Money, Dirt & Steel: Spring 2015 NC Real Property Litigation Update

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MONEY:

GUARANTORS CAN NOW RELY ON G.S. §45-21.36 VALUE DEFENSES

By statute in North Carolina, G.S. §45-21.36, certain obligors may defend a deficiency action where the bank is the successful bidder by arguing the collateral was fairly worth the debt. Also, under G.S. §45-21.36, an obligor may by way of offset show the winning foreclosure bid by the bank was substantially less than the true value of the collateral. Historically, these defenses have not been found applicable to guarantors. All that changed with the recent decision of the North Carolina Court of Appeals in *Branch Banking and Trust Company v. Smith*, COA14-554, February 17, 2015. There, following a foreclosure and sale where the bank bid the property in, the bank sued the guarantors for the deficiency. The guarantors asserted G.S. §45-21.36 in defense, and the evidence was that the property's value was higher than the bank's bid. The trial court held the defense not applicable based on the existing law. The Court of Appeals reversed, stating that it was compelled based on the 1938 North Carolina Supreme Court decision, *Virginia Trust Company v. Dunlap*, 214 N.C. 196, 198 S.E. 645 (1938), to conclude that even guarantors may avail themselves of the G.S. §45-21.36 defense/offset, even where the borrower has been dismissed from the action. This decision will have a significant impact on lender bidding practices at foreclosure sales and on pending litigation against guarantors.

STATUTE OF FRAUDS THAT APPLIES TO COMMERCIAL LOANS ALSO APPLIES TO MODIFICATION OF THE SAME LOANS

North Carolina General Statutes §22-5 requires all commercial loans in excess of $50,000 to be in writing. In *Macon Bank, Inc. v. Gleaner*, COA14-809, and COA14-810, March 17, 2015, the North Carolina Court of Appeals made clear that, if this statute applies to the loan, it also applies to asserted modifications of the loan, thereby barring claims of oral modification. The facts in *Gleaner* were that in 2002 Gleaner and Patterson borrowed $260,000 to purchase land and a rental house secured by a deed of trust. In 2007, they borrowed an additional $150,000 secured by the same property. In 2010, Gleaner and the bank agreed to a modification of the 2007 note, and thereafter the bank and Gleaner agreed to release Patterson from the 2002 note. Later, the bank foreclosed and ultimately sued Gleaner, his wife and Patterson on both the 2002 and 2007 notes. In defense Gleaner asserted an oral

understanding or agreement with the bank that he should stop making payments and that the bank "would take care of it" and that he gave the bank the property "in lieu of any foreclosure or judgment or other losses" and gave the bank the keys to the rental house a year before the foreclosure started. Essentially he argued that there was an oral agreement to have an accord and satisfaction. The trial court rejected the borrower's assertion and entered judgment for the bank. On appeal, the North Carolina Court of Appeals affirmed, explaining that the defenses based on an oral agreement and accord and satisfaction were barred by the statute of frauds, G.S. §22-5, which requires commercial loans in excess of $50,000 to be in writing, finding the statute applied to any asserted modifications as well. The Court of Appeals further found that equitable estoppel cannot override the statute of frauds. Last, the Court found that no offset could lie for lost rent despite the borrower having given over the keys, because the bank was not a mortgagee-in-possession. This decision should be helpful for lenders in defending claims based on alleged oral agreements.

TIME TO SUE ON PROMISSORY NOTE RUNS FROM ACCELERATION OR MATURITY, NOT SIMPLE DEFAULT

In the Matter of the Foreclosure of Deeds of Trust executed by Grover C. Brown, COA14-937, April 21, 2015, two notes were secured by separate purchase money deeds of trust. The maturity dates on the notes was April 1, 2010. Both notes included acceleration clauses in the event of default. Payment in full was never made and the last payment to be made on the Notes was due in February, 1995. Seventeen years later, upon the death of the holder in 2012, her estate accelerated the notes and attempted foreclosure. The owner claimed the debts and foreclosures were time barred. The trial court rejected the defense, found the notes in default and authorized foreclosure. On appeal, the North Carolina Court of Appeals affirmed and rejected the owner's assertion that the claims were time barred. The Court explained that under G.S. §1-47 an action is barred if: there is a lapse of 10 years after the forfeiture or power of sale becomes absolute or after the last payment (i.e. the default) and the mortgagor remains in absolute possession the entire 10 years. The Court ruled that where a note includes an acceleration right, the default alone does not start the running of the 10 year statute of limitation unless an acceleration demand is also made based on the default. Absent such acceleration, the statute runs from the maturity date (the date the power of sale became absolute). In short, even though the borrower stopped making payments in 1995 long before the debt was paid and 15 years before the maturity date, the 10 year statute of limitation did not start to run until the maturity date because the lender did not accelerate the notes upon the default in 1995. This decision will be of significance in avoiding defenses based on time on neglected notes and deeds had trust.

