G.S. Chapter 45: Power of Sale Foreclosure
Case Summaries
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Jurisdiction

In re Foreclosure of Foster (COA14-108; Feb. 17, 2015)

Lender filed a power of sale foreclosure before clerk of superior court. The clerk dismissed the foreclosure and the lender appealed. While the lender's appeal was pending, the borrowers filed a motion in the same proceeding for permanent injunctive relief based on fraud by the lender. The NC Court of Appeals held that permanent injunctive relief is an equitable remedy and is outside the subject matter jurisdiction of the court in a power of sale foreclosure under Chapter 45, regardless of whether the request for relief is made before the clerk or on appeal of the same action before the superior court judge.

Lien Priority

Henkel v. Triangle Homes, Inc. (COA15-1123; Sept. 20, 2016)

The North Carolina Court of Appeals held that a deed to real property obtained at a foreclosure sale without notice to the United States does not extinguish a federal tax lien on the property. The court noted that the general rule that federal tax liens are inferior to local tax liens applies only when the United States is provided prior notice of a foreclosure sale arising from a local tax liability. A senior lienholder foreclosing on a property subject to a federal tax lien must provide the United States notice prior to the foreclosure sale in order to extinguish the lien. If no notice is provided to the United States, then the federal tax lien remains undisturbed by the foreclosure.

Statute of Limitations

In re Foreclosure of Brown (COA14-937; April 21, 2015)

Mortgagor/Borrower challenged foreclosure on the basis of the expiration of the statute of limitations applicable to a foreclosure under G.S. 1-47(3). Provided that the mortgagor remains in absolute possession of the property during the 10 year period, court held that the 10-year statute of limitations period runs from the last to occur of the following: (i) the date that the power of sale becomes absolute, (ii) the date of the last payment made on the loan, and (iii) the date of the forfeiture of the mortgage. The court also held that the power of sale becomes absolute on the date the loan is accelerated and, if the loan is not accelerated, on the maturity date.

Role of the Substitute Trustee

In re Foreclosure of Cain (COA15-591; July 5, 2016)

Trustee filed power of sale foreclosure, the clerk entered an order authorizing sale, and the debtor appealed. After the hearing before the clerk, but before the appeal hearing in superior

court, the trustee was removed and replaced with a new trustee. The former trustee appeared at the superior court hearing as counsel for the lender. Debtor objected to former trustee appearing as lender's counsel, the superior court overruled the objection, and entered the order authorizing sale. The debtor argued on appeal that the superior court erred in allowing the former trustee to appear on behalf of the lender because the change in representation constituted a breach of the trustee's fiduciary duty. The NC Court of Appeals affirmed the superior court. The court noted the trustee has a fiduciary duty to both the debtor and the lender and must maintain the strictest impartiality while serving in the role as trustee. However, the court held that the former trustee was not precluded from withdrawing as trustee and later appearing as lender's counsel, particularly where the former trustee gave notice to the debtor of the change in representation and there was no evidence that (i) the trustee acted in bad faith or (ii) the debtor was injured by the trustee's actions. In addition, the court found no evidence of an ethical violation by the attorney/trustee based on a review of NC State Bar ethics opinions and a determination that the change in representation did not create an unfair advantage in favor of the lender.

Evidence

- **Business Records Exception**

In re Foreclosure of Cain (COA15-591; July 5, 2016)

Clerk entered an order authorizing foreclosure sale and the debtor appealed to superior court. On appeal, the debtor objected to the admission of records of the debtor's loan account into evidence. The superior court overruled the debtor and the debtor appealed. The NC Court of Appeals affirmed the superior court and held the records were properly admitted under the business records exception to the hearsay rule. The court found that the "authorized signor" of the lender's affidavit of indebtedness constituted a qualified witness with personal knowledge able to authenticate the records through the affidavit. The court found that the records were properly authenticated based on statements in the affidavit that (i) the records were made and kept in the regular course of business by persons having knowledge of the information set forth at or near the time of the acts recorded, (ii) the signor had reviewed the records, and (iii) the signor had personal knowledge as to how the records were kept and maintained. The court noted that there is no requirement that the records be authenticated by the person who made them.

