



Lis Pendens in Ohio: Tips for Leasehold Mortgagees and Other SNDA Beneficiaries

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Ohio's lis pendens statute is maddeningly simple. Ohio Revised Code section 2703.26's two sentences read:

When a complaint is filed, the action is pending so as to charge a third person with notice of its pendency. While pending, no interest can be acquired by third persons in the subject of the action, as against the plaintiff's title.

In ordinary foreclosure cases, the statute means that the mortgagor cannot frustrate the foreclosure litigation by transferring away the lien property thus depriving the foreclosure case court of jurisdiction to complete the litigation. [Stewart v. Railway Co., 53 Ohio St. 151, \(1895\)](#) (discussing a prior lis pendens statute). I am happy to say the statute accomplishes this task and permits ordinary foreclosure litigation to proceed.

The purpose of this blog post is to discuss the application of lis pendens in an unusual situation: a commercial leasehold property interest and foreclosure of a commercial leasehold mortgage.

The lis pendens statute is not limited to its common application described above. One commentator expounded on Ohio's lis pendens statute in 6 Law of Distressed Real Estate Section 74.37 with this:

The general rule is that one not a party to a suit is not affected by the judgment. The exception is that one who acquires an interest in property which is at that time involved in litigation in a court having jurisdiction of the subject-matter and of the person of the one from whom the interests are acquired, from a party to the proceeding, takes subject to the judgment or decree, and is as conclusively bound by the result of the litigation as if he had been a party thereto from the outset. . . . It is essential to the existence of a valid and effective lis pendens that three elements be present: (1) the property must be of a character to be subject to the rule; (2) the

court must have jurisdiction both of the person and the res; and (3) the property or res involved must be sufficiently described in the pleadings. . . .

Lis pendens prevents third parties who claim to have “acquired an interest” in the property, after service and during the pendency of the foreclosure action, from challenging the trial court’s judgment.

The doctrine places any such conveyed interest at risk and notifies the parties that they are bound by the decree and sale thereunder. In addition, while the foreclosure action is pending, no other action may be commenced concerning the property. (bold added).

This commentator correctly implies that lis pendens can apply to leasehold interests that are the subject of the pending litigation.

Ohio’s application of lis pendens to lease related litigation fits the general rule. 54 C.J.S. Lis Pendens Section 10 includes this: “**Lis pendens applies to all claims affecting title to real property, use and occupation of property, and interest in property.** . . . Thus, lis pendens applies to actions which are brought to enforce any lien, charge, or encumbrance against real property.” (bold added). An Ohio court that applied lis pendens to a leasehold interest and related mortgage described lis pendens this way:

When properly applied, [Ohio’s lis pendens statute] insures that the ‘conveyed interest * * * becomes subject to the outcome of the pending litigation.’ Cincinnati ex rel. Ritter v. Cincinnati Reds, LLC, 150 Ohio App.3d 728, 2002-Ohio-7078, 782 N.E.2d 1225, ¶ 31 (1st Dist.). . . . ‘The general intent and effect of the doctrine of lis pendens is to charge third persons with notice of the pendency of an action, and to make any interest acquired by such third persons subject to the outcome and judgment or decree of the pending lawsuit.’ Bank of New York v. Barclay, 10th Dist. No. 03AP-844, 2004-Ohio-1217, 2004 WL 503935, ¶ 10.

Huntington Nat. Bank v. R Kids Count Learning Center, 97 N.E.3d 1228 (Franklin Cty. App. 2017).

With this background, I want to discuss the application of lis pendens to litigation involving leases and leasehold mortgages. This discussion will also give us a couple important reminders

concerning Subordination, Non-disturbance and Attornment Agreements (“SNDAs”). Commonly, SNDAs control the rights of fee owners, leaseholders and lenders that are all interested in the same real property. In my experience, most SNDAs have the landlord consenting and subordinating to the lender’s leasehold mortgage or other lien interests.

