The Lender's Source

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Bankruptcy Court: Security Deed Avoidable Where Signed, But Not Sealed, by Notary

A December 7, 2016 bankruptcy court decision permitted the bankruptcy trustee to avoid a lender's recorded security deed because, though the deed was signed by a notary public as official witness, the notary had not stamped his official *seal* on the deed.

The opinion (designated as *In re Taylor*) was issued by the U.S. Bankruptcy Court for the Middle District of Georgia, Valdosta Division. The situation giving rise to the dispute occurred in 2013, when the borrowers purchased real property in Thomasville with financing provided by the bank. On the same date, the seller delivered a warranty deed transferring the property to the borrowers; the borrowers delivered a security deed covering the property to the bank; and the borrowers delivered an additional security deed, intended to be second in priority to the bank, to the seller. All three deeds were properly signed by the respective grantors, properly signed by an unofficial witness, and signed by a notary public. However, while the notary did stamp his official seal upon the warranty deed to the borrowers and the security deed to the seller, he did not (for reasons unknown) stamp his seal on the security deed to the bank. Two days later the deeds were recorded, with the bank's security deed being recorded prior to that of the seller.

Almost three years after the purchase, the borrowers filed for Chapter 7 bankruptcy protection. The bankruptcy trustee instituted an adversary proceeding against the bank, seeking to use the "strong-arm powers" of the trustee (essentially, the trustee is treated as a bona fide purchaser of the debtors' real property as of the bankruptcy filing date) to avoid the bank's security deed. The trustee claimed that because the security deed lacked a notary seal, it was patently defective and thus ineffective against later good faith purchasers—even though the deed had been recorded.

The court began its analysis by noting that, in order to be valid under Georgia law, a security deed must be attested by a notary public or other designated official. Attestation is considered a *notarial act*, and Georgia law requires that a notary authenticate all notarial acts by affixing his seal of office. As no official seal was stamped on the deed, the court reasoned, the notary's act of signing as witness to the grantor's signature was not a valid notarial act of attestation.

Continuing its analysis, the court repeated the now-settled concept that a security deed lacking an attestation is ineffective to provide constructive notice to later purchasers, even where the security deed has been recorded and indexed. As the bank's security deed was not validly attested at any time, and as the trustee had the status of a bona fide purchaser of the property as of the bankruptcy filing, the bank lost its rights in the property as a result of the borrowers' bankruptcy filing.

Internal Payoff Discrepancies Vex Lenders in Recent Appellate Decisions

In two separate decisions recently issued by the Court of Appeals of Georgia, trial court judgments in favor of lenders were reversed due to discrepancies in the lenders' own payoff evidence having been presented to the trial court.

In the earlier of the two opinions (*Ray Mashburn Homes v. CharterBank*), issued November 16, the bank had obtained a judgment against the borrower upon a promissory note that bore interest at the bank's own internal prime rate. This rate was not linked to any external benchmark, and was changed by the bank from time to time.

The bank sued the borrower following default, and presented the following evidence to obtain summary judgment: an affidavit from the bank's CFO detailing all changes to the bank's prime rate during the life of the loan; bank executive committee notes detailing changes to the bank's prime rate; and a detailed payoff spreadsheet showing principal, interest, payments, and fees for the life of the loan. The trial court granted judgment to the bank for

the amount shown owing in the payoff calculation. The borrowers appealed, arguing that the bank was not entitled to judgment as the bank's own evidence showed a discrepancy as to the interest accrued upon the loan.

On appeal, the Court of Appeals agreed with the borrower and reversed the judgment. The court found that while the payoff calculation spreadsheet and executive committee notes presented by the bank showed a particular increase in the prime rate in *January* of 2009, the affidavit of the bank's CFO stated that this increase had occurred in *February* of 2009. Though this was a seemingly small discrepancy, it affected all calculations for the years thereafter. This uncertainty as to the final balance owing meant the bank was not entitled to summary judgment in its favor.

In the later of the two decisions (*Vance v. FD 2011-C1 Grove Road LP*), dated December 29, 2016, the Court of Appeals again overturned summary judgment in favor of a lender on the basis of a discrepancy in the lender's payoff evidence. The lender had filed suit against the defendants to recover a deficiency remaining following foreclosure on real property securing a loan.

In order to obtain judgment, the lender presented an affidavit of its servicing representative. The defendants presented no contrary evidence. The lender's affidavit stated the balance owing as of a particular date; stated that no payments had been made to the lender following foreclosure; and attached a copy of the bank's payment history for the life of the loan and the bank's payoff statement for the loan as of the particular date in issue.

Problematically, the affidavit and its attachments were not consistent. While the payoff statement attached to the affidavit was consistent with the amounts stated as owing in the affidavit, the payment history was not. The payment history showed a smaller amount owing as of the date in issue, and further showed regular payments applied to the loan *after* foreclosure and various "unapplied" credits and payments issued in relation to the loan.

