

UNITED STATES BANKRUPTCY COURT  
NORTHERN DISTRICT OF INDIANA  
SOUTH BEND DIVISION

IN THE MATTER OF	)	
	)	
JAMES FREDERICK SCHROEDER and	)	CASE NO. 05-37986 HCD
ELLYN EILEEN SCHROEDER,	)	CHAPTER 13
	)	
DEBTORS.	)	
	)	
	)	
DEBRA L. MILLER, TRUSTEE,	)	
PLAINTIFF,	)	
vs.	)	PROC. NO. 06-3099
	)	
COMMUNITYWIDE FEDERAL CREDIT	)	
UNION,	)	
DEFENDANT.	)	

Appearances:

Rebecca Hoyt Fischer, Esq., counsel for plaintiff, 112 West Jefferson Boulevard, Suite 310, South Bend, Indiana 46601-1438;

Andrea E. Halpin, Esq., counsel for defendant, Leone, Halpin & Konopinski LLP, 205 West Jefferson Boulevard, Suite 605, South Bend, Indiana 46601; and

Kristin R. Fox, Esq., counsel for defendant, Leone, Halpin & Konopinski LLP, 205 West Jefferson Boulevard, Suite 605, South Bend, Indiana 46601.

MEMORANDUM OF DECISION

At South Bend, Indiana, on September 19, 2007.

Before the court is the Motion for Summary Judgment filed by the plaintiff Debra L. Miller, Chapter 13 Trustee in the bankruptcy case of James Frederick Schroeder and Ellyn Eileen Schroeder (“debtors”). It requests summary judgment against the defendant CommunityWide Federal Credit Union (“defendant” or “Credit Union”) with respect to the Trustee’s Complaint to Avoid Lien, which seeks to avoid the defendant’s mortgage lien on the debtors’ residence. The defendant has opposed the Trustee’s motion. After the parties briefed the issues underlying the summary judgment motion, the court took the matter under advisement.

### Jurisdiction

Pursuant to 28 U.S.C. § 157(a) and Northern District of Indiana Local Rule 200.1, the United States District Court for the Northern District of Indiana has referred this case to this court for hearing and determination. After reviewing the record, the court determines that the matter before it is a core proceeding within the meaning of § 157(b)(2)(K) over which the court has jurisdiction pursuant to 28 U.S.C. §§ 157(b)(1) and 1334. This entry shall serve as findings of fact and conclusions of law as required by Federal Rule of Civil Procedure 52, made applicable in this proceeding by Federal Rules of Bankruptcy Procedure 7052 and 9014. Any conclusion of law more properly classified as a factual finding shall be deemed a fact, and any finding of fact more properly classified as a legal conclusion shall be deemed a conclusion of law.

### Background

The facts in this adversary proceeding are not contested. On June 19, 2002, more than three years before the debtors filed bankruptcy, they purchased real property on Willard Drive in Mishawaka, Indiana, by executing a mortgage and a promissory note in the original principal amount of \$98,600. On the last page of the 4-page mortgage document was printed a standard form of acknowledgment,<sup>1</sup> also called the notary's jurat,<sup>2</sup> because it is a statement by the notary public ("notary") certifying that the mortgagors had appeared before him or her and duly had executed that mortgage. In this case, the acknowledgment at issue was only partially completed: It did not name the individuals who appeared before the notary and executed the document. The debtors' mortgage contained this acknowledgment:

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<sup>1</sup> Black's Law Dictionary defines "acknowledgment" as "[a] formal declaration made in the presence of an authorized officer, such as a notary public, by someone who signs a document and confirms that the signature is authentic. In most states, the officer certifies that (1) he or she personally knows the document signer or has established the signer's identity through satisfactory evidence, (2) the signer appeared before the officer on the date and in the place (usu. the county) indicated, and (3) the signer acknowledged signing the document freely."

Black's Law Dictionary 24 (8th ed. 2004).

<sup>2</sup> The Latin term "jurat" means "he (or she) swears." Its definition in Black's Law Dictionary is quite similar to the definition of "acknowledgment." *See* Black's Law Dictionary 866 (8th ed. 2004).

ACKNOWLEDGMENT: STATE of Indiana, COUNTY of St. Joseph, ss.  
Before me, [notary's name was written here], a Notary Public, this    day of 24, June 2002  
   [left blank]    acknowledged the execution of the annexed mortgage.

R.1, Ex. A, p. 4. The notary wrote in her name, county, and date her commission expires. *See id.*

On October 12, 2005, the debtors filed their petition for relief under Chapter 13. Debra L. Miller was named the chapter 13 Trustee in their bankruptcy case. On December 28, 2005, the defendant Credit Union filed a proof of claim in the amount of \$113,920.85 and asserted that it was a secured creditor. The claim was allowed, and the debtors' chapter 13 plan was confirmed on June 7, 2006.

On September 28, 2006, the Trustee filed a Complaint to avoid the defendant's mortgage on the debtors' real estate. The Trustee alleged that the mortgage was not properly acknowledged under Indiana law. As a result, she contended, the mortgage was not entitled to recordation under Indiana Code Section 32-1-2-18<sup>3</sup> and did not serve as constructive notice to bona fide purchasers or mortgagees under Indiana law. The Trustee asked that the mortgage lien be avoided pursuant to 11 U.S.C. § 544.

