

## **6TH CIR REJECTS BORROWERS' ATTEMPT TO INVALIDATE DOT BASED ON FAULTY ACKNOWLEDGEMENT**

The U.S. Court of Appeals for the Sixth Circuit recently held that two borrowers lacked standing to challenge the validity of a deed of trust in a lien priority dispute interpleader action filed by the foreclosure trustee, as the borrowers did not dispute that they executed the deed of trust, the lien placed on the property was valid, or that they were in default.

In so ruling, the Court rejected the borrowers' argument that an alleged defect in the acknowledgement invalidated the deed of trust, because a validly recorded instrument that was not properly acknowledged shall nevertheless place "all interested parties . . . on constructive notice of the contents of the instrument." Tenn. Code Ann. § 66-24-101(e)(2).

A copy of the opinion is available at: [Link to Opinion](#).

The borrowers executed a deed of trust ("first DOT") on their home to secure a loan from a lender to refinance. Although the first DOT's acknowledgment stated it was acknowledged in Alabama, it was actually executed in Tennessee. The first DOT was later re-recorded with the acknowledgement revised to reflect "Tennessee" instead of "Alabama" allegedly without the borrowers' knowledge, re-execution, or acknowledgement.

The borrowers subsequently executed and recorded a second deed of trust ("second DOT") with a separate, second lender. The borrowers later defaulted on the loan secured by the first DOT and the substitute trustee sold the property to a third-party purchaser at a foreclosure sale resulting in a surplus.

The trustee filed an interpleader action in state court against the borrowers and various lienholders, which was removed to federal district court.

The second lender filed a motion for summary judgment claiming priority over the proceeds. The borrowers filed a third-party complaint against the purchaser and a response to the second lender's motion claiming that the first lender had invalid title due to the first DOT's allegedly defective acknowledgment.

The district court granted both the second lender's and the purchaser's motions for summary judgment and awarded the proceeds to the second lender. The court denied the borrowers' motion and declined their request to certify a question of state law to the Tennessee Supreme Court. The district court also denied the

borrowers' subsequent motion to alter the judgment arguing that the court lacked jurisdiction over the complaint. The borrowers appealed.

On appeal, the Sixth Circuit rejected the borrowers' arguments that the district court lacked subject matter jurisdiction over the complaint and that the complaint violated Rule 14 of the Federal Rules of Civil Procedure. Although parties cannot waive the issue of subject matter jurisdiction, the Court noted that whether impleader was proper under Rule 14 is a different inquiry. The Court held that Rule 14 does not extend jurisdiction, it merely sanctions an impleader procedure. Accordingly, because the borrowers did not raise this issue in the trial court, the Sixth Circuit held it was waived.

As statutory impleader provides an independent grant of subject-matter jurisdiction, the Court determined that the district court possessed original subject-matter jurisdiction over the interpleader action under 28 U.S.C. § 1335. The surplus funds far surpassed the statutory threshold of \$500; and, the borrowers and the second lender were citizens of different states, which satisfied the minimum diversity requirement.

Further, the Court determined that resolution of the complaint required a determination of the first lender's title and the relative priority of the other liens on the property when it foreclosed. Accordingly, the operative facts necessary to resolve the claims in the complaint were common to those needed to determine the proper distribution of the proceeds in the interpleader. As the complaint and the interpleader action derived from a common nucleus of operative facts, the Court found that the district court had supplemental jurisdiction over the complaint under 28 U.S.C. § 1367.

The Sixth Circuit also held that the borrowers lacked prudential standing to assert that the first DOT was defective. The Court explained that the borrowers did not dispute that they executed the first DOT, the lien placed on the property was valid, or that they were in default.

Thus, the Court held, by the borrowers asserting that the first lender's title was invalid, they were not asserting their own rights but rather those of the second lender.

The Sixth Circuit noted that the borrowers should have asserted an argument as to the commercial reasonableness of the sale to achieve their true goals. The Court believed that the borrowers' true intention was to invalidate the sale in order for the property to be sold at a higher price to satisfy their remaining debts. However,

the borrowers never raised a commercial reasonableness argument and therefore it was waived.

The Court last determined that the state law acknowledgement issue was moot. The statute at issue provided that an otherwise validly recorded instrument that was not properly acknowledged shall nevertheless place “all interested parties . . . on constructive notice of the contents of the instrument.” Tenn. Code Ann. § 66-24-101(e)(2).

Because the second lender never raised the issue and the borrowers did not have standing to raise the issue, any determination of the statute’s effect on potential priority would not have been dispositive of the case.

Accordingly, the Sixth Circuit affirmed the district court’s judgment.