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Prove It Or Lose It: How Not To Botch A Foreclosure

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If you are a lender with real estate-secured loans in your portfolio that you acquired from another institution, or if you routinely buy commercial paper secured by real estate for investment purposes, then you need to be aware of a recent case from the North Carolina Court of Appeals. The decision provides a cautionary tale for what can befall a lender that overlooks certain basic facts about foreclosure in North Carolina. If you want to exercise the rights contained in a promissory note—including the right to foreclose on real estate securing the note—then you need to be able to establish certain things, one of which is that you are the holder of the note—that is, that you own the note and have the right to enforce it.

In Basmas v. Wells Fargo Bank, the plaintiffs had borrowed money from a lender and had secured the loan with a deed of trust on their real estate. Later, the original lender sold the loan to Wells Fargo. When Wells Fargo purchased the loan, it obtained the promissory note indorsed in blank by the lender. For reasons satisfactory to itself, Wells Fargo had a custodian hold possession of the original note for it.

When the plaintiffs defaulted, Wells Fargo commenced a foreclosure special proceeding. At the foreclosure hearing, Wells Fargo was required to establish, among other things, that it was the owner and holder of the promissory note.

The Clerk of Court entered an order allowing Wells Fargo to proceed with a foreclosure sale, but the plaintiffs appealed the decision to the Superior Court. The Superior Court held that Wells Fargo failed to produce competent evidence that it was the holder of the promissory note because all it had was a copy of the note indorsed in blank. It did not produce the original note or a copy of the note indorsed to Wells Fargo. Since Wells Fargo had failed to prove that it was the holder of the promissory note, the Superior Court vacated the Clerk's order and ruled that Wells Fargo could not conduct a foreclosure sale.

Wells Fargo was then required to file a second foreclosure proceeding. When it did so, the plaintiffs responded that the doctrine of *res judicata* barred the second foreclosure proceeding. Under the doctrine of *res judicata*, a final judgment on the merits in a prior action in a court of competent jurisdiction precludes a second suit involving the same claim between the same parties. In other words, a party does not get to re-try an issue that has already been ruled on by the court. The trial court disagreed with the plaintiffs, holding that the doctrine of *res judicata* did not apply, and the plaintiffs appealed to the North Carolina Court of Appeals.

Fortunately for Wells Fargo, the Court of Appeals agreed with the trial court and held that *res judicata* did not apply for two reasons. First, the plaintiffs had defaulted on the promissory note a second time after the

proceedings in the first foreclosure. Second, in the second proceeding, Wells Fargo provided the court with the original promissory note, thereby establishing its status as holder of the note. The Court agreed that Wells Fargo could now foreclose.

Ultimately, Wells Fargo prevailed. But consider that the plaintiffs defaulted in March 2009 and Wells Fargo presumably made demand shortly thereafter. If Wells Fargo had been more careful about meeting the criteria necessary for foreclosure (specifically that it was the holder of the promissory note), it could have sold the real property before the end of 2009 and, in all likelihood, after a single hearing before the Clerk of Court. Instead, Wells Fargo had to expend time and resources for multiple hearings in multiple proceedings. Although Wells Fargo eventually got the relief it wanted, it did not get it until December 2012—three years after it should have been able to realize on its collateral.

You can avoid this predicament with a few simple steps. First, when you acquire loan documents from another lender, your purchase documents should establish a clear, written "chain of custody" so there is no dispute that you are the holder. Second, when you get ready to foreclose your collateral, ensure that your counsel has all the paperwork needed to establish your right to foreclose, primarily the original note with either an indorsement to you or, at least, in blank.

Ward and Smith, P.A. routinely represents purchasers of commercial paper in note sale transactions, as well as lenders in foreclosure proceedings. We can provide you with documents and advice to maximize your investment and avoid time delays and unnecessary expense in the foreclosure process.

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