Money, Dirt and Steel: Spring 2016 Newsletter

05.10.2016

A snapshot of noteworthy cases from the Spring terms of the North Carolina appellate courts related to lending practices, property rights and construction in North Carolina

Money

FORECLOSURE:

Lender may lower its bid on resale and keep the deposit of the defaulting bidder.

In re Foreclosure of Ballard, No. COA15-475 (N.C. Ct. App. 15 Mar, 2016), U.S. Bank, as trustee for J.P. Morgan Trust, foreclosed on its deed of trust. A third party, Abtos, was the successful bidder at the initial sale with a bid of $424,264,20, $1.00 over U.S. Trust?s opening bid of $424,263.20, and paid its bid deposit into court. When Abtos defaulted on its bid, the property was resold. This time, U.S. Trust was the successful bidder at $400,300.00. Abtos moved for a return of its deposit, which the Clerk denied pursuant to G.S. § 45-21.30(d). The Superior Court affirmed, and Abtos appealed to the Court of Appeals for *de novo* review. On appeal, Abtos referred the Court to the provision in G.S. 45-21.30(d) which provides that the deposit is forfeited, but also provides that the procedure for resale shall be the same in every respect as in the case of the original sale. Abtos asserted that, because the lender?s opening bid at the resale was less than its opening bid in the original sale, the ?procedures? in the sales were not the same, and its bid deposit needed to be refunded. The Court rejected the argument that the bid amount was part of the ?procedure? of the original sale and, based on the unstable real estate markets, saw no reason to impose such a requirement and affirmed. The Court stated that ?a party?s choice to lower its opening bid in a resale does not violate N.C. Gen. Stat. §45-21.30(c).?

Lender?s acceptance of late payments does not constitute a waiver of right to accelerate for future late payments.

In *Speer v. Great Western Bank*, No. COA15?553 (N.C. Ct. App. 1 Mar. 2016), Speer executed a promissory note to Tier One Bank secured by a deed of trust which included an acceleration clause providing that the lender could declare the entire principal balance due if a payment default was not cured after thirty (30) days? notice. The note matured and was not paid. The bank continued to accept monthly interest payments for approximately three (3) years. After an attempt to modify the note failed, the bank gave written notice of default and demanded payment within 90 days. Subsequently, Great Western acquired the note and deed of trust by assignment and threatened foreclosure if not paid in 30 days, refusing to accept any further interest payments. Great Western foreclosed, and the secured property was sold. Two years later Speer filed suit against both Tier One Bank and Great Western alleging breach of contract, breach of implied contract, and unfair and deceptive trade practices. The trial court dismissed the unfair and deceptive trade practice claim but denied dismissal as to the contract claims. Summary judgment later was entered in favor of the defendants on the remaining claims. Speer appealed.

On appeal, Speer asserted that the lenders breached the contract by acceleration and foreclosure because they had waived the right to demand payment after failing to do so at maturity and accepting interest payments for three years. The Court of Appeals rejected the claim, explaining that the repeated acceptance of monthly payments after the due date was a waiver of the right to insist on punctual payment ?unless,? prior to the late payments on which default and acceleration were based, the noteholder gave notice that prompt payment was again required. Thus, although the acceptance of payments of interest for three years after maturity without declaring a default may have barred acceleration for that time period, once Speer was notified that payment was being demanded in full and that interest payments would not be accepted, it was entitled to foreclose. There was no breach of contract. Because there was no breach of contract, the court did not need to consider the dismissal of the unfair trade practice claim which was based on an alleged wrongful demand for payment.

Borrower unable to set aside foreclosure by separate lawsuit after the rights of the parties become fixed.

In *Thompson v Nationstar Mortgage*, COA 15-981 (N.C. Ct. App. 5 April 2016), the secured lender commenced a power of sale foreclosure against Mr. Thompson. Although power of sale foreclosures are commonly referred to as ?non-judicial,? in North Carolina, a county Clerk of Superior Court must conduct a hearing and make certain findings before the foreclosure auction. The County Clerk found that the secured lender had satisfied the six statutory requirements for a power of sale foreclosure and entered a foreclosure sale order. Mr. Thompson did not appeal the Clerk?s order within the 10-day appeal period, and his property was auctioned at foreclosure. Mr. Thompson thereafter filed a civil action to set aside the lender?s foreclosure.

