

THE EFFECT OF ELECTRONIC FILING OF COVER SHEETS IN VIRGINIA

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I. INTRODUCTION

Prior to electronic filing, if the Clerk of the Court misindexed a deed of trust, the law still held the unfortunate property purchaser liable for the misindexed deed of trust. Then, the purchaser had recourse against the Clerk and potentially, the title abstractor and the title insurer. With the advent of electronic filing, many Clerks now require the electronic filing of instruments along with a required cover sheet to assist the Clerk in recording the instrument. If the lender prepares an incorrect cover sheet, is the property purchaser still liable for the misindexed deed of trust? In *Mega International Commercial Bank, Ltd v. MCAP Capitol, LLC*, Civil Action 07-1319 (Norfolk Cir. Ct. 2007), the Court answered yes, holding, on demurrer, that the property purchaser was still liable for the misindexed deed of trust and the Clerk was still liable to the purchaser. While the case is unfinished, the Court has resolved the major legal issue, namely, the effect of the filing of an erroneous cover sheet. This article explores the result.

II. STATEMENT OF FACTS

Mega Bank filed suit for judicial foreclosure of a Deed of Trust, dated October 20, 2003, encumbering 890 Poplar Hall Drive, Norfolk, Virginia (the "Property"), which is now owned by MCAP. When Mega Bank recorded the Deed of Trust, Mega Bank provided the Clerk with a cover sheet, as required by law. Mega Bank's attorney made a misstatement on the cover sheet. The attorney identified the Deed of Trust's grantor as Stanley Tsen, T[rustee]. The grantor's actual name was Stanley Tseng, Trustee. The Clerk then automatically and electronically indexed the Deed of Trust under the incorrect name supplied by Mega Bank's attorney. MCAP purchased the Property for approximately \$2 million on December 14, 2004. Prior to acquiring the Property, MCAP had the title searched. MCAP's title examiner did not find Mega Bank's Deed of Trust because it had been misindexed. Theoretically, MCAP's title examiner could have found the Deed of Trust by searching all of the land records of the Norfolk Circuit Court from 1607 to the present day.

III. THE COVER SHEET STATUTE AND THE CONSEQUENCES OF MISINDEXING

A. The Purpose of a Cover Sheet

The purpose of the Clerk's index is to enable a purchaser of property to determine who owns the property and what liens encumber the property. In 2000 the General Assembly enacted VA. CODE § 17.1-227.1 (the "Cover Sheet Statute"), which authorized the clerks of the circuit courts to require that any deed or other instrument conveying or relating to an interest in real property be filed with a cover sheet detailing the information contained in the deed or other instrument necessary for the clerk to properly index such instrument. Through the cover sheet, an instrument is automatically and electronically entered into the Clerk's index. The legislative history of VA. CODE § 17.1-227.1, found in the 1998 Final Report of the Land Records Management Task Force, Exhibit 1 ("Final Report"), notes that "the advent of automation, though a boon to both the indexer and researcher does require that the person using the index use the **exact same name** as was used by the indexer."

B. The Consequences of Misindexing

Prior to the Cover Sheet Statute, the grantee of an interest in property had no responsibility with regard to indexing the instrument. Section § 55-96 (A)(2) of the VIRGINIA CODE required the Clerk of the Court to prepare the index. If the Clerk made an error in indexing a mortgage, a subsequent purchaser was held to have constructive notice of the deed of trust and took the property subject to the mortgage,

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even if he did not know about it. *Jonas v. Folks*, 149 Va. 140, 140 S.E. 126 (1927); *see also Shaheen v. County of Matthews*, 265 Va. 462, 579 S.E.2d 162 (2003); *Williams v. Consolvo*, 237 Va. 608, 379 S.E.2d 333 (1989); *Smith v. Sovran Bank*, 18 Va. Cir. 237 (Richmond Cir. Ct. 1989). The injured purchaser could shift all or part of his loss to the Clerk by suing the Clerk for negligence. *See First Virginia Bank - Colonial v. Baker*, 225 Va. 72, 301 S.E.2d 8 (1983).

The public policy behind this approach is evident. If a secured lender has done everything within his power to put the public on notice of his deed of trust, an innocent lender should not bear the risk of a Clerk's indexing error. Therefore, a properly recorded but misindexed deed of trust provided constructive notice to a subsequent purchaser.

