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SEQUENCE OF EVENTS

Court Upholds Defective Foreclosure Deed

Bankruptcy Petition Filed Too Late to Prevent Sale

BY CHRISTOPHER R. VACCARO

SPECIAL TO BANKER & TRADESMAN



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The vast majority of mortgage loans are repaid without incident, but when they go into default, peculiar twists and turns can ensue. A federal district court decision issued in January, involving a home in Framingham, offers an example.

Andy Tran mortgaged his home to Citizens Bank in 2008, to secure a modest home equity line of credit. He defaulted several years later, resulting in a foreclosure auction sale by Citizens Bank in 2022. Herbert Jacobs was the successful bidder at the foreclosure sale, with a \$235,000 bid price. Jacobs signed a memorandum of sale after the auction.

A few weeks later, a foreclosure deed to Jacobs was recorded, together with an affidavit of sale from Citizens Bank stating under oath that the foreclosure complied with Massachusetts law. However, the recorded foreclosure deed to Jacobs was missing Citizens Bank's notarized signature page. This omission turned out to be a costly embarrassment for those involved.

After the defective deed was recorded, Jacobs demanded that Tran vacate the



A recent court decision applies to debtors who seek to prevent a foreclosure sale by filing for bankruptcy.

property. Tran promptly filed a Chapter 13 bankruptcy petition and an adversary proceeding in the bankruptcy court to recover the property. Tran claimed that the foreclosure deed was defective because of the missing notarized signature, and therefore the property remained part of his bankruptcy estate. Citizens Bank and Jacobs contested Tran's claim, and the parties filed cross-motions for summary judgment with the bankruptcy court.

The bankruptcy court ruled in favor of Citizens Bank and Jacobs. According to the court, Tran could not undo the foreclosure sale to Jacobs, because Tran lost his rights to the property, known as an equity of redemption, when the foreclosure auction concluded and Jacobs signed the memorandum of sale. The delivery of the foreclosure deed was unnecessary to extinguish Tran's equity of redemption, and Citizens Bank's

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recorded affidavit of sale provided adequate notice of the foreclosure sale to third parties. Accordingly, the foreclosure sale extinguished Tran's equity of redemption, and Tran could not use bankruptcy law to disrupt the sale to Jacobs.

A Question of Applying Bankruptcy Law

Tran appealed the bankruptcy court's decision to the U.S. District Court for Massachusetts, maintaining that his rights to the property were not extinguished by the foreclosure auction alone, and the defective foreclosure deed failed to extinguish his equity of redemption. Tran also argued that Citizens Bank's recorded affidavit of sale did not serve as a substitute for a valid foreclosure deed.

The federal district court noted that all of the material facts of this case were uncontested; namely, Citizens Bank conducted a foreclosure auction where Jacobs emerged as the winning bidder, a foreclosure deed and affidavit were recorded at the registry but the deed lacked a notarized signature page, and Tran filed his bankruptcy petition after the deed and affidavit were recorded. Because these crucial facts were uncontested, the district court only needed to determine whether

the bankruptcy court properly applied Massachusetts law in ruling that Tran lost his equity of redemption to the property before he filed his bankruptcy petition.

The district court examined decades of Massachusetts appellate court decisions when considering the parties' arguments.

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Tran relied heavily on a 1924 Supreme Judicial Court case holding that a borrower's equity of redemption was not extinguished until the foreclosure deed was recorded. But the district court cited more recent Massachusetts appeals court decisions holding that the foreclosure auction and the signing of the memorandum of sale extinguished the borrower's equity of redemption. The district court observed that the

SJC had agreed with those later decisions. The district court also noted that the bankruptcy court in Massachusetts, which is a federal court, had concurred with the more recent approach taken by the Massachusetts courts.

The district court followed those later decisions, and upheld the bankruptcy court's ruling in favor of Citizens Bank and Jacobs. The court also affirmed the bankruptcy court's holding that, even though the foreclosure deed lacked a signature page, the recorded foreclosure affidavit provided sufficient notice of the foreclosure sale to potential good faith purchasers. Therefore, Tran could not successfully invoke provisions of the Bankruptcy Code that allow bankruptcy trustees and debtors in possession to avoid real estate transfers that are not recorded at the registry of deeds.

The district court's decision makes it clear that if a debtor wants to prevent a foreclosure sale, it should file a bankruptcy petition before the auction begins, instead of waiting until after a foreclosure deed to the winning bidder is recorded. ◀

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