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CHAPTER VIII - Security Transactions in Real Property

Witkin Summary of California Law

I. INTRODUCTION

A. Types of Security Transactions.

4 Witkin Sum. Cal. Law STRP § 1

[§ 1] Types of Security Transactions.

(1) *In General; Voluntary Types.* There are many types of security transactions in real property, but all have a single objective: creation of an interest in realty to secure the performance of an obligation. Typically, the obligation to be secured is a loan for the purchase of the particular property in which the security interest is created, and the security transaction is an indispensable element in land acquisition and development.

(2) *Voluntary Types.* The following voluntary transactions are recognized:

(a) The mortgage, which has been virtually abandoned in California, although "mortgage" has become a generic term for security transactions in land. (See *infra*, §3.)

(b) The deed of trust, now the most widely used security instrument. (See *infra*, §4 et seq.)

(c) The real property sales contract or installment land contract. (See *infra*, §§24, 25.)

(d) The deed absolute in form but intended as a mortgage. (See *infra*, §10 et seq.)

(e) The equitable mortgage. (See *infra*, §14 et seq.)

(3) *Involuntary Types.* Involuntary security interests are created by operation of law. These include the following:

(a) Tax and assessment liens. (See 9 *Summary* (10th), *Taxation*, §252; on priorities, see *infra*, §59 et seq.; on Uniform Federal Lien Registration Act, see *infra*, §65.)

(b) The mechanic's lien. (See *infra*, §26 et seq.)

(c) The design professional's lien. (See *infra*, §32.)

(d) Other equitable liens created by statute or by the application of equitable principles. (See *infra*, §18 et seq.)

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B. Texts and Practice Works.

4 Witkin Sum. Cal. Law STRP § 2

[§ 2] Texts and Practice Works.

(1) *In General.* A number of texts and practice works deal with security transactions in real property. (See generally 4 Powell, Chap. 37; 54A and 55 Am.Jur.2d (1996 ed.), Mortgages; 4 Miller & Starr 3d, §10:1 et seq.; California Real Estate Law and Practice, Vols. 4, 5; C.E.B., Mortgage and Deed of Trust Practice 3d; Uniform Commercial Code, 3 U.L.A. (Master Ed.); Article 3 of the Uniform Land Transactions Act, 13 (Part II) U.L.A. (Master Ed.), p. 254 et seq.; on methods of financing purchase price, see C.E.B., 2 Real Property Sales Transactions 3d, §8.12 et seq.; on financial institution practices in real estate sales, see C.E.B., 1 Real Estate Finance Practice, §4.1 et seq.)

(2) *Restatement.* A new element of the Third Restatement of Property, entitled Mortgages, was adopted in 1996. It covers mortgages, deeds of trust, and other transactions in which real property secures an obligation. These provisions are cited throughout this chapter. The following chapters are included:

Chapter 1: Creation of Mortgages (§1.1 et seq.).

Chapter 2: Future Advances (§2.1 et seq.).

Chapter 3: Mortgagor's Equity of Redemption and Mortgage Substitutes (§3.1 et seq.).

Chapter 4: Rights and Duties of the Parties Prior to Foreclosure (§4.1 et seq.).

Chapter 5: Transfers of Mortgaged Real Estate and Mortgages (§5.1 et seq.).

Chapter 6: Payment and Discharge (§6.1 et seq.).

Chapter 7: Priorities (§7.1 et seq.).

Chapter 8: Foreclosure (§8.1 et seq.).

SUPPLEMENT: [This section is current through the latest supplement]

(1) *In General.* See C.E.B., 2 Real Property Sales Transactions 4th, §9:14 et seq.



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I. INTRODUCTION
C. Mortgage.

4 Witkin Sum. Cal. Law STRP § 3

[§ 3] Mortgage.

(1) *Definition*. "A mortgage is a contract by which specific property, including an estate for years in real property, is hypothecated for the performance of an act, without the necessity of a change in possession." (C.C. 2920(a); on parties to mortgage, see *infra*, §5; on real property sales contract as mortgage, see *infra*, §24.)

(2) *Lien Theory*. At common law, the mortgagee received title subject to defeasance by a condition subsequent--payment of the debt by the mortgagor. In California and other lien theory jurisdictions, no title passes by the mortgage; the mortgagee only acquires a lien. (C.C. 2888; *Martin v. Becker* (1915) 169 C. 301, 304, 146 P. 665; *Bank of Italy v. Bentley* (1933) 217 C. 644, 654, 20 P.2d 940; see C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §1.30.)

The lien theory places the mortgagee in a precarious position where one joint tenant mortgages without the consent of the other. Because the mortgage is only a lien and gives the mortgagee no right of possession, it does not destroy any of the four unities (see 12 *Summary* (10th), *Real Property*, §34) that would terminate the joint tenancy. The result is that, on the death of the mortgagor, the surviving joint tenant takes the property free of the mortgage. (*People v. Nogarr* (1958) 164 C.A.2d 591, 593, 330 P.2d 858.) (See *Hamel v. Gootkin* (1962) 202 C.A.2d 27, 30, 20 C.R. 372, *infra*, §6 [same result under deed of trust]; 67 A.L.R.2d 999 [enforceability of mortgage after death of one of joint tenants].)

The court in *Nogarr* saw nothing inequitable in this conclusion: The mortgagees (with a demand note) could have foreclosed and by sale terminated the joint tenancy; they chose instead to await the contingency of which joint tenant died first. "If the event had been otherwise and the mortgagor had been the survivor the security of their lien would have been doubled." (164 C.A.2d 598.) (For a contrary view of the equities, see 8 *Hastings L. J.* 297; 11 *Stanf. L. Rev.* 574.)

(3) *Power of Sale Mortgage*. The mortgagee's traditional remedy after default is foreclosure by judicial sale. (See *infra*, §139 et seq.) But a mortgage may provide that on default the mortgagee has the power to take possession and sell the property. In this case, the mortgagee conveys the mortgagor's title to the purchaser as the mortgagor's attorney in fact. The power of sale is coupled with an interest and survives the death of the mortgagor. (*New York Life Ins. Co. v. Doane* (1936) 13 C.A.2d 233, 239, 56 P.2d 989.) But even with this power, the mortgagee's interest is still only a lien, and the statute of limitations bars the power of sale when it has run on the principal obligation. (*Faxon v. All Persons* (1913) 166 C. 707, 716, 137 P. 919; see *infra*, §121.) (See C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §2.8; 55 *Am.Jur.2d* (1996 ed.), *Mortgages* §532 et seq.)

The chief differences between the ordinary mortgage and one with power of sale are these:

(a) In the power of sale mortgage, the mortgagee has the option of two remedies: foreclosure or sale (see *C.C.P.* 725a).

(b) A sale under the power of sale precludes any deficiency judgment (see *infra*, §199), and cuts off the statutory right of redemption (see *infra*, §233).

Commencement of a foreclosure suit is not a binding election of remedies, and does not prevent the subsequent exercise of the power of sale. (*Commercial Centre Realty Co. v. Superior Court* (1936) 7 C.2d 121, 129, 59 P.2d 978; *infra*, §138.)

West's Key Number Digest, Mortgages k.1

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I. INTRODUCTION

D. Deed of Trust.

1. Origin and Validity.

4 Witkin Sum. Cal. Law STRP § 4

[§ 4] Origin and Validity.

The deed of trust is an anomaly, for it is an established principle that a deed intended as security will be construed as a mortgage. (See *infra*, §10.) But in spite of this inconsistency, the deed of trust was recognized as a valid form of security at an early date, before the adoption of the codes. (See *Koch v. Briggs* (1859) 14 C. 256.) Later cases also upheld its validity, and today it is well established and is far more widely used in this state than the mortgage. (See *Bank of Italy v. Bentley* (1933) 217 C. 644, 649, 20 P.2d 940; *Bayer v. Hoagland* (1928) 95 C.A. 403, 408, 273 P. 58; C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §1.31; 12 Cal. L. Rev. 307; 26 Cal. L. Rev. 206.)

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D. Deed of Trust.

2. Mortgage Compared.

4 Witkin Sum. Cal. Law STRP § 5

[§ 5] Mortgage Compared.

(1) *Differences.* A deed of trust is distinguishable from an ordinary mortgage in several respects. (See generally C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §1.31; C.E.B., 1 Real Estate Finance Practice, §4.1; 7 U.C.L.A. L. Rev. 83; 26 Cal. L. Rev. 206.) The following are the chief differences:

(a) *Parties.* In the *mortgage*, there are two parties: the mortgagor and the mortgagee. D, the debtor-mortgagor, gives C, the creditor-mortgagee, a lien on the property of D, as security for an obligation owed to C. In the *deed of trust*, there are usually three parties: the trustor, the trustee, and the beneficiary. D, the debtor-trustor, conveys the title to the property to T, trustee, to be reconveyed to D if D performs the obligation, but, in case D fails to perform, to be sold for the satisfaction of D's obligation to C.

(b) *Title.* In the *mortgage*, title remains with the mortgagor until a foreclosure sale; then it passes from the mortgagor to the purchaser. In the *deed of trust*, title passes to the trustee, who holds it until default; then, after sale, it goes from the trustee to the purchaser. (See *infra*, §169.)

(c) *Remedies.* In the *mortgage*, the only remedy of the mortgagee is foreclosure, unless the mortgage provides for a power of sale. In the *deed of trust*, alternative remedies of sale or foreclosure are permitted. (See *infra*, §§124, 137, 138.)

(d) *Deficiency Judgment.* On foreclosure of the *mortgage*, a deficiency judgment, if proper, may be entered. In the case of a *deed of trust*, no deficiency judgment may be had unless the remedy of foreclosure is employed. (See *infra*, §§178, 199.)

(2) *Differences Minimized.* For most purposes, the differences between the two instruments have been minimized by the practice of including a nonjudicial power of sale in the mortgage and by the statutory provision for judicial foreclosure of the deed of trust. (See *supra*, §3 and *infra*, §137.) Thus, it can be said that "in California there is little practical difference between mortgages and deeds of trust." (*Domarad v. Fisher & Burke* (1969) 270 C.A.2d 543, 553, 76 C.R. 529; C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §1.31.)

(3) *Construction in Favor of Mortgage.* In *Banta v. Wise* (1901) 135 C. 277, 280, 67 P. 129, the court declared that,

if there is any doubt as to the nature of the transaction, it will be construed to be a mortgage, and not a deed of trust. In *Banta*, there was a power of sale in a third party as trustee, so that on its face, the transaction was a deed of trust. But the trustee was also one of the creditors secured by the transaction (hence, not only the trustee but a beneficiary as well). *Held*, the instrument was a mortgage. (135 C. 280.) And in *First Fed. Trust Co. v. Sanders* (1923) 192 C. 194, 219 P. 440, a grant, bargain, and sale deed was made, with a defeasance provision in the event of payment of the debt. *Held*, title did not pass; the instrument was merely a mortgage, not a deed of trust. (192 C. 198.) (See 12 Cal. L. Rev. 307.) However, the mere fact that the creditor is a trustee will not invalidate the deed of trust, if it clearly appears that a deed of trust was intended. (*Copsey v. Sacramento Bank* (1901) 133 C. 659, 66 P. 7, 66 P. 204.)

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(2) *Differences Minimized*. See *Aviel v. Ng* (2008) 161 C.A.4th 809, 813, 816, 74 C.R.3d 200 [subordination clause in lease making lease subordinate to "mortgages which may now or hereafter affect" real property was properly interpreted as subordinating lease to deed of trust because mortgage and deed of trust are functionally and legally same].



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D. Deed of Trust.

3. Effect of Deed of Trust.

4 Witkin Sum. Cal. Law STRP § 6

[§ 6] Effect of Deed of Trust.

(1) *Earlier Title Theory*. It was once said that the deed of trust "has no feature in common with a mortgage," except that it is executed to secure an indebtedness; and it was further declared that its outstanding characteristic was the transfer of title, vesting the trustee with "the entire estate" in the property. (See *Koch v. Briggs* (1859) 14 C. 256, 262; *Bateman v. Burr* (1881) 57 C. 480, 482; *Anglo-Calif. Trust Co. v. Oakland Railways* (1924) 193 C. 451, 464, 225 P. 452; *Bayer v. Hoagland* (1928) 95 C.A. 403, 408, 273 P. 58.) And the cases recognize the passage of title for certain special purposes; e.g., the running of the statute of limitations on the debt does not extinguish the power of the trustee to sell. (*Grant v. Burr* (1880) 54 C. 298.)

These statements are, however, misleading. It would, e.g., be impossible to have a *second deed of trust* if the legal title vested in the trustee, for in that case the trustees under the first and second deeds of trust would each have the legal title. It would likewise be impossible in theory for the trustor to convey title to a grantee. An examination of the decisions shows that the deed of trust actually gives the trustee only the interest that is necessary to carry out the trust; and in practical effect it is "little more than a mortgage with power to convey." The trustee takes the legal title for security only, leaving a legal estate and the ordinary rights of ownership in the trustor. (*Sacramento Bank v. Alcorn* (1898) 121 C. 379, 383, 53 P. 813; see *Bank of Italy v. Bentley* (1933) 217 C. 644, 654, 20 P.2d 940; *Wilson v. McLaughlin* (1937) 20 C.A.2d 608, 611, 67 P.2d 710; *Fleisher v. Continental Auxiliary Co.* (1963) 215 C.A.2d 136, 139, 30 C.R. 137, citing the text; C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §1.31; 26 Cal. L. Rev. 206; 27 Cal. L. Rev. 66; 12 So. Cal. L. Rev. 485; 7 U.C.L.A. L. Rev. 83.)

(2) *Modern Lien Theory*. In most situations, the title theory has been disregarded, and the deed of trust has been deemed to create a mere *lien* on the property.

(a) It is a "lien or other encumbrance" within the meaning of statutes stating the rights of mechanic's lien claimants. (*Fickling v. Jackman* (1928) 203 C. 657, 661, 265 P. 810; *Wasco Creamery & Const. Co. v. Coffee* (1931) 117 C.A. 298, 300, 3 P.2d 588; see C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §1.31.) It is common to speak of the "lien of this trust indenture." (*La Arcada Co. v. Bank of America* (1932) 120 C.A. 397, 402, 7 P.2d 1115.)

(b) On payment of the debt by the trustor, a *reconveyance* by the trustee is unnecessary; the estate ceases, and the title is thereafter in the trustor. (*Tyler v. Currier* (1905) 147 C. 31, 36, 81 P. 319; *MacLeod v. Moran* (1908) 153 C. 97,

100, 94 P. 604.)

(c) On giving a deed of trust, the trustor nevertheless retains a "legal estate" as against all persons except the trustees and those lawfully claiming under them. (*MacLeod v. Moran*, supra.; *Charles A. Warren Co. v. All Persons* (1908) 153 C. 771, 775, 96 P. 807; *Wyser v. Truitt* (1928) 95 C.A. 727, 732, 273 P. 147; *Wasco Creamery & Const. Co. v. Coffee*, supra.) The trustor may therefore retain possession, file a declaration of homestead on the property, and devise or transfer it, subject to the trust. (*Sacramento Bank v. Alcorn* (1898) 121 C. 379, 383, 53 P. 813; *Zolezzi v. Michelis* (1948) 86 C.A.2d 827, 830, 195 P.2d 835.)

(d) If the beneficiary acquires the estate of the trustor, a *merger* results, notwithstanding the so-called legal title of the trustee. (*Wilson v. McLaughlin* (1937) 20 C.A.2d 608, 610, 67 P.2d 710.)

In *Davidow v. Corporation of America* (1936) 16 C.A.2d 6, 60 P.2d 132, it was argued that a second deed of trust could never be enforced while the first deed of trust remained in existence, on the theory that the first deed of trust conveyed all the present title and the trustee under the second deed of trust took only a future interest. It was nevertheless held proper to sell under the second deed of trust. (16 C.A.2d 10.)

In *Conlin v. Coyne* (1937) 19 C.A.2d 78, 64 P.2d 1123, it was held that the trustor may bring an action against third persons for damages for injury to the property. The objection that the cause of action is vested in the trustee is untenable (though the trustee can also sue for any impairment of the value of the security). (19 C.A.2d 84.)

In *Hamel v. Gootkin* (1962) 202 C.A.2d 27, 20 C.R. 372, decedent and G were joint tenants. Decedent made deeds of trust on the property, without the consent or knowledge of G. *Held*, on decedent's death, G took free of the trust deeds. The court, treating the deed of trust as the equivalent of a mortgage, applied the rule of *People v. Nogarr* (1958) 164 C.A.2d 591, 330 P.2d 858, supra, §3. (202 C.A.2d 30.)

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I. INTRODUCTION

D. Deed of Trust.

4. Strict Trust Compared and Distinguished.

4 Witkin Sum. Cal. Law STRP § 7

[§ 7] Strict Trust Compared and Distinguished.

The Codes draw a distinction between strict or "voluntary" trusts and deeds of trust. (See 13 *Summary* (10th), *Trusts*, §§1, 3.)

(1) *Revocability*. The strict trust is normally for the benefit of a named beneficiary only, while the deed of trust is created for the benefit of both beneficiary and trustor. Accordingly, *Prob.C. 15400*, which permits revocation of voluntary trusts unless expressly made irrevocable, does not apply to deeds of trust. To hold it applicable would be to allow the debtor arbitrarily to destroy the creditor's interest under a deed of trust, while denying this power to a mortgage debtor. (*Touli v. Santa Cruz County Title Co.* (1937) 20 C.A.2d 495, 497, 67 P.2d 404 [discussing former C.C. 2280 (now *Prob. C. 15400*)].)

(2) *Powers and Duties of Trustee*. A trustee under a deed of trust has neither the powers nor the obligations of a strict trustee, and lacks a true trustee's interest in, and control over, the trust property. (*Monterey S.P. Partnership v. W.L. Bangham* (1989) 49 C.3d 454, 462, 261 C.R. 587, 777 P.2d 623, citing the text; *Hatch v. Collins* (1990) 225 C.A.3d 1104, 1111, 275 C.R. 476, citing the text; see *Stephens, Partain & Cunningham v. Hollis* (1987) 196 C.A.3d 948, 955, 242 C.R. 251, citing the text [trustee under deed of trust is not absolutely prohibited from purchasing property at trustee's own sale]; 90 A.L.R.2d 501 [trustee's duties to holders of bonds and other obligations secured by mortgage, deed of trust, or other trust instrument].)

A strict trustee has the exclusive power to bring and defend actions on behalf of the trust. But under *C.C.P. 725a* (infra, §137), the beneficiary in a deed of trust may bring a foreclosure action without interference by the trustee, and the trustee may not appear in the action and claim attorneys' fees. (*Field v. Acres* (1937) 9 C.2d 110, 113, 69 P.2d 422.) Further, in an action affecting the interest of the beneficiary or trustor under a deed of trust, service on the trustee does not constitute service on the beneficiary or the trustor, and the trustee has no obligation to notify these parties of the action. (C.C. 2937.7; see *Monterey S.P. Partnership v. W.L. Bangham*, supra, 49 C.3d 461 [serving trustee, but not beneficiaries, was insufficient to foreclose mechanic's lien].)

