoiding the mortgage in the bankruptcy court. Here are some examples of errors that could potentially lead a mortgagee to disaster:

- The notary public's commission has expired.
- The acknowledgement is made in the presence of an officer who was not specifically prescribed by the statutes.
- The power of attorney has expired or is otherwise invalid.
- A certificate of authority is required and omits the seal.
- A certificate of authority is required and omits a statement that the secretary of state or clerk of court is well-acquainted with the grantor's signature and that it is believed to be genuine.

Although there does not appear to be any reported case law in Massachusetts in which a recorded instrument was invalidated for the above reasons, given the strong public policy in favor of strict adherence to the execution and acknowledgement formalities, it is quite possible that any of the above errors could lead to avoidance of a mortgage by the trustee as a bona fide purchaser.

(2) Mortgagee Name Errors

Outside of the realm of acknowledgements, there are other opportunities, however, which could result in mortgage avoidance. The following errors are less likely to occur, but are possible. For example, the mortgage may mistakenly omit reference to the mortgagee or list the wrong mortgagee altogether. In Massachusetts, a deed may not be accepted for recording unless it contains the grantee's full name and address, pursuant to MASS. GEN.

LAWS ch. 183, § 6.[81] A deed that totally omits the name of the grantee is invalid.[82] Furthermore, if the incorrect grantee is inadvertently named, the court will not allow parol evidence, absent a latent defect.[83] This statute states that the validity of the deed shall not be affected by failure to comply.[84] While it may be true that validity will not be affected as between the mortgagee and the mortgagor, a bona fide purchaser, such as the trustee, cannot be charged with constructive notice if the incorrect party is named as a mortgagee or the name is omitted altogether.[85]

(3) Defective Descriptions

The same argument can be made for a deed that is defective by reason of its property description. According to Massachusetts law, a deed shall not be accepted for recording unless it contains an adequate description of the land being conveyed.[86] The "adequate description" standard is easily met. However, it is possible that the mortgage's property description might accidentally be omitted in its entirety, describe the wrong property,[87] and/or fail to reference the property by incorporation. Under these circumstances, the trustee will not be on constructive notice and the mortgagee will lose its secured position if the trustee exercises his or her strong-arm powers.

(4) Obsolete Mortgage

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[81] MASS. GEN. LAWS ch. 183 § 6.
[82] *Flavin v. Morrissey*, 327 Mass. 217, 219 (1951); *Macurda v. Fuller*, 225 Mass. 341, 344 (1916).
[83] *Crawford v. Spencer*, 62 Mass. (1 Cush.) 418, 419-20 (1851)(an example of a latent defect is if a father and son had the exact same name and there was question as to which was the grantee).
[84] M.G.L. ch. 183, § 6.
[85] In recent Massachusetts bankruptcy decisions, self-proclaimed mortgage holders have been denied relief from automatic stay to foreclose on real estate because they failed to establish standing through "submission of an accurate history of the chain of ownership of the mortgage." *In re Hayes*, 393 B.R. 259, 269 (Bankr. D. Mass. 2008). Parties who do not hold or service the mortgage do not have standing to pursue relief from stay. S*ee In re Nosek*, 386 B.R. 374, 380 (Bankr. D. Mass. 2008), *reversed on other grounds*, 406 B.R. 434 (D. Mass. 2009).
[86] MASS. GEN. LAWS ch. 183, § 6A; *Suga v. Maum*, 29 Mass.App.Ct. 733, 737 (1991)(stating that a "description may be complete in itself, or it may incorporate other documents by reference").
[87] *See Headwall Recovery Corp. v. Adams Bldg. Corp.*, 66 Mass.App.Ct. 1118 (2006)(invalidating a foreclosure sale and deed because they described a parcel rather than the correct lot).

