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## Attack on Deed of Trust in Bankruptcy Court Redux

### *Not All Ambiguities Are Created Equal*

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A recent opinion from the Bankruptcy Court in the Eastern District of North Carolina adds another chapter to the continuing saga of attacks lodged against the validity of deeds of trust encumbering real property owned by debtors. *In re Deuce Investments, Inc.* involved real property owned by the corporate debtor in Pender County, North Carolina. The real property was subject to a deed of trust held by Crescent State Bank. Donald Mason, another creditor of the debtor, sued the debtor and obtained a judgment in excess of \$800,000 prior to the bankruptcy filing. Therefore, as of the bankruptcy petition date, Mason's judgment lien was junior in priority to Crescent State Bank's deed of trust, giving Mason incentive to scrutinize the deed of trust for defects.

Mason filed an adversary proceeding in the bankruptcy case against Crescent State Bank and the debtor seeking to have the deed of trust declared void due to a defective description of the real property in the deed of trust as originally recorded. In the original filing, the deed of trust lacked a metes and bounds description of the debtor's real property. The deed of trust did contain a description of the property in the conveyance paragraph stating the street name (but without a street number), the county, zip code and acreage, and identifying Hampstead as the city. In reality, at the time the deed of trust was recorded the property had been annexed by Surf City so Hampstead was inaccurate, but the zip code remained unchanged and was correct.

Six days following its original recordation, the deed of trust was re-recorded to include a metes and bounds description of the real property. Mason contended that the defective description of

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the real property in the original deed of trust rendered it, and any subsequent recordings, void and unenforceable, such that Mason's judgment lien should be declared to have first priority.

The bankruptcy court found that the original deed of trust was ambiguous with regard to the identity of the real property encumbered. However, whether that ambiguity rendered the deed of trust and subsequent re-recordings void turned on whether, in legal terms, the ambiguity was "patent" or "latent."

If the real property encumbered by the deed of trust is capable of certain identification through examination of extrinsic evidence referred to in the deed of trust, then the deed of trust contains a latent ambiguity that may not be fatal. In contrast, if the description is insufficient to locate the property or fails to refer to any extrinsic evidence to help resolve the ambiguity, a patent ambiguity exists and renders the deed of trust invalid. For example, when a description is so general that it might apply to more than one piece of property owned by the grantor in the same county, or the land being transferred is part of a larger tract owned by the same grantor, the ambiguity would be considered patent.

The Bankruptcy Court determined that the ambiguity in Crescent State Bank's deed of trust was latent, allowing the court to consider evidence other than the deed of trust itself to identify the property. Crescent State Bank, which had the burden of producing such extrinsic or parol evidence, submitted an affidavit from a local real estate attorney who opined that the deed of trust was sufficient considering that two deeds conveying the property to the debtor and including the metes and bounds descriptions were recorded just prior to the deed of trust, and the deed of trust itself had been re-recorded to include the metes and bounds. The court relied on the affidavit and the re-recording of the deed of trust to find the property was properly identified and the deed of trust was valid.

Although the deed of trust holder prevailed in this case, the opinion re-emphasizes the need for

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lenders taking an interest in real property to use the utmost care in preparing deeds of trust and related loan documents. Prudent practices include an internal procedure mandating review of the recorded deed of trust by someone other than the person who prepared it to check for inconsistencies compared to the associated promissory notes and obvious defects or errors. When a potential problem is identified, legal counsel should be consulted to determine the appropriate means of correction. Preventative measures of this sort are the best offense when it comes to protecting interests in real property. Finally, if you develop concerns about the borrower's or property owner's financial status down the road, review any existing deeds of trust to determine whether corrective measures are needed before entering into workout negotiations, which might present an opportunity for you to obtain cooperation in rectifying a problem before it is used against you.



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