In its Answer, the Credit Union denied that the improperly acknowledged mortgage should be avoided. *See R. 6 at 3.* It also raised, as an affirmative defense, the doctrine of res judicata. According to the defendant, the Judgment of Foreclosure, Order Confirming the Chapter 13 Plan, and Joint Stipulation and Order to Commence Adequate Protection Mortgage Payments without Notice were judicial determinations that had a res judicata effect barring all matters raised in the adversary proceeding.

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<sup>3</sup> This section was repealed in 2002 and was replaced by Indiana Code § 32-21-2-3, which provides:

Requirements for recording. – For a conveyance, a mortgage, or an instrument of writing to be recorded, it must be:

- (1) acknowledged by the grantor; or
- (2) proved before a:
  - ...
  - (E) notary public.

At the conclusion of a telephonic pre-trial conference, the court directed the parties to file dispositive motions on the issues. The Trustee's motion for summary judgment asserted that the debtors' mortgage, with an incomplete acknowledgment, was not entitled to be recorded under Indiana law and therefore could be avoided by the Trustee pursuant to § 544(a)(3). *See* R. 11, 12. The defendant's Response urged the court to deny the Trustee's request to avoid the mortgage lien due to the res judicata effect of the three aforementioned documents. *See* R. 13 at 3-4. The defendant argued that the "Trustee's arguments in this cause of action fail under I.C. 36-2-11-16(f) and under the doctrines of res judicata and collateral estoppel and, therefore, summary judgment should be granted in favor of" the Credit Union.<sup>4</sup> *Id.* at 5. When the briefing schedule had passed, the court took the matter under advisement.

#### Discussion

The Trustee, in her summary judgment motion, asks the court to consider the legal sufficiency of the incomplete acknowledgment (or notary's jurat) in this mortgage. It is undisputed that a portion of the acknowledgment was left blank; it does not identify the person or persons who executed the mortgage. The Trustee asserts that, as a matter of law, the mortgage lien can be avoided based on the improper acknowledgment. She moves the court for summary judgment on her Complaint to Avoid Lien.

This court renders summary judgment only if the record shows that "there is no genuine issue as to any material fact and the moving party is entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(c); Fed. R. Bankr. P. 7056; *see Celotex Corp. v. Catrett*, 477 U.S. 317, 322, 106 S. Ct. 2548, 2552, 91 L.Ed.2d 265 (1986). The moving party bears the initial burden of demonstrating that no genuine issue of material fact exists. *See Celotex*, 477 U.S. at 323. If the moving party satisfies its initial burden, then the nonmoving party must "go beyond the pleadings and by [its] own affidavits, or by the 'depositions, answers to interrogatories, and admissions on file,' designate 'specific facts showing that there is a genuine issue for trial.'" *Id.* at 324 (quoting

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<sup>4</sup> The defendant did not file a motion for summary judgment.

Fed. R. Civ. P. 56(e)). The court neither weighs the evidence nor assesses the credibility of witnesses. *See Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 249, 106 S. Ct. 2505, 2511, 91 L.Ed.2d 202 (1986).

The Trustee brought the complaint under § 544 of the Bankruptcy Code, often called the “strong-arm statute,” a provision which considers the Trustee to be a bona fide purchaser of a debtor’s real property. Section 544(a)(3) “permits a Trustee to avoid any transfer of the debtor’s property if the transfer would be voidable by a bona fide purchaser of that property.” *Sandy Ridge Oil Co., Inc. v. Centerre Bank Nat’l Ass’n (In re Sandy Ridge Oil Co., Inc.)*, 832 F.2d 75, 75 (7th Cir. 1987). In this case, the real property transferred by mortgage contract was located in Mishawaka, Indiana; therefore, the law of Indiana governs the court’s decision. *See Baldin v. Calumet Nat’l Bank (In re Baldin)*, 135 B.R. 586, 594 (Bankr. N.D. Ind. 1991) (explaining that § 544(a)(3) requires an examination of “applicable law,” in this case Indiana law, to determine whether the Trustee had constructive notice of the transfer of the property).<sup>5</sup> The statute provides:

544(a). The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any 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 –

...

(3) 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 at the time of the commencement of the case, whether or not such a purchaser exists.

11 U.S.C. § 544(a)(3). “While it is true that the bankruptcy trustee generally acquires no greater rights in property than those held by the debtor, § 544(a)(3) is an exception to this limitation.” *In re Sagamore Park Properties*, 1995 WL 1049898 at \*2 (Bankr. N.D. Ind. 1995), *aff’d*, *Sagamore Park Centre Assocs. Ltd. P’ship v. Sagamore Park Props.*, 200 B.R. 332 (N.D. Ind. 1996). Through this strong-arm section, then, “[t]he estate gets what the debtor could convey under local law rather than only what the debtor owned under local law.” *Belisle v. Plunkett*, 877 F.2d 512, 516 (7th Cir.), *cert. denied*, 493 U.S. 893 (1989). Therefore, “if a hypothetical bona fide transferee