In some respects, however, the trustee's acts are subject to the same legal rules as those governing a strict trustee. Thus, although neither can make a valid transfer in contravention of the terms of the instrument, an unauthorized reconveyance by the trustee under a deed of trust (before full payment of the loan), like a strict trustee's conveyance in

breach of trust, cannot be avoided if the title has come to a bona fide purchaser. (*Firato v. Tuttle* (1957) 48 C.2d 136, 139, 308 P.2d 333; cf. *Wutzke v. Bill Reid Painting Service* (1984) 151 C.A.3d 36, 44, 198 C.R. 418 [forged deed of reconveyance was void, and subsequent innocent encumbrancer's "claim of title flowing from such a deed" was also void]; see *Schiavon v. Arnaudo Bros.* (2000) 84 C.A.4th 374, 381, 100 C.R.2d 801 [where request for reconveyance, but not reconveyance itself, was forged, reconveyance was voidable and not void, and bona fide purchaser received title free and clear of security interest; following *Firato* and distinguishing *Wutzke*]; 13 *Summary* (10th), *Trusts*, §251.)

Prob.C. 15643, on vacating the office of a trustee (see 13 *Summary* (10th), *Trusts*, §53), and *Prob.C. 18102*, on protecting third persons dealing with a former trustee (see 13 *Summary* (10th), *Trusts*, §255), are *expressly applicable* to trustees under deeds of trust. (C.C. 2934b.)

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D. Deed of Trust.

5. Substitution of Trustee.

4 Witkin Sum. Cal. Law STRP § 8

[§ 8] Substitution of Trustee.

(1) *In General.* A new trustee may be substituted by notice recorded and served in conformity with the statute. (See C.C. 2934a.) However, an informal substitution by agreement of the parties may be upheld though not in strict compliance with the statute. (*Brooks v. Independent Exploration Co. (1952) 109 C.A.2d 475, 481, 240 P.2d 1037; U.S. Hertz v. Niobrara Farms (1974) 41 C.A.3d 68, 84, 116 C.R. 44* [parties may contract as to form of and procedure for substitution of trustee].)

A substitution acknowledged by all the beneficiaries or their successors is effective "notwithstanding any contrary provision" in the instrument. (C.C. 2934a(a)(1) [trust deeds executed after 1967].) The substitution is effective from the date it is executed by the mortgagee, the beneficiaries, or their authorized agents. Once recorded, it constitutes conclusive evidence of the substituted trustee's authority. (C.C. 2934a(d).)

(2) *Effect on Power of Sale.* Unless a new notice of sale containing the name, street address, and telephone number of the substituted trustee is given, a sale conducted by the substituted trustee is void. (C.C. 2934a(e).) (On content and manner of notice of sale, see C.C. 2924f, *infra*, §150 et seq.) And once a new trustee has been substituted, a subsequent sale by the former trustee is void. (*Dimock v. Emerald Properties LLC (2000) 81 C.A.4th 868, 876, 97 C.R.2d 255.*) However, the provisions of C.C. 2934a are waivable. Thus, the failure to have the recorded trustee conduct the foreclosure sale may justify reformation to validate the sale where the facts so warrant. (*Jones v. First Amer. Title Ins. Co. (2003) 107 C.A.4th 381, 389, 131 C.R.2d 859* [distinguishing *Dimock*].)

(3) *Multiple Deeds of Trust.* Substitution with respect to multiple deeds of trust is permitted by recording a single document, if the deeds are recorded in the same county in which the substitution is being recorded and have the same trustee and beneficiary. (C.C. 2934a(a)(4).)

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D. Deed of Trust.

6. Trustee's Declaration of Nonmonetary Status.

4 Witkin Sum. Cal. Law STRP § 9

[§ 9] Trustee's Declaration of Nonmonetary Status.

In an action involving a deed of trust, the trustee may file a declaration of nonmonetary status when it reasonably believes that it was named solely in its capacity as trustee and not because of a wrongful act or omission on its part. (C.C. 2924l(a).) The parties have 15 days within which to object. (C.C. 2924l(c).) If there is no objection within the 15-day period, the trustee (1) is not required to participate further, (2) is not subject to any damage awards, attorneys' fees, or costs, but (3) must respond to discovery requests as a nonparty, and (4) is bound by a court order relating to the deed of trust. (C.C. 2924l(d).)

Parties who have failed to object, but who later determine that the trustee should participate in the action because of the performance of its duties as trustee, may file and serve a motion for participation by the trustee, after which the trustee must participate if the motion is granted. (C.C. 2924l(e).)

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I. INTRODUCTION

E. Deed Construed as Mortgage.

1. Intention To Create Security Interest.

4 Witkin Sum. Cal. Law STRP § 10

[§ 10] Intention To Create Security Interest.

(1) *In General.* "Notwithstanding an agreement to the contrary, a lien, or a contract for a lien, transfers no title to the property subject to the lien." (C.C. 2888.) Similarly, "[e]very transfer of an interest in property, other than in trust, made only as a security for the performance of another act, is to be deemed a mortgage." (C.C. 2924 [excepting pledges of personal property].)

This exception to the parol evidence rule is applied in California to any deed except a deed of trust. (See *Banta v. Wise* (1901) 135 C. 277, 279, 67 P. 129; *Todd v. Todd* (1912) 164 C. 255, 257, 128 P. 413; *Jones v. Dickerman* (1931) 114 C.A. 357, 362, 300 P. 135; *McGuigan v. Millar* (1931) 117 C.A. 739, 742, 4 P.2d 607; *Deming v. Smith* (1937) 19 C.A.2d 683, 688, 66 P.2d 454; *Sherman v. Panno* (1954) 129 C.A.2d 375, 381, 277 P.2d 80; cf. *Petit v. Blenkiron* (1936) 16 C.A.2d 751, 754, 61 P.2d 527 [where absolute deed is later followed by declaration of trust making property security for debt, instruments will be construed to create deed of trust]; *Munger v. Moore* (1970) 11 C.A.3d 1, 8, 89 C.R. 323, *infra*, §168 [only party to transaction or person claiming under him or her may attack transfer]; 4 Proof of Facts 2d 567 [warranty deed intended as mortgage].)

(2) *Evidence and Burden of Proof.* The burden of proof is on the party asserting that the deed is a mortgage, and the evidence must be clear and convincing. (See *Kohn v. Parent* (1917) 174 C. 570, 571, 163 P. 1008; *Beeler v. American Trust Co.* (1944) 24 C.2d 1, 7, 147 P.2d 583, *infra*, §11; *Mealy v. Sunland Refining Corp.* (1950) 96 C.A.2d 700, 703, 216 P.2d 59 [fact that deed was subject to repurchase option was not controlling]; *Workmon Const. Co. v. Weirick* (1963) 223 C.A.2d 487, 491, 36 C.R. 17; *Rest.3d, Property (Mortgages)* §§3.2, 3.3; 4 Powell §37.18; Cal. Civil Practice, 1 Real Property Litigation, §4:30 [complaint by grantor to have deed absolute declared mortgage and to quiet title], §4:31 [complaint by grantee to have deed absolute declared mortgage and foreclosed].)

A compelling indicator that the parties intended a transfer of interest to be security is when the sales price of property bears no proportion to its market value. (*Earp v. Earp* (1991) 231 C.A.3d 1008, 1013, 283 C.R. 43 [lease providing that if plaintiff failed to make community property equalization payment to ex-wife, then she could purchase property for price significantly less than its value, was mortgage]; see 89 A.L.R.2d 1040 [value of property as factor in determination].)

However, in *Develop-Amatic Engineering v. Republic Mortg. Co.* (1970) 12 C.A.3d 143, 91 C.R. 193, plaintiff

corporation owned land worth \$ 900,000, which was encumbered with a \$ 300,000 deed of trust. In need of funds to satisfy the encumbrance and provide working capital for its business, plaintiff sold the property to R Co. for \$ 450,000, with a 2-year repurchase option at \$ 650,000. R Co. extended the option once, but it was never exercised. Plaintiff brought this action to have the deed declared to be a mortgage, and, prior to trial, filed a Chapter XI bankruptcy petition. *Held*, judgment for defendant R Co. affirmed. The only significant factor indicating a mortgage was the discrepancy between the fair market value of the property and the sale price. The factors showing a conveyance of title were: R Co. advised plaintiff that it would not enter into a security transaction; plaintiff was given the power to assign the repurchase option; R Co. went into possession, exercising all rights of ownership, including encumbering the property; and plaintiff did not list the property as an asset in its bankruptcy schedule. (12 C.A.3d 148.)

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E. Deed Construed as Mortgage.

2. Test: Survival of Obligation.

4 Witkin Sum. Cal. Law STRP § 11

[§ 11] Test: Survival of Obligation.

In determining whether a deed was intended as a mortgage, the crucial inquiry is whether there was an existing obligation that survived the conveyance. (See 4 Powell §37.18; 54A Am.Jur.2d (1996 ed.), *Mortgages* §102 et seq.)

(1) *Obligation Extinguished by Deed.* If the obligation did not survive the execution of the deed, this is evidence that the deed was given in satisfaction of it, and was not intended as a mortgage. (*Borton v. Joslin* (1928) 88 C.A. 515, 521, 263 P. 1033; *Spataro v. Domenico* (1950) 96 C.A.2d 411, 413, 216 P.2d 32.)

In *Cavanaugh v. High* (1960) 182 C.A.2d 714, 6 C.R. 525, the trial judge found that plaintiff second mortgagee, to protect his interest when the first mortgagee was about to foreclose on defendant's property, agreed with defendant to take a grant deed in lieu of foreclosure, and to give her an option to repurchase after a specified period, meanwhile renting to her. Defendant, a licensed real estate broker with an understanding of real estate transactions, paid rent without question for some time. *Held*, the deed was effective. (182 C.A.2d 720.)

(2) *Obligation Surviving.* If the obligation survives, the inference is that the deed was intended as security. (*Chapman v. Hicks* (1919) 41 C.A. 158, 162, 182 P. 336.)

In *Beeler v. American Trust Co.* (1944) 24 C.2d 1, 147 P.2d 583, notes were cancelled, and plaintiff debtor, in addition to the deed, contemporaneously signed a verified affidavit reciting that it was an absolute conveyance in consideration of cancellation of debts, and was not intended as a mortgage or other security. *Held*, the affidavit was not conclusive, and parol evidence of the negotiations and subsequent transactions was admissible to show that the deed was intended as security; also, the sufficiency of the evidence under the clear and convincing rule was for the trial judge and not the appellate court to determine. (24 C.2d 24.) (On clear and convincing evidence rule, see 9 Cal. Proc. (4th), *Appeal*, §365.)

SUPPLEMENT: [This section is current through the latest supplement]

(2) *Obligation Surviving.*

Cross-Reference: 9 Cal. Proc. (5th), *Appeal*, §371.



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E. Deed Construed as Mortgage.

3. Variant Forms.

4 Witkin Sum. Cal. Law STRP § 12

[§ 12] Variant Forms.

(1) *Deed Fraudulently Obtained.* A distinction in theory, though not in the ultimate result, is made where the debtor is induced by fraud to sign a grant deed, believing it to be a deed of trust or mortgage as represented. If the elements of fraud are proved, the debtor-grantor has a right of *reformation*. And evidence of misrepresentations is admissible under the ordinary fraud exception to the parol evidence rule rather than the special exception that applies where both parties intended the deed to operate as security only. (See *Massow v. Gianacis* (1953) 120 C.A.2d 24, 27, 260 P.2d 655.)

(2) *Conveyance With Power To Sell and Satisfy Debts.* Another variation occurs where an instrument purports to transfer land to a grantee with power to sell it and apply the proceeds to the satisfaction of a debt. Does it create a *trust* or a *mortgage*? In *Jensen v. Friedman* (1947) 79 C.A.2d 494, 179 P.2d 855, the court applied the usual test (continuance of relationship of debtor and creditor) and held that only a mortgage resulted. The opinion quotes Tiffany on Real Property as follows: "A conveyance made to a trustee to secure a debt or debts is to be distinguished from one made to a trustee for the purpose of effecting the payment of debts. A conveyance of the latter character, ordinarily known as an assignment for the benefit of creditors, involves a complete divestiture of the grantor's title to the property conveyed, he having no right to redeem by paying the debts, and having merely a resulting trust as to any surplus which may possibly remain after the debts are paid, while a conveyance in trust made merely for purposes of security does not, any more than does a mortgage in ordinary form, divest the grantor or mortgagor of the rights of an owner, he having still a right to redeem by paying the indebtedness." (79 C.A.2d 498.)

(3) *Title Conveyed Directly to Third-Party Lender.* The general principle is also applied where the loan is made to finance the purchase of the property, and the lender-grantee takes title directly from the vendor instead of from the debtor. Thus, in *Wilcox v. Salomone* (1953) 118 C.A.2d 704, 258 P.2d 845, plaintiff husband and his wife leased property and negotiated for its purchase. Defendants, parents of the wife, financed the deal and took a deed. Plaintiff testified that the money was lent; defendants claimed that this original intention was abandoned and that they purchased for themselves. *Held*, plaintiff met the burden of showing a continuing obligation, and defendants had only a security interest. The court, quoting Bogert, *The Law of Trusts and Trustees*, characterized this as "a resulting trust by way of a mortgage," and observed that in this three-party transaction, "wherein the one who takes title to the property holds it as trustee for the party to whom he loaned the purchase money, and also holds a lien as mortgagee for repayment of the loan, the usual rules applying to a deed absolute-mortgage case apply." (118 C.A.2d 710.)

To the same effect is *Talbot v. Gadia* (1954) 123 C.A.2d 712, 718, 267 P.2d 436: "When a conveyance is executed from the vendor direct to the lender, to secure a loan of the purchase money made by him to the purchaser, the legal title is held not only for the lender as security, but also in trust for the borrower for the purpose of finally having title go to him. ... The grantee thus holds a double relationship to the purchaser, being trustee of the legal title and mortgagee for the money advanced for its purchase." (See *Greene v. Colburn* (1958) 160 C.A.2d 355, 358, 325 P.2d 148.)

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4. Rights of Bona Fide Purchaser.

4 Witkin Sum. Cal. Law STRP § 13

[§ 13] Rights of Bona Fide Purchaser.

If the deed is intended as a mortgage, but nevertheless purports to be a deed, the grantee (mortgagee) has the power to convey to a *bona fide purchaser*, and the latter will be protected. (*Carpenter v. Lewis* (1897) 119 C. 18, 21, 50 P. 925; *Duncan v. Ledig* (1949) 90 C.A.2d 7, 10, 202 P.2d 107.)

The burden of proof is on the purchaser to show that he or she is in good faith without notice. (*Smith v. J.R. Newberry Co.* (1913) 21 C.A. 432, 434, 131 P. 1055.) A purchaser is not a bona fide purchaser if he or she has notice of the mortgagor's rights, and open and notorious possession by the mortgagor is sufficient notice. (*Daubenspeck v. Platt* (1863) 22 C. 330, 335.) (See 12 *Summary* (10th), *Real Property*, §331.)

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F. Equitable Mortgage.

1. Rule and Theory.

4 *Witkin Sum. Cal. Law STRP* § 14

[§ 14] Rule and Theory.

Although the deed absolute construed as a mortgage is often called an "equitable mortgage," the term is also used in a distinct sense in situations where the *creditor* needs equitable protection. A mortgage defective in formal requirements is not necessarily a nullity. Where there is an agreement to give a mortgage and an attempt to execute it, and consideration has been given by the mortgagee, equity will create a specific lien on the property and enforce it. (*Bank of Suisun v. Fiske* (1924) 65 C.A. 771, 777, 225 P. 7; *Stockel v. Elich* (1931) 112 C.A. 588, 592, 297 P. 595; *Clayton Dev. Co. v. Falvey* (1988) 206 C.A.3d 438, 443, 253 C.R. 609; see 4 Miller & Starr 3d, §10:28 et seq.)

The same rule is applied where the parties deliberately choose not to execute a formal mortgage or deed of trust. An instrument may be an equitable mortgage even though it does not expressly mention a security interest, "if it otherwise appears that the parties intended to create such an interest." (*Coast Bank v. Minderhout* (1964) 61 C.2d 311, 314, 38 C.R. 505, 392 P.2d 265, *infra*, §15; *Kaiser Industries Corp. v. Taylor* (1971) 17 C.A.3d 346, 350, 94 C.R. 773, *infra*, §15; see 53 Cal. L. Rev. 165; 4 Powell §13.17 et seq.)

A different result is reached, however, where the defect is not one of form but a total lack of authority to create the security interest. (See *Meier v. Hayes* (1937) 20 C.A.2d 451, 454, 67 P.2d 120 [executor without authority attempted to mortgage property of estate].)

West's Key Number Digest, Mortgages k.26, 27

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F. Equitable Mortgage.

2. Equitable Mortgage Established.

4 *Witkin Sum. Cal. Law STRP* § 15

[§ 15] Equitable Mortgage Established.

In *Burns v. Peters* (1936) 5 C.2d 619, 55 P.2d 1182, a debtor's note and deed of trust were handed to plaintiff creditor (beneficiary). The trust deed was recorded but never delivered to the named trustee. A foreclosure sale was held and plaintiff purchased. Thereafter defendant, another creditor, recovered judgment and sold the same property on execution, buying at the sale. The deed of trust, if valid, gave plaintiff a prior lien; but defendant argued that it was void for lack of compliance with a provision therein that it should not be effective unless accepted by the trustee. *Held*, plaintiff's claim was prior. Whether sufficient as a trust deed or not, the instrument should be upheld between the parties as an equitable lien or mortgage; and plaintiff's claim was superior to that of an attaching creditor, who took only the interest of the debtor (defendant) at the time of the levy. (5 C.2d 625.)

The doctrine was given an unusual application in *Coast Bank v. Minderhout* (1964) 61 C.2d 311, 38 C.R. 505, 392 P.2d 265. Plaintiff bank made loans to E, who gave a promissory note for the amount. But, instead of taking the usual security of a mortgage or deed of trust, the bank prepared, and E signed, an "Agreement Not To Encumber or Transfer Property," designated "For use with Property Improvement Loan." This agreement provided that E would not transfer or encumber certain real property until the debt was paid; plaintiff, on default in payments, could accelerate, declaring the whole debt due immediately; and plaintiff could record the instrument (which it did). With part of the balance owing, E conveyed to defendants without plaintiff's knowledge or consent. Plaintiff then declared the whole debt due and brought this action to foreclose the "equitable mortgage." *Held*, judgment of foreclosure affirmed.

Defendants pointed out that the instrument did not show on its face that the parties intended to make the property security for the indebtedness, and argued that the bank and E, presumably familiar with the standard forms, deliberately chose this different form which was simply an extension of unsecured credit, with a provision for accelerating the debt on breach of a separate agreement not to convey the property. In answering this contention, the court held only that the agreement *could be* an equitable mortgage:

(a) The instrument may be an equitable mortgage even though it does not expressly mention a security interest. (61 C.2d 314; see *supra*, §14.)

(b) The requisite intention may be shown by extrinsic evidence, provided that the instrument is susceptible of that interpretation. Here, it restricted E's rights in specific property for plaintiff's benefit, was described as "For use with

Property Improvement Loan," and authorized its recordation. These provisions give some indication of an intention to create a security interest, and extrinsic evidence of this intent would therefore be admissible. (61 C.2d 315.)

