The Lender's Source

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Appeals Court Rejects Guarantors' Argument to Limit Post-Foreclosure Deficiency Balance

By now it is "old news" a guarantor can contractually waive the requirement that a lender confirm a real property foreclosure before pursuing the guarantor for deficiency. A May 20, 2016 Georgia Court of Appeals decision (known as *Nine Twenty, LLC v. Bank of the Ozarks*) again confirmed this settled concept, but also addressed a new question: where a guarantor has waived the confirmation requirement, does the duty of good faith require a lender to credit the guarantor with the fair market value of foreclosed collateral even where a lesser price was received at foreclosure?

The underlying facts of the case were that a bank extended loans to two entities, with the loans secured by real property. The bank also obtained guaranties from two individuals, each of which guaranty contained sufficient language to waive any requirement of confirmation of foreclosure. The borrowers later defaulted on the loans, and the bank foreclosed on the collateral property without confirming the foreclosure. The bank then sued the two guarantors, seeking recovery of the difference between the loan balance and the sale proceeds received at foreclosure. The bank was granted summary judgment by the trial court, and the guarantors appealed.

On appeal, the guarantors acknowledged that they had effectively waived any requirement for confirmation of the bank's foreclosure sale. They argued, however, that the trial court should have been required to determine the fair market value of the foreclosed property and to credit that amount (rather than the actual sale proceeds amount) to the loan balance in order to determine the amount of the guarantors' final liability. The basis for the guarantors' argument was that the duty of "good faith and fair dealing," which is implied upon the bank by Georgia law, supposedly required the bank to give the guarantors credit for the actual fair market value of collateral foreclosed. In other words, if the foreclosure brought less than the property's fair market value, the bank should have been required to apply an additional credit to the balance to make up for the shortfall.

The Court spent little effort in denying the guarantors' assertions. The Court acknowledged that Georgia law imposes a general duty of good faith on the bank, but pointed out that this duty cannot contradict the express terms of the parties' agreements. In their guaranty agreements, the guarantors had expressly agreed "to remain liable for any deficiency remaining after foreclosure," and that their liability would not be affected "by any foreclosure of any collateral security." Requiring the bank to credit the guarantors with a court-determined fair market value of collateral, rather than the actual foreclosure proceeds, would contradict these contractual provisions, according to the Court. As such, the implied duty of good faith could not effectively impose such a contradictory requirement on the bank, and the bank was entitled to recover the difference between the loan balance and the foreclosure sale proceeds.

At first glance this decision seems valuable to lenders in that, at least in some cases, the lender will be entitled to recover a greater amount from the guarantor. The decision itself made no mention of the size of the alleged difference between the fair market value of the collateral and the amount of the foreclosure proceeds—and it is likely the guarantors spent little time arguing the precise value. This is because the true importance of the guarantors' argument, and this Court decision, lies more in legal procedure.

If the guarantors' argument had prevailed, the fair market value of the property would have been a disputed fact, with the guarantors likely entitled to a jury trial to determine the value—all before the lender could obtain a judgment against the guarantors. This would be a far more lengthy and expensive process for the lender, giving the guarantors greater leverage in attempting to negotiate a reduced settlement. For this reason, the decision may prove quite valuable in pursuing guarantors for post-foreclosure deficiency.

Reminder: New Garnishment Procedures Now in Effect

As discussed in the April 2016 *Lender's Source* update, a new system of garnishment laws became effective in Georgia on May 12. These new laws bring several important changes affecting how banks must handle garnishment actions. First, the deadline for the bank to file an answer to the garnishment has been drastically shortened. An answer must now be filed not more than fifteen days, nor fewer than five days, after the garnishment is served upon the bank. Second, the so-called "garnishment period"—the period during which account funds must be held, and eventually paid over to the court—has also been shortened. The garnishment period now lasts for only five days after the date of service on the bank. Finally, the new laws require the bank to provide to the garnished customer, by mail, a statutorily-prescribed notice of potential exemption of funds from garnishment and a claim form for use by the defendant in filing a claim of exemption with the court. Both of these documents should be provided to the bank by the plaintiff (the party who filed the garnishment), with the bank then mailing the documents to the customer.

In our firm's experience the transition to the new laws and deadlines has proceeded rather smoothly, although there was some initial confusion among banks, courts, and attorneys as to which laws would apply in the days immediately before and after May 12. As always, banks should take care to follow the deadlines imposed by law and to provide the customer with all notices that are required. If the plaintiff fails to provide the necessary notice and claim form documents to the bank, the bank should either specifically request the documents from the plaintiff or obtain them from another source. The bank should not fail to provide the notice and claim documents to the customer on the basis of the plaintiff's own failure to comply with the law.

Banks must also remember that the filing of a claim form by the customer or other person will not relieve a bank from its duty to file a garnishment answer and pay garnished funds into court. A bank may be found in default for failing to answer even if a customer's claim has previously been filed.

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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.

Understanding the UCC-1: What is an *Agricultural Lien*? (It's Probably Not What You Think)

Those familiar with the UCC-1 financing statement form will recall that near the bottom right-hand side of the form there is a check-the-box option of "agricultural lien" that can be selected by the filer. Many lenders providing production money or other credit secured by crops mistakenly select this option when preparing the financing statement for filing.

