

UNAUTHORIZED CANCELLATION OR SATISFACTION; DOCUMENTS OF RESCISSION

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1. Mortgages and deeds of trust - Unauthorized cancellation or satisfaction and reinstatement

There are several reported cases dealing with unauthorized cancellation of record and its effect on purchasers and lenders, not to mention title examiners.

In *Household Realty Corp. v. Lambeth*¹, the most recent case citing the others, a recorded deed of trust was given by Lambeth, the owner, to a trustee for Axiom and Axiom assigned the note and deed of trust to Household. Household recorded its deed of trust assignment. Lambeth quitclaim deeded the property to Heineman and Johnson, trustees of the Lambeth Family Trust. The opinion indicates that, in a wild set of facts, even Lambeth became a substitute trustee of record improperly, Heineman as trustee of the deed of trust improperly executed a "Full Reconveyance" which the court characterized as an unauthorized cancellation, which also reconveyed the property to the Lambeth Family Trust. Months later, Fremont, relying on the public records, recorded its deed of trust from "Lambeth" securing a new loan. (The opinion is not clear whether Lambeth or the Lambeth Family Trust was in title.) Subsequently, in litigation, judgments were entered reinstating the Household deed of trust as of its original recording and establishing its priority ahead of Fremont's deed of trust. The Court of Appeals affirmed, holding for Household, citing prior cases and analyzing them. The published cases cited were *First Financial Savings Bank, Inc. v. Sledge*², *Monteith v. Welch*³, and *Union Central Life Ins. Co. v. Cates*⁴.

In *Monteith v. Welch*⁵, the owner granted a deed of trust to Franks, trustee for the Monteiths; years later, the property was sold to the Welches; at the closing, the Welches, aware of the Monteiths' deed of trust, gave Franks the money to pay the Monteiths and cancel their deed of trust; eight days later, Franks cancelled the Monteiths' deed of trust but did not pay the Monteiths, who then sued to reestablish their deed of trust. The Supreme Court held that since the Welches had notice of the Monteiths' deed of trust, they did not qualify as subsequent innocent purchasers. In the course of its discussion, the Court noted that "[t]he cancellation made by Franks could not, in any event, protect [the Welches] unless it was made before they purchased and in fact purchased relying on its validity." The *Household* Court of Appeals noted, but dismissed, an unpublished Fourth Circuit Court of Appeals' opinion.⁶

In *Household*⁷, the court held that *Union Cent. Life Ins. Co. v. Cates*,⁸ followed in *First Financial*,⁹ is the longstanding rule in North Carolina, and thus controlled the resolution of *Household*. *Union Central* held that:

As between a mortgagee, whose mortgage has been discharged of record solely through the act of a third person, whose act was unauthorized by the mortgagee, and for which he is in no way responsible, and a person who has been induced by such cancellation to believe that the mortgage has been canceled in good faith ... the equities are balanced, and the lien of the prior mortgage, being first in order of time, is superior.

¹ *Household Realty Corp. v. Lambeth*, ___ N.C. App. ___, 656 S.E.2d 336 (2008)

² *First Financial Savings Bank, Inc. v. Sledge*, 106 N.C. App. 87, 415 S.E. 2d 206 (1992)

³ *Monteith v. Welch*, 244 N.C. 415, 94 S.E. 2d 345 (1956)

⁴ *Union Central Life Ins. Co. v. Cates*, 193 N.C. 456, 137 S.E. 324 (1927)

⁵ N. 3, supra

⁶ See n. 1, supra. *Household* noted that in *Smith v. United Carolina Bank*, 1995 WL 11908, 1995 U.S. App. Lexis 696 (4th Cir. Jan. 13, 1995), the Fourth Circuit, in an unpublished opinion referencing the *Monteith* opinion, stated:

From this passage, we discern the following rule of North Carolina law: a subsequent lien creditor with a properly recorded deed of trust enjoys priority, despite the unauthorized cancellation of a prior deed of trust, if the subsequent creditor obtains its deed of trust after the cancellation has occurred, in reliance on the cancellation's validity, and without knowledge that the cancellation was unauthorized.

Id. at 3, 1995 U.S. App. Lexis 696 at 9. *Household* stated that "passage," however, was plainly *obiter dictum*. and did not constitute the Court's holding in *Monteith*. Furthermore, any purported rule of law that the Fourth Circuit formulated in an unpublished opinion based on that *dictum* was not controlling on the *Household* court

⁷ N. 1, supra

⁸ N. 4, supra

⁹ N. 2, supra

In *First Financial*,¹⁰ the Sledges granted a deed of trust to Boyde, trustee for First Financial, which was recorded. The deed of trust described lots 28, 29, 31, 34 and 35. After receiving the fee for lot 31, First Financial gave Mr. Sledge the unrecorded deed releasing lot 31. Without the knowledge or authorization of First Financial, Mr. Sledge altered the release deed to include lots 28, 29, and 34, as well as lot 31. Mr. Sledge then recorded the release deed. Later, Sledge sold and conveyed lot 34 to the Walkers and the Walkers executed a deed of trust securing the State Employees' Credit Union (SECU), all of which was recorded. The Court of Appeals held for First Financial and against the Walkers and SECU, stating:

The law in this State is clear regarding material alterations of written instruments. The discharge of a perfected mortgage upon public record by the act of an unauthorized third party entitles the mortgagee to restoration of its status as a priority lienholder over an innocent purchaser for value.