(c) No such evidence was offered; nevertheless, the finding of equitable mortgage was proper because plaintiff *pleaded* that the parties intended to create a security interest in the property, and defendants filed a general demurrer and, on its overruling, failed to answer. The situation, therefore, was exactly as if the case had gone to trial and the extrinsic evidence had been introduced; i.e., the pleaded meaning was one of which the instrument was reasonably susceptible. (61 C.2d 315.) (See *Kaiser Industries Corp. v. Taylor* (1971) 17 C.A.3d 346, 352, 94 C.R. 773 [following *Coast Bank*; property of debtor was in escrow pursuant to unrelated holding agreement, and escrow depositary instructed that debtor's interest could not be transferred or encumbered without creditor's consent until an indebtedness had been satisfied]; *Clayton Dev. Co. v. Falvey* (1988) 206 C.A.3d 438, 443, 253 C.R. 609 [note secured by deed of trust mistakenly containing incorrect property description]; *Lovelady v. Bryson Escrow* (1994) 27 C.A.4th 25, 28, 29, 32 C.R.2d 371 [UCC-1 financing statement covering equipment and leasehold interest in restaurant, which identified secured party and debtor, created equitable leasehold mortgage]; 53 Cal. L. Rev. 165 [*Coast Bank*].)

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F. Equitable Mortgage.

3. Equitable Mortgage Not Established.

4 *Witkin Sum. Cal. Law STRP* § 16

[§ 16] Equitable Mortgage Not Established.

In *Jonathan Manor v. Artisan* (1967) 247 C.A.2d 651, 56 C.R. 14, defendant purchasers gave unsecured promissory notes in part payment of the purchase price of 52 lots in a tract. The notes contained a provision that, in addition to monthly payments of \$ 250, a \$ 500 payment would be required from defendants on their sale of any of the lots. In this action by plaintiff vendor on the note, defendants contended that this provision made the instrument an equitable mortgage, subject to the anti-deficiency provision of C.C.P. 580b (infra, §182 et seq.). *Held*, plaintiff was entitled to judgment on the note. There was no equitable mortgage: Title to the land had passed to defendants, and they could convey lots free of any claim of the vendor except the payment of \$ 500. (247 C.A.2d 653.)

In *Tahoe Nat. Bank v. Phillips* (1971) 4 C.3d 11, 92 C.R. 704, 480 P.2d 320, defendant borrowed \$ 34,000 from plaintiff bank for a business venture with three others, and executed an instrument entitled "Assignment of Rents and Agreement Not to Sell or Encumber Real Property." The property described was defendant's residence, and it remained unencumbered until she recorded a declaration of homestead. Plaintiff bank sued defendant and her joint venturers on their obligations, and sought foreclosure. The trial judge sustained the bank's contention that, construing the instrument with the aid of extrinsic evidence, it was an equitable mortgage. *Held*, reversed.

(a) The agreement, on the bank's printed form, was hurriedly executed because defendant needed the money within 2 hours. (4 C.3d 15.)

(b) It was a type of agreement commonly used with unsecured loans, contained no words of hypothecation, and included language inconsistent with a mortgage. (4 C.3d 17.)

(c) The covenants on recordation and duration and persons bound are consistent with a mortgage but equally consistent with an instrument "designed to afford the bank the security that the borrower retains unencumbered assets." (4 C.3d 18.) The covenant that the borrower would not permit a lien or encumbrance to exist without consent of the bank assumes that the assignment itself is not an encumbrance; its absolute prohibition of junior encumbrances is inappropriate in a mortgage. (4 C.3d 19.)

(d) "[T]o permit a creditor to choose an allegedly ambiguous form of agreement, and then by extrinsic evidence seek to give it the effect of a different and unambiguous form, would be to disregard totally the rules respecting

interpretation of adhesion contracts, and to create an extreme danger of overreaching on the part of creditors with superior bargaining positions." (4 C.3d 20.)

The majority thought *Coast Bank v. Minderhout* (1964) 61 C.2d 311, 38 C.R. 505, 392 P.2d 265, supra, §15, was distinguishable. In that case (a) the agreement contained an acceleration clause and a statement that the loan was intended to improve the property described in the agreement--both indicative of a mortgage; and (b) the borrower had breached the covenant prohibiting conveyance, and the court was confronted with the problem of fashioning an effective remedy. (4 C.3d 20, 21.) The dissenting justice, on an elaborate comparison of the two cases, concluded that they were indistinguishable (4 C.3d 31), and that the trial judge's finding, based on sufficient extrinsic evidence, was correct (4 C.3d 33). (See 60 Cal. L. Rev. 968 [criticizing opinion and suggesting possible rationale].)

In *Orange County Teachers Credit Union v. Peppard* (1971) 21 C.A.3d 448, 98 C.R. 533, the agreement was similar to those in *Coast Bank* and *Tahoe Nat. Bank*, but the court found it unnecessary to invoke the latter decision. Assuming admissibility of extrinsic evidence to establish an intent to create an equitable mortgage, the evidence offered did not support this conclusion. (21 C.A.3d 454.) (See *Rest.3d, Property (Mortgages)* §3.5.)

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F. Equitable Mortgage.

4. Effect of Equitable Mortgage.

4 Witkin Sum. Cal. Law STRP § 17

[§ 17] Effect of Equitable Mortgage.

Once an equitable mortgage is established, the general law governing rights and remedies of mortgagor and mortgagee apply. (See *Clayton Dev. Co. v. Falvey* (1988) 206 C.A.3d 438, 444, 253 C.R. 609 [C.C.P. 580b, prohibiting anti-deficiency judgment, is applicable].)

In *Aguilar v. Bocci* (1974) 39 C.A.3d 475, 114 C.R. 91, defendant attorney agreed to represent plaintiff on a criminal charge for a \$ 10,000 fee, and plaintiff made a deed of his home (in which he had a half interest) to defendant. Some 8 years later, plaintiff sued to quiet title. Defendant set up the statute of limitations, and also sought to quiet title to an undivided half interest in the property and recover the unpaid balance of the fee. *Held*, neither party was entitled to the relief sought.

(a) The evidence clearly established that the deed was intended as security for the fee, and hence was an equitable mortgage. (39 C.A.3d 478.)

(b) Defendant, a mortgagee not in possession, had only the remedy of foreclosure; but the statute of limitations, having run on the underlying debt, barred that remedy. (39 C.A.3d 478; see *infra*, §121.)

(c) Plaintiff, a mortgagor in possession, could not be ousted, but could not clear his title without satisfying the debt. (39 C.A.3d 478; see *infra*, §104.)

(d) "Although both parties are left without available remedy for the present, self-interest should permit disposition by agreement, or the occurrence of events inevitable with the passage of time will break the impasse." (39 C.A.3d 478.)

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I. INTRODUCTION

G. Other Equitable Liens.

1. In General.

4 Witkin Sum. Cal. Law STRP § 18

[§ 18] In General.

(1) *Attempt To Make Property Security for Obligation.* The general doctrine that equity will create a lien on property where this is necessary to accomplish justice is not confined to situations involving defective mortgages, but extends to any case where the parties attempt to make property security for an obligation. (See *McColgan v. Bank of Calif. Assn.* (1929) 208 C. 329, 338, 281 P. 381; *Estate of Pitts* (1933) 218 C. 184, 189, 22 P.2d 694; *Lentz v. Lentz* (1968) 267 C.A.2d 891, 894, 73 C.R. 686.)

(2) *Equity Considerations.* In some cases, the lien is created as a desirable remedy though the parties did not in fact intend to make the property security for an obligation; e.g., where the object is to prevent unjust enrichment. (See *Rest., Restitution* §161; *Smith v. Anglo-Calif. Trust Co.* (1928) 205 C. 496, 504, 271 P. 898; *Hayward Lumber & Inv. Co. v. Coast Fed. Savings & Loan Assn. of Los Angeles* (1941) 47 C.A.2d 211, 214, 117 P.2d 682; 15 So. Cal. L. Rev. 264; on equitable liens arising where two persons obtain tax titles to property, see *infra*, §61.)

However, in *Grappo v. Coventry Financial Corp.* (1991) 235 C.A.3d 496, 286 C.R. 714, plaintiff husband, after separating from defendant wife, loaned her money for construction of a house. Although plaintiff repeatedly requested that defendant give him security for the loan in the form of a deed of trust, defendant refused. Plaintiff nevertheless continued to advance funds for construction. Defendant and others later used the property to secure a loan, and then defaulted on their payments to the lender. After the lender initiated foreclosure proceedings, plaintiff sought a declaration that his interest in the property was prior and superior to that of the lender, claiming that he was entitled to an equitable lien on the property. *Held*, plaintiff had no equitable interest in the property.

(a) This was not a case of creation of a defective mortgage or deed of trust. Nor did plaintiff's claim that he thought his advances of construction funds would give him a security interest establish an intent on the part of both parties to create a security interest in the property. (235 C.A.3d 509, 510.)

(b) There was no justification for a finding that an equitable lien was necessary to prevent unjust enrichment of defendant. Plaintiff was an experienced real estate investor who had prevailed on defendant to accept the advances for construction, and he had discouraged defendant from obtaining financing through other sources. Moreover, plaintiff could not have had any realistic expectation of obtaining a security interest, and to establish this interest would be unjust. (235 C.A.3d 510.)

(3) *Statutory Lien*. An equitable lien also arises where, e.g., a purchaser who is not in default is unable to secure performance, i.e., the transfer of title from the vendor. The lien is imposed to secure recoverable prior payments. (C.C. 3050; see *Moresco v. Foppiano* (1936) 7 C.2d 242, 60 P.2d 430; *Garcia v. Atmajian* (1980) 113 C.A.3d 516, 520, 521, 169 C.R. 845 [purchaser has lien to extent of amount paid on contract, plus amount expended on improvements, taxes, and insurance]; 82 A.L.R.3d 1040 [right of vendee under executory land contract to lien for amount paid as against subsequent creditors or purchasers from vendor].)

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2. Vendor's Lien.

4 Witkin Sum. Cal. Law STRP § 19

[§ 19] Vendor's Lien.

(1) *In General*. If a vendor has transferred title to property prior to full payment of the price, without other security, the vendor has an equitable lien for the balance due. (C.C. 3046; see *Estate of Pitts* (1933) 218 C. 184, 189, 22 P.2d 694; *La Hue v. Dougherty* (1949) 34 C.2d 1, 3, 206 P.2d 640; *McGreevy v. Constitution Life Ins. Co.* (1965) 238 C.A.2d 364, 369, 47 C.R. 711; *Edwards-Town v. Dimin* (1970) 9 C.A.3d 87, 92, 87 C.R. 726 ["A vendor's lien arises at the time of sale and the transfer of legal title, if full consideration is not paid, and if the vendor has not taken other security"]; 4 Miller & Starr 3d, §10:33; 77 Am.Jur.2d (1997 ed.), Vendor and Purchaser §589 et seq.; on priorities between vendor's lien and purchase money mortgage, see *infra*, §75.)

The lien may also be created by express contract. (*Barron-Gray Packing Co. v. Tapley* (1947) 78 C.A.2d 432, 436, 177 P.2d 776 [lien on future crop, reserved by vendor, was good against subsequent crop mortgagee].)

(2) *Waiver of Lien*. The lien may be waived by any act clearly showing the intent to do so; e.g., by taking independent security for the payment of the balance due from the purchaser, or entering into an agreement that by its terms indicates a waiver. (*McGreevy v. Constitution Life Ins. Co.*, *supra*, 238 C.A.2d 368.) Thus the seller's absolute transfer of a sales contract for all or part of the purchase price waives the seller's lien "to the extent of the sum payable under the contract." (C.C. 3047 [excepting transfer in trust to pay debts with return of surplus].)

The burden of proving waiver is on the party asserting it, and no inference of waiver can be drawn from the mere fact that the parties may not have originally contemplated assertion of the lien. (*McGreevy v. Constitution Life Ins. Co.*, *supra*, 238 C.A.2d 370 [no waiver found].)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *In General*. See 77 Am.Jur.2d (2006 ed.), Vendor and Purchaser §493 et seq.



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3. Construction Lender's Lien.

4 Witkin Sum. Cal. Law STRP § 20

[§ 20] Construction Lender's Lien.

In *Jones v. Sacramento Savings & Loan Assn.* (1967) 248 C.A.2d 522, 56 C.R. 741, owners of 13 lots of residential property gave purchase money trust deeds containing provisions for subordination to trust deeds securing construction loans. Defendant made the construction loans, but departed substantially from the conditions specified in the subordination clause, thereby losing its priority (see *infra*, §57). After the homes were built, both loans became delinquent. Plaintiff acquired the purchase money notes at a discount, held trustee's sales, and purchased the properties. Defendant, relying on its subordination clause, ignored plaintiff's sales, conducted its own sales, and purchased the properties. Plaintiff sued to quiet title. *Held*, plaintiff had priority and was entitled to the properties, but defendant had an equitable lien on them for the money paid out in construction loans.

(a) An equitable lien may be created not only to give effect to a defective mortgage but generally as a remedy to prevent unjust enrichment. (248 C.A.2d 529, quoting the text; see *supra*, §18.)

(b) Plaintiff would be unjustly enriched if his trustee's sales wiped out defendant's loans. The notes had a face value of about \$ 800 per lot, and plaintiff bought them at a discount; the construction loans amounted to \$ 11,000-\$ 12,000 per lot; thus defendant, mistakenly relying on its expected priority, stood to lose \$ 143,000, while plaintiff, with knowledge of the facts, acquired improved property at a fraction of its value. (248 C.A.2d 529, 530.)

(c) The proper remedy for defendant was not a constructive trust, with an immediate sale of the property and distribution of the proceeds, but creation of equitable liens, to be paid off, as determined by the lower court, in a manner that would avoid undue hardship to plaintiff. (248 C.A.2d 531.)

SUPPLEMENT: [This section is current through the latest supplement]



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CHAPTER VIII - Security Transactions in Real Property

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I. INTRODUCTION

G. Other Equitable Liens.

4. No Subcontractor's Lien on Loan Fund.

4 Witkin Sum. Cal. Law STRP § 21

[§ 21] No Subcontractor's Lien on Loan Fund.

(1) *Case Law Development.* Case law developed the rule that a lien could be imposed on a construction loan fund if either the borrower or the lender induced the subcontractor to rely on the fund for payment. (See *Smith v. Anglo-Calif. Trust Co.* (1928) 205 C. 496, 502, 271 P. 898; *A-1 Door & Materials Co. v. Fresno Guarantee Savings & Loan Assn.* (1964) 61 C.2d 728, 732, 40 C.R. 85, 394 P.2d 829; *Miller v. Mountain View Savings & Loan Assn.* (1965) 238 C.A.2d 644, 662, 48 C.R. 278; *Doud Lumber Co. v. Guaranty Savings & Loan Assn.* (1967) 254 C.A.2d 585, 589, 60 C.R. 94; 5 Santa Clara Lawyer 69; 40 So. Cal. L. Rev. 439; 12 U.C.L.A. L. Rev. 1246; 1 U.S.F. L. Rev. 225; 54 A.L.R.3d 848 [contractor's equitable lien on percentage of funds withheld by contractee or lender].)

The uncertain application of this loose doctrine, and the difficulties facing the lender, were highlighted in *McBain v. Santa Clara Savings & Loan Assn.* (1966) 241 C.A.2d 829, 836, 51 C.R. 78. Plaintiffs agreed to sell a lot to P for \$ 7,500, subject to P obtaining a construction loan and subordination of plaintiffs' purchase money second deed of trust to the first deed of trust covering that loan. P obtained a \$ 19,000 loan from defendant, commenced construction, incurred obligations of \$ 4,311.59 to four subcontractors with mechanics' liens, and then abandoned. Plaintiffs had the property sold under their second deed of trust and bought it for \$ 5,000. A balance of \$ 6,948.44 remained in the loan fund. Plaintiffs claimed it on the theory that the second deed of trust was recorded before any work commenced, and hence, it was prior to the subcontractors' mechanics' liens. Defendant claimed its lien to the full extent of its loan. *Held*, though the mechanics' liens were wiped out by the sale under the second deed of trust, the subcontractors were entitled to an equitable lien on the balance of the funds.

The significance of the holding, underscored by a strong dissent, was that the subcontractors were given priority over the lender (defendant) even though they were unaware of its identity and their only reliance was on representations of the borrower (P). The court saw no equitable reason to give preference to the lender. It already had a first deed of trust on the property, and was not entitled to additional priority on the unexpended loan funds, after having benefited from the work and materials of the subcontractors, with knowledge of their reliance on the fund. (241 C.A.2d 841.)

The dissenting justice argued that existing law merely supported priority over the borrower, and that the majority made new law. "[T]he effect of the decision is to give a mechanic's lien claimant a priority over the lender with the first deed of trust, whenever he can show that the borrower--not necessarily the lender--induced him to rely on the loan fund." (241 C.A.2d 848.)

(2) *Statutory Limitation*. In 1967 the Legislature limited the liens of subcontractors to those established by the mechanic's lien law or by contract. "The rights of all persons furnishing labor, services, equipment, or materials for any work of improvement, with respect to any fund for payment of construction costs, are governed exclusively by" the Civil Code provisions governing stop notices (C.C. 3156 et seq.; C.C. 3179 et seq.), and no person may assert any legal or equitable right with respect to the fund other than a right created by direct written contract between that person and the person holding the fund, except pursuant to those provisions. (C.C. 3264; see *Boyd & Lovesee Lumber Co. v. Western Pac. Financial Corp.* (1975) 44 C.A.3d 460, 465, 118 C.R. 699 [statute "abolishes all theories of equitable liens or trust funds"]; *Sofias v. Bank of America* (1985) 172 C.A.3d 583, 586, 218 C.R. 388 [following *Boyd & Lovesee*]; 40 So. Cal. L. Rev. 459; 30 Hastings L. J. 493.)

The statute does not, however, preclude a tort action seeking personal liability against a construction lender that wrongfully converts construction loan funds or otherwise defrauds subcontractors and materialmen. (See *Cal-West Nat. Bank v. Superior Court* (1986) 185 C.A.3d 96, 99, 229 C.R. 431.)

To protect subcontractors and homeowners, amendments were also made in the notice provisions of the mechanic's lien statutes. The principal innovation was a written preliminary notice to the owner or repudiated owner, original contractor or reputed contractor, and construction lender or reputed lender, if any, not later than 20 days after the claimant has furnished labor or materials. (C.C. 3114.) A belated notice is effective only for claims for labor or materials furnished within 20 days prior to the service of the notice and thereafter. (C.C. 3097(d); see C.E.B., *Mechanics' Liens* 3d, §3.13 et seq.; 2 U.S.F. L. Rev. 216; 3 Cal. Proc. (4th), *Actions*, §212 et seq.)

SUPPLEMENT: [This section is current through the latest supplement]

(2) *Statutory Limitation*.

Cross-Reference: 3 Cal. Proc. (5th), *Actions*, §217 et seq.



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G. Other Equitable Liens.

5. No Contractor's Lien on Loan Fund.

4 Witkin Sum. Cal. Law STRP § 22

[§ 22] No Contractor's Lien on Loan Fund.

C.C. 3264 (*supra*, §21) applies to general contractors. The statutory language that the rights of "all persons" are governed exclusively by the statutory stop notice procedures, and that "no person" may assert a right to the loan fund not created by a direct written contract, admits no exception. (*Nibbi Bros. v. Home Fed. Savings & Loan Assn. (1988) 205 C.A.3d 1415, 1420, 253 C.R. 289*; see C.E.B., *Mechanics' Liens* 3d, §§1.31, 1.34, 7.6.)

