

WESTERN DISTRICT OF VIRGINIA BANKRUPTCY CONFERENCE
MAY 30, 2025

COMMERCIAL FORECLOSURE OF DEEDS OF TRUST

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I. Background

A. Security Documents

1. Deed of Trust: conveyance of the title to trustee(s) to secure a debt or obligation to the secured party, usually a bank or credit union but could include an individual or entity financing the sale.
 - a. Conveyance usually fee simple, but leasehold deeds of trust may be used in commercial transactions.
 - b. Foreclosure is by trustee's sale pursuant to applicable state law (referred to "power of sale" as opposed to judicial foreclosure).
2. Mortgages: conveyance of the title (again, usually fee simple, but commercial leasehold mortgages are common) to the secured party, subject to the equity of redemption.
 - a. Foreclosure is by direct sale by secured party pursuant to applicable state law. (Mortgages are recognized in Virginia, but uncommon.).
3. Indentures: indentures are a legal contract outlining the terms and conditions of a debt security, like a bond, and the rights and obligations of the issuer, trustee, and bondholders.
 - a. Infrequent use but seen in larger transactions involving national corporations and large financial institutions.

B. Alternative Enforcement Procedures

1. Foreclosure suit (sometimes called "strict foreclosure"): a proceeding for court-ordered sale under a security instrument; some states require foreclosure suits in every case, under more or less streamlined procedures. See Va. Code Ann. §§ 8.01-96 to 8.01-113.

- Subset of judicial process is appointment of a *receiver* to preserve property from waste/deterioration. Virginia law permits the appointment of both general and special receivers (Va. Code Ann. §§ 8.01-582 to 8.01-599). Special receiverships are customary for foreclosure actions (Va. Code Ann. §§ 8.01-591 to 8.01-599).
2. Non-judicial foreclosure: sale without any court order being required
 - a. State law procedural requirements seek to protect against abuse;
 - b. Common (practically universal) Virginia foreclosure practice is non-judicial foreclosure of deeds of trust.
 3. Deeds in lieu of foreclosure: “voluntary” conveyance to the secured party
 - a. Title vested in secured party generally merges with the lien under the security instrument;
 - b. Conveyance does not extinguish subordinate liens as a foreclosure would extinguish (*e.g.*, judgment liens, tax liens).

C. Debtor’s Defenses

1. Injunction:
 - a. Pre-Sale: Failure to comply with Note/Deed of Trust; no default; failure to comply with request for accounting of debt.
 - b. Post-Sale: Inadequacy of price; trustee conflict.
2. Bankruptcy: most powerful tool of borrower/debtor.
 - a. Automatic Stay (11 U.S.C. § 362(a)): most fundamental debtor protections (see *In re Thompson*, 182 B.R. 140, 146 (Bankr. E.D. Va. 1995).
 - b. Relief from Stay (11 U.S.C. § 362(d)): no equity in property; no adequate protection (11 U.S.C. § 361); fraud (multiple filings); single asst real estate case (applies to Chapter 7 cases as well as Chapter 11 and Chapter 13; see *In re Planet 10*, 213 B.R. 478, 480 (Bankr. E.D. Va. 1997).
 - c. Violation of Stay: any individual injured by any willful violation of the stay **shall** recover actual damages, including costs and attorneys’ fees, and, in appropriate circumstances, may recover punitive damages. 11 U.S.C. § 362(k)) (*emphasis added*).
 - d. Fraudulent conveyance attacks on foreclosures: 11 U.S.C. § 548 grants a trustee or debtor in possession the ability to avoid certain transfers (concern for creditors taking a deed in lieu). See *In re Marshall*, 15 B.R. 738 (Bankr. W.D. NC 1981).
 - e. Further Debtor “bites at apple”:

- i. in a plan, Debtor may have opportunity to cure defaults and reinstate obligation with creditor. See, e.g., 11 U.S.C § 1322(b)(5); *In re Stokes*, 39 B.R. 336 (Bankr. E.D. Va. 1988);
- ii. Equity of Redemption (when extinguished?): split in Courts as to when debtor's equity of redemption extinguished. Extinguished when sale is concluded ("knocked down") see *Abdelhaq v. Pflug*, 82 B.R. 807, 809 (E.D. Va. 1988); But see *In re Chitwood*, 54 B.R. 396 Bankr. W.D. Va 1985)(sale "knocked down" but Bankruptcy Code permits a distressed debtor to effect cure of default before preparation, delivery, and recordation of trustee's deed).

