United States Bankruptcy Court
Northern District of Illinois
Eastern Division

Transmittal Sheet for Opinions for Posting

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Bankruptcy Caption: **In re: Gilbert V. Johnson**

Adversary Caption: **In re: Gregg Szilagyi, Chapter 7 Trustee vs.**
JPMorgan Chase Bank AND Charter One Bank

Bankruptcy No. **04 B 33054**

Adversary No. **05 A 01717**

Date of Issuance: **4/18/2006**

Judge: **Wedoff**

Appearance of Counsel:

Attorneys for Gregg Szilagyi: **Joseph A. Baldi, Donna B. Wallace, Joseph Baldi & Associates, Chicago, IL**

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IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

In re:	)	
	)	**Chapter 7**
GILBERT V. JOHNSON,	)	
	)	**Case No. 04 B 33054**
Debtor.	)	
	)	
	)	
GREGG SZILAGYI, Chapter 7 Trustee of the estate of GILBERT V. JOHNSON,	)	
	)	
Plaintiff,	)	**Adversary Proceeding No. 05 A 01717**
v.	)	
	)	
JPMORGAN CHASE BANK, N.A. f/k/a BANK ONE, N.A. and CHARTER ONE BANK, N.A.,	)	
	)	
Defendants.	)	

MEMORANDUM OF DECISION

This adversary proceeding is before the court for judgment following a trial on stipulated facts. Gregg Szilagyi, Chapter 7 Trustee of the estate of Gilbert V. Johnson, brought this proceeding against defendants JPMorgan Chase Bank, N.A., f/k/a/ Bank One, N.A. ("Chase") and Charter One Bank, N.A. ("Charter One") for avoidance of a mortgage recorded by NBD Mortgage Company, now Chase. Chase and Charter One filed a counterclaim seeking a declaration that Chase's lien is valid and that Chase has a valid mortgage lien and security interest in a portion of the proceeds generated by the court-authorized sale of the property.

As discussed below, the facts set out in the Stipulated Facts filed December 2, 2005, demonstrate that Chase's mortgage has been released and that the trustee may avoid any interest Chase retained in the property.

Jurisdiction

Under 28 U.S.C. § 1334(a), the district courts have exclusive jurisdiction over bankruptcy cases. Pursuant to 28 U.S.C. § 157(a) and its own Internal Operating Procedure 15(a), the District Court for the Northern District of Illinois has referred its bankruptcy cases to the bankruptcy court of this district. When presiding over a referred case, the bankruptcy court has jurisdiction under 28 U.S.C. § 157(b)(1) to enter appropriate orders and judgments in core proceedings within the case. The pending adversary proceeding is a core proceeding under 28 U.S.C. § 157(b)(2)(K) (proceedings to determine the extent of the validity, extent, or priority of liens). This court may therefore enter a final judgment.

Findings of Fact

The stipulation of the parties establishes the following facts.

On June 16, 1995, NBD Mortgage Company loaned Gilbert V. Johnson and Melba Jean Johnson $183,000. The loan was evidence by a promissory note and secured by a mortgage on certain property (the "1995 Mortgage"). On June 22, 1995, the 1995 Mortgage was recorded with the Cook County Recorder as Document No. 95403870. Stipulated Facts, ¶ 4.

Sometime after the 1995 Mortgage was executed, NBD Mortgage Company was renamed, becoming First Chicago NBD Mortgage Company ("First Chicago"). *Id.*, fn. 1.

On or about October 13, 2000, First Chicago of Bloomingdale n/k/a First Chicago NBD Mortgage Company executed a Release of Mortgage Trust Deed (the "Release"). The Release was recorded on January 1, 2001. *Id.*, Exh. 2.

The Release referred to a mortgage dated July 13, 1990 and recorded November 21, 1990, between the Johnsons, on the one hand, and First Chicago Bank of Bloomingdale, on the other hand (the "1990 Mortgage"). In addition to identifying the parties to the mortgage, the date of the mortgage and the date of recordation, the Release also identifies the document number and permanent index number of the 1990 Mortgage. *Id.*

Immediately below this identifying information is the following: "Also release mortgage document 95403870." *Id.* "Mortgage document 95403870" refers to the 1995 Mortgage. *Id.*, Exhs. 1 and 2. The statement "also release mortgage document 95403870" was included in error; First Chicago did not intend to release the 1995 Mortgage. *Id.*, ¶ 6.

As of January 2001, the Johnsons still owed at least $160,000 on the loan secured by the 1995 Mortgage. After the Release was recorded, the Johnsons continued to make payments on the loan and listed the lender as a secured creditor in their schedules. *Id.*, ¶¶ 3, 7.

In or around September 2001, First Chicago merged with and into Bank One, N.A. Chase is the successor by merger to Bank One, N.A. *Id.*, ¶ 8.