ERRONEOUSLY FILED CERTIFICATE OF SATISFICATION NOT BINDING

In re Dispute over the sum of $375,757.47, COA14-1239, April 21, 2015, a homeowner obtained a $600,000 loan secured by a deed of trust from Mountain 1st Bank, with the deed of trust naming MERS as its nominee. The loan was thereafter assigned by Mountain 1st to Resource Solutions, a division of Net Bank, then to Wells Fargo Bank, and finally to HSBC. After the assignment to Wells Fargo, some four years after the first assignment, Mountain 1st erroneously recorded a Certificate of Satisfaction on the public record. The debtor continued to make payments after the cancellation was recorded, and, when the property came to be sold, the satisfaction was discovered. Given the relative confusion on the title, an escrow was established to allow the sale to conclude. After the sale, MERS recorded a

document of rescission, as did HSBC, as the current noteholder. Suit was filed to declare the parties rights in the escrow. The trial court granted HSBC summary judgment, and the Court of Appeals affirmed. The Court believed the record clear that Mountain 1st was no longer the holder when the Certification of Satisfaction was filed and, therefore, lacked authority to cancel the deed of trust. The lesson from this case is for a lender to be sure that it is in fact the current holder before filing a cancellation.

DIRT:

NEGLIGENCE NOT A DEFENSE TO MUTUAL MISTAKE

In *Wells Fargo Bank, N.A. v. Coleman*, COA14-683, February 3, 2015, the deed of trust correctly referenced the street address for the home to be encumbered but referenced the book and page and tax parcel numbers for adjacent lots. Wells Fargo sought reformation of the deed of trust based on mutual mistake. The defendant asserted that Wells Fargo "would have immediately discovered the error if it had acted with reasonable diligence" and therefore there could not be a mutual mistake. The defendant also asserted the claim was time barred, and barred by the estate non-claim statute. Summary judgment was entered for the defendant. The North Carolina Court of Appeals reversed and remanded. Most significantly, the Court of Appeals found that a claim for reformation does not require proof of reasonable diligence – even if a mistake was the result of negligence there can still be reformation if clear, cogent and convincing evidence is presented that the mutual mistake prevented the instrument from embodying the parties' actual original intent. It is not necessary to allege or prove the mutual mistake was a reasonable or neglect-free mistake. In regard to the statute of limitations, the 3 year period applied, and it was an issue of fact as to when the mistake should have been discovered – but the court did explain that mere recording of the deed of trust does not start the running of the limitations period. The same principles applied to laches. The non-claim statute was found to apply to estates but not to apply to enforcement of a deed of trust by express exclusion in the statute, G.S.§28A-19-3(g).

COURT STRIKES DOWN TOWN'S ATTEMPT TO INVOKE EMINENT DOMAIN POWER FOR IMPROPER PURPOSE

In *Town of Matthews v. Wright*, COA14-943, April 21, 2015, the Town of Matthews filed a condemnation action to take the small portion of a road fronting a home at the end of a dead end street. The homeowner's deed included the roadway within the property boundaries. The roadway had been the subject of several prior court cases and proceedings, with the question being whether the road had become a public street, by proper proceedings, prescription, dedication, gift or sale. After several failed attempts to resolve the matter and out of concern the homeowner would build upon or block the roadway, the Town sought to condemn the portion of the road in front of the homeowner's residence. The trial court dismissed the action, and the Court of Appeals affirmed, finding the condemnation was not for a public use or benefit and in violation of G.S. §40A-3. The Court found no merit in the condemnation being for the purpose of "opening" the roadway as a public benefit because it found the road had never been closed in the first place. The Court noted that the Town was only condemning the specific landowner's portion of the road and not the portions owned by other adjoining owners, and,

therefore, there was no evidence of a need to "open" the road. The Court found no other benefit from opening a small portion of a larger dead end street, where the neighbors would retain any rights they had. Most of all the Court found "the Town was motivated by considerations irrelevant to the public benefit. The evidence showed that Major Taylor and some Commissioners considered personal conflicts between the Town and the homeowner in making the decision to condemn rather than the public use and benefit of the condemnation." Based on *Wright,* entities with the power of eminent domain are again reminded it is not a *carte blanche* power to be exercised on a whim or for improper purposes.

