REAL PROPERTY QUESTION CORNER:

(By Kraettli Q. Epperson)

DO STATUTORY MONETARY PENALTIES, ARISING DUE TO A LENDER'S FAILURE TO FILE A MORTGAGE RELEASE, APPLY TO CONSTRUCTIVE MORTGAGES AND FIXTURES FILINGS?

(Two-part article)

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(Part I of a Two-month-- II Part Article)

DO STATUTORY MONETARY PENALTIES, ARISING DUE TO A LENDER'S FAILURE TO FILE A MORTGAGE RELEASE, APPLY TO CONSTRUCTIVE MORTGAGES?

What advice would you give your lender or borrower client in the following circumstances:

{Hint: "46 O.S.1961 Sec. 15, is a penal statute and must be strictly construed.
'Strict construction', as applied to 46 O.S.1961, Sec. 15, is that which refuses to extend the law by implications or equitable considerations, and confines its operations to cases clearly within the letter of the statute, as well as within its spirit or reason." Walker v. Dugger, 1962 OK 88, ¶0, 371 P.2d 910, 910 syllabus}

1. Borrower is the holder of title to Blackacre and gives a deed to Lender#1 to secure payment of a debt ("First Mortgage").

2. Lender#1 gives a note and mortgage on Blackacre to Lender#2, to provide additional funds to Borrower ("Second Mortgage").

3. Borrower defaults on the debt to Lender#1, and Lender#1 sues to foreclose the so-called First Mortgage. Such sheriff's sale is made subject to Lender#1's Second Mortgage to Lender#2.

4. After a foreclosure judgment is taken, a sheriff's sale held, and a sheriff's deed issues, in regard to the First Mortgage, the Borrower produces funds to pay off both the First Mortgage and the Second Mortgage.

5. "[O]n sufficient showing that he was ready and willing to pay Bullington's judgment [First Mortgage] and the $5,000.00 mortgage [Second Mortgage] to the Demming Investment Company [Lender#2], the order confirming the sale, the order of sale, and the sheriff's deed were set aside, apparently by agreement of the parties, and the title quieted in Lowe [Borrower]." [¶1]

6. The funds to pay off the First Mortgage are delivered by the new third party lender ("Lender#3") on behalf of Borrower into the Court to justify Lender#1 giving his release of the First Mortgage; however, "At the suggestion of the court it was agreed by the attorneys, the parties being present, that Bullington [Lender#1] should not release the judgment [First

Mortgage] until he (Bullington) was released from the notes signed by him [Second Mortgage] to the Demming Investment Company [Lender#2] for Lowe's benefit [Borrower]." [¶1]

7. The balance of the funds to be used to pay off the Second Mortgage is delivered by Borrower's attorney of record to Lender#2 who promptly files the release of record as to the Second Mortgage. Borrower's attorney fails to advise Lender#1 that the Second Mortgage has been paid off and released; so, Lender#1 fails to release the First Mortgage.

8. There is a statutory requirement for a lender to release a mortgage within 10 days after being requested to do so. Failure to file such release subjects the lender to a monetary daily penalty of 1% of the original face amount of the mortgage, up to $100.00 per day, up to the full face amount of the mortgage. [now 46 O.S.§15]

9. WHAT HAPPENS NEXT?

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According to Bullington v. Lowe, 1923 OK 978, 221 P. 502, (opinion by C. Ray):

1. The Borrower serves a written demand on Lender#1 to release the First Mortgage, and when such lender fails to promptly file the release, the Borrower files a civil action – 90 days later -- to recover the statutory penalty, and is awarded over $5,000.00.

2. The matter is appealed by Lender#1.

3. This author expected that the penalty would be thrown out due to either: (a) the fact that the Court holds the funds and they have not been paid to Lender#1, or (b) Borrower's own attorney of record failed to advise Lender#1 that the Second Mortgage has been satisfied and released.

4. However, on appeal, the matter is argued on different grounds and then reversed by the Oklahoma Supreme Court based on such different grounds.

5. Lender#1 argues the statutory penalty did not apply to the failure to release a money judgment (i.e., the foreclosure decree herein [First Mortgage], which had already been vacated by agreement).

6. The appeals court finds that this First Mortgage (a deed given as security) is, as between the parties, deemed by the legislature to be a mortgage, under the provisions of 46 O.S.§1 [then §5253], which provides: "Every instrument purporting to be an absolute or qualified conveyance of real estate or any interest therein, but intended to be defeasible or as security for the payment of money, shall be deemed a mortgage and must be recorded and foreclosed as such."

7. However, the appeals court goes on and holds that such deed [¶7], "when not accompanied by a defeasance agreement, stands upon the record as a deed, and not as a mortgage, and is not included in the clear language of section 7642 [now 46 O.S.§15]."

8. The appeals court goes on to conclude [¶7]: "That section [46 O.S.§15] does not contemplate the release of mortgage liens, but the release of the recorded mortgage after the lien has been satisfied by payment of the debt for the purpose of removing a cloud from the record title. It applies to mortgages only."

9. Such decision seems to too quickly reject the clear legislative intent expressed in 46 O.S.§1 which provides that such deed "<u>shall be deemed a mortgage</u> and must be recorded and foreclosed as such."

10. Also, the language of the appellate opinion [¶7] does not seem to make sense when it says that the penalty statute is dealing with "the release of the recorded mortgage", rather than "the release of mortgage liens". This statement seems to say that it will treat the deed-type mortgage as creating a "mortgage lien" but not as a "mortgage". While this penalty statute has been held to be subject to strict construction (i.e., not allowing expansion of its coverage based on equity), the court's distinction seems contrary to both the

"spirit or reason" for the penalty statute, which appears to be to encourage the prompt release of voluntary consensual liens on real property or any interest therein.