- **Hearsay**

In re Foreclosure of Cain (COA15-591; July 5, 2016)

Clerk entered an order authorizing foreclosure sale and the debtor appealed to superior court. On appeal, the debtor objected to the admission of certain statements in the lender's affidavit of indebtedness into evidence as hearsay. The superior court overruled the objection and the debtor appealed on this basis as well. The NC Court of Appeals affirmed the superior court and held that the court properly considered the affidavit as competent evidence given (i) the specific provision in G.S. 45-21.16(d) allowing the court to consider affidavits and certified copies of documents and (ii) the necessity for expeditious procedure in a power of sale foreclosure. The court found that the debtor provided no reason to require the lender's out-of-state employee to

appear at the foreclosure hearing and present live witness testimony. The court also noted that any legal conclusions contained in the affidavit, such as statements that the lender is the holder of the loan, are to be disregarded by the court, but do not otherwise invalidate the affidavit as evidence.

Rule 41 Two-Dismissal Rule

In re Foreclosure of Beasley (COA14-387; June 2, 2015)

Trustee on behalf of lender filed power of sale foreclosure. Trustee then filed a notice of voluntary dismissal of the foreclosure proceeding. Fifteen months after the dismissal, the trustee filed a second power of sale foreclosure. Prior to the foreclosure hearing before the clerk, the borrower filed a motion to dismiss the action with prejudice and the trustee filed a second voluntary dismissal of the foreclosure. At the hearing, the clerk entered an order finding that the second voluntary dismissal filed by the trustee operated as an adjudication on the merits pursuant to Rule 41(a) and granted the borrower's motion to dismiss with prejudice. Lender appealed. In its opinion, the NC Court of Appeals addressed two issues raised by the application of Rule 41 to a power of sale foreclosure.

- First, the court noted that Rule 41 allows a plaintiff to dismiss the action any time prior to resting the plaintiff's case and file a new action on the same claim within one year after the dismissal. The court held that this one year time period is a "savings provision" that constitutes an extension beyond the general statute of limitations. It does not limit the statute of limitations if it has not yet expired. In the case of a foreclosure, there is a 10 year statute of limitations. Therefore, Rule 41 did not preclude the second power of sale foreclosure in the instant case even though it was filed more than one year after the first dismissal because the 10 year statute of limitations had not yet expired.
- After determining that Rule 41 did not preclude the second foreclosure filing by the trustee, the court then analyzed the effect of the second voluntary dismissal under Rule 41(a). The court held that the trustee's two prior voluntary dismissals of the Chapter 45 foreclosure proceeding on the same note did not operate as an adjudication on the merits that would prevent a third Chapter 45 foreclosure proceeding under Rule 41(a). Notwithstanding that the lender accelerated the debt prior to the first action, if the second action is based on different defaults or new period of defaults from the first action, then a third action is not barred because the first two actions did not arise out of the same claim of default. The court noted that the lender's election to accelerate the amount due under a note does not necessarily place future payments at issue such that the lender is barred from filing subsequent foreclosure actions based on subsequent defaults.

In re Foreclosure of Herndon (COA15-488; Jan. 19, 2016)

Applying a holding from In re Foreclosure of Beasley to a similar set of facts, the NC Court of Appeals held that a third Chapter 45 foreclosure proceeding filed after the trustee voluntarily dismissed two previous actions under Chapter 45 on the same note was not barred by the Rule 41(a) "two-dismissal rule." The court found that each action was based on a different period of defaults and therefore the second voluntary dismissal did not operate as an adjudication on the

merits and did not preclude the trustee from filing a third Chapter 45 foreclosure. The court reiterated from Beasley that the prior acceleration of the loan by the lender did not preclude the filing of future foreclosure actions based on subsequent defaults.

Application of Rule 52(a): Findings of Fact and Conclusions of Law; De Novo review
In re Foreclosure of Garvey (COA14-570; June 2, 2015)
The court restated language from earlier decisions that the N.C. Rules of Civil Procedure apply to power of sale foreclosures. Specifically, the court held that Rule 52(a), which requires the trial judge to make written findings of fact and conclusions of law, applies when a superior court judge conducts a hearing *de novo* on appeal from an order of the clerk. The order of the judge must include more than a summary conclusion that the party seeking to foreclose satisfied the statutory requirements. The judge must make findings as to each of the six factors required to foreclose under Chapter 45 and do so by conducting a *de novo* hearing on appeal, which is more than a *de novo* review of the clerk's order. After the *de novo* hearing, the judge must make the judge's own findings of fact and conclusions of law before entering an order as to whether the trustee may proceed with the foreclosure.

