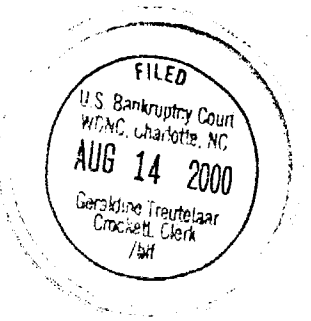

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NORTH CAROLINA
CHARLOTTE DIVISION

In Re:	)	
	)	**Case No. 99-30986**
CARL WILLIAM JONES and	)	
SUSAN GODWIN JONES,	)	**Chapter 7**
	)	
Debtors.	)	JUDGEMENT ENTERED ON AUG 14 2000
	)	

ORDER DETERMINING PRIORITY OF LIENS

This matter came on for hearing before the undersigned on June 19, 2000, upon Branch Banking & Trust Company's ("BB&T") Motion to Determine Lien Priority in Property of the Estate. The parties consented to the Court subject matter jurisdiction over their dispute and, additionally, treating this as a contested matter under F.R.B.P Rule 9014 rather than by adversary proceeding. Now, based on the record before it, the Court makes the following:

Findings of Fact

The Debtors are the sole shareholders of KRJ Motors, Inc. ("KRJ"). The Debtors filed a joint Chapter 7 bankruptcy petition on April 22, 1999. KRJ filed a separate Chapter 7 petition on the same date.

Previously on December 16, 1994, Respondent Centura Bank made a commercial loan of $225,000 to KRJ ("SBA Loan"). The SBA loan was guaranteed by the Small Business Administration and additionally was partially secured by a second deed of trust on the debtors' residence("SBA Deed of Trust"). The SBA Deed of Trust was junior in priority to an existing first deed of trust dated January 30, 1987 in favor of Home Savings of America.

The SBA Deed of Trust contained the following language, which is germane to this motion:

> This Deed of Trust secures the guaranty of KRJ Motors, Inc., dated December 16, 1994 of a Promissory Note dated December 16, 1994 payable to the order of Centura Bank in the original principal amount of Two Hundred twenty-five Thousand and No/100 Dollars ($225,000.00).

In the fall of 1996, Debtor Carl Jones applied with Centura to extend or refinance the SBA Loan. Centura declined this request, but agreed to grant KRJ a business credit line and to extend a $100,000 equity line of credit to the Debtors. Accordingly, on October 4, 1996, the Debtors executed an "Equity Line of Credit Account Agreement" and placed another deed of trust on their residence ("Equity Line Deed of Trust") in favor of Centura. The Equity Line Deed of Trust was recorded on February 19, 1997.[1]

Centura's policy at the time was to close many of its equity line loans in-house and without the assistance of an attorney in either preparing the loan documents or in handling the closing. In this case, a Centura employee who was not an attorney drafted the Equity Line Deed of Trust. The Equity Deed of Trust contained mostly preprinted, boilerplate language. It does not refer to a promissory note. Instead, in a typed in space describing the debt which was being secured, this instrument (erroneously) repeats the description used in the prior SBA Deed of Trust:

> This Deed of Trust secures the guaranty of KRJ Motors, Inc., dated December 16, 1994 of a Promissory Note dated December 16, 1994 payable to the order of Centura Bank in the original

---

[1] The Equity Line Deed of Trust was first recorded in the incorrect county on December 31, 1996. It was subsequently re-recorded.

principal amount of Two Hundred twenty-five Thousand and No/100 Dollars ($225,000.00).

In other words, the Deed of Trust which was meant to secure the Equity Line states that it secures the SBA Loan.

The Equity Line Deed of Trust also contained blanks where the draftsman was to fill in the property's market value and any prior liens. Here, Centura listed a property value of $340,000.00. As to prior liens, Centura (erroneously) noted a single lien in the amount of $185,000. The identity of that lienholder was left blank. The $185,000 amount coincided with the approximate balance due on the first deed of trust to Home Savings, but did not reflect the amounts owed under Centura's other SBA Deed of Trust. These errors would soon create problems.

