

Release and Reinstatement of
Trust Deed
Mistake
11 U.S.C. § 544(a)(3)
11 U.S.C. § 547(b)
Preference

Gray v. Household Finance Corp. II, Adversary No. 02-3587-elp
In re Gray, Case No. 302-42486-elp13

05/07/03

ELP

Unpub.

The issues in this adversary proceeding, which were tried on stipulated facts, are whether a trust deed that was released by mistake prepetition may be reinstated and, if so, whether the security interest is avoidable under §§ 544 or 547. The court concludes that the trust deed may be reinstated and that the security interest is not avoidable.

The court concludes that Oregon law follows the general rule that, in the absence of prejudice to any party acting in reliance on the release, a mortgage released by mistake may be reinstated to its original priority.

The court then explains that the security interest was not avoidable under § 544, because the plaintiff had constructive notice of the security interest by virtue of the defendant's prepetition filing of a notice of lis pendens. The court rejects the plaintiff's argument that §§ 544 and 547 work interactively, so that if the filing of the lis pendens is avoidable under § 547, it cannot provide notice under § 544. The court states that a party seeking avoidance under § 544 must prove the elements of that claim independently of the operation of § 547.

Finally, the court concludes that the security interest is not avoidable as a preference under § 547, because once the trust deed is reinstated with its original priority, the relevant transfer is that which occurred when the trust deed was originally recorded, a date that was well outside of the 90 day preference period.

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UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF OREGON

In Re:)	Bankruptcy Case
)	No. 302-42486-elp13
CHRISTOPHER ELLIOT GRAY,)	
)	
Debtor.)	
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CHRISTOPHER ELLIOT GRAY,)	Adversary No. 02-3587-elp
)	
Plaintiff,)	
)	
v.)	MEMORANDUM OPINION
)	
HOUSEHOLD FINANCE CORP. II,)	
)	
Defendant.)	

The issues in this adversary proceeding are whether a trust deed that has been released by mistake may be reinstated and, if so, whether the security interest is avoidable under §§ 544 or 547.¹ These issues were tried on stipulated facts. For the reasons

¹ Unless otherwise indicated, all section references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330.

1 discussed below, I conclude that the trust deed may be reinstated,
2 and that the security interest is not avoidable.

3 FACTS

4 On April 5, 2001, Christopher E. Gray ("plaintiff") executed
5 a note payable to Household Finance Corp. II ("HFC"). The note was
6 secured by a deed of trust of the same date. The deed of trust
7 encumbered real property located at 13189 Southwest 154th Ave,
8 Tigard, Oregon 97223 ("the property"). There is no dispute that the
9 deed of trust was properly recorded in the real property records for
10 Washington County.²

11 On February 21, 2002, HFC mistakenly recorded an Appointment
12 of Successor Trustee and Deed of Full Reconveyance ("the
13 reconveyance"). According to HFC's proof of claim in this case,
14 plaintiff still owed HFC approximately \$223,626.98 on the note as of
15 the petition date.

16 On September 21, 2002, HFC recorded a Notice of Lis Pendens
17 in the Washington County real property records. The notice stated
18 that HFC had filed an action against plaintiff in state court and
19 that "[t]he object of the action is: Complaint to set aside
20 Reconveyance, for Declaratory Relief regarding Reconveyance and for
21 Recovery of Funds or Damages[.]" Notice of Lis Pendens, ¶ 3. HFC,
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23 ² These facts concerning the note and deed of trust are
24 taken from the parties' stipulated facts. The parties state in
25 their stipulated facts that exhibits A and B are copies of the note
26 and trust deed, respectively. Exhibits A and B appear to be
documents relating to an earlier loan, not the transaction at issue
here.

1 in its state court complaint, requested that the reconveyance be
2 rescinded, cancelled or declared void ab initio and that the deed of
3 trust be reinstated with its original validity and priority.

