Paying After It’s Too Late

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ROGER BERNHARDT

Paying After It's Too Late

Your clients bring you a letter they have received from a total stranger advising them that he has claims to the property they recently purchased and demanding that they make all further mortgage payments to him rather than to the person who sold them the property. A complex and fascinating court of appeal decision, *Lewis v Superior Court* (1995) 30 CA4th 1850, 37 CR2d 63 (reported at 18 CEB RPLR 152 (Apr. 1995)), seems to say you can tell your clients to ignore the claim and continue paying as before, but my advice, notwithstanding *Lewis*, would be to refuse to pay either the claimant or the seller until the matter was safely resolved.

*Lewis* is much too complicated to be described completely here, and the following oversimplified version includes only the facts bearing on the payment issue: a lis pendens (arising from litigation involving the seller) was recorded (but not indexed) against the property on February 24, the deed conveying the property to the new buyers was delivered and recorded on February 28, the recorded lis pendens was indexed on February 29, and the buyers paid (most of) the price to the seller on March 1 or 2. The court held that the buyers took free of all claims related to the lis pendens.

The court held that the lis pendens was improper (being based on purely monetary claims and untenable constructive trust theories) and that, in any event, it gave no notice before it was indexed, which was after the buyers’ deed had been delivered and recorded.

The difficult feature of this case is that the lis pendens nevertheless did get indexed before the price was paid in full, which forced the court to get around an old California Supreme Court decision (*Davis v Ward* (1895) 109 C 186, 41 P 1010). *Ward* held that California’s recording laws do not protect a subsequent grantee who has not yet paid the entire price at the time that the preexisting claim surfaced (the “payment of value” rule). In distinguishing *Davis* on six different grounds, *Lewis* made enough provocative statements to generate the discussion below.

A lis pendens gives constructive rather than actual notice to the world. CCP §405.24. Potential purchasers of property must make a presale search of its title, because it will be taken subject to that recorded claim, whether they know of it or not. On the other hand, purchasers who have closed escrow and taken title before the lis pendens is recorded are not thereafter charged with notice of it, because none of us have any duty to make ongoing searches of our own titles. For the same reason, purchasers with continuing purchase money mortgage obligations are not required to make title searches before every payment. Thus the buyers in *Lewis* who paid the price in actual ignorance of the belatedly indexed lis pendens had to prevail.

Some of the statements in *Lewis* suggest, however, that the result would have been the same even if the lis pendens claimant had given the buyers actual notice of the claim before they paid the seller. Notwithstanding, I would not risk advising buyers to pay under those circumstances.

Recording act protection requires that the purchaser pay value as well as take without notice. CC §1214. It is only the party who has paid out money in reliance on a title search who needs statutory protection against the prior but unrecorded claim; to protect unrecorded claims...
against purchasers for value is to make title searches a waste of time. Thus, while a paying buyer searches title, a nonpaying grantee or heir does not, because nothing is lost if title is bad.

In the case of purchasers who have not yet paid the full price when the rival claim appears, the payment of value rule advises them not to pay and thereby avoid harm. (Assuming that the claim is valid, paying the price will cause harm to either the claimant or the payor/buyer, and will unjustly enrich the payee/seller. On the other hand, if payment is withheld, the claimant’s title or interest is not defeated by the recording act and the payor/buyer avoids any detrimental reliance by refusing to pay; only the wrongful payee/seller suffers.)

*Lewis* calls the payment of value rule “an archaic and misunderstood principle of real property conveyancing,” but I believe it still has force and will be applied to purchasers who continue paying the unpaid purchase price balance to their sellers. Every dollar paid to the allegedly wrongful seller of real property in the face of the positive assertion of a claim to title or to its proceeds causes the unnecessary harm the *Davis* rule sought to avoid. Those dollars should be withheld, trust-funded, impounded, or interpleaded until the situation is clearer.

(All of this is subject to being trumped by superior third-party legal claims to the money, such as when the mortgage has gone into the secondary market or was originally made by an innocent third-party financial institution.)

When the claimant, rather than the owner/buyer, comes to your office, *Lewis* should be taken more seriously. Title should be searched immediately. If the tortfeasor still has title, the lis pendens must be not only recorded, but also indexed, at once—the mechanics will have to be worked out with the county recorder. (Because the sales contract is usually not of record, immediate indexing is necessary in order to prevail against an unknown purchaser’s final title search.) If title has already been transferred, steps have to be taken to see that any remaining proceeds from the sale go to your client rather than the tortfeasor/seller. I have said that actual notice to the purchasers ought to be enough to require the purchasers to pay any remaining sale proceeds to your client, but my opinion should not be trusted. Attachment, garnishment, preliminary injunction, or whatever procedural steps you can think of should be taken to keep that money from getting into the wrong hands and thereafter vanishing.