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A Newsletter of Current Business and Legal Matters

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Upcoming Event:

Webinar: Using Unmanned Aircraft (Drones) in Business

Thursday, January 15, 2015
3:00 - 3:30 p.m.

Complimentary for Clients & Guests
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Managing a Home Under Foreclosure

By Joseph A. "Joe" Davies

Fortunately, foreclosures on single-family homes hit a six-year low in 2013. Unfortunately, it looks like foreclosures may be again on the rise, even if it is nowhere near the depths the housing market hit during the worst part of the recession. Foreclosures can be especially stressful and confusing for residential tenants – the first they learn of a foreclosure may be when they get a notice from the bank that their former landlord no longer owns the home. They can also be a headache for property managers, who may or may not learn of the foreclosure before it occurs.

For tenants, there are some important legal protections – under the Protecting Tenants at Foreclosure Act (which is currently scheduled to expire later this year), the buyer of a foreclosed home is legally required to honor any lease that was entered into before the foreclosure. This means that the buyer must allow the tenant to continue living in the home under the exact same terms (including rent), as long as the tenant pays the rent and meets the other terms of the lease. There are two important exceptions – first if the tenant is the former mortgage-holder or a child, spouse, or parent; second if the property is sold to someone who intends to use it as their primary residence. Less common exceptions exist if the lease was not an arms-length transaction or calls for rent that is substantially less than fair market value.

The foreclosure buyer must also give the tenant at least ninety days' notice to vacate the property, even if there is no lease in effect or if the time on the lease is less than ninety days.

Under North Carolina law, if the tenant has a written lease that is recorded in the Register of Deeds office, then any buyer, including a buyer at foreclosure, takes the home subject to that lease. A tenant with a recorded lease is also entitled to a notice of the foreclosure hearing. Of course, the vast majority of residential leases are not recorded.

For property managers, the level of stress of dealing with a home under foreclosure depends entirely upon the homeowner. Unfortunately, in a great many cases, a home under foreclosure also means an absent homeowner. However, until the property actually transfers ownership, the homeowner remains entitled to the rent from the tenant, even if he or she is otherwise completely non-responsive. The best approach may be to include a provision in your management agreement that a homeowner's default on their mortgage, as illustrated by a notice of foreclosure, is a breach. That would allow the property manager to terminate the agreement and avoid being in the middle of a bad situation.

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Using Guarantees Effectively: What Every Credit Manager and Business Owner Needs to Know

By James R. Vann

Guaranties are effective tools in the collection of past due accounts; unfortunately some guaranties are out-dated and have not been recently reviewed. Reviewing your current guaranty forms and business practices will most likely create additional opportunities to be paid.

What Is a Guaranty and What Kind Do You Have?

Generally, a guaranty contract is a promise to be liable in the event that the principal debtor, who is primarily liable for the debt, fails to pay; a guaranty is collateral to the principal obligation and, dependent on its terms, may be either absolute or conditional. A guaranty is different from a suretyship in that a guaranty is a collateral, independent obligation that creates a secondary liability, while a suretyship is a direct, primary obligation which makes the surety and principal jointly liable.

Guaranty contracts come in several forms. A guaranty of collection is a promise by the guarantor to pay the debt of another on the express condition that the credit grantor shall first diligently pursue the principal debtor without success. A guaranty of payment, on the other hand, is an absolute and unconditional promise to pay the debt of another if not paid by the principal debtor. The credit grantor is not required to pursue the principal debtor unsuccessfully before seeking payment from the guarantor; the mere default of the principal debtor is enough for the credit grantor to proceed against the guarantor. Additionally, a continuing guaranty is one which allows the principal debtor to have credit over an extended time and with respect to successive transactions; the guaranty is not limited to one transaction.

Dealing with a Corporation or Subsidiary Corporation

When taking a guaranty from a corporation, be certain you have a certified copy of a corporate resolution authorizing the execution of the guaranty. You may safely assume that unless you have a resolution to the contrary, the corporation has no power or authority to become a guarantor or otherwise lend its credit to another entity. You should also find out why the corporation is providing the guaranty; if the corporation does not directly benefit from the extension of credit to the primary debtor, an argument may be made that the execution of the guaranty by the corporation was a fraudulent transfer. Additionally, you should always know who has actual authority, as well as the scope of that authority, to transact business on behalf of the corporation.