In *Nibbi Bros.*, plaintiff general contractor received an assurance from defendant lender that sufficient money had been set aside in a construction loan fund to cover the cost of \$ 290,000 in tenant improvements that plaintiff was to construct for a developer. In the early stages of the project, defendant paid plaintiff directly from the construction loan fund, but suspended payments after recording a notice of default on the deed of trust securing the loan. Plaintiff did not learn of the notice of default, and when it asked defendant when it would be paid, it was assured that it "would be paid for work performed." Plaintiff expended another \$ 66,000 in additional tenant improvements, for which it was never paid. After defendant acquired the property at a private foreclosure sale, plaintiff sued for unjust enrichment and negligent misrepresentation, alleging that defendant induced it to perform work on the property, knowing that the developer was in default on its loan, and then secured the benefit of plaintiff's performance by purchasing the property at the foreclosure sale for the amount of the loan balance. The trial judge dismissed the action. *Held*, affirmed.

(a) C.C. 3264 bars "all theories of equitable liens or trust funds" asserted against construction lenders. (*205 C.A.3d 1421*, quoting *Boyd & Lovesee Lumber Co. v. Western Pac. Financial Corp. (1975) 44 C.A.3d 460, 118 C.R. 699*.) If defendant's "inducement falls within the traditional categories of mistake, fraud, coercion or request, it may give rise to a valid cause of action for unjust enrichment distinguishable from an equitable lien." (*205 C.A.3d 1422*.)

(b) The complaint does not allege that defendant itself promised to pay plaintiff. Hence, the alleged assurance by defendant that plaintiff would be paid must relate chiefly to future performance by the developer, i.e., that defendant optimistically assessed the developer's capacity to sustain continued financing. "A representation of this sort constitutes a nonactionable expression of opinion." (*205 C.A.3d 1423*.)

(c) Plaintiff's negligent misrepresentation claim is based on defendant's failure to disclose that it had filed a notice of default. By abolishing the supplier's rights to the construction loan fund, C.C. 3264 impliedly negates any duty that the lender may owe to the supplier including a duty of disclosure. "If the lender's duties to the supplier survived section

3264, the supplier would retain the right to bring an action against the lender based on its activities in establishing and administering the construction loan fund. This is precisely the kind of right that section 3264 was intended to abolish." (205 C.A.3d 1424.)

(d) The allegations present a close question concerning the application of the principle that one under no duty to speak who nevertheless does so is bound to speak honestly and not suppress facts that materially qualify those stated. (205 C.A.3d 1425; see 5 *Summary* (10th), *Torts*, §799.) But the complaint does not allege that defendant made any representation of fact. Defendant allegedly gave no more than a generally worded assurance that plaintiff would be paid. (205 C.A.3d 1425.) Since enactment of C.C. 3264, lenders will incur liability only by making promises or factual representations. (205 C.A.3d 1425.)

SUPPLEMENT: [This section is current through the latest supplement]



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I. INTRODUCTION

H. Reverse Mortgage.

4 *Witkin Sum. Cal. Law STRP* § 23

[§ 23] Reverse Mortgage.

C.C. 1923 et seq. govern reverse mortgage loans executed on or after January 1, 1998.

(1) *Definition.* A "reverse mortgage" is a nonrecourse loan secured by real property that (a) provides cash advances to a borrower based on the equity in, or value of, the borrower's owner-occupied principal residence; (b) requires no payment of principal or interest until the entire loan is due; and (c) is made by a lender licensed or chartered in California or the United States. (C.C. 1923; see 16 *U.C. Davis L. Rev.* 435 [effect of reverse annuity mortgages on SSI]; on home equity conversion mortgages, see 12 *U.S.C.*, §1715z-20.)

(2) *Features.* Some of the features of a reverse mortgage include:

(a) Prepayment, in whole or in part, must be permitted without penalty at any time during the term of the loan. (C.C. 1923.2(a).)

(b) The interest rate may be fixed or adjustable. (C.C. 1923.2(b).)

(c) A lender who fails to make the required advances is subject to forfeiting to the borrower treble the amount wrongfully withheld, plus interest. (C.C. 1923.2(e).)

(d) If the home is sold or the borrowers cease to occupy it as their principal residence, the reverse mortgage may become due and payable. (C.C. 1923.2(f).)

(3) *Reverse Mortgage as Lien.* A reverse mortgage constitutes "a lien against the subject property to the extent of all advances made pursuant to the reverse mortgage and all interest accrued on these advances," and it has "priority over any lien filed or recorded after recordation of a reverse mortgage loan." (C.C. 1923.3.)

(4) *Notice to Borrower.* An application for a reverse mortgage must contain a prescribed notice advising the borrower to seek counseling prior to obtaining the loan. (See C.C. 1923.5.)

(5) *Effect of Payments to Borrower.* Reverse mortgage loan payments made to a borrower are treated as loan proceeds and not as income for purposes of determining eligibility for government aid, except to the extent this provision conflicts with federal law. (C.C. 1923.9.)

SUPPLEMENT: [This section is current through the latest supplement]

(4) *Notice to Borrower*. The mandatory notice must include a statement that the borrower is required to consult with an independent loan counselor before entering into the transaction. (C.C. 1923.5, as amended in 2006.)

(6) *(New) Borrower Protection Features*. Before accepting a final loan application for a reverse mortgage or assessing fees, a lender must refer the borrower to an approved housing counseling agency. (C.C. 1923.2(j), added in 2006.) A signed certification that counseling has been completed must be given to the lender before completion of the loan application or assessment of fees. (C.C. 1923.2(k), added in 2006.)

A lender may not require the purchase of an annuity as a condition of obtaining a reverse mortgage. (C.C. 1923.2(i), added in 2006.)

A lender must comply with any applicable requirements of C.C. 1632 regarding documents being provided in languages other than English. (C.C. 1923.2(l), added in 2006.)

See 38 *McGeorge L. Rev.* 45 [statutory amendments protecting seniors contemplating reverse mortgages].



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I. INTRODUCTION

I. Real Property Sales Contract.

1. In General.

4 *Witkin Sum. Cal. Law STRP* § 24

[§ 24] In General.

(1) *Nature of Transaction.* The executory real property sales contract, which puts the buyer in possession of the property but obligates the seller to tender a deed only on payment of the purchase price, is a common security device. (See 4 *Miller & Starr* 3d, §§10:25, 10.35 et seq.; C.E.B., 1 *Mortgage and Deed of Trust Practice* 3d, §1.28; C.E.B., 2 *Real Property Sales Transactions* 3d, §8.12 et seq. [installment land contracts]; 48 *Cal. L. Rev.* 729, 773; 7 *U.C.L.A. L. Rev.* 95; 9 *U.C.L.A. L. Rev.* 608, 643; on nature of contract, see *Kosloff v. Castle* (1981) 115 *C.A.3d* 369, 372, 171 *C.R. 308*, *infra*, §25; *Petersen v. Hartell* (1985) 40 *C.3d* 102, 108, 219 *C.R.* 170, 707 *P.2d* 232, *infra*, §25; on application of anti-deficiency legislation to land sale contracts, see *infra*, §188.)

(2) *Definition.* The "real property sales contract" is an agreement to transfer real property, on specified conditions, that does not require conveyance of title within 1 year. (C.C. 2985.)

(3) *Transfer of Contract and Property.* The fee owner cannot transfer the contract without a transfer of the property, and cannot transfer the property without an assignment of the contract. (C.C. 2985.1; see *Petersen v. Hartell*, *supra*, 40 *C.3d* 116.) The vendor who receives pro rata payments for insurance and taxes must hold them in trust for this purpose. (C.C. 2985.4.)

(4) *Disclosures.* Every real property sales contract must contain a statement of the number of years required to complete payment, and the basis on which the tax estimate is made. (C.C. 2985.5.)

Generally, contracts that involve divided property must include information (a) disclosing compliance with the Subdivision Map Act (*Govt.C.* 66410 et seq.; see 12 *Summary* (10th), *Real Property*, §§809, 814.) or an exemption or waiver; and (b) describing any improvements that must be completed as a condition of that waiver. (C.C. 2985.51(a).) A vendor making false statements of compliance or exemption may be liable for damages, and the contract will be voidable at the buyer's option. (C.C. 2985.51(c).)

(5) *Prepayment.* The buyer under a real property sales contract of residential property (property that has been subdivided into a residential lot or lots containing a dwelling for not more than four families) has the right to prepay all or any part of the balance due. (C.C. 2985.6(a).) This right may not be waived (C.C. 2985.6(b)), except that the seller may by written agreement prohibit prepayment for up to 12 months after the sale (C.C. 2985.6(a)). (On prepayment

penalties generally, see *infra*, §92 et seq.)

(6) *Transfer Fees*. The vendor of a single family residential property may not charge a fee over \$ 10 for signing and delivering a document of transfer, cancellation, or reconveyance on exercise of an option to buy or on completion of performance. (C.C. 1097.)

(7) *Criminal Offenses*. Three criminal offenses are recognized: (a) Placing an excessive encumbrance. (C.C. 2985.2.) (b) Not applying an installment payment to the amount due. (C.C. 2985.3.) (c) Receiving pro rata payments for insurance and taxes and not holding them in trust. (C.C. 2985.4; P.C. 506b.) (See 2 *Cal. Crim. Law* (3d), *Crimes Against Property*, §201.)

(8) *Foreclosure*. A real property sales contract containing a power of sale is a "mortgage" for purposes of C.C. 2924 et seq. (nonjudicial foreclosure sales; see *infra*, §144 et seq.). (C.C. 2920(b); see *Fountain Valley Chateau Blanc Homeowner's Assn. v. Department of Veterans Affairs* (1998) 67 C.A.4th 743, 757, 79 C.R.2d 248 [Cal-Vet loans, involving land sale contracts enforced by forfeiture rather than foreclosure, are in reality mortgages under C.C. 2920(b); thus, Department of Veterans Affairs was not "owner" of property subject to liability for violation of covenants, conditions, and restrictions].)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Nature of Transaction*. See C.E.B., 2 Real Property Sales Transactions 4th, §9:14 et seq.



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I. INTRODUCTION

- I. Real Property Sales Contract.
2. Rights of Defaulting Purchaser.

4 Witkin Sum. Cal. Law STRP § 25

[§ 25] Rights of Defaulting Purchaser.

(1) *Historical Development.* A broad hint of a possible judicial extension to defaulting purchasers of the right of a defaulting mortgagor to cure default (see *infra*, §216 et seq.) appears in dicta in *MacFadden v. Walker* (1971) 5 C.3d 809, 816, 97 C.R. 537, 488 P.2d 1353: "[W]e note ... the persuasive arguments that installment land sale contracts should be treated as security devices substantially on a par with mortgages and deeds of trust, and that therefore 'the law governing those security devices should be adopted with appropriate modifications in determining the remedies for breaches of installment contracts.' " (5 C.3d 816.)

In *Kosloff v. Castle* (1981) 115 C.A.3d 369, 171 C.R. 308, the court took note of the suggestion in *MacFadden*, but concluded that this development had not yet occurred by judicial decision and that it was a matter for legislation. (115 C.A.3d 369, 374, 377.) Hence, where defendant purchaser was wilfully in substantial default for more than 2 years, and had allowed the property to fall into disrepair, reinstatement of the contract was properly denied. (115 C.A.3d 376.)

(2) *Right of Redemption.* The suggestion became a rule in *Petersen v. Hartell* (1985) 40 C.3d 102, 219 C.R. 170, 707 P.2d 232. G made agreements to sell small portions of a 160-acre tract to her grandchildren at \$ 1,500 per acre, with no downpayment and monthly installments of \$ 50 or less. In 1967, plaintiffs, G's granddaughter and her husband, bought six acres for a total price of \$ 9,162. Of the 65 payments due from November 1967 through March 1973, they made 58. In 1973, the couple separated and payments ceased. In September 1975, with \$ 1,800 overdue, plaintiff wife tendered a check for \$ 250. G rejected the tender and notified plaintiffs that she was terminating the contract. G died in 1976, and the present action was brought against her administrator, seeking specific performance, and tendering the entire balance due. The trial judge denied specific performance on the ground that plaintiffs' breach was wilful, but ordered restitution of the payments made (\$ 2,000) with interest. *Held*, judgment reversed; plaintiffs were entitled to specific performance.

(a) In *MacFadden*, the trial judge granted specific performance; here, he denied it, and the issue is whether the denial was an abuse of discretion. (40 C.3d 110.) The judge's memorandum indicated that he did not determine whether the contract was just and reasonable and the consideration was adequate because these factors would not have altered his decision, which was based on a balance of equities that included the seriousness of the purchasers' defaults. (40 C.3d 111.) If his theory were correct, the evidence would support the decision. Plaintiffs' monthly payments were "erratic and delinquent almost from the beginning," even though G made it clear that she needed them for her support. Hence, the

question is whether plaintiffs, despite their wilful defaults in payments, have an absolute right to a conveyance on payment of the entire balance of the price. (40 C.3d 112.)

(b) For at least a century, a vendor of land sold under an installment contract who sued to quiet title because of the purchaser's default in installments has been required to give the purchaser a reasonable opportunity to complete performance. (40 C.3d 112, citing *Keller v. Lewis* (1878) 53 C. 113, 118, and later decisions.) There was no indication in those cases that the purchaser's right of redemption was contingent on a showing of facts that would mitigate the wilfulness or seriousness of the default. (40 C.3d 113.)

(c) In the early cases, the purchaser who failed to exercise the right to redeem by completing the payments forfeited payments already made. *Freedman v. The Rector, Wardens & Vestrymen of Saint Matthias Parish of Los Angeles* (1951) 37 C.2d 16, 230 P.2d 629, 13 Summary (10th), *Equity*, §22, changed the rule, giving the defaulting purchaser a right of restitution. (40 C.3d 113.) Some later decisions treated the purchaser's right to a reasonable opportunity to redeem as merely discretionary. (40 C.3d 114.) But under *Keller* and its progeny, these cases are wrong. The purchaser who has made substantial payments and whose default consists solely of failure to make further payments "has an unconditional right to a reasonable opportunity to complete the purchase by paying the entire remaining balance plus damages before the seller is allowed to quiet title." (40 C.3d 114.)

(d) In the present case, the vendor did not sue to quiet title but gave the purchasers written notice of election to terminate; and when plaintiffs sued for specific performance, defendant merely answered, praying that plaintiffs take nothing. Thus, the right of redemption cannot be justified as a condition to granting of relief sought by the vendor. (40 C.3d 115.) However, other circumstances lead to the conclusion that G had only a security interest, and that the purchasers' right to purchase could be terminated only by foreclosure sale or by strict foreclosure (i.e., a judicial proceeding quieting the vendor's title). Foreclosure by sale is an available remedy under C.C.P. 580b (see *infra*, §182 et seq.). (40 C.3d 115, footnote 5.)

(e) C.C. 2985 and 2985.1 (*supra*, §24) prohibit one who has contracted to sell land under a long-term installment contract from conveying title in disregard of the purchaser's interest. "The intended protection of the vendees' interest is best served by interpreting section 2985.1 to require continuation of that linkage between seller's title and vendee's contractual interest until the latter has been affirmatively terminated by conveyance of title to the vendee, by a foreclosure sale ... , or by strict foreclosure." (40 C.3d 116.)

(f) To give the purchaser the same absolute right of redemption in response to the vendor's notice of termination as would be given in response to a vendor's suit to quiet title, would avoid undue burdens on courts and litigants by reason of time-consuming and expensive legal proceedings. The purchaser's complaint seeking this remedy should not be designated as one for specific performance, but rather as one "to redeem the vendee's interest in real property." (40 C.3d 116, 117.)

(g) "Accordingly, we conclude that plaintiffs are entitled to a conveyance of title to the property in exchange for payment of the entire remaining balance due under the contract together with interest and any consequential damages as determined by the court. Should plaintiffs fail to make such payments within a reasonable time fixed by the court, the adjudication that plaintiffs have no further interest in the property should become effective only upon defendant's payment of the sums due to plaintiffs as restitution." (40 C.3d 117.)

Two justices joined in a dissent, asserting that the decision was without support in either precedent or policy, and that the trial judge's exercise of discretion was rational and should have been upheld. (40 C.3d 122.)

SUPPLEMENT: [This section is current through the latest supplement]



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I. INTRODUCTION

J. Mechanic's Lien.

1. In General.

4 *Witkin Sum. Cal. Law STRP* § 26

[§ 26] In General.

(1) *Nature and Effect of Mechanic's Lien.* "Mechanics, persons furnishing materials, artisans, and laborers of every class, shall have a lien upon the property upon which they have bestowed labor or furnished material for the value of such labor done and material furnished; and the Legislature shall provide, by law, for the speedy and efficient enforcement of such liens." (Cal. Const., Art. XIV, §3.) This constitutional directive is carried out by detailed statutory provisions. (See C.C. 3109 et seq.; C.C. 3128 [land on which building or improvement is constructed is also subject to lien if it belongs to person causing work to be done]; *Pacific Coast Refrigeration v. Badger* (1975) 52 C.A.3d 233, 239, 124 C.R. 786 [construing C.C. 3128]; *B. & P.C. 7018.5* [requiring contractors to give "Notice to Owner" form concerning mechanic's lien laws before entering into contracts for home improvement or swimming pool construction]; on enforcement of mechanic's liens and stop notices on private property, see 3 *Cal. Proc.* (4th), *Actions*, §§212, 213.)

Neither the constitutional provision nor the implementing statutes apply to public works. (C.C. 3109; *Miles v. Ryan* (1916) 172 C. 205, 207, 157 P. 5; on substitute remedies provided to claimants on public projects, see 3 *Cal. Proc.* (4th), *Actions*, §214.)

(2) *Texts and Practice Works.* A number of texts and practice works deal with mechanics' liens. (See 5 Powell §38.10 et seq.; Marsh, *California Mechanics' Lien Law and Construction Industry Practice*; C.E.B., *Mechanics' Liens* 3d, §§2.2 et seq., 3.2 et seq.; C.E.B., *Real Property Sales Transactions* 3d, §4.60 et seq.; 51 *Cal. L. Rev.* 331 [comprehensive study and proposed revisions]; 24 *Pacific L. J.* 83 [lessor liability for mechanics' liens under "participating owner" doctrine]; 9 *Santa Clara Lawyer* 101; 76 *A.L.R.2d* 1087 [validity and effect of contract provision against mechanic's lien]; 50 *A.L.R.3d* 944 [mechanic's lien based on contract with vendor pending executory contract for sale of property as affecting purchaser's interest]; 68 *A.L.R.3d* 1300 [single lien on several parcels]; 74 *A.L.R.3d* 330 [lien attached to leasehold estate; enforceability against landlord's fee]; 75 *A.L.R.3d* 505 [release or waiver of lien by general contractor as affecting rights of subcontractor or materialman]; 24 *A.L.R.4th* 963 [right of subcontractor's subcontractor or materialman, or of materialman's materialman]; 30 *A.L.R.4th* 134 [mortgagee's duty in disbursing funds to protect mortgagor against mechanics' liens]; 33 *A.L.R.4th* 1017 [liability of purchaser as to mechanic's lien filed after title passed]; 31 *A.L.R.5th* 664 [applicability of mechanic's lien statutes to architects' services]; 53 *Am.Jur. Trials* 367 [litigating construction liens]; 33 *Proof of Facts* 3d 113 [collusive relationships in construction liens]; 17B *Am.Jur. P.P. Forms* (2000 ed.), *Mechanics' Liens*, §1 et seq.)

West's Key Number Digest, Mechanics' k.Liens 1 et seq.

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Nature and Effect of Mechanics' Liens.*

Enforcement on private property:

Cross-Reference: 3 *Cal. Proc.* (5th), *Actions*, §217 et seq.

