PLUNKETT COONEY

What To Do In Indiana When Reformation Doesn't Work

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Over the past decade reformation has been the title-equivalent to penicillin – it has been used to treat almost any defect that can affect title to real property (i.e., error in legal description, issues with tenancy by entirety).

Recently, however, borrowers and competing lienholders have been fighting back by directing courts to the fact that reformation requires the proponent to establish that the defect was caused by the mutual mistake of all the parties to the instrument. *Parish v Camplin*, 139 Ind. 1 (1894); *Walls v State*, 140 Ind. 16 (1894); *Board v Owens*, 138 Ind. 183 (1894); *Easter v Severin*, 78 Ind. 540 (1881)

Borrowers and/or competing lienholders have argued that unless the proponent can establish, for example, that the borrowers – not just the lender – intended a mortgage to attach to a particular parcel, the instrument may not be reformed.

However, not all is lost. Lenders have several alternative remedies that can be employed to secure the lender in a particular parcel or, for example, obtain a judicially declared interest over property held in tenancy by the entirety.

First, a lender can see the judicial imposition of an equitable lien. An equitable lien arises from an express contract in which a party promises to transfer, or indicates an intent to charge or appropriate, particular property as security for an obligation. Whenever it fairly appears from an instrument, notwithstanding its form, that it is intended to afford a security, an equitable lien exists in favor of the person in whose behalf the provision is made. *Root Mfg. Co. v Johnson*, 219 F. 397 (C.C.A. 7th Cir. 1914)

Second, a lender can demand the imposition of a constructive trust. A constructive trust may be imposed where a person holding title to property is subject to an equitable duty to convey it to another on the ground that he would be unjustly enriched if he were permitted to retain it. *Criss v Bitzegaio,* 420 N.E.2d 1221 (Ind.1981); *Kalwitz v Estate of Kalwitz*, 822 N.E.2d 274 (Ind. App. 2005); *Kerber v Guthrie*, 885 N.E. 2d 768 (Ind. App. 2008)

Third, an argument can be raised that one or more of the borrowers is estopped to defeat a lender's equitable right to enforce a mortgage against a particular parcel. Indeed, an owner of real property, or an interest therein, who stands by and sees a third person selling or mortgaging it under claim of title, without asserting his or her own title or interest or giving the purchaser or mortgagee any notice thereof, is estopped, as against such purchaser or mortgagee, to assert thereafter his or her title. *Walner v Capron*, 224 Ind. 267 (1946); *Suman v Springate*, 67 Ind. 115 (1879); *Anderson v Hubble*, 93 Ind. 570 (1884)

Regardless of whether a lender seeks to employ an equitable lien, constructive trust and/or the doctrine of estoppel, the lender will need to focus on the equities of the situation. In most instances, loan origination files and/or closing files will contain documentation that strongly supports an argument that it would be unjust to allow the borrowers to retain a particular parcel "free and clear"' and/or improper for a subsequent mortgagee to claim lien priority under the particular circumstances.

That documentation, when coupled with well-crafted written discovery and deposition testimony, is a strong response to a borrower/competing lienholder's efforts to defeat reformation.

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