Under the obsolete mortgage statute, if a mortgage is unsatisfied 35 years after the date of its recording (if no term is stated therein) or after 5 years of the stated term, before the expiration of the 35 years or 5 years, as the case may be, a mortgagee must record an extension of the mortgage or affidavit stating that the mortgage is still unsatisfied.[88] If the mortgagee fails to take these steps, the mortgage is automatically considered discharged, and the mortgagee may not enter and foreclose upon the real estate.[89] In a bankruptcy setting, the mortgagee might seek approval of relief from automatic stay to foreclose on an unsatisfied mortgage. If the trustee is paying attention and notices that the mortgage has expired by the terms of this statute, the trustee may seek a determination that the mortgage is discharged and therefore not valid, if such action stands to benefit the bankruptcy estate. This particular statute does not seem to implicate the trustee's strong-arm powers as a bona fide purchaser because it is unnecessary to avoid a mortgage that has been automatically discharged as a matter of law. Note that recording an extension or affidavit to preserve the mortgage during the bankruptcy process does not constitute a violation of the automatic stay and is not avoidable by the trustee under § 544, as such an act merely preserves status quo of a valid mortgage and is not a transfer of property.[90]

E. Implications of Invalidated or Avoided Mortgage

[88] MASS. GEN. LAWS ch. 260, § 33. The extension and affidavit expire after 5 years. *Id*.
[89] M.G.L. ch. 260, § 33.
[90] In the case of *In re 201 Forest Street, LLC et al.*, 404 B.R. 6, 10 (Bankr. D. Mass. 2009) the mortgagee argued that the mortgagor knew that the mortgagee had been attempting to exercise its power of sale for years, but the mortgagor filed for bankruptcy protection preventing the mortgagee from recording an extension/affidavit, thus the mortgagor should not benefit from the statute. The court held that the mortgage was discharged by operation of law. *Id.* at 17. Note, however, that the court in *Shamus Holdings, LLC v. LBM Fin., LLC* (*In re Shamus Holdings, LLC)* held that recording an extension to prevent automatic discharge under obsolete mortgage statute would not be a violation of the automatic stay or a transfer of property that could be avoided under § 544, as it is merely continuing the status quo of a duly perfected mortgage. 2009 WL 2407664, at *11 (Bankr. D. Mass. Aug. 5, 2009).

The all-important question is: What happens when a mortgage is declared invalid or avoided by the efforts of the trustee using his strong-arm powers? As a practical matter, the trustee will not avoid or seek to invalidate the mortgage unless the bankruptcy estate stands to benefit. If the second or third mortgage is avoided, for example, and there is no equity in the real estate due to a valid first mortgage, the estate would not benefit. Conversely, if a fair amount of equity in the real estate would remain after the mortgage is avoided, then the trustee will likely pursue the matter to enable a distribution to creditors of the estate. The next question is logically this: Why is a debtor, who has duly recorded a declaration of homestead, not entitled to the equity? The case of *In re Guido* amply addressed this question and held that the declaration of homestead is subordinated to a mortgage which has been preserved for the benefit of the estate. [91]

(1) Declaration of Homestead Subordinated to Avoided Mortgage - *In re Guido*

Jule A. Guido ("Guido") purchased residential real estate on March 18, 1994.[92] She financed the purchase and granted a first mortgage to Milford Federal Savings Bank and Loan.[93] Then, on March 31, 1997, Guido granted Diversified Coolidge Realty Corporation ("Diversified") a second mortgage to secure an additional loan.[94] Diversified, however, failed to record the second mortgage at that time.[95] Some time later, Diversified sued Guido in state court and obtained a judgment as a result of Guido's defaulted loan payments.[96] Diversified levied on the real estate by recording the execution at the registry of deeds, which

[91] *In re Guido*, 344 B.R. 193, 200 (Bankr. D. Mass. 2006).
[92] *Id*. at 194.
[93] *Id*.
[94] *Id*.
[95] *Id*.
[96] *Id*.

prompted Guido to file a declaration of homestead on July 1, 2004.[97] Finally, on November 10, 2004, Diversified recorded its second mortgage at the registry of deeds.[98]