4 After plaintiff filed his chapter 13 petition, he instituted
5 this adversary proceeding against HFC. In his first claim for
6 relief, plaintiff seeks a determination that HFC has no security
7 interest in the property. In his second claim for relief, plaintiff
8 alleges that, if HFC does have a security interest in the property,
9 that interest is avoidable under § 544(a)(3) as an unperfected
10 security interest. Finally, in his third claim for relief,
11 plaintiff alleges that, "if HFC has a perfected security interest in
12 the Property by virtue of the recording of the Lis Pendens," that
13 interest is avoidable as a preferential transfer under § 547(b).
14 Adversary Complaint, ¶ 25.³

15 ISSUES

- 16 1. Whether HFC has a security interest in the property.
- 17 2. Whether HFC's security interest may be avoided under
18 § 544(a)(3).
- 19 3. Whether HFC's security interest may be avoided under
20 § 547(b).

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25 ³ The chapter 13 trustee has assigned the avoidance claims
26 to plaintiff.

1 DISCUSSION

2 1. HFC has a security interest in the property.

3 State law governs whether and to what extent a creditor holds
4 security interests in a debtor's property. In re Bakersfield Westar
5 Ambulance, Inc., 123 F.3d 1243, 1246 (9th Cir. 1997). Generally,
6 where a mortgage has been released by mistake, the release may be
7 vacated and the mortgage reinstated.

8 It is a generally accepted rule that where a mortgage . . .
9 has been released or satisfied through mistake, it may be
10 restored in equity and given its original priority as a
11 lien[,] provided no injury is inflicted on one who has
12 innocently relied on the release and either purchased the
13 property or made a loan thereon on the strength of such
14 cancellation. . . . "The principle which underlies all the
15 reported decisions . . . is, when the legal rights of the
16 parties have been changed by mistake, equity restores them to
17 their former condition, when it can be done without
18 interfering with any new rights acquired on the faith and
19 strength of the altered condition of the legal rights, and
20 without doing injustice to other parties."

21 United States v. 168.8 Acres of Land, 35 F.Supp. 724, 726-27
22 (M.D.N.C. 1940)(quoting Lumber Exch. Bank v. Miller, 40 N.Y.S. 1073
23 (N.Y. App. Div. 1896))(citations omitted). See also 55 AM.JUR.2D
24 MORTGAGES § 474 (1996); 59 C.J.S. MORTGAGES § 260 (2002).

25 Oregon law is in accord. In Holzmeier v. Van Doren, 172 Or.
26 176 (1943), a first priority deed of trust was released based on the
mistaken belief that certain real property was not encumbered by
junior liens. The Oregon Supreme Court affirmed the trial court's
decree cancelling the reconveyance of the deed. In so doing, the
court rejected the argument that relief was only appropriate where
the mistake was not attributable to the plaintiff's own negligence.
The court concluded that, in the absence of prejudice, a

1 "considerable degree of carelessness" would not bar relief. Id. at
2 189.⁴

3 The parties have stipulated that HFC "executed and filed the
4 Reconveyance by mistake, since Plaintiff has not paid the underlying
5 obligation." Stipulated Facts, ¶ 4. There is no indication that
6 reinstating HFC's deed of trust will prejudice any third party who
7 acted in reliance on that release.⁵

8 Plaintiff cites Oregon statutes governing the creation,
9 perfection and release of security interests in real property. To
10 the extent plaintiff is arguing that HFC cannot have a security
11 interest in the property without again complying with those
12 statutory requirements, I reject that argument. Where a lien is
13 discharged by mistake, equity merely reinstates the lien, it does
14 not create a new one. See French v. DeBow, 1878 WL 3406, *2 (Mich.
15 1878).

16 2. Plaintiff may not avoid HFC's security interest under
17 § 544(a)(3).

18 § 544(a) provides, in relevant part, that
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21 ⁴ HFC also relies on Oregon Bank v. Hildenbrand, 81 Or.App.
22 171 (1986). This case does not support HFC's position. The court
23 in Oregon Bank allowed reinstatement of the mortgage "[w]ithout
24 considering [the] plaintiff's claim of inadvertence and mistake."
25 Id. at 176.

26 ⁵ While plaintiff does argue that the trustee's rights will
be prejudiced by reinstatement of the deed of trust, the validity of
that claim depends on whether the requirements for avoidance under
§ 544 are met. I will address that issue in the next section of
this memorandum.

