2007

Creditor's Inability to Set Aside a Judicial Foreclosure Sale Despite Gross Underbidding: Amalgamated Bank v Superior Court (2007)

Roger Bernhardt
Golden Gate University School of Law, rbernhardt@ggu.edu

Creditor's Inability to Set Aside a Judicial Foreclosure Sale Despite Gross Underbidding
Amalgamated Bank v Superior Court (2007)
149 CA4th 1003, 57 CR3d 686

Real property claimant must establish probable validity of claim in order to vacate postjudgment order expunging lis pendens.

As judgment creditor on real property owned by Winncrest, Pension Trust Fund for Operating Engineers and its corporate cotrustee, Amalgamated Bank (collectively, PTF), requested the county sheriff to issue a writ of sale to execute on the property and sell it to the highest bidder (subject to the mortgagor's right of redemption). The property was worth approximately $6.5 million. PTF intended to bid at the public auction but did not do so because its designated bidders, delayed in traffic, did not arrive until after the property was sold to Palmbaum for $2000. Winncrest did not exercise its right of redemption within the one-year redemption period.

PTF sued to set aside the foreclosure sale for irregularities and recorded a notice of lis pendens. The trial court granted Palmbaum summary judgment, concluding that PTF was barred from setting aside the sale. While PTF's appeal was pending, Palmbaum successfully moved to expunge the lis pendens. PTF petitioned for writ of mandate to stay the expungement order. The court of appeal granted an alternative writ and stayed the expungement order pending resolution of the petition.

The court of appeal denied the writ. It first concluded that its stay of the expungement order was superfluous because, under CCP §405.35, a stay upon filing a petition for writ of mandate is automatic; the expungement order is not effective until the writ proceeding is finally adjudicated.

Code of Civil Procedure §405.32 requires a court to order the expungement of a notice of lis pendens if it finds "that the claimant has not established by a preponderance of the evidence the probable validity of the real property claim." Code of Civil Procedure §405.3 defines "probable validity" as "more likely than not" that the claimant will prevail against the defendant in the action. The code comment to §405.32 states that it was intended to disapprove cases that held that the court on a motion to expunge may not conduct a mini-trial on the merits of the case, and to change the law to require judicial evaluation of the merits.

The language of §405.32 is plainly targeted at motions to expunge before trial, not expungement motions made after judgment has been entered and while an appeal is pending. In *Mix v Superior Court* (2004) 124 CA4th 987, 21 CR3d 826, the court held that a trial court presented with an expungement motion after judgment against the claimant must apply the probable validity standard and may deny the motion only if the court believes that its own decision will be reversed on appeal. The trial court did not err in granting the expungement motion.

In deciding a writ petition under CCP §405.39, after judgment and pending appeal, an appellate court must also assess whether the underlying real property claim has probable validity, *i.e.*, whether it is more likely than not the real property claim will prevail at the end of the appellate process. The appellate court will conduct a prima facie review of the probable success of the underlying appeal, a mini-review that is not equivalent to a full-scale resolution of the underlying appeal. Summary denial of a writ petition does not constitute law of the case requiring the appellate court to decide the appeal against the real property claimant.

PTF had no standing to bring an action to rescind the judicial foreclosure sale. Under CCP §701.680(c)(1), which applies to judicial foreclosure sales, including those subject to a right of redemption, only the judgment debtor can set aside the sale for irregularity and only if the purchaser was the judgment creditor. Here, the property was sold to

Palmbaum, a third party; he became the fee owner, subject only to the right of redemption. Because Winncrest did not bring an action to set aside the sale or exercise its right of redemption within the statutory time frames, Palmbaum's title to the property was perfected.

THE EDITOR'S TAKE: From a systems point of view, one should approve this decision as showing that deadlines really are meaningful and apply to creditors as well as lenders. On the other hand, from a common-sense or equity point of view, one should say it is insane to reject an attempt to set aside a foreclosure of collateral that was worth between $6 million and $10 million but was sold for only $2000 because the lender was held up in a traffic jam and showed up at the sale a minute late, and had its attempt to enter a bid thereupon rejected. (I confess to some bias in this analysis, having been involved in this case at some of its stages.)

