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Foreclosure by Power of Sale

Legal vs. Equitable and Other Defenses

G.S. Chapter 45-21.16

At a power of sale foreclosure hearing held before the clerk of superior court, the clerk's authority is limited.[1] At the hearing, the party seeking an order authorizing the foreclosure sale, whether the original lender or an assignee of the original lender, must prove the existence six statutory requirements:

(i) The existence of a valid debt of which the party seeking to foreclose is the holder,
(ii) Default,
(iii) Right to foreclose under the deed of trust,
(iv) Proper notice,
(v) Home loan compliance as set forth in G.S. 45-21.16(d), and
(vi) That the sale is not barred due to a party's military service.[2]

The clerk may only consider legal defenses to these elements raised by a party in making a decision whether or not to enter the order for sale. The clerk has no equitable jurisdiction, meaning that the clerk is not able to consider defenses based on general fairness.[3] Furthermore, the clerk has no other legal jurisdiction outside of these six elements. The clerk must decline to address any party's request for equitable relief or relief on the basis of some other legal defense even if the parties stipulate that an equitable or other legal issue is properly before the clerk.[4]

The outline below constitutes a list of commonly raised defenses to a foreclosure action. Those listed as legal defenses may be considered by the clerk, as they are defenses to the six elements listed above. Those listed as equitable and other legal defenses may not. A foreclosure by power of sale before the clerk does not resolve all matters in controversy between the parties.[5] The proper mechanism to raise equitable and other legal defenses to the foreclosure is by filing an action before the superior court to enjoin the foreclosure sale under G.S. 45-21.34.

In addition to considering the legal defenses raised in connection with the six elements described above, the clerk must also determine whether there is a reasonable likelihood that the parties will resolve the matter without foreclosure.[6] At the start of the hearing, the clerk has an affirmative obligation to inquire whether the borrower currently occupies the property subject

[1] *See* In re Helms, 55 N.C. App. 68, 71-72 (1981). The superior court, on appeal *de novo* from a decision of the clerk, is similarly limited to legal defenses resolved by the clerk. *Id.*
[2] *See* G.S. 45-21.16(d).
[3] *See* In re Helms, 55 N.C. App. at 71-72.
[4] *See* Mosler ex rel. Simon v. Druid Hills Land Co., Inc., 199 N.C. App. 293, 298 (2009).
[5] *See* In re Helms, 55 N.C. App. at 72.
[6] *See* G.S. 45-21.16C.

to foreclosure as his or her primary residence.[7] If so, then the clerk must ask questions to find out the status of efforts between the parties to reach a non-foreclosure solution, including a loan modification, short sale, forbearance agreement, or loan reinstatement. If, for example, the clerk determines that the borrower has submitted a loan modification application in good faith or is in the process of modification discussions with the lender, then the clerk must continue the hearing to a date certain that is not more than 60 days from the original hearing date.[8] If alternative resolution efforts are still ongoing at the time of the continued hearing date, the clerk may continue the hearing again for good cause to any date the clerk determines is appropriate.[9] These types of defenses are not set forth below because they would not result in an order not authorizing the foreclosurebut rather a continuance of the hearing.[10] In contrast, the legal defenses to the six elements set forth above, if proven, may result in an order from the clerk not authorizing the foreclosure[11]

[7] *Id.*
[8] *Id.*
[9] *Id.*
[10] G.S. 45-21.16C(b).
[11] Typically, if there are viable defenses raised with regarding to any of the elements then the clerk will not authorize the foreclosure. In re Foreclosure of Lucks, ____ N.C. ____ (Dec. 21, 2016). However, if any party is not served or is not timely served prior to the date of the hearing, the clerk shall order the hearing continued to a date and time certain that is not less than 10 days from the original hearing date. G.S. 45-21.16(a).

Equitable and Other Legal Defenses – May Not Be Considered by the Clerk[12]

1. The borrower disputes the amount owed to the lender under the note, the amount the borrower is in default, or the amount of other charges, such as late fees.[13]

2. The borrower disputes the amount of the interest rate charged by the lender.[14]

3. The borrower argues that the lender waived a default or multiple defaults by the lender's conduct and/or course of dealing, such as consistently accepting late payments and applying them to the debt[15] or stating that the borrower would have additional time to make payments due.[16]

4. The loan officer or other agent of the lender led the borrower to believe that the lender was going to modify the loan and as a result the borrower stopped making payments or changed his or her conduct in reliance on the lender's representations that the lender was going to modify the loan.