1 [t]he trustee shall have, as of the commencement of the case,
2 and without regard to any knowledge of the trustee or of any
3 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--

4 . . .

5 (3) a bona fide purchaser of real property . . . from
6 the debtor, against whom applicable law permits such
7 transfer to be perfected, that obtains the status of a
8 bona fide purchaser and has perfected such transfer at
the time of the commencement of the case, whether or not
such a purchaser exists.

9 This provision allows the trustee to avoid an interest in real
10 property that would be voidable under state law by a bona fide
11 purchaser. In re Michael, 49 F.3d 499, 501 (9th Cir. 1995).

12 "To qualify as a bona fide purchaser" under Oregon law, a
13 purchaser must have acquired its interest "without any knowledge or
14 notice of the" prior claim. Akins v. Vermast, 150 Or.App. 236, 241
15 (1997). "The notice that will deprive the mortgagee of priority can
16 be either actual or constructive." High v. Davis, 283 Or. 315, 333
17 (1978)(en banc). "Constructive notice may be 'record notice' (a
18 recorded document) or 'inquiry notice' (a duty to inquire)." Akins,
19 150 Or.App. at 242 (citations omitted). The filing of a notice of
20 lis pendens "is notice . . . of the rights and equities in the
21 premises of the party filing the notice." ORS 93.740(1).

22 Plaintiff may not avoid HFC's security interest, because he
23 had constructive notice of HFC's interest in the property by virtue
24 of HFC's prepetition filing of a notice of lis pendens. See In re
25 Gurs, 27 B.R. 163, 165 (9th Cir. BAP 1983)(§ 544(a)(3) claim
26 defeated by filing of notice lis pendens).

1 Plaintiff concedes in his trial memo that the filing of a
2 notice of lis pendens will normally defeat a § 544 avoidance action.

3 However, plaintiff argues that,

4 in the case at hand, the recording of the Lis Pendens against
5 [plaintiff's] Property is a transfer avoidable under 11
6 U.S.C. § 547(b) as a preference. Due to the avoidance of the
7 Lis Pendens, no other document satisfying the requirements of
8 ORS 93.643⁶ was filed in the county records, therefore,
9 [HFC's] unperfected security interest is avoidable pursuant
10 to 11 U.S.C. § 544(a)(3).

11 Plaintiff's Trial Memo, 9:4-8.

12 The problem with plaintiff's argument is that it assumes that
13 §§ 544 and 547 operate interactively, which they do not. A party
14 seeking avoidance under § 544 must prove the elements of that claim
15 independently of the operation of § 547. In re Gurs, 34 B.R. 755,
16 757 (9th Cir. BAP 1983). Assuming HFC's filing of the notice of lis
17 pendens effected a transfer that may be avoided in bankruptcy under
18 § 547(b), it does not follow that the notice can be treated as if it
19 never existed for purposes of a § 554(a)(3) analysis. There is a
20 difference, which plaintiff seeks to ignore, between avoidance and

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22 ⁶ With certain exceptions not relevant here, ORS 93.643(1)
23 provides that

24 [t]o give constructive notice of an interest in real property,
25 a person must have documentation of the interest recorded in
26 the indices maintained under ORS 205.130 in the county where
the property is located. Such recordation, and no other
record, constitutes constructive notice to any person of the
existence of the interest[.]

1 declaring something void from its inception. In appropriate
2 circumstances, § 547(b) allows the former, not the latter.⁷

3 3. Plaintiff may not avoid HFC's security interest under
4 § 547(b).