Charter One Bank, N.A., a/k/a CCO Mortgage Corporation ("Charter One"), became the investor and/or holder of the Johnsons' loan secured by the 1995 Mortgage.

Chase Home Finance LLC services the loan secured by the 1995 Mortgage for Charter One. *Id.*

A title commitment for title insurance provided around August 31, 2004, disclosed the 1995 Mortgage and further stated:

> Note: Release Doc 0010024502 purports to release this mortgage, but the release may be an error. The lender asserts that the debt is unpaid and that the release was an error. The borrower agrees.

Id., ¶ 9.

Gilbert Johnson commenced this bankruptcy case on September 7, 2004, by filing a voluntary petition for relief under chapter 7 of the Bankruptcy Code. Gregg Szilagyi is the Chapter 7 trustee in this case. *Id.*, ¶¶ 1-2.

Conclusions of Law

The trustee's complaint against Chase and Charter One sets forth three grounds for relief. First, the trustee seeks a declaration that the Release extinguished the 1995 Mortgage. In the alternative, the trustee seeks to avoid the mortgage pursuant to either § 544(a)(3) or § 544(a)(1) of the Bankruptcy Code (Title 11). Chase and Charter One have filed a counterclaim seeking a declaration that Chase's lien is valid and that Chase has a valid mortgage lien and security interest in a portion of the proceeds generated by the court-authorized sale of the property.

A. The trustee is entitled to a declaration that the 1995 Mortgage was released.

The trustee's first cause of action seeks a declaration that the 1995 Mortgage was released, and thus Chase has no interest in the property. The trustee's argument is based upon the fact that First Chicago, the admitted holder of the mortgage, executed the Release. The Release, if effective, extinguishes the 1995 Mortgage. *See In re Kids*

Creek Partners, L.P., 210 B.R. 547, 553 (Bankr. N.D. Ill. 1997) (release of a mortgage extinguishes the lien of the mortgage (citing *Petkus v. St. Charles Sav. and Loan Ass'n*, 182 Ill. App. 3d 327, 330, 538 N.E.2d 766, 768 (1989))).

Chase argues that the Release did not sufficiently identify the 1995 Mortgage to constitute a release of the Mortgage. However, Chase does not cite any authority that requires a release to contain any more information than that which is contained in the Release. Section 2 of the Illinois Mortgage Act, 765 ILCS 905/2 requires the execution of a release when the debt secured by a mortgage has been paid in a manner that permits its recording. It also requires that the release contain certain language if it is being delivered to the mortgagor. But it does not specify any other information that must be contained within a release for it to be effective.

In order for a document to be recorded, it must contain three pieces of information: (1) the name and address of the person to whom the instrument is to be returned; (2) the recorder's document number of any instrument referred to in the instrument being recorded; and (3) the book and page number, if applicable, of any instrument referred to in the instrument being recorded or relating to the instrument being recorded. 55 ILCS 5/3-5020.5. When a release of a mortgage is being recorded, the instrument must set forth the document number of the mortgage. *Id*. Here, the Release provides the name and address of the party to whom it is to be returned and the document number of the mortgage to be released. There is no evidence that the original mortgage had a book and page number. The Release met the requirements for recordation and was, in fact, recorded. These statutes do not provide any basis to invalidate the Release.

Chase also argues that the Release was invalid because it was not executed by one with either apparent or actual authority. Specifically, Chase contends that the Release was executed by First Chicago of Bloomingdale, "which had no authority to release the June 16, 1995 Mortgage between the Johnsons and NBD Mortgage Company." (Chase's Trial Brief at 4.) However, Chase's argument is based upon a misunderstanding of the facts. The Release was executed by "First Chicago of Bloomingdale N/K/A First Chicago NBD Mortgage Company." Stipulated Facts, ¶ 5, Exh. 2. The initials "N/K/A" stand for "now known as." *See Blacks Law Dictionary* 1047 (6th ed. 1990). Thus at the time the Release was executed, First Chicago of Bloomingdale had been renamed First Chicago NBD Mortgage Company. Similarly, NBD Mortgage Company had been renamed First Chicago NBD Mortgage Company. Stipulated Facts, ¶ 4, fn. 1; Exh. 2. Accordingly, First Chicago executed the Release at a time when First Chicago in fact held the mortgage.[1]

Chase argues that the reasoning in *Olsen v. Bank One, Rockford, NA (In re Bruder)*, 207 B.R. 151 (N.D. Ill. 1997), requires the court to hold that the Release was not valid. In *Olsen*, the court held that a mistaken release by bank was valid as to third parties, even though the bank no longer owned the mortgage, because nothing in the chain of title reflected the assignment from the bank to another entity. A third party discovering the release would have no reason to know that the entity releasing the mortgage did not own the mortgage and was therefore entitled to rely on the release.