Best practices:

- *Orders: when relief from stay granted after trial or upon agreement of the parties (do not forget the Trustee!), make sure that there is an entered Order from the Bankruptcy Court approving the sale. Doing so will prevent headaches from a potential purchaser of assets (and title company/insurer) at a subsequent sale.*
- *Default provisions: from a creditor perspective, if relief is not granted, insist on default provisions (e.g., if debtor misses payments, stay is automatically lifted for creditor to pursue rights and remedies).*

II. Virginia Foreclosure Procedure and Practice

- If you represent a lender, close attention must be paid to each statutory requirement to ensure foreclosure sale is conducted in compliance with document and statutory requirements.
- If you represent a borrower/debtor, trustee's compliance with such statutory requirements should be examined closely.

A. Statutory Requirements: generally, governed by the terms of the deed of trust and applicable statutes, especially Va. Code Ann. §§55.1-316, *et seq.* Federal and state consumer protection laws, particularly the federal Fair Debt Collection Practices Act, also may present issues.

B. Pre-Foreclosure Notices

Virginia law does not require lenders to deliver written notice of default, demand letter, or similar communication to a borrower in default before proceeding with foreclosure of commercial real property. A deed of trust is a contract under Virginia law. Unless a deed of trust conflicts with Virginia law, it will be interpreted as written. (Va. Code Ann. § 55.1-320 and see *Mathews v. PHH Mortg. Corp.*, 724 S.E.2d 196, 201 (Va. 2012); *In re Burke*, 98 B.R. 746 (Bankr. W.D. Va. 1989)(terms of the deed of trust must be strictly followed). Lender's counsel should carefully review the terms of the note and security instrument (deed of trust, mortgage, or indenture) for any contractually required notice requirements before foreclosure.

- pay attention to Fannie/Freddie/VA documents
- does borrower/debtor have a right to cure? Virginia law does not specifically provide a borrower in default with the right to cure or reinstate the loan after the note has been accelerated. Any right to cure a default is determined by the loan documents.

In Virginia, every deed of trust is presumed to contain an acceleration provision unless the deed of trust states otherwise (Va. Code Ann. § 55.1-320 and see *Lipps v. First Am. Serv. Corp.*, 286 S.E. 2d 215, 219 (Va. 1982)). An acceleration provision allows the lender to immediately call the entire loan due if the borrower defaults. At the request of a beneficiary (typically the lender), the trustee must notify the borrower that it is accelerating the loan. (Va. Code Ann. § 55.1-320(6).)

- See Va. Code Ann. § 55.1-321(A) (“The written notice of proposed sale when given as provided in this subsection shall be deemed an effective exercise of any right of acceleration contained in such deed of trust or otherwise possessed by the party secured relative to the indebtedness secured.”)
- *Best practice: provide defaulting borrowers with a demand letter before beginning the foreclosure process. The demand letter should state:*
 - *The terms of the loan.*
 - *A description of the default.*
 - *That the debts secured by the deed of trust are immediately due and payable, including a notice of acceleration.*
 - *That the loan documents will be strictly enforced if any default is not remedied.*
 - *Pay attention to lender requirements for curing defaults, if any (Farm Credit entities).*

C. Noteholder’s Written Request for Pursue Rights and Remedies

The secured party then exercises its right to have the obligation satisfied by enforcing its lien and typically appoints a substitute trustee, usually a law firm or other firm experienced in foreclosure and debt collection work. Document used to accomplish this appointment is a “substitution of trustee”.