5. The lender failed to offer a modification in accordance with federal loan modification regulations such as the Home Affordable Modification Program (HAMP).[17]

6. The borrower asserts that he or she rescinded the loan after the lender made the loan.[18]

7. The borrower asserts that the lender failed to comply with the federal Truth in Lending Act or other state and federal regulations.[19]

[12] This list is not an exhaustive list but rather an example of the types of equitable arguments that may not be considered by the clerk in a power of sale foreclosure proceeding.
[13] *See* In re Foreclosure of Burgess, 47 N.C. App. 599, 603 (1980). If the borrower is a day late or a dollar short, that is typically enough to constitute a default under the loan documents unless the documents specifically provide otherwise, such as a right to notice and opportunity to cure before a late payment becomes a default. The amount the borrower is in default does not generally impact the lender's right to foreclose.
[14] *See* In re Helms, 55 N.C. App. 68, 70 (1981).
[15] *See* In re of Foreclosure of Deed of Trust by Goforth Properties, Inc., 334 N.C. 369, 374 (1993); In re Fortescue, 75 N.C. App. 127, 131 (1985).
[16] *See* In re Helms, 55 N.C. App at 71.
[17] *See* In Foreclosure of Raynor, ___ N.C. App. ___, 748 S.E.2d 579, 583-84 (2013). The North Carolina Court of Appeals decided the case on other grounds but stated that superior court's decision was premised on the determination that the lender's failure to comply with HAMP regulations constituted an equitable defense.
[18] *See* In re David A. Simpson, P.C., 211 N.C. App. 483, 488 (2011).
[19] *Id.*

8. The borrower asserts that he or she did not have sufficient bargaining power to negotiate different terms; the lender had the upper hand in the negotiation and execution of the loan documents.

9. The lender was malicious, aggressive, or unfair in the way they demanded payment from the borrower.

10. Any defense based on fraud[20], duress, unfair and deceptive trade practices, bad faith, malice, tortious interference, or general unfairness.

11. The borrower argues that the borrower's attorney failed to take some action or make a particular argument or defense.

12. The servicer or holder of the loan failed to comply with requests for information required under G.S. 45-93.[21]

13. The borrower argues there is a good reason or excuse as to why the borrower did not make payments when the borrower was supposed to under the note.

14. The borrower was not competent or lacked capacity at the time he or she signed the note and deed of trust.[22]

15. The lender failed to comply with the terms of a loan modification agreement and the lender is equitably estopped from pursuing foreclosure.[23]

[20] *But see* In re Hudson, 182 N.C. App. 499, 503 (2007) (holding that it is within the authority of the clerk of superior court to determine whether the property is secured by the lien of the deed of trust, even if the basis for the defense is as a result of the fraudulent acts of the lender related to the note and deed of trust); Espinosa v. Martin, 135 N.C. App. 305, 308 (1999) (holding that forgery of a legal document is a proper legal defense to a lender's assertion that a valid debt exists). *But see also* In re Foreclosure of Rivera, ____ N.C. App. ____, 775 S.E.2d 36 (2015) (unpublished).

[21] *See* G.S. 45-94.

[22] *See* In re Foreclosure of Godwin, 121 N.C. App. 703, 705 (1996).

[23] *See* In re Young, ___ N.C. App. ___, 744 S.E.2d 476, 479 (2013).

Legal Defenses – May Be Considered by the Clerk[24]

Default

1. The borrower is not in default because the borrower made all payments due and satisfied all obligations under the loan documents.[25]

2. The loan documents require the lender to give the borrower notice of the default and an opportunity to cure the default and the lender did not give the borrower the required notice and opportunity to cure.[26]

3. The officer or agent of the lender who executed the affidavit of default filed by the lender does not have sufficient personal knowledge of the loan or the related transactions to attest to the statements contained in the affidavit regarding the default.[27]

Notice to Proper Parties

4. A party entitled to notice under G.S. 45-21.16(c) did not receive written notice via personal service at least 10 days prior to the hearing or via posting at least 20 days prior to the hearing.[28]

5. The notice received by a party entitled to notice does not contain all of the required information set forth in G.S. 45-21.16(c).