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<sup>5</sup> “Actual knowledge of an encumbrance on a property is irrelevant under § 544(a)(3), regardless of any state law or actual notice.” *Camp v. Select Portfolio Servs., Inc. (In re Camp)*, \_\_\_ B.R. \_\_\_, 2007 WL 2257653 (N.D. Ind. 2007) (citing *In re Sandy Ridge Oil Co., Inc.*, 807 F.2d 1332, 1336 (7th Cir. 1986); *In re Baldin*, 135 B.R. at 594).

from the debtor would come ahead of the ‘true’ owner’s rights, then the trustee takes ahead of the true owner.”  
*Id.*

The Trustee argues that the defendant’s mortgage lien is defective and therefore not valid. To have a valid mortgage lien under Indiana law, a mortgage “must be recorded in the recorder’s office of the county where the land is situated.” Ind. Code § 32-21-4-1. “The purpose of recording a mortgage is to give notice to persons subsequently dealing with the property of the existence of the mortgage and to charge them with notice of what the records disclose.” *Bank of New York v. Nally*, 820 N.E.2d 644, 649 (Ind. 2005). A mortgage thus requires recordation in order to take priority against a subsequent bona fide purchaser such as the Trustee. *See Stubbs v. Chase Manhattan Mortgage Corp. (In re Stubbs)*, 330 B.R. 717, 725 (Bankr. N.D. Ind. 2005) (stating that the state statute “provides that constructive notice sufficient to defeat the interests of a bona fide purchaser is given only if certain instruments are recorded”), *aff’d*, 2006 WL 2361814, at \*5 (N.D. Ind. 2006)).

It is well settled in this state that, to entitle a mortgage to be recorded, it must be properly acknowledged or proved before a notary public, judge, or other authorized official. *See* Ind. Code § 32-21-2-3; *Bledsoe v. Ross*, 109 N.E. 53, 54 (Ind. App. 1915); *see also Moehlenkamp v. Shatz*, 396 N.E.2d 433, 438 (Ind. App. 1979) (stating that the jurat was “substantial and probative evidence of due execution of the mortgage”). The Supreme Court of Indiana has summarized succinctly that a “mortgage provides constructive notice to subsequent purchasers when it is properly acknowledged and recorded.” *Nally*, 820 N.E.2d at 648. On the other hand, an otherwise valid mortgage which was not entitled to be recorded or which was improperly recorded does not provide constructive notice. *See In re Stubbs*, 330 B.R. at 726 (citing *Keybank Nat’l Ass’n v. NBD Bank*, 699 N.E.2d 322, 327 (Ind. App. 1998)); *Bledsoe*, 109 N.E. at 54 (citing *Watkins v. Brunt*, 53 Ind. 208 (Ind. 1876)); *cf. Haverell Distributors v. Haverell Mfg. Corp.*, 58 N.E.2d 372, 375 (Ind. App. 1944) (concluding that the acknowledgment in a chattel mortgage, which did not identify the signors, was defective and thus that the mortgage was invalid and not entitled to be recorded).

In evaluating whether a mortgage is properly acknowledged, the court begins with the underlying principle that Indiana law “requires compliance with the formalities of execution as required by the acknowledgment and recording statutes.” *In re Baldin*, 135 B.R. at 599.

Pursuant to Indiana Law, a proper acknowledgment must provide the identity of the acknowledgers, and state that they are the same parties that executed the underlying instrument as well. If this is not done, and if such a defectively acknowledged instrument is recorded, it is nevertheless considered as never having been filed as such.

*Id.* at 596 (citing I.L.E. *Acknowledgments*, § 1); *see also Sandy Ridge Oil Co., Inc., v. Centerre Bank Nat’l Assoc. (In re Sandy Ridge Oil Co., Inc.)*, 510 N.E.2d 667, 671 (Ind. 1987) (emphasizing that the recording requirements, “if absent from a recorded instrument, will not be excused so as to permit the improper document to be afforded constructive notice”). However, Indiana requires substantial, not strict, compliance with those formalities. The state statute has provided an acceptable form of an acknowledgment, one which will meet the statutory criteria if inserted in a mortgage but which allows other forms that are “substantially the same”:

The following or any other form substantially the same is a good or sufficient form of acknowledgment of a deed or mortgage:

“Before me, E.F. (judge or justice, as the case may be), this \_\_\_\_\_ day of \_\_\_\_\_, A.B. acknowledged the execution of the annexed deed (or mortgage, as the case may be).”

Ind. Code § 32-21-2-7; *cf. Gregory v. Ocwen Fed’l Bank (In re Biggs)*, 377 F.3d 515, 518 (6th Cir. 2004) (reviewing statutory forms that fulfill acknowledgment requirement under Tennessee law, finding that “all of the forms require the notary to include the names of the individuals acknowledging their signatures”).