Even if you have a long-standing relationship with the president of a corporation or other corporate employee, remember you are dealing with the corporation, not the person. Anytime the name of the corporation changes, you should be cautious, even if the person with whom you deal does not change. Most likely this new corporate name means it is a new entity; be sure you receive a new resolution before extending credit to this new corporation.

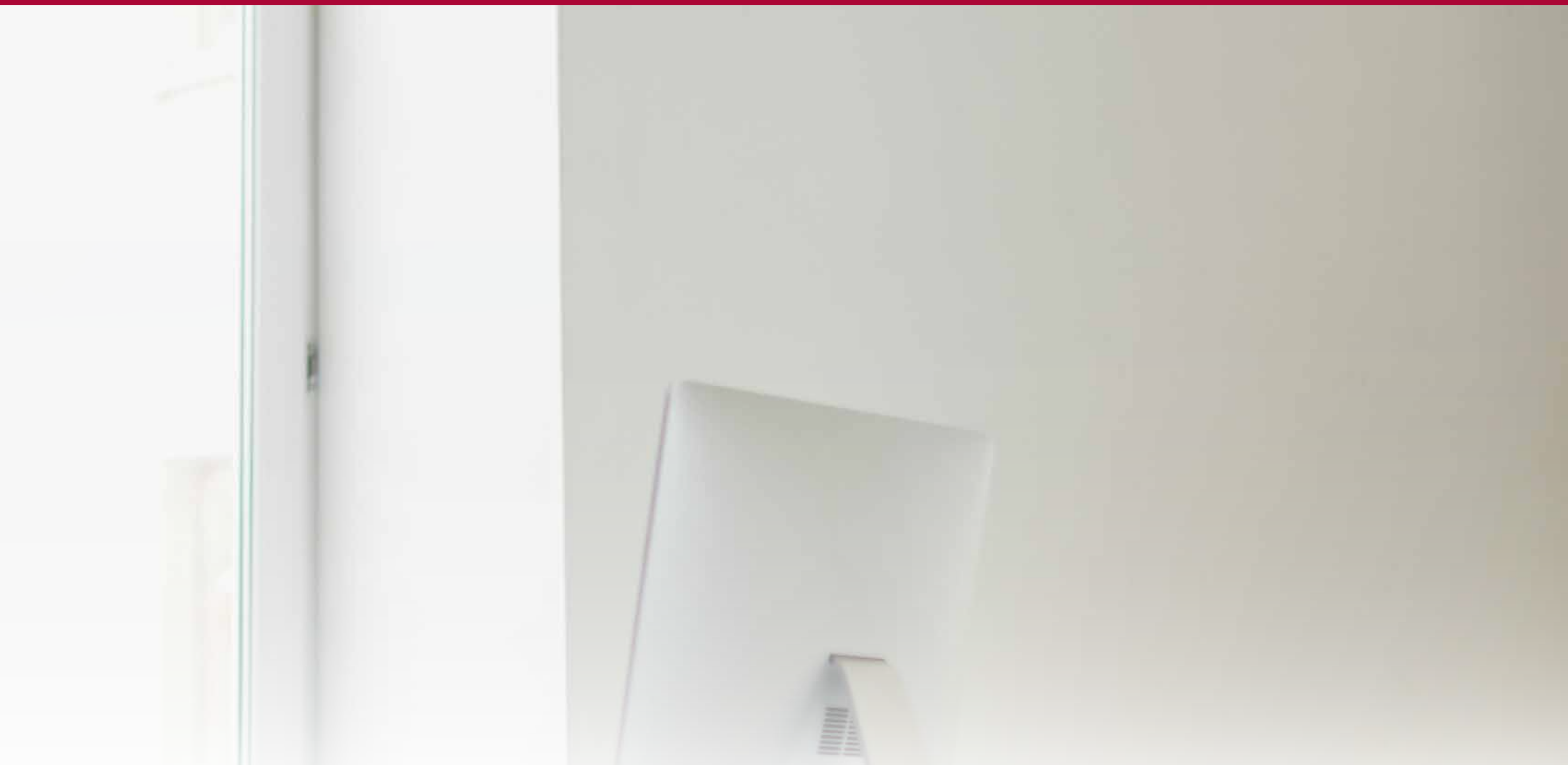
Special consideration should be given when dealing with a corporation that is a subsidiary or affiliate of another corporation; securing the parent or affiliate corporation's guaranty should, if possible, be secured since subsidiaries are often created for a particular purpose and may not have assets sufficient to pay on the account. If you notice that a parent corporation hesitates in signing a guaranty for its subsidiary, be cautious; modify the terms of your agreement, lower the amount of credit extended, etc. You are, after all, assuming a larger risk.

