

UNITED STATES DISTRICT COURT  
DISTRICT OF VERMONT

MORTGAGE LENDERS NETWORK, :  
USA :

v. :

JAN SENSENICH, TRUSTEE, :  
and STANLEY AND SUSAN POTTER :  
\_\_\_\_\_ :

CIVIL NO. 1:01CV835

01-1031  
USPX-VT  
#27-1

CLERK  
BY  
DEPUTY CLERK

2002 JAN 22 3:37

U.S. DISTRICT COURT  
DISTRICT OF VERMONT  
FILED

MEMORANDUM OF DECISION

The issue in this appeal is whether, under applicable provisions of Vermont and federal bankruptcy law, the proper filing of a foreclosure complaint serves as constructive notice of the underlying, defective mortgage, and thereby divests a bankruptcy trustee of his ability to avoid the lien. The Bankruptcy Court (Colleen A. Brown, B.J.) held that such filing does not. For the reasons set forth below, the ruling of the Bankruptcy Court is AFFIRMED.

Background

The District Court has jurisdiction over appeals from final judgments of the Bankruptcy Court. 28 U.S.C. § 158(a). It will not disturb a Bankruptcy Court's findings of fact unless clearly erroneous. See, e.g., In re Parrotte, 22 F.3d 472, 474 (2d Cir. 1994). However, legal determinations are

subject to de novo review. Id.; In re Donahue, 232 B.R. 610, 613 (D. Vt. 1999).

The facts underlying this dispute are straightforward and undisputed. See Brief of Appellee (Paper 6) at 2 (trustee agrees with appellant's statement of the case).

The home mortgage at issue was executed on December 10, 1998. See Amended Record on Appeal (Paper 5) at 46-47.

Although the mortgage was recorded in the land records, it was not properly witnessed as required by 27 V.S.A. § 341. In relevant part, § 341(a) requires that "conveyances of land . . . shall be signed by . . . two or more witnesses . . . ."

On January 24, 2000, Mortgage Lenders Network USA (hereinafter "Mortgage Lenders") initiated a foreclosure action in Rutland Superior Court against the debtors, Stanley and Susan Potter. Paper 5 at 37. Mortgage Lenders properly filed its foreclosure complaint in the Rutland Clerk's Office. On March 31, 2000, the state court issued a Judgment Order and Decree of Foreclosure in favor of Mortgage Lenders. See Paper 5 at 39.

On May 22, 2000, the debtors filed for relief under Chapter 13 of the Bankruptcy Code. About one month later, the Chapter 13 trustee initiated this adversary proceeding. See Paper 5 at 43. The trustee sought to avoid Mortgage Lenders' mortgage on debtors' property based on the lender's failure to

comply with 27 V.S.A. § 341. In response, Mortgage Lenders argued that its filing of the foreclosure complaint in the Rutland Clerk's Office constituted constructive notice sufficient to prevent the trustee from avoiding its mortgage on the Potters' homestead property. See 12 V.S.A. § 4523(b) (filing provides notice of the foreclosure action).

Upon consideration of cross-motions for summary judgment, Judge Brown declared "[a]ny lien on the subject premises arising from the defendant's invalid mortgage is avoided. . . ." Paper 5 at 8 (Amended Memorandum of Decision dated September 21, 2001). She reasoned:

The majority of jurisdictions that have addressed the issue hold that instruments that are deemed defective because of a missing signature fail to impart constructive notice to a subsequent purchaser. . . . These cases deal with the very issue raised herein and defeat Mortgage Lenders' argument that the trustee had constructive notice of the mortgage because it filed the Foreclosure Complaint in the Rutland clerk's office. Vermont law is clear that an invalid mortgage is not sufficient to put someone on notice and that a deed or mortgage that is improperly witnessed or acknowledged is deemed invalid. . . . Moreover, Vermont courts construe the doctrine of lis pendens strictly and against extending its operation without strict necessity. The simple act of recording a copy of foreclosure proceedings based upon an invalid mortgage as described in 12 V.S.A. § 4523(b) cannot by legerdemain somehow cure the fatal defect and create a valid instrument for purposes of constructive notice.