The facts and holdings in *R Kids Count* case cited above are instructive for both litigators and commercial lawyers. The facts of the *R Kids Count* case include the following transfers:

- the property owner and a related entity signed a long-term lease at a favorable rent^[1] covering a portion of the owner’s property;
- later, with the landlord’s approval, the tenant assigned the lease to an unrelated party who paid a fair market purchase price for the leasehold interest;
- to finance the purchase of the leasehold interest, the assignee-tenant (R Kids Count Learning Center) granted a leasehold mortgage to the bank. As part of the same lease assignment and mortgage transaction, the property owner, new tenant and bank executed an SNDA titled “subordination, consent, and non-disturbance agreement” in which the landlord subordinated its interests to the leasehold mortgage;
- the leasehold mortgage was recorded and indexed “only under the name of the lessee.” The SNDA which “subordinated” the property owner’s “rights as fee owner and lessor” was not recorded;
- the property owner then sold the entire parcel to a third party “by general warranty deed in 2008, subject to the leasehold.” The new property owner later sold the entire parcel to another unrelated third party; and
- last, the assignee tenant defaulted on its obligations under the lease and its loan payment obligations to the bank.

You can already see the extremely common problem: two “business partners” of one troubled business are going to compete for that business’s most valuable asset – the long-term below-market-rent

lease. Foreclosure litigation was started. The tenant did not participate in the litigation and, at the property owner's request, a default judgment was entered terminating the lease. The two solvent entities, however, fought over the leasehold – the bank wanted to foreclose its leasehold mortgage and collect the sale proceeds while the property owner wanted to terminate the leasehold and gain control over the leased premises. To resolve this dispute, the trial court made the following determinations:

- the trial court held that the landlord properly terminated the lease, but the bank's "mortgage interest in the leasehold survived termination of the lease by application of Ohio's lis pendens statute." Lis pendens prevented termination of the leasehold mortgage; and
- the subordination agreement executed in favor of the bank by the by the prior property owner / landlord was unenforceable against subsequent fee holder due to lack of notice to that fee owner (recall that the SNDA was not recorded); and
- the bank's leasehold mortgage was recorded outside the chain of title^[2] for ownership of the property and so the new property owner did not receive constructive notice of the leasehold mortgage through Ohio's recording statute; but
- the property owner was "nonetheless charged with constructive knowledge" of the leasehold mortgage due to the owner's actual knowledge of the lease itself and the tenant's use of the property.

Based on those determinations, the trial court ruled that the bank could conduct a foreclosure sale of the leasehold.

On appeal, the appellate court reversed the trial court's crucial determination that the existence of the lease and the tenant's occupancy of the premises gave the new property owner constructive knowledge of the leasehold mortgage. Specifically, the appellate court:

- agreed with the trial court that since the new property owner/landlord acquired the property before the bank filed its foreclosure case, the landlord's contractual rights under the

lease arising from the tenant's default did "not represent an 'acquisition' as contemplated by the lis pendens statute. The trial court, therefore, did not err in concluding that lis pendens did not bar default judgment . . . against R Kids and termination of the ground lease."[\[3\]](#)

- agreed with the trial court that the leasehold mortgage was recorded outside the chain of title. The bank suffered this misfortune because (i) the mortgage was indexed only using the names of the bank and tenant, and (ii) no instruments in the fee simple owner's chain of title referred to the leasehold mortgage or the SNDA.
- held that the new property owner was not obligated to search for any liens, including a leasehold mortgage, against the tenant's interest in the real property even though the fee interest acquired by the new owner and the tenant's leasehold interest had a "common grantor," specifically the original property owner/landlord. The appellate court said that the bank "argues that [landlord] was not only charged with constructive knowledge of recorded instruments directly within the chain of title, but obligated to follow-up the lease and discover subsequently recorded documents pertaining to the lease parties. The Supreme Court of Ohio, however, has rejected this common-grantor theory of constructive notice."
- disagreed with the trial court and held that the mere existence of a tenant on the property did not give the new property owner constructive notice of the leasehold mortgage or SNDA. Simply put, there is no obligation to search for stray property interests not in your chain of title or investigate how a tenant you inherited from the prior property owner financed its occupancy of the property.
- finally, the bank could not prove that the new property/owner landlord had actual notice of the leasehold mortgage or SNDA when it acquired the property.

