SENATE BILL 2223
CREATION OF CH. 35-03, N.D.C.C.
DEED IN LIEU OF FORECLOSURE

SB 2223 proposes the creation and enactment of a new section to chapter 35-03 of the North Dakota Century Code, relating to a deed in lieu of foreclosure. It reads:

> If a deed in lieu of foreclosure is granted by a mortgagor to discharge a mortgage obligation to a mortgagee, the title to the real property that is the subject of the deed in lieu of foreclosure may not be transferred to the mortgagee until a judgment of foreclosure is entered, regardless of whether the deed in lieu of foreclosure was delivered to the mortgagee and recorded in the office of the recorder by the mortgagee before the judgment of foreclosure was entered.

There are several issues with this proposed statute, fully described herein.

ISSUE #1. THE PURPOSE OF A DEED IN LIEU OF FORECLOSURE IS TO AVOID A JUDICIAL FORECLOSURE ACTION; THIS BILL REQUIRES A JUDGMENT IN ALL CASES, MEANING IT REQUIRES AN ACTION.

A deed in lieu of foreclosure is an offer by the mortgagor to deed the property to the mortgagee "in lieu of" – or instead of – the mortgagee commencing a foreclosure action against the mortgagor.[1] As with any other deed, the property is ordinarily conveyed upon delivery of the deed by the grantor/mortgagor and acceptance by the grantee/mortgagee.[2]

The bill is contrary to this entire notion. It prohibits the transfer of title prior to a judgment of foreclosure being entered. To have a judgement of foreclosure entered, the mortgagee will need to bring an action in district court for the foreclosure of the mortgage under Ch. 32-19, N.D.C.C. In other words, even where a mortgagor offers to deed the property to the mortgagee in lieu of a foreclosure action, the mortgagee will be forced to commence a foreclosure action in order to have the title actually transferred. This makes the concept of a "deed in lieu of foreclosure" moot.

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[1] *See CUNA Mortg. v. Aafedt*, 459 N.W.2d 801, 802 (N.D. 1990) (referring to the mortgagor's offer "to deed the properties back to [mortgagee] in lieu of the foreclosure actions"); *Volk v. Wisconsin Mortg. Assur. Co.*, 474 N.W.2d 40, 42 (N.D. 1991) (referring to mortgagor's offer to give the mortgagee "a quitclaim deed to the property in lieu of a foreclosure action"). *See further In re Anderson*, No. 95-15419-SSM, 1997 WL 1102027, at *6 (Banker. E.D. Va. Aug. 29, 1997) ("As its name implies, a deed in lieu of foreclosure is a voluntary deed conveying mortgaged property to the secured party as an alternative to the proceedings that would otherwise be required under applicable state law to foreclose the owner's equity of redemption.").

[2] *See CUNA Mortg.*, 459 N.W.2d at 803-04 ("Under North Dakota law, conveyance by deed takes effect upon delivery of the deed by the grantor...[I]t is well settled that 'acceptance by the grantee is an essential part of a delivery.").

ISSUE #2. THE POLICY BEHIND THIS BILL IS UNCLEAR: BORROWERS OPT FOR DEEDS IN LIEU OF FORECLOSURE TO AVOID THE TIME, EXPENSE, AND HUMILIATION OF A FORECLOSURE ACTION.

As stated in Issue #1, the bill will require a judgment of foreclosure (and attendant foreclosure action) in every case. A judicial foreclosure action has several time delays involved. For instance, a Notice Before Foreclosure must be served on the mortgagor at least 30 days before an action may even be commenced. Even if the mortgagor/defendant agrees that the mortgagee should have the right to foreclose, it will have 21 days to answer and the mortgagee will need to comply with other timelines required of a default judgment or summary judgment. Thus, obtaining a judgment of foreclosure will take an exorbitant amount of time even where it is clearly the intent that the mortgagee obtain title to the property upon transfer and recordation of the deed.

Deeds in lieu not only "alleviate a burden on the courts but…spare [the mortgagor] the adverse publicity which accompanies a foreclosure action."[3]A mortgagor will no longer be able to avoid having a judgment docketed against him or her (which is a matter of public record). If publication of the sale is required (*see* Issue #3), this will add to further public humiliation.

