

North Carolina Supreme Court Holds That Liberal Standard of Notice Pleading Applies to Judicial Foreclosure Actions

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In an important decision for creditors, the North Carolina Supreme Court recently clarified the distinction between judicial foreclosure and non-judicial foreclosure by power of sale. In [U.S. Bank v. Pinkney](#), the Supreme Court held that judicial foreclosure is an ordinary civil action subject to the liberal standard of notice pleading of North Carolina's Rules of Civil Procedure. The ruling benefits creditors because it means if they bring a judicial foreclosure action, they need not prove their case in their initial complaint. They merely must allege a debt secured by a deed of trust, a default, and their right to enforce the deed of trust. The ruling is

especially helpful for creditors who acquired loans through transfer and assignment, and who may have indorsement or other issues in their documentation raising questions about whether they may enforce the loans.

Civil Actions and Judicial Foreclosure

To understand the decision, it helps to know the difference between civil actions and special proceedings, and the difference between judicial and non-judicial foreclosure. A civil action is an ordinary lawsuit before a trial judge. A plaintiff files a complaint against a defendant, the defendant answers, and the case proceeds. The complaint must contain sufficient allegations that, if proven, entitle a party to relief, but a plaintiff need not prove its entire case. Under the liberal standard of notice pleading, the court must accept allegations as true and view them in the light most favorable to the plaintiff. A court should not dismiss a complaint unless the plaintiff could prove no set of facts entitling him to relief under some legal theory. In a civil action, the parties can engage in discovery, present and defend evidence, and make legal arguments by motion. If the parties do not resolve the case through settlement or dispositive motion, it culminates in a trial.

A judicial foreclosure is a civil action. The lender files a complaint in the county where the property is located asking that it be sold under judicial process and the proceeds applied to the mortgage debt. The complaint must allege, at minimum, a debt, default on the debt, a deed of trust securing the debt, and the plaintiff's (lender's) right to enforce the deed of trust. If the lender prevails, the court enters a judgment on the debt and orders a judicial sale of the mortgaged property.

Special Proceedings and Non-Judicial Foreclosure Under Chapter 45

Special proceedings are resolved by the clerk of court. They are not lawsuits. When a creditor forecloses under the power of sale provision in a deed of trust, it engages in a non-judicial foreclosure. Chapter 45 of the North Carolina General Statutes governs non-judicial foreclosures and requires the clerk to authorize a foreclosure sale if the lender establishes the existence of (1) a valid debt, (2) default, (3) the creditor's right to foreclose (including that creditor is the "holder" of the loan documents), (4) notice, (5) "home loan" classification and applicable pre-foreclosure notice, and (6) that the sale is not barred by the

debtor's military status. Most foreclosures in North Carolina are of this non-judicial variety. At a foreclosure hearing, the creditor files an affidavit to prove these elements.

The Pinkney Case

In 1997, the Pinkneys borrowed money from Ford Consumer Finance Company to purchase real property. The Pinkneys signed a promissory note and a deed of trust encumbering the property. U.S. Bank acquired the loan through a series of transfers and assignments. In 2014, after the Pinkneys defaulted, U.S. Bank filed a complaint seeking judicial foreclosure of the deed of trust. The complaint alleged that the Pinkneys owed a valid debt to U.S. Bank, that they had defaulted, and that they had refused to pay the debt after written notice of default. As to U.S. Bank's right to enforce the Ford Consumer Finance Company loan documents, the complaint alleged a series of transfers and attached various assignments and allonges as exhibits.

The borrowers moved to dismiss the complaint. The trial court found the exhibits failed to include a required indorsement and dismissed the action with prejudice. The North Carolina Court of Appeals affirmed, finding that U.S. Bank failed to establish affirmatively all elements under Chapter 45. Specifically, the Court of Appeals found that the complaint failed to establish that U.S. Bank was the holder of the note secured by the deed of trust. In reaching their decisions, the trial court and Court of Appeals looked at U.S. Bank's complaint as if it were the affidavit filed in a non-judicial foreclosure proceeding.

The North Carolina Supreme Court's Decision

The North Carolina Supreme Court reversed the Court of Appeals. The Supreme Court began by reminding the courts that North Carolina's Rules of Civil Procedure contain a liberal standard of notice pleading. Under that standard, a complaint sufficiently alleges a claim if it contains enough detail to place the court and the parties on notice of the essential facts to be proved at trial. The Court held that—just like any other civil action—a creditor seeking judicial foreclosure does not have to prove its entire case at the initial pleading stage. Trial courts may not evaluate judicial foreclosure complaints by considering if they prove all elements of a Chapter 45 non-judicial foreclosure by power of sale.

Here, because U.S. Bank alleged a debt, default, a deed of trust securing the debt, and that—through the chain of transfers—it was the holder of the promissory note (with the right to enforce the deed of trust), the Court determined that its complaint met this standard.

Conclusion

The North Carolina Supreme Court's ruling addresses the minimum requirements for bringing a judicial foreclosure action. A complaint sufficient to survive dismissal under North Carolina law is not the same as a judgment on the debt and a judicial sale of the mortgaged property. Creditors still must prove their right to foreclose and be able to defend evidentiary and other objections by the borrower. But this case is a victory for creditors. If nothing else, it provides leverage to creditors. Borrowers can no longer dismiss a case at inception and will be forced to submit to discovery, motions, and the specter of a full-blown trial to avoid foreclosure.

If you have judicial foreclosure questions, please contact our **Creditors' Rights Practice Group** for more information on how best to advocate your position given this decision.

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