# New Legislation Applicable to Attorneys Serving as Trustees in Chapter 45 Foreclosures

A trustee in a power of sale foreclosure has a fiduciary duty to both the debtor and the creditor. In re Foreclosure of Vogler Realty, Inc., 365 N.C. 389, 397 (2012). The trustee must be impartial in the performance of his or her duties as a disinterested third party and may not give an unfair advantage to one party to the detriment of the other. *Id.* *See also* In re Foreclosure by Goddard & Peterson, PLLC, 789 S.E.2d 835, 841 (2016); In re Foreclosure of Real Property for $143,600.00, 156 N.C. App. 477, 483 (2003). This duty is recognized in G.S. Chapter 45, which requires that the notice of hearing include a statement that the trustee is a neutral party and, while holding that position, may not advocate for the creditor or the debtor in the foreclosure proceeding. G.S. 45-21.16(c)(7)(b).

A trustee may be held liable for breach of fiduciary duty through a civil action brought in district or superior court. *See* Goddard, 789 S.E.2d at 841. If the trustee is an attorney or represented by an attorney, then the attorney also may be subject to sanctions by the N.C. State Bar for violating the N.C. Rules of Professional Conduct. This includes Rule 1.7(a) which prohibits the common representation of multiple clients if the representation involves a concurrent conflict of interest. A number of ethics opinions drafted by the Ethics Committee of the State Bar provide guidance to an attorney serving as or representing a trustee in a power of sale foreclosure. *See* CPR 94; CPR 166; CPR 201; CPR 220; CPR 297; CPR 305; RPC 3; RPC 64; RPC 82; RPC 90; 2004 FEO 3; 2008 FEO 11; 2011 FEO 5; 2013 FEO 5; and 2014 FEO 2.

A new law, Session Law 2017-206, went into effect on August 30, 2017 codifies a number of these opinions. The law contains a modification and addition to G.S. Chapter 45-10 and directly applies to those situations in foreclosure proceedings where an attorney is serving as the trustee. This post will give some preliminary thoughts on the new law as well as briefly discuss some of the related ethics opinions. For a more detailed review and application to a particular case in your practice, I would recommend reviewing the full ethics opinions cited herein.

### A. Key Provisions of Revised G.S. 45-10 Related to the Attorney Serving as Trustee

The key modifications of G.S. 45-10 in S.L. 2017-206 related to foreclosures are as follows:

1. **An attorney who serves as trustee or substitute trustee shall not represent either the noteholder* or the interests of the borrower while initiating a foreclosure proceeding. G.S. 45-10(a).**

This means that an attorney may not do two things at once – both serve as trustee and represent either the noteholder, commonly referred to as the lender, or the borrower at the same time when

initiating a foreclosure proceeding. This language appears to be adopted from a series of ethics opinions from the State Bar that draw the same conclusion. *See* CPR 166; RPC 82; RPC 90; 2004 FEO 3 ("[A] lawyer who serves as a trustee must be neutral as between the interests of the lender and the interests of the borrower and may not, therefore, represent either party individually while initiating a foreclosure proceeding").

In CPR 166, the N.C. State Bar Ethics Committee notes that the trustee as a fiduciary represents the interests of both the lender and the borrower and would violate his or her fiduciary duty to also be the attorney-advocate for either party at any stage of the foreclosure proceeding while serving as trustee. In another opinion, RPC 90, the Ethics Committee notes that this restriction precludes representation of the lender by the attorney serving as trustee in the negotiation of a loan modification related to the deed of trust, even if the negotiation is amicable and no foreclosure proceeding has been initiated. However, the attorney/trustee may draft and preside over the execution of documents evidencing the agreement negotiated between the lender and the borrower. RPC 90. Finally, if an attorney is serving as trustee and is unable to ethically represent either party in an advocacy role, then no member of the attorney's law firm may represent the lender in the foreclosure proceeding or matters related to the foreclosure. CPR 220.

The Ethics Committee has noted that this restriction does not ethically prohibit the attorney/trustee from presenting evidence at the hearing on behalf of the lender necessary to support the clerk's findings essential to a foreclosure order ***if*** the matter is uncontested. CPR 166. However, if the matter becomes contested, then the trustee must assume a neutral posture consistent with the trustee's fiduciary duty. *Id.* A matter becomes contested according to the Ethics Committee when anyone with standing, including the borrower, contests jurisdiction or any one of the six statutory elements under G.S. 45-21.16(d) the clerk is charged with finding to authorize the sale. 2008 FEO 11. The same opinion notes that a matter does not become contested if the borrower or the trustee simply requests a continuance or makes a request to postpone the sale. *Id.*

A frequent question raised is whether an attorney may serve as trustee where, prior to serving as trustee, the attorney sent a demand letter on behalf of the lender or otherwise represented lender in connection with the loan that is the subject of the foreclosure. The Ethics Committee has given guidance on this question and provides that prior representation of the lender does not ethically prohibit the attorney from serving as trustee, provided that the attorney does not also represent the lender in the foreclosure or related proceedings. RPC 3. This includes if the attorney previously represented the lender in negotiating and closing the original loan that is the subject of the foreclosure provided the attorney terminates representation of the lender on all matters related to the foreclosure proceeding. *Id.*