Sometime in August 1996, Carl Jones approached BB&T about refinancing the SBA Loan. On May 16, 1997, after lengthy negotiations, BB&T issued a commitment letter to Mr. Jones and KRJ agreeing to lend them $225,000.00 to refinance the SBA Loan and to provide additional working capital to KRJ. The collateral required by BB&T included a guaranty from the Debtors and a second lien on their residence. BB&T was unaware of the Equity Line from Centura to the Debtors, as it was not disclosed by the Debtors and apparently did not appear on credit reports received by BB&T.

Attorney R. Dale Fussell ("Fussell") was hired to close the BB&T loan. Fussell did a title search on the Debtors' residence which revealed the existence of both the SBA Loan and the Equity Line deeds of trust. However, because each instrument purported to

secure a $225,000 obligation, Fussell incorrectly concluded that both deeds of trust were meant to secure the SBA Loan.

Fussell called Centura to obtain a verbal payoff of the SBA Loan and was informed he would have to submit a written authorization signed by Jones before the information would be provided. On June 18, 1997, Fussell faxed a letter to Centura, accompanied by Jones' express authorization, requesting a payoff figure. This request did not turn up the secured Centura loan, however. For reasons, that no doubt will be addressed in other litigation in applying for this most recent loan, the Debtors had told BB&T only about one of Centura's loans, the SBA loan. Accordingly, Fussell's letter specifically referenced the SBA Loan only and made no reference to the Equity Line.[2] As a result, Centura's computer only picked up the SBA loan and its response to Fussell stated a payoff of $117,365.63, the amount due on the SBA Loan. BB&T and Fussell remained unaware of the existence of Centura's Equity Line.

Fussell closed the BB&T loan on June 19, 1997. KRJ executed a $225,000 note to BB&T, and the Debtors gave BB&T a guaranty secured by a deed of trust on their residence in the full amount of the loan. A payoff check for $117,433.44 was issued to Centura to

---

[2] Like most modern businesses, the banking industry is highly computerized. When a request for a loan payoff is made using a specific loan number, that loan number is entered into the query section of the relevant computer program. The program then retrieves the information related to that loan and that loan only. The program will provide information on other loans only when additional inquiry is made using the customer name and other loan numbers. Both Centura and BB&T utilize such programs.

retire what was believed by Fussell and BB&T to be the only debt on the Debtors' residence. From the closing, the Debtors and/or their business received net proceeds of $106,305.31.

Fussell sent the payoff check to Centura via Federal Express with a cover letter dated June 19, 1997. In the cover letter, Fussell asked Centura to mark the original note and deed of trust "paid in full" and returned to him for cancellation. Fussell also typed in and highlighted the following language in his cover letter:

> PLEASE NOTE THAT THERE ARE TWO (2)
> OPEN DEEDS OF TRUST ON THIS LOAN.
> Book 754 Page 216 for $225,000.00
> Book 943 Page 813 for $110,000
> PLEASE PROVIDE CANCELED PAPERS FOR BOTH LOANS

Centura's payoff department received the letter from Fussell. Centura processed the payoff check and sent the SBA Loan note and deed of trust to Fussell for cancellation, but did not send those documents pertaining to the Equity Line. Nor did Centura contact Fussell to question either the payoff amount or the instructions in his transmittal letter.

On April 23, 1998, Fussell wrote a second letter to Centura's payoff department pointing out that he had not received the documents necessary to cancel the Equity Line Deed of Trust. Again, Centura did not respond to Fussell's letter.

In 1999, the Debtors and KRJ defaulted under their various obligations and commenced bankruptcy proceedings before this Court. The record reflects the following encumbrances presently remaining on the Debtors' residence: first, the deed of trust in favor of

Home Savings; second, the Equity Line Deed of Trust to Centura; and third, the BB&T Deed of Trust.