C. VIRGINIA CODE § 17.1-227.1 Does Not Exonerate the Clerk of Liability

MCAP brought a third party complaint against the Clerk of the Court and the Clerk argued VA. CODE § 17.1-227.1 exonerated him from all liability for misindexing. As noted previously, under Virginia law, the Clerk is liable to a property purchaser for his negligence in misindexing an instrument. *See First Virginia Bank - Colonial v. Baker*, 225 Va. 72, 301 S.E.2d 8 (1983). Nothing in VA. CODE § 17.1-227.1, or in any other statute, overruled *Baker*.

After 1990, the Clerk's duties to record instruments were codified in VA. CODE § 55-96(A)(2) and VA. CODE § 17.1-223. These statutes require the Clerk to record instruments and to ensure they are in proper form. The statutes authorized the Clerk to reject an instrument, if a grantor's surname was not underlined or written in capital letters. To determine whether an instrument complied with the statute, the Clerk necessarily had to look at the instrument.

Virginia Code Va. Code § 17.1-227.1 was enacted in 2000. The statute provides:

Circuit court clerks may require that any deed or other instrument conveying or relating to an interest in real property be filed with a cover sheet detailing the information contained in the deed or other instrument necessary for the clerk to properly index such instrument. The cover sheet shall be developed in conjunction with the Supreme Court of Virginia.

When a statute's meaning is plain, the "resort to rules of construction, legislative history, and extrinsic evidence is impermissible." *Doss v. Jamco, Inc.*, 254 Va. 362, 370, 492 S.E.2d 441, 445 (1997). VIRGINIA CODE § 17.1-227.1 provided only that the Clerk could require a cover sheet to facilitate indexing. Nothing in § 17.1-227.1 repealed the Clerk's duty to index a recorded instrument, as required by § 55-96 (A)(2). Nothing in § 17.1-227.1 overruled *Baker*.

If VA. CODE § 17.1-227.1 were ambiguous, the Court could resort to legislative history to interpret the statute. The legislative history is a 1998 Final Report of the Land Records Management Task Force ("Final Report"), a 2002 Land Records Management Progress Report prepared by the Compensation Board ("Progress Report"), and the statute, as finally adopted.

The Final Report notes that, "the advent of automation, though a boon to both the indexer and researcher does require that the person using the index use the **exact same name** as was used by the indexer." Given this situation, the Final Report advocated the use of indexing standards, including the use of a parcel identification number ("PIN"). Through the use of a PIN, a researcher could search for records affecting a property by grantor's name and by PIN.

The Final Report advocated that, "the Clerk should be allowed to index from the cover sheet without being held liable for indexing errors where the information on the cover sheet is different from the information on the document." Pursuant to this objective, the Final Report proposed a statute, to be known as VA. CODE § 17-79.4, that required the Clerk to index records both by grantor's name and by PIN, and that also would have relieved the Clerk of all liability for errors on the land records cover sheet.

Under this procedure, a researcher would have two methods of searching a Property's title, by grantor's name and by PIN.

The General Assembly did not enact proposed VA. CODE § 17-79.4. This meant three things. First, the Clerk is not required to index land records by PIN. (Nor did the Clerk of the Norfolk Circuit Court index land records by PIN at the time in question.) Second, a researcher can still only find land records by a search of the grantor's name. Finally, the General Assembly clearly rejected proposed legislation that relieved the Clerk of liability for misindexing errors.

IV. EQUITABLE ESTOPPEL

MCAP acknowledged that Mega Bank had filed a proper Deed of Trust in the land records, but argued Mega Bank was estopped from enforcing it. Simply, MCAP asserted Mega Bank's filing of the erroneous cover sheet had prevented MCAP from obtaining actual knowledge of the Deed of Trust. An estoppel is that which prevents one from showing the truth. 7A MICHIE'S JURISPRUDENCE: Estoppel § 2. Equitable estoppel is founded upon the great principles of morality and public policy. *Id.* MCAP asserted there were two kinds of equitable estoppel, 1) estoppel by record, and 2) estoppel by representations or conduct, or estoppel in pais.