Substitute remedies for public projects:

Cross-Reference: 3 *Cal. Proc.* (5th), *Actions*, §220.

(2) *Texts and Practice Works.* See C.E.B., 1 *Real Property Sales Transactions* 4th, §§4.69, 4.78, 4.172.



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J. Mechanic's Lien.

2. Right to Lien.

4 Witkin Sum. Cal. Law STRP § 27

[§ 27] Right to Lien.

Mechanics, materialmen, contractors, subcontractors, lessors of equipment, and other specified persons and laborers performing labor or bestowing skill or other necessary services on, or furnishing materials or leasing equipment to be used or consumed in, or furnishing appliances, teams, or power contributing to a *work of improvement* have a *lien on the property* for the value of the labor done or material furnished and for the value of the use of the appliances, equipment, teams, or power whether done or furnished at the instance of the owner or of any person acting by or under his or her authority, as contractor or otherwise. For this purpose, "every contractor, subcontractor, sub-subcontractor, architect, builder, or other person having charge of a work of improvement or portion thereof shall be held to be the agent of the owner." (C.C. 3110; see C.C. 3106 [broadly defining "work of improvement"]; C.C. 3112 [site improvement lien]; *R.D. Reeder Lathing Co. v. Allen* (1967) 66 C.2d 373, 379, 57 C.R. 841, 425 P.2d 785 [building industry practices]; *Tracy Price Associates v. Hebard* (1968) 266 C.A.2d 778, 784, 72 C.R. 600 [architect's lien]; *Primo Team v. Blake Const. Co.* (1992) 3 C.A.4th 801, 807, 4 C.R.2d 701 [assembling work force and administering payroll was not "furnishing" labor within meaning of C.C. 3110]; *Angeles Elec. Co. v. Superior Court* (1994) 27 C.A.4th 426, 441, 32 C.R.2d 660 [subcontractor's acceptance of payment resulted in express surrender of mechanic's lien; fact that payment was recovered as avoidable preference did not resurrect subcontractor's lien rights]; *Mechanical Wholesale Corp. v. Fuji Bank, Ltd.* (1996) 42 C.A.4th 1647, 1655, 50 C.R.2d 466 [California's statutory mechanic's lien scheme only applies to California projects]; *Ivy Trucking v. Creston Brandon Corp.* (2000) 84 C.A.4th 85, 88, 100 C.R.2d 582 [although transportation of materials for construction project usually does not constitute labor, services, or materials under C.C. 3110, there is exception when hauler is hired by subcontractor, who is agent of owner under statute].)

For the lien to attach, visible work on the project must have commenced. There are two reasons for this rule: (1) The lien attaches to the work of improvement and the land on which it is located, and (2) visible work notifies potential lenders that mechanic's lien rights have arisen. (*D'Orsay Int. Partners v. Superior Court* (2004) 123 C.A.4th 836, 841, 842, 20 C.R.3d 399 [there is no "owner prevention" exception to requirement that work be visibly commenced; when work failed to commence, contractor who had filed mechanic's lien for design-related services could not seek recovery based on fact that obtaining design professional's lien is not dependent on commencement of actual construction]; see *infra*, §70.) Architects, engineers, etc., who perform work prior to commencement of construction are protected by the design professional's lien law. (See *infra*, §32.)

SUPPLEMENT: [This section is current through the latest supplement]



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I. INTRODUCTION

J. Mechanic's Lien.

3. Amount of Lien.

4 Witkin Sum. Cal. Law STRP § 28

[§ 28] Amount of Lien.

A mechanic's lien is for the "reasonable value of the labor, services, equipment, or materials furnished or for the price agreed upon by the claimant and the person with whom he or she contracted, whichever is less." (C.C. 3123(a).) With specific exceptions, the lien is not limited by the amount stated in the contract. (C.C. 3123(a).) In addition to amounts for labor, services, equipment, or materials furnished pursuant to a written modification of the contract, a lien claimant may include amounts resulting from rescission, abandonment, or breach of the contract. (C.C. 3123(b).) Thus, a claimant may "include in the lien an amount for the reasonable value of the labor, services, equipment or materials furnished based on the owner's breach of contract, even if based on oral modifications to the contract." (*Basic Modular Facilities v. Ehsanipour* (1999) 70 C.A.4th 1480, 1484, 1485, 83 C.R.2d 462.)

SUPPLEMENT: [This section is current through the latest supplement]



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I. INTRODUCTION

J. Mechanic's Lien.

4. Enforcing or Protecting Against Lien.

4 Witkin Sum. Cal. Law STRP § 29

[§ 29] Enforcing or Protecting Against Lien.

(1) *In General.* Except for (a) prime contractors, (b) those performing actual labor for wages, and (c) persons or entities to whom a portion of a laborer's compensation is paid by agreement with the laborer or his or her collective bargaining agent, each claimant is required to give the owner, the original contractor, and the construction lender, or the "reputed" owner, contractor, and lender a "preliminary 20-day notice (private work)" as a prerequisite to enforcing a mechanic's lien; the mechanic's lien is limited to items supplied commencing 20 days before the notice is served. (C.C. 3097; see 3 *Cal. Proc.* (4th), *Actions*, §212; on stop notices for private and public property, see 3 *Cal. Proc.* (4th), *Actions*, §§213, 214; on priorities between real mortgage and mechanic's lien, see *infra*, §§69, 70.)

(2) *Time Limits.* The claimant must file a claim of lien (C.C. 3084) within prescribed time limits. (C.C. 3115, 3116; see *Vaughn Materials Co. v. Security Pac. Nat. Bank* (1985) 170 C.A.3d 908, 912, 216 C.R. 605.) The claimant must also commence suit to foreclose the lien within the specified time limit, usually 90 days. (C.C. 3144(a); see *L.A.M. Const. v. Kriz* (1993) 14 C.A.4th Supp. 1, 6, 18 C.R.2d 304 ["proper court" for commencing foreclosure is superior court in county where property is located].)

The time limits for filing a claim of lien are shortened when a work of improvement is made pursuant to two or more original contracts covering different portions of the work and the owner files a *notice of completion* within 10 days after completing the contract for a particular portion of the work. (C.C. 3117.) However, a claimant who has failed to file a lien within the statutory period does not gain a second opportunity to do so when the landowner files a late notice of completion. A notice of completion filed more than 10 days after completion of the work is invalid and does not have the effect of reopening the period for filing a lien. (*Fontana Paving v. Hedley Bros.* (1995) 38 C.A.4th 146, 154, 158, 45 C.R.2d 295 [defendant was not estopped to argue that its late notice of completion was invalid; even assuming failure to record completion notice could constitute representation to plaintiff supplier, there was no evidence that supplier relied on it].)

(3) *Failure To Commence Timely Action.* Failure to commence the action to foreclose the lien within the time limit "automatically" renders the lien "null and void and of no further force and effect." (C.C. 3144(b); see *Automatic Sprinkler Corp. v. Southern Calif. Edison Co.* (1989) 216 C.A.3d 627, 633, 266 C.R. 662 [action commenced in wrong court and not transferred to proper court within 90 days; foreclosure barred under C.C. 3144(a)]; *Westfour Corp. v. California First Bank* (1992) 3 C.A.4th 1554, 1559, 5 C.R.2d 394 [designation of prior lender as "Doe" defendant tolled

limitations period under C.C. 3144 until plaintiff acquired knowledge of lender's interest in property].) However, notwithstanding C.C. 3144(b), a claimant who fails to commence a timely foreclosure action retains an inchoate right to a lien. Hence, if the landowner fails to take action to release the lien under C.C. 3154 (see *infra*, §30), the claimant may perfect the inchoate lien by filing a new claim of lien within the statutory time periods. (See *Coast Cen. Credit Union v. Superior Court* (1989) 209 C.A.3d 703, 710, 257 C.R. 468.)

(4) *Notice of Nonresponsibility and Release Bond.* A landowner who does not authorize work giving rise to a mechanic's lien but has knowledge of it can protect himself or herself from the lien by filing a notice of nonresponsibility within 10 days after knowledge of the work. (C.C. 3094, 3129.) And if, after work is done and a lien is filed, the landowner disputes the correctness or validity of the claim, he or she may record a bond and free the property from the lien. (C.C. 3143.) An action on the lien release bond must be commenced within 6 months of the bond's recording. A person obtaining a lien release bond must give notice of its recording to the lienholder. Failure to give notice tolls the statute of limitations on any action on the bond until the notice is given. (C.C. 3144.5.) (See *Royster Const. Co. v. Urban West Communities* (1995) 40 C.A.4th 1158, 1166, 1169, 47 C.R.2d 684 [action against landowner to foreclose mechanic's lien and action against surety on C.C. 3143 release bond are one and same cause of action; thus, surety, like landowner, can raise defense that attorneys' fees are barred]; 15 *Pacific L. J.* 525; 28 *U.C.L.A. L. Rev.* 95 [California's release bond statutes]; on release of lien generally, see *infra*, §30.)

The requirement of C.C. 3144.5 that an action on an owner's release bond be commenced within 6 months does not apply to pending lien foreclosure actions. If a lien foreclosure action is timely filed before the bond is recorded and the surety is thereafter made a party defendant to the action, the surety may not invoke the limitation period of C.C. 3144.5 as a defense. (*Hutnick v. United States Fidelity & Guaranty Co.* (1988) 47 C.3d 456, 460, 253 C.R. 236, 763 P.2d 1326.)

(5) *Claimant's Unclean Hands.* Mechanic's lien statutes (C.C. 3261, 3262) do not eliminate the equitable defense of unclean hands; the entire lien may be invalidated by application of the doctrine. (*Burton v. Sosinsky* (1988) 203 C.A.3d 562, 569, 250 C.R. 33.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *In General.*

Mechanic's lien on private property:

Cross-Reference: 3 *Cal. Proc.* (5th), *Actions*, §217, 218.

Stop notices:

Cross-Reference: 3 *Cal. Proc.* (5th), *Actions*, §§219, 220.



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J. Mechanic's Lien.

5. Release of Lien.

a. In General.

4 Witkin Sum. Cal. Law STRP § 30

[§ 30] In General.

When no action has been brought to enforce a mechanic's lien within the time period specified in C.C. 3144 (see *supra*, §29), the owner of an interest in the property may petition to remove the lien. (C.C. 3154.)

In *Santa Clara Land Title Co. v. Nowack & Associates* (1991) 226 C.A.3d 1558, 277 C.R. 497, plaintiff title company brought a quiet title action against defendant civil engineering firm. Defendant contended that a release it had executed, stating that its *recorded* mechanic's notice and claim of lien was "fully satisfied, released and discharged," did not wipe out its *inchoate* personal right to a lien that attached when it began work on the property. *Held*, the underlying inchoate rights were also released, and defendant's claim did not have priority over a construction loan deed of trust recorded after the release. (226 C.A.3d 1566.) Further, once the lien was released, it was neither necessary nor possible for the construction lender to proceed under C.C. 3154. (226 C.A.3d 1567.) (See *Maris Management Corp. v. Assured Drywall & Textures* (1984) 152 C.A.3d 268, 272, 199 C.R. 309 [once decree pursuant to C.C. 3154 is entered, no lien based on same work exists to serve as basis for new claim of lien]; 11 *Pacific L. J.* 346.)

The result in *Santa Clara Land Title* was distinguished in *Koudmani v. Ogle Enterprises* (1996) 47 C.A.4th 1650, 55 C.R.2d 330. A roofing company recorded a mechanic's lien against plaintiff's property for roofing materials the company had supplied. After plaintiff recorded a notice of completion, the roofing company recorded a second claim of lien, and then, several days later, it released plaintiff from the first lien claim because the 90-day period for a foreclosure action had expired. The company refused to release the second claim and assigned that claim to defendant. Plaintiff filed an action to release his property from both liens, and the trial judge entered a judgment in favor of plaintiff. *Held*, reversed.

(a) There is a difference between a claim of lien and the inchoate personal right on which it is based. When no foreclosure action is brought within the period specified by C.C. 3144, the lien claim is extinguished; however, if the period for recording a lien is still open, a subsequent lien, based on the same inchoate personal right, may be recorded. (47 C.A.4th 1657, 1658, citing *Coast Cen. Credit Union v. Superior Court* (1989) 209 C.A.3d 703, 257 C.R. 468, *supra*, §29, and disagreeing with *Maris Management Corp.*, *supra*)

(b) The release signed by the roofing company is likewise no impediment to foreclosure. Unlike the release in

Santa Clara Land Title, the roofing company's release did not represent that the first lien claim was "fully satisfied," but only that it was "hereby satisfied or otherwise released and discharged." A release of this type, indicating that a claim may *not* be satisfied, does not extinguish the inchoate right to record subsequent liens based on the same work or material. "To hold a release of an unsatisfied claim bars the right to later record a timely claim of lien for the same work or materials would frustrate the essential purpose of the mechanic's lien statutes, which is to protect contractors, laborers and material suppliers from nonpayment." Accordingly, the second lien remains a valid lien against the property. (47 C.A.4th 1659.)

The holding in *Maris Management Corp.*, that no new claim of lien based on the same work may be pursued after entry of a decree pursuant to C.C. 3154, was overruled in *Solit v. Tokai Bank, Ltd., New York Branch* (1999) 68 C.A.4th 1435, 1447, 81 C.R.2d 243. The decision was partly based on the *Koudmani* court's determination that a mechanic's right to a lien rests on the Constitution, not in the *Civil Code* (68 C.A.4th 1446): "We improperly treated the inchoate constitutional right to a lien and the lien itself as synonymous, and, to the extent the opinion in *Maris* suggests that a decree pursuant to section 3154 releasing a stale mechanic's lien, or a gratuitous voluntary release recorded under threat of a section 3154 petition, would preclude the claimant from recording another claim of lien, based on the same work and materials as the released lien, even though such subsequently recorded lien was timely under section 3115 or section 3116, we overrule it." (68 C.A.4th 1447.)

SUPPLEMENT: [This section is current through the latest supplement]

See *T.O. IX v. Superior Court* (2008) 165 C.A.4th 140, 148, 80 C.R.3d 602 [company that constructed street through 9-home subdivision had no right to file mechanic's lien against each parcel in full amount of debt; posting single bond in statutory amount to cover entire debt and releasing 9 liens at issue would satisfy mechanic's lien statutes].



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J. Mechanic's Lien.

5. Release of Lien.

b. Conditional Waiver of Release.

4 *Witkin Sum. Cal. Law STRP* § 31

[§ 31] Conditional Waiver of Release.

(1) *Former Rule.* In *Halbert's Lumber v. Lucky Stores* (1992) 6 C.A.4th 1233, 8 C.R.2d 298, a subcontractor ordered beams from plaintiff lumber company for use in a supermarket construction project. After delivery of the beams to the job-site, the subcontractor requested that plaintiff sign a "conditional waiver release upon progress payment" in the form prescribed by C.C. 3262(d)(1). Although plaintiff signed the release, it was not aware that the beams were already at the job site, or that the amount payable specified in the waiver did not include the cost of the beams. Plaintiff was never compensated for the beams and filed a mechanic's lien. After a bond to release the mechanic's lien was filed, plaintiff brought an action to recover the cost of the beams from the issuer of the bond, but was denied recovery. *Held*, affirmed; the release covered all mechanic's lien rights that potentially existed as of the release date.

(a) Although plaintiff argued that its lien rights in the beams did not arise until the beams were actually installed, and therefore could not be included in the release, plaintiff had waivable mechanic's lien rights in the beams when they were delivered to the site. (6 C.A.4th 1244.) The word "furnished" in the statutory release form should be given its ordinary meaning, which is to make something available. Delivering materials to a job-site satisfies this definition. (6 C.A.4th 1240.) Even though there are a number of requirements that must be met before a mechanic's lien is enforceable, a mechanic's lien that is not yet enforceable may still be waivable. (6 C.A.4th 1242.)

(b) The lien rights in the beams were within the scope of the release. Although the language in the statutory release form is ambiguous, and legislative history is inconclusive, these releases would be useless if material suppliers were still able to assert mechanics' liens after payment of the amount specified in the release. (6 C.A.4th 1250, 1251.)

(2) *Statutory Amendment.* C.C. 3262 was amended in 1993 to revise the "Conditional Waiver and Release Upon Progress Payment" forms construed in *Halbert's Lumber*. The form no longer provides for a "pro tanto" release, and specifies that the release does not cover retentions retained before or after the release date, or extras for which payment has not been received. (On waiver of mechanics' liens generally, see 1 *Summary*, (10th), *Contracts*, §684.)

J.A. Jones Const. Co. v. Superior Court (1994) 27 C.A.4th 1568, 33 C.R.2d 206, held that the 1993 changes to the release form in C.C. 3262 were not intended to operate retroactively. (27 C.A.4th 1579.) Thus, a construction company that signed two of the old forms releasing a hotel owner from everything it owed through September 15, 1990, released

its mechanic's lien rights to all but \$ 5,000 in labor and materials furnished after September 15, even though \$ 803,396 in claims remained unpaid. (27 C.A.4th 1584.) (See *Western Landscape Const. v. Bank of America* (1997) 58 C.A.4th 57, 62, 67 C.R.2d 868 [use of form provided in former C.C. 3262 in applying for progress payments did not release subcontractor's stop notice and mechanic's lien rights with respect to retention payments; distinguishing *Halbert* and *Jones*].)

SUPPLEMENT: [This section is current through the latest supplement]

(2) *Statutory Amendment.* A conditional waiver under C.C. 3262 is limited to express lien rights. By executing a release, the subcontractor or materialman does not waive his or her "rights to pursue compensation for unpaid services and materials under the terms of the contract or as otherwise provided by law or equity." Further, a conditional release does not prevent a subcontractor or materialman from exercising his or her mechanic's lien rights to recover payment for goods and services provided after the release date. (*Tesco Controls v. Monterey Mechanical Co.* (2004) 124 C.A.4th 780, 797, 21 C.R.3d 751.)



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I. INTRODUCTION

K. Design Professional's Lien.

4 *Witkin Sum. Cal. Law STRP* § 32

[§ 32] Design Professional's Lien.

(1) *In General.* C.C. 3081.1 et seq. provide for a lien on real property, similar to the mechanic's lien, in favor of a "design professional" who furnishes services for a work of improvement. (See C.E.B. *Mechanics' Liens* 3d, §2.75 et seq.; 22 *Pacific L. J.* 381; on priorities between real mortgage and design professional's lien, see *infra*, §71.) The statute does not apply to a work of improvement relating to a single-family, owner-occupied residence where the construction costs are less than \$ 100,000. (C.C. 3081.10.)

(2) *Design Professional.* A "design professional" is defined as "any certificated architect, registered professional engineer, or licensed land surveyor who furnishes services pursuant to a written contract with a landowner for the design, engineering or planning of a work of improvement." (C.C. 3081.1.)

(3) *Lien for Fee.* The design professional's lien is on the real property for which the work of improvement is planned to be constructed, "notwithstanding the absence of commencement of actual construction of the planned work of improvement," if the landowner contracted for the services and is also the owner of the real property at the time of recordation of the lien. (C.C. 3081.2.) The lien is for the amount of the fee for services rendered prior to commencement of the work, or the reasonable value of those services, "whichever is less"; and the amount is reduced by the amount of any deposit or prior payments as specified in the contract. (C.C. 3081.2.) However, no lien may be created "unless a building permit or other governmental approval in furtherance of the work of improvement has been obtained in connection with or utilizing the services rendered by the design professional." (C.C. 3081.2.)