Conclusions of the Parties

BB&T maintains it paid Centura for something that it did not receive: a second lien position on the Debtors' residence. It asks this Court to Order Centura to cancel its Equity Line Deed of Trust or subordinate Centura's position to BB&T's. Alternatively, BB&T believes that Centura should refund the $117,433.44 it was paid by BB&T, plus interest and the Court should retire Centura's deed of trust.

In support thereto, BB&T raises several theories under state contract law and general equitable principles. First, BB&T argues its payoff check to Centura, together with Fussell's letter referencing both the SBA Loan and Equity Line Deeds of Trust, constitute an offer of the payoff funds in exchange for the cancellation of both instruments. BB&T says Centura accepted the offer when it cashed the payoff check and then breached that contract by failing to cancel the Equity Line Deed of Trust.

Second, BB&T says if not a contract, there was a mutual mistake of fact between it and Centura, since the two banks held different views about the effect of the payoff on the Equity Line Deed of Trust. Obviously BB&T intended for both the Equity Line Deed of Trust and the SBA Loan Deed of Trust to be canceled; Centura intended to maintain its Equity Deed of Trust until paid on this debt. BB&T requests rescission of the payoff transaction under this theory. See MacKay v. McIntosh, 270 N.C. 69, 153 S.E.2d

800 (1967)(equity will grant relief for mutual mistake as to a material term of the agreement); Howell v. Waters, 82 N.C. App. 481, 347 S.E.2d 65 (1986) (rescission is a proper remedy for mutual mistake).

Finally, BB&T argues that Centura is estopped to deny the seniority of its deed of trust under a theory of "quasi-estoppel." The crux of this argument is that Centura accepted the benefits of the BB&T payoff check and cannot now refuse to comply with the burdens attendant to that benefit. BB&T requests either cancellation or subordination of the Equity Line Deed of Trust as a remedy under this theory.

Centura's response is that it should not suffer for the mistakes of others. Centura maintains that Attorney Fussell erred in assuming that the SBA Deed of Trust and the Equity Line Deed of Trust secured only one obligation, and that BB&T negligently failed to perform adequate due diligence before lending the Debtors and KRJ additional funds. Centura also argues that there is no basis for equitable subordination of its Equity Line Deed of Trust, citing § 510(c) of the Bankruptcy Code.[3]

After reviewing the facts and the arguments of the parties, it is evident that there is blame to go around in this transaction.

---

[3] Equitable subordination under 11 U.S.C. § 510(c) generally requires a three-factor analysis: 1) whether the party against whom subordination is sought engaged in fraud or other inequitable conduct; 2) whether the conduct resulted in injury to creditors of the debtor; and 3) whether subordination would be consistent with other bankruptcy law. See Benjamin v. Diamond, 563 F.2d 692, 700-701 (5th Cir. 1997); In re ASI Reactivation, Inc., 934 F.2d 1315, 1320 (4th Cir. 1991).

Poor drafting, hasty assumptions, and a lack of communication were the order of the day. However, it is also evident that of these parties, Centura's errors were predominant and induced the errors of the others. Centura created the confusion by its drafting errors in the Equity Line Deed of Trust. Centura also had the best and last opportunity to protect this train wreck. Since Centura benefitted from this transaction, in equity, if not at law, BB&T is entitled to relief.

It is axiomatic that bankruptcy courts have broad equitable authority to modify debtor-creditor relationships. United States v. Energy Resources Co., 495 U.S. 545, 549, 120 S.Ct. 2139, 2142, 109 L.Ed.2d 580 (1990). Furthermore, while bankruptcy is federal law, a party's rights in property within the bankruptcy context are defined by state law. American Bankers Ins. Co. of Florida v. Maness, 101 F.3d 358, 362 (4th Cir. 1996).

