SO ORDERED.
SIGNED this 22nd day of January, 2020

Suzanne H. Bauknight
UNITED STATES BANKRUPTCY JUDGE

THIS ORDER HAS BEEN ENTERED ON THE DOCKET.
PLEASE SEE DOCKET FOR ENTRY DATE.

IN THE UNITED STATES BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF TENNESSEE

In re

DAVID S. SCRAGGS

Debtor

Case No. 3:19-bk-32561-SHB
Chapter 7

ANN MOSTOLLER, TRUSTEE

Plaintiff

v.

VILLAGE CAPITAL & INVESTMENT, LLC

Defendant

Adv. Proc. No. 3:19-ap-3052-SHB

MEMORANDUM AND ORDER ON MOTION TO DISMISS ADVERSARY COMPLAINT

Plaintiff filed the Complaint initiating this adversary proceeding on November 27, 2019 [Doc. 1], seeking a determination that Defendant's lien on Debtor's real property is unperfected such that Plaintiff holds a superior interest in the property pursuant to 11 U.S.C. § 544. Defendant filed its Motion to Dismiss Pursuant to Federal Rule of Civil Procedure 12(b)(6)

("Motion to Dismiss") on December 4, 2019 [Doc. 5], seeking dismissal under Federal Rule of Civil Procedure 12(b)(6), made applicable to this proceeding by Federal Rule of Bankruptcy Procedure 7012(b), and attaching two exhibits: (1) a Deed of Trust between David S. Scaggs and Village Capital & Investment, LLC ("Deed of Trust") that was recorded with the Knox County Register of Deeds on June 8, 2015, and (2) an Affidavit of Scrivener's Error ("Scrivener's Affidavit") recorded with the Knox County Register of Deeds on September 11, 2017, filed "for the purpose of correcting the spelling of the borrower's first name on page 1 [of the Deed of Trust]." [Doc. 5-1 at 15.] Plaintiff timely filed the Response of Plaintiff to Motion to Dismiss ("Response") in accordance with E.D. Tenn. LBR 7007-1(a) on December 26, 2019. [Doc. 10.][1]

I. Rule 12(b)(6)

Rule 12(b)(6) of the Federal Rules of Civil Procedure requires dismissal for "failure to state a claim upon which relief can be granted."

> A pleading that states a claim for relief must contain: (1) a short and plain statement of the grounds for the court's jurisdiction . . . ; (2) a short and plain statement of the claim showing that the pleader is entitled to relief; and (3) a demand for the relief sought, which may include relief in the alternative or different types of relief.

Fed. R. Civ. P. 8(a) (applicable to adversary proceedings under Fed. R. Bankr. P. 7008). "To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'" *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007)).

The complaint is not required to contain

[1] Defendant filed a Reply to Plaintiff's Response on December 27, 2019 [Doc. 11]; however, because the Reply, which was not authorized under the Local Rules of the United States Bankruptcy Court for the Eastern District of Tennessee, was filed without leave of Court, and raised a new argument, it is STRICKEN. Because, however, the new argument concerned the jurisdictional issue of mootness, the Court addresses the issue below.

> detailed factual allegations[; however,] a plaintiff's obligation to provide the grounds of his entitlement to relief requires more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do. Factual allegations must be enough to raise a right to relief above the speculative level[.]

Twombly, 550 U.S. at 555 (citations omitted) (internal quotation marks omitted).

> While a complaint will survive a motion to dismiss if it contains "either direct or inferential allegations respecting all material elements" necessary for recovery under a viable legal theory, this [C]ourt "need not accept as true legal conclusions or unwarranted factual inferences, and conclusory allegations or legal conclusions masquerading as factual allegations will not suffice."

Philadelphia Indem. Ins. Co. v. Youth Alive, Inc., 732 F.3d 645, 649 (6th Cir. 2013) (quoting *Terry v. Tyson Farms, Inc*., 604 F.3d 272, 275-76 (6th Cir. 2010)).

