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Foreclosure Trustees and Fiduciary Duties
Heritage Oaks Partners v First Am. Title Ins. Co. (2007)
155 CA4th 339, 66 CR3d 510

Trustee under deed of trust merely acts as common agent for trustor and beneficiary and owes no fiduciary obligation to third parties.

The Peppertree Owners defaulted on a loan from Union Bank that was secured by a deed of trust on the Peppertree Property. In January 1996, First American Title (First American) conducted a trustee sale on Union Bank's instructions; Union Bank acquired the property by making a credit bid. First American, however, was not the trustee under the deed of trust, as Union Bank had previously substituted itself as the trustee. Heritage Oaks Partners bought the Peppertree Property from Union Bank in October 1996.

In December 1997, when the Peppertree Owners discovered that First American was not the trustee of record incident to the foreclosure sale, they sued Union Bank, First American, and Heritage Oaks, alleging that the foreclosure sale was void. Heritage Oaks had incurred over \$500,000 in attorney fees defending itself in the litigation. In September 1999, the trial court found in Peppertree Owners' favor, concluding that the foreclosure sale was void. Peppertree Owners filed a second suit against Heritage Oaks seeking return of the property. Heritage Oaks settled by paying Peppertree Owners \$1.4 million and quitclaiming the property to them.

The court of appeal reversed, holding that, based on mutual mistake, the trial court should have reformed the deed of trust to permit First American to conduct the foreclosure sale in order to carry out the intent of the parties.

Heritage Oaks then sued First American for equitable indemnity and negligence, claiming that First American breached its duty as trustee under the deed of trust to properly record a substitution of trustee, thereby causing Heritage Oaks to incur attorney fees and other damages. The trial court sustained a demurrer on the equitable indemnity cause of action because First American had not caused any injury to Peppertree Owners; therefore, there was no fault to apportion among the defendants in that action. The court later granted summary judgment on the claim of negligence, finding that First American had no duty to Heritage Oaks arising out of the foreclosure sale because Heritage Oaks was not a party to the trust deed.

The court of appeal affirmed. The trustee under a deed of trust merely acts as a common agent for the trustor and the beneficiary and owes no fiduciary obligations. In order to pursue a claim for equitable indemnity, the defendant must be at least partially at fault.

The trustee under a deed of trust is not a true trustee. Its only duties are, on default, to take steps necessary to foreclose the deed of trust or, on satisfaction of the debt, to reconvey the deed of trust. The nonjudicial foreclosure statutes reflect a balance of interests of beneficiaries, trustors, and trustees. They provide quick recovery of amounts due under promissory notes while providing protection against forfeiture of property rights. Trustees are provided clearly defined responsibilities allowing them to perform their duties without costly litigation.

The court found that policy militates against judicial expansion of the trustee's duties. Recognizing a duty running to subsequent purchasers of the property would upset the balancing of interests among beneficiaries, trustors, and trustees. If the duty were provided to the initial subsequent purchaser, then it would also need to be provided to every other subsequent purchaser and would throw into doubt the ownership of every property that has been the subject of a foreclosure sale.

The foreclosure sale was not intended to affect anyone other than the parties to the deed of trust and the successful bidder at the sale. Similarly, the substitution of trustee

and partial deed of reconveyance were not intended to affect any parties other than Union Bank and the Peppertree Owners.

Because there had been a finding of mutual mistake between First American and the Peppertree Owners and the court granted reformation of the deed of trust to cure that mistake, First American could not have created a foreseeable title flaw. If there was a flaw, then it could also be detected by Heritage Oaks because the substitution of trustee and partial deed of reconveyance was a recorded document.

Equitable indemnity is apportionment based on fault and requires a determination of fault on the part of the alleged indemnitor. Because First American had already been cleared of fault and there can be no indemnity without liability, Heritage Oaks could not state a cause of action for equitable indemnity against First American.

THE EDITOR'S TAKE: The underlying facts in this case are so unique as to make it hard to predict very much about the future applicability of this holding. A foreclosure sale is not likely to be conducted too often by the wrong trustee as the result of a mutual mistake between the trustor and beneficiary as to the meaning of an earlier substitution of trustee (and which error is then ultimately forgiven by a judicially ordered reformation), which makes this case unlikely to ever work as direct precedent for anything else.

But what can happen in run-of-the-mill cases for a wrong trustee to sell (perhaps because of a forgotten substitution), or for the right trustee to sell the wrong property, or to make some other kind of mistake, which will then force a court to decide the trustee's liability and to whom? The court's holding that trustee duties are limited to those "imposed by statute or specified in the deed of trust," taken literally, makes it seem that most of the time the trustee should not be liable because no duty was breached. A typical deed of trust only requires the trustee to record notice of default, give notice of sale, sell the property, deliver a deed to the purchaser, and disperse the sales proceeds. Our foreclosure statutes, mainly in the CC §2924s, merely fill in the details of these responsibilities. Since, typically, nothing is said in either those statutes or the deed of trust about the trustee being the one legally authorized to sell (or about, e.g., selling the right property), a trustee who gets it wrong seems unlikely to be held negligent under that standard.

There are also recitals in the trustee deed about the property that was sold (and these recitals are themselves authorized by the deed of trust and also by statute), but those recitals are also mainly limited to the details of the foreclosure sale steps that were taken by the trustee and do not cover the problem of an unauthorized trustee, such as occurred in this case. If those recitals establish the full scope of duty, then a similarly errant trustee—even if not protected by a subsequent reformation order—may be similarly unworried about those recitals. They are by no means the equivalent of the implied warranty of title or right to convey that a grant deed includes. See CC §1113.

The court's alternative holding of the nonforeseeability of remote purchasers is further protective of the careless trustee, although in a different direction. If a later purchaser is to be expected to discover the trustee's lack of authority to sell from her own search of the records (as readily as the trustee could have done), that should not only protect the unauthorized trustee, but may also insulate it from other kinds of mistakes that would constitute negligence even under these more restrictive tests.

On this foreseeability issue (which looks like a sort of lack of privity defense), the *Heritage Oaks* decision gives to immediate foreclosure purchasers more protection than is given to remote purchasers, on the likelihood that the latter have probably obtained title insurance. (That is certainly true, since any rational consensual purchaser would condition its offer on title being marketable as well as insurable by a title company, whereas the immediate direct purchaser at a foreclosure sale generally must make a bid that is unconditional, and will most likely not have incurred the cost of a title search before making its bid.)

The greater protection given to a first purchaser may often be offset by the fact that he is usually the foreclosing beneficiary, directly involved in the sale, and perhaps part of the cause of the problems that followed. Nevertheless, if the first purchaser is truly innocent,

and the trustee truly negligent (and if there is no reformation defense to save it), then there may be trustee liability.

P.S. The Peppertree property involved in this case is perhaps the most litigated piece of California land in recent foreclosure history. There is page after page of Westlaw citations to litigation concerning it, including the famed supreme court decision involving multiple security. See *Dreyfuss v Union Bank* (2000) 24 C4th 400, 101 CR2d 29. If the Heritage people incurred only some \$500,000 in attorney fees, they must have gotten a discount from their lawyers. —*Roger Bernhardt*