After these decisions, the bank lost.

Lessons for the Drafting and Recording of a Commercial

Leasehold Mortgage and SNDA

- The bank tried to avoid termination of the lease even though the tenant/borrower did not participate in the litigation. The appellate court stated, however, that the SNDA did not give the bank the right to answer the landlord's complaint or argue on behalf of the tenant. Moreover, the court stated that even if the SNDA had provided that right to the bank, the bank's power might not have been effective against the new property owner/landlord since that entity did not have notice of the SNDA. The appellate court said that the bank had "not established any authority to assert such a right to answer on behalf of R Kids" and so the bank "cannot assert that its memorandum filed in opposition to default judgment against R Kids was effective to preclude [the] default judgment" that terminated the lease.
- It is not surprising that the tenant defaulted in the litigation and thus its lease was terminated via a default judgment. Litigation costs money and there probably would be no foreclosure litigation if the tenant had money. I have seen loan documents that give the lender a limited power of attorney to take certain legal actions if the borrower fails to do so. Commercial attorneys might consider such a provision permitting the lender to protect the existence of the lease by defending lease termination litigation if the borrower/tenant fails to take that action.
- The *R Kids Count* appellate court noted that "[a]s a general proposition, when a landlord terminates a lease due to the tenant's default, the leasehold mortgagee will see the mortgage rendered valueless with the extinction of the tenant's leasehold estate. This is because the mortgage given in a leasehold estate covers only such rights as are held by the lessee." Some leasehold mortgages I have foreclosed (or a related SNDA) include the landlord acknowledged right in favor of the bank to cure any lease defaults and thus preserve, or even revive, the mortgaged leasehold interest. It is unclear if these rights existed in favor of the bank in the *R Kids Count* case – even if yes, they might have been unenforceable against the current landlord because (i) that entity was not a party to the leasehold mortgage or SNDA, (ii) the bank could

not prove that the current landlord had actual notice of the leasehold mortgage or SNDA, (iii) the SNDA was not recorded so as to give the landlord constructive notice of the SNDA, and (iv) the recorded leasehold mortgage was not in the property owner's chain of title and so that recorded document was not constructive notice to the owner. Commercial lawyers should work to avoid one or more of these four failings.

- The bank's constructive notice argument based on the recorded leasehold mortgage lost, in part, because the recorded leasehold mortgage was not within the new property owner's chain of title. Given that the landlord/fee owner is a party to most SNDAs, that document, if properly recorded, can be within the fee simple chain of title. Commercial counsel can address this risk by proper drafting and recording of relevant instruments; or, at least, an affidavit of facts or Memorandum of Lease might be recorded describing the leasehold mortgage and the fee owner and indexed so that it is within the fee owner's chain of title.
- I strongly suspect that the new unrelated property owner had a copy of the lease. Who would buy partially occupied commercial real property without examining the documentation that granted your to-be tenant the right to occupy property you are buying? The bank's actual notice argument would have been enhanced if the lease document had been amended as part of the mortgage transaction that granted the leasehold mortgage and created the SNDA. Fairly simple options include: (i) the lease could have been marked with legend in the margin as happens with restricted securities, or (ii) generation of a lease addendum with the new information that is attached to the original lease.

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[1] The lease was for 99-years, renewable and charged \$100 per year in rent.

[2] Although not explicitly stated, it seems that the leasehold mortgage did not reference the property owner. Otherwise, if properly indexed, it might have been found by a “chain of title” search for the property’s fee ownership interest which is a tracing from buyer to seller over the relevant time period. See, *Spellman Outdoor Advertising Services v. Ohio Turnpike and Infrastructure Commission*, 72 N.E.3d 229 (Portage Cty. App. 2016). See also, 80 O. Jur.3d Records and Recordings Section 74 titled “Instrument Within or Without Chain of Title.”

[3] The appellate court did not explicitly address the fact that termination of the lease transferred to the landlord a real property right it did not previously enjoy – possession of the leased property. Might the transfer of that property right be an “acquisition” prevented by the lis pendens statute while litigation was pending?

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