> A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged. The plausibility standard is not akin to a "probability requirement," but it asks for more than a sheer possibility that a defendant has acted unlawfully. Where a complaint pleads facts that are "merely consistent with" a defendant's liability, it "stops short of the line between possibility and plausibility of 'entitlement to relief.'"

Iqbal, 556 U.S. at 678 (quoting *Twombly*, 550 U.S. at 556, 557).

When deciding whether to dismiss under Rule 12(b)(6), a court must "construe the complaint in the light most favorable to the plaintiff, accept its allegations as true, and draw all reasonable inferences in favor of the plaintiff." *Bassett v. Nat'l Collegiate Athletic Ass'n*, 528 F.3d 426, 430 (6th Cir. 2008) (quoting *Directv, Inc. v. Treesh*, 487 F.3d 471, 476 (6th Cir. 2007)). The Court also "'consider[s] the complaint in its entirety, as well as . . . documents incorporated into the complaint by reference, and matters of which a court may take judicial notice.'" *Solo v. United Parcel Serv. Co.*, 819 F.3d 788, 794 (6th Cir. 2016) (alteration in original) (quoting *Tellabs, Inc. v. Makor Issues & Rights, Ltd*., 551 U.S. 308, 322 (2007)); *see also Spier v. Coloplast Corp.*, 121 F. Supp. 3d 809, 813 (E.D. Tenn. 2015) ("[M]atters of public

record, orders, items appearing in the record of the case, and exhibits attached to the complaint also may be taken into account [when reviewing a Rule 12(b)(6) motion]." (citations omitted)).

II. The Parties' Positions

Here, the Complaint alleges that Debtor scheduled Dovenmuehle Mortgage Inc. as holding an unsecured claim relating to a mortgage on his residence located at 8105 Morning Rose Lane, Corryton, Tennessee ("Property"), and that, upon her investigation, she found that the Deed of Trust recorded against the Property is in the name of "David S. Scaggs." [Doc. 1 at ¶¶ 8, 9.] The Complaint also avers that Plaintiff was alerted by Defendant of a Scrivener's Affidavit recorded on September 11, 2017, that attempted to correct the misspelling of Debtor's last name in the Deed of Trust. [*Id.* at ¶ 9.] Plaintiff alleges that the nature of the misspelling and the difficulty in locating the Scrivener's Affidavit render it (and the Deed of Trust) insufficient to perfect Defendant's lien against the Property. [*Id.* at ¶¶ 10, 11.] Finally, Plaintiff avers that if the lien is unperfected or can be avoided under 11 U.S.C. § 544, she may use, sell, or lease the Property for the benefit of the bankruptcy estate. [*Id.* at ¶ 12.]

Although Defendant acknowledges that the Deed of Trust incorrectly spells Debtor's last name, it argues that the Scrivener's Affidavit sufficiently corrected the error and that, in any event, the misspelling was not a material defect. [Doc. 5 at pp. 4-7.] Defendant does not argue that Plaintiff has failed to plead sufficient facts to support avoiding the lien under § 544 but instead argues that Plaintiff's claim that the Scrivener's Affidavit was insufficient to perfect the lien is "not based on any cognizable legal theory" and "Plaintiff's arguments related to the Scrivener's Affidavit fail as a matter of law and must be dismissed with prejudice." [Doc. 5 at p. 4.]

In her Response to the Motion to Dismiss, Plaintiff explains that her investigation into the matter as alleged in the Complaint consisted of reviewing Defendant's proof of claim filed on

September 26, 2019, which includes the Deed of Trust and Scrivener's Affidavit, and thereafter finding the documents in the public record.[2] [Doc. 10.] She argues that "[t]he ultimate question for the Court is whether a reasonable person would be able to locate the trust deed without being provided specific recording information by the Defendant." [Doc. 10 at p. 2.] Plaintiff also argues that a trial is necessary to determine whether "a defective trust deed, which may or may not be found in a routine search, corrected by a defective scriveners affidavit, which may or may not be found in a routine search, constitutes adequate notice of a perfected security interest." [*Id.* at p. 3.]

