

# FORECLOSURE

In 21 states, foreclosures must commence, or generally are started, by the lender's filing of a complaint or petition in a court.<sup>1</sup> This is commonly called judicial foreclosure, as opposed to the other most common practice, nonjudicial foreclosure by "power of sale" authorized in a mortgage or deed of trust. Tennessee falls into the latter category.

*The Deed of Trust.* In Tennessee, the foreclosure provision is contained in a deed of trust between the borrower and the lender. With some exceptions discussed below, it governs whether: the lender must give *personal* notice to the borrower of acceleration of the entire unpaid balance and the lender's intent to foreclose; the lender must later give *personal* notice to the borrower that newspaper notice of foreclosure is being published and, thus, that the foreclosure process is underway; personal notice must be by registered or certified mail, rather than first class mail; the personal notice period required by contract is the same (20 days) as the statutory period for notice of foreclosure by newspaper publication or posting in public places; the period for personal notice is measured from the date of receipt or the date of mailing; the lender may give personal notice to only one borrower, rather than all, when there is more than one borrower; the borrower has an opportunity to prove that no default has occurred; the borrower has the opportunity to show that the proper procedure for foreclosure has not been followed; the borrower has the opportunity to raise defenses such as usury, fraud, and Truth-in-Lending Act violations; an alternative dispute resolution process – such as mediation or arbitration – must be used before foreclosure occurs; a loss mitigation process such as those employed by federal agencies<sup>2</sup> must be employed before foreclosure occurs; foreclosure may occur at all if the borrower is less than 90 days' delinquent, also a procedure followed by federal agencies making or insuring home loans; the lender must furnish a pay-off amount so the borrower may refinance with another lender, thus protecting the borrower's equity; the foreclosure fees charged by the lender must be justified by an affidavit or other proof; industry-standard marketing efforts are required so that a competitive bidding is more likely to occur at a foreclosure; an independent party – such as a government official – must conduct the foreclosure; the borrower may bid at the foreclosure and must pay cash even if a third party need not do so; and a court, a referee, an administrative tribunal, or another independent panel must review the sale procedures and confirm the sale.

*The Involvement of the State in Nonjudicial Foreclosures.* The role of the State of Tennessee in foreclosure proceedings takes many forms. Notably, it extends beyond authorization or acknowledgement of contractual provisions to what amounts to

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<sup>1</sup>Appendix I, National Consumer Law Center, *Repossessions and Foreclosures* (5<sup>th</sup> ed. 2002).

<sup>2</sup>*See, generally*, U.S. Department of Housing and Urban Development, *Providing Alternatives to Mortgage Foreclosure: A Report to Congress, March 1996*.

compulsion of non-judicial foreclosure. Thus, in *Clark v. Jones*, 27 S. W. 1009 (Tenn. 1894) the Supreme Court held that a borrower could not be charged with the costs of a judicial foreclosure if it were resorted to needlessly. It has been followed in subsequent cases.<sup>3</sup> In other words, lenders are compelled to bear an economic burden if they seek judicial foreclosure in the interest of fairness or to resolve questions such as whether a default has truly occurred.

The state also sanctions foreclosure rules established by contract, even where they differ from those provided in statutes. Thus, Tenn. Code Ann. § 35-5-101(d) provides that statutory rules are inapplicable to notice published “in accordance with any contract entered into heretofore, and expressed in a mortgage, deed of trust or other legal instruments.” In addition, *Napier v. Stone*, 114 S.W.2d 57, 61 (Tenn. App. 1937), citing three other judicial decisions, recites: “Where the time, place, and terms of sale are not fixed in the mortgage or deed of trust, then the same are governed by statute... But, where the time, place, and terms of sale are set out in the deed of trust, the deed of trust controls and must be fully complied with in order to render the sale valid....”

One commentator<sup>4</sup> takes the view that this statute and those judicial decisions trump any other Tennessee statute that has conflicting language. If this view is correct, it is possible by contract to use a publication or posting process that calls for *less* than the statutory period of 20 days’ notice of a foreclosure sale. In other words, the statutes discussed below are not minimum requirements of fairness to be incorporated into a deed of trust. Instead, they are meant only for situations – rare indeed – when the deed of trust has no comparable provisions contained in it. Even if this view is incorrect and Tennessee’s foreclosure statutes *do* afford *minimum* standards that deeds of trust must observe, they ameliorate the potentially harsh contractual process in only nominal ways, as we elaborate below.