Authority to Cancel a Note
In re Dispute over the sum of $375,757.47 (COA14-1239; April 21, 2015)
The NC Court of Appeals applied G.S. 25-3-604 to determine whether the original lender had the authority to cancel a note where the original lender recorded a Certificate of Satisfaction with the Register of Deeds. The NC Court of Appeals determined, based on a review of the allonge to the note and the original note submitted into evidence by the current holder of the note, that the original lender did not have the authority to cancel the note because at the time of the recording of the satisfaction, the lender had previously assigned the note, no longer owned the loan, and was not a "person entitled to enforce the instrument" under G.S. 25-3-604.

Holder of the Note; Indorsements
In re Dispute over the sum of $375,757.47 (COA14-1239; April 21, 2015)
The NC Court of Appeals summarized the law under G.S. Chapter 25 applicable to indorsements and the assignment of notes. The court then applied the holding of In re Bass, 366 N.C. 464 (2013) to the indorsements challenged by the borrower. Under Bass, there is a presumption that an indorsement to a note is valid. The court held that where a purported holder appears in court with the original note and the note is the subject of a clear chain of indorsements ending with a blank indorsement, the court could find sufficient competent evidence that purported holder was in fact the holder of the note. The burden then shifts to the borrower to provide evidence that the purported holder is not in fact the holder. The court determined that both arguments made by the borrower failed to overcome the legal presumption and physical fact that the purported holder was the actual holder of the note. The first argument made by the borrower was that the version of the note presented in court did not match an earlier version faxed to the borrower's counsel. The court did not find this argument persuasive because the

only substantive difference the court found between the copy and the original presented in court was the addition of the most recent indorsement, which was dated after the date the copy of the note was faxed to the borrower's counsel. Second, the court held that the borrower's arguments that MERS improperly assigned the note were without merit. The court held that MERS was merely the nominee under the deed of trust and had no authority to assign the note as MERS was never the holder of the note. The court held that the deed of trust followed the note and therefore any assignment of the note resulted in an assignment of the deed of trust.

In re Foreclosure of Rawls (COA15-248; Oct. 6, 2015)

The clerk of superior court entered an order authorizing sale in a power of sale foreclosure proceeding. The owner of the real property appealed. At the *de novo* hearing before the superior court judge, the party seeking the order of foreclosure produced the original promissory note indorsed in blank. The owner of the real property disputed whether the party seeking the order of foreclosure produced sufficient competent evidence that it was the holder of the note. The NC Court of Appeals held that production of the original note indorsed in blank by the party seeking the order of foreclosure is alone enough to establish that the party is the holder.

In re Foreclosure of Kenley (COA15-97; Jan. 5, 2016)

Production of the original note indorsed in blank at the Chapter 45 foreclosure hearing by the party seeking to foreclose constitutes sufficient evidence for the court to determine that the party is the holder of the note.

Liability of a Default Bidder

Glass v. Zaftrin, LLC (COA14-907; Feb. 3, 2015)

Bidder entered a high bid of $315,000.00 during the upset bid period of a foreclosure proceeding. In connection with the bid, the bidder paid a deposit of $15,750.00. After expiration of the upset bid period, the bidder notified the substitute trustee that it would be unable to complete purchase of the property and thus defaulted on its bid. The substitute trustee moved the court for an order to resell the property and at the second sale the high bid was $350,000.00. The original defaulting bidder sought the return of the full amount of its deposit from the first sale. Question before the Court of Appeals was whether G.S. 45-21.30(d) allows the costs of the resale to be deducted from the deposit refund where the resale price was more than the defaulting bid plus the costs of resale. The court held that a defaulting bidder is only liable on its deposit to the extent that the final sale price is less than the bid plus the costs of resale. In this case, the final sale price from the resale ($350,000.00) exceed the total of the defaulting bid ($315,000.00) plus the costs of resale ($1,469.80), therefore the defaulting bidder was entitled to the return of its entire deposit ($15,750.00).

In re Foreclosure of Ballard (COA15-475; March 15, 2016)

Holder of a note, U.S. Bank, as trustee for J.P. Morgan Mortgage Trust 2006-A2, submitted an opening bid at the foreclosure sale. A third party, Abtos LLC, filed a winning upset bid and bid

deposit with the clerk of superior court. Abtos then defaulted on the bid and the clerk ordered a resale of the property pursuant to G.S. 45-21.30(c). At the resale, U.S. Bank was the only bidder and bid an amount lower than the bank's opening bid at the original sale. Upon a motion of Abtos to release the original bid deposit, the clerk ordered the bid deposit disbursed to U.S. Bank pursuant to G.S. 45-21.30(d), which provides a defaulting bidder at any sale or resale is liable on the bid to the extent the final sale price is less than the bid plus the costs of the resale. Abtos appealed the clerk's order and argued that the procedure for resale was not the same in every respect as the original sale as is required under G.S. 45-21.30(c) due to the fact that the trustee accepted an opening bid at resale that was less than the opening bid at the original sale. The superior court and the NC Court of Appeals affirmed the order of the clerk. The NC Court of Appeals held that a party's choice to lower its opening bid in a resale does not violate G.S. 45-21.30(c). The court noted that given the "vagaries of the real estate market" it would "seem strange to bind a party to the amount of its opening bid in a previous sale." Abtos made no other argument that the actual procedure for resale was different than the original sale.