III. Lien Avoidance under § 544

Chapter 7 trustees have been granted the authority to avoid liens and transfers within the scope of the Bankruptcy Code, including those enumerated within the "strong-arm provision" to the extent that a lien may be void or avoidable under state law by a judgment lien creditor or bona fide purchaser of real property. *See* 11 U.S.C. § 544(a)(1), (3); *Gregory v. Ocwen Fed. Bank (In re Biggs)*, 377 F.3d 515, 517 (6th Cir. 2004). Although federal law conferred Plaintiff with her strong-arm powers, state law determines the applicability thereof and whether Plaintiff's interest is superior to that of Defendant. *See Isaacs v. DBI-ASG Coinvestor Fund, III, LLC (In re Isaacs)*, 895 F.3d 904, 908 (6th Cir. 2018).

> "[T]he intervening rights of bona fide purchasers without notice — rights also possessed by the bankruptcy trustee under the strong arm provisions of the Bankruptcy Code — would preclude the reinstatement of a mistakenly released deed of trust if the purchaser could assert lack of notice." *Holiday Hospitality Franchising, Inc. v. States Res., Inc.*, 232 S.W.3d 41, 54 (Tenn. Ct. App. 2006). "As a hypothetical bona fide purchaser, the Trustee, under § 544(a)(3), is deemed to have conducted a title search, paid value for the property, and perfected its interest as a legal titleholder as of the date of the commencement of the case. However, the Trustee's right as a bona fide purchaser does not override state

[2] This point was the focus of Defendant's mootness argument raised in the unauthorized reply brief. [Doc. 11.] The Court does not find that Plaintiff's admission of having located the Deed of Trust in the public record moots her claim. If such were the case, no Chapter 7 trustee could ever bring a § 544 avoidance claim because, by definition, the knowledge of the security interest sought to be avoided is necessary to the assertion of an avoidance claim.

> recording statutes and permit avoidance of any interest of which the Trustee would have constructive notice under state law." *Jones v. First Cmty. Bank E. Tenn. (In re Silver Dollar, LLC)*, Nos. 2:07-cv-25, 2:07-cv-26, 2008 WL 53695, at *3 (E.D. Tenn. Jan. 2, 2008) (citations omitted).

Smoky Mtn. Title, Inc. v. Tenn. State Bank (In re Thomas Homes, LLC), No. 09-32553, Adv. No. 10-3129, 2012 WL 122539, at *8 (Bankr. E.D. Tenn. Jan. 17, 2012).

Under Tennessee law, which is a "race-notice recording system," *Bank of Am. v. Greene*, 465 B.R. 789, 794 (E.D. Tenn. 2012), a deed of trust "shall have effect between the parties to the same, and their heirs and representatives, without registration; but as to other persons, not having actual notice of them, only from the noting thereof for registration on the books of the register, unless otherwise expressly provided." Tenn. Code Ann. § 66-26-101. An unrecorded deed of trust is "null and void as to existing or subsequent creditors of, or bona fide purchasers from, the makers without notice." Tenn. Code Ann. § 66-26-103. Finally, "[a]ny instruments first registered or noted for registration shall have preference over one of earlier date, but noted for registration afterwards; unless it is proved in a court of equity, according to the rules of the court, that the party claiming under the subsequent instrument had full notice of the previous instrument." Tenn. Code Ann. § 66-26-105.