The Court of Appeals held the lender bore the burden of proving the specific amount owing by the defendants, and as a result of inconsistencies in the lender's own evidence, it failed to meet the burden. If there was an explanation for the inconsistencies, the lender was required to provide it before obtaining judgment. The lender made no attempt to do so, leaving uncertainty as to the balance owing; thus the judgment in favor of the lender was reversed.

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. The firm has attorneys licensed to practice in Georgia, Florida, Alabama, South Carolina, and Tennessee. Please contact us to see how we can help.

Supreme Court to Review *York v. RES-GA* Opinion on Confirmation Waiver

The Supreme Court of Georgia recently granted certiorari to review whether the Court of Appeals correctly decided the case of *York v. RES-GA LJY* in March of 2016.

The Court of Appeals' decision, discussed in an earlier edition of this newsletter, held that a guarantor effectively waived Georgia's post-foreclosure confirmation protections by virtue of a provision in the guaranty agreement waiving all defenses "based on suretyship" expressly including "anti-deficiency" laws. The Court reasoned that confirmation requirements could only apply to the guarantor based on his status as guarantor (surety)—he was not a primary obligor on the loan. As the confirmation defense was "based on" the defendant's status as surety, and as the guaranty agreement waived all defenses based on suretyship, the court held the guaranty was effective to waive confirmation protections. The court disagreed with the defendant's argument that the language was not sufficiently clear to support an effective waiver.

The Supreme Court's grant of certiorari will allow it to review, and potentially reverse, the Court of Appeals' decision. Certiorari is not granted automatically, but instead only where the court finds the issue to be "of gravity or great public importance."

Understanding the UCC-1: Where to File

Georgia procedures for UCC-1 financing statement filing differ from most states in that there is no statewide central filing office. In most states, a single office (usually the secretary of state) is used for all non-realty related financing statement filings. Georgia utilizes a statewide searchable central index for financing statements (maintained by the Georgia Superior Court Clerks Cooperative Authority), but filing itself is done at the county level. Each of Georgia's 159 Clerks of Superior Court is an "office" for UCC-1 filing, with filings transmitted by each Clerk for addition to the central index.

The use of 159 separate filing locations may make Georgia's system appear much more complex than those of other states using a single central filing office. In practice, it adds little difficulty.

When filing a financing statement, which of the 159 county Clerks of Superior Court should be used? The answer depends on the type of collateral involved and, potentially, the state in which the debtor is "located." If the collateral is growing crops, standing timber to be cut, minerals to be extracted, or fixtures (e.g., irrigation pivots, affixed appliances, or other equipment attached in a permanent or semi-permanent manner to realty), the filing must be done in the *real property records* of the Clerk of Superior Court for the county where the *collateral* is located.

If the collateral at issue is not growing crops, standing timber, minerals, or fixtures, the lender must determine the *state* where the debtor is "located" according to UCC standards. This sometimes-overlooked step is crucial, as the financing statement must be filed in the state where the debtor is located—and determining the proper state of location is not merely a matter of common sense.

Most importantly, a corporation, limited liability company, or other registered organization is located *only* in the state where it was organized. In other words, for example, a corporation organized under Delaware law is "located" only in Delaware even if it only conducts operations in Georgia. A financing statement covering equipment or inventory collateral in our example would need to be filed in Delaware, even if the collateral itself, as well as all production facilities of the debtor, are located exclusively in Georgia.

An individual debtor, even if doing business using a trade name, is located only in the state where the debtor primarily resides (as compared to where he operates his business). An unregistered partnership or organization is located in the state where its business facility is located, or if it has facilities in multiple states, only in the state where the unregistered organization's chief executive office is located. Again, filing must be completed in the debtor's state of location.

If the debtor is located in Georgia, and if the collateral is not growing crops, standing timber, minerals to be extracted, or fixtures, the lender can file its financing statement in the office of *any* of the State's 159 Clerks of Superior Court. It is *not* necessary to file in the county where the debtor is located, or in the county where the collateral is located; nor is it necessary to file in multiple counties within the state.

Assume, for example, that SportsCo is a Georgia corporation with its registered office in Fulton County. The corporation has retail stores in Bibb, Houston, and Lowndes Counties. Bank, located in Tift County, provides a loan to SportsCo secured by all inventory. If Bank files a properly completed financing statement with the Clerk of Superior Court of Tift County, will it be perfected? Yes. Bank can file in any one of Georgia's 159 counties. It does not matter that the debtor has no connection to Tift County, or that its registered office is located in Fulton County. Further, a single filing is sufficient despite the fact the collateral is housed in multiple counties.

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The hiring of a lawyer is an important decision that should be based upon a thorough assessment of the attorney's levels of skill and experience. Before you decide, ask us to send you free written information regarding our firm's qualifications.