2. **An attorney may serve as the trustee in a foreclosure proceeding while simultaneously representing the noteholders on unrelated matters and others within the attorney's firm may also continue to represent the noteholders on unrelated matters. G.S. 45-10(a).**

While an attorney may not serve as trustee and at the same time represent the noteholder in the foreclosure or matters related to the foreclosure, the attorney/trustee and other attorneys in the same firm may represent the noteholder on other matters unrelated to the foreclosure. This new provision inserted in G.S. 45-10(a) appears to be a codification of 2008 FEO 11. *See also* RPC 3. In that opinion, the Ethics Committee addressed the following (paraphrased) question:

Attorney A is employed by a law firm. The firm's biggest client is Bank Z. All of the lawyer's in the firm perform some work for Bank Z. May the attorney ethically serve as trustee in the foreclosure of a deed of trust securing a loan made by Bank Z while the attorney and others in the firm continue to represent Bank Z on unrelated matters?

The Ethics Committee opined that it is possible for the attorney to ethically serve as trustee under those circumstances provided that the attorney determines he can protect the interests of the bank in unrelated matters and maintain impartiality in the foreclosure proceeding. 2008 FEO 11. However, while serving as trustee, the attorney and the other attorneys in the firm could not represent the bank on matters related to the loan with the borrower, including filing a motion for relief from stay in a related bankruptcy proceeding. CPR 305.

3. **An attorney who initiates a foreclosure as trustee may resign as trustee after the foreclosure becomes contested and act as counsel to the noteholders. G.S. 45-10(a).**

It is clear based on the revised G.S. 45-10 and ethics opinions that an attorney may not serve as trustee in a foreclosure proceeding and at the same time represent the noteholder or borrower in a contested foreclosure proceeding. However, G.S. 45-10(a) makes clear that if the foreclosure is initiated by an attorney serving as trustee and the proceeding later becomes contested, the attorney may resign as trustee and subsequently appear as attorney for the noteholder in the proceeding. This appears to codify ethics opinions CPR 201, RPC 82, and RPC 90, which generally state that former service as trustee does not preclude an attorney from resigning and assuming a partisan role in all further proceedings related to the foreclosure. Note, the new trustee must be substituted by execution of a written document properly recorded pursuant to G.S Chapter 47. G.S. 45-10(a).

**B. Attorney Does Not Serve as Trustee but Represents the Trustee**

The revisions to G.S. 45-10 apply to those situations where the attorney is serving as trustee in a power of sale foreclosure. This new law does not directly address where an attorney represents an entity or individual who serves as trustee. However, the same ethical rules apply to an attorney where the attorney represents the trustee. The Ethics Committee has addressed a number of scenarios involving representation of the trustee by an attorney and has stated:

1. An attorney may not ethically represent the lender in an adversarial proceeding related to the deed of trust where the trustee is a corporation that is controlled by or the alter ego of

the attorney for the lender. *See* RPC 82.
2. An attorney may not represent the lender and a corporate trustee in the same foreclosure proceeding, regardless of whether the attorney or the attorney's firm has ties to the corporation. *See* 2008 FEO 11; 2014 FEO 2.
3. An attorney is precluded from representing the lender in a foreclosure where the attorney's spouse, relative, or employee is serving as trustee or owns an interest in the closely-held corporate trustee. *See* RPC 82; 2011 FEO 5.

**C. Remedy for a Violation of G.S. 45-10(a) – What May the Clerk Do?**

Many of these provisions frequently cause confusion with borrowers appearing in foreclosure proceedings before the clerk. Prior to the initiation of the foreclosure proceeding, the borrower may have received communications from the attorney asserting that the attorney represents the lender. The attorney is subsequently substituted in as trustee and appears at the hearing as a neutral party with a fiduciary duty to both the borrower and the lender. However, G.S. 45-10(a) and the ethics opinions from the State Bar make clear that these actions on their face are not prohibited. This is true as long as the attorney is not serving as trustee and advocating for the lender on matters related to the foreclosure at the same time and the attorney can maintain his or her impartiality when later serving as trustee.

If an attorney/trustee appears at a contested hearing before the clerk and advocates for the lender, the revised G.S. 45-10 does not give authority to the clerk to take action in response to a violation of the statute. The borrower may have a separate cause of action in civil court for breach of fiduciary duty against the trustee or could file a complaint against the attorney with the State Bar. Vogler Realty, 365 N.C. at 397 (2012).

If an attorney appearing before the clerk is acting in contradiction to the statute or an ethical rule, it is appropriate for the clerk to caution the attorney and remind the attorney of the trustee's fiduciary duty. If the attorney persists with the conduct in light of the clerk's warning or concerns, the clerk may contact the State Bar with the parties to the proceeding for guidance as to the appropriateness of the attorney's continued service as trustee or representation of a party to the proceeding. This is always an option for a clerk presiding over a hearing where the clerk has concerns or questions about the ethical propriety of an attorney's conduct.

What are your thoughts about this new law and the role of the trustee in these proceedings? What are you seeing in practice? Feel free to leave comments below.

* Noteholder is defined in a new subsection (d) to G.S. 45-10 as "the holders or owners of a majority in the amount of the indebtedness, notes, bonds, or other instruments evidencing a

promise to pay money and secured by" instruments creating a lien on property, such as a deed of trust.  A noteholder is commonly referred to as the creditor or lender.