*Personal Notice.* No personal notice to the borrower is required by statute. Most lenders provide a limited form of it,<sup>5</sup> sometimes for only a few days and usually only to one of several borrowers whether at the same or different addresses. But there are no statutory rules about matters such as whether notice to a parent is also notice to a child who lives at the same address. Needless to say, the rules of civil litigation universally require individual summons to multiple defendants, whether or not they share the same address.

*Notice by Newspaper Publication or Posting in Public Places.* This is a statutory process with occasional embellishment by judicial decision. Under Tenn. Code Ann. § 35-5-101, advertisement of a foreclosure sale must be made three different times in “some” newspaper “published” in the “county where the sale is to be made,” which *could*

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<sup>3</sup> *Foster v. Harle*, 64 S.W.2d 21 (Tenn. 1933).

<sup>4</sup> John A. Walker, Jr., *Simple Real Estate Foreclosures Made Complex: The Byzantine Tennessee Process*, 62 Tenn. L. Rev. 231 (1995).

<sup>5</sup> *Mennonite Board of Missions v. Adams*, 462 U.S. 791 (1983) may be the reason. The court found unconstitutional a tax sale procedure that gave no personal notice to a lender of the borrower’s failure to pay real property taxes.

be a county other than the one in which the land is located. Only 20 days' notice is required, and the use of publications read almost exclusively by lenders and lawyers is permitted.<sup>6</sup> Indeed, they are routinely used<sup>7</sup> more for the purpose of generating prospective purchasers rather than giving actual notice.

Publication, as opposed to circulation of a newspaper, is the statutory term. Thus, it is conceivable that some counties will have no eligible newspapers, even though metropolitan papers are widely read within them. If this happens, written notice may then be posted in five "of the most public places in the county."<sup>8</sup> There is no guidance about what such places are or how they are to be determined.

All that is required<sup>9</sup> in the advertisement or notice are: the names of the interested parties, presumably meaning the borrower, lender, and the trustee under the deed of trust; a description of the land in brief terms, including the street address, if available; the time and place of sale; and information pertaining to federal and state liens on the property.

*The Foreclosure Sale.* To a limited extent, judicial decisions have created bounds within which a foreclosure sale must take place. They have dealt with whether the foreclosure must occur in the county in which the property is located;<sup>10</sup> it must take place at an accessible location;<sup>11</sup> a lender may use a purely technical default as a basis for foreclosure;<sup>12</sup> the borrower can cure the delinquency by paying the disputed amount before the foreclosure occurs;<sup>13</sup> there is any minimum price that must be paid;<sup>14</sup> a third party must pay cash at a foreclosure sale;<sup>15</sup> and the lender may recover a deficiency judgment if the amount received in the sale is less than the amount owed.<sup>16</sup>

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<sup>6</sup> In *Pope v. Craft*, 1 Tenn. App. 356 (1925), the court approved use of a newspaper in Memphis that had circulation of some 3,000; whose subscribers were principally business men, lawyers, bankers, clerks of court, and the like; and which was not sold at the newsstands but instead delivered by mail or courier.

<sup>7</sup> Compare these procedures to Tenn. Code Ann. §§ 21-1-203 through 21-1-205 where service by publication in other cases is justifiable only under carefully prescribed conditions designed to protect defendants and withstand constitutional challenge.

<sup>8</sup> Tenn. Code Ann. § 35-5-103.

<sup>9</sup> *Id.*

<sup>10</sup> In *Pugh v. Richmond*, 425 S.W. 2d 789 (Tenn. App. 1967), a sale in another county was set aside, but the court seems to have been influenced also by a sale outside a closed and locked courthouse as well as the receipt of \$32,000 for property valued at \$60,000.

<sup>11</sup> In *Mitchell v. Sherrell*, 11 Tenn.App. 210 (1929), the notice of sale was posted near a farm, but the sale occurred a great distance away and the price was less than fair value. Noting both of these factors, the court set aside the foreclosure.