Both the trial and the appellate court decisions are based on pure formalism: the trial court's summary judgment against undoing the sale on the ground that judicial foreclosure sales are statutorily invulnerable from attack, regardless of merits; and the appellate court's refusal to issue a writ undoing expungement of the lis pendens, despite its disclaimer that the merits of the case had not been decided. Both results have great appeal as policies that should be generally supported, but at the same time they generate considerable doubt as to the wisdom of their application in this particular case.

1. As to the *summary judgment*, the foreclosure sale was upheld because CCP §701.680 provides that a judicial foreclosure is "absolute and may not be set aside for any reason" except in an attack made by the judgment debtor (not the creditor, as here). But despite this statute saying that foreclosure sales are absolute, CCP §726 provides at the same time that they are subject to rights of postsale redemption whenever a deficiency judgment can be rendered. Since "absolute" is supposed to mean "not subject to redemption" (*Yancey v Fink* (1991) 226 CA3d 1334, 1350, 227 CR 415), there clearly has to be a carve-out for sales, such as this one, when a deficiency judgment was sought if both §§726 and 701.680 are to be respected.

When §701.680(a) then also says that the sale "may not be set aside for any reason," is that subject to the same carve-out, or are the two clauses in the section to be treated differently? Since the policy behind this section is to give sales more finality, in order to encourage bidding at them, is any additional finality gained by making a sale immune to attack when it is already subject to redemption? Would a prospective bidder offer more in one case than in the other? When a sale is truly "absolute" (not subject to redemption), then "finality" (invulnerability to attack) is a meaningful companion, but what good does invulnerability do when there can be a redemption anyway? It does not seem very likely to me that the legislature truly wanted to bar judicial attacks on sales that were already subject to statutory redemption.

I can understand having what seems like a logically absurd principle if it did a party some good, but that does not seem to be the case. Denying the creditor an opportunity to vacate the sale so that it can enter a *higher* bid certainly does not help the debtor, who only loses the prospect of the deficiency judgment being reduced by virtue of a higher bid (if it exceeded fair value). Nor does it help junior creditors, who, like the debtor, lose the opportunity to receive any surplus from a higher bid. It clearly hurts the selling creditor, whose deficiency recovery remains limited by fair value regardless of how little was bid. Only the third party bidder comes out a winner. (Unless the trustor then redeems, and it is certainly puzzling why there was no redemption here, when it would have taken only $2000 to reacquire property worth $6 million to $10 million.)

I have written previously about my misgivings as to making the fall of the hammer the crucial last moment of the sale, as opposed to the delivery or the recordation of the trustee's or sheriff's deed. See Midcourse Correction, *Setting Aside Foreclosure Sales*, 24 CEB RPLR 80 (Mar. 2001), and my Editor's Take (26 CEB RPLR 161 (July 2003)) on *Residential Capital, LLC v Cal-W. Reconveyance Corp.* (2003) 108 CA4th 807, 134 CR2d 162. I think either party—debtor or creditor—whose objection is publicly made before the selling official has accepted the bidder's money and delivered the deed to the bidder should have standing

to make that protest in court even though the hammer had already fallen, but that does not appear to be the rule.

2. With regard to *expunging the lis pendens*, the court of appeal applied similar policy notions: Notices of pendency have to be readily expungeable in order to keep them from being frivolously or abusively filed. As with foreclosure sale finality, I think that is an admirable policy, but only when and if it serves some appropriate purpose.

By permitting this lis pendens to be expunged when the merits have yet to be decided, this lender—even if it prevails—will recover nothing. Even if the debtor is not a single-asset judgment-proof entity, the lender's deficiency judgment will be calculated according to the $6 million to $10 million fair value, rather than the $2000 bid, allowing all of the rest in between those numbers to escape. Even if the lender's arguments on the merits are upheld, the sale cannot be undone if title was transferable to a BFP because of the expungement, and such a transfer did occur. The bidder will have sold for $6 million what it purchased for $2000, and it will take some pretty imaginative theorizing for the lender to find a way to reach into its pocket and retrieve that profit. Once the lis pendens is expunged, the foreclosure purchaser can capture the kind of resale profit that was sought and lost in *Residential Capital*, *supra*, regardless of whatever happens on the merits.

The probable validity test that the court of appeal applies seems generally an appropriate standard. But nowhere in it is any consideration given to the potential harm that can result if expungement is permitted at the preliminary stage and then regretted at the final stage.

Again, efficiency beats equity.—*Roger Bernhardt*