CONSTRUCTION:

MECHANIC'S LIEN LITIGANTS MUST DOCUMENT THEIR POSITIONS IN REGARD TO ATTORNEYS' FEES

North Carolina General Statute §44A-35 allows for the recovery of attorneys' fees to the prevailing party on a mechanic's lien claim "upon finding that there was an unreasonable refusal by the losing party to fully resolve the matter which constituted the basis of the suit or the basis of the defense." "Prevailing party" is defined as a party "who obtains a judgment of at least fifty percent (50%) of the monetary amount sought in a claim or is a party . . against whom a claim is asserted which resulted in a judgment of less than fifty percent (50%) of the amount sought in the claim defended." In *R&L Construction of Mt. Airy, LLC v. Diaz*, COA14-1127, April 7, 2015, the North Carolina Court of Appeals upheld an award of fees even after the parties had participated in mediation of the case. There a claim of lien and suit were filed for $11,175.49. At mediation the plaintiff reduced its demand to $9,000. Mediation failed and summary judgment was entered for the plaintiff for the full amount plus $8,823 in fees. The trial court found an unreasonable refusal to resolve the matter. The Court of Appeals affirmed, making clear the record lacked details of the defenses. The lessons here are that the details of a mediated settlement conference can become relevant in regard to whether a lien claimant is entitled to fees, and that those involved in lien disputes should be especially careful to document on the record the details and reasons for their positions.

LACK OF CONTROL ALLOWS CONTRACTOR TO ESCAPE LICENSE REQUIREMENT

North Carolina's Contractor Licensing Statute appears to facially require a license any time the project involved exceeds $30,000. However, in *Brown's Builders Supply, Inc. v. Johnson*, COA14-836, March 17, 2015, the North Carolina Court of Appeals made clear there is also a control test. In *Johnson*, the homeowners hired a general contractor to remodel their home. The general contractor located plaintiff to remodel the kitchen area, and arrangements were made for the owners to pay him directly. Essentially, the owner then had one contract with the general contractor and one with the kitchen contractor, as opposed to the owner having a contract with the general contractor and it in turn having a subcontract with the kitchen contractor. When an oven hood was discovered damaged, the owner refused to make payment to the kitchen contractor. The kitchen contractor filed a mechanic's lien and law suit. The homeowners defended claiming the work was in excess of $30,000, and, therefore, the kitchen contractor was required to hold a general contractor's license in order to be entitled to payment. Judgment was entered for the kitchen contractor. On appeal, the Court of Appeals found that a license was not required because the scant written evidence did not suggest "that [kitchen contractor] exercised

more than minimal control over the remodel project." The Court found the general contractor oversaw the construction, ordered various materials and coordinated the work and was in charge of the project. In short, the Court ignored the technical contract arrangement under which the homeowners had a contract for over $30,000 with an unlicensed contractor because a licensed contractor was in control of the overall project. Attorneys' fees were also awarded to the unlicensed contractor under G.S. §40A-35. The best that can be taken away from this decision is that the Court of Appeals is willing to look at substance over form in the licensing context.

GENERAL MATTERS:

VENUE CLAUSES IN NORTH CAROLINA MUST BE OTHERWISE PROPER

Many commercial contracts include a venue provision. For the most part venue is selected in a location most convenient for both parties, or for the party with the most negotiating power. However, in doing so the parties must be certain that the courts will enforce the venue selection. In*A&D Environmental Services, Inc. v. Miller*, COA14-913, April 7, 2015, an employment agreement provided that venue for any litigation would be in Mecklenburg County. When the employee departed, the employer filed suit in Guilford County. The employee's motion to dismiss based on the venue clause was denied. The Court of Appeals affirmed. After stating that, based on case law, a venue clause specifying a certain county in this state will only be enforced if the case is otherwise proper in that county, the court found no evidence that Mecklenburg was a proper county. Thus, the rule is that a forum selection clause requiring suit to be brought in a certain North Carolina County is enforceable *only if* the state statutes provide that venue is proper in the designated county.

NO CIVIL CLAIM FOR EXTORTION IN NORTH CAROLINA

In *Hester v. Hubert Vester Ford, Inc.*, COA14-233, January 6, 2015, the plaintiff purchased a Jeep. After the vehicle was repossessed for non-payment, the buyer sued for unfair trade practice ("UDTP"), fraud and extortion, asserting the dealer had rewritten the contract and increased the payments under threat of repossessing the vehicle after it was first sold. Per the paperwork, the sale took place on September 30. However, the plaintiff contended the sale took place earlier, and the dealer wrote up a new contract that he later signed when financing fell through. The plaintiff asserted he was told the new contract was the same as the first. But, the alleged new contract called for payments twice the amount of those specified in the first. Summary judgment was entered for the dealer. The Court of Appeal reversed as to the claim of UDTP based on evidence the dealer had threatened to repossess the Jeep if a new contract was not signed and other factors, and found the same as to the claim of fraud. However, the Court of Appeals affirmed as to the claim of extortion making clear that North Carolina does not recognize a civil action for extortion and refusing to adopt such an action.

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