Lien Survives Despite Unwinding of Fraudulent Transactions

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in Title Policies

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Plaintiffs, husband and wife sought to avoid the Sheriff's Sale of their home as a result of a foreclosure on their mortgage. Plaintiffs entered into a transaction with a third party who claimed that he would save their property by placing it in trust. After conveyance of the property to the third party in trust, the third party re-conveyed the property to new owners who made a new mortgage on the property, the proceeds of which were used to pay off plaintiffs' existing delinquent mortgage and other debts. Plaintiffs claimed that they were the victims of fraud by the third party and sought to unwind the transaction with the third party, the subsequent transaction with the new owners and to divest the lien of the new mortgage from the property. The holder of the new mortgage claimed that it was a bona fide mortgagee for value and asked the Court to confirm that its mortgage was valid. *HELD: The United States Bankruptcy Court for the Eastern District of Pennsylvania held that plaintiffs were victims of fraud, that both transactions should be unwound, but determined that the new lender was entitled to an equitable lien on the property to the extent of the debts that it paid off on plaintiffs' behalf. Fowler, et al. v. Rauso, et al., Adv. No. 07-00139ELF (Bankruptcy E.D. Pa., March 4, 2010).*

The recent deluge of mortgage foreclosures has driven many property owners to consider a variety of alternative and sometimes desperate means to save their homes. Property owners often voluntarily enter into transactions purportedly designed to help them save their properties. However, the terms of these transactions can be complex, confusing and in some instances, fraudulent. Courts have been increasingly faced with claims by property owners that they were the victims of "foreclosure rescue scams". In most instances, the property owners seek to unwind the allegedly fraudulent transaction, as well as other transactions down the chain of title which have no relationship to the alleged fraud. A recent decision issued by the United States Bankruptcy Court in Fowler v. Rauso, et al., highlights the complexity of these transactions and the consequences for other parties whose subsequent interests in the property can be stripped when a Court finds that fraud has occurred.

In Fowler, Rhodie and Larry Fowler sought to stop the impending foreclosure of their home. On the eve of a scheduled Sheriff's Sale of their property, the Fowlers were approached by defendant, Gennaro Rauso who proposed a plan to save their home by placing the property in trust. The Fowlers transferred title to the property to Rauso as "trustee" for no consideration, and further agreed to lease back their home, with the option to repurchase it in one year. Almost immediately, the Fowlers attempted to rescind the transaction, but Rauso refused. Instead, Rauso conveyed the property to third parties, David Borso and Corey Maness, who financed the purchase with a mortgage from Countrywide Home Loans, Inc. The financing was used to pay off many of plaintiffs' debts, including the original delinquent mortgage on the property.

Rhodie Fowler subsequently filed for bankruptcy. In the context of that proceeding, Fowler asserted an adversary claim in which she sought to restore property in her name, invalidate the conveyance of the property to Rauso, as well as the subsequent conveyance to Borso and Maness and Countrywide's mortgage lien. The third parties and Countrywide claimed that they were bona fide purchasers/mortgagee for value without notice of the alleged fraud and therefore, their interests in the property should be preserved.

The Court held that fraud occurred in the underlying transaction with Rauso and also rejected the bona fide purchaser/mortgagee claims made by Borso, Manness and Countrywide. The Court noted that Borso, Manness and Countrywide were on constructive notice of certain facts which could have been derived from the publicly-recorded documents within the chain. In particular, the Court found that anyone examining the record could have seen that Rauso was conveyed title in trust for the Fowlers and that his authority to re-convey the property was limited by the terms of the trust. The Court also noted that throughout the various transactions, Rhodie Fowler maintained clear, open and exclusive possession of the property. The Court found that Pennsylvania law imposed a duty of inquiry concerning the basis of her possession which had not been met. As a result, the Court rejected the bona fide purchaser claims and set aside the ownership and mortgage interests in the property.

The Court next considered whether Countrywide, while not found to be a bona fide mortgagee for value, was nevertheless entitled to an equitable lien on the property to the extent of the debts that it paid off on the Fowlers' behalf. Essentially, the equitable lien would replace the Countrywide mortgage that the Court had set aside. The Court noted that this was a novel issue which has not yet been addressed under Pennsylvania law. The Court surmised that had the Pennsylvania Supreme Court considered the issue, it would find that Countrywide's constructive notice of the Fowlers' interest in the property would not defeat Countrywide's claim for equitable relief. The Court determined that Countrywide was entitled to an equitable lien and that allowing the Fowlers to regain ownership of their property free and clear of all liens would not be equitable.

The Fowler case is instructive for title insurers. In its almost-100-page opinion, the Court took great pains to discuss how the notice of the potential fraud should have been detected by the title agent who handled the re-conveyance to Borso and Maness and that the notice could be imputed to them and to Countrywide. The Fowler case should serve as an important reminder to title companies and their agents that they serve on the front lines for identifying potentially fraudulent transactions. The consequences of failure to recognize “red flags’ when they arise can be devastating to those who obtain subsequent interests in the property. In addition, while equitable remedies may exist for a lender whose mortgage is set aside, this is still a novel issue under Pennsylvania law. As a result, great care should be taken when handling any transaction which has elements that may constitute a foreclosure rescue scam.

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