1. Substitution of Trustee

- i. The authority to sell the property at the request of the secured party, to satisfy the obligation secured by the deed of trust, is implicit. Va. Code §55.1-320(9)
- ii. The substitute trustee must be appointed before exercising any authority under the deed of trust. *Id.*

- iii. The substitution of trustee must be recorded before or with any instrument in which the substitute trustee's authority is exercised (including, of course, the foreclosure trustee's deed.) *Id.*
- iv. Conflict of Interest Concerns: see Legal Ethics Opinions Nos. 359, 528, 554, 659, 679. The Trustee has a fiduciary duty responsibility to both a creditor and debtor and must impartially. See *In re Boswell*, 206 B. R. 421, 423 (W.D. Va. 1997); *Crosby v. ALG Trustee, LLC*, 296 Va. 561 (2018) (citing *Gay v. Hancock*, 22 Va. 72 (1882) ("A trustee in a deed of trust is considered as the agent of both parties and bound to act impartially between them; and it is his duty to use every reasonable effort to sell the estate to the best advantage."))

2. Documentation: Substitute Trustee gathers the following from lender:

- a. Complete names of borrowers/debtors;
- b. SSN;
- c. Property address;
- d. Last known mailing address for borrower/debtor*
- e. Unpaid Principal balance; date of last payment and amount received; total amount of principal, interest, costs, fees due in arrears (required for owner occupied sales but good idea for commercial as well);
- f. Original loan amount;
- g. Default date;
- h. Current interest rate;
- i. Payoff statement/quote;
- j. Name of current owner of Note: also verify and obtain original Note with all allonges (needed for accounting) see *In re Woodberry*, 383 B.R. 373 (Bankr. S.C. Feb. 4, 2008)(producing original show is prima facie evidence that bank is proper holder to enforce);
- k. Copy of recorded deed of trust;
- l. Copy of title policy;
- m. Copy of a breach/default letter that lender has sent;
- n. Copy of any recorded assignments of deed of trust see *In re Gilbreath*, 395 B.R. 356 (Bankr. S.D. Texas 2008)(putative holder of note must show proper assignment).

**Best practice: search records (Accurint, GIS, SCC) to determine if other addresses for borrower/debtor exists – objective is to cut off any defense of “I never received it because they didn’t send to the proper address.”*

D. Title Search

- 1. Substitute Trustee or agent conducts title search to identify liens and other encumbrances:
 - a. Junior deeds of trust;

- b. Mechanics liens;
- c. Property owner association lien;
- d. Status of real estate taxes, water and sewer fees (TACS referrals);
- e. Bankruptcy Court/PACER search (Best practice: start of process, during process and just prior to sale);
- f. Existing leases/tenants?
 - *Best Practice: if tenant on property, communicate and send notice so it can prepare. Lease provisions may have requirement that landlord notify tenant but trustee not under duty – however, best to keep tenant in loop which will help with a new owner.*

E. Notice. The foreclosing trustee must notify the owner and certain others. See Va. Code §55.1-321;

1. Content and Mailing of Notice: include either (i) the instrument number or deed book and page numbers of the instrument of appointment substitute trustee, or (ii) a copy of the executed and notarized appointment of substitute trustee by personal delivery or by mail (certified or registered mail) with the notice of sale at least 14 days before the sale of the property to:
 - a. Owner(s) at their last known address in the records of the secured party; prudence also requires the foreclosure trustee to send notice to any other address(es) disclosed in the land records, if different, as stated above.
 - b. Noteholders of notes secured by deeds of trust recorded at least 30 days prior to the foreclosure sale, including assignees of those noteholders if the assignment is recorded at least 30 days before the sale.
 - c. Condominium unit and property owners' or proprietary lessees' associations that have filed notices of liens at least 30 days before the sale.
 - d. Internal Revenue Service, if notice of federal tax lien has been filed at least 30 days before the sale for any lien recorded against property in prior 25 days. Read IRS Publication 786. (26 U.S.C. § 7425(c)(1)). The foreclosure does not extinguish the tax lien if the trustee does not give notice of the sale to the IRS. The IRS has 120 days following the sale to redeem the property. (26 U.S.C. § 7425(a), (d).)
 - e. "Failure to comply with the requirements of notice contained in Va. Code Ann. §55.1-321 shall not affect the validity of the sale, and a purchaser for value at such sale shall be under no duty to ascertain whether such notice was validly given." Va. Code Ann. §55.1-321 (C). *Concern: evidence of proper notice is an underwriting requirement for title insurance, at least when insuring the foreclosure sale transaction.*
 - f. New notice is not required if the sale is postponed (Va. Code Ann. § 55.1-321(D)).