[1] Chase does not specifically challenge the authority of the assistant vice president to execute the Release. It is not disputed that the Release was effective to release the 1990 Mortgage. If the assistant vice president had authority to execute the Release with respect to the 1990 Mortgage, it appears to have been within the scope of his or her authority generally to execute such documents.

In this case, NBD Mortgage Company's name change to First Chicago NBD Mortgage was not recorded. Nor is there any indication in the property records that First Chicago of Bloomingdale or First Chicago NBD Mortgage had any interest in the mortgage. Chase argues that since the record did not show apparent authority by the signatory, then the 1995 Mortgage was never released. (Chase's Tr. Brief at 5.)

Chase's argument confuses the concepts of apparent authority and actual authority. An agent may bind the principal where the agent had actual authority or where the agent had apparent authority. *See Faber-Musser Co. v. William E. Dee Clay Mfg. Co.*, 291 Ill. 240, 244, 126 N.E. 186, 188 (1920). If, as in this case, an agent has actual authority then the absence of apparent authority is irrelevant; the principal is still bound by the agent. *See Taylor v. Taylor*, 20 Ill. 650, 652 (1858) (all acts of agent performed within the scope of the agency bind the principal). Because First Chicago owned the 1995 Mortgage, it could, and did, release the Mortgage. The trustee is entitled to declaration that Chase has no mortgage on the property.

B. Alternatively, the trustee is entitled to avoid Chase's lien, if any, pursuant § 544(a)(3).

Section 544(a)(3) permits a trustee to avoid a lien to the same extent that a bona fide purchaser of real property could avoid the lien under Illinois law. 11 U.S.C. § 544(a)(3). Pursuant to § 30 of the Illinois Conveyance Act, deeds, mortgages and other instruments of writing that are authorized to be recorded do not take effect until recorded as to all creditors and subsequent purchasers without notice. 765 ILCS 5/30. Chase argues that a bona fide purchaser could not avoid the 1995 Mortgage because the purchaser would be on inquiry notice that the Release was executed in error. This argument fails for two reasons. First, there is no issue of reliance because there is no

mortgage; it was released. Moreover, to the extent that Chase retained some equitable interest against the property, Chase has failed to prove that the Release would give constructive notice of any such interest.

"Under Illinois law, equitable liens arise in two general situations: when a written contract reflects the parties' intent to satisfy a debt from particular property, or when a court grants equitable relief in light of the parties' relationship and dealings." *Small v. Beverly Bank,* 936 F.2d 945, 949 (7th Cir. 1991). Equitable liens may be imposed in the absence of an express agreement out of considerations of fairness. *See Oppenheimer v. Szulerecki*, 297 Ill. 81, 87, 130 N.E. 325, 327 (1921). Here, the parties agreed that the debt would be secured by a particular property. In addition, the parties agreed that the Release was executed in error. Therefore an Illinois court might recognize an equitable lien against the property in favor of Chase.

However, the holder of an unrecorded interest, such as an equitable lien, does not take priority over the interest of a creditor or subsequent purchaser who acquired an interest in the property without notice of the equitable interest. *See Trustees of Zion Methodist Church v.* Smith, 335 Ill. App. 233, 239, 81 N.E.2d 649, 651 (1948) (under Illinois' conveyancing and recording laws, equitable mortgage would not be effective against judgment creditors or purchasers); *Great American Insurance Co. v. Bailey (In re Cutty's-Gurnee, Inc.),* 133 B.R. 934, 949 (Bankr. N.D. Ill. 1991) (under Illinois law, prior unrecorded mortgage is not effective over the interest of a subsequent purchaser without notice). The subsequent purchaser takes the property subject to the equitable interest only if the purchaser has notice of it. *See In re Cutty's-Gurnee, Inc.*, 133 B.R. at 949 (a

party with notice of an existing equitable interest in the same property is liable in equity to the same extent as the seller (citing *Rohde v. Rohn*, 232 Ill. 180, 83 N.E. 465 (1908))).

Illinois law is clear that purchasers of real estate have a duty to examine property records and are chargeable with notice of whatever appears in the chain of title. *See Smith v. Grubb*, 402 Ill. 451, 464-65, 84 N.E.2d 421, 428 (1949). Moreover, if the record gives notice of facts that would put a prudent person on inquiry, the purchaser is chargeable with knowledge of other facts that might have been discovered through diligent inquiry. *See Reed v. Eastin*, 379 Ill. 586, 591-92, 41 N.E.2d 765, 768 (1942). The party alleging that a bona fide purchaser would have been on constructive notice that it had a continuing interest in the property has the burden of proof. *Id.*, at 592, 41 N.E.2d at 768 ("The burden of proof is, of course, upon the person charging notice to prove it.").