(4) *Conditions for Entitlement to Lien.* For the design professional to be entitled to a lien all of the following must occur: (a) the landowner defaults in a required payment; (b) the design professional mails written demand for payment; (c) the design professional records a notice of lien with prescribed information: amount, current owner of record, legal description of property, governmental approval. (C.C. 3081.3.) Recordation must be no later than 90 days after the design professional knows or has reason to know that the landowner is not commencing the work of improvement. (C.C. 3081.7.)

(5) *Creation and Expiration of Lien.* On recordation of the notice of lien, a lien is created. It automatically expires on the occurrence of either of the following: (a) the commencement of the work of improvement, or (b) the expiration of 90 days after recordation, unless suit is filed to enforce it within the 90-day period. If the landowner partially or fully satisfies the lien, the design professional "shall execute and record a document which evidences a partial or full

satisfaction and release of the lien, as the case may be." (C.C. 3081.4.)

(6) *Enforcement of Lien*. The lien "shall be enforced pursuant to the provisions" of C.C. 3143 et seq. (mechanics' liens: see supra, §26 et seq.). However, the design professional statute does not affect the ability of a design professional to obtain a mechanic's lien under C.C. 3082 et seq. (C.C. 3081.6), and the perfection of a lien does not affect the ability of a design professional to pursue other remedies (C.C. 3081.8).

SUPPLEMENT: [This section is current through the latest supplement]



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I. INTRODUCTION
L. Conflict of Laws.

4 Witkin Sum. Cal. Law STRP § 33

[§ 33] Conflict of Laws.

(1) *Law of Situs Governs Security Interest.* The effect of a mortgage in creating an interest in land, the nature of the interest, and the method of foreclosure are determined by the law of the situs of the land; i.e., the conflicts rule is the same as that applicable to a conveyance of land. (See *Rest.2d, Conflict of Laws* §§228, 229; *Leflar 3d*, §171; *Scoles & Hay 3d*, §§19.9, 19.10.)

(2) *Exception: Deficiency Judgment.* The statutes limiting the right of the creditor to a personal deficiency judgment against the debtor (see *infra*, §178 et seq.) raise distinct issues, and the law of the situs need not be applied. (See *Rest.2d, Conflict of Laws*, §229, Comment e; *44 A.L.R.3d* 922 [conflict of laws as to application of statute proscribing availability of action for deficiency after sale of collateral real estate].)

Yunker v. Manor (1967) 255 C.A.2d 431, 63 C.R. 197, illustrates this approach. Defendants R Corp., a California corporation, and L, its president, purchased Nevada land from plaintiffs, giving a note and deed of trust for the purchase price. Foreclosure of a prior deed of trust wiped out the security, and plaintiffs sought a deficiency judgment in California, despite *C.C.P. 580b* (*infra*, §182 et seq.), prohibiting the judgment after foreclosure of a purchase money mortgage. Plaintiffs argued that Nevada law, allowing a deficiency judgment, should apply because the land was there and the note was made and payable there. *Held*, California law applied.

Although Nevada law was properly applied to the "real property" aspects, such as the validity of the deed of trust and means of foreclosure, and the title obtained at the foreclosure sale, the "personal" aspects were subject to California law for the following reasons: (a) R Corp. was a California corporation and L was a California resident; and this state has an interest in their solvency. (b) The California anti-deficiency statute expresses a strong policy of this state. (c) Plaintiffs represented to defendants at the time of purchase that Nevada law on deficiency judgments was the same as California law. (255 C.A.2d 437.) (See *Stuart v. Lilves* (1989) 210 C.A.3d 1215, 1219, 258 C.R. 780, 7 Cal. Proc. (4th), Judgment, §311 [following *Yunker*]; *Guardian Savings & Loan Assn. v. MD Associates* (1998) 64 C.A.4th 309, 323, 75 C.R.2d 151, 1 Summary (10th), Contracts, §72 [complex security interests in large commercial property in California, negotiated between sophisticated Texas domiciliaries].)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Law of Situs Governs Security Interest.* See McDougal, American Conflicts Law 5th, §171.

Stuart case:

Cross-Reference: 7 Cal. Proc. (5th), Judgment, §311.



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Witkin Summary of California Law II. REQUISITES OF MORTGAGE AND DEED OF TRUST A. What Property Can Be Mortgaged.

4 *Witkin Sum. Cal. Law STRP* § 34

[§ 34] What Property Can Be Mortgaged.

(1) *In General*. "Any interest in real property which is capable of being transferred may be mortgaged." (C.C. 2947; see *Chapman v. Great Western Gypsum Co.* (1932) 216 C. 420, 427, 14 P.2d 758 [lessee's option to purchase, in form of covenant running with land]; 4 Powell §37.13; 4 Miller & Starr 3d, §10:16 et seq.; C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §1.43 et seq.; 54A Am.Jur.2d (1996 ed.), *Mortgages* §34 et seq.)

(2) *After-Acquired Property*. A lien may be created on "property not yet acquired," the lien attaching at the time it is acquired. (C.C. 2883(a); see *California Title Ins. & Trust Co. v. Pauly* (1896) 111 C. 122, 126, 43 P. 586; 23 Cal. L. Rev. 628; 8 So. Cal. L. Rev. 358.) The mortgage must contain an express provision to that effect. (*Hosford v. Henry* (1951) 107 C.A.2d 765, 774, 238 P.2d 91.) However, the beneficiary of an estate subject to administration may not create a lien on real property of the estate "unless and until" the property is distributed to that beneficiary. (C.C. 2883(b).)

Improvements and appurtenances inure to the benefit of the mortgagee without express mention. In *Harper v. Buckles* (1937) 19 C.A.2d 481, 65 P.2d 947, the owner made a first deed of trust in 1923, covering land and a water appropriation under permit. Then he constructed pipelines, rights of way, and a distributing system. In 1926, he made a second deed of trust covering the land, water rights, and all fixtures or improvements. On default, a sale was held under the *first* instrument, and defendant purchased. A sale was then held under the *second*, and plaintiff purchased. The first sale obviously extinguished the second lien, and defendant took title to the land; but plaintiff claimed the water system on the ground that it was not built at the time of the first trust deed. *Held*, not entitled. The water right, when acquired, became an easement appurtenant to the land, and as an incident thereto would pass without express mention on the foreclosure sale. The fixtures and improvements subsequently attached to the land likewise passed to the purchaser though not mentioned in the instrument. (19 C.A.2d 484.) (See *Hellweg v. Cassidy* (1998) 61 C.A.4th 806, 809, 71 C.R.2d 798 [citing *Harper*; although lot addition was not noted in trustee's deed on sale of foreclosed property, deed of trust securing loan applied to "additions" and was sufficient to grant entire parcel to purchasers]; 54A Am.Jur.2d (1996 ed.), *Mortgages* §36.)

(3) *After-Acquired Title*. "Title acquired by the mortgagor subsequent to the execution of the mortgage, inures to the mortgagee as security for the debt in like manner as if acquired before the execution." (C.C. 2930.) This statute applies the familiar doctrine of *estoppel by deed* to mortgages. (See C.C. 1106, 12 *Summary* (10th), *Real Property*, §334.)

In *Barberi v. Rothchild* (1936) 7 C.2d 537, 61 P.2d 760, plaintiff made first and second deeds of trust. Sale was held under the first, and his brother purchased. Subsequently, plaintiff obtained a discharge in bankruptcy, and bought the land back. Defendant, holder of the second, then held a sale and bought the property. Plaintiff sued to quiet title on the theory that the lien of the second trust deed had been wiped out by sale under the first, and that his personal obligation on the note had been wiped out by bankruptcy. *Held*, he could not quiet title. (a) Sale to the brother extinguished the second lien; hence, an ordinary purchaser from the brother would have obtained a clear title. (b) But plaintiff was not an ordinary purchaser; he had previously made a deed of trust to defendant, and the title thereafter acquired inured to the latter's benefit. (c) The second trust deed contained an express warranty of title, and this also estopped plaintiff from setting up any adverse claim in his own behalf. (7 C.2d 540.) (See 25 Cal. L. Rev. 360.)

SUPPLEMENT: [This section is current through the latest supplement]



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4 Witkin Sum. Cal. Law STRP § 35

[§ 35] Institutional Lenders.

Most mortgages secure promissory notes in favor of state or federally regulated institutional lenders. The types of mortgages these institutional lenders offer and various aspects of those mortgages are controlled by statute. (See C.E.B., 1 Real Estate Finance Practice §1.1 et seq.; for other legislation affecting institutional lenders, see *infra*, §36 et seq.) The major regulations include the following:

(1) *Federal Savings and Loan Associations*. (See 12 U.S.C., §1464(c) [subject to regulations of Office of Thrift Supervision]; 12 C.F.R., §560.1 et seq.)

(2) *State Savings and Loan Associations*. (See *Fin.C.* 7500 et seq.)

(3) *Federal Banks*. (See 12 U.S.C., §371(a) [real estate loans as permitted by Comptroller of the Currency]; 12 C.F.R., §34.20 et seq. [adjustable rate mortgages]; 12 C.F.R., §34.1 et seq. [real estate lending].)

(4) *State Banks*. (See *Fin.C.* 1227 et seq.)

(5) *Federal Credit Unions*. (See 12 U.S.C., §1757(5)(A) [subject to regulations of National Credit Union Administration Board]; 12 C.F.R., §701.21.)

(6) *State Credit Unions*. (See *Fin.C.* 14950 et seq.)

(7) *Insurance Companies*. (See *Ins.C.* 1192.2.)

(8) *Real Estate Brokers*. (See *B. & P.C.* 10240 et seq., 1 *Summary* (10th), *Contracts*, §461.)

SUPPLEMENT: [This section is current through the latest supplement]



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4 *Witkin Sum. Cal. Law STRP* § 36

[§ 36] Federal Preemption.

Whenever a federally regulated lender acts pursuant to a federal regulation that conflicts with state law, or a federal statute purports to govern lending practices of all lenders, the question arises whether the federal law *preempts* the conflicting state law. (On preemption generally, see 7 *Summary* (10th), *Constitutional Law*, §8.)

The issue has been raised most frequently by federally chartered savings and loan associations. Because they are comprehensively regulated by the federal Office of Thrift Supervision pursuant to statutory authority (see *supra*, §35), conflicting state laws have been held inapplicable to them. (See *Fidelity Fed. Savings & Loan Assn. v. de la Cuesta* (1982) 458 U.S. 141, 102 S.Ct. 3014, 73 L.Ed.2d 664, *infra*, §90; *Pacific Trust Co. TTEE v. Fidelity Fed. Savings & Loan Assn.* (1986) 184 C.A.3d 817, 823, 229 C.R. 269, *infra*, §92; *Washington Mut. Bank v. Superior Court* (2002) 95 C.A.4th 606, 615, 115 C.R.2d 765 [action challenging bank's practice of charging interest on home loans funded before close of escrow was preempted by Home Owner's Loan Act and its implementing regulations]; 15 *Pacific L. J.* 217.) (On national banks, see *Fin.C. 100(b)* [national banks are subject to state laws that "are not inconsistent with and do not infringe paramount federal laws"]; on federal legislation specifically preempting state law as to all lenders, see 12 U.S.C., §3801 *et seq.*, *infra*, §42; 12 U.S.C., §1701j-3, *infra*, §90.)

Of course, where there is no federal preemption, state law governs. (See *Siegel v. American Savings & Loan Assn.* (1989) 210 C.A.3d 953, 957, 258 C.R. 746 [claims that advance reconveyance fees violate C.C. 2941 (*infra*, §118) were not preempted by federal law]; *Black v. Financial Freedom Senior Funding Corp.* (2001) 92 C.A.4th 917, 936, 112 C.R.2d 445 [claims regarding manner of marketing reverse mortgages were not preempted by federal Truth in Lending Act or Depository Institutions Deregulation and Monetary Control Act]; *Gibson v. World Savings & Loan Assn.* (2002) 103 C.A.4th 1291, 1299, 128 C.R.2d 19 [distinguishing *Washington Mut. Bank*; federal regulations concerning operation of savings associations did not preempt claim under California Unfair Competition Law for restitution for overcharging borrowers for replacement insurance].)

SUPPLEMENT: [This section is current through the latest supplement]

See *Weiss v. Washington Mut. Bank* (2007) 147 C.A.4th 72, 75, 53 C.R.3d 782 [federal regulations preempted state claims relating to prepayment penalties imposed by federal savings and loan association]; 13 *A.L.R. Fed* 2d 161 [preemption issues arising under Home Owners' Loan Act].



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B. Statutory Regulation.
3. Aspects Regulated.

4 *Witkin Sum. Cal. Law STRP* § 37

[§ 37] Aspects Regulated.

The following are important aspects of mortgage loan transactions subject to statutory regulation:

- (1) *Loan Terms*. (See *infra*, §39.)
- (2) *Formal Requisites of Execution*. (See *infra*, §40 et seq.)
- (3) *Recordation Requirements*. (See *infra*, §46.)
- (4) *Form and Content of Subordination Provisions*. (See *infra*, §51 et seq.)
- (5) *Impound Accounts*. (See *infra*, §80.)
- (6) *Acceleration Clauses*. (See *infra*, §87 et seq.)
- (7) *Prepayment and Prepayment Charges*. (See *infra*, §92 et seq.)
- (8) *Rent Skimming*. (See *infra*, §96.)
- (9) *Reassignments of Contracts Secured by Realty*. (See *infra*, §106.)
- (10) *Disclosure Requirements of Arranger of Credit*. Compensated "arrangers of credit" for the sale of property containing one to four dwelling units must make specified disclosures regarding the financing. (See C.C. 2956 et seq.; C.C. 2957 [defining "arranger of credit"]; C.E.B., 2 Real Property Sales Transactions 3d, §8.8 et seq. [seller's disclosures].)
- (11) *Disclosure Requirements for Loans Secured by Condominium Interest*. A lender who originates a loan secured by the borrower's separate interest in a condominium project must make specific disclosures to the borrower when "earthquake insurance or a fee or any other condition in lieu of earthquake insurance" is required pursuant to an underwriting requirement imposed by an institutional third-party purchaser. (C.C. 2955.1(a); see C.C. 2955.1(b) [defining "institutional third party"].)

(12) *Disclosure Requirements for Home Equity Loans.* (See C.C. 2971; on protection against unfair home equity purchases, see *infra*, §222 et seq.)

(13) *Disclosure of Cancellation Information for Mortgage Guaranty Insurance.* (See *infra*, §§214, 215.)

(14) *Commencement of Interest on Obligation.* A borrower may not be required to pay interest on a principal obligation secured by a mortgage or deed of trust on property containing one to four residential dwelling units for any period that meets one of the following requirements:

(a) If there is an escrow, the period is more than one day prior to the disbursement of loan proceeds from escrow. (C.C. 2948.5(a)(1).)

(b) If there is no escrow and recording is requested in connection with the disbursement, the period is "more than one day prior to the date the loan proceeds are disbursed to the borrower, to a third party on behalf of the borrower, or to the lender to satisfy an existing obligation of the buyer." (C.C. 2948.5(a)(2).)

(c) If there is no escrow and recording is not requested, the period is "prior to the date funds are disbursed to the borrower, to a third party on behalf of the borrower, or to the lender to satisfy an existing obligation of the borrower." (C.C. 2948.5(a)(3).)

For obligations described in C.C. 2948.5(a)(1) and (a)(2), interest may begin to accrue on the business day immediately preceding the day of disbursement if (1) the borrower affirmatively requests and the lender agrees that disbursement will be on Monday, or a day following a bank holiday, and (2) specific information relating to the amount of per diem interest charged to facilitate disbursement is disclosed to the borrower in writing. (C.C. 2948.5(b).)

SUPPLEMENT: [This section is current through the latest supplement]

(10) *Disclosure Requirements of Arranger of Credit.* See C.E.B., 2 Real Property Sales Transactions 4th, §9:10 et seq.



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4 Witkin Sum. Cal. Law STRP § 38

[§ 38] Other Legislation.

The following statutes also deal with real property security transactions:

(1) *Truth in Lending Act*. The federal Truth in Lending Act (15 U.S.C., §1601 et seq.), which is implemented by Regulation Z prescribed by the Board of Governors of the Federal Reserve System, applies to all credit transactions in which a security interest is acquired in real property regardless of the amount of credit extended. (15 U.S.C., §1603(3).) (See 4 Powell, Chap. 37A; 1 Summary (10th), Contracts, §483.)

(2) *Real Estate Settlement Procedures Act*. The federal Real Estate Settlement Procedures Act (RESPA) (12 U.S.C., §2601 et seq.), which is implemented by Regulation X, regulates costs and disclosure requirements at closings and impound accounts (see *infra*, §80) on "federally related mortgage loans" secured by first liens on real property on which a residential structure for one to four families is located or is to be built. (12 U.S.C., §2602(1).) (See *Washington Mut. Bank v. Superior Court* (1999) 75 C.A.4th 773, 787, 89 C.R.2d 560, 7 Summary (10th), Constitutional Law, §24 [there is no conflict between RESPA and private state law actions]; *Wanger v. EMC Mortg. Corp.* (2002) 103 C.A.4th 1125, 1134, 1137, 127 C.R.2d 685 [both RESPA and Regulation X are remedial consumer protection statutes that should be liberally construed; failure to give proper notice of mortgage transfer subjects lender to liability for actual damages, which may include damages for wrongful foreclosure]; 4 Powell §37A.02; C.E.B., 2 Real Property Sales Transactions 3d, §13.93 et seq.; 142 A.L.R. Fed 511 [construction and application of Act].)

(3) *Redlining*. The practice of refusing to make secured loans within certain geographic areas, and other discriminatory mortgage lending practices, are the subject of both federal and state legislation. (See 12 U.S.C., §2801 et seq. [Home Mortgage Disclosure Act of 1975]; 12 U.S.C., §2901 et seq. [Community Reinvestment Act of 1977]; 15 U.S.C., §1691 et seq. [Equal Credit Opportunity Act]; 42 U.S.C., §§3601 et seq., 3605 [Fair Housing Act]; *Health & Saf.C. 35800* et seq. [Holden Act]; C.E.B., Real Property Financing, §4.9; 107 Harv. L. Rev. 1463 [critique of role of 12 U.S.C., §2901 et seq. and 15 U.S.C., §1691 et seq. in solving community investment problems].)

(4) *Secondary Mortgage Markets*. Institutional lenders can sell mortgages and the notes secured thereby to organizations created under federal and state legislation. (See 12 U.S.C., §1717 et seq. [Government National Mortgage Association and Federal National Mortgage Association]; 12 U.S.C., §1454 [Federal Home Loan Mortgage Corporation]; *Health & Saf.C. 53000* et seq. [Solar and Energy Conservation Mortgage Corporation Act of 1981];

C.E.B., 1 Real Estate Finance Practice, §§1.18, 1.90 et seq.)

(5) *Government-Subsidized Loans*. (See 42 U.S.C., §5301 et seq. [Housing and Community Development Act of 1977]; *Health & Saf.C.* 33000 et seq., 50660 et seq. [Community Redevelopment Law]; *Health & Saf.C.* 37910 et seq. [Marks-Foran Residential Rehabilitation Act]; *Health & Saf.C.* 51000 et seq. [California Housing Finance Agency].)

