

Dude, Where's My Note?

*UPDATE: On February 7, 2017, in an **unpublished** decision, [In re Foreclosure of Iannucci](#), the NC Court of Appeals upheld the trial court's reliance on a lost note affidavit as competent evidence to support the court's findings of fact and, in turn, the conclusion of law that the lender is the holder of a valid debt. In the opinion, the court did not directly address the jurisdictional issues raised in question two below. However, the superior court makes the same inquiry on appeal de novo from the clerk as the clerk does in the first instance in a power of sale foreclosure. See [In re Foreclosure of Lucks](#), ___ NC ___ (Dec. 21, 2016). By finding that the superior court appropriately relied on a lost note affidavit, a similar finding would likely apply to the jurisdictional authority of the clerk to rely on a lost note affidavit. Because the court's decision is unpublished, it does not constitute controlling legal authority, but is some indication of how a court may decide a similar issue on appeal in the future.*

*UPDATE #2: On October 2, 2018 in a **published** opinion, the NC Court of Appeals upheld an order authorizing sale entered in a non-judicial foreclosure where the person seeking to enforce the note lost the original note. The court of appeals based the decision on the conclusion that the mortgagee presented evidence to satisfy the requirements of G.S. 25-3-309 of the NC Uniform Commercial Code. You can reach the decision, [In re Foreclosure of Frucella](#), [here](#).*

Imagine this scenario: A borrower defaults on a loan and the lender notices the default and gives the borrower an opportunity to cure it. The borrower is unable to remedy the default and the lender engages a trustee and begins to gather the loan documents to proceed with a foreclosure action. In the process of going through the loan file, the lender realizes that the original note is missing and the lender is not able to locate a copy of the note.

May the lender still proceed with the foreclosure?

Yes, the lender may proceed with the foreclosure. [G.S. 25-3-309](#) states that a person (as defined in [G.S. 25-1-201\(b\)\(27\)](#) and including individuals, business, and other legal entities) not in possession of a note is entitled to enforce it if:

1. The person was in possession of the instrument and entitled to enforce it when the loss of possession occurred, and
2. The loss of possession was not due to transfer by the person or a lawful seizure, and
3. The person is not reasonably able to obtain possession of the instrument because the instrument was destroyed, it is lost, or it is in the wrongful possession of an unknown person or a person that cannot be found or served with process.

Typically, the lender seeking to foreclose submits an affidavit or testimony to the court that attests to the occurrence of the events described above along with the terms of the note. [G.S. 25-3-309 \(b\)](#). If there is sufficient proof of these events as well as the terms of the note, then the person

seeking enforcement is entitled to the rights set forth in [G.S. 25-3-308](#) (regarding (i) proof of signatures, and (ii) payment) as if the person had produced the note. *Id.*

What type of foreclosure may the lender file – a judicial foreclosure before a superior court judge or a power of sale foreclosure before the clerk of superior court?

The answer to this question isn't quite as easy as the first. Based on a plain language reading of Chapter 45, the clerk does not have jurisdiction to hear a foreclosure case involving a lost, stolen, or destroyed note.

The clerk's jurisdiction in the context of a power of sale foreclosure is limited. [In re Vogler Realty, Inc., 365 N.C. 389, 395 \(2012\)](#). The clerk cannot perform functions involving the exercise of judicial discretion in the absence of statutory authority. *Id.* Under Chapter 45, the clerk may not enter an order authorizing sale unless the clerk finds competent evidence of six factors. [G.S. 45-21.16\(d\)](#). One of these factors includes finding that the party seeking to foreclose is the **holder** of a valid debt. [G.S. 45-21.16\(d\)\(i\)](#).

The North Carolina Supreme Court has stated that the term "holder" as used in GS 45-21.16 is defined by the UCC. [In re Bass, 366 N.C. 464, 468 \(2013\)](#). To be a holder under the UCC, a person must meet two criteria: (1) they must be in possession of a note, and (2) the note must be payable to that person or to bearer, either originally or through subsequent [indorsements](#). [G.S. 25-1-201\(b\)\(21\)\(a\)](#).

In contrast, a person seeking to enforce a lost, stolen, or destroyed note must attest that they do *not* have possession of the note. [G.S. 25-3-309\(a\)](#). Furthermore, the UCC as set forth in Chapter 25 sets forth a list of persons "entitled to enforce" the note, by foreclosure or otherwise. [G.S. 25-3-301](#). They include:

1. The holder of the note
2. A nonholder in possession of the note who has the rights of a holder
3. A person not in possession of the note who is entitled to enforce a lost, stolen or destroyed note pursuant to G.S. 25-3-309
4. A person not in possession of note who is entitled to enforce the note pursuant to GS 25-3-418(d)

[G.S. 25-3-301](#). As is evident from the foregoing list, a holder of the note under the UCC is not the same as a person who seeks to enforce a lost, stolen or destroyed note. [G.S. 35-3-301](#). Given that Chapter 45 limits the clerk's authority to enter an order to those cases where the clerk finds that the party seeking to foreclose is the holder, the clerk does not have clear authority under Chapter 45 to enter an order for sale when a person other than a holder seeks an order from the clerk, including a person entitled to enforce a lost, stolen, or destroyed note under G.S. 25-3-301.

The disconnect between Chapter 25 and Chapter 45 may be a result of amendments to Chapter 25 that were not reflected in Chapter 45. In 1995, the legislature replaced the former and more limited G.S. 25-3-301 entitled “rights of a holder” with the more expansive “persons entitled to enforce the instrument” to reflect that the enforcement of notes is not limited to holders and includes other persons and cases such as when the note is lost. [G.S. 25-3-301, cmt. 1](#). However, a similar change has not been made to Chapter 45 to expand the clerk’s jurisdiction to include other persons entitled to enforce the note in addition to the holder.

It is more expensive and time-consuming for a lender to have to pursue a judicial foreclosure where the note is lost, stolen, or destroyed. This is a cost that is most frequently passed on to a borrower as part of the terms of the loan. Some may point out that it goes against the spirit of Chapter 45 to require a lender to pursue a judicial foreclosure where a person may not be a holder, but they are entitled to enforce the note. In one unpublished decision, the NC Court of Appeals applied the statute regarding lost, stolen, or destroyed notes in the context of a power of sale foreclosure. [In re Carter, 198 N.C. App. 702 \(2009\) \(unpublished\)](#). The court did not expressly address the limitation in Chapter 45 on the clerk’s authority to enter an order only when the holder seeks to foreclose. *Id.* Ultimately, the court found that the affidavit submitted by the lender was insufficient to prove the terms of the instrument and affirmed the trial court’s dismissal of the action. *Id.* The case does leave open some question as to whether the court could see things differently and expand the definition of holder to include other persons entitled to enforce the note under the UCC. To do that, the court would first have to contend with the current language of Chapter 45 and other case law from the NC Supreme Court limiting the definition of holder to a person in possession of the note.

What are your thoughts? Please share them below.