Be careful to secure the parent corporation's guaranty for credit extended to its subsidiary and not the other way around; courts have held that a subsidiary's guaranty of the parent's debt is without consideration and is unenforceable because the subsidiary cannot legally benefit from credit extended to its parent.

Sole Proprietorships

When you are dealing with a "DBA" ("doing business as"), you are really dealing with the owner. Just remember that an owner may only be guarantying debts incurred by the owner, not whatever debts are incurred under the business name. A 1997 North Carolina case will serve to illustrate:

The defendant, Dori Leeds, operated a "DBA" known as Blind Ambitions, which installed window treatments and Faber brand blinds purchased from Sun Control Systems. Dori Leeds signed a guaranty of payment for Sun Control guaranteeing "the prompt payment, when due of every claim of [Sun Control Systems] which may hereafter arise in favor of [Sun Control Systems] against [Dori Leeds d/b/a Blind Ambitions]." Sun Control later assigned the guaranty to Faber when Sun Control assigned the rest of its assets. Some time later, Dori Leeds sold or transferred her business to new owners, who operated under the same name, Blind Ambitions. When the new owners defaulted, Faber sought payment from Dori, ar-



guing that she guaranteed payment for the debts of Blind Ambitions, even though incurred by someone other than Dori Leeds. The Court disagreed, holding that Dori Leeds and Blind Ambitions were not separate entities; therefore, when Dori Leeds transferred her business she had no obligation for debts incurred by the new owners. This ruling makes sense when one remembers that "DBA's" are not legally separate entities from the individual owner(s).

Informal Documents That Constitute Guaranties

Sometimes a debtor will send letters to its creditor making reference to a past due amount. Such letters should be retained since they will often be admitted as evidence against the debtor in the event legal action becomes necessary. Even more importantly, however, these letters may sometimes give a creditor an additional entity from which to seek payment.

In one North Carolina case, the president of the corporate defendant wrote the following letter to the plaintiff creditor: "Please accept this letter as my personal guarantee for the purchases of Carolina Plywood Distributors through December 31, 1970. If we are continuing to do business at that time we will be glad to renew this guarantee." The Court held that this letter constituted a guaranty and that the words "please accept" were nothing more than words of courtesy rather than legally operative language. To make this situation clear, before the corporation's president wrote this letter, the only debtor liable for the debt was the corporation. No formal personal guaranty had been executed by the president. The effect of this letter was to allow an additional avenue of collection to a creditor who otherwise had little chance of being paid.

Notice to Guarantors

If you are a secured party, that is, the credit extended to the debtor is secured by collateral, you must send any and all guarantors a notice of sale by certified or registered mail before that property is sold to satisfy the debt. Although a creditor's failure to give proper notice of sale to the guarantor will not completely bar the creditor from suing for the difference between the amount owed and the amount recovered by the sale of the property, it does raise a presumption that the collateral was worth at least the amount of the debt. This means the creditor must prove that the collateral was sold at market value and that the market value was less than the amount of the debt in order to maintain an action against the debtor for the difference. By sending proper notice to the primary debtor and the guarantor and otherwise complying with certain other statutory provisions, the creditor is given a presumption that the collateral was sold at market value and in a commercially reasonable manner.

Additionally, secured creditors should be aware that in North Carolina a predefault waiver of proper notice of sale is invalid and will not be enforced. The only time a debtor or guarantor may effectively waive the notice of sale requirement is after that debtor or guarantor has already defaulted.