5 With certain exceptions not relevant here, § 547(b) states
6 that

7 the trustee may avoid any transfer of an interest of the
8 debtor in property--

9 (1) to or for the benefit of a creditor;

10 (2) for or on account of an antecedent debt owed by the
debtor before such transfer was made;

11 (3) made while the debtor was insolvent;

12 (4) made--

13 (A) on or within 90 days before the date of the
14 filing of the petition; or

15 (B) between ninety days and one year before the
16 date of the filing of the petition, if such
creditor at the time of such transfer was an
insider; and

17 (5) that enables such creditor to receive more than such
18 creditor would receive if--

19 (A) the case were a case under chapter 7 of this
20 title;

21 ⁷ Citing In re Professional Investment Properties of Am.,
22 955 F.2d 623 (9th Cir. 1992), HFC also argues that certain portions
23 of the chapter 13 bankruptcy schedules and proposed plan filed in
24 this case put plaintiff on inquiry notice of HFC's claim to the
25 property. Plaintiff disagrees, citing In re Clearwater, 1997 WL
26 101975 (Bankr. D. Or. 1997). Because I have decided that plaintiff
had constructive notice of HFC's claim to the property by virtue of
the filing of the notice of lis pendens, I need not decide whether
plaintiff's bankruptcy schedules and proposed plan also imparted
notice of HFC's interest in the property.

1 (B) the transfer had not been made; and

2 (C) such creditor received payment of such debt to
3 the extent provided by the provisions of this
title.

4 The issue in this case is whether there was a transfer within the 90
5 day preference period.⁸ HFC does not dispute that the other
6 requirements are met. Plaintiff's argument is that HFC's filing of
7 the notice of lis pendens was an avoidable transfer of an interest
8 of debtor in property under 547(b), and that the avoidance of that
9 transfer results in the avoidance of HFC's security interest in the
10 property. I disagree.

11 Plaintiff relies solely on In re Lane, 980 F.2d 601 (9th Cir.
12 1992), but the facts of Lane are distinguishable from those of this
13 case. In Lane, a creditor initiated a prepetition California state
14 court action against the debtor. Shortly thereafter, the creditor
15 filed a notice of lis pendens. The state court entered a judgment
16 in favor of the creditor. Lane filed a bankruptcy petition and,
17 within 90 days preceding the filing of the petition, the creditor
18 recorded the state court judgment. The Ninth Circuit affirmed the
19 bankruptcy court's determination that the creditor's security
20 interest was not avoidable under § 547. The court in Lane held that
21 under California law, the filing of the notice of lis pendens was a
22 transfer within the meaning of § 547, and that the creditor's
23 interest in Lane's property created pursuant to the recordation of
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25 ⁸ There is no indication that the longer preference period
26 for insiders provided for under § 547(b)(4)(B) is applicable in this
case.

1 the judgment related back to the date the lis pendens was filed, a
2 date that was outside of the preference period.

3 In this case, the facts and applicable state law differ from
4 those presented in Lane. The court in Lane acknowledged that the
5 operation of a notice of lis pendens is determined "by the terms and
6 effective scope of the" ultimate decision concerning the property in
7 dispute. 980 F.2d at 604. As I have discussed above, Oregon law
8 requires that the reconveyance be set aside and HFC's lien restored
9 to its original priority. Plaintiff's argument misses the point
10 that once the reconveyance is cancelled, and HFC's deed is
11 reinstated to its original priority, the relevant transfer is that
12 which occurred in April 2001 when the trust deed was originally
13 recorded, a date that is well outside of the preference period.

14 Thus, assuming that HFC's filing of a notice of lis pendens
15 effected a transfer within the meaning of § 547, avoidance of that
16 transfer does not equate to avoidance of HFC's security interest in
17 the property. The creation and validity of HFC's security interest
18 is not dependent on the filing of the notice of lis pendens. Under
19 Oregon law, HFC's interest in the property was created in April of
20 2001. Absent a bona fide purchaser or other transferee with greater
21 rights under Oregon law, the reinstatement of HFC's lien by vacating
22 the mistakenly filed reconveyance is continuously effective from the
23 original date of the trust deed.

24 CONCLUSION

25 For the reasons set forth above, I conclude that HFC has a
26 security interest in the property and that the security interest is

1 not avoidable under §§ 544 or 547. Counsel for HFC shall lodge a
2 judgment within ten (10) days of entry of this memorandum opinion.

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ELIZABETH L. PERRIS
Bankruptcy Judge

cc: Krista L. White
Robert J Vanden Bos
United States Trustee
Rick A. Yarnall