The Court of Appeals held that Mr. Thompson waited too long to file his civil action. In North Carolina, the rights of the parties to a foreclosure become fixed when the post-auction upset bid period expires. A borrower may keep the upset bid period alive by seeking an injunction under a specific foreclosure statute during the upset bid period. However, Mr. Thompson failed to seek an injunction pursuant to the statute. Invoking the legal principle of collateral estoppel, the Court ruled that the expiration of the upset bid period cut off any right Mr. Thompson had to challenge issues the clerk already had decided at the foreclosure hearing.

Dirt

DAMAGES FOR CONTAMINATION:

> ***Where no personal use exception applies, and the cost of remediation to property is disproportionate to or greatly exceeds the diminution in value of the property or is otherwise unreasonable under the circumstances, the damage for injury to property from contamination should be the diminution in value of the property.***

In *BSK Enterprises, Inc. et al v. Beroth Oil Company*, No.COA15-189 (N.C. Ct. App. 1 Mar. 2016), an underground storage tank leaked, and the leak migrated onto the neighboring property of the plaintiff. The plaintiff filed suit to recover damages based on the cost of remediation or the cost to relocate its business associated with the contaminated ground water on its property. The North Carolina Department of Natural Resources (NCDENR) had reviewed the matter and determined that no active remediation was required for the plaintiff?s property, and that the focus would be on addressing the source on the defendant?s property. Further, the well water on plaintiff?s property was not affected. Summary judgment was granted as to defendant?s liability, and the matter went to the jury on the issue of damages. Plaintiff?s experts estimated the cost to remediate plaintiff?s property at over $1 million. The jury found plaintiff?s property diminished in value by $108,500 and that the cost to remediate was $1,492,000, awarding both. The trial judge entered JNOV and capped the damages at the $108,500 diminution in value. Plaintiff appealed.

The sole issue on appeal was whether the plaintiff was entitled to the cost of remediation in addition to the diminished value of it property. In affirming the limitation on the award to the diminished value, the Court of Appeals reiterated several rules for damages in real property actions. First, as a general rule damages for a permanent injury to real property may be recovered using one of two measures: (1) the difference in market value before and after the injury; or (2) the cost of restoring the land to the pre-injury state. However, replacement and repair costs are relevant to both diminution in value and replacement cost; therefore the trial judge must instruct the jury to consider the replacement cost in assessing the diminution in value. Second, where the damage is impermanent, the diminution in value method of assessing damage is less appropriate, and other rules such as the cost of replacement or repair come into play. However, in all events the award may not shock the conscience. Thus, where the cost of restoring the land to its pre-injury condition is disproportionate to the diminution in value, damages are limited to diminution in value ?unless there is a reason personal to the owner? for restoring the property to original condition. A homestead or residence may be the type of property where there is a reason personal to the owner to restore the property to its pre-injury condition, but this is not typical for business properties.

After setting out the general rule, the Court of Appeals rejected the plaintiff?s argument that, due to the limitations in North Carolina?s Oil Pollution and Hazardous Substances Control Act (OPHSCA) requiring the ?least expensive clean up? and the availability of no further action letters, limiting an award to diminished value was unreasonable, and in the end found this was not the appropriate case for awarding restoration damages.

The Court of Appeals ultimately held that ?where no personal use exception applies, and the cost of remediation to property is disproportionate to or greatly exceeds the diminution in value of the property or is otherwise unreasonable under the circumstance, the cost awarded should be the diminution in value of the property.?

EMINENT DOMAIN DAMAGES:

> ***In taking to widen highway to allow light rail to be located in middle of existing right of way, landowner not entitled to damages to remainder based on the impaired visibility of the remainder predicated on rail bridge, because rail bridge not to be located in the area taken.***

In *The City of Charlotte v. University Financial Properties, LLC*, No. COA15-473 (N. C. Ct App. 5 Apr. 2016), the City condemned in fee 5,135 square feet of University Financial?s 75,079 square foot parcel to widen the travel lanes of North Tryon Street because of infrastructure for a new light rail, including a track and bridge, to be located in the middle of the existing roadway. The City filed a motion under G.S. §136-108 contending that University Financial was not entitled to any compensation for loss of visibility to its property resulting from the construction of the bridge to be built for the light rail project, because it was not being built on the condemned property. The trial court ruled that the construction of the bridge is part of the taking of University Financial?s property and therefore, it would be allowed to present evidence of any and all damage from the impact of the construction of the light rail, including the bridge and that the loss of visibility of the remaining property resulting from the bridge was a factor to be considered in determining the market value of the remainder. The City appealed.