F. Lost Note Problem. If the original note or other evidence of the secured debt is lost, the trustee may still proceed with the sale if the lender:

1. provides the trustee an affidavit stating that evidence of the secured debt cannot be produced;
2. provides written notice to the debtor-borrower that the note or other evidence is unavailable;
3. states in the notice that a request for sale will be made on the trustee within 14 days from the date of the mailing of the notice. The notice must:
 - a. be sent by certified mail, return receipt requested, or registered mail to the last known address of the debtor;
 - b. contain the name and address of the trustee; and
 - c. advise the debtor that if he is subject to a claim by another person, he may petition the court for an order requiring the lender to provide protection against that claim.

(See Va. Code Ann. § 55.1-321(B)).

Concern: a lost note process will “freeze” the foreclosure process by at least 14 days (60 days in non-commercial sales).

G. Advertisement. The foreclosing trustee also must advertise the sale in a local newspaper. See Va. Code Ann. §§55.1-322 and 55.1-323 (Notice of Sale used)

- *Best Practice: contact local Commissioner of Accounts to confirm that chosen newspaper is acceptable.*

1. Frequency of Advertisements (see Va. Code Ann. §55.1-322)

- a. as required by the terms of the deed of trust; or
- b. subject to minimum statutory requirements (once a week for 4 successive weeks).
- c. “Failure to comply with the requirements for advertisement contained in this section shall, upon petition, render a sale of the property voidable by the court.” Va. Code Ann. §55.1-322(E). *Concern: evidence of advertisement complying with the requirements of the deed of trust and the minimum statutory requirements is an underwriting requirement for title insurance, at least when insuring the foreclosure transaction.*

2. Contents (see Va. Code Ann. § 55.1-323)

- a. Adequately describe property but does not have to be extensive as deed of trust description (consider costs of publication);
- b. Time and place (courthouse steps; at property; other location in the city or county where the property is located; corporate limits of any surrounding or contiguous city). See Va. Code Ann. § 55.1-320(7);
- c. Trustee’s identity;
- d. Contact person;
- e. Personal property: a deed of trust can include personal property and also act as a security agreement – ensure proper noticing under UCC

- (see *United Va. Bank/Seaboard Nat'l v. B.F. Saul Real Estate Inv. Trust*, 641 F.2d 185, 189 (4th Cir. 1981);
- f. Deposit (Va. Code Ann. § 55.1-324 permits).
- *Best Practice: require deposits by certified funds (certified checks)*

H. Conduct of Sale.

1. Reinstating Debt Prior to Sale: Depending on terms of deed of trust, borrower has the right to reinstate the indebtedness after the start of a nonjudicial foreclosure but before the foreclosure is completed. If the deed of trust contains the words “renewal, extension, or reinstatement permitted,” or words to that effect, the borrower has the right to cure a default and reinstate the debt either (a) according to the loan’s schedule of maturity at acceleration, or (b) As the parties may otherwise agree. (Va. Code Ann. § 55.1-325(5)).
2. Auctioneers: common with commercial property/farms because of uniqueness of property and extensive network/marketing abilities. No Virginia statute that either authorizes or prohibits use of auctioneers (see *Yaffe v. Heritage Savings & Loan Ass’n*, 235 Va. 577, 369 S.E.2d 404 (1988)).
 - a. Auctioneer Fee/Commission: the trustee may be reimbursed for a “reasonable” fee for an auctioneer in addition to a trustee’s commission. See *Manual for Commissioners of Accounts*, ¶ 16.602 (Virginia CLE 6th ed. 2019).
 - *Concern: Buyer’s Premiums: many times, an auctioneer will apply a “buyer’s premium”, a certain percentage of the winning bid price, to obtain its commission. Commissioners of Accounts are enforcing belief/recommendation that the full purchase price (winning bid price plus buyer’s premium) be shown as a credit on the accounting. Id. Some Commissioner’s are limiting percentages for buyer’s premium.*
 - *Concern: Creditor’s ability to collect interest after sale is not permitted. Interest on obligation is permitted only to date of sale (not to closing). Id at ¶ 16.605.*
3. Announcements: No Virginia statutes that govern announcements at the sale. Trustee and auctioneer can make announcements to clarify and emphasis terms of sale; avoid announcements that alter or conflict with terms of sale as set forth in advertisements and notices.
4. Bidding orally (in person or on phone); written one price bids (usually from lender who cannot attend); any person other than the trustee may bid at the foreclosure sale, including a person who has submitted a written one-price bid; any bidder in attendance has the right to inspect written bids by making a request to the trustee. (see Va. Code Ann. § 55.1-324(A)(1)).

