

RESOURCES

NC Court of Appeals Expands Guarantors' Defenses to Payment

A February 2015 opinion of the North Carolina Court of Appeals has again brought to the forefront the issue of whether a guarantor can assert a defense to payment under a guaranty following a foreclosure sale of real property that was previously thought to be available only to a borrower.

N.C.G.S. § 45-21.36 provides that when a foreclosing creditor purchases real property at a foreclosure sale and subsequently sues to collect the deficiency, certain obligors may (1) as a defense to payment, show that the collateral was worth more than the amount of the debt, and (2) as an offset to payment, show that the creditor's winning foreclosure bid was substantially less than the value of the collateral. If the defense is available, the obligor would not be liable for any deficiency judgment. If the offset is available, the obligor would be entitled to an offset against a deficiency judgment. The statute provides the defense/offset is available only to "the mortgagor, trustor or other maker" of the debt which owns the property which has been foreclosed. Over the years, the Court of Appeals has held many times that only the owner of the real property could assert the defense/offset. A guarantor, usually not being the owner of the real property foreclosed, has not been able to take advantage of the statute.

In December 2013, and again in February 2015, the North Carolina Court of Appeals was asked to decide if guarantors were entitled to assert the defense and offset to payment under N.C.G.S. § 45-21.36. In both cases, the Court of Appeals ruled in favor of the guarantors. If the holdings in these cases aren't overturned by the North Carolina Supreme Court, the cases will affect the way guaranties are drafted and the way debts secured by real property are collected.

The facts of the two cases recently before the North Carolina Court of Appeals are similar, although not identical. Following foreclosure of its deed of trust, the lender filed suit against guarantors for collection of the deficiency remaining after application of the net foreclosure sales proceeds to the debt. In one case, the lender also sued the borrower. In the other case, the borrower was initially a defendant, was dismissed from the suit by the lender and was later re-joined by the guarantors. The primary issue in each case was whether the guarantors could assert the defense and offset available to a borrower as an "obligor" under N.C.G.S. § 45-21.36.

In *High Point Bank & Trust Co. v. Highmark Props., LLC*, ___ N. C. App. ___, 750 S.E.2d 886 (2013), petition for discretionary review allowed, 367 N.C. 321, 755 S.E.2d 627 (2014), the Court of Appeals reasoned that the guarantors were responsible for the borrower's debt and that, once the borrower asserted its defenses and offsets, the guarantors' liability was limited to the debt owed by the borrower. The Court of Appeals stated that "we have not held that guarantors had the right to avail themselves of the offset defense in NCGS Section 45-21.36. We quite assiduously avoided making that determination." The Court cited a 1938 North Carolina Supreme Court case (*Virginia Trust Co. v. Dunlop*, 214 N.C. 196, 198 S.E.2d 645 (1938)) that held, in connection with an appeal of the granting of a motion to strike the defense, a guarantor had a right to "present the facts" concerning the statutory offset defense at trial. The Dunlop court stated they weren't deciding the issue of whether the guarantor in that case could "make good the allegations of their [offset] defense."

In *Branch Banking and Trust Company v. Smith*, ___ S.E.2d ___, 2015 WL 690851, decided on February 15, 2015, the Court of Appeals again relied on Dunlop, this time finding the Dunlop court had "[i]n so many words, . . . affirmed the guarantor's . . . right to assert the statutory defense. . ." and holding that the guarantors had the right to assert the defense. The North Carolina Court of Appeals held that, until the North Carolina Supreme Court

speaks on the issue and renders a decision contrary to Dunlop, the Court of Appeals was bound by Dunlop, notwithstanding the many holdings of the Court of Appeals which conflict with that case.

The 2013 High Point Bank & Trust Co. case has been appealed to the North Carolina Supreme Court. Briefs have been filed, including an amicus brief by the North Carolina Banker's Association in support of High Point Bank & Trust Co.'s position and an amicus brief by the North Carolina Advocates for Justice in support of the guarantors' position. There is no indication at this time when the North Carolina Supreme Court will render a decision.

If the decisions of the Court of Appeals are upheld, our lending clients should consider including in their respective guaranty agreements additional waivers and also consider commencing suits against borrowers and guarantors prior to the foreclosure of any real property.

We routinely represent lenders in both documenting and collecting commercial loans and would be happy to discuss strategies with you should the need arise.

Carruthers & Roth, P.A.
(336) 379-8651
235 North Edgeworth Street
P.O. Box 540 (27402)
Greensboro, NC 27401