In *Household*¹¹, the court stated that the law as enunciated in *Union Central* and followed in *First Financial* is the rule in North Carolina and *Monteith* did not overturn it.

In *Household*¹², the Court of Appeals found no negligence on Household's part, quoting *First Financial*¹³:

The discharge of a perfected mortgage upon public record by the act of an unauthorized third party entitles the mortgagee to restoration of its status as a priority lienholder over an innocent purchaser for value. *Union Central Life Insurance Co. v. Cates*, 193 N.C. 456, 462, 137 S.E. 324, 327 (1927). The owner of a mortgage, however, will lose priority over an innocent purchaser if the mortgagee is negligent with respect to the release of the mortgage. *Id.*

In *Household*¹⁴, there was no negligence on the part of Household since there was no duty on Household to respond to the "administrative demand" that later resulted in the unauthorized cancellation and Household did not learn of the unauthorized cancellation until four days after Fremont extended its loan. In *First Financial*¹⁵, First Financial was *not* deemed negligent or in breach of duty by virtue of giving Mr. Sledge the release deed in proper form, which Mr. Sledge subsequently fraudulently altered.

Where the lender mistakenly sent a letter to the borrower stating that \$979 was due on the mortgage debt, the borrower knew of the mistake, the borrower paid the lender who returned the note and deed of trust (marked paid and satisfied) to the borrower who had the deed of trust cancelled, the Court of Appeals held, in a case of first impression, that the lender could prevail in a declaratory judgment action to establish the continuing validity of the note and deed of trust due to the equitable powers of the court.¹⁶ The court noted that there were no intervening interest holders involved.¹⁷

2. Mortgages and deeds of trust - documents of rescission

G.S. 45-36.6 pertains to documents of rescission and their effect, as well as liability for wrongful recording. Section 1. of this article should be noted for cases dealing with unauthorized cancellation or satisfaction.

In G.S. 45-36.6, "document of rescission" means a document stating that an identified satisfaction or affidavit of satisfaction of a security instrument was recorded erroneously or that a security instrument was satisfied of record erroneously, the secured obligation remains unsatisfied, and the security instrument remains in force.¹⁸

If a person records a satisfaction or affidavit of satisfaction of a security instrument in error or if a security instrument is satisfied of record erroneously by any other means, the person or the secured creditor may execute and record a document of rescission. The document of rescission must be duly acknowledged before an officer authorized to make acknowledgments. Upon

¹⁰ N. 2, supra

¹¹ N. 1, supra

¹² N. 1, supra

¹³ N. 2, supra

¹⁴ N. 1, supra

¹⁵ N. 2, supra

¹⁶ *G.E. Capital Mortg. Services, Inc. v. Neely*, 135 N.C. App. 187, 519 S.E. 2d 553, 39 U.C.C. Rep. Serv. 2d 1170 (1999). The court cited G.S. 25-3-604 regarding cancellation and surrender of the note due to clerical error.

¹⁷ The lender, prior to the suit, had filed of record a "Rescission of Satisfaction and Reinstatement of Mortgage." To adequately protect against persons relying upon the record, the lender probably should have filed a notice of lis pendens.

¹⁸ G.S. 45-36.6(a).

recording, the document rescinds an erroneously recorded satisfaction or affidavit and the erroneous satisfaction of record of the security instrument and reinstates the security instrument, subject to the rule in G.S. 45-36.6(c), set forth below.¹⁹

A recorded document of rescission has no effect on the rights of a person that: (1) records an interest in the real property described in a security instrument after the recording of the satisfaction or affidavit of satisfaction of the security instrument or the erroneous satisfaction of record of the security instrument by other means and before the recording of the document of rescission; and (2) would otherwise have priority over or take free of the lien created by the security instrument as reinstated under Chapter 47 of the General Statutes.²⁰

This rule can be illustrated by an example:

EXAMPLE: *M* records *M*'s deed of trust. *M*'s deed of trust is erroneously satisfied due to *M*'s error. *X* obtains a lien upon or an interest in the real property. *M* records a document of rescission. If *X*'s interest in the real property is a lien or other interest in the real property and that lien or interest is evidenced of record after the satisfaction of record but before the recording of the document of rescission, *X* will prevail over *M*'s security instrument as reinstated by the document of rescission. However, because G.S. 45-36.6(c) requires *X* to be a party who "records an interest in the real property," if *X* is (1) a furnisher of labor, material, services, or equipment under Chapter 44A or (2) a tenant holding a lease which need *not* be recorded in order to have priority²¹, the exact wording of G.S. 45-36.6(c) would *not* protect *X* if *X*'s lien or interest is not evidenced of record after *M*'s deed of trust is erroneously satisfied of record and before the document of rescission is recorded. G.S. 45-36.6(c) is in need of clarification. It may be that if *X* holds an unrecorded interest, *X*'s situation would be governed by case law and other statutory law.

G.S. 45-36.6 is intended to be consistent with earlier law.²²

¹⁹ .S. 45-36.6(b)

²⁰ G.S. 45-36.6(c)

²¹ See G.S. 47-18(a) and G.S. 47-20(a)

²² See *G.E. Capital Mortgage Services, Inc. v. Neely*, 135 N.C. App. 187, 519 S.E.2d 553 (1999). This is discussed in Section 1. of this article text at N.N. 16 and 17. G.S. 45-36.6(d) provides that a person that erroneously or wrongfully records a document of rescission is liable to any person injured thereby for the actual loss caused by the recording and reasonable attorneys' fees and costs.