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Admit and Legislators Acknowledge That Real Estate Professionals Are Human and Need Protection From Harmless Errors

Ohio and other states where Frost Brown Todd has offices have long had witness and/or notary requirements for the execution of mortgages. Ohio Revised Code Section 5301.01 provides that a “mortgage . . . shall be signed by the . . . mortgagor. . . . The signing shall be acknowledged by the . . . mortgagor . . . before a . . . notary public . . . who shall certify the acknowledgment and subscribe [his or her] name to the certificate of the acknowledgment.” Bankruptcy trustees often try to use their “strong-arm” powers^[1] to defeat recorded mortgages in order to remove the lien from property of the bankruptcy estate, if the recorded mortgage was defectively executed under state law (in the alternative, the bankruptcy trustee can preserve the lien for the benefit of the bankruptcy estate).

^[1] Bankruptcy trustees so-called strong-arm powers include their avoidance powers: the right to avoid competing parties’ interests by acting as if the trustee was a judicial lien creditor, an execution creditor, or a bona fide purchaser. See 11 U.S.C. Section 544. A Chapter 11 Debtor-in-possession can also exercise the strong arm powers.

In this situation, the avoided mortgages were granted by the property’s owner, given in exchange for money that was actually advanced and known to the world because they were properly recorded.^[1] The avoidance of these liens was a penalty on human error by a real estate professional and a windfall for junior lienor or unsecured creditors. After all, neither the judgment lien creditors nor the unsecured creditors advanced money thinking the mortgaged property was available to pay the debts owed to them. The trustees’ activity became so frequent that Ohio’s legislature acted in 2013 to restrict some of the trustees’ activities by enacting Ohio Revised Code Section 1301.401 titled “Filing or Recording as Constructive Notice” which states, in part:

(B) The recording with any county recorder of any document described in division (A)(1) of this section or the filing or recording with the secretary of state of any document described in division (A)(2) of this section shall be constructive notice to the whole world of the existence and contents of either document as a public record and of any transaction referred to in that public record,

(C) Any person contesting the validity or effectiveness of any transaction referred to in a public record is considered to have discovered that public record and any transaction referred to in the record as of the time that the record was first filed with the secretary of state or tendered to a county recorder for recording.

By 2016, questions concerning the operation of this statute to bankruptcy trustees' activities had reached the Ohio Supreme Court via a certified question from the United States Bankruptcy Court for the Southern District of Ohio.

In *In re Messer*, 145 Ohio St.3d 441 (2016) the Ohio Supreme Court held that Section 1301.401 applies to all recorded and filed documents (including mortgages and UCC filings) and means that "the world" has notice of the filed or recorded document. As a result, no competing party whose competing status requires lack-of-knowledge can defeat the lien or other interest created by the recorded document. During this discussion, the court noted that a defectively executed mortgage would provide notice and thus prevent a competing party from becoming a "bona fide purchaser who has no knowledge of the existence" of the recorded or filed document. *Id.*, 145 Ohio St.3d 441, 444.

Section 1301.401 as interpreted in the *Messer* case means that in Ohio a bankruptcy trustee's ability to assume the role of a bona fide purchaser does not permit the avoidance of a defectively executed but still recorded or filed document. *In re Oakes*, 917 F.3d 523, 529 (6th Cir. 2019)[[2](#)] ("With the Ohio Supreme Court's interpretation of Ohio's revenue [sic] code, a bankruptcy trustee can thus no longer avoid mortgages as a bona fide purchaser. The constructive notice provision of [§ 1301.401](#) subverts a bona fide purchaser's ability to claim lack of notice. Lack of notice is central to the avoidance powers of a bona fide purchaser. In the context of single-family mortgage foreclosures, a bona fide purchaser is defined by [12 U.S.C.](#)

§ 3752 as being ‘a purchaser for value in good faith and without notice of any adverse claim, and who acquires the security property free from any adverse claim.’”)

Bona fide purchaser status, however, is not a bankruptcy trustee’s only avoidance power. A bankruptcy trustee can also assume the status of a judgment lien creditor and that status escapes the reach of O.R.C. Section 1301.401 because lack-of-knowledge is not required to become a judgment lien creditor. “Notice, however, is not relevant to the status of a judicial lien creditor. ‘Neither the Bankruptcy Code nor Ohio law requires that a judgment creditor have the same attributes of a bona fide purchaser as it pertains to notice of a prior interest; neither requires a judgment creditor to lack notice of an unrecorded or defective lien in order to obtain a superior lien on a judgment debtor’s property.’ Stubbins v. Wells Fargo Bank, N.A. (In re Gibson), 395 B.R. 49, 57 (Bankr. S.D. Ohio 2008). In Ohio, a defectively executed mortgage is invalid to a subsequent lienholder ‘even if the subsequent mortgagee-lienholder had actual knowledge of the prior defectively executed mortgage.’ Acacia on the Green Condo. Ass’n, Inc. v. Jefferson, 47 N.E.3d 207, 212 (Ohio Ct. App. 2016)” *In re Oakes* at 530-1.

The *In re Oakes* decision started with bankruptcy court cases filed in 2013 and 2014. It took until 2019 for decisions by the bankruptcy court and then Bankruptcy Appellate Panel to be reviewed by the Sixth Circuit. The *In re Oakes* decision states that O.R.C. Section 1301.401 does not defeat a judgment lien creditor and that is true. *In re Oakes*, however, did not apply Ohio Revised Code Section 5301.07 that was added in 2017 and directly addresses the rights of judgment lien creditors vis-a-vis recorded but defectively executed “real property instruments.”

Under section 5301.07, a recorded but defectively executed real property instrument (such as a mortgage) is “cured of the defect and [shall be] effective in all respects as if the instrument had been legally made, executed, acknowledged, and recorded” four years after the document was recorded. O.R.C. Section 5301.07(C). In a nutshell: a judgment lien creditor [including a bankruptcy trustee who assumes that status] has four years to file against a defectively executed but still recorded “real property instrument.”

Two final notes:

- The *In re Oakes* court gave the following warning regarding the limits of Section 1301.401 (but not Section 5301.07) “Under Ohio law, notice—whether constructive or actual—does not affect *the priority* of recordings. That is, regardless of notice, a defectively executed mortgage is not ‘perfected’ so it does not trump a subsequently perfected lien.” This means that a lien that can be perfected despite notice of the prior defectively executed lien instrument is not impacted by the notice provisions of Section 1301.401; and
- Section 1301.401 applies to filing or recording of any documents recorded by the County Recorder and UCC filings. Section 5301.07 applies to a subset of those documents, specifically “real property instruments.” So, do not assume that in all instances when a bona fide purchaser cannot prevail over a recorded but defectively executed instrument, a judgment lien creditor also cannot prevail over a four-year-old recorded but defectively executed instrument because the two statutes have different scopes.

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[1] County Recorders in Ohio and elsewhere are not responsible for checking the documents presented for recordation to ensure that the mortgage was properly executed. Real estate professionals (title agents, lawyers, paralegals, etc.) are responsible for their own work.

[2] From *In re Oakes*, “Previously in Ohio, a bankruptcy trustee could avoid defectively executed mortgages by acting as a bona fide purchaser without actual notice. See, e.g., [Rhie v. Central Mortg. Co. \(In re Kebe\)](#), 469 B.R. 778 (Bankr. S.D. Ohio 2012). In 2013, however, the Ohio legislature revised the state law. [Ohio Rev. Code § 1301.401](#), effective March 27, 2013 . . .”

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