

## Determination of Clerk at Foreclosure Hearing is Binding in Subsequent Litigation

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In *Funderburk v. Chase*, COA14-1258 (N.C. Ct. App. 2014), the North Carolina Court of Appeals held that the issues decided by the Clerk of Court are binding in subsequent litigation involving the same parties on the same loan (such as a counterclaim by the borrower against the lender for breach of contract) when the determination by the Clerk of Court is not timely appealed. While this is good news for secured lenders in that it may prevent some post-foreclosure litigation, this decision raises the stakes for borrowers at the foreclosure hearing in that they cannot raise claims contrary to the decision of the Clerk of Court in subsequent litigation regarding the same loan. As a result, secured lenders may see increased litigation by borrowers at the foreclosure hearing stage and more appeals from the results of the foreclosure hearing.

In North Carolina, foreclosures are considered to be quasi-judicial proceeding in that a secured lender must establish at a hearing before the Clerk of Court in the county where the foreclosed property resides that: (1) the borrower is in default; (2) there is a valid debt between borrower and lender; (3) proper notice has been served on all necessary parties; (4) the trustee is empowered to sell the property; (5) that the foreclosure hearing does not violate special rights afforded to borrowers during the foreclosure of a primary residence; and (6) that the foreclosure does not violate North Carolina's protections for active duty service members. At the hearing the borrower is only entitled to contest these six issues. To the extent these issues are decided against the borrower, the borrower has the right file an appeal within ten days of the foreclosure hearing to contest the foreclosure determination and have a new hearing in front of a judge. Any counterclaims or defenses available to the borrower regarding the foreclosure, outside of the six issues described above, must be raised by the borrower by a separate lawsuit filed with the Superior Court of the county where the property resides prior to the expiration of the upset bid period. Under North Carolina law, once the last day of the upset bid period expires, the rights of the parties to the foreclosure become "fixed", and the foreclosure becomes final.

In *Funderbunk*, the borrower claimed that they could still raise defenses and counterclaims against the secured lender after the time the foreclosure became "fixed" if those defenses and counterclaims did not seek to overturn the foreclosure, but rather to assert money damages against the lender for various loan-related claims (including breach of contract, promissory estoppel, quantum meruit and tortious interference with contracts). The secured lender argued that all of the borrower's claims against it were premised on the borrower not being in default under the loan, and because the Clerk

of Court already determined that the borrower was in default at the foreclosure hearing, the trial court was bound by the Clerk's determination of default, and the trial court must dismiss the borrower's claims.

Due to the relatively informal nature of the hearings, and because the hearing occurs in front of a clerk and not a judge, it was sometimes unclear under North Carolina law whether the findings of the Clerk of Court at foreclosure hearing would be binding on the same parties in later litigation regarding the same loan. Relying on a number of unpublished decisions, the Court of Appeals held that the determinations made by the Clerk of Court constituted a conclusive determination on the issue of default, preventing further litigation on the issue of default for the loans analyzed by the Clerk of Court. These determinations are subject to appeal to a judge within ten (10) days of the Clerk of Court's decision. Once the foreclosure becomes final, however, these determinations are binding as to the same parties on the same loan. Because the borrower's counterclaims against the secured lender were predicated upon the borrower not being in default under the loan, and the Clerk of Court determined that the borrower had defaulted, these claims were properly dismissed.

The *Funderbunk* decision does provide some certainty for secured lenders in pursuing post-default remedies. Once the foreclosure is complete, borrowers are prohibited from re-litigating the issue of default under the loan documents. Because the foreclosure hearing is binding on subsequent litigation, the borrower may be forced to litigate issues decided during the foreclosure hearing more fiercely, raising the prospect of increased litigation and appeals during the foreclosure stage of any collection efforts by the lender.

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