The Court of Appeals reversed. Where there is a partial taking, the fair market value of the remainder ?contemplates the project in its completed state and any damage to the remainder due to the use to which the part taken may, or probably will, be put.? However, this rule only allows for damages that flow ?directly from the use? to which the part taken is to be put and does not allow damages that ?are shared by neighboring property owners and the public which arise regardless of whether the landowner?s property has been condemned.? Applying these principles the Court of Appeals found that the loss of visibility occasioned by the bridge was akin to the flow of traffic from the road, and that the loss of visibility from the bridge did not flow directly from the use to which the land taken was being put - road widening, but from the location of the bridge. The Court was unable to discern a meaningful distinction between the assertion that a landowner is entitled to compensation due to the reduction of traffic past his property, which has been held not to be compensable, and the contention that the visibility of the property is reduced to passing traffic caused by elevation of a light rail bridge.

In the final analysis, the Court of Appeals simply found that, because the bridge was not to be located on the portion of the property taken in the action, the effects of the bridge on the visibility of the remainder was not a factor to be considered in establishing compensation.

CONTRACT PROVISIONS GENERALLY

VENUE:

> ***Subcontractor starting work with unsigned subcontract did not bind subcontractor to the written subcontract terms such as the venue clause, but did not preclude the finding of a contract between the parties.***

In *Southeast Caissons, LLC v. Choate Construction Company*, No. COA15-1284 (N.C. Ct. App. 19 Apr . 2016), Choate Construction as general contractor solicited bids from subcontractors for certain concrete pier work on a Wake Tech parking deck project. Southeast Caissons submitted two bids, and Choate emailed a proposed subcontract to Caissons. The proposed subcontract included a venue clause stating ?Venue for any arbitration, settlement meetings or any subsequent litigation whatsoever shall be in the city of Contractor?s office shown on page 1 of the Subcontract.? Choate?s office as shown on page 1 was Raleigh, Wake County, North Carolina. Despite some back and forth, no subcontract was executed, but Caison commenced work in all events. Caisson completed the work and requested payment, but Choate refused to pay until a subcontract was signed. Caisson filed suit in Forsythe County, North Carolina. Among other things, Choate responded with a motion to dismiss based on improper venue or for a change of venue. The trial court denied the motion finding that the subcontract with the venue provision was never signed and that venue was otherwise proper in Forythe County. Choate appealed.

The Court of Appeals affirmed. First, the Court found that the venue clause was not mandatory, even if part of the parties? contract. Second, the Court found that the parties did not agree to the subcontract. The Court made clear that its findings did not preclude a finding that a contract had been formed, just that the parties had not agreed to the subcontract in the form proposed by Choate, including the venue provision. Therefore, the venue provision was not enforceable.

ARBITRATION:

Issue of arbitrability can be contractually delegated to arbitrators.

In Epic Games, Inc. v. Timothy F. Murphy-Johnson, No.COA15-454 (N.C. Ct. App. 19 Apr. 2016), Epic Games entered into an employment agreement with Mr. Johnson as part of a complex business arrangement. The employment agreement included an arbitration provision providing that ?Any dispute between Employee and Epic in any way concerning his employment, this Agreement or this Agreement?s enforcement, including the applicability of this Paragraph, shall be submitted at the initiative of either party to mandatory arbitration . . .pursuant to the rules of the [AAA] . . provided however that this Paragraph does not apply to the Confidentiality Obligation and Intellectual Property Rights Agreement referred to in Paragraph 7 . .? Epic fired Johnson, and Johnson demanded arbitration alleging breach of contract, breach of the covenant of fair dealing and breach of fiduciary duty. Epic responded seeking to enjoin arbitration in part, claiming it never agreed to arbitration of certain of the claims asserted. The Wake County Superior Court, after an ill-fated attempt to remove to federal court, enjoined arbitration of specific claims but allowed arbitration to proceed for breach of the employment agreement. Johnson appealed.

