The Lender's Source

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New Georgia Court Decisions Affirm Waivers of Post-Foreclosure Confirmation Protections

In the past two months both the Georgia Supreme Court and Court of Appeals have confirmed guarantors' ability to waive protections of post-foreclosure confirmation laws through use of pre-printed waiver language in guaranty agreements.

The decision of the Supreme Court, dated February 22, 2016, was noteworthy as the State's highest court had remained silent on the issue for more than two years after the Court of Appeals first recognized a valid waiver of confirmation in the 2013 *HWA Properties* decision.

The Supreme Court's decision, designated as *PNC Bank v. Smith*, was issued at request of a federal court wanting clarification on Georgia law. The federal court asked the Supreme Court to confirm whether (1) obtaining confirmation of a foreclosure is a condition to the lender's ability to pursue a deficiency judgment against a guarantor, and if so, (2) whether the requirement of confirmation can be waived by a borrower or guarantor.

As to the first question, the Supreme Court unsurprisingly answered in the affirmative: both borrowers and guarantors are protected by confirmation laws. The Court limited its response to the second question, refusing to address whether primary borrowers—as compared to guarantors—can waive confirmation. This issue thus remains unresolved. But as to guarantors themselves, the Supreme Court agreed with the Court of Appeals that confirmation protections can be waived. The Court reasoned that the protections of confirmation laws are not so important as to outweigh an individual's rights to contract on terms he may see fit. As a result, if a guarantor contractually agrees to waive confirmation protections, that waiver will be enforced.

One justice (Nahmias) issued a separate concurring opinion, suggesting that from the state of Georgia law "it would seem to follow" that primary borrowers, like guarantors, would be able to effectively waive confirmation requirements via provisions in loan documents. The justice predicted Georgia confirmation laws will soon be "dead letter," as use of both borrower and guarantor waivers will become common lending practices.

Separately, on March 16, 2016, the Court of Appeals' *York v. RES-GA LJY* decision again upheld a guarantor's confirmation waiver. This is the Court's third decision that does so. The case involved a guarantor's waiver of all defenses "based on suretyship," which the guaranty defined to include "anti-deficiency" laws protecting guarantors after foreclosure. The guarantor argued that Georgia confirmation law was not a "suretyship" defense, and thus was not covered by the waiver, as it was applicable to both borrowers and guarantors. The Court disagreed, construing the waiver to cover all defenses that arise out of status of a surety (i.e., guarantor).

York suggests courts should take a plain language approach to construing waiver provisions, rather than restricting them narrowly. Lenders should nonetheless use express confirmation waivers for maximum protection from a hostile court.

Court of Appeals Finds Bank Can be Liable to Evicted Tenant for Discarded Belongings

In a recent decision, the Georgia Court of Appeals ruled that a bank could be liable to an evicted tenant for failing to allow the tenant access to retrieve her personal property before it was discarded.

The case involved a bank that had foreclosed on a home and obtained a writ of possession to evict a non-paying tenant from the home. In performing the eviction, the bank's agents removed all furniture and other belongings from the house and placed them in a dumpster. The bank then had the dumpster removed from the premises. During and after this process, the tenant was not allowed access to the premises or the dumpster in order to recover any of her belongings.

The tenant sued the bank for theft of her property. The trial court dismissed the claims, but the Court of Appeals reversed. It noted that Georgia law requires that any personal items removed during eviction must be made accessible on some part of the premises or in another location approved by the legal officer present at the eviction. Once this is done, the landlord has no further responsibility to the tenant for the property. It becomes the tenant's duty to retrieve the property or risk the loss. But if this access is not provided—such as where the landlord immediately destroys or disposes of the items during eviction—the landlord remains liable to the tenant for property that is destroyed or which is otherwise not returned to the tenant.

While desire to rapidly return a property to clean, marketable condition is understandable, care must be taken to strictly follow the law in dealing with an evicted tenant's possessions. The alternative may be costly.

Georgia Supreme Court Limits Borrowers' Ability to Challenge Assignment of Secured Debt

In an opinion dated March 7, 2016, the Supreme Court of Georgia ruled that a borrower had no legal standing to challenge whether the borrower's security deed had been assigned to a new lender prior to foreclosure.

In order to secure a sizeable loan, the borrowers granted Washington Mutual Bank a security deed covering their home. That bank later failed, with the FDIC appointed as receiver. The FDIC assigned the security deed to another bank, and that bank recorded an assignment document relating to the security deed in the appropriate deed records. The assignment was signed by certain officers of the bank pursuant to a written power of attorney granted by the FDIC.

