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Roger Bernhardt

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

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Full credit bids:
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Roger Bernhardt

Loan purchaser's full credit bid, based on fraudulent appraisal, does not preclude original lender's action against appraiser.

First Commercial Mortgage Co. v Reece (2001) 89 CA4th 731, 108 CR2d 23

First Commercial Mortgage Co. (Commercial) made a loan secured by real property based on an appraisal of the property prepared by Reece that grossly inflated the property's value. Commercial sold the loan to First Nationwide Mortgage Co. (Nationwide), which later acquired the property by a full credit bid at its foreclosure sale. Commercial was compelled by its contract with Nationwide to repurchase the property from Nationwide in order to indemnify Nationwide for its loss. Thereafter, Commercial suffered a substantial loss when it resold the property. Claiming that it made the loan and sale to Nationwide based on Reece's grossly inflated appraisal of the property, Commercial sued Reece and others for fraudulently inducing it to make the loan. The trial court granted summary judgment for Reece, holding that the action was barred by Nationwide's full credit bid.

The appellate court reversed. Normally, a full credit bid establishes the value of the security as being equal to the outstanding indebtedness and will preclude later claims by the bidder that the property was worth less than the bid. There is an exception, however, when the bidder is fraudulently induced to make a full credit bid, *e.g.*, by being intentionally and materially misled by its own fiduciaries or agents. *Alliance Mortgage Co. v Rothwell* (1995) 10 C4th 1226, 44 CR2d 352. Moreover, when a lender justifiably relies on third party representations in selling its loan, damages resulting from any compelled repurchase (as here) are incurred as a direct result of the fraud. 10 C4th at 1248. Thus, if a lender justifiably relies on a fraudulent appraisal in making and selling a loan, it may maintain an action for fraud and intentional or negligent misrepresentation against its appraiser, in spite of the loan purchaser's full credit bid foreclosing the loan. Accordingly, Nationwide's full credit bid has no bearing on Commercial's suit for damages.

►**THE EDITOR'S TAKE:** This opinion—by Judge Klein of the Second District—goes significantly farther than the recent decision—by Judge Kline of the First District—in *Kolodge v Boyd* (2001) 88 CA4th 349, 105 CR2d 749, reported in 24 CEB RPLR 162 (May 2001), in minimizing the effect of the full credit bid. If matters continue the way they are going, only the most blundering lender will be prohibited from recovering for wrongs done to it merely because it entered a full credit bid at a previous foreclosure sale.

Indeed, under the circumstances of this case, it would be almost impossible for the full credit bid rule to have any effect. Once a loan has been sold by the original lender to a second lender on recourse terms, what happened at the foreclosure sale becomes entirely irrelevant. The second lender's exercise of its recourse rights against the first lender are contractually independent of how much it bid at the foreclosure sale, and the first lender's causes of action against the

underlying tortfeasors are no longer affected by how a different lender bid at a foreclosure sale that it did not conduct.

(I guess that could change if lenders who sell their loans either conditioned their recourse liability on being compelled by the buying lender to repurchase the loan before rather than after foreclosure, or required the buying lender to consult with them about the amount to bid at the buying lender's foreclosure sale. But those are distant possibilities, and neither lender seems motivated to pursue them, since both are as well off as they can be under the present arrangement, which lets each recover fully despite a full credit bid.)

Under this decision, once an originating lender sells its loan to a second lender, whatever underlying tort or contract rights are assertable against the borrower or third persons become immune from later defenses based on how much was bid at the foreclosure sale. A good way for lenders to reduce their worries about overbidding at later foreclosure sales is to promptly sell all their loans to other lenders and buy back different loans from them.

This decision goes far in eliminating the effectiveness of a full credit defense in both fraud and negligence claims by the first lender against third parties. In its final paragraph, it goes even farther in letting that lender assert a breach of contract claim against the broker who arranged the loans beforehand, even though the buying lender made a full credit bid at the end. With so many gaps filled in, the only issue still possibly subject to the protection of the full credit rule is a borrower's personal liability for torts. We shall have to wait for more judicial imagination to see how that issue gets handled. --*Roger Bernhardt*