6. The trustee did not comply with the notice provisions in the note and/or the deed of trust.

[24] This list is not an exhaustive list but rather an example of the types of legal arguments that may be raised in defense of a foreclosure. A clerk should look for a defense raised to be supported by competent evidence and more than a mere empty recitation of the defense itself.
[25] *See* In re Foreclosure of Burgess, 47 N.C. App. 599, 603 (1980).
[26] *See* In re Michael Weinman Assoc., 333 N.C. 221, 231-32 (1993). If this argument is raised by a borrower, the clerk should request that the borrower identify the provision in the loan documents that requires the lender to give the borrower notice prior to holding them in default. Not all loan documents require a pre-default notice and opportunity to cure.
[27] It is important to note that any such assertions by the borrower must be supported by competent evidence that the person signing the affidavit does not have personal knowledge. *See* In re David A. Simpson, P.C., 211 N.C. App. 483, 496 (2011).
[28] *But see* In re Norton, 41 N.C. App. 529, 531 (1979) (a party given less than 10 days' notice waives the right to 10 days' notice by appearing at the hearing and not objecting).

7. The trustee and/or the lender did not use due diligence in attempting to locate and serve the borrower before relying on posting.[29]

Right to Foreclose

8. The property has been released from the deed of trust and does not secure the note.[30]

9. The lender does not have a right to foreclose on the property because the borrower is entitled to a release of the property from the lien of the deed of trust and the lender refuses to deliver or record the release.[31]

10. The property described in the Notice of Hearing is not encumbered by the lien of the deed of trust because the legal description in the deed of trust is invalid or missing.[32]

11. The substitute trustee does not have the right to foreclose because the substitution of trustee was recorded after the filing of the notice of hearing with the clerk of superior court.[33]

12. The deed of trust does not contain a valid power of sale provision.[34]

13. The lien of deed of trust is invalid because the grantor under the deed of trust did not own the property at the time the deed of trust was granted.

14. The deed of trust does not encumber the property because it was not properly executed by the appropriate parties.[35]

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[29] *See* Dowd v. Johnson, ___ N.C. App. ___, 760 S.E.2d 79, 83-84 (2014). *But see* In re Powell, N.C. App. COA14-498 (Dec. 2, 2014) (holding that the substitute trustee does not have to exhaust all methods of service before relying on posting and the diligence used in attempting to locate and serve a party is analyzed on a case by case basis).

[30] *See* In re Michael Weinman Assoc., 333 N.C. at 228 (rejecting the argument that "right to foreclose under the instrument" under GS 45-21.16(d)(iii) should be read narrowly so that if the deed of trust contains the requisite "power of sale" language that there is a per se right to foreclose under the instrument and holding that in addition to the power of sale language that in order for a trustee under a deed of trust to have any right to foreclose on a parcel of land, the deed of trust must also encompass the subject property as security for the debt owed by the mortgagor).

[31] *Id.*

[32] *See* In re Foreclosure of Deed of Trust by Goforth Properties, Inc., 334 N.C. 369, 375 (1993); In re Michael Weinman Assoc., 333 N.C. at 230.

[33] *See* ANN M. ANDERSON AND JOAN BRANNON, North Carolina Clerk of Superior Court Procedures Manual, August 2012, Page 130.4.

[34] *See* In re Michael Weinman Assoc., 333 N.C. at 230.

[35] *See* Espinosa v. Martin, 135 N.C. App. 305, 308 (1999).

15. The deed of trust does not secure the debt (promissory note) described in the notice of hearing.

16. The lender does not have a right to foreclose because the owner of the property subject to foreclosure owns the property free and clear of the deed of trust being foreclosed.[36]

17. The property is not secured by the deed of trust because the lender fraudulently attached a legal description to the deed of trust after the borrower signed it and before the lender recorded it.[37]

Holder of a Valid Debt

18. The holder must present the original note because the copies presented are not authentic and do not constitute accurate representations of the original note.[38]

19. A condition precedent to the foreclosure contained in the loan documents has not been met.[39]

20. The party seeking to foreclose does not have actual possession of the note or possession through an agent and is therefore not the holder of the debt.[40]

21. The holder did not present competent evidence of transfer of title of the note to the holder, by indorsement, merger, or otherwise, and relied solely on a legal conclusion in an affidavit that the party is a holder of the note to prove holder status.[41]