In everyday terms, one might refer to a lender's security interest as a *lien*; and thus the lender's security interest in some agricultural product—such as crops or livestock—would be an *agricultural lien*, right? No. Within the Uniform Commercial Code, *agricultural lien* is a specially defined term that does not include security interests created by agreement (i.e., a security agreement). Instead, an agricultural lien includes only liens that are created by statutory law in favor of a person who provides goods or services used in the debtor's farming operation, or provides real property used by the debtor in its farming operation. The important concept is that in order to qualify as an *agricultural lien*, the lien must have been imposed by statutory law—in other words, enacted legislation—rather than by contract with the debtor. In the ordinary situation of a lender providing production money credit secured

by crops, using a security agreement signed by the debtor, the lender does not have an "agricultural lien."

Many states do have laws that provide sellers making credit sales of seed or chemicals, or landlords of cropland, with liens on the crops of the buyer (or tenant) without necessity of any security agreement or other contract. The lien arises solely by virtue of the law (much like a materialman's lien or mechanic's lien) when the credit sale is made, or the land is rented. Such a lien is an *agricultural lien* in UCC terminology, and the lienholder can perfect its lien—and potentially gain priority over subsequent creditors—by filing a UCC-1 financing statement with respect to the lien. The lienholder should select the *agricultural lien* option at the bottom right of the UCC-1 form in order to indicate that it claims its lien by virtue of a statutorily-imposed lien, rather than by virtue of a security agreement with the debtor.

In Georgia, true agricultural liens are rarely encountered in the real estate or UCC records. Georgia law does provide statutory crop liens for certain landlords and laborers, but these lienholders rarely act to perfect their liens by financing statement filing. Instead, most financing statements filed within Georgia to indicate an *agricultural lien* are mistakenly filed by secured creditors holding a contractual security interest in crops.

Mistakenly selecting the agricultural lien option should not, at least in most cases, be a fatal defect for the financing statement. Competing creditors will be put on notice that the lender claims some sort of interest in the crop. Nonetheless, secured lenders should avoid making this mistake. It is not unforeseeable that in a priority dispute a competing creditor might argue (probably unsuccessfully, but perhaps not) that the mistake should limit the creditor to whatever lien rights it has under statutory law—which could be nothing. While the risk may be minor, there is simply no reward to justify selecting the *agricultural lien* option when the lender does not, in fact, have such a lien.

Recent Case Highlights Lender Protections from Timber Removal

A recent decision from the Court of Appeals of Georgia provided a valuable display of the protections given by Georgia law to lenders secured by land featuring standing timber—even where the lender may make some "mistakes" in administering the loan. The facts of the case (known as *AgSouth Farm Credit v. Gowen Timber Company, Inc.*) were that the lender provided a loan of approximately $2 million to the borrower, taking in exchange a security deed covering a tract of approximately 1,000 acres. The deed, which was properly recorded, required the lender's written consent for the borrower to remove any timber from the tract. However, there was evidence that the lender's loan officer told the borrower at closing that some timber harvest would be permissible so long as it was consistent with good management practices.

The borrower did later sell certain timber from the tract to a timber company, the eventual defendant in the case. The timber company did not check the deed records to determine whether any secured lender was involved, and did not require any consent document from the lender. There was evidence that the borrower subsequently informed the loan officer (who supposedly consented at closing to limited harvest) that certain "thinning" had taken place, and the loan officer approved of the thinning.

The loan officer eventually discovered that in fact approximately 80 acres had been "clear cut" of timber, without payment of the proceeds to the lender. In conjunction with an effort to renew the loan, the loan officer sent an email to the borrower's son explaining that the loan officer would try to justify the harvest to the lender's loan committee and acknowledging that the officer had given permission for the borrower to "thin" the timber at the time of closing. The lender did allow renewal of the loan.

When the loan again came up for renewal, the lender discovered that the borrower had been continuing his sale of timber to the eventual defendant. By this time, approximately 200 acres of timber had been clear-cut and sold. The lender did not agree to another renewal, and foreclosed on the real property following the borrower's default. A sizeable deficiency remained. The lender then sued the timber company to recover the value of the timber harvested from the property (approximately $420,000).

At trial, the timber company argued that the lender, through the loan officer, had given verbal permission for the borrower to sell timber. The jury agreed, finding that the timber company was not liable to the lender as the lender had consented to the timber harvest. The lender appealed the jury's decision.

On appeal, the lender argued that regardless of whether its loan officer gave verbal consent to cut timber from the property, Georgia statutory law requires a consent to be in writing in order to be effective. The statute relied upon by the lender provides that any person who cuts, removes, buys, or sells timber from property "without the written consent" of the secured lender holding title to the property as shown by deed records shall be liable to the lender for the value of the trees removed, up to the amount of the total outstanding debt. According to the lender, this statute clearly requires *written*, rather than merely *verbal*, consent.

The Court of Appeals agreed with the lender, holding that the language of the law was clear and unambiguous in requiring that a consent must be in writing to be effective. As neither the borrower nor the timber company could show the lender had given written consent to the timber harvest or sale, the timber company was liable to the lender for the trees it purchased from the borrower.

In summary, despite evidence that the lender's own officer gave verbal permission for some sort of timber sale, the lender was permitted to recover for all of the timber harvested on the basis that no consent had been given in writing. This decision is certainly a valuable tool for a lender's legal arsenal, but it should by no means be viewed as a license to make untrue or conflicting verbal representations to borrowers. If the lender does not wish for the borrower to dispose of any collateral, it must be consistent to that effect in its communications to the borrower. While the outcome was favorable to the lender in this case, in many similar scenarios a lender would be well advised to expect trouble.

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