5. The lender usually bids the amount of its debt plus the expenses of foreclosure (credit bid). See *In re Carter*, 86 F. Supp. 385, 388 (W.D. Va. 1944) (“the creditor, for his protection, may bid at the sale and may apply the amount of his debt upon his bid”).
6. The sale will be subject to prior liens (except real estate taxes, which must be paid).
7. Terms may be as permitted by the deed of trust but should not be so unilateral that the contract between the foreclosing trustee and purchaser lacks mutuality and becomes unenforceable. See *Busman v. Beeren & Barry Investments, LLC*, 69 Va. Cir. 375 (2005).
8. Memorandum of Sale: a written memorandum of sale must be signed so that contract will be enforceable under the statute of frauds. The trustee maintains a copy of the memorandum in the trustee’s file and provides a copy of the memorandum to the commissioner of accounts for review. The memorandum of sale is not recorded.
 - *Best Practice: prior to calling sale, have copies to distribute; read or highlight provisions of Memorandum (and have staff check PACER one more time!)*

I. Settlement.

1. Foreclosing trustee will convey title by special warranty trustee’s deed.
2. Disbursements by foreclosing trustee (who must account for sale proceeds to the Commissioner of Accounts), in order of priority, as follows (see Va. Code Ann. § 55.1-324(A)(3)).
 - a. expenses of foreclosure sale
 - b. real estate taxes
 - c. secured debt (payoff lender)
 - d. subordinate liens
 - e. owner prior to sale.

Concern: the foreclosing trustee cannot use proceeds of the foreclosure sale to satisfy prior liens; the sale is subject to prior liens.

3. The foreclosing trustee must account for the sale proceeds and disbursements according to the statute, but no purchaser is required to see to the proper application of the proceeds. (see Va. Code Ann. § 55.1-324(A)(3)). As a result, filing the foreclosing trustee’s accounting with the Commissioner of Accounts and approval of the accounting by the Commissioner is not required for title insurance. Accounting made to the commissioner of accounts of the circuit court where the deed of trust was first recorded within 6 months of sale date (see Va. Code Ann. § 64.2-1309).

4. Deed of Release: If the sale proceeds satisfy the underlying obligations of the borrower, then the trustee, upon request of the grantor/borrower, should execute and deliver a deed of release to the borrower (Va. Code Ann. § 55.1-324(B)), but release requirement does not apply after a foreclosure sale.

J. Effect of foreclosure sale.

1. The foreclosure sale discharges the lien of the deed of trust being foreclosed; it becomes a link in the chain of title and is not released.
2. Subordinate liens are extinguished.
 - a. subordinate deeds of trust
 - b. subordinate judgments (usually judgments subsequent to the deed of trust, but not always; date of *attachment* determines priority, not date of docketing, if the judgment lien does not attach immediately upon docketing.)
3. Special cases
 - a. Federal law grants the IRS a right of redemption to purchase property from the foreclosure purchaser for the purchase price plus certain other allowances until 120 days after the sale, provided the IRS was notified; if the IRS was not properly notified, the federal tax lien is not extinguished, regardless of state law priority.
 - b. A purchase money lien will take priority even over previously-docketed judgments that otherwise would attach immediately (except judgments in favor of the federal government—judgments, not tax liens.)