A. Estoppel by Record

Under the doctrine of estoppel by record, a party can be estopped from changing his position to the detriment of a third person. *Id.* Estoppel § 8. The doctrine is normally applied in the context of judicial proceedings. *Id.* However, the Virginia Supreme Court has ruled that the doctrine also applies to recorded instruments. *Pruitt v. Ferguson*, 224 Va. 507, 513, 297 S.E.2d 714, 717 (1982).

Mega Bank's erroneous cover sheet is a recorded instrument. The Clerk recorded the cover sheet immediately prior to Mega Bank's Deed of Trust. The recordation of the cover sheet was consistent with the practices observed in the City of Norfolk and elsewhere in Virginia. Although the cover sheets are not part of the instrument to which they relate, cover sheets are matters of public record. Their purpose under the Cover Sheet Statute is to enable the Clerk to automatically and electronically index a document affecting real estate title immediately on the recordation of the document. Because a cover sheet is a public record, a misstatement in a cover sheet should give rise to an estoppel under the doctrine of estoppel by record.

In *Pruitt*, a deed conveyed certain land to Henrietta Baker, George Rush, and Reanna Rush. Due to a scrivener's error, the recorded deed substituted the word "Bush" for "Rush" throughout the deed. Thus, a competent title searcher would not find any reference to Rush in the land records. For many years, the taxes on the land were unpaid, and the Sternes family purchased the land by tax deed. The Sternes conveyed the property to the Fergusons. By a series of deeds, the Pruitts obtained the land from the Rushes. The Pruitts claimed neither they nor the Rushes received the required notice of the tax sale. The Fergusons asserted the Pruitts were equitably estopped from disputing the accuracy of the record, because their predecessor in title was responsible for the misnomer perpetuated in the land records. The Virginia Supreme Court agreed, stating "wherever one of two innocent persons must suffer by the acts of a third, he who enabled such third person to [cause] the loss, must suffer it." *Pruitt v. Ferguson*, 224 Va. 507, 513, 297 S.E.2d 714, 717 (1982).

Just like *Pruitt*, the error here was caused by the grantee's agent, namely Mega Bank's counsel. Due to the automatic and electronic indexing of the Deed of Trust through the required cover sheet, Mega Bank's counsel was responsible to ensure the Cover Sheet was accurate so the Clerk could automatically and electronically record the Deed of Trust accurately.

Just like in *Pruitt*, it is impossible to locate Mega Bank's Deed of Trust in the land records. In *Pruitt*, the Fergusons could not find the deed because, due to the scrivener's error, the instrument was recorded under "Bush" not "Rush." Here, it was impossible for MCAP to find the Deed of Trust because,

due to the 2002 change in automating the land records, one can only find the Deed of Trust by searching the land records for the grantor's name "Tseng" (or by searching the land records one by one from 1607 to the present day).

Just like *Pruitt*, the grantee caused the land records to reflect the wrong person had an interest in the property. Moreover, just like the Fergusons in *Pruitt*, MCAP is an innocent party. Accordingly, MCAP argued that Mega Bank was estopped from enforcing the Deed of Trust.

B. Estoppel In Pais By Affirmative Representation

While the Court did not address the estoppel by record argument, the Court found that estoppel in pais did not apply. Essentially, the Court held that MCAP did not rely on any representation made by Mega Bank, but relied on the Clerk's representations about the state of the land records.

MCAP argued that to establish estoppel in pais, it is not necessary for a party to show actual fraud, but only that the person to be estopped has misled another to his prejudice. *T v. T*, 216 Va. 867, 872-73, 224 S.E.2d 148, 152 (1976). The elements necessary to establish estoppel are: a representation, reliance, change of position, and detriment. *Id.*

First, Mega Bank had a statutory duty to file the cover sheet and to provide the Clerk with information for the clerk to index the Deed of Trust properly. VA. CODE § 17.1-227.1. Mega Bank stated on the cover sheet that the grantor was "Tsen" and not "Tseng." This representation was a false statement. Because Mega Bank knew all persons interested in the property's status would rely on the information Mega Bank submitted, Mega Bank's statutory duty ran to all persons interested in the property's status.

Mega Bank contended it made no false representation to MCAP because Mega Bank delivered the cover sheet only to Clerk for indexing purposes. MCAP argued this argument ignored the fundamental nature of electronic indexing, which feeds cover sheet information into an electronically created index without Clerk intervention. Because Mega Bank was charged with knowledge of the law, Mega Bank should reasonably have foreseen that the information Mega Bank provided in the cover sheet would be immediately made available to, and relied upon by, members of the public who were interested in determining the status of the title to the property.

