The General Specific: The N.C. Supreme Court Decision In re Foreclosure of Lucks

Author : Meredith Smith

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On December 21, 2016, the North Carolina Supreme Court published a final set of opinions for the year. Without a doubt, one case in particular stopped me in my tracks. The case, In re Foreclosure of Lucks, will have a significant impact on G.S. Chapter 45 power of sale foreclosures going forward. ____ N.C. ____ (Dec. 21, 2016). Here's both the general and the specific about what the court had to say.

The Rules of Civil Procedure Do Not Apply to Non-Judicial Foreclosures

The biggest takeaway from the Lucks decision is the holding that the Rules of Civil Procedure applicable to judicial actions do not apply to power of sale, or non-judicial, foreclosure proceedings. G.S Chapter 45 governs these proceedings and provides the "comprehensive statutory framework." This includes both the initial proceeding before the clerk of superior court and the proceeding on appeal before the superior or district court. Any case that implies otherwise is expressly overruled by the opinion. This includes decisions by N.C. Court of Appeals such as In re Foreclosure of Garrett, ___ N.C. App. ___ (Nov. 15, 2016) (applying Rule 60); In re Foreclosure of Herndon, ____ N.C. App. ____ (Jan. 19, 2016) and Lifestore Bank v. Mingo Tribe, 235 N.C. App. 573 (2014) (each applying Rule 41); In re Foreclosure of Garvey, ___ N.C. App. ___ (June 2, 2015) (applying Rule 52(a)); and In re Foreclosure of Cain, ___ N.C. App. ___ (July 5, 2016) (applying Rules 36(a) and Rule 58).

The saga of whether the Rules of Civil Procedure apply to power of sale foreclosures picked up steam over the past couple of years. A string of recent cases from the N.C. Court of Appeals starting with Lifestore stated "[a] foreclosure under power of sale is a type of special proceeding, to which our Rules of Civil Procedure apply." This language caused some concern among court officials and practitioners that depositions, requests for production of documents, interrogatories, and other discovery tools might work their way into power of sale foreclosure proceedings. These rules and related procedures now clearly do not apply to a power of sale foreclosure under G.S. Chapter 45.

As a result of Lucks, the procedures that apply to power of sale foreclosures are found solely in G.S. Chapter 45. The Rules of Civil Procedure that many clerks, judges, and parties have come to rely on to fill in the gaps where G.S. Chapter 45 is silent do not apply. This includes rules like Rule 17, which provides guidance on how a party must defend a proceeding when they lack capacity, and Rule 11, which requires a party or attorney to file a pleading, motion, or other paper based on the law and in good faith and authorizes court sanctions for failing to do so. Rule 60 also no longer applies which some practitioners relied upon to seek an order setting aside the foreclosure sale. Going forward, unless G.S. Chapter 45 specifically incorporates a rule by reference, the Rules of Civil Procedure are no longer available for guidance in power of sale foreclosure proceedings both before the clerk and the superior or district court on appeal.*

A Trustee Withdraws a Notice of Hearing Rather Than Dismisses It

The court in Lucks also weighed in on a creditor's (holder's) decision not to proceed with a foreclosure hearing after a

notice of hearing is filed by the trustee. The court stated that in those instances the creditor does not file a "dismissal" of the case. Instead, the trustee simply files a withdrawal of the notice of hearing. The withdrawal of the notice ***terminates*** the case. *See* In re Foreclosure of Beasley, ___ N.C. ___ (Dec. 21, 2016). The court noted that the withdrawal by the trustee has no collateral consequence, meaning it does not impact the ability of the trustee to re-file another power of sale foreclosure at a later date - either on the same default or a different default.

Going forward, clerks and judges should expect to see notices of withdrawal filed in power of sale foreclosures by trustees instead of voluntarily dismissals. There are some counties that have already seen such notices since the Lucks decision.

If a dismissal is filed by a trustee, it should be treated as a withdrawal of the notice and the case is terminated. This was the effect of a case decided by the N.C. Supreme Court on the same day as Lucks. The court in In re Foreclosure of Beasley treated a dismissal previously filed by the trustee as a withdrawal and held that the filing of the withdrawal meant there was no longer a pending case "on which the clerk of court could act."