The Court of Appeals found as an initial matter that it need not determine whether the Federal Arbitration Act (FAA) or the Revised Uniform Arbitration Act (RUAA) controlled as both dictate that arbitration is strictly a matter of contract. The Court found that the contract?s plain language delegated the threshold issue of arbitrability to the arbitrator(s), not the court. Further in the rules of the AAA, Employment Rule 6(a) granted the arbitrator(s) the power to rule on the scope of arbitration agreements. The Court went on to explain that, when ?an arbitration clause incorporates an arbital body?s rules, and those rules explicitly delegate the threshold issue of arbitrability to an arbitrator, this is clear and unmistakable evidence that the parties agreed to arbitrate the issue of substantive arbitrability.?

The court reversed finding that the trail court lacked the power to determine arbitrability. Simply put, since the parties expressly agreed to arbitrate the initial issue of arbitrability, they were bound to do so, and this agreement was found both in the language of the contract and by the parties? incorporation by reference of AAA arbitration rules that also delegated the duty to the arbitrators.

JUDICIAL MODIFICATION OF CONTRACT PROVISIONS:

The Court will not rewrite a contract provision for the parties even if the contract provides for it. The blue pencil rule is limited to striking improper provisions.

In *Beverage Systems of the Carolinas, LLC v. Associated Beverage Repair, LLC*, No. 316A14 (N.C. S. Ct. 18 Mar. 2016), the parties included a non-compete provision in the documents for the sale of a business prohibiting competition in either North or South Carolina. The contract also included a specific clause providing that the Court was permitted to revise the temporary and geographic limits if it found them unreasonable. One of the parties? spouses, who was not a party to the agreement, later began a competing business in parts of North and South Carolina, and the seller filed suit. Aside from the normal defenses, the spouse asserted that the territorial provision of the agreement was overbroad. Summary judgement was granted to the defendant both because she was not a party and because of the over-breadth of the provision. On appeal, the Court of Appeals reversed and found that, based on the contract provision allowing judicial revision and the ?blue pencil rule,? the trial court erred in refusing to revise the territorial restriction and otherwise reversed the ruling in defendant?s favor. Based on a dissenting opinion, the matter went to the Supreme Court.

The Supreme Court initially noted that the plaintiff?s business it sought to protect with the restriction did not encompass all of North and South Carolina and therefore, that the scope of the restriction was unreasonably broad. Turning to the ?blue pencil? rule, the Court explained its application as a ?process by which a court of equity will take notice of the divisions the parties themselves have made [in a covenant not to complete], and enforce the restrictions in the territorial divisions deemed reasonable and refuse to enforce them in the divisions deemed unreasonable.? The Court then went on to make clear that the rule only applies if a clause sets out both reasonable and unreasonable provisions, which was not the case before it. The Court wholly rejected the ability or power of contracting parties to delegate to a court the power to revise their contract to make it reasonable. ?Allowing litigants to assign to the court their drafting duties as parties to a contract would put the court in the role of scrivener, making judges postulate new terms that the court hopes the parties would have agreed to be reasonable at the time the covenant was executed or would find reasonable after the court rewrote the limitation. We see nothing but mischief in allowing such a procedure.? The Court of Appeals was reversed, and the Supreme Court found that the trial court properly entered summary judgment in defendant?s favor.

RECEIVERSHIPS:

Court upholds Receiver?s Asset Sale and Payment to Consultant.

In *EHP Land Company v Bosher*, No. COA15-881 (N.C. Ct. App. 5 Apr. 2016), the trial court appointed Hunter Wyche as a receiver to wind up a partnership. The partnership was the developer of a 750-acre residential subdivision and related amenities. The trial court?s receivership order specifically authorized the receiver?s retention of Mr. Perry as a consultant. Mr. Perry thereafter performed many functions, including the securing of necessary financing for the partnership?s continued operation. The trial court monitored the receiver?s activities. Ultimately, the trial court approved the receiver?s final report and terminated the receivership.

One of the partners filed an appeal to strike down two actions?namely, the trial judge?s approval of (i) the receiver?s sale of a partnership asset to a third party, and (ii) the compensation that the receiver paid to his consultant, Mr. Perry. Unfortunately for the complaining partner, the Court of Appeals held that an ?abuse of discretion? standard applied in both instances. As to the first challenged action, the appealing partner asserted that the receiver should have accepted the partner?s higher monetary offer to purchase the partnership asset. The court found that the accepted offer was not an apples-to-apples offer when compared to the partner?s offer, and held that the trial court did not abuse its discretion in concluding that the third party?s offer was ?the best available.? The court also noted that it would have been improper for the receiver to have given the partner?s offer special favor.