Guido filed for chapter 7 bankruptcy protection on February 7, 2005.[99] As a result, the trustee in bankruptcy filed an adversary proceeding against Diversified to avoid the second mortgage, as it was preferential under 11 U.S.C. § 547(b) (i.e., the mortgage was recorded within 90 days of the bankruptcy filing).[100] The trustee successfully preserved a portion of the value of the second mortgage for the bankruptcy estate through settlement.[101] Apparently hoping to preserve her own equity in the real property, Guido filed a motion to compel the trustee to abandon the second mortgage.[102] She argued that the second mortgage was subordinated in right to her homestead, because the homestead was recorded before the second mortgage.[103] Furthermore, she argued that any equity that resulted in the avoided mortgage was insignificant and burdensome to the estate, and should thus be abandoned by the trustee.[104]

The court considered which claim took priority: the second mortgage that was signed on March 31, 1997 (not recorded until November 10, 2004) or the declaration of homestead recorded on July 1, 2004. The court held that the second mortgage was unhampered by § 522(c), and under Massachusetts law, had priority over the declaration of homestead (regardless of the fact that the homestead was recorded before the second mortgage).[105] The court stated that it is well-settled that, while the trustee assumes the secured position formerly

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[97] *Id*.
[98] *Id*. at 195.
[99] *Id*.
[100] *Id*.
[101] *Id*.
[102] *Id*.
[103] *Id*.
[104] *Id*. at 195-96.
[105] *Id*. at 198.

held by the mortgagee, 11 U.S.C. § 551 does not elevate the priority of the avoided transfer.[106] The mortgage has only the priority it would have held under applicable state law.[107] In this case, the homestead was on record prior to the second mortgage.[108]

Notwithstanding the order of recording, based on precedent and supporting Massachusetts law, the court held that a previously recorded declaration of homestead is subordinate to a subsequently recorded mortgage.[109] This holds true even if the mortgage does not include a provision that expressly releases or subordinates the homestead, provided however that the mortgage contains words of grant and standard mortgage covenants.[110] The court found that second mortgage in question did contain the requisite mortgage covenants under Massachusetts law.[111] Thus, the court ruled that as between Guido and the trustee, the trustee held the second mortgage pursuant to 11 U.S.C. § 551, and the second mortgage enjoyed priority over the declaration of homestead.[112] Guido's motion to compel the trustee to abandon the second mortgage was consequently denied, as the second mortgage held value to the bankruptcy estate.

(2) Preservation of the Mortgage for the Benefit of the Estate

After the trustee avoids a mortgage, 11 U.S.C. § 551[113] automatically preserves the mortgage in the same secured position it had prior to avoidance so that a junior mortgage does not gain priority over it to the detriment of the bankruptcy estate. Otherwise, the trustee would first have to pay off all the junior liens before the trustee could realize any benefit of

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[106] *Id.*
[107] *Id.*
[108] *Id.*
[109] *Id.* at 198-99.
[110] *Id.* at 199 (citing *In re Desroches*, 314 B.R. 19, 22 (Bankr. D. Mass. 2004); *Atlantic Savings Bank v. Metropolitan Bank and Trust*, 9 Mass.App.Ct. 286 (1980).
[111] *Id.* at 199-200
[112] *Id.* at 200.
[113] "Any transfer avoided under … 544 … of this title … is preserved for the benefit of the estate but only with respect to property of the estate." 11 U.S.C. § 551.

equity for the estate. The trustee stands in the shoes of the creditor whose mortgage was avoided. The avoided mortgage's priority is not superior over senior mortgages. Once the trustee successfully avoids the mortgage, the mortgage is preserved for the bankruptcy estate, and the mortgagee is left holding an unsecured debt—a very undesirable situation for the mortgagee.

F. Conclusion

Simple mistakes were fatal to the mortgagees discussed above. The point lenders and practitioners should take away from this is that they must familiarize themselves with the applicable Massachusetts statutes and exercise extreme care to adhere to them. During a time when bankruptcy filings are increasing and debtors are surrendering their homes more frequently, mortgagees are particularly susceptible to avoidance of their mortgages by the trustee utilizing his strong-arm powers under § 544.