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Setting Aside Foreclosure Sales

ROGER BERNHARDT

Seldom in the commercial world will a clerical error force its maker to suffer a \$90,000 loss when no harm was shown to result from it and the error was discovered before the deal actually closed. But then, mortgage law has never pretended to include much commercial common sense in its rulings, as *6 Angels, Inc. v Stuart-Wright Mortgage, Inc.* (2001) 85 CA4th 1279, 102 CR2d 711, illustrates. (The case is reported on page 84.)

In *6 Angels*, the beneficiary discovered that its intended foreclosure bid of \$100,000 had been mistakenly converted into a bid of \$10,000 (on a debt with an outstanding balance of about \$145,000), thereby permitting a professional foreclosure bidder to increase the bid by one cent (to \$10,000.01) and thus prevail at the trustee sale. But before anything else happened (the opinion does not say precisely when, but only says “shortly thereafter”), the beneficiary discovered the error and instructed the auctioneer not to deliver a trustee’s deed to the “high” bidder, who then brought this action to compel delivery of that deed. This raises two intertwined issues regarding the nature of the mistake and the timing of its discovery.

When Is a Foreclosure Sale Complete?

A sale is ordinarily “set aside” only after it has become a completed sale; before then, there is really nothing to set aside. Just as is true for the conventional real estate sales contract, significant changes of status occur between before and after the execution of the contract, and, again, between the execution of the contract and its consummation at the close of escrow: equitable conversion ends and the parties switch from seller/buyer to grantor/grantee. Specifically, before a binding sales contract is signed, the seller is the sole owner of the property and the buyer is merely an interested third party or perhaps an offeror; after the sales contract has been fully performed (by a close of escrow), then the buyer is the sole owner and the seller is merely a former owner and perhaps a secured creditor if money is still due. Between the execution and the completion of the contract, however, the seller holds the legal title and the buyer’s right to have specific performance means that she or he holds the equitable title, which can make a difference when people die or other unexpected events occur in that time period.

Is a trustee sale subject to the same distinctions? Do we treat an event differently according to whether it occurred before the hammer fell, after the hammer fell, or after the trustee’s deed was delivered? Elsewhere, passage of title requires delivery of a deed; the sale is not final just because the auctioneer pounds her hammer. Civil Code §2924h(b) defines sale completion as the falling of the hammer (or acceptance of the last and highest bid; see §2924h(c)), but it is pretty clear that this definition was created to allow the foreclosure bidder to win the race against the bankruptcy trustee when the bankruptcy petition is filed after the hammer falls and before the trustee’s deed is recorded. Furthermore, the code provision making the statutory recitals of compliance in the trustee’s deed conclusive (CC §2924) seems clearly to require that the deed be delivered for compliance to occur. I think considerable uncertainty remains as to rights and duties between the fall of the hammer and delivery of the deed (Suppose, for example, that an earthquake damages the property in the intervening period. Who is liable to a bypasser injured on the property at that time?)

“Do we treat [a foreclosure defect] differently according to whether it occurred before the hammer fell, after the hammer fell, or after the trustee’s deed was delivered?”

Thus, we have cases like *Angell v Superior Court* (1999) 73 CA4th 691, 86 CR2d 657, *Whitman v Transtate Title Co.* (1985) 165 CA3d 312, 211 CR 582, and *Little v CFS Serv. Corp.* (1987) 188 CA3d 1354, 233 CR 923 (not all of which were mentioned in the *6 Angels* opinion), which are far more generous in undoing sales when the trustee’s deed was not delivered, than are *Moeller v Lien* (1994) 25 CA4th 822, 30 CR2d 777 (and perhaps *Estate of Yates* (1994) 25 CA4th 511, 32 CR2d 53), when the deed had been delivered.

6 Angels does make this distinction, but applies it only in terms of the preclusive effect of trustee’s deed recitals. It acknowledges that the plaintiff must show that the buyer was not a bona fide purchaser only when the plaintiff attacks a sale after the deed has been delivered, but otherwise applies the same standard to evaluating the underlying challenge. I think that disregards the significance of the fact of whether or not the deed has been delivered.

What Are Sufficient Grounds To Stop or Set Aside a Sale?

All courts agree that gross inadequacy of price alone is not enough to set aside a completed foreclosure sale (*i.e.*, when the deed has been delivered), but that it is sufficient if there was also some irregularity in the sale. In *6 Angels*, there was clear gross price inadequacy, but was the beneficiary’s clerical error in the bidding instructions a sufficient irregularity? Continuing the distinction I made above, I think that most courts would hold that the error would not suffice to set aside the sale had it been discovered only after the foreclosure deed was delivered, but I doubt that they would have the same reaction to a predelivery discovery of that error.

Granted, the kind of irregularities that defeat sales usually result from mistakes made by the trustee, rather than the beneficiary. But the overriding consideration seems to be whether the irregularities lead to lower bidding. A trustee’s mistake regarding the date or location of the sale, or the location of the property, is a significant irregularity because there will then be fewer bidders for the property. On the other hand, when the bid is entered at \$10,000 rather than \$100,000, how much should it matter that the mistake was made by the beneficiary rather than the trustee? Perhaps this mistake might not rise to the dignity of an irregularity if the deed has already been delivered (although many decisions state that only a “slight irregularity” is required), but when no delivery has occurred, that standard seems too high.

The standard that ought to apply in predelivery cases is whether the purchaser is entitled to specific performance (which is what this sort of action is, in fact). That requires the bidder to show that the contract was just and reasonable, and the consideration adequate. See CC §3391(2). And since I doubt that \$10,000 is adequate consideration for a property worth over \$100,000, this sale might not be upheld even though there was no irregularity caused by the trustee.

Who Cares?

The fact that it was the beneficiary who suffered injury in this case may have had a lot to do with the outcome. Courts often show little sympathy for lenders, even when their mistakes are innocent. Because of CCP §580d, the trustee sale was the end of the line for this lender, and the remaining \$135,000 of the money it lent is now a total loss. Because of §580d, the trustors were not hurt by the misbid and were probably legally and factually indifferent to the struggle between the beneficiary and the foreclosure bidder.

But suppose this had been a judicial foreclosure (of a nonpurchase money debt) where the mistake was discovered before delivery of the sheriff’s deed and the trustor was likely to be

personally liable for a deficiency judgment. (Our statutory fair value requirement might help, but only some: If the fair value of the property was \$95,000, rejecting the beneficiary's bid of \$100,000 would cost the trustor \$5000 of deficiency protection.) Would a court still regard this irregularity as inconsequential and order the sheriff to deliver the deed? Or suppose the note was guaranteed (by a guarantor who had waived all of her *Grady* rights). Could the misbidding beneficiary—after being outbid at the sale—then make the guarantor pay? (Our antideficiency and fair value statutes don't apply to guarantors.) If so, could the guarantor act to stop delivery of the deed?

A “yes” answer to questions like these suggests that the real distinction should not pertain to when the irregularity occurred, or whether it was significant or slight, but rather whether the loss was suffered by the debtor or by the creditor. None of the cases say that, but it is a conclusion that seems hard to resist when mortgages are involved.