The Tennessee Supreme Court explained that notice in Tennessee takes two forms, actual or constructive notice, and that actual notice includes the variant of inquiry notice:

> While "[i]t is true that recordation creates constructive notice as distinguished from actual notice, in that ordinarily actual notice is when one sees with his eyes that something is done," "another kind of notice occupying what amounts to a middle ground between constructive notice and actual notice is recognized as inquiry notice. Some authorities classify inquiry notice as a type of constructive notice, but in Tennessee, it has come to be considered as a variant of actual notice." "The words 'actual notice' do not always mean in law what in metaphysical strictness they import; they more often mean knowledge of facts and circumstances sufficiently pertinent in character to enable reasonably cautious and prudent persons to investigate and ascertain as to the ultimate facts." Even a good faith failure to undertake the inquiry is no defense. Thus, "[w]hatever is sufficient to put a person

> upon inquiry, is notice of all the facts to which that inquiry will lead, when prosecuted with reasonable diligence and good faith."

Blevins v. Johnson Cty., 746 S.W.2d 678, 683 (Tenn. 1988), *quoted in Bank of Am.*, 465 B.R. at 796.

As explained by the district court in *Bank of America*, even an error by the register over which the lien creditor had no control operates like "the misfiling of a document that prevents a subsequent purchaser from having notice of a property interest." *Bank of Am.*, 465 B.R. at 800. In the event of such an error, if "the [t]rustee searche[s] the Register's property records, but that . . . search d[oes] not put the [t]rustee on notice, either actual or constructive, of the [deed of trust] and [the creditor's] interest in the [p]roperty," *id.*, and if the trustee otherwise acted reasonably in her search, then the lien may be avoided under § 544. *See id.* at 800-01.

In other words, in Tennessee, although a lien will be effective between the parties, a chapter 7 trustee would stand in the shoes of a bona fide purchaser who has a superior interest from an unperfected lien because of an error in registration. For purposes of the Motion to Dismiss, the question is whether the Complaint sufficiently pleads such a claim. The Court finds that it does.

IV. Sufficiency of the Complaint

The Complaint contains the following allegations intended to state a claim under § 544(a): Debtor scheduled his mortgage as an unsecured creditor; the Deed of Trust incorrectly identified Debtor as "David S. Scaggs"; Plaintiff was notified by Defendant of the existence of the Scrivener's Affidavit attempting to correct the misspelling; the Scrivener's Affidavit was difficult to locate and, given the defect in the Deed of Trust, was insufficient to correct the notice error; and Plaintiff's interest is superior to that of Defendant's under Tennessee law and § 544. [Doc. 1 at ¶¶ 8-12.]

As further explained by Plaintiff in her Response, her investigation included review of the Deed of Trust and Scrivener's Affidavit, which had been attached to Defendant's proof of claim filed on September 26, 2019. [Doc. 10 at p. 2.] She also explained that she initiated the adversary proceeding in reliance on Tennessee Code Annotated § 66-26-101; that it "was apparent that counsel for the debtor could not locate the trust deed resulting in the awkward scheduling of the debt"; and that "the [S]crivener's [A]ffidavit is recorded in such a way that one only finds it after being told the recording information . . . [and it] specifically states that it is presented to correct the borrower's *first* name, while it is the borrower's *last* name that is incorrect in the deed of trust." [*Id*. (emphases added).] She correctly defines the issue as "whether a defective trust deed, which may or may not be found in a routine search, corrected by a defective [S]criveners [*sic*] [A]ffidavit, which may or may not be found in a routine search, constitutes adequate notice of a perfected security interest." [*Id*. at p. 3.]

Plaintiff's allegations are sufficient to state a claim based in § 544 that Plaintiff may avoid Defendant's lien because the errors in the Deed of Trust and the Scrivener's Affidavit created a defect in recording such that neither actual nor constructive notice was given by those recordings under Tennessee law. Thus, taking Plaintiff's allegations as true and considering the Complaint in a light most favorable to Plaintiff, as required by Rule 12(b)(6), the Court finds that Plaintiff has sufficiently pleaded facts that allow the Court to draw the reasonable inference that Defendant's lien may be avoidable under § 544(a). Accordingly, the Motion to Dismiss is DENIED.

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