In this case, the acknowledgment in the debtors’ mortgage left blank the space where the names of those who appeared before the notary public were to be inserted. It does not substantially comply with the statutory prerequisites. The court finds that the language of the pre-printed mortgage was only somewhat similar to the acceptable acknowledgment set forth in the statute. More importantly, it left an empty space in which the notary was expected to insert, in writing, the identity of the persons who personally appeared before that notary and who were in fact the ones who executed the mortgage. *See Moehlenkamp*, 396 N.E.2d at 438 (stating that

the jurat was “substantial and probative evidence of due execution of the mortgage”). By leaving that space blank, the notary did not recognize the signers of the document in any way. The identity of the individuals who signed the mortgage was left uncertain. The signature and seal of the notary, at the end of the acknowledgment, thus did not perform the role of confirming the signatures of the mortgagors and of authenticating the proper execution of the document. *Cf. Fifth Third Bank v. Edgar County Bank & Trust*, 482 F.3d 904, 906 (7th Cir. 2007) (stating that “the notary tells us that the signatures are genuine”). In addition, without the names of the acknowledging individuals properly inserted, a subsequent purchaser could not be certain that the mortgage was signed by the actual owners of the real property and that the document was signed freely, without fraud or forgery. *Cf. In re Biggs*, 377 F.3d at 520 (discussing the role of an acknowledgment under Tennessee law).

It is clear, therefore, that under the laws of Indiana “the recording of a document not entitled to be recorded does not afford constructive notice.” *In re Sandy Ridge Oil Co., Inc.*, 510 N.E.2d at 669. “Following this rule, courts have held, for example, that recording a mortgage with a defective acknowledgment does not provide constructive notice.” *Camp v. Select Portfolio Servs, Inc. (In re Camp)*, \_ B.R. \_, 2007 WL 2257653 at \*5 (N.D. Ind. Aug. 2, 2007) (citing *In re Baldin*, 135 B.R. at 602; *In re Stubbs*, 330 B.R. at 731).<sup>6</sup>

The Indiana legislature has recognized and adopted the general rule requiring identification of the acknowledger in the body of the acknowledgment before an instrument can be recorded. To hold that this requirement may be waived by leaving that space blank is to ignore the long standing case law in Indiana, the plain language of the statutes, and the apparent intent of the legislature.

*In re Baldin*, 135 B.R. at 601-02; *see also In re Stubbs*, 330 B.R. at 730 (“the most critical part of an acknowledgment is missing, i.e., the identity of the person who appeared before the attesting officer to certify that he/she had signed the instrument”). Both courts concluded that the acknowledgment was defective and thus that the mortgage was invalid, the recording of that mortgage was improper, and the Trustee could avoid the mortgage lien.

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<sup>6</sup> *In re Camp* affirmed the bankruptcy court’s determination that a technical error in the definition of the Note’s “Borrower” in the mortgage was an exception to the general rule: That error was not fatal to giving constructive notice of the encumbrance to a bona fide purchaser. *See In re Camp*, 2007 WL 2257653 at \*6.

This court therefore determines that, as a matter of law under Indiana law, this acknowledgment that omitted the identity of the document signers is defective. *See In re Stubbs*, 330 B.R. at 731 (concluding that “an acknowledgment that fails to specifically state *who* appeared before an attesting officer to acknowledge his/her execution of a mortgage is not a valid acknowledgment”); *In re Baldin*, 135 B.R. at 600 (“This is a case of no compliance whatsoever as to the completion of the formal part of the acknowledgment”). It further finds that this mortgage containing the defective acknowledgment fails to comply with Indiana law. *See Nally*, 820 N.E.2d at 648 (“A mortgage provides constructive notice to subsequent purchasers when it is properly acknowledged and recorded.”). Moreover, the improperly acknowledged mortgage was not entitled to recordation and cannot provide constructive notice to subsequent purchasers. *See In re Baldin*, 135 B.R. at 602 (concluding that a “recording of this mortgage, with its defective acknowledgment, is in effect no recording at all, and thus does not provide constructive notice, even though in fact received for recording by the County Recorder”). As a result, the court determines, the mortgage lien may be avoided under 11 U.S.C. § 544(a)(3). *See In re Stubbs*, 330 B.R. at 731; *In re Baldin*, 135 B.R. at 603; *cf. Williams v. Wells Fargo Fin’l Mississippi 2, Inc. (In re Rick’s Auto Outlet)*, 327 B.R. 650, 653 (8th Cir. B.A.P. 2005) (reversing on ground that trustee can avoid deed of trust with defective acknowledgment under Mississippi law); *Burden v. CitGroup/Consumer Finance, Inc. (In re Armstrong)*, 366 B.R. 716, 719 (Bankr. E.D. Ky. 2007) (finding that trustee may avoid mortgage with defective acknowledgment under Kentucky law); *Geygan v. World Savings Bank, FSB (In re Nolan)*, 365 B.R. 804, 807 (Bankr. S.D. Ohio 2007) (same, under Ohio law); *Lyon v. Franklin Mortgage Funding (In re Shannon)*, 343 B.R. 585, 589 (Bankr. E.D. Ky. 2006) (same, under Kentucky law).

The defendant insists, however, that it obtained a state court Judgment of Foreclosure based on the recorded mortgage and that “the recorded mortgage in this case is ‘conclusively presumed to comply’ with the acknowledgment requirements because it was received and recorded by the St. Joseph County Recorder.” R. 13 at 5. The defendant relies on Indiana Code § 36-2-11-16(f), which states that “[a]n instrument, document, or copy received and recorded by a county recorder is conclusively presumed to comply with this section.”

