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Foreclosing on one of two liens on property: Ostayan v Serrano Reconveyance, 2000

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Neither lender nor trustee owed duty to buyer at foreclosure sale who relied on third party title report that erroneously described junior lien being foreclosed as secured by first deed of trust.

Ostayan v Serrano Reconveyance Co. (2000) 77 CA4th 1411, 92 CR2d 577

Home Savings (lender) lent the borrower $230,000 in 1983 and $110,000 in 1988, each loan secured by a deed of trust recorded by Serrano Reconveyance Company (trustee). The 1983 loan had two dragnet clauses stating that the deed secured payment of any additional sums borrowed or advanced by the lender. The 1988 loan was titled "Additional Advance Deed of Trust." The lender treated the loans as a single obligation by combining scheduled payments and billing statements and using the same loan number. When the borrower defaulted, the trustee recorded a notice of default and election to foreclose, which expressly provided that the sale was for satisfaction of the 1988 note.

The purchaser-to-be obtained copies of the notice, the two deeds of trusts, and an independent preliminary title report (for which neither the lender nor the trustee were responsible), which erroneously disclosed that the 1988 note was secured by the 1983 trust deed. Based on the title report, the buyer concluded that the 1988 deed evidenced additional sums advanced against the original deed of trust. At the foreclosure sale, the auctioneer announced twice that the property was also encumbered by a senior lien, but that the sale was for the junior lien. The buyer heard the disclaimer, disregarded it as "unfounded," and entered a successful bid.

After discovering the existence of the senior lien, the buyer sued to enjoin conclusion of his foreclosure sale and the later foreclosure of the senior lien (which resulted in a third party's acquisition of the property), by claiming that he was induced to purchase the property by the misleading manner in which (1) the trustee noticed and conducted the sale and (2) the lender treated the loans as a single obligation. The trial court granted summary judgment to defendants, finding that the buyer's losses resulted from his own legal or economic errors.

The court of appeal affirmed. The buyer's claim for intentional or negligent misrepresentation was without merit because the buyer did not actually and reasonably rely on any false, untrue, or misleading representation made by the lender or trustee; the notice of sale clearly stated that the lien being foreclosed was the 1988 trust deed; the auctioneer announced that the foreclosure was subject to a senior lien; and the buyer admitted that he was aware and in possession of both trust deeds and notice of sale of the 1988 trust deed when he attended the sale, and that he relied on his own knowledge, experience, and the title report.

The court additionally found that the trustee had no duty to protect bidders from their own legal or economic errors. The court opined that to do so would "create a new economic tort [imposing] a new duty of care from foreclosing trustees to bidders . . . to provide sua sponte detailed explanations concerning recorded encumbrances," because such duty would encourage

"trustees to make excessive, self-protective disclosures, thus emphasizing risks and depressing sale prices." 77 CA4th at 1420.

Although the lender had treated both loans as a single obligation, the court also rejected the buyer's claim for merger of the trust deeds. The court found that the dragnet clauses in the first trust deed did not apply to the later loan because the second note did not expressly recite that it was secured by the 1983 trust deed and, accordingly, the two loans did not qualify for merged treatment. Moreover, the application of the merger doctrine in *Simon v Superior Court* (1992) 4 CA4th 63, 5 CR2d 428 (holding that a lender secured by two successive trust deeds, after foreclosing the first on a credit bid, was not a true third party sold-out junior lienholder and was therefore barred from obtaining a deficiency on the second under CCP §580d) was distinguishable because, here, the lender foreclosed on its junior lien with full disclosures and did not seek a deficiency judgment.

▶***THE EDITOR'S TAKE:*** There was some pretty fierce language in *Simon v Superior Court* about the evils of one lender taking both a first and second deed of trust and the judicial sanctions that could follow. This caused justifiable worry to lenders as to how safely they could make equity line second loans to their clients when they were already holders of the first on the same property. As a result of the ruling against the foreclosing purchaser in this case, most of those worries can be forgotten. It is all right to make both a first and second loan on the same property and to secure it by separate deeds of trust, even though the first deed of trust had the capacity (by virtue of its dragnet clause) to sweep the second loan under it (at least when the second loan is made at a later date and as a separate transaction; one could certainly argue that a bundle of first and second deeds of trust given at the same time—as was done in *Simon*—is more suspect).

(It is even all right to consolidate the monthly payments for bookkeeping purposes without causing a merger, although I think it is unwise to do so without an agreement with the debtor as to how payments are to be allocated, especially in light of CC §1479 (governing the application of payments by a debtor owing multiple obligations to a single creditor); of course, if no payment is made at all, there is not much of an allocation problem.)

This decision restricts *Simon* and its brethren to deficiency issues, thus upholding the validity of such loan packages for all other purposes. A lender holding both a first and a second can sell under its second and thereafter sell under its first if it has not been paid. The fact that the lender cannot instead sell under its first and then sue as a sold-out junior on its second means that it remains worse off than any third party lender (who could later sue as a sold-out junior); but its lawyers ought to be able to advise it of that at the start.

As far as advising borrowers is concerned, you should of course suggest to them that if their property has appreciated enough to justify a second mortgage on it, they would probably be better off getting the loan from the lender who holds the first. Maybe there is still the possibility of deficiency liability if a judicial foreclosure of the second is held first, but such an event seems rather unlikely. —*Roger Bernhardt*