

Litigation Update - Recent Cases About Recorded Documents: A Reminder that Close only Counts in Horseshoes and Hand Grenades

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It goes without saying that the recording acts provide important protections to businesses that engage in activities such as providing financing for real estate or machinery. Recording an interest in real property at the county recorder, or with the Minnesota Secretary of State for UCC filings (or, in other states, the appropriate office as designated by statute), allows the lender-creditor to establish priority over any later claims against the same collateral. Moreover, the presence of the records helps to inform prospective lenders whether to accept certain property as security for financing. However, to work correctly, those seeking the protections of the recording acts must strictly abide by the rules. Two recent appellate cases help to demonstrate that close is not good enough when it comes to the recording acts and protecting a creditor's priority.

In MidCountry Bank v. Krueger, No. A08-534, 2010 Minn. LEXIS 245 (Minn. May 20, 2010), the Minnesota Supreme Court found that a creditor properly recorded a prior mortgage, despite the fact that the existence of the prior mortgage was not evident from the county recorder's indexing system. The owners of a tract of land, the Kruegers, used the tract of land (referred to in the case as the Hinshaw property) as collateral for a mortgage with MidCountry Bank when they purchased two other parcels of property. The two new parcels of property were also to be secured by the same mortgage. When the mortgage and deed were recorded, the county recorder, because of the process by which it entered data, only entered the information from the deed for the two new parcels into the record. Rather than separately entering the information from the mortgage in order to create the index for the mortgage, the county recorder cloned the information from the deed to create the mortgage index. The mortgage documents, containing the mortgage information on the Hinshaw property, were recorded, even though the indexes only described the two new pieces of land. Had a party reviewed the actual contents of the record rather than just the record index, the existence of the mortgage on the Hinshaw property would have been evident. The Kruegers sold the Hinshaw property to another buyer, who then secured the property under subsequent mortgage. The Kruegers defaulted and MidCountry Bank moved to foreclose on all of the secured properties, including the Hinshaw property.



In finding that MidCountry Bank's mortgage was properly recorded, the Minnesota Supreme Court found that the failure of the mortgage on the Hinshaw property to appear on the county's index was not fatal. Proper recording is not the same as proper indexing; rather a proper recording "requires a reference in the indexes sufficient to locate the document and a record of the document itself, and that between the indexes and the record, there is sufficient evidence that the document pertains to the property." A subsequent purchaser is deemed to have a duty to review a copy of the recorded documents, not solely perform an index search. The information in the recorded documents, therefore, is fair game and provides constructive notice of any encumbrances, even if the same information does not appear in the indexes. Accordingly, it may now be insufficient to search the tract indexes; businesses may want to consider reviewing at least parts of the recorded documents to ensure that there are no "hidden" details that fail to appear in the county's indexes. If the information can be found through more thorough investigation, the court will find that other parties had constructive knowledge of such information.

The Bankruptcy Appellate Panel for the Eighth Circuit similarly dealt with a recording issue in a bankruptcy case, *Hastings State Bank v. Stalnaker (In re: EDM Corp.)*, No. 10-6001, 2010 Bankr. LEXIS 1373, 53 Bankr. Ct. Dec. 36 (B.A.P. 8th Cir. May 14, 2010). In that case, a lender, Hastings State Bank, unsuccessfully argued that it had a prior lien on proceeds of EDM Corporation. Hastings State Bank lent EDM Corporation over \$4.5 million and filed a UCC financing statement listing the debtor as "EDM CORPORATION D/B/A EDM EQUIPMENT"; "EDM Equipment" was a common name of the corporation, but not a registered trade name. When subsequent parties ran a search using the debtor's proper name, the financing statement by Hastings Savings Bank did not appear, and the parties filed their own filing statement.

In finding that Hastings Savings Bank had not properly filed a financing statement, the court concluded the applicable Uniform Commercial Code section required that the financing statement contain "the name of the debtor indicated on the public record of the debtor's jurisdiction of organization" - nothing more and nothing less." The organizational name to be listed on the financing statement has a specific meaning, and to obtain the protection of filing the statement, this requirement must be strictly complied with.

Accordingly, while sometimes it may seem unnecessary, this case highlights the importance of doing research into issues as simple as the proper name of the business for which financing may be provided. There is no room for error when it comes to determining the name of the debtor party. If others cannot find the debtor by searching under the proper legal name, you will lose your priority.

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