(6) *Government Insured Loans*. (See 12 U.S.C., §1701 et seq. [National Housing Act]; 38 U.S.C., §3710 et seq. [housing loans to veterans]; 38 U.S.C., §7703 [Veterans Benefits Administration]; *Mil. & Vet.C.* 985 et seq. [state Department of Veterans Affairs]; *Young v. Hampton* (1951) 36 C.2d 799, 802, 228 P.2d 1; *Cole v. Ames* (1957) 155 C.A.2d 8, 13, 317 P.2d 662; *Byars v. SCME Mortg. Bankers* (2003) 109 C.A.4th 1134, 1143, 135 C.R.2d 796 [lender's payment of yield spread premium (YSP) to mortgage broker as rebate on FHA loan did not violate HUD regulation imposing 1% cap on loan origination fees charged directly to buyers; YSP may be stated as lump sum, without specifying particular services provided by mortgage broker].)

(7) *Environmentally Impaired Property*. (See *infra*, §208 et seq.)

(8) *California Residential Mortgage Lending Act*. (See *Fin.C.* 50000 et seq. [licensing and regulation of residential mortgage lenders and servicers]; *Fin.C.* 50700 et seq. [permitting residential mortgage lenders to provide brokerage services to borrowers; unless extended, statute expires on June 30, 2005].)

(9) *Miscellaneous*. (See 15 U.S.C., §1681 et seq. [Fair Credit Reporting Act]; 12 U.S.C., §2001 et seq. [Farm Credit Act of 1971]; *Ins.C.* 12640.01 et seq. [Mortgage Guaranty Insurance Act]; *B. & P.C.* 11423 [requirement that lender supply copy of appraisal to loan applicant]; C.C. 2944.5 [lender prohibited from rejecting insurance policy without fixed expiration date]; C.C. 2955.5 [lender prohibited from requiring borrower to provide hazard insurance exceeding replacement value of improvements]; C.C. 1770(b) [mortgage broker or lender may not use home improvement contractor, directly or indirectly, to negotiate loan secured by borrower's residence]; *Fin.C.* 4970 et seq. [consumer protections for covered consumer loans secured by residential real property not exceeding \$ 250,000]; 54A *Am.Jur.2d* (1996 ed.), *Mortgages* §7; 40A *Am.Jur.2d* (1999 ed.), *Housing Laws and Urban Renewal* §8.)

SUPPLEMENT: [This section is current through the latest supplement]

(2) *Real Estate Settlement Procedures Act*. See C.E.B., 1 Real Property Sales Transactions 4th, §§6.36, 6.37; C.E.B., 2 Real Property Sales Transactions 4th, §15.95.(9) *Miscellaneous*. See 40A *Am.Jur.2d*. (2008 ed.), *Housing Laws and Urban Redevelopment* §8.*Fin.C.* 4970 et seq.: *Fin.C.* 4970, as amended in 2005, provides protections for consumer loans not exceeding the "conforming loan limit for a single-family first mortgage loan established by the Federal National Mortgage Association."

See *Wolski v. Fremont Inv. & Loan* (2005) 127 C.A.4th 347, 353, 357, 25 C.R.3d 500 [yield spread premium (YSP), which lender pays to broker at closing and which causes borrower to pay higher interest rate over life of loan, is not part of points and fees regulated by *Fin.C.* 4970 et seq., and charging YSP is not predatory lending practice].



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C. Form, Content, and Terms.
1. In General.

4 Witkin Sum. Cal. Law STRP § 39

[§ 39] In General.

Although a security transaction in real property may secure the performance of an "act" (C.C. 2872, 2920), most mortgages secure the obligation of a promissory note in favor of the mortgagee. The form and content of the promissory note will vary with the type of real property (residential, commercial, etc.), the purpose of the loan (construction loan, take-out loan, improvement loan, etc.), and the mortgagee (federal- or state-regulated financial institution, real estate broker, etc.).

Mortgage obligations in favor of noninstitutional lenders and secured by commercial property are ordinarily subject only to the requirements of contract and negotiable instruments law. (See 1 *Summary* (10th), *Contracts*, §342; 4 *Summary* (10th), *Negotiable Instruments*, §10.) But extensive statutory regulations govern (1) the terms of obligations secured by residential property, in particular property occupied by one to four families, and (2) mortgagees lending on residential real property, primarily savings and loan associations, which have been subjected to more extensive regulation. (See *infra*, §42.) (On secured obligation generally, see *Rest.3d, Property (Mortgages) §1.1* et seq.; 4 Powell §37.12 et seq.; 4 Miller & Starr 3d, §10:5; C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §1.16 et seq.; C.E.B., 2 Mortgage and Deed of Trust Practice 3d, §8.2 et seq.)

West's Key Number Digest, Mortgages k.40, 42, 44 et seq.

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2. Mortgage.

4 *Witkin Sum. Cal. Law STRP* § 40

[§ 40] Mortgage.

A mortgage must be in writing and executed with the formalities required of a deed of real property. (C.C. 2922; see 12 *Summary* (10th), *Real Property*, §268.) No particular form is required. A simple form is provided by statute. (See C.C. 2948; *Lovelady v. Bryson Escrow* (1994) 27 *C.A.4th* 25, 30, 32 *C.R.2d* 371, citing the text; C.E.B., 1 *Mortgage and Deed of Trust Practice* 3d, §1.30; 54A *Am.Jur.2d* (1996 ed.), *Mortgages* §12 et seq.; 13 *Am.Jur. Legal Forms* 2d, §179:68.)

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3. Deed of Trust.

4 *Witkin Sum. Cal. Law STRP* § 41

[§ 41] Deed of Trust.

There is no statutory form for a deed of trust, and title companies and lending institutions have prepared elaborate instruments. (See C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §1.32 et seq.; 13 Am.Jur. Legal Forms 2d, §179:67.) The lien is created by execution and delivery of the instruments. (See *Hahn v. Hahn* (1954) 123 C.A.2d 97, 101, 266 P.2d 519 [delivery by agent of duplicate original was valid]; on special actions against beneficiaries who forge residential trust deeds, see C.C.P. 749, 749.5.)

The theory of "adhesion contract" (see 1 *Summary* (10th), *Contracts*, §323) and the legibility and notice requirements for unusual provisions in a printed form (see 1 *Summary* (10th), *Contracts*, §123) were invoked against the lender in *Lomanto v. Bank of America* (1972) 22 C.A.3d 663, 99 C.R. 442. A deed of trust executed by plaintiffs, husband and wife, contained a provision making it security for future advances. The husband obtained additional loans without his wife's knowledge. *Held*, in determining the wife's liability, a question of fact arose as to whether the provision was unusual enough to require that her attention be directed to it, "either orally, by print of a distinctive size, or, as is sometimes done with a clause permitting acceleration in the event of an unauthorized conveyance, by placing it in a box with heavy borders." (22 C.A.3d 670.) (On notice of acceleration clause, see *infra*, §88.)

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4. Alternative Mortgage Transactions for Residential Loans.

4 Witkin Sum. Cal. Law STRP § 42

[§ 42] Alternative Mortgage Transactions for Residential Loans.

(1) *In General.* At one time, the usual type of mortgage note for the purchase of residential property was the long-term, fixed rate, fixed payment, fully amortized "installment" note. The volatile interest rates of the late 1970s and early 1980s led to an increased use of nonamortized or partially amortized notes ("balloon payment notes") and to a proliferation of "alternative mortgage transactions." (See 12 U.S.C., §3802(1).) Alternative mortgage transactions secure obligations in which the interest rate is subject to renegotiation or adjustment, either directly or by adjusting the term of the loan, or which involve "any similar type of rate, method of determining return, term, repayment, or other variation not common to traditional fixed-rate, fixed-term transactions, including without limitation, transactions that involve the sharing of equity or appreciation." (12 U.S.C., §3802(1).) The following are the principal types:

(a) *Variable interest rate loans and adjustable-payment, adjustable rate loans.* (See C.C. 1916.5, 1916.6 [variable interest rates]; C.C. 1916.7 [adjustable-payment, adjustable rate mortgages]; C.C. 1921 [disclosures for adjustable-rate loans]; 12 C.F.R., §34.20; 4 Powell §37.16 et seq. [variable rate mortgages]; C.E.B., 1 Real Estate Finance Practice, §§1.26, 1.27, 3.11 et seq.; 26 Santa Clara L. Rev. 253.)

(b) *Renegotiable rate mortgage loans.* (See C.C. 1916.8, 1916.9; C.E.B., 1 Real Estate Finance Practice, §1.25 et seq.)

(c) *Shared appreciation loans.* (See C.C. 1917 et seq.; C.C. 1917.010 et seq. [E.R.I.S.A. Pension Funds]; C.C. 1917.320 et seq. [seniors]; C.E.B., 1 Real Estate Finance Practice, §1.52.)

(d) *Reverse annuity mortgages.* (See C.C. 1923 et seq., supra, §23.)

(e) *Notes not fully amortized.* (See Fin.C. 7504(a)(3) ["nonamortized loan"]; Fin.C. 7504(a)(5) ["partially amortized loan"]; C.C. 2924i [balloon payment due-date notice requirements].)

(2) *State-Federal Parity.* The regulations developed by California and other states to govern alternative mortgage transactions and their use by state regulated lenders are more restrictive than those developed under federal law, thus putting state regulated lenders under a competitive disadvantage in attracting investment dollars. Both federal and state legislation has attacked this disparity. The Alternative Mortgage Transaction Parity Act of 1982 (12 U.S.C., §3801 et

seq.) preempts state law and allows state chartered and other nonfederally chartered "housing creditors" (see 12 U.S.C., §3802(2)) to enter into alternative mortgage transactions as permitted by regulations governing their federally regulated counterparts: state banks in accord with the regulations governing national banks, credit unions in accord with the regulations governing federal credit unions, and all other "housing creditors" in accord with regulations governing federal savings and loan associations (see *supra*, §35). (12 U.S.C., §3803(a); see *Black v. Financial Freedom Senior Funding Corp.* (2001) 92 C.A.4th 917, 929, 112 C.R.2d 445 [Parity Act did not preempt claims that defendants' manner of marketing reverse mortgages violated state laws regarding elder abuse, unlawful business practices, fraudulent concealment, and negligent misrepresentation].)

The Secretary of the Business, Transportation, and Housing Agency, or his or her designee, may prescribe rules and regulations extending to lenders making loans on the security of residential real property any right, power, privilege, or duty relating to mortgage instruments that is equivalent to the authority extended by federal statute or regulation to federally regulated financial institutions. (C.C. 1916.12(b).) Loans made under regulations pursuant to C.C. 1916.12 are expressly exempt from the provisions of more restrictive statutes (C.C. 1916.5 et seq. and C.C. 1918 et seq.) that otherwise would control. (C.C. 1916.12(d); on requirements of mortgage instrument where there is no exemption, see C.C. 1920.)

Subject to specified restrictions, savings and loan associations may adjust the interest rate, payment, balance, or term-to-maturity of real property loans. (*Fin.C. 7504.*)

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(2) *State-Federal Parity.* See 7 A.L.R. Fed 2d 151 [validity, construction, and application of Alternative Mortgage Transaction Parity Act of 1982].



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5. Wrap-Around Mortgage.

4 *Witkin Sum. Cal. Law STRP* § 43

[§ 43] Wrap-Around Mortgage.

With a "wrap-around mortgage" (also known as an "all-inclusive deed of trust" or "over-riding deed of trust"), the amount of the note is equal to the sum of existing liens or mortgages "wrapped around," on which the lender agrees to make the required payments, *plus* the cash or equity advanced by the lender. These instruments, which become popular when current interest rates are higher than those on the "wrapped" obligations, can present various issues involving usury, due-on-sale clauses, foreclosure, etc., and require careful drafting. (See C.C. 2957(h) [definition of "all inclusive trust deed"]; *Armsey v. Channel Associates* (1986) 184 C.A.3d 833, 836, 229 C.R. 509, *infra*, §175; 10 *Pacific L. J.* 923; 4 *Miller & Starr* 3d, §10:21 et seq.; C.E.B., 2 *Mortgage and Deed of Trust Practice* 3d, §9.36 et seq.; C.E.B., 1 *Real Estate Finance Practice*, §1.53; 21 *U.C.L.A. L. Rev.* 1529; 36 *A.L.R.4th* 144 [validity and effect of wrap-around mortgage].)

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C. Form, Content, and Terms.

6. "Dragnet" and Future Advances Clauses.

4 *Witkin Sum. Cal. Law STRP* § 44

[§ 44] "Dragnet" and Future Advances Clauses.

In addition to securing a promissory note or other contemporaneous obligation, a mortgage may provide that it is to be security for other existing or future debts. A provision that attempts to secure all debts, existing and future, that the mortgagor may owe to the mortgagee is commonly called a "dragnet" clause. (See *Union Bank v. Wendland* (1976) 54 C.A.3d 393, 398, 126 C.R. 549; *Fischer v. First Int. Bank* (2003) 109 C.A.4th 1433, 1446, 1 C.R.3d 162 [trial court erred in granting defendant bank's motion for summary judgment in action relating to defendant's alleged misappropriation of funds through application of proceeds from sale of plaintiff's home to two loans when parties had agreed that plaintiff's home only secured one of those loans; boilerplate "dragnet" clause in deed of trust and conflicting loan agreement created triable issue regarding intentions of parties]; 4 Miller & Starr 3d, §10:12; C.E.B., 2 Mortgage and Deed of Trust Practice 3d, §9.58 et seq.; 3 A.L.R.4th 690 [modern status of dragnet clause].) A more narrowly drawn clause may provide that the mortgage is security for future advances, either generally or, as is common with construction mortgages, specifically provided for installments. (See *Frank H. Buck Co. v. Buck* (1912) 162 C. 300, 303, 122 P. 466; *Oaks v. Weingartner* (1951) 105 C.A.2d 598, 600, 234 P.2d 194 [absence of stated maximum amount is not objectionable]; 4 Miller & Starr 3d, §10:11; 65 Harv. L. Rev. 478 [discussion of "package mortgage" with provision for future advances for repair and replacement of appliances].) These clauses may raise issues of priority, redemption, or the application of the anti-deficiency statutes. (On priority and future advances, see *infra*, §§72, 73; on redemption, see *infra*, §232 et seq.; on application of anti-deficiency statutes, see *infra*, §199.)

In *Wong v. Beneficial Savings & Loan Assn.* (1976) 56 C.A.3d 286, 291, 128 C.R. 338, the original owners built an eight-unit apartment complex on eight parcels of land, giving separate deeds of trust to defendant lender for each unit. Every deed of trust contained a clause making it cover not only the original loan but also "any other indebtedness or obligation of the Trustor." Plaintiffs acquired the properties, defaulted in payments, and then sought to redeem four front parcels by tendering the amount due on each. These parcels contained the parking lot and the swimming pool used by all the tenants. Defendants offered to accept the tender on condition that plaintiffs give an easement for use of the parking lot and the swimming pool by the tenants of the rear parcels. Plaintiffs refused, and brought this action for damages for rejection of their tender. *Held*, judgment for defendants affirmed.

(a) *Nature of dragnet clause.* "The literal meaning of this clause extends the deed of trust to cover every past and present obligation between the debtor and the creditor. The clause purports to say that a bank holding a deed of trust on a borrower's property to secure his real estate loan from it may turn to that deed of trust any time he falls behind on a

personal loan from it, misses a payment on his automobile loan from it, or overdraws his checking account at the bank. ... It also appears to mean that any other creditor of the debtor can sell his obligation to the bank, which can then tack that debt to its deed of trust." (56 C.A.3d 292.)

(b) *Judicial attitude toward clause.* The courts tend to prefer a construction in accord with the parties' actual expectations, and the burden should be on the lender to show that both parties intended the additional indebtedness to be included. (56 C.A.3d 293, 294, citing *Lomanto v. Bank of America* (1972) 22 C.A.3d 663, 99 C.R. 442, supra, §41.) In determining the reasonable intention of the parties, two considerations are significant: the relationship of the loans, and the reliance on the security. (56 C.A.3d 295.)

(c) *Application of principles.* (1) Although plaintiffs testified that they were unaware of the dragnet provision, they viewed the property, were aware of its nature, and purchased it as a single unit in one transaction. Thus, the circumstances showed reliance by the creditor on all the parcels as security. (56 C.A.3d 296.) (2) Despite the separation of the property into eight units to obtain a more favorable loan, the parcels were not separable for zoning purposes (some units would have been prohibited if erected alone) or for use or market value (access to the common facilities--parking lot and swimming pool--was essential). (56 C.A.3d 297.) (3) Plaintiffs were offered the four front lots if they would give easements to the rear lots; and, knowing that the absence of these easements would have a devastating effect on the rear lots, they refused. "Their ignoble scheme made them unworthy of equity's favor." (56 C.A.3d 297.)

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CHAPTER VIII - Security Transactions in Real Property

Witkin Summary of California Law
II. REQUISITES OF MORTGAGE AND DEED OF TRUST
D. Construction of Note and Security Instrument.

4 Witkin Sum. Cal. Law STRP § 45

[§ 45] Construction of Note and Security Instrument.

If there is a conflict in the note and the mortgage with respect to the *maturity of the debt*, the provisions of the note will control. (*Pacific Fruit Exchange v. Duke* (1930) 103 C.A. 340, 345, 284 P. 729; see C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §1.8.) Ordinarily, however, the note and mortgage or trust deed are to be construed together. Thus:

(1) Where a mortgage has an *acceleration* clause, this matures the obligation of the note even though it contains no such clause. (*First-Trust Joint Stock Land Bank of Chicago v. Meredith* (1936) 5 C.2d 214, 218, 53 P.2d 958; see C.C. 2924.5, *infra*, §88 [requiring acceleration clauses to appear in both instruments].)

(2) A trust deed provision that a note may be extended will be construed together with a note lacking that provision. (*Western Fruit Growers v. Security Title Ins. & Guarantee Co.* (1937) 20 C.A.2d 150, 154, 66 P.2d 742.)

(3) A slight variance between the actual note secured and its description in a deed of trust or mortgage will not invalidate the security. (*Rogers v. Evans* (1934) 137 C.A. 538, 545, 31 P.2d 233 [note described as payable to husband and wife, actually was payable to husband alone].)

It is possible for an owner to sign a deed of trust and thereby subject his or her property interest to the debt without having signed a note, because a mortgage or deed of trust secures the debt rather than the note that evidences it. In this situation, the owner may not be borrowing money, but simply contracting with the lender to make the property primarily liable for the debt. (*Matthews v. Hinton* (1965) 234 C.A.2d 736, 742, 44 C.R. 692.)

West's Key Number Digest, Mortgages k.97 et seq.

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Witkin Summary of California Law II. REQUISITES OF MORTGAGE AND DEED OF TRUST E. Recordation.

4 *Witkin Sum. Cal. Law STRP* § 46

[§ 46] Recordation.

(1) *In General.* Mortgages of real property are acknowledged, certified, and recorded in the same manner as grants of real property. (C.C. 2952; see 12 *Summary* (10th), *Real Property*, §283.)

A deed of trust or mortgage with power of sale will not be accepted for recordation unless it contains the address of the trustor or mortgagor and a request for notice of default under C.C. 2924b (see *infra*, §153). (See *Govt.C.* 27321.5(b).)