Deficiency Action filed in connection with a Foreclosure

Brach Banking and Trust Co. v. Smith (COA14-554; Feb. 17, 2015)

Lender loaned $1,675,000 to borrower, secured by real estate. In connection with the loan, the lender entered into guaranty agreements with eight different individuals. Borrower defaulted, lender foreclosed on the property, and lender entered a credit bid at the sale in the amount of $800,000. Lender was the high bidder, leaving a deficiency in the amount of approximately $700,000 based on the balance remaining on the loan. Lender filed a civil deficiency action in superior court against each of the eight individual guarantors, which included one guarantor who had executed a limited guaranty agreement capping his liability at $418,750. As a defense, the limited guarantor raised G.S. 45-21.36, arguing that the amount bid was substantially less than the true value of the property, and therefore he was entitled to defeat or offset any deficiency judgment against him. Lender objected and argued that defense/offset provisions under G.S. 45-21.36 do not extend to guarantors. The Court of Appeals held the defense/offset set forth in G.S. 45-21.36 is available to guarantors, even if the mortgagor is dismissed from the case. The court remanded the case to allow the guarantor the opportunity to present evidence regarding the true value of the property.

United Community Bank v. Wolfe (COA14-1309; July 7, 2015)

Lender foreclosed and was the high bidder at the foreclosure sale. Lender's bid was less than the total value of the debt. Lender filed a deficiency action against the borrowers for the remaining amount due on the loan. Superior court granted summary judgment in favor of the lender and borrowers appealed. NC Court of Appeals reversed and remanded. The court's analysis included a discussion of the defenses available to a borrower under GS 45-21.36 in a deficiency action: (1) the property was worth more than the outstanding debt, or (2) the amount of the lender's bid was substantially less than the true value of the property. The court held that an affidavit from the owner of the property setting forth the specific value of the property is sufficient to raise a genuine issue of material fact whether the value of the property

was fairly worth the amount of the debt and thus defeat a summary judgment motion. The court noted prior case law from the NC Supreme Court that the owner's opinion of value is competent to prove the property's value.

Enforcement of a Lost, Stolen, or Destroyed Promissory Note in a Civil Suit on the Note
Emerald Portfolio LLC v. Outer Banks/Kinnakeet Associates, LLC (COA16-31; Sept. 6, 2016)
Lender made a loan to a limited liability company borrower and individual members of the LLC signed guaranty agreements guaranteeing the debt. Lender subsequently sold the loan to Lender #2. Borrower defaulted. Lender #2 filed complaint alleging the borrower and the guarantors were in default under the terms of the note and sought a judgment against both to recover the unpaid balance of the note. Trial court granted summary judgment in favor of Lender #2. Borrowers appealed. NC Court of Appeals held that Lender #2 did not have a right to enforce the lost note against the borrower LLC as Lender #2 was not in possession of the note when the loss of possession occurred, which is a requirement of GS 25-3-309. The court noted that North Carolina did not adopt the 2002 amendments to the UCC which provide that a person who acquires ownership from a person entitled to enforce the note when the loss of possession occurred may also enforce the lost, stolen or destroyed note. As a result, such relief was not available to the note purchaser under NC's version of the UCC. The court further held that the guaranty remained enforceable notwithstanding the unenforceability of the note against the borrower and therefore did not serve as a viable defense for the individual guarantors.

The following synopses are adapted from summaries prepared by Ann Anderson at the School of Government. Ann's summaries of civil cases are distributed through an electronic mailing list. To receive distributions from the mailing list, you can sign up at http://www.sog.unc.edu/sogcivil/mailinglist.