The statute cited by the defendant is a provision in county government law (Title 36, Article 2), specifically in the chapter pertaining to county recorders (Chapter 11). Section 36-2-11-16 of the Indiana Code is entitled “Identification of Signatories by printing, typewriting or stamping – Exceptions.” Relevant to this discussion are two pertinent subsections:

(c) The recorder may receive for record an instrument only if:

(1) the name of each person who executed the instrument is legibly printed, typewritten, or stamped immediately beneath his signature or the signature itself is printed, typewritten, or stamped;

. . . ; and

(4) the name of each person who executed the instrument appears identically in the body of the instrument, in the acknowledgment or jurat, in his signature, and beneath his signature [.]

Ind. Code § 36-2-11-16(c)(1), (4). Under subsection (c), therefore, a recorder is required to examine an instrument such as a mortgage to determine that the names appearing on the instrument – those identifying the person or persons who executed, acknowledged, and signed the instrument – are identical. Only when the elements listed in subsection (c) are checked and verified (or are explained by affidavit, *see* § 36-2-11-16(d)) may the recorder receive the instrument to be recorded. *See In re Sandy Ridge*, 510 N.E.2d at 669 (“Section 16 allows recording of instruments only if signatures are followed by printed, typewritten or stamped names . . .”).

Subsection (f), found at the end of this statute, states that any recorded instrument is “conclusively presumed to comply with this section.” The Indiana Supreme Court, in dictum in *Sandy Ridge*, provided guidance in analyzing this statute.<sup>7</sup> It referred to subsection (f) as a “curative provision,” *id.* at 669-70, but determined that

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<sup>7</sup> As background, the court notes that the statute under scrutiny in the *Sandy Ridge* cases was Ind. Code § 36-2-11-15(b), a provision not affecting the case before this court. In *Sandy Ridge Oil Co., Inc., v. Centerre Bank Nat’l Ass’n*, 807 F.2d 1332, 1338 (7th Cir. 1986), the Seventh Circuit certified to the Indiana Supreme Court the question “Does a recorded instrument conveying, creating, encumbering, assigning, or otherwise disposing of an interest in or lien on property that does not disclose the name of the preparer as required by Ind. Code § 36-2-11-15(b) nevertheless impart constructive notice to a bona fide purchaser?” In *Sandy Ridge*, 510 N.E.2d at 671, the Indiana Supreme Court affirmed that “a recorded instrument, notwithstanding the omission of the name of its preparer, nevertheless does impart constructive notice to a bona fide purchaser.” Based on that answer, the Seventh Circuit then held that the chapter 11 debtor “Sandy Ridge may not avoid the mortgage under (continued...)”

it was “not appropriate” to extend that provision’s utilization to encompass the later enacted section 15, since “the preparer’s name requirement [found in § 36-2-11-15] applies only to the recording of documents pertaining to interests in property, rather than to all documents eligible for recording [as § 36-2-11-16 does].” Its holding also draws a distinction between section 15, the preparer’s name requirement, and other recording requirements. The state supreme court limits its decision carefully:

We emphasize that the recording requirements which affect the nature of the interest and the formalities of execution, if absent from a recorded instrument, will not be excused so as to permit the improper document to be afforded constructive notice. By our decision today, we hold only that the omission of the preparer’s name, contrary to the requirements of Section 15, does not operate to deprive a recorded document of the constructive notice to which it would otherwise be entitled.

*Sandy Ridge*, 510 N.E.2d at 671. Subsequent court decisions have respected the narrowness of that ruling. See *In re Stubbs*, 330 B.R. at 727 (following the Indiana Supreme Court’s clear, unequivocal statement that it “has long recognized the general principle that the recording of a document not entitled to be recorded does not afford constructive notice”); *In re Baldin*, 135 B.R. at 596-99 (thoroughly discussing the case, finding that “[n]o where in that decision can this Court find any language, either express or implied, changing the well-established case law of Indiana that the recording of a document not entitled to be recorded does not afford constructive notice.”). In *Sandy Ridge*, the Supreme Court of Indiana held only that, if the preparer’s name is omitted, the mortgage when recorded nevertheless provides constructive notice. *Sandy Ridge*, 510 N.E.2d at 671. The Indiana Supreme Court eighteen years later underscored that “[a] mortgage provides constructive notice to subsequent purchasers when it is properly acknowledged and recorded.” *Nally*, 820 N.E.2d at 648 (emphasis added).

In the view of this court, therefore, § 36-2-11-16 imposes a duty on a county recorder to examine an instrument and to establish that the § 16 criteria are met before the recorder receives and records that instrument. Subsection (f) provides the presumption that any instrument that in fact was recorded by a county recorder was examined by that recorder pursuant to § 36-2-11-16. Whether the criteria actually were fulfilled – that is, whether

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<sup>7</sup>(...continued)  
§ 544(a)(3).” *In re Sandy Ridge*, 832 F.2d at 76.

the names in the body of the instrument, in the acknowledgment, and on the signature lines are identical, and whether the other factors were verified – is a question of fact. Nevertheless, the statute conclusively presumes that the recorder acted in compliance with the requirements of the county recorder statute and that the instrument, if received and recorded, qualified for recordation. Subsection (f) of § 36-2-11-16 presumes compliance only with the county recorder statute, however; it does not presume compliance with the real property conveyance laws found in Article 21 of Title 32 or more specifically with the recording requirements for mortgages and acknowledgments in mortgages, found in §§ 32-21-2-3 and 32-21-2-7. As the Indiana Supreme Court emphasized, “the recording requirements . . . , if absent from a recorded instrument, will not be excused so as to permit the improper document to be afforded constructive notice.” *Sandy Ridge*, 510 N.E.2d at 671.