<sup>12</sup> In *Overholt v. Merchants & Planters Bank*, 637 S.W. 2d 463 (Tenn. App. 1982), the court ruled against the lender when payment was one day late and acceleration of the entire indebtedness had not occurred.

<sup>13</sup> Not if the debt has been accelerated. *Lee v. Security Bank & Trust Co.*, 139 S.W. 690 (Tenn. 1911).

<sup>14</sup> *Holt v. Citizens Central Bank*, 688 S.W.2d 414 (Tenn. 1984) says no.

<sup>15</sup> In *Marlin v. Sawyer*, 57 S.W. 416 (Tenn. Ch. App. 1899), the deed of trust required cash in full, but the failure to pay it was permitted.

<sup>16</sup> Yes, under *McDill Columbus Corp. v. The Lakes Corp.*, 1992 Tenn. LEXIS 601, even if the price at the foreclosure sale is shockingly low.

Statutes play a more important, even determinative, role in the conduct of a foreclosure sale. Thus, trustees may act via agents in conducting sales.<sup>17</sup> Remarkably, a foreclosure sale is neither void nor voidable if the trustee or agent fails to follow the minimal statutory procedures.<sup>18</sup> Instead, the trustee or other offending party is subject to conviction of a Class C misdemeanor<sup>19</sup> as well as civil liability for the resulting damages.<sup>20</sup> After the foreclosure sale is completed, if there are any tax liens on the property, the trustee must describe governmental redemption rights in the deed to the purchaser.<sup>21</sup>

*Redemption.* If foreclosure takes place, Tenn. Code Ann. § 66-8-101 contains a nominal two-year right of redemption that may be – and uniformly is – waived by the borrower in the deed of trust or mortgage.

*Injunctions against Foreclosure.* Because the right of redemption plays no significant role in the foreclosure process, the borrower’s chief remedy is an injunction forestalling or preventing the foreclosure. Once again, Tennessee statutes play a central role. To obtain an injunction, the borrower must “distinctly state how, when, and to whom the debt or any part ... has been paid, or any circumstances of fraud which vitiate the contract.”<sup>22</sup> The process is made more arduous for the borrower by a requirement<sup>23</sup> that he or she give five days’ notice to the lender before seeking to enjoin the foreclosure. Proof of service of the notice is required unless the trustee or mortgagee is “not to be found in the county of usual residence, or is a nonresident.” In other words, the borrower must do all of the following in a 15-day period in order to prevent foreclosure: read the right newspaper – or go to the right public place – on the right day; find a lawyer willing to take the case or represent himself or herself; give notice to the lender of the intent to seek an injunction; prove that the notice has been served or show that proof of service is not required; file a complaint in the proper court; and seek an injunction from a judge or chancellor.

Even then, there can be difficulty in obtaining an injunction delaying or stopping a foreclosure. By virtue of Rule 65 of the Tennessee Rules of Civil Procedure, temporary injunctions require a “clear” showing of “immediate and irreparable injury, loss or damage” or “that the acts or omissions of the adverse party will tend to render [the] final judgment ineffectual.” The most difficult requirement of all may be the need to give a bond “in such sum as the court ... deems proper” unless the plaintiff successfully obtains permission to bring the action on a “pauper’s oath.” A homeowner with only modest amounts of other assets and income may be unable to qualify as indigent and may also be unable to find any surety willing to provide a bond, especially one on short notice.

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<sup>17</sup> Tenn. Code Ann. § 35-5-114.

<sup>18</sup> Tenn. Code Ann. § 35-5-106.

<sup>19</sup> The penalty may be as much as a \$50 fine, 30 days in jail, or both. Tenn. Code Ann. § 40-35-11 1(d)(3).

<sup>20</sup> Tenn. Code Ann. § 35-5-107.

<sup>21</sup> Tenn. Code Ann. § 35-5-104(b). Ironically, meaningful notice must be given to a third party but is virtually denied to the borrower at earlier stages of the foreclosure process.

<sup>22</sup> Tenn. Code Ann. § 29-23-202.

<sup>23</sup> Tenn. Code Ann. § 29-23-201.