Overall, it is unclear what the overarching policy concern is that justifies the curtailing or elimination of a significant option for borrowers who seek to avoid mortgage foreclosure actions. Courts have repeatedly upheld deeds in lieu of foreclosure as fair, "especially…where a sophisticated commercial borrower is involved, where there is no disparity in bargaining power and negotiating strength, where the borrower is represented by knowledgeable counsel, where there is an acknowledged loan default, where there is little or no equity in the mortgaged property, and where there is actual and meaningful consideration for the deed in lieu of foreclosure such as a forbearance agreement or a release of personal liability."[4] Deeds in lieu further "valid policy considerations...including out-of-court settlements of disputed matters and avoidance of the time and expense (and publicity) of protracted and contested foreclosure and bankruptcy proceedings."[5]

ISSUE #3. A JUDGMENT OF FORECLOSURE REQUIRES THE SHERIFF TO SELL THE PROPERTY TO SATISFY THE DEBT; TITLE IS NOT TRANSFERRED UNTIL AFTER THE REDEMPTION PERIOD.

SB 2223 says that title to the real property may not be transferred to the mortgagee until a judgment of foreclosure is entered. A judgment of foreclosure directs the sheriff to sell the property, not that the title of the property be transferred from the mortgagor to the mortgagee.[6] Thus, it does not make sense that the title would not be transferred until a judgment of foreclosure has been entered.

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[3] *CUNA Mortg.*, 459 N.W.2d at 804; *see also Volk*, 474 N.W.2d at 42 (stating that the mortgagor offered the deed in lieu so he "wouldn't have to go through the embarrassment and suffer the damage which a foreclosure action would cause").

[4] *See In re Greene*, No. 06-33611-KRH, 2007 WL 1309047, at *5 (Bankr. E.D. Va. May 3, 2007).

[5] *Id.*

[6] *See* N.D.C.C. § 32-19-06 (In any action for the foreclosure of a real estate mortgage, the court shall render judgment for the amount found to be due and the costs of the action, and shall order a sale of the premises to pay the amount adjudged to be

Furthermore, the sheriff's sale directed by a judgment of foreclosure must be set up in accordance with N.D.C.C. § 28-23-04, which requires that a Notice of Sale be published for 3 weeks in the county newspaper. At the sale, anyone can bid on the property; not just the mortgagee. Following the sale, the owner of the property generally has 60 days to "redeem" or buy back the property (depending upon whether the property is agricultural or non-agricultural land). The transfer of title does not occur until the redemption period has expired and the Sheriff's Deed is recorded.

The bill does not make it clear what is to happen after the judgment of foreclosure is entered – does this mean that a recorded deed in lieu is automatically "effective"? Or must the usual requirements – publication, sale, and redemption – be followed? If they are still required, would the statute giving the mortgagor the right to possession of and rents/income from the property during the redemption period still apply? If so, this is also contrary to the concept of a deed in lieu; one of the reasons a mortgagee takes a deed in lieu is to obtain possession of the property to control and safeguard it, even if the mortgagee still has to foreclose junior encumbrancers. Would the mortgagor be entitled to possession even if marketable title does not transfer without the foreclosure action?

ISSUE #4. IT IS UNCLEAR WHETHER THE LAST PORTION OF THE PROPOSED STATUTE IS MEANT TO GIVE THE STATUTE RETROACTIVE EFFECT.

Notice that the statute prohibits the transfer of title <u>regardless of whether the deed in lieu of foreclosure was delivered to the mortgagee and recorded in the office of the recorder by the mortgagee before the judgment of foreclosure was entered</u>.

Is this language meant to make this retroactive? There is serious concern with how this is meant to affect deeds in lieu of foreclosure already on record with the county recorder, especially if meant to require that actions need to be commenced for all of said deeds in lieu for all time.

One problem would be that a "deed in lieu of foreclosure" is a concept, not a formal type of deed. There may be deeds in lieu of foreclosure on file with the county recorder designated "quitclaim" or "warranty" deeds, making it impossible to tell which deeds require actions for the transfer of title.

It is also unclear whether pending sales or mortgage transactions with deeds in lieu in the chain of title now require a foreclosure before marketable title can be conveyed; or whether property with a deed in lieu in the chain of title would be unmarketable. Further, what would the remedy be for a property owner whose title is now unmarketable – a foreclosure action or quiet title action? There are a lot of unanswered questions that arise from this proposal.

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due…The judgment must provide that during the redemption period the debtor or owner of the premises is entitled to possession, rents, use, and benefit of the real property sold except as provided by section 32-19-19."); N.D.C.C. § 32-19-08 ("A sale of mortgaged premises under a judgment of foreclosure…must be made by the sheriff of [the county where the premises are situated].").