In this case, the court first finds that the notary failed to perform the essential function of naming the persons who appeared before her and who signed the instrument in her presence. It next finds that the county recorder failed to perform her duty properly: She recorded the mortgage even though identical names were not written in the body of the document, in the acknowledgment, and on the signature lines, as required by Indiana Code § 36-2-11-16(c)(4). The mortgage remains recorded under the curative provision of § 36-2-11-16(f). Nevertheless, Indiana case law has made clear that the omission of names from an acknowledgment renders a mortgage defective and that a defective mortgage, even though recorded, cannot provide constructive notice of the mortgage. *See Keybank Nat’l Ass’n v. NBD Bank*, 699 N.E.2d at 327. The county recorder’s recording of the invalid mortgage cannot validate an instrument with a fatally defective acknowledgment. The court finds that the defendant’s reliance on the county recorder statute’s conclusive presumption provision in § 36-2-11-16(f) has no merit.

The defendant’s final argument is based upon the doctrine of res judicata. The Credit Union contends that the Trustee is barred by the principles of res judicata from challenging the validity of the mortgage lien. According to the defendant, the state court July 15, 2005 Judgment of Foreclosure conclusively “cured any

alleged defect in the Mortgage in that the foreclosure judgment serves as a judicial determination that [the Credit Union] has a secured interest in the Real Estate.” R. 13 at 5.

“Res judicata forecloses all that which might have been litigated previously.” *Brown v. Felsen*, 442 U.S. 127, 139 n. 10, 99 S. Ct. 2005, 2213 n. 10, 60 L.Ed.2d 767 (1979). “A federal court must give to a state-court judgment the same preclusive effect as would be given that judgment under the law of the State in which the judgment was rendered.” *Migra v. Warren City Sch. Dist. Bd. of Educ.*, 465 U.S. 75, 81, 104 S. Ct. 892, 79 L.Ed.2d 56 (1984). The effect that this court thus accords the Indiana foreclosure judgment depends on the treatment that such a judgment would receive in Indiana.

Res judicata dictates that “a judgment rendered on the merits is an absolute bar to a subsequent action between the same parties or those in privity with them on the same claim or demand.”

*Smith v. State*, 825 N.E.2d 783, 789 (Ind. 2005) (quoting *Gill v. Pollert*, 810 N.E.2d 1050, 1057 (Ind. 2004)). “It ‘prevents the repetitious litigation of that which is essentially the same dispute.’”<sup>8</sup> *Id.* (quoting *Ben-Yisrayl v. State*, 738 N.E.2d 253, 258 (Ind. 2000)). In deciding whether there is an identity of parties or privies in the two suits, “the parties to the subsequent action must be the same parties as, or those in privity with, those in the first action.” *Dickson v. D’Angelo*, 749 N.E.2d 96, 100 (Ind. App. 2001) (quoting *Small v. Centocor, Inc.*, 731 N.E.2d 22, 27 (Ind. App. 2000)).

The term “privity” describes the relationship between persons who are parties to an action and those who are not parties to an action but whose interests in the action are such that they may nevertheless be bound by the judgment in that action. The term includes those who control an action, although not a party to it, and those whose interests are represented by a party to the action.

*Id.* at 27-28 (citation omitted).

In the state court foreclosure action, the Credit Union and the debtors (and others listed as co-defendants) are the parties. *See* R. 13, Ex. 1. In this present adversary case, the Credit Union and the Trustee are

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<sup>8</sup> In Indiana, “[t]he principle of res judicata is divided into two branches: claim preclusion and issue preclusion, also referred to as collateral estoppel.” *Collins v. State*, \_\_\_ N.E.2d \_\_\_, 2007 WL 2622717 at \*6 (Ind. App. 2007) (setting forth the distinction between issue preclusion and claim preclusion). *See also Northern Indiana Pub. Serv. Co. v. Sharp*, 732 N.E.2d 848, 854 (Ind. App. 2000). The distinctions do not affect the court’s analysis in this case.

the parties. “A trustee represents the interests of creditors.” *In re Luster*, 981 F.2d 277, 279 (7th Cir. 1992). The court finds that the debtors and the Trustee represent different interests and that the creditors whom the Trustee represents cannot be considered the real parties in interest in the foreclosure action. This court agrees with the conclusion of the Seventh Circuit Court of Appeals in *In re Jones*, 226 F.3d 917 (7th Cir. 2000): “The Trustee was not in privity with the Debtors, and the foreclosure action does not preclude the Trustee’s challenge to the validity of the mortgage.” *Id.* at 920.<sup>9</sup> An essential element of res judicata is missing in this case; therefore the doctrine cannot bar the Trustee’s litigation herein.