The Court's Decision: Authorize or Deny the Request to Authorize the Foreclosure Sale

If the court finds the existence of six elements set forth in G.S. 45-21.16(d), the court authorizes the trustee to proceed with the foreclosure sale under the deed of trust. This may be done by "authorization or order" of the court. G.S. 45-21.16(d). In practice, most clerks and judges enter an order authorizing sale. *See* N.C. Clerk of Superior Court Procedures Manual, pg. 130.29.

If the court does not find sufficient evidence of the existence of the requisite statutory elements, the court by order **denies the request to proceed with a foreclosure sale.** *Id.* However, a common practice in North Carolina is for the court to deny the request for sale by entering an order dismissing the proceeding. The court in Lucks seemed to take issue with this practice by referring to each dismissal by the clerk and the superior court in quotes as a "dismissal" – suggesting that the court's actions were not a dismissal but rather a denial of the request to proceed with the sale. And in fact, the court ultimately ruled that the superior court erred by entering an order dismissing the case *with prejudice*.

After the court's decision in Lucks, if the court does not find the existence of the six statutory elements, it seems as though the better practice is for the court to enter an order denying the request to proceed rather than entering a dismissal of the proceeding. This aligns with the procedure described in the NC Clerk of Superior Court Procedures Manual as well. *See* N.C. Clerk of Superior Court Procedures Manual, pg. 130.29. Note, however, there is at least one instance when both the clerk and the superior and district court on appeal clearly have the authority to enter a dismissal of a power of sale foreclosure proceeding. If the court determines that the certification contained in the notice of hearing pertaining to the pre-foreclosure notice under G.S. 45-102 (the 45 day letter) or the pre-foreclosure information required under G.S. 45-103 (the home loan registration) contain a materially inaccurate statement, the court may enter an order dismissing the proceeding without prejudice. G.S. 45-107(b).

Res Judicata and Collateral Estoppel

The N.C. Supreme Court in Lucks also held that collateral estoppel (issue preclusion) or res judicata (claim preclusion) do not apply to power of sale foreclosure proceedings and specifically to a denial of a request to proceed with the foreclosure. Once a court **denies a request to proceed with a sale**, the following applies:

1. The creditor is prohibited from filing another power of sale foreclosure based on the same default.
2. The creditor may file a judicial foreclosure under G.S. Chapter 1 on the same default.
3. The creditor may file another power of sale foreclosure on a *different* default.

One open question I have involves the breadth of the court's statement that traditional doctrines of res judicata and

collateral estoppel applicable to judicial actions do not apply to power of sale foreclosures and the extent to which prior case law implying otherwise is overruled. As recently as June of 2015, the North Carolina Court of Appeals held that collateral estoppel barred a borrower from re-litigating the issue of default in a separate civil action where the clerk and the superior court had already entered orders authorizing sale in a power of sale foreclosure proceeding. *See* Funderburk v. JPMorgan Chase Bank, N.A., ___ N.C. App. ___ (June 16, 2015).

The court in Funderburk cited a string of cases from 2014 and 2015 where courts held that an order authorizing sale from a power of sale foreclosure had a preclusive effect on subsequent suits involving the same issues (valid debt, default, etc.). Read broadly, it would seem that Lucks overrules those decisions and going forward the court's order from a power of sale foreclosure has no preclusive effect. The nature of a power of sale foreclosure described by the court in Lucks – the fact that it is not a judicial action, the Rules of Evidence are relaxed, and the Rules of Civil Procedure do not apply – seem to support this position as a party does not have the same opportunity to gather information and challenge an issue in a non-judicial proceeding as it does in a civil action. However, a future court may read Lucks more narrowly and limit the holding stating that res judicata and collateral estoppel do not apply to only other power of sale and judicial foreclosure proceedings. I guess we'll see….

What are your thoughts on the application of Lucks in practice? Feel free to leave them below.

*One instance where Rules of Civil Procedure do apply to a foreclosure is in connection with service of the notice of hearing – G.S. 45-21.16(a) incorporates Rules 4 and 17 by reference. Service of the notice of hearing is made in the same manner as service of summons under the Rules of Civil Procedure, which is by Rule 4. GS 45-21.16(a); G.S. 1A-1, Rule 4. Rule 4(j)(2)(b) sets forth the requirements for serving a natural person under disability, which includes an incompetent ward and a minor, and for the appointment a Rule 17 guardian ad litem to complete service of process in certain limited circumstances described therein.