The RESTATEMENT SECOND OF TORTS § 552 states the following rule that applies to this situation: "(3) The liability of one who is under a public duty to give the information extends to loss suffered by any of the class of persons for whose benefit the duty is created, in any of the transactions in which it is intended to protect them." Comment k to RESTATEMENT SECOND OF TORTS § 552 provides:

k. *Public duty to give information.* When there is a public duty to supply the information in question, an exception arises to the rule stated in Subsection (2), and the maker of the negligent misrepresentation becomes subject to liability to any of the class of persons for whose benefit the duty is created and for their pecuniary losses suffered in any of the general type of transactions in which they are intended to be protected.

The usual case in which the exception arises is that of a public officer who, by his acceptance of his office, has undertaken a duty to the public to furnish information of a particular kind. Typical is the case of a recording clerk, whose duty it is to furnish certified copies of the records under his control. *The rule stated is not, however, limited to public officers, and it may apply to private individuals or corporations who are required by law to file information for the benefit of the public.* (Emphasis supplied.)

MCAP argued VA. CODE § 17.1-227.1, along with the Clerk's requirement of filing of cover sheet, created a public duty for Mega Bank to provide the information on the cover sheet so that its Deed of Trust would be indexed properly. The index was intended for the benefit of a limited and foreseeable class of persons – those interested in the status of the title to the property. MCAP's purchase of the

property was one of the kinds of transactions for which the information provided by Mega Bank was intended to provide protection. Therefore, Mega Bank plainly had a public duty to MCAP under the rule set forth in the RESTATEMENT.

Second, MCAP argued Mega Bank made the false representation on the cover sheet when it knew the grantor was “Tseng” and not “Tsen.” The Deed of Trust establishes Mega Bank knew the grantor was Tseng.

Third, MCAP argued Mega Bank made the false representation on the cover sheet to all parties interested in determining the property’s title status, as set forth previously. Mega Bank obviously intended the recordation through the cover sheet would bring its Deed of Trust to the attention of a purchaser like MCAP, so that someone like MCAP could pay Mega Bank what it was owed.

Fourth, MCAP argued Mega Bank made the false representation with the intention that all persons interested in determining the property’s title status should rely upon Mega Bank’s representation.

Fifth, MCAP argued it was induced to rely upon the false representation. A court’s land records are the only place someone can check a property’s title status. The system for recording deeds of trust requires the filer to correctly state the grantor’s name. In relying on the system, MCAP relied on persons, like Mega Bank, to lodge properly their claims to the property.

Finally, MCAP argued it was misled to its injury by Mega Bank’s false representation. MCAP contracted to purchase the property free and clear of liens. MCAP did not get what it bargained for because the property was subject to Mega Bank’s Deed of Trust.

C. Mega Bank Prevented MCAP From Getting Actual Notice

Mega Bank cited a number of cases for the proposition that negligent indexing by the Clerk will not prevent a recorded instrument from imparting constructive notice to a purchaser. *See, e.g., Smith v. Sovran Bank*, 18 Va. Cir. 237 (Richmond Cir. Ct. 1989). Mega Bank then asserted that estoppel should not apply because MCAP had constructive knowledge of the Deed of Trust. Yet, in *Hiden v. Mahanes*, 119 Va. 116, 89 S.E. 121 (1916), the Supreme Court stated “silence will not bar a man from asserting a title of record in the public registry . . . so long as no act is done to mislead the other party.” *Hiden*, 119 Va. at 120 (emphasis added). Constructive knowledge is not the same as actual knowledge. Based on *Hiden*, MCAP argued that having prevented MCAP from obtaining actual knowledge of the Deed of Trust, the Court should not allow Mega Bank to assert that MCAP had constructive knowledge of it.

V. CONCLUSION

The problem presented here will reoccur. Undoubtedly, some unscrupulous person will view this article as a road map for fraud. A person desiring to disguise his interest in real estate could simply misspell the grantor’s name and, in the future, use the wrong PIN on a cover sheet for a deed or deed of trust. Rather than serving its intended purpose of preventing fraud, the recording act would become an instrument for perpetrating a fraud. Either the Courts or the General Assembly should address the situation.