The borrowers later defaulted on the loan, and the assignee bank instituted foreclosure proceedings. The borrowers filed a lawsuit against the bank seeking to recover for wrongful foreclosure, alleging that the bank could not prove that it was the actual holder of the security deed by valid assignment. The borrowers' claims were dismissed by the trial court, and the borrowers appealed the dismissal to the Supreme Court of Georgia.

Upholding the trial court's dismissal, the Supreme Court ruled that the borrowers had no standing—essentially, a legal right to pursue a claim in litigation—to challenge whether the security deed had in fact been assigned to the bank. The court noted that although the borrowers were clearly parties to the security deed itself, the assignment agreement was a separate contract solely between the assignor (the FDIC) and the assignee (the purchasing bank). As the borrowers were not parties to the separate assignment contract, and the borrowers themselves did not claim to be the true holder of the security deed, the borrowers did not have a legally recognizable right to challenge the validity of the assignment. The court opined that if the borrowers believed the bank was attempting to enforce a deed that it did not own, the borrowers' remedy was merely to alert the true holder of the deed (which, according to the borrowers, was the FDIC) so that the holder could take appropriate legal action against the bank.

The court further noted that aside from the fact that the borrowers were not parties to the assignment, the borrowers could not point to any applicable law or any provision of the security deed that was violated by the assignment. Georgia law expressly authorizes assignment of security deeds, and nothing in the security deed itself prohibited assignment by the original lender. While Georgia law does require that assignments be recorded prior to foreclosure under an assigned security deed, there was no dispute that the bank had recorded the assignment document before commencing foreclosure.

As the borrowers were not parties to the assignment and could not show that the assignment violated any law, their claims challenging the assignment had to be dismissed.

Have questions? Need help?

Moore, Clarke, DuVall & Rodgers, P.C. has experienced attorneys available to provide guidance and representation throughout a broad range of concerns a financial institution may face. The firm's practice includes document preparation for complex loans, lender representation in bankruptcy and collection litigation, foreclosure, real estate transactions, taxation, estate planning, and employer representation in employment disputes. Contact us to see how we can help.

Security Deed's Undated Notary Acknowledgement Causes Lender to Lose Out in Bankruptcy

Addressing a previously undecided legal issue, a recent bankruptcy court decision in Atlanta found that because a notary failed to insert the date in the acknowledgement clause of a security deed, the lender's rights in the collateral property were lost in bankruptcy.

To survive the powers of a bankruptcy trustee, a lender's security deed must be recorded in the appropriate deed records *and* must meet the legal requirements for recording. Courts in Georgia have held that the fact a deed was actually recorded does not mean that the deed met all legal requirements necessary in order to be recorded. The idea is that the official in charge of recording may make a mistake in allowing a deed to be recorded even though one or more legal requirements are unsatisfied. In that event, recording the deed will not cure its legal defects. If it is apparent on the face of the deed that one or more legal requirements for recording have not been met, the bankruptcy trustee will be able to avoid (essentially, do away with) the lender's interest in the collateral property just as if the deed had never been recorded at all.

One of the legal requirements for recording deeds dated prior to July 1, 2015 was that the signature of the grantor (borrower) must have been attested by, or acknowledged before, a notary public or similar officer (due to a 2015 change in law, deeds dated after July 1, 2015 must be attested by a notary—acknowledgements are no longer sufficient). This must appear in addition to the signature of a separate second witness, generally referred to as an "unofficial witness."

The February 2016 court decision in *In re Simpson*, issued by the Bankruptcy Court for the Northern District of Georgia, addressed the bankruptcy trustee's claim that the lend-

er's recorded security deed was avoidable because the acknowledgement clause was defective. The deed at issue was signed by the grantor and by an unofficial witness. It also featured an acknowledgement clause—stating that the grantor appeared before the notary and acknowledged the signature as the grantor's act—that was signed and sealed by the notary. The clause featured blank lines in which the notary was supposed to fill in the date on which the acknowledgement was made. The notary did not do so, however.

The grantor later filed for bankruptcy protection, and the bankruptcy trustee argued that the deed was avoidable due to the notary's failure to write the date into the acknowledgement clause.