WESTERN DISTRICT OF VIRGINIA BANKRUPTCY CONFERENCE
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RESIDENTIAL FORECLOSURES – RECENT DEVELOPMENTS

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I. RECENT LEGISLATIVE CHANGES

a. 2018 HB 755

- VA Code 55.1-321 - Required notices of sale to be sent to heirs and administrators identified on a recorded list of heirs.
- VA Code 55-64 – Modified distribution obligation where Borrower deceased prior to sale.

b. 2021 HB 2175

- VA Code 55.1-320(10) – Affidavit requirement for notices of sale.
- VA Code 55.1-321 – Required 60 day notice of sale and notice of a lost note “in the case of a deed of trust conveying owner-occupied residential real estate.”
- Notices to owners must include:
 1. Website address of the HUD Office of Housing Counseling;
 2. Listing of HUD certified housing counseling agencies;
 3. Website address and telephone number for the “statewide legal aid center”;
 4. Disclaimer – “This is NOT a notice to vacate the premises. You should consider contacting an attorney or your local legal aid or housing counseling agency.”
 5. Last payment date and amount received;
 6. Total amount of principal, interest costs, and fees due in arrears;
 7. Unpaid principal balance of the loan.

c. 2024 HB 184

- Zombie Mortgage Protection
 1. Affidavit from subordinate mortgage lienholder regarding periodic statements

2. Notice to Borrower
3. Purchaser required to certify they will pay the superior loan within 90 days after recordation of the Trustee's Deed.

d. 2024 HB 264

- Permitting legal notices in online-only publications

e. 2024 SB 349

- Extended validity of non-judgment common-interest community liens from 3 to 10 years.
- Provided for judicial foreclosure of common interest community liens.

II. RECENT NOTABLE CASELAW

- a. *Bayview Loan Servicing v. Simmons*, 275 Va. 114, 654 S.E.2d 898 (2008)
 - The stepping off point for the Virginia Supreme Court's modern current trend of strict construction with the contractual requirements of the DOT. Particularly relevant to the pre-acceleration letter required by Paragraph 22 of the FNMA/FHLMC Form 3047 DOT.
- b. *Horvath v. Bank of New York, N.A.*, 641 F.3d 617 (4th Cir. 2011)
 - The right to enforce the DOT follows the rights of the Noteholder which are determinative where the Trustee foreclosing is in possession of a "properly" endorsed Note.
- c. *Mathews v. PHH Mortgage Corp.*, 283 Va. 723, 724 S.E.2d 196 (2012)
 - Supreme Court clarified that the Applicable Law provisions in the FHA form DOT were specifically intended to incorporate the Regulations of the Department of Housing and Urban Development into the DOT as conditions precedent to acceleration and sale.
- d. *Squire v. Virginia Housing Development Authority*, 287 Va. 507, 758 S.E.2d 55 (2014)
 - *Squire* is a particular application of the holding in *Mathews* where the face-to-face meeting allegation was sufficient to satisfy the pleading requirement for Breach of Contract and Breach of Fiduciary Duty, but that rescission was not an appropriate remedy under the circumstances.
- e. *Crosby v. ALG Trustee, LLC*, 296 Va. 561 (2018)
 - Following in the line of *Squire* and holding the Trustee can be liable for breach of fiduciary duty where it disregards the rights of the Borrower and sells the Property for an unconscionable price.

- f. *Young-Allen v. Bank of America, N.A.*, 298 Va. 462 (2020)
 - Insufficiency of Memorandum of lis pendens to defend against foreclosure. Injunction necessary.
- g. *Parrish v. Federal National Mortgage Association*, 292 Va. 44, 787 S.E.2d 116 (2016).
 - Particularly interesting, Parrish held that the General District Court lacks subject matter jurisdiction to hear Unlawful Detainer actions wherein the Defendant raises a *bona fide* defense requiring the Court adjudicate title to real property.
- h. *Obduskey v. McCarthy & Holthus, LLC*, 139 S. Ct. 1029, 203 L. Ed.2d 390 (2019)
 - Confirming the text of the FDCPA - mere enforcement of a security instrument does not fall within the coverage of the main provisions of the FDCPA, but is still covered for taking or threatening to take action to affect dispossession or disablement of property without a legal right.
- i. *Show Me State Premium Homes, LLC v. McDonnell*, 74 F. 4th 911 (8th Cir. 2023)
 - 8th Circuit held that subordinate HUD liens on the property were not extinguished through a non-judicial tax sale because, pursuant to 28 USC § 2410(c), the property must be foreclosed judicially to extinguish a junior lien in favor of the United States. This would include any junior HUD/partial claim mortgages, VA mortgages, SBA, USDA, or DOJ liens on the property.