Chase has failed to demonstrate by a preponderance of the evidence that a bona fide purchaser would be on notice of Chase's equitable interest. Chase argues that a bona fide purchaser would have been put on inquiry notice for two reasons: (1) because the Release does not identify the date of the mortgage, the amount of the mortgage, the date of recordation or the parties to the mortgage; and (2) because the party executing the release was not the named mortgagee and did not indicate any authority to execute the Release. Both of these arguments fail because Chase did not submit any evidence that either of these asserted irregularities would put a bona fide purchaser on notice.

Chase was required to submit some evidence to demonstrate that the absence of certain information in the Release would put a purchaser on inquiry notice. Similarly, Chase needed to establish that the execution of a release by an entity other than a named mortgagee merits further inquiry by a purchaser. Given the common practice of selling

mortgage loans as well as the profusion of bank mergers—resulting in the very type of name changes evident in this case—it is by no means obvious that execution of a release by an entity other than the original mortgagee, or by an assignee whose assignment has been recorded, would put a purchaser on inquiry notice. By not submitting any evidence supporting its contentions, Chase has failed to prove that the language of the Release and the manner of its execution create a duty on behalf of bona fide purchaser to inquire as to the validity of the Release.

The only evidence Chase did submit was the somewhat ambiguous evidence that a title company apparently made inquiry regarding the Release. However, there was no evidence explaining why the title company made such inquiry. Nor is there any reason to assume that the business practice of a title company establishes the standard of care for a bona fide purchaser.

The facts of this case are distinguishable from those in *Mosello v. Ali, Inc. (In re Mosello)*, 190 B.R. 165 (Bankr. S.D.N.Y. 1995), relied upon by Chase. In that case, the release itself was internally inconsistent. The title of the document was "Release of Part of Mortgaged Premises" and it had a granting clause that stated that the creditor released a part of the mortgaged property. *Id.* at 170. However, the attachment to the document described the entire property, not merely a "part" of the property. Because of these inconsistencies, a prospective purchaser would have been on notice of a discrepancy requiring further inquiry. *Id.*

The decision in *Maine National Bank v. Morse (In re Morse)*, 30 B.R. 52 (1st Cir. BAP 1983), is also of no assistance to Chase. In that case, subsequent to the mistaken release of a mortgage, the bank commenced foreclosure proceedings and a certificate of

foreclosure was recorded. As a result, any party inspecting the record would see inconsistent documents—a release of mortgage followed by the foreclosure of the mortgage. This inconsistency would place a bona fide purchaser on inquiry notice and chargeable with all that further inquiry as to the state of title would reveal. *Id.* at 55-56. Because of the "obvious inconsistency" in the property record, the court held that the rights of the bank were superior to that of the trustee. *Id.* at 56. As discussed above, there is no such obvious inconsistency in the Release executed by First Chicago.

For the foregoing reasons, to the extent that First Chicago had an equitable lien in the property, its lien could be avoided by a bona fide purchaser and thus may be avoided by the trustee pursuant to § 554(a)(3).[2]

C. The trustee is also entitled to avoid Chase's lien, if any, pursuant § 544(a)(1).

Section 30 of the Illinois Conveyance Act applies equally to creditors and subsequent purchasers. 765 ILCS 5/30. Thus, a judgment creditor that records its judgment acquires rights superior to the holder of a prior unrecorded interest. *See Echols v. Olsen*, 63 Ill. 2d 270, 276347 N.E.2d 720, 722-23 (1976); *East St. Louis Lumber Co. v. Schnipper*, 310 Ill. 150, 157, 141 N.E. 542, 544-45 (1923). For the same reasons that a bona fide purchaser would prevail over any equitable lien that Chase might have on the property, so too would a judgment creditor. Therefore the trustee may avoid any such lien pursuant to § 554(a)(1).

[2] This conclusion is consistent with that reached by other bankruptcy courts applying similar law in other jurisdictions. *See In re Godwin*, 217 B.R. 540 (Bankr. S.D. Ohio 1997) (based on the trustee's status as a bona fide purchaser and Ohio law, the trustee is able to avoid the lender's erroneously canceled lien); *In re Price*, 97 B.R. 264 (Bankr. E.D.N.C. 1989) (trustee could avoid lien under § 544(a)(3) when, under North Carolina law, a bona fide purchaser would prevail against a bank that erroneously cancelled its deed of trust); *In re Mosley*, 55 B.R. 341 (Bankr. W.D. Ky. 1985) (trustee could avoid lien under § 544(a)(3) when the lender mistakenly released its mortgage prior to the bankruptcy filing).

Conclusion

For the reasons stated above, judgment will be entered, by separate order, in favor of the trustee on all claims. Each party shall bear its own costs.

Dated: April 18, 2006

Eugene R. Wedoff
United States Bankruptcy Judge