The court ultimately agreed with the trustee, finding that Georgia law requires an acknowledgement (but not necessarily an attestation) to be dated by the notary in order to be valid. The court reasoned that the requirement of a date is important because an acknowledgement (but not an attestation) can occur on a different date than the date on which the deed itself is signed.

As the deed did not have a valid acknowledgement or attestation of a notary, it failed to meet Georgia's legal requirements for recording and thus was avoidable by the trustee despite the fact the deed had been recorded well in advance of the bankruptcy filing. The lender lost its rights in the collateral, and was treated as an unsecured creditor.

Although bankruptcy court decisions are not binding on other courts, lenders would be well advised to keep this decision in mind. As many cases over the past few years have shown, seemingly minor errors in execution of security deeds can have disastrous effects if the borrower later files for bankruptcy protection.

Court of Appeals Affirms Dismissal of Debtor's Claim to Recover for Acts of Failed Bank Officer

In pursuing a lawsuit to collect an unpaid loan purchased from the FDIC as receiver for a failed bank, one of the firm's clients was faced with a counterclaim by the debtor seeking sizeable damages for alleged unlawful actions taken by an officer of the failed bank before the FDIC was appointed receiver.

The firm sought and obtained summary judgment dismissing the debtor's claim, arguing that because the debtor failed to present its claim to the FDIC receivership claims process, federal law (more specifically, scattered sections of FIRREA) barred the debtor from asserting the claim in any state or federal court.

The debtor filed an appeal of the judgment dismissing the claim, and considering the briefs filed by the parties the Court of Appeals of Georgia issued an unpublished decision upholding the trial court's dismissal of the claim.

For financial institutions dealing with assets purchased from the FDIC as receiver, federal law provides important (and under-utilized) protection from claims based on pre-receivership actions of the failed bank or its employees. Should you have any questions about these valuable protections, feel free to contact us.

Topics in Taxation

by
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New Partnership Audit Rules Affect All Partnerships

The recently enacted budget agreement (the "2015 Budget Act") makes substantive changes to the rules governing federal income tax audits of entities that are treated as partnerships for federal income tax purposes, such as general partnerships, limited partnerships, and many limited liability companies.

An entity classified as a partnership for federal income tax purposes is a flow-through entity and is not subject to federal income tax. Rather, each individual partner is allocated a share of the partnership's income, gain, loss, deduction, and credit, and the individual partners pay income tax on their allocated shares. Whenever there are adjustments to partnership items following the audit of a partnership, any additional federal income tax is assessed against the partners rather than the partnership.

Under the rules enacted under the 2015 Budget Act, federal income tax liabilities arising from an audit are now imposed directly on the partnership instead of partners, regardless of any changes in the ownership of the partnership that might have occurred between the taxable year in which the partnership items arose and the taxable year in which the partnership items are adjusted. These new rules significantly alter the economic arrangement between partners whenever federal income tax liabilities arise from an audit. Now the economic risk of adjustments on audit is transferred from the partners who were allocated such items to the partners who own partnership interests at the time that the adjustments are made.

While the new rules provide that partnership proceedings will continue to be conducted at the partnership level, they eliminate the familiar tax matters partner in favor of a "partnership representative" who has the absolute authority to bind the partnership on tax matters. Addition-

ally, the new rules eliminate the rights of partners to receive notice of any tax proceedings or to separately contest adjustments agreed to by the partnership representative. The new rules also provide that adjustments to the partnership's items for any particular year are taken into account by the partnership (rather than the partners) in the tax year that the audit is completed. Any tax liability resulting from the adjustments, which includes any penalties associated with such adjustments) is imposed on the partnership in the adjustment year.

The new rules provide that a partnership with one hundred or fewer partners will be permitted to elect out of the new rules so long as the partners are "qualifying partners." For purposes of this election, qualifying partners typically include individuals, estates, C corporations, and S corporations. Qualifying partners do not include other partnerships.

The new rules are effective for partnership taxable years beginning after December 31, 2017. However, a partnership may elect to apply the rules (other than the small-partnership opt-out election rule) for taxable years beginning after November 2, 2015, and before January 1, 2018.

Now is the time for partnerships to review their governing agreements. Agreements must be revised to address issues, such as the partnership representative, information sharing between the partnership representative and the other partners, the election by the partnership to opt out of this new regime, and indemnification whenever a partner withdraws from the partnership prior to the initiation of an audit.

W. Ralph Rodgers, Jr. and Michael Eric Hooper, partners in the firm's Albany office, regularly advise professionals and businesses in tax matters.

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