*Setting Aside a Foreclosure.* While Tennessee courts have recognized the borrower's right to set aside a wrongful foreclosure that has already occurred, the grounds for doing so are limited to procedural matters: "If a foreclosure sale is legally held, conducted and consummated, there must be some evidence of irregularity, misconduct, fraud, or unfairness on the part of the trustee or the mortgagee *that caused or contributed to an inadequate price*, for a court of equity to set aside the sale."<sup>24</sup> Substantive defenses like absence of a delinquency, usury, or violations by the lender of federal or state commercial law may not be raised because they do not bear upon the adequacy of the price.

Just as significantly, the borrower has the burden of proof in any litigation to set aside a foreclosure. It is he or she who must bring the lawsuit, not the lender as is the case in judicial foreclosure proceedings and, indeed, virtually all the rest of civil lawsuits.

In addition, while it appears that the lender can be enjoined from conducting a resale to a third party, damages seem to be the only remedy if the resale occurs before a judge or chancellor enters an injunction. As far as our research indicates, there is nothing to prevent a third-party purchaser from taking property free of the borrower's claim even if he knew of it and even if he believes that the borrower's claim is meritorious.

*Possession.* Finally, suits in which a foreclosure is challenged when the lender (or other new owner of the property) seeks possession by a detainer action face other obstacles under Tennessee statutes.

Tenn. Code Ann. § 29-18-119(c) says: "The estate, or merits of the title, shall not be inquired into" in a detainer action. While its meaning is uncertain, lenders may claim that it prohibits not only litigation about defects in title but also defenses and counterclaims attacking the validity of the foreclosure. In other words, they may assert that a wrongful foreclosure may not be challenged even when the parties are before the court on the issue of possession, the right to possession is necessarily founded on ownership, and ownership depends on the lawfulness of the foreclosure.<sup>25</sup>

The lender or other new owner is afforded significant statutory remedies which entitle it not only to possession but also to the rental value of the property from the date of foreclosure until the date of removal.<sup>26</sup> If unsuccessful in General Sessions Court, the borrower has only ten days for an appeal to Circuit Court and must furnish a bond.<sup>27</sup> The amount of it can be prohibitive: a "sufficient amount to cover, besides costs and damages, the value of the rent of the premises during the litigation."<sup>28</sup> Even the furnishing of an affidavit of indigency may be insufficient to retain possession during an appeal. According to dicta expressed in *Newport Hous. Auth. v Ballard*, 839 S.W.2d 86 (Tenn.

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<sup>24</sup> *Holt v. Citizens Central Bank*, *supra* (emphasis added).

<sup>25</sup> In our view, the statute disallows only attacks upon title based on transactions prior to the creation of the deed of trust.

<sup>26</sup> Tenn. Code Ann. § 29-18-125.

<sup>27</sup> *Id.*

<sup>28</sup> *Id.*

1992), appeal bond requirements “do not impose any unreasonable or irrational burdens upon parties seeking to appeal an adverse decision from the general sessions court. Moreover, ... if a party „is willing to surrender possession pending the litigation in the higher courts, there is a remedy by appeal which may be obtained on the pauper oath.’ See *Ammons v. Coker*, 139 S.W. 732, 733 (1911).” In other words, the indigent must move; others may stay until the case is over after the appeal.

After the time for an appeal has expired, if the borrower remains on the property, the purchaser at the foreclosure sale may have a writ of possession issued against him or her.<sup>29</sup> When the court clerk has issued a writ of possession, the sheriff may evict the borrower.<sup>30</sup> If necessary, a court may command a sheriff or constable to dispossess the borrower.<sup>31</sup>

Tenn. Code Ann. § 29-18-133 applies the final touches. Although found in the civil law portion of the Tennessee Code, this statute creates a Class C misdemeanor<sup>32</sup> if the borrower resumes possession, and the “only evidence, required or admitted on the trial of the criminal charge, is that the defendant was turned out of possession by action brought for the purpose, and that the defendant has again taken possession the premises.” No mention is made of the need for proof of criminal intent.

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<sup>29</sup> Tenn. Code Ann. § 29-15-1 14.

<sup>30</sup> Tenn. Code Ann. § 29-18-130(a).

<sup>31</sup> Tenn. Code Ann. § 26-1-101.

<sup>32</sup> The penalty may be as much as a \$50 fine, 30 days in jail, or both. Tenn. Code Ann. § 40-35-11 1(d)(3).