Paper 5 at 7 (citations omitted). Mortgage Lenders appealed this ruling.

### Discussion

Mortgage Lenders' claim is that, despite the fact that the mortgage at issue was defectively executed in that it lacked two witnesses, its subsequent recording of the foreclosure complaint somehow makes the mortgage valid and provides constructive notice sufficient to defeat the bankruptcy trustee's rights under 11 U.S.C. § 544(a)(3). As correctly noted by the Bankruptcy Court, resolution of this matter involves the interplay of Vermont property law and federal bankruptcy law.

"Under 12 V.S.A. § 4523(b), the filing of a foreclosure complaint in the town clerk's office constitutes notice to all persons who subsequently acquire 'any interest' in the mortgaged premises." Green Mountain Bank v. Bruehl, 148 Vt. 567, 568 (1987). "Once notice is given by filing the complaint in the town clerk's office, the foreclosure action supersedes any after-acquired interest, and the possessors of any such interest are 'foreclosed from all rights or equity in the premises as completely as though they had been parties in the original action'. 12 V.S.A. § 4523(b)." Id. at 569. Therefore, in most cases, Mortgage Lenders' filing of its foreclosure complaint would foreclose another party from asserting an after-acquired interest.

However, in this case, the Chapter 13 trustee has unique statutory rights. Under 11 U.S.C. § 544(a)(3),

[t]he trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any other 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 . . . 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.

Therefore, in this case, "without regard to any [actual] knowledge," the trustee may avoid Mortgage Lenders' recorded but defective mortgage, if, under similar circumstances, the mortgage would be ineffective to give notice to a theoretical, bona fide purchaser who purchased the property at the commencement of the bankruptcy case.

In the only apparent case to examine this question, the First Circuit, in In re Ryan, 851 F.2d 502 (1988) concluded that, under Vermont law, a mortgage deed which was defective because it lacked two witnesses could not serve as constructive notice and therefore could not defeat the priority of a bankruptcy trustee. Citing long-established Vermont law, the Ryan court explained:

In Day v. Adams, 42 Vt. 510 (1869), the Vermont Supreme Court ruled that a mortgage deed which lacked the signatures of two witnesses was

"defective" under the Vermont recording statute, Vt.Stat.Ann.tit. 27, § 341 . . . (modern day codification of the two witnesses rule used in Day v. Adams). Even though physically registered with the town clerk, the deed could not serve as constructive notice to future purchasers. 42 Vt. 515. This clear holding of the Vermont Supreme Court is, in our view, entirely dispositive of whether the trustee had constructive notice: under Day, as the mortgage here lacked the signature of one witness, it could not serve as constructive notice to a future purchaser.

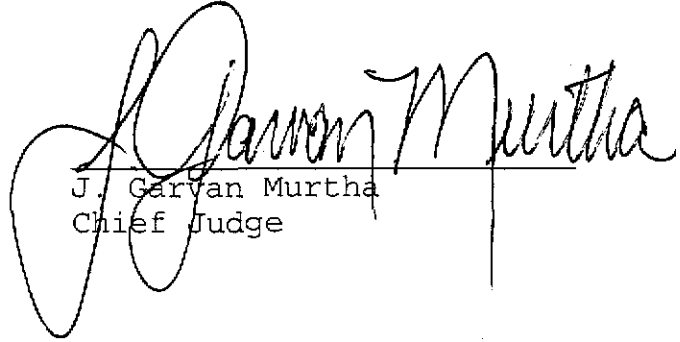
851 F.2d at 507.

As applied to this case, since the defectively-witnessed mortgage could not serve as constructive notice, 11 U.S.C. § 344 accords the trustee the status of a bona fide purchaser who, in turn, could avoid Mortgage Lenders' lien. That Mortgage Lenders filed its foreclosure complaint does not alter the fact that, under Vermont law and prior to the debtors' filing for bankruptcy, the mortgage itself was insufficient to constitute notice to a subsequent bona fide purchaser. See Day v. Adams, 42 Vt. 515; see also Merchants Bank v. Bouchard, 153 Vt. 6, 11 (1989) (two subscribing witnesses are required for a valid deed); cf. In re SSL Corp., 26 F.3d 302 (2d Cir. 1994) (a pre-petition recording of an affidavit adding a second witness could cure the defect and prohibit the trustee from assuming the status of a hypothetical bona fide purchaser under § 544(a)(3)).