The appellate court also upheld the trial judge?s approval of the receiver?s $212,500.00 payment to Mr. Perry. In reaching this result, the court emphasized the trial judge?s ?detailed findings? regarding Mr. Perry?s services and their value to the receivership.

The *EHP Land Company* case well illustrates the law?s deference to a court-appointed receiver.

Steel

MECHANIC?S LIENS:

Court Rejects Secured Lender?s Technical Challenge to Mechanic?s Lien.

In *Parks Building Supply v Blackwell Homes*, No. COA 15-727 (N.C. Ct. App. 19 Apr. 2016), a buyer contracted to purchase two residential lots from Odell A. Smith Properties. The written purchase contract identified the buyer as ?Blackwell Homes.? Two weeks later the buyer closed on the lots. The recorded deeds identified the buyer as ?Blackwell Homes, Inc.? New Century Bank financed the buyer?s purchase and house construction. When the closing attorney recorded the deeds to Blackwell Homes, Inc., he also recorded the corporation?s deeds of trust to the bank encumbering the two lots. In the interim period between the signing of the purchase contract and the closing, a supplier delivered construction materials to the corporation.

The failure of Blackwell Homes, Inc. to pay the supplier led to the filing of a materialman?s lien?also known as a mechanics lien--against both lots after the closing. The supplier?s lawsuit to enforce the materialman?s lien also named the secured bank as a defendant. The supplier asserted that its materialman?s lien trumped the bank?s recorded deeds of trust, relying on the rule of law that a materialman?s lien is established as of the first date on which a supplier delivers materials to a contract purchaser who thereafter acquires title.

The bank challenged the supplier?s materialman?s lien on the grounds that the purchase contract identified the buyer as ?Blackwell Homes? rather than ?Blackwell Homes, Inc.? Specifically, the bank asserted that the parole evidence rule barred the supplier?s introduction of outside evidence showing Blackwell Homes, Inc. was the contract purchaser. The trial judge held that the parole evidence rule was inapplicable. The supplier then introduced outside evidence showing the contracting parties intended Blackwell Homes, Inc. to be the buyer. Presumably the secured lender, who was not a party to the purchase contract, was unable to provide contrary evidence of the parties? intent. The supplier prevailed over the bank at trial.

The Court of Appeals agreed with the trial court?s ruling, holding that the wrong name in the purchase contract was merely a latent ambiguity, which could be cured by the admission of outside evidence. In its analysis, the court noted a more substantial ambiguity would be deemed a ?patent ambiguity,? in which case the parole evidence rule would apply.

Contractor?s subordination agreement is valid despite unfilled blanks in document.

In *Old Republic National Title Insurance Company v Hartford Fire Insurance Company*, No. COA 15-881 (N.C. Ct. App. 5 Apr. 2016), United Bank made a $13,600,000.00 construction loan secured by a deed of trust from the developer. Before the loan closing, the bank obtained a subordination agreement from the general contractor. The contractor signed the subordination agreement before the lender had prepared its deed of trust. Consequently, the signed subordination agreement stated that the contractor was subordinating its mechanic?s lien priority to a loan evidenced in ?Book __, Page __? of the county register of deeds office.

A lien priority dispute arose when the contactor filed a mechanic?s lien against the property. Specifically, the contractor asserted that the subordination was ineffective because the deed of trust did not exist when it signed the subordination agreement, and the recording information was left blank. The Court of Appeals disagreed. While the court noted that it would be ?more prudent? to sign a subordination agreement after the book and page numbers were known, its overarching objective was to uphold the intent of the parties. The lender?s evidence?including the testimony of the contractor?s president?showed that the parties intended to subordinate the contractor?s mechanic?s lien rights to the lender?s deed of trust recorded at the county register of deeds office.

Related People

- Gilbert C. "Gib" Laite, III ? 919.981.4046 ? glaite@williamsmullen.com

Related Services

- Real Estate
- Litigation
- Construction
- Real Estate and Project Finance