The defendant, rather than considering the principles of res judicata, cited two inapposite cases to advance its argument that the foreclosure judgment (a) judicially determined that the Credit Union had a secured interest in the property and (b) cured any alleged defect in the mortgage. *See* R. 13 at 5, citing *Lapping v. Duffy*, 47 Ind. 51, 53-54 (Ind. 1874), and *Evansville Gas-Light Co. v. State ex rel. Reitz*, 73 Ind. 219, 225-26 (Ind. 1881).<sup>10</sup> The court finds that neither case supports the propositions of the defendant. *Lapping* concerned assignments of judgments; it does not bolster the defendant’s position. *Evansville Gas-Light Co.* states the bedrock principles that the lien on real property is created by the mortgage, not the judgment; that the mortgage lien is extinguished only by payment or release; and that the mortgage lien is not merged in or absorbed by the

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<sup>9</sup> In *Jones*, the Seventh Circuit reviewed a bankruptcy decision concerning Indiana chapter 7 debtors and the foreclosure and sale of their Ohio property. The debtors had signed the mortgage in their home, with no witnesses, and mailed it to the bank. The chapter 7 trustee asserted, and the bankruptcy court found, that the mortgage was invalid against the trustee and that the payment to the bank of the foreclosure sale proceeds represented a preferential transfer which the trustee could avoid. The district court affirmed, and the appellate court also affirmed. Interpreting Ohio law (which is virtually identical to Indiana law in its analysis of res judicata and the identity or privity of parties), the appellate court concluded that the Ohio foreclosure action did not bar the Trustee’s challenge to the validity of the mortgage because the foreclosure action was not between the same parties or those in privity with those parties. *See In re Jones*, 226 F.3d at 920.

<sup>10</sup> The defendant also asserted that “it has always been the law in Indiana that[,] even if a mortgage is improperly recorded, or has not been recorded, it is valid between the parties.” R. 13 at 5, citing *In re Dunn*, 109 B.R. 865, 873 (Bankr. N.D. Ind. 1988). This court does not disagree. Crucial to this well established principle, however, is the recognition that a mortgage, if improperly acknowledged or recorded, is effective *only* as to the parties thereto and not as to third parties without notice. *See Beneficial Fin. Co. v. Nelson*, 153 N.E.2d 613, 614 (Ind. App. 1958). *Dunn* goes on to say, moreover, that a mortgage still must meet certain minimum requirements in order to be valid. *See Dunn*, 109 B.R. at 873.

decree of foreclosure. Because a foreclosure judgment is simply a method for enforcing a lien created by a mortgage contract, it cannot and does not “cure” a defective mortgage. The defendant’s arguments and cases cited do not prove otherwise. The court finds that the defendant in this case holds an invalid mortgage purported to secure the debtors’ obligation and a judgment of foreclosure upon which it did not act. Even if the defendant had foreclosed on the debtors’ real estate and sold the property, the Trustee could have recovered the foreclosure proceeds as a preferential transfer, based on the defective mortgage which the Trustee could have avoided. *See In re Jones*, 226 F.3d at 921. The court determines, therefore, that the Judgment of Foreclosure does not bar the Trustee’s avoidance of the Credit Union’s mortgage lien.

The defendant also argued that the Joint Stipulation and Order to Commence Adequate Protection Mortgage Payments was binding on the debtors and the Trustee. The court agrees that the Joint Stipulation and Order of January 10, 2006, requiring that mortgage payments be commenced to the Credit Union in the amount of \$750 per month, beginning October 1, 2005, was binding on the parties signing it and was confirmed by the court. *See* R. 49. However, that document neither validated the improperly acknowledged mortgage nor barred the Trustee from seeking to avoid the invalid mortgage lien. The defendant offers no argument or case law to prove its assertion, and the court finds no justification for its position.

The Credit Union’s final claim is that the Special Order Confirming Chapter 13 Plan, a final order on the merits, had a res judicata effect on the Trustee’s action. The court recognizes that the Special Order required that the mortgage claim “shall be paid as allowed and the Plan payment increased as necessary.” R. 86 at 2, ¶ 2 (Case No. 05-37986). The defendant argued that neither the debtors nor the Trustee “raised the issue of the validity of [the Credit Union’s] mortgage lien prior to confirmation, they did not object to the confirmation, they consented to the confirmation, and they did not appeal the confirmation.” R. 13 at 8. Relying on *In re Layo*, 460 F.3d 289 (2d Cir. 2006), it insisted that the res judicata effect of a confirmation order supports the strong policy favoring finality in the reorganization process. *See id.*

This court finds *Layo* to be factually and legally distinguishable from the case before it. First, the underlying facts in that case (whittled down to the bare essentials) are not at all comparable to those herein.<sup>11</sup> In *Layo*, the debtor had executed four mortgages; he stopped making payments on the fourth mortgage in the belief that he had paid it off. The bank disagreed; it moved to lift the automatic stay to foreclose on the property. The debtor and the trustee asserted that the debt had been discharged and that the debtor had satisfied the lien; they then filed a complaint to avoid the mortgage. The bank did not deny the factual allegations but responded that, since the confirmation order had accepted the bank as a secured creditor, the doctrine of *res judicata* precluded further litigation on the issue. *See In re Layo*, 460 F.3d at 291. It readily is seen that the background facts in *Layo* are altogether different from the straightforward ones in this case. The preliminary issue in *Layo* was whether the mortgage lien had been discharged; there is no claim that the mortgage at issue was invalid or that its recording was improper.

