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LEGAL ALERT

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Holder of Deed Need Not Be Holder of Note to Foreclose, Georgia Supreme Court Rules

The Georgia Supreme Court held this week that the holder of a security deed need not also hold the underlying note to exercise the power of sale in accordance with the terms of the security deed. *You v. JP Morgan Chase Bank, N.A.*, 2013 WL 2152562 (Ga. Sup. Ct. May 20, 2013). The decision is linked here.

In *You*, the borrowers financed the purchase of a home with a mortgage from Excel Home Loans, Inc., executing a promissory note and security deed in favor of Excel. After the initial transaction, the note was assigned to an "unidentified entity," and the security deed was assigned to Chase Manhattan Mortgage Corporation, which, after a series of mergers, was succeeded by JPMorgan Chase Bank. The assignment of the deed explicitly granted the assignee the right to exercise all "power, options, privileges and immunities" in the security deed. In residential mortgage securitization arrangements, such assignments, split from the note, are commonplace.

The borrowers ultimately defaulted under the note, and Chase initiated non-judicial foreclosure proceedings by sending them written notice that the property would be sold at a foreclosure auction. Chase was the highest bidder at the auction. After executing a deed under power conveying the property to itself, Chase quitclaimed the property to Fannie Mae, which, pursuant to the quitclaim deed, commenced dispossessory proceedings against the borrowers in Gwinnett County Magistrate Court. The magistrate court issued a writ of possession, and the borrowers filed an action in Gwinnett County Superior Court against Chase and Fannie Mae for declaratory relief, wrongful foreclosure, and wrongful eviction. Chase and Fannie Mae removed the case to the United States District Court for the Northern District of Georgia on the basis of diversity jurisdiction and moved to dismiss the borrowers' complaint for failure to state a claim. The district court dismissed the borrowers' claim for declaratory relief because they failed to tender the amount due under the loan, relying on the well-established rule under Georgia law that "[h]e who would have equity must do equity." O.C.G.A. § 23-1-10; *You v. JPMorgan Chase Bank, N.A.*, No. 1:12-cv-202-JEC-AJB, 2012 WL 3904363, at *2 (N.D. Ga. Sept. 7, 2012).

On the wrongful foreclosure and eviction counts, the borrowers argued that Chase was not entitled to foreclose because it held only the security deed and not the note—the so-called "note-splitting" argument. Specifically, the borrowers argued that, to be a "secured creditor" entitled to foreclose under Georgia law, the foreclosing entity must hold both the security deed (*i.e.*, be secured) and the note (*i.e.*, be a creditor). The borrowers also argued that the notice they received from Chase failed to comply with O.C.G.A. § 44-14-162.2 because it did not identify Chase as the secured creditor. Surveying Georgia law on the meaning of "secured creditor," the district court recognized a "split of authority" in the Northern District on whether the holder of a security deed must also hold the note to foreclose. The district court therefore certified the following question to the Georgia Supreme Court:

> Can the holder of a security deed be considered a secured creditor, such that the deed holder can initiate foreclosure proceedings on residential property even if it does not also hold the note or otherwise have any beneficial interest in the debt obligation underlying the deed?

The Georgia Supreme Court answered the question in the affirmative. *You*, 2013 WL 2152562 at *2. Non-judicial foreclosure is governed primarily by contract law, the Court observed, and the "scant" statutory law that does apply to such foreclosures concerns the "the manner and content of notice that must be given to a debtor in default prior to the conduct of a foreclosure sale." *Id.* The plain language of these statutes, O.C.G.A. § 44-14-160 through O.C.G.A. § 44-14-162.4, does not specify whether the foreclosing entity must also hold the note. *Id.* at *3. The term "secured creditor," which is left undefined in the statutes, was introduced with the 1981 amendments requiring notice to debtors before conducting a foreclosure. At that time, the Court noted, Georgia common law "appears to have allowed for the possibility of a non-judicial foreclosure conducted by one who held legal title to the property but not the underlying note." *Id.* The Court cited, as examples, *White v. First National Bank of Claxton*, 162 S.E. 701 (Ga. 1932), which affirmed the validity of a non-judicial foreclosure sale conducted by a party who held title to the property, but not the note, and *Shumate v. McLendon*, 40 S.E. 10 (Ga. 1904), which recognized that a debt secured by a security deed may be transferred without transferring title to the property. Leaving the term undefined with its introduction in 1981, the legislature did not intend to make any changes in existing law then, or in 2008, when amendments were enacted in direct response to the foreclosure crisis.

The district court also found uncertainty on the notice requirement. In *Reese v. Provident Funding Associates, LLP*, the Georgia Court of Appeals, in a closely divided opinion, held that the foreclosure notice must identify the name of the secured creditor. 730 S.E.2d 551, 553-54 (Ga. Ct. App. 2012). Although Chase's notice to the borrowers did state that Chase was the entity with "full power to negotiate, amend and modify all terms of the mortgage with the debtor," and, as the district court noted, "the only realistic candidate for the role of secured creditor is defendant Chase," the notice did not *expressly* state that Chase was the secured creditor. *You v. JPMorgan Chase Bank, N.A.*, No. 1:12-cv-202-JEC-AJB, 2012 WL 3904363, at *8 (N.D. Ga. Sept. 7, 2012). In the absence of any briefing on substantial compliance, the district court certified the following question to the Georgia Supreme Court:

> Does O.C.G.A. § 44-14-162.2(a) require that the secured creditor be identified in the notice described by that statute?

In answering "no," the Court cited the statute's plain language, which requires that the notice to the debtor "include the name, address and telephone number of the individual or entity who shall have full authority to negotiate, amend, and modify all terms of the mortgage with the debtor." O.C.G.A. § 44-14-162.2(a). The Court reasoned that the "individual" or "entity" could be the note holder or the security deed holder.

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