[36] *See* In re Michael Weinman Assoc., 333 N.C. at 230.
[37] *See* In re Hudson, 182 N.C. App. 499, 503 (2007).
[38] *See* In re Helms, 55 N.C. App. 68, 70 (1981). Originals of the note and deed of trust are required only when there is a dispute as to the authenticity of the copies presented by the lender as evidence. *See* In re Adams, 204 N.C. App. 318, 323-24 (2010). If the borrower raises this as a defense, the borrower is required to offer some proof that the copies are not authentic. *Id.* Mere assertions that the copies of the note and/or the deed of trust are not accurate are not enough. *See* Dobson v. Substitute Trustee Services, Inc., 212 N.C. App. 45, 49 (2011).
[39] *See* In re of Foreclosure of Deed of Trust by Goforth Properties, Inc., 334 N.C. 369, 376-77 (1993) (the deed of trust subject to foreclosure required lender to first foreclose another deed of trust and apply proceeds to debt and only if there was a deficiency from that foreclosure could lender foreclose the second deed of trust in question).
[40] *See* Connolly v. Potts, 63 N.C. App. 547, 551 (1983). *See also* G.S. 25-3-201, Official Comment ("…nobody can be a holder without possessing the instrument, either directly or through an agent").
[41] *See* In re David A. Simpson, P.C., 211 N.C. App. 483, 491 (2011). A statement in the bank's affidavit that it was the owner and holder of the note is not sufficient competent evidence of a valid holder. *Id.*

22. The purported indorsement or allonge or related circumstances unambiguously indicate that the indorsement signature was made for a purpose other than indorsement.[42]

23. Although the foreclosing party has possession of the original note, the note is not payable to bearer or indorsed to the foreclosing party or in blank.[43]

24. The signatures on the loan documents were forged.[44]

25. The borrower and/or the owner of the property did not receive consideration in exchange for signing the note and/or the deed of trust.[45]

26. The person who signed the indorsement on behalf of the company or entity transferring the note did not have the authority to sign on the company's behalf.[46]

Military Status

27. The borrower under the note or the grantor under the deed of trust is currently serving in the military or returned from service within the last 90 days, the loan originated prior to the person's military service, and the lender did not obtain a valid waiver from the servicemember.[47]

[42] *See* In re Bass, 366 N.C. 464, 468 (2013) (stating that the signature or other evidence must unambiguously indicate that the signature is intended for something besides indorsement and may be treated as an indorsement even though the signer intended something else where that standard is not met).
[43] *See* In re David A. Simpson, P.C., 211 N.C. App. at 491.
[44] *See* Espinosa v. Martin, 135 N.C. App. 305, 308 (1999); In re Hudson, 182 N.C. App. 499, 503 (2007). Note, where a party raises a defense that a note or deed of trust was forged, the N.C. Court of Appeals in an unpublished decision stated that it was within the court's authority to also consider whether the party otherwise consented to the loan and the security for the loan based on some other legal theory, such as ratification. *See* In re Foreclosure of Rivera, ____ N.C. App. ____, 775 S.E.2d 36 (2015) (unpublished). Furthermore, signatures to a negotiable instrument are presumed to be authentic and authorized, except in very limited circumstances. G.S. 25-3-308(a). This means that until some evidence is introduced that would support a finding that a signature is forged or unauthorized, the plaintiff is not required to prove it is valid. *Id.,* Official Comment.
[45] *See* Foreclosure of Deed of Trust of Blue Ridge Holdings Ltd., 129 N.C. App. 534, 537-38 (1998). A note signed under seal creates a rebuttable presumption of consideration. *Id.*
[46] It is important to note that any such assertions by the borrower must be supported by competent evidence that the person signing the affidavit does not have such authority. The North Carolina Supreme Court has stated that an indorsement is presumed to be authentic and authorized until some evidence is introduced which would support a finding that the signature is forged or unauthorized. *See* In re Bass, 366 N.C. at 470-71. Until the party disputing the validity of the indorsement presents evidence that it is invalid due to forgery, error or otherwise, the purported holder is not required to prove that the signature is valid. *Id.* In Bass, the North Carolina Supreme Court held that a stamp with only the names of the transferring holder and the current holder was enough to show holder status. *Id.*
[47] *See* Servicemembers' Civil Relief Act, 50 U.S.C. sec. 3931*;* G.S. 45-21.12A(a).

28. The foreclosing party did not file an affidavit that the hearing is scheduled to take place at least 90 days after a period of military service of the borrower under the note or the grantor under the deed of trust and the loan originated prior to the person's military service.[48]

Home Loan

29. The underlying mortgage debt is a home loan and the foreclosing party failed to send the 45 day pre-foreclosure notice.[49]

30. The underlying mortgage debt is a home loan and the 45 day pre-foreclosure notice sent by the foreclosing party failed to include the information required under G.S. 45-102 in all material respects.[50]

31. The foreclosing party failed to file the 45 day pre-foreclosure notice in the N.C. Administrative Office of the Courts home loan database within three business days of mailing the notice.[51]

[48] *See id.*
[49] *See* G.S. 45-21.16(d).
[50] *See id.*
[51] *See* G.S. 45-103.