The Case Of The Missing Mortgage

Both title company and servicer may be in hot water when foreclosure begins and the document has vanished.

BY BRUCE J. BERGMAN

This is another one of the bad - but apparently mundane - things that can happen in the mortgage arena. What it means and how it can impact the servicer when the mortgage is misfiled is the focus, although, in the end, a solution is not as likely to be offered. To answer the question raised, yes, when a mortgage is misfiled, it is the title company's problem, but it effectively becomes the servicer's dilemma, too.

The real basis of all this is the obvious concept that once a mortgage goes into foreclosure, time becomes a critical element. The foreclosure must proceed, so anything that slows or halts the case is pointedly a problem. That is the danger of a misfiled mortgage.

For symmetry, let's look first at the more common problem of a mortgage that, rather than being misindexed in the county clerk's (or register's) office, was never recorded at all. At the mortgage closing, the title closer takes the mortgage, intending to record it. (Typically, insurance for the mortgage is purchased from the title company insuring the borrower's title.) The title closer somehow fails to have the mortgage recorded. It was lost in the mail sent to the county clerk, the closer gave it to a secretary who neglected to take care of it, the closer put it in a drawer of things to do, never did it and later moved on to another company.

However it might happen, months or years later, when that mortgage goes into default, the file is given to counsel to foreclose. It is the foreclosure search that reveals the mortgage was never recorded. Whether the foreclosure upon an unrecorded mortgage can even begin may vary from state to state, but there is no doubt that the foreclosure cannot proceed to a *conclusion* until there is a recorded mortgage.

This, naturally, elicits a claim to the title company, since it was its responsibility to record the mortgage. If the company can locate the original mortgage, or a duplicate original, it can ultimately have the document recorded. It will also need to dispose of intervening interests that may have attached to the property. While the company is endeavoring to do all this, interest on the mortgage is accruing. In most states, the title company's liability is confined to the face amount of the policy. So, if the loan at issue went into default quickly, the accrual of interest could easily generate a debt greater than the policy. If the mortgage could somehow never be recorded, the title company might payoff on the policy - but the lender could still have incurred a loss!

Even though the title company would not have caused it, should the local clerk misfile (or misindex) a mortgage, the mortgage holder has a similar problem - all highlighted by a recent case in New York (*Sragg vs. Feiger*, N.Y.L.J., Nov. 27, 2000, at 37, col. 4 (Sup. Ct., Rich. Co., Lebowitz, J.)).

The difficulty in that case was that a mortgage was somehow filed under a closed and no longer used block designation. The borrower-owner sold the property, and the new purchaser knew nothing about the mortgage. When payments stopped, the lender began a foreclosure action - and lost! The court ruled that where a subsequent purchaser has no actual knowledge of a prior mortgage, an incorrectly indexed mortgage affords no constructive notice.

In other words, the misindexed mortgage cannot provide the very protection that recording a mortgage is supposed to give. Further, because without actual or constructive notice a mortgage lien is extinguished when the property is sold. The misindexed mortgage simply could not be foreclosed. Whether the mortgage holder in this case would be made whole by a title company (if there was one) is problematic.

If there is a lesson in all this is similarly uncertain. Should a lender or servicer have a choice, engaging a title company known for diligence and meticulousness is a good idea. It will not absolutely assure, however, that the mortgage will be recorded, or if sent for recording, correctly indexed. Should the worst ultimately be revealed (that the mortgage was never recorded or was misfiled), the best course is to be exceptionally vigorous in urging the title company to move as quickly as possible to address a resolution. SM