It is also clear that the legal issues presented in *Layo* are different. The Second Circuit first stated that it was making a de novo review of “the dismissal of a claim on *res judicata* grounds.” *Id.* It explained that the case “involves an after-the-fact attack on a lien by a debtor who did not dispute the lien despite having notice and opportunity to do so.” *Id.* at 295. It also described the debtor’s and trustee’s position as a “post-confirmation attempt to avoid a confirmed, recorded lien on the debtor’s property where the lien was claimed by [the bank] at the outset of the bankruptcy proceedings and included by the debtor in his plan.” *Id.* at 296. Indeed, the circuit court recognized that “a proceeding to determine the validity, priority, or extent of a lien or other interest in property” must be brought as an adversary proceeding under Federal Rule of Bankruptcy Procedure 7001(2):

We acknowledge that challenges to the validity of a lien must be brought through an adversary proceeding. Where, at the outset, there is no dispute as to the basis of a lien, however, given the policy embodied in § 1327(a) that confirmation of a plan “bind the debtor and each creditor,” it does not follow that a non-objecting creditor has a right to bring an adversary proceeding whenever he gets around to doing so.

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<sup>11</sup> As a caveat, the court notes that the facts are distilled from the Second Circuit decision without the benefit of descriptions from the bankruptcy court’s or district court’s unpublished opinions.

*Id.* at 294. It is clear, therefore, that *In re Layo* is distinguishable on factual and legal grounds. It does not mention § 544 or discuss the avoidance powers of a trustee. Moreover, it does not recognize that a trustee is limited in bringing a § 544 avoidance action by the § 546 statute of limitations rather than by the date of the order of confirmation of the chapter 13 plan.<sup>12</sup> In contrast to *Layo*, the case herein is an adversary proceeding challenging the validity of the mortgage lien and seeking to avoid it under § 544. It falls squarely under Rule 7001(2) of the Federal Rules of Bankruptcy Procedure, which states that “a proceeding to determine the validity, priority, or extent of a lien or other interest in property” is an adversary proceeding. Fed. R. Bankr. P. 7001(2).

The court finds that the Trustee properly brought an adversary proceeding, based on 11 U.S.C. § 544(a)(3), to avoid the invalid mortgage lien on the debtors’ real estate. Disputes concerning the validity or existence of a lien require an adversary proceeding and “are not resolved by the confirmation process.” *In re Beard*, 112 B.R. 951, 956 (Bankr. N.D. Ind. 1990) (“If an issue must be raised through an adversary proceeding it is not part of the confirmation process and, unless it is actually litigated, confirmation will not have a preclusive effect.”). During the confirmation process, the parties resolved the monthly payment amounts to be paid to the defendant and agreed that payments must begin before confirmation of the plan. *See id.* at 954-55 (describing differences between contested matters and adversary proceedings, explaining that questions concerning amounts of claim are contested matters “which are properly before the court in the context of

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<sup>12</sup> Section 546, “Limitations on avoiding powers,” presents the following statute of limitations:

(a) An action or proceeding under section 544, 545, 547, 548, or 553 of this title may not be commenced after the earlier of –

(1) the later of –

(A) 2 years after the entry of the order for relief; or

(B) 1 year after the appointment or election of the first trustee . . . ; or

(2) the time the case is closed or dismissed.

11 U.S.C. § 546(a).

confirmation”). Only after the plan was confirmed did the Trustee question the validity of the mortgage lien securing the defendant’s claim, an issue requiring an adversary proceeding. *See* Fed. R. Bankr. P. 7001(2).

Section 544 actions to avoid a lien are subjected to the time limitations found in § 546, which sets a two-year limit on the avoidance powers of a trustee. In this case, the debtors filed their petition for relief on October 12, 2005. The trustee filed this § 544 complaint on September 28, 2006, less than a year after the entry of the petition and order for relief. The court finds, therefore, that the adversary proceeding was timely and was not barred by the order confirming the debtors’ chapter 13 plan.

In conclusion, the court determines that, under Indiana law, an acknowledgment in a mortgage instrument must be properly completed to be sufficient. The state law is clear that constructive notice is given only by properly acknowledged and recorded instruments. In this case, the acknowledgment omitted the names identifying the signers of the document as the persons who appeared before the notary and who freely executed the instrument. The defective acknowledgment invalidated the mortgage and failed to create a valid lien. It therefore was not entitled to be recorded. In addition, it could not and did not provide constructive notice to subsequent bona fide purchasers. Neither the recording of the mortgage by the St. Joseph County Recorder nor the curative provision of § 36-2-11-16(f) can resuscitate the invalid mortgage. The court also rejects the defendant’s res judicata claim that the foreclosure judgment, stipulation, and special confirmation order were absolute bars to the Trustees subsequent avoidance action. Consequently, the court determines that the Trustee may avoid the defendant’s mortgage lien on the debtors’ residential real estate under 11 U.S.C. § 544(a)(3).

#### Conclusion

For the reasons presented in this Memorandum of Decision, the court grants the Motion for Summary Judgment of the Trustee Debra L. Miller on her Complaint to Avoid Lien concerning the mortgage lien held by the defendant CommunityWide Federal Credit Union.

SO ORDERED.

/s/ HARRY C. DEES, JR.  
Harry C. Dees, Jr., Chief Judge  
United States Bankruptcy Court