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Risky Recitals

By: Roger Bernhardt

Lenders who operate in jurisdictions that force them to judicially foreclose on their defaulted mortgages should not be so envious of their counterparts in states that permit trustee sales because that nonjudicial foreclosure alternative can generate as many problems on the rear end as it seeks to avoid on the front end - as the recent case of *Bank of America v La Jolla Group*, 129 Cal. App. 4th 706 (2005) illustrates.

Background -- Trustee's Sale Follows Trustor's Cure

In *La Jolla Group*, after the trustors went into default the lender had the trustee give notice of default, and then notice of sale, setting a sale for November 12. California law permits trustors to reinstate and thereby have the sale cancelled up until five days before the sale, but lenders will always permit that to happen up to the last minute, and in this case the trustors cured on November 8. A bank employee accepted their check but forgot to tell anybody else about it and so the trustee went ahead and sold the property four days later, as it had previously been instructed to do. A group of professional purchasers bid \$500 over the \$15,000 that was owed (on property that had a market value of \$115,000) and won the auction. A trustee's deed was issued and then recorded on November 20, but on November 25 the trustee informed the buyers about the mistake. They ignored that and sued to evict the trustors on December 3. That forced the trustee to record a notice of rescission on December 5 and to attempt to return their money, but since that was rejected, the beneficiary then filed this action to cancel the trustee's deed. It was pretty clear that the sale was improper under

California law (and probably would be anywhere else as well), but the bidders' main defense was that they were insulated from attack by the recitals in the trustee's deed.

Trustee's Deed Protects Purchaser at Trustee's Sale

Trustee's deed recitals derive their importance from the fact that nonjudicial foreclosure sales have no judges watching over the proceedings, making sure that the debtors have been heard, and ruling on (and usually rejecting) their objections to the process. As a result of those safeguards, a completed judicial foreclosure sale carries much more protective finality than accompanies a nonjudicial sale. If something was wrong about the trustee sale process, it may not be pointed out until everything is all over, and the consequence may be having to start all over again from the beginning. Trustee's deed recitals are an attempt to provide trustees' sales with some of the armor that insulates the judicial foreclosure from most post sale attacks.

In California, these recitals follow a three step process. First, there is a supporting statute. Civil Code §2924 provides:

"A recital in the deed executed pursuant to the power of sale of compliance with all requirements of law regarding the mailing of copies of notices or the publication of a copy of the notice of default or the personal delivery of the copy of the notice of default or the posting of copies of the notice of sale or the publication of a copy thereof shall constitute prima facie evidence of compliance with these requirements and conclusive evidence thereof in favor of bona fide purchasers and encumbrancers for value and without notice."

Second, there is always an enabling provision in the deed of trust authorizing the inclusion of such recitals in the trustee's deed. And then, third, there are the recitals themselves included in the trustee's deed. In this case the opinion quotes the recitals as saying:

"All requirements per California Statutes regarding the mailing, personal delivery and publication of copies of Notice of Default and Election to Sell under Deed of Trust and Notice of Trustee's Sale, and the posting of copies of Notice of Trustee's Sale have been complied with."

Trustors Who Cured Default Prior to Sale Trump Purchasers

Under the circumstances, it was not hard for a court to strip away any protection the recitals could offer to the purchasers: the challenge to the sale was not based on any failure to mail, deliver, publish or post notices - which were the only matters covered by the recitals. This sale was irregular because the trustors were not in default at the time it occurred, and notices saying they were - even if those notices had been properly mailed, delivered, published and posted - could not undo the fact of no default, nor do the bidders no good, even if they qualified as bona fide purchasers. The trustee was only reciting that it had performed its presale tasks properly; it knew and could say nothing about direct dealings of the beneficiary and trustor thereafter (or at any time).

California's code is particularly narrow about the scope of recitals, confining them to the giving of presale notices. Statutes elsewhere² often permit trustees to add that they properly handled "the conduct of the sale" itself - a matter not embraced in

the California statute or the trustee's deed in *La Jolla Group*. Inclusion of that language would not have mattered here, but it could make a real difference where, e.g., the trustee is accused of having wrongly rejected someone's attempt to bid at the sale, or his tender of a certified rather than a cashier's check, or her request for a short delay to go get additional funds. The sale itself, since it usually conducted by the trustee or its agent, is as much within its direct knowledge as was the presale giving of notice, and it is surprising that California lenders have not lobbied to broaden the statute or to include provisions relating to the sale in their deeds of trust and demand that trustees do the same in their deeds on sale, with or without express statutory support.

Other statutes go significantly further and allow trustees to be considerably more extravagant as to what they say about the situation. Arkansas, for instance, refers not only to conduct of the sale but also to "compliance ... relating to the exercise of the power of sale", which could even mean declaring a default.³ Even more dramatically, Nevada permits the recital to cover the fact of default, the waiting for the required three months, the making a demand for sale by the beneficiary, and the sale being regularly and validly made; its next sentence goes on to add that the recitals are conclusive against the grantor "and all other persons", making it presumably indifferent to the question of whether or not the grantee was a BFP or an insider.⁴ Taken literally, these versions look like they might well immunize a sale even as bad as was conducted in *La Jolla Group* (although the likelihood of a court reaching that result is rather small).

Reliance on Recitals -- Lenders and Bidders Beware

When seeking protection behind a recital, it is not enough to simply point out that the relevant statute covers

the particular challenge being made. Many statutes only authorize recitals, not mandating their inclusion nor implying them when express language is not actually in the deed. Lenders and bidders should be sure that all of the good recitals are included in deeds as well as in the statute.

And then there is the problem of symmetry. How do you treat recitals that go beyond the statutory umbrella? Are they invalid per se as clogs or waivers or do they have at least some estoppel effect against the trustors who signed the deed of trust authorizing them (and perhaps against successors and juniors who took subject to the instrument)? How do you treat recitals in the trustee's deed that go beyond what the deed of trust authorized? Which language controls when the statute provides for "A", the deed of trust calls for "B", and the trustee's deed recites "C"? Discrepancies like that are easily possible when the attorneys for the auctioneer conducting the sale are too enamored with their own computer generated forms for trustees' deeds to be bothered to compare them to the computer generated forms the bank lawyers used in drafting the loan documents. Recitals are only worthwhile after something has gone wrong at the sale, and then it is far too late to notice the mismatches.

Life would have been different had there only been a judge around to approve or prohibit the sale from the start.♦

Footnotes

¹ ACMA member Roger Bernhardt is the Editor of the California Real Property Law Reporter (California Continuing Education of the Bar). This article is derived from a recent column he wrote there.

² A good discussion of these statutes can be found in Baxter Dunaway's *Law of Distressed Real Estate*, §§17.21 & 64.176.

³ See Arkansas Code 18-5-111.

⁴ See Nevada Revised Statutes §107.030.

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