The decision of the Bankruptcy Court is AFFIRMED.

SO ORDERED.

Dated at Brattleboro, Vermont, this 2ND day of January,  
2002.



J. Garvan Murtha  
Chief Judge

8

# United States District Court

District of Vermont

MORTGAGE LENDERS NETWORK, USA, :  
: Appellant, :  
: v. :  
JAN SENSENICH, Trustee; :  
STANLEY POTTER, and :  
SUSAN POTTER, :  
: Appellees. :

**JUDGMENT IN A CIVIL CASE**  
CASE NUMBER: 1:01-CV-335

U.S. DISTRICT COURT  
DISTRICT OF VERMONT  
FILED  
2002 JAN 23 8 12:01  
BY CLERK  
DEPUTY CLERK

       **Jury Verdict.** This action came before the Court for trial by jury. The issues have been tried and the jury has rendered its verdict.  
  X   **Decision by Court.** This action came to trial or hearing before the Court. The issues have been tried or heard and a decision has been rendered.

**IT IS ORDERED AND ADJUDGED** that pursuant to the Court's Memorandum of Decision (Paper No. 7) filed January 7, 2002, the ruling of the Bankruptcy Court is **AFFIRMED**.

Date: January 23, 2002

RICHARD PAUL WASKO  
Clerk

*William J. Lopez*  
(By) Deputy Clerk

JUDGMENT ENTERED ON DOCKET  
DATE: 01/23/02

0



RICHARD PAUL WASKO  
CLERK

UNITED STATES DISTRICT COURT  
OFFICE OF THE CLERK  
DISTRICT OF VERMONT  
FEDERAL BUILDING  
BURLINGTON, VERMONT 05402-0945

■ BURLINGTON:  
(MAIN HEADQUARTERS)  
P.O. BOX 945  
(802-951-6301)

■ RUTLAND 05702-0607  
(DIVISIONAL OFFICE)  
P.O. BOX 607  
(802-773-0245)

■ BRATTLEBORO 05302-0998  
(DIVISIONAL OFFICE)  
P.O. BOX 998  
(802-254-0250)

Civil Action No. 1:01-cv-335 Date January 23, 2002

Mortgage Lenders vs. Sensenich, et al

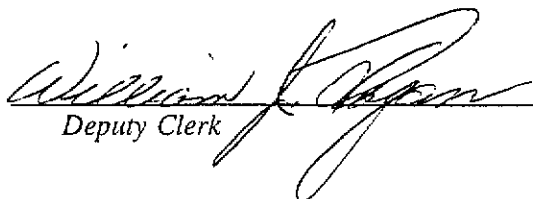
NOTICE TO LITIGANTS

If you wish to appeal the enclosed judgment or order, you must file a Notice of Appeal within 30 days after date of the entry of the judgment or order appealed from (or 60 days if the United States or an officer or agency of the United States is a party). Fed.R.App.P. 4(a)(1). The fee for filing an appeal is \$105.00.

If you wish to appeal but are unable to file your Notice of Appeal within 30 days [or 60 days if applicable] after the date of entry shown on line 2 below, then you have an additional 30 days to file a Motion for Extension of Time. The Motion for Extension of Time **must** be filed within the additional 30 days after the date on line 3 below. Every Motion for Extension of Time must contain an explanation which demonstrates "good cause" or "excusable neglect" for failure to file the Notice of Appeal within the time limit required. Fed.R.App.P. 4(a)(5).

**PLEASE TAKE NOTICE**

- |  |                          |
|--|--------------------------|
| 1. Judgment or Order filed   | <u>January 23, 2002</u>  |
| 2. Date of Entry of Judgment or<br>Order on the docket of this court | <u>January 23, 2002</u>  |
| 3. Notice of Appeal <b>MUST</b> be filed<br>on or before             | <u>February 22, 2002</u> |

  
Deputy Clerk