Discharge of Guarantor

A guarantor may be discharged from an obligation for several reasons: the payment of the principal obligation; the failure of the creditor to disclose the information as described in the preceding section; a material change of the contract terms between the principal debtor and the creditor; an unjustifiable impairment of the collateral, and an extension of time to the debtor, among others. The general rule to keep in mind is if the guarantor will be prejudiced by your action or inaction, you should notify the guarantor and obtain consent.

To some extent, the language used in the guaranty contract will be effective to waive some of the guarantor's rights. Absent effective contractual waiver, however, a material alteration of the contract terms between the principal debtor and the creditor will discharge the guarantor if the alteration was made without the guarantor's consent. Additionally, an extension of time to the principal debtor may also discharge a guarantor, if such an extension prejudices the guarantor.

A creditor should be aware of a guarantor's remedies so as to prevent an involuntary discharge of the guarantor. The language used in the guaranty contract should be reviewed to ensure that the guarantor's waiver of these rights is effective.

Conclusion

The guaranty is an important tool in a credit manager's arsenal since it will offer additional opportunities to be paid. The effective use of the guaranty will minimize the ultimate risk assumed by a creditor, and sound business practices and tightly-drafted contracts will protect your interests. If you have a specific question or a recurring set of facts involving your use of guaranty contracts, legal counsel should be consulted.

Essentials for Executing Documents

By James A. "Jim" Beck

Understanding the legal issues concerning the execution of documents is essential, whether you are a business owner seeking to take full advantage of the protections offered by your limited liability company or a credit manager working to ensure an account is correctly established and secured by a personal guarantor. Knowledge of the potential pitfalls and the best practices can help you avoid costly litigation and increase your chances of success if a dispute arises.

When signing a document, the most basic but perhaps most overlooked matter is the identity of the parties. Specifically, it is imperative that the name of each individual and corporate entity is properly identified on the document. If there is an error in the name of one of the parties, then there could be a challenge to the enforceability of the contract or the validity of the document in question. The courts in North Carolina have addressed this issue in several respects:

In one case, the president of a corporation did not disclose that he was acting on behalf of the corporation when he signed a contract. As a result, the other party sued him personally, believing that he signed the contract on his own behalf. While the court finally determined that he was in fact acting through his corporate entity, much time and expense was incurred through the litigation process. Note that the court is allowed to examine evidence outside of the contract if it is not clear in order to determine whether the intent was to bind the corporation as opposed to the individual. In this case, money was advanced for the corporation's use and was to be repaid out of the corporation's funds, so the contract bound the corporation, not the individual.

However, in another instance, a court found that piercing the corporate veil (in order to extend liability to the business owner) was appropriate where a company did not identify itself as a separate legal entity. In that case, the court indicated that if a corporation and an individual are to be liable on a contract, it is important to use two signatures- one by an officer on behalf of the company and one by the personal guarantor- even if it is the same person signing twice.

In another insightful case, a court ruled that a corporate officer must give notice to the other party if he is acting in a corporate capacity. If the other party is not notified, the court will find that the officer acted in his individual capacity.

These cases make it clear that identifying the party to the document and designating in what capacity an individual is signing are vital. Otherwise, you could end up contracting with a corporation which does not exist, failing to obtain a personal guaranty, or accidentally subjecting yourself to personal liability.

Another good practice when executing a contract is to use the word "seal" next to each signature. North Carolina law provides that a lawsuit on a breach of contract must be brought within three years of the date of breach. However, when a contract is signed under seal, the statute of limitations is extended to ten years. This is a simple way of extending the time to enforce a contract.

Finally, it is always beneficial to keep a record of those present at the time a contract or other document is executed. This can be done officially, by having them sign the document as witnesses, or by noting the information in your records and storing the notes along with the document. These witnesses may be important in the event of a dispute, as they can attest to the execution of the document, the presence of the parties to the document at the time of execution and with respect to issues involving mental capacity and whether the document was signed voluntarily. The best practice would be to have the document notarized, but that is not always possible.

There are many aspects to making sure your company's documents are effective to accomplish the intended purpose, legally sufficient and properly executed. If you need assistance with any of these issues, our lawyers would be excited to hear from you.

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