High Point Bank and Trust Co. v. Highmark Props, LLC (NC No. 8PA14; Sept. 25, 2015)
In this case, the Supreme Court further resolved the question of whether a non-mortgagor guarantor to a loan may raise the anti-deficiency defense in order to reduce its outstanding debt to the lender. Here, Plaintiff bank issued two loans to Highmark—$4.7 million and $1.75 million. Guarantors, members of Highmark, guaranteed the loans. Highmark later defaulted, leaving balances of about $3.5 million and $1.3 million. The bank sued Highmark and the guarantors and also foreclosed on the properties, putting in the only bids: about $2.6 million and $720,000. In the action to collect on the deficiency, the bank dismissed Highmark and sought to collect only against the guarantors. The guarantors raised the defense under G.S. 45-21.36, the anti-deficiency statute, which allows an offset where the amounts paid for the property at foreclosure are substantially less than their true value. The trial court allowed the guarantors' motion to add Highmark (back) as a party and submitted the anti-deficiency issue to the jury. The jury found that the fair market values of the properties were about $3.7 million and about $1 million, leaving guarantors with respective debts of $0 and $300,000.

The bank appealed, arguing that non-mortgagor guarantors are not permitted to take advantage of the anti-deficiency statute. The Court of Appeals affirmed, holding that the

guarantors could indeed raise the defense; the majority and concurrence differed, however, as to whether the defense could be raised in an action in which the debtor itself was not a party. The Supreme Court looked closely at the language of G.S. 45-21.36 and concluded that a non-mortgagor guarantor may "stand in the shoes of the principal borrower" and raise the anti-deficiency defense whether or not the borrower is a party to the action. In addition, the court stated that conditioning a guarantee agreement on guarantor's waiver of anti-deficiency protection violates public policy.

***TD Bank, N.A. v. Williams* (COA15-598; June 7, 2016).**
Summary judgment was properly granted against debtor/guarantor in creditor's action to collect the debt. Debtor/guarantor failed to create a genuine issue of material fact as to his defense under the anti-deficiency statute. His contention regarding the value of the property was contained in an unverified answer and thus could not be used as evidence, and the materials included in his verified motion for partial summary judgment did not actually include appraisals or opinions of the value of the property.

Preclusive effect of foreclosure on separate contract and tort claims action against lender.
Funderburk v. JPMorgan Chase Bank, N.A. (COA14-1258; June 16, 2015)
Plaintiffs filed this action against their former mortgage lender for breach of contract, breach of the covenant of good faith and fair dealing, negligent misrepresentation, tortious interference with contracts and business expectancy, quantum meruit, and punitive damages—all in connection with an earlier series of foreclosures. The trial court properly dismissed these claims pursuant to Rule 12(b)(6). Each of the properties had already been foreclosed upon pursuant to Chapter 45 based on plaintiffs' payment default, and the foreclosure orders of the clerk had become final. Each of the claims in the present action was essentially premised upon an argument that there had been no default; because the issue of default had been conclusively determined in the earlier foreclosure proceedings, it could not be re-litigated in this separate civil action.

Rescission of certificate of satisfaction under G.S. 45-36.6
***Wells Fargo Bank, NA v. American National Bank and Trust Co.* (COA15-689; Nov. 1, 2016) (with dissent).** After homeowners refinanced their mortgage in 2006 through Wells Fargo, Wells Fargo filed a certificate of satisfaction certifying that an earlier 2004 deed of trust had been satisfied and was accordingly cancelled. Wells Fargo neglected, however, to enter into a subordination agreement with Defendant American National regarding an earlier home equity line of credit on the property. The effect was to elevate American National's line of credit to first priority. Wells Fargo discovered the problem six years later and filed a document of rescission of the certificate of satisfaction in an attempt to restore Well Fargo's loan to first priority. In this declaratory judgment action, Wells Fargo argued that G.S. 45-36.6's provision allowing rescission "if a security instrument is erroneously satisfied of record" allows rescission for *any* erroneous satisfaction. Defendant, on the other hand, argued that the statute only permits rescission when a satisfaction is erroneously filed for an obligation *that was not actually satisfied*. The trial court granted summary judgment in favor of Wells Fargo. Analyzing

the plain language of the statute, its legislative history, and its construction, the Court of Appeals agreed that Wells Fargo's interpretation was the right one. The court reversed the grant of summary judgment for Wells Fargo, however, holding that a genuine issue of material fact existed as to whether Wells Fargo actually filed the certificate of satisfaction erroneously or on purpose.

The dissenting judge argued that Wells Fargo's "error" was not in filing the certificate of satisfaction, but in failing to enter into a subordination agreement with defendant by which it would have secured its first priority status. Thus it did not commit the kind of error that is correctable under G.S. 45-36.6.