Looking to state law, North Carolina recognizes the doctrine of quasi-estoppel, also referred to as "estoppel by the acceptance of benefits." Brooks v. Hackney, 329 N.C. 166, 404 S.E.2d 854 (1991). The doctrine is based on a party's acceptance of benefits. Quasi-estoppel provides that "where one having the right to accept or reject a transaction or instrument takes and retains the benefits thereunder, he ratifies it, and cannot avoid its obligation or effect by taking a position inconsistent with it." Carolina Medicorp, Inc. v. Board of Trustees, 118 N.C. App. 485, 492-93, 456 S.E.2d 116, 120 (1995).

The doctrine of quasi-estoppel is certainly applicable in this case. The June 19, 1997 payoff letter from Attorney Fussell to Centura left no doubt: in return for the payoff check, BB&T expected Centura to cancel the SBA Loan Deed of Trust and the Equity Line Deed of Trust. Both instruments were referenced in the letter along with their book and page numbers in the county real estate registry. Centura cannot expect to retain the $117,433.44 paid by BB&T without honoring the latter's good faith expectations.

Centura points out that the purpose of recording a deed of trust is to provide notice, and a recorded instrument is sufficient to notify a prudent examiner that additional inquiry may be necessary. Massachusetts Bonding & Insurance Co. v. Knox, et. al., 220 N.C. 725, 18 S.E.2d 436 (1942).

Attorney Fussell and BB&T were doubtless aware that Centura had two deeds of trust on the Debtors' residence. This was evident from Fussell's June 19, 1997 payoff letter. However, it was also apparent from Fussell's letter that Fussell and BB&T mistakenly understood both instruments secured the same debt and that both instruments would be canceled in return for the payoff check.

The foundation of their error is Centura's mistake in drafting the debt secured by the Equity Line Deed of Trust. Because of this error, rather than giving record notice of the new Equity Line, the second deed of trust appeared to relate to the SBA note. This error, entirely caused by Centura, led Fussell to conclude there was only one debt owed to Centura and occasioned this loss.

Centura now says Fussell should have drawn a different

conclusion -- that the description of the debt was in error. This Court does not agree. While the title report may have suggested something unusual to the examiner, it was not readily apparent that the designation of the debt in the second deed of trust was erroneous.

Moreover, Centura ignored a chance to correct the misunderstanding. Fussell's cover letter shows an attempt to have Centura corroborate that his assumption was correct. Unfortunately, Centura took the BB&T check but ignored his note.

Having both originated the confusion by fouling up the Deed of Trust, and thereafter throwing away the last chance to correct the mistake (by not reading or responding to Fussell's note), Centura cannot shift its responsibility to Fussell or BB&T. Centura was in the best position at that point to catch the mistakes in its security instruments.

A Centura loan service associate gave deposition testimony that the bank's standard policy was to review payoff instruction letters and to contact the closing attorneys if questions arose. Instead, on two separate occasions in this case, once when it received the June 19, 1997 payoff letter and again when it received the April 23, 1998 follow up letter, Centura made no effort to contact Fussell. In light of these facts, it would be manifestly unfair for Centura to retain the benefits of this transaction on the theory that BB&T and Fussell were at fault.

Conclusion

The Court views cancellation of the Equity Line Deed of Trust and the imposition of monetary damages as overly harsh remedies in this instance, where all parties share some measure of the blame for their predicament, and particularly where the Debtors failed to inform BB&T of the Equity Line Deed of Trust. However, the Court concludes that under the doctrine of quasi-estoppel, Centura is estopped to deny the seniority of BB&T's Deed of Trust and that its Equity Line Deed of Trust should be subordinated to BB&T's. Having decided the case on this basis, the Court does not reach the other arguments raised by the parties.

WHEREFORE, IT IS ORDERED:

1. Centura is hereby estopped to deny the seniority of BB&T's Deed of Trust under the doctrine of quasi-estoppel;
2. The Equity Line Deed of Trust in favor of Centura is hereby subordinated to the BB&T Deed of Trust.

Dated as of date entered

J. Craig Whitley
United States Bankruptcy Court