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# Alliance Mortgage: Partial Answers About Full Credit Bids

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## ***Alliance Mortgage: Partial Answers About Full Credit Bids***

ROGER BERNHARDT

Based on the number of appellate decisions involving careless full credit bids, it appears that lenders concentrate far more on deciding whether to make a loan than on considering what they will do when that loan goes into default. If they would ask their lawyers beforehand how much to bid, the lawyers' warnings about the effect of a full credit bid would pretty much answer the question. (Miller and Starr go so far as to say that an attorney's failure to advise a client about the effect of a full credit bid is probably malpractice. Miller & Staff, California Real Estate §9:158 (2d ed 1989).) When lenders bid first and ask questions later, however, legal advice becomes much more situational. The California Supreme Court's decision in *Alliance Mortgage v Rothwell* (1995) 10 C4th 1226, 44 CR2d 352, has only complicated that situation.

*Alliance* introduces a new variable into the full credit bid rules: With regard to fraud committed by a third party, a full credit bid is not a bar to "general" deceit damages (the phrase I use for the difference between the loan balance and the actual value of the collateral recovered at the trustee sale) if the amount bid was itself a "proximate result" of the fraud; however, when the full credit bid was not the proximate result of the fraud, a lender can recover only "other" damages resulting from the fraud, and such damages seem unlikely in normal loan cases.

As an aftermath of this decision, here are some questions lenders are likely to ask their lawyers, and some suggested answers.

### **Question: Did my full credit bid effectively eliminate any recovery against third parties for fraud?**

**Answer: Maybe.**

Since the profit in deceiving a lender inevitably relates to inducing the lender to loan too much at the outset, rather than to bid too much at the foreclosure, the *Alliance* proximate-cause standard appears to work against lenders most of the time. However, the court's discussion of proximate cause may change that balance considerably. Under *Alliance*, it appears that the lender, who was misled at the start, and not later disabused, will be regarded as still relying on the original deception in making a full credit bid at a trustee sale. Because perpetrators of initial fraud are not likely to voluntarily confess their misdeeds later on, the average lender who knows merely that one of its loans is in default when it enters a full credit bid may yet be able to recover significant damages from its corrupt loan officer or appraiser when the lender later discovers that it was defrauded when it made the loan.

Proximate cause is now an issue, however. Therefore, fraudulent inducers will seek protection by claiming that the lender knew or had reason to know of the fraud before the sale, in order to confine their exposure to "other," rather than "general," fraud damages. As a "fact-based inquiry," this determination apparently will be made by the jury. Thus, the amount a lender can recover for being swindled in January will depend on the jury's opinion about how careless the lender was when it foreclosed in December.

### **Question: What is the effect of a full credit bid on my rights against the borrower?**

**Answer: It's hard to tell.**

*Alliance* reaffirmed earlier decisions holding that lenders were barred from going after additional security, rents, insurance proceeds, or deficiency judgments after entering full credit bids. It is unlikely that a lender could avoid that bar by arguing that its bid was uninformed, because underbidding in order to reach additional security is based, not on the reduced value of the main security, but instead on the value of the additional security still available. When the lender is seeking a *nondeficiency* personal judgment against the borrower, however, its assertion that it did not know the true (*i.e.*, lower) value of the security may become relevant.

In *Cornelison v Kornbluth* (1975) 15 CM 590, 125 CR 557, the court held that a lender could recover from a borrower for bad faith waste *unless* the lender had made a full credit bid. Because *Cornelison* never mentioned whether the lender knew of the waste at the time it made its bid, it is tempting to conclude that a full credit bid insulates the borrower from all liability, regardless of the borrower's wrongful conduct or the lender's ignorance. That could make the full credit bid a complete defense for any defrauders who are also borrowers.

If, however, the borrowers were part of a larger conspiracy to defraud the lender and were found to have proximately caused the overbid (by virtue of failing to tell the lender the truth about the matters previously concealed), the above conclusion would force a court to hold the coconspirators fully liable while at the same time entirely insulating the borrowers, or at least holding them to a lesser measure of liability (and then deciding what to do when the coconspirators seek some kind of apportionment or indemnification from the borrowers).

It is likely, therefore, that the *Alliance* proximate cause test may be applied to waste as well. Borrowers who commit bad faith waste may be hard to distinguish from those who conceal similar conditions from their lenders (especially when the concealed condition was the result of waste) and the logic of forgiving innocent or fraudulently induced overbids looks as applicable to waste as to fraud, and as applicable to borrowers as to third parties.

**Question: Will a full credit bid affect other rights against third parties?**

**Answer: It depends.**

A lender can also sue third parties who nonfraudulently damage its security. It can do so before foreclosing, but if it waits until after it has made a full credit bid, courts will have to decide if and how the *Alliance* proximate-cause test applies in nonfraud cases. Can the lender who was innocently ignorant of the damage get around its full credit bid like the lender who was still under the influence of fraud? Would it matter if the third party was instrumental in concealing from the lender the damage it had caused? Because answers to these questions probably depend on resolution of borrowers' liability for concealed bad faith waste after a full credit bid, discussed above, the result in such a situation is unpredictable.

**Question: What is the effect of the one-action and antideficiency rules on these cases?**

**Answer: I don't have the faintest idea.**

I never understood *Cornelison's* assertions that a waste judgment was sufficiently close to a deficiency judgment to be subject to antideficiency policies, or why the similarity ended in bad faith waste cases, or why borrowers who did not take care of their properties in bad times were good faith wasters. (The federal courts didn't understand it either, I might add, at least according to *U.S. v Haddon Haciendas Co.* (9th Cir 1976)541 F2d 777.) That makes it hard to make rational predictions from those underlying assumptions.

**Question: Should I ever make a full credit bid?**

**Answer: No.**