11. Conclusion: Lender#1 wins, and Borrower loses.

[NOTE: Next month, in Part II, this discussion continues with a review of whether a fixtures filing in the land records covering mobile homes, which are affixed to the real property, is subject to this penalty statute, followed by a suggested legislative amendment to better effectuate the obvious intent of the legislature.]

(Part II of a two month-- II Part Article)

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1. Lender files both a mortgage and a fixture filing in the land records. The fixture filing covers mobile homes admittedly affixed to the subject real property.

2. The Borrower pays off the debt underlying the mortgage and the fixture filing. The Lender files the release of the mortgage in the land records, but fails to release the fixture filing.

3. Presumably after Borrower makes demand for a release and Lender fails to timely provide the release, Borrower sues Lender for the statutory monetary penalty provided under 46 O.S.§15 (i.e., 1% per day of the original amount of the mortgage, up to $100.00 per day, up to the full face amount of the mortgage).

4. As mentioned in 12A O.S.§1-9-502, a financing statement can cover "goods that are or are to become fixtures". If the filing party intends to cover such affixed goods, he must include sufficient information to "(1) indicate that it covers this type of collateral; (2) indicate that it is to be filed against the tract index in the real property records; (3) provide a description of the real property to which the collateral is related; and (4) if the debtor does not have an interest in the real property, provide the name of a record owner."

5. Such a fixture filing would look like and have the same effect as a "mortgage on real estate". It creates a lien (not a security interest) on the

real estate. It just does not have the label of "mortgage" at the top of the first page.

6. Does a fixture filing qualify as a "mortgage on real estate" under the terms of this penalty statute, and the earlier holding in Bullington v. Lowe, 1923 OK 978, 221 P. 502? [discussed in a earlier issue of the Briefcase]

7. Such question seems to ask which side wins: form or substance.

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According to Rhynes v. EMC Mortgage Corporation, 2007 OK CIV APP 82, 168 P.3d 251 (opinion by Adams):

1. The statutory penalty statute was adopted in 1910 and amended in 1977, in 1978, and in 1987.

2. Under the latest version of this penalty statute, the lender must file the release (it cannot deliver it to the borrower) within 50 days of the payment of the debt, and will be liable for a daily monetary penalty for failure to file such release within 10 days after the borrower, or its agent, makes a written demand for the release.

3. Echoing the rationale of the earlier decision in Bullington v. Lowe, 1923 OK 978, 221 P. 502, the appeals court affirmed the trial court, and held that [¶7]: "However, their [the landowners'] argument ignores the requirement of strict construction of §15, which the Court followed [in Bullington] when deciding §15's predecessor did not apply to a warranty deed given as security for payment of a debt although by law it is deemed to be a mortgage, because a deed lacks a defeasance agreement, does not stand on the record as a mortgage, and is *not* included in the clear language of section 7642 [§15's predecessor]. That section does not contemplate the release of mortgage liens, but the release of the recorded mortgage after the lien has been satisfied by payment of the debt for the purpose of removing a cloud

from the record title. *It applies to mortgages only."* [emphasis added by court]

4. This language makes it sound like the court is saying that both deeds (when serving as liens) and fixtures filings do create a "mortgage lien" on real estate, but are not covered by the penalty statute because they simply are not labeled as a "mortgage". Such a distinction, which focuses on the label attached to an instrument, fails to effectuate the clear legislative intent to encourage lenders to free up real property from satisfied voluntary consensual liens, so that the making of future loans is not delayed. To interpret this penalty statute to include all voluntary consensual liens on real estate would seem to be within the "spirit or reason" for §15.

5. The court further supports its holding -- affirming that the penalty statute does not apply to fixture filings – by explaining that both parties agree that the instruments are valid UCC fixture filings and that [¶9] "As such, our position that §15's penalty for failure to release a mortgage does not apply to the UCC fixture filings is further supported by the Legislature's treatment of mortgages and fixture filings as different instruments. *See* 12A O.S.2001 § 1-9-502 and § 1-9-515."

6. Finally, the court announces [¶9] "The trial court correctly concluded from the undisputed facts that §15 does not apply to the UCC fixture filings. The trial court's judgment is affirmed."

7. The legislature previously clarified the language of §15, by adding, in 1987, part B. which defined "mortgagee" to "include any subsequent purchaser of the mortgage real estate." This step was clearly intended to overcome prior restrictive Court interpretations of this statute that barred an interested and harmed party – the "subsequent purchaser" -- from having this tool available to free up his improperly encumbered real estate. [Hope v. United Sav. & Loan Ass'n, 1936 OK 487, 60 P.2d 737]

8. In addition to deeds which are deemed mortgages and fixture filings, there are several other statutes where the legislature expressly chose to "deem"

instruments as mortgages. These would include constructive mortgages [16 O.S.§11A] and deeds of trust [46 O.S.§ 1.1].

9. Therefore, it would be helpful – in order to carry out the "spirit or reason" for the penalty statute -- to define the term "mortgage" to include other voluntary consensual liens on real estate, to effectuate the clear expressions by the legislature that such liens are intended to be "deemed" mortgages. Such new language might look approximately like the following: *"(C) For purposes of this section, "mortgage of real estate" shall include any voluntary consensual lien on real estate or an interest therein, including but not limited to (1) deeds of trust, (2) constructive mortgages, (3) an instrument purporting to be an absolute or qualified conveyance of real estate or any interest therein, but intended to be defeasible or as security for the payment of money, (4) financing statements and fixture filings relating to real estate or any interest therein, and (5) any other instrument deemed by the legislature to be a mortgage on real estate or any interest therein."*

10. Such amendment would carry out the clear public policy as intended by the legislature.