Recordation is not essential to the validity of a real mortgage, but only affects its priority as against subsequent bona fide purchasers or encumbrancers. (*Boye v. Boerner* (1940) 38 C.A.2d 567, 569, 101 P.2d 757; *Wells Fargo Bank v. PAL Inv.* (1979) 96 C.A.3d 431, 438, 157 C.R. 818, citing the text; cf. *Hosford v. Henry* (1951) 107 C.A.2d 765, 773, 238 P.2d 91 [holding, under law prior to adoption of Commercial Code, that instrument covering personal as well as real property created valid lien on personalty only if there was recordation in conformity with then applicable chattel mortgage statute]; on filing requirements under U.C.C., see 4 *Summary* (10th), *Secured Transactions in Personal Property*, §48; on effect of recordation on priority, see *infra*, §49.)

(2) *Fictitious Mortgage or Deed of Trust.* Title insurance companies and commercial lenders may record fictitious or reference instruments containing all of the provisions of the standard form instruments that are normally used. (C.C. 2952.) The prerecorded instrument, sometimes referred to as a "master" mortgage or deed of trust, is then included by reference in each short form instrument prepared for a particular transaction. (See *Karrell v. First Thrift of Los Angeles* (1951) 104 C.A.2d 536, 538, 232 P.2d 1; 4 *Miller & Starr* 3d, §10:6; C.E.B., 1 *Mortgage and Deed of Trust Practice* 3d, §1.32; 23 *So. Cal. L. Rev.* 35.) C.C. 2952 provides:

(1) Any person may record a fictitious mortgage or deed of trust in any county without acknowledgment or certification.

(2) Thereafter, a mortgage or deed of trust recorded in that county may incorporate by reference any provisions of the fictitious instrument.

(3) This recordation gives constructive notice of the incorporated provisions, and the parties are bound as though those provisions were set forth in full.

West's Key Number Digest, Mortgages k.89 et seq.

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II. REQUISITES OF MORTGAGE AND DEED OF TRUST
F. Lien Is Incident of Debt.

4 Witkin Sum. Cal. Law STRP § 47

[§ 47] Lien Is Incident of Debt.

The lien of the mortgage, like any other lien, is accessory to the act for the performance of which it is security. (C.C. 2909; see C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §1.9; C.E.B., 2 Mortgage and Deed of Trust Practice 3d, §7.27.) In other words, the lien is an incident of the debt. If the note is unenforceable, the mortgage gives it no additional validity. (*Coon v. Shry* (1930) 209 C. 612, 615, 289 P. 815.) If the note is assigned, it carries the security with it, and a negotiable note imparts its quality of freedom from defenses to the mortgage. (See *infra*, §105.)

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III. PRIORITIES

A. In General.

1. Priority in Time.

4 *Witkin Sum. Cal. Law STRP* § 48

[§ 48] Priority in Time.

(1) *In General*. "Other things being equal, different liens upon the same property have priority according to the time of their creation." (C.C. 2897; see *United States v. New Britain* (1954) 347 U.S. 81, 74 S.Ct. 367, 370, 98 L.Ed. 520, 526; *Guinn v. McReynolds* (1918) 177 C. 230, 232, 170 P. 421; *Bank of South San Francisco v. Pike* (1921) 53 C.A. 524, 528, 200 P. 752; *Rest.3d, Property (Mortgages)* §7.1 et seq.; 4 Powell §37.28; on exception for purchase money mortgages under C.C. 2898, see *infra*, §74.)

But a mortgage or trust deed, even after execution and recordation, remains only an incident of the debt (*supra*, §47) and is ineffective to give priority until the debt itself is created, e.g., by delivery of a promissory note. (See *Western Loan & Bldg. Co. v. Scheib* (1933) 218 C. 386, 389, 23 P.2d 745; 5 Miller & Starr 3d, §11:93 et seq.; C.E.B., 2 Mortgage and Deed of Trust Practice 3d, §9.42.)

(2) *Effect of Renegotiation of Senior Loan*. In *Friery v. Sutter Buttes Savings Bank* (1998) 61 C.A.4th 869, 878, 72 C.R.2d 32, the court refused to extend the remedy used in *Gluskin v. Atlantic Savings & Loan Assn.* (1973) 32 C.A.3d 307, 108 C.R. 318, *infra*, §57--elevating the junior lienholder to senior status--where plaintiff, a junior lienholder who had not subordinated, bought the property without assuming the senior loan and then sold the property to a third party without the consent of the senior lienholder, who then had the right to accelerate the note, but instead renegotiated the loan with the buyer to protect its lien.

West's Key Number Digest, Mortgages k.149 et seq.

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III. PRIORITIES

A. In General.

2. Effect of Recordation.

4 *Witkin Sum. Cal. Law STRP* § 49

[§ 49] Effect of Recordation.

Priority is largely determined by recordation. Regardless of the time of transfer, the California real property recording system gives priority to the person whose instrument is first recorded, if that person is a bona fide purchaser or encumbrancer without notice of prior interests. Any subsequently recorded mortgage is inferior. (C.C. 1213, 1214; *Wittenbrock v. Parker* (1894) 102 C. 93, 99, 36 P. 374; *Redondo Imp. Co. v. O'shaughnessy* (1914) 168 C. 323, 326, 143 P. 538; see 5 Miller & Starr 3d, §11:1 et seq.; 12 *Summary* (10th), *Real Property*, §§328, 329; for purchase money mortgage exception, see *infra*, §74.) The same protection against a prior unrecorded mortgage is given to the *transferee* of a bona fide purchaser or encumbrancer. (*Jones v. Independent Title Co.* (1944) 23 C.2d 859, 861, 147 P.2d 542; see 12 *Summary* (10th), *Real Property*, §330.)

But an unrecorded mortgage prior in time takes precedence over an attachment or judgment lien, for the attaching or judgment creditor is not a bona fide purchaser for value within the meaning of C.C. 1214. (*Livingston v. Rice* (1955) 131 C.A.2d 1, 3, 280 P.2d 52; *Wells Fargo Bank v. PAL Inv.* (1979) 96 C.A.3d 431, 438, 157 C.R. 818, citing the text; see 12 *Summary* (10th), *Real Property*, §328; 62 *So. Cal. L. Rev.* 105 [lien creditors versus prior unrecorded transferees].)

The lien of the mortgage attaches on its execution and delivery, not its recordation. (See *supra*, §46.) Hence, where two mortgages are executed on the same day, the fact that one is recorded before the other does not raise a presumption that it is prior. In the absence of other facts, both claims would apparently be equal. (See *Walker v. Buffandeau* (1883) 63 C. 312.)

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III. PRIORITIES

A. In General.

3. Effect of Notice.

4 *Witkin Sum. Cal. Law STRP* § 50

[§ 50] Effect of Notice.

Priority may also be affected by actual or constructive notice. Where a lien or other interest is first in time but not recorded, a later mortgage, though first recorded, may nevertheless be inferior if the mortgagee has actual *knowledge* of the first lien, or *notice of facts* sufficient to put him on inquiry. (See 12 *Summary* (10th), *Real Property*, §331.) This is the case, e.g., where the prospective mortgagee observes that a third party, and not the prospective mortgagor, is in open and exclusive possession of the property about to be mortgaged. (*Randall v. Allen* (1919) 180 C. 298, 303, 180 P. 941; see *First Fidelity Thrift & Loan Assn. v. Alliance Bank* (1998) 60 C.A.4th 1433, 1444, 71 C.R.2d 295 [subsequent encumbrancer learned that prior deed of trust had been reconveyed, and obtained clarification from borrower and nonparty bank that was consistent with that reconveyance; encumbrancer had no notice that reconveyance was in error and thus was under no duty to investigate further]; *Triple A Management Co. v. Frisone* (1999) 69 C.A.4th 520, 539, 81 C.R.2d 669 [beneficiaries of subsequent deed of trust could not rely on subordination agreement unilaterally signed by assignee of security interest in first deed of trust where knowledge of beneficiaries' escrow agent that executor of subordination agreement owned collateral interest in deed of trust was imputed to beneficiaries, who then had duty to inquire into exact nature of executor's security interest and its power to subordinate].)

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III. PRIORITIES

B. Subordination Agreements.

1. In General.

4 Witkin Sum. Cal. Law STRP § 51

[§ 51] In General.

(1) *Early Law.* It has long been recognized that parties may agree to waive or subordinate the priority of their liens. (See C.C. 2934 [subordination agreement may be recorded and thereafter gives constructive notice of contents]; *International Mortg. Bank v. Eaton* (1918) 39 C.A. 39, 40, 177 P. 880; *United States Bldg. & Loan Assn. of Los Angeles v. Salisbury* (1932) 217 C. 35, 41, 17 P.2d 140; *Bank of America v. Hirsch Mercantile Co.* (1944) 64 C.A.2d 175, 182, 148 P.2d 110 [subordination of trust deed to lease, for limited period, with provisions covering termination]; *Petit v. Blenkiron* (1936) 16 C.A.2d 751, 754, 61 P.2d 527 [provision for priority as between two notes secured by same trust deed]; C.E.B., 2 Mortgage and Deed of Trust Practice 3d, §9.73 et seq.; 25 Cal. L. Rev. 504.)

(2) *Modern Development.* The typical instrument today is one in which the seller of undeveloped land subordinates his or her purchase money mortgage to the construction loans to be obtained by the purchaser-builder. These agreements are described generally in *Miller v. Citizens Savings & Loan Assn.* (1967) 248 C.A.2d 655, 662, 56 C.R. 844, as follows: "Subordination arrangements are in the nature of a mutual enterprise, wherein the vendor provides the land, the purchaser the 'know how' and the purchaser's lending agency the capital, for the mutually beneficial purpose of developing the land and disposing of it (usually by sale; occasionally by rental), to provide a fund out of which the vendor is paid for his land, the lender is repaid its loan with interest, and the purchaser receives compensation for his efforts and skill. ... While it may not be impossible that a vendor has agreed to subordinate his purchase money lien to a lien secured by the purchaser to be used for purposes entirely apart from the mutual enterprise, such an arrangement would be so unusual and so unlikely that we would require it to be spelled out with particularity. Typically the loan proceeds are to be used for purposes which will promote the mutual enterprise and which will either enhance the vendor's equity in case he must foreclose his lien, or will provide funds from which he will be paid. A subordination agreement should be construed, unless it expressly provides otherwise, as permitting the loan proceeds to be used only for such purposes." (See *Handy v. Gordon* (1967) 65 C.2d 578, 581, 55 C.R. 769, 422 P.2d 329, *infra*, §55; *Middlebrook-Anderson Co. v. Southwest Savings & Loan Assn.* (1971) 18 C.A.3d 1023, 1029, 96 C.R. 338, *infra*, §58; *Rest.3d, Property (Mortgages)* §7.7; 13 A.L.R.5th 684 [construction lender's duty to protect interest of subordinated purchase-money mortgagee]; cf. *Schneider v. Ampliflo Corp.* (1983) 148 C.A.3d 637, 196 C.R. 172 [provision in subordination agreement permitting use of portion of funds from subordinating loan for purposes other than improvement of the land is enforceable, notwithstanding conflict with purposes envisioned in escrow instructions and with subordinated deed of trust].)

SUPPLEMENT: [This section is current through the latest supplement]



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III. PRIORITIES

B. Subordination Agreements.

2. Types of Agreements.

4 Witkin Sum. Cal. Law STRP § 52

[§ 52] Types of Agreements.

Subordination of the vendor's purchase money mortgage or deed of trust is usually accomplished in one of two ways:

(1) By a *subordination provision* in the mortgage or deed of trust, stating that it is subordinated, "without the necessity of any approval by the seller or any further instrument of subordination," to a construction loan that meets required terms and conditions. (See *Woodworth v. Redwood Empire Savings & Loan Assn.* (1971) 22 C.A.3d 347, 351, 99 C.R. 373; C.E.B., Mortgage and Deed of Trust Practice 3d, §9.74; C.E.B., 2 Real Property Sales Transactions 3d, §§8.66, 8.69, 8.82; 5 Miller & Starr 3d, §11:187; 52 Cal. L. Rev. 157; 55 Cal. L. Rev. 1184; 13 U.C.L.A. L. Rev. 1298; 13 Am.Jur. Legal Forms 2d, §179:466.)

(2) By an *executory agreement*; i.e., a provision in the contract of sale of the land or separately, by which the vendor agrees to subordinate his or her prior lien to the lien of the lender who furnishes construction financing. (See *Handy v. Gordon* (1967) 65 C.2d 578, 581, 55 C.R. 769, 422 P.2d 329, *infra*, §55; *Miller v. Citizens Savings & Loan Assn.* (1967) 248 C.A.2d 655, 662, 56 C.R. 844, *supra*, §51; *Schneider v. Ampliflo Corp.* (1983) 148 C.A.3d 637, 639, 196 C.R. 172; C.E.B., 2 Mortgage and Deed of Trust Practice 3d, §9.81; C.E.B., 2 Real Property Sales Transactions 3d, §8.70 et seq.; 5 Miller & Starr 3d, §11:188 et seq.; 13 Am.Jur. Legal Forms 2d, §§179:277, 179:461 et seq.; on subordination by prior recordation, see *infra*, §58.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Subordination provision*: See C.E.B., 2 Real Property Sales Transactions 4th, §9.66 et seq.

(2) *Executory agreement*: See C.E.B., 2 Real Property Sales Transactions 4th, §9.74 et seq.



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III. PRIORITIES

B. Subordination Agreements.

3. Circuity of Liens.

4 *Witkin Sum. Cal. Law STRP* § 53

[§ 53] Circuity of Liens.

In *Bratcher v. Buckner* (2001) 90 C.A.4th 1177, 109 C.R.2d 534, a case of first impression, the court addressed the effect of subordination of a higher lien to a lower lien on the priority of an intervening lien. Had subordination not been an issue, the priority of the relevant lienholders would have been: attorneys' deed of trust (A), parents' deed of trust (B), plaintiff's lien (C), and SBA loan (D). However, loans A and B were expressly subordinated to D. Plaintiff claimed that by subordinating their liens to a junior lien (D), A and B also subordinated their priority position to any intervening lien (C). The court adopted a formula under which the plaintiff would be neither prejudiced nor benefited by the subordination agreements: D succeeds to the lien positions of A and B, but only to the extent of the amount of A's claim and B's claim, and, after subtracting the amount of D's claim, the A and B liens retain priority over C. (90 C.A.4th 1188.)

SUPPLEMENT: [This section is current through the latest supplement]



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B. Subordination Agreements.

4. Notice Requirements.

4 Witkin Sum. Cal. Law STRP § 54

[§ 54] Notice Requirements.

Where the subordinating loan, or the loan to be subordinated, does not exceed \$ 25,000, notice of a subordination agreement must appear in the security instrument. (C.C. 2953.2; C.C. 2953.5(a).) The statute does not apply to loans over that amount. (C.C. 2953.5(b); *13 U.C.L.A. L. Rev. 1300.*) However, some title companies follow the requirement for all loans as a matter of policy. (See C.E.B., 2 Real Property Sales Transactions 3d, §8.85.) The essential notice provisions are as follows:

(1) *Security instrument with subordination clause.* This instrument must contain in at least 10-point bold type (or underlined capitals if typewritten) the word "Subordinated" and a "Notice" in at least 8-point type (or capitals if typewritten) that the security interest may be of lower priority than the lien of some other instrument, and a further notice if the obligor is permitted to obtain a loan, a portion of which may be expended for purposes other than improvement of the land. (C.C. 2953.2.)

(2) *Subordination agreement.* This agreement must contain, in similar prominent printing or typewriting, the words "Subordination Agreement," and similar notices. (C.C. 2953.3.)

A subordination clause or agreement not executed in substantial compliance is voidable on the election of the person whose security interest is to be subordinated (or his or her successor) within 2 years of the date on which the security instrument is executed. The election must be exercised by recording a notice. (C.C. 2953.4.) However, the right to avoid is lost (a) if the person had actual knowledge of the existence and terms of the subordination clause or agreement (C.C. 2953.4(a)), or (b) if that person subsequently executes and records a statement that he or she knows of it and waives the statutory protection (C.C. 2953.4(c)).

SUPPLEMENT: [This section is current through the latest supplement]
See C.E.B., 2 Real Property Sales Transactions 4th, §9.89 et seq.



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III. PRIORITIES

B. Subordination Agreements.

5. Enforcement of Executory Agreement.

a. Reasonableness of Agreement.

4 *Witkin Sum. Cal. Law STRP* § 55

[§ 55] Reasonableness of Agreement.

"[A]n enforceable subordination clause must contain terms that will define and minimize the risk that the subordinating liens will impair or destroy the seller's security." This limitation is achieved by denying specific performance to an executory subordination agreement on the ground that the contract is not "just and reasonable." (*Handy v. Gordon* (1967) 65 C.2d 578, 581, 55 C.R. 769, 422 P.2d 329; see C.E.B., 2 Mortgage and Deed of Trust Practice 3d, §9.74 et seq.; C.E.B., 2 Real Property Sales Transactions 3d, §8.71; 5 Cal. L. Rev. 1184; 26 A.L.R.3d 855 [specific performance: requisite definiteness of provision in lease or sales contract that vendor or landlord will subordinate his or her interest to permit other party to obtain financing]; on "unjust and unreasonable" defense to specific performance under C.C. 3391(2), see 13 *Summary* (10th), *Equity*, §39.)

In *Handy*, defendant vendors agreed to sell a tract of about 320 acres to plaintiff purchaser-developer. Plaintiff executed a note and trust deed for \$ 1.2 million at 2% per year, payable in annual installments of \$ 120,000 to begin 3 years after close of escrow, with the balance due 10 years after close of escrow. Defendants agreed to subordinate their trust deed to other trust deeds securing financing and construction loans obtained by plaintiff. Plaintiff sued for specific performance, and judgment for defendants on the pleadings was affirmed in a definitive opinion specifying proper and improper provisions in these agreements.

(a) *Adequate provisions.* The terms necessary to protect the vendor's security "may include limits on the use to which the proceeds may be put to insure that their use will improve the value of the land, maximum amounts so that the loans will not exceed the contemplated value of the improvements they finance, requirements that the loans do not exceed some specified percentage of the construction cost or value of the property as improved, specified amounts per square foot of construction, or other limits designed to protect the security." (65 C.2d 581.)

(b) *Unfairness of clause without adequate provisions.* "Without some such terms ... the seller is forced to rely entirely on the buyer's good faith and ability as a developer to insure that he will not lose both his land and the purchase price. Even if we were to assume that a contract of sale contemplating subdivision by the vendee is sufficiently different from the usual land sale contract to take it out of the operation of the anti-deficiency legislation ... , the personal liability alone of the vendee would not constitute sufficient protection to the vendor to permit specific performance." (65 C.2d 581.)

(c) *Unfairness of clause in this agreement.* The clause provided that loans should be in the maximum amounts of \$ 10,000 and \$ 52,000 per lot; maximum interest rates should be 7% and 6.6%; maturity should be not more than 6 and 35 years respectively; other details were left to the purchaser and his lender. The clause did not meet the tests:

(1) Use of loans to improve value of security. Although the proceeds were to be used primarily for construction and refinancing, any funds not needed for those purposes could be disbursed to plaintiff purchaser, leaving defendants without the assurance that all of the proceeds would be used to improve the land. (65 C.2d 581.)

(2) Loans not to exceed value of improvements. The specification of money limits gave no assurance that the amounts of the loans would not exceed the value that the improvements would add to the security. (65 C.2d 581.)

(3) Loans not to exceed specified percentage of cost or value of property. Because the limits were maximums per lot, and plaintiff had unrestricted power to determine the size of each lot, there was no assurance that the total amount of subordinating loans would be kept low enough for defendants to protect themselves by bidding at a foreclosure of the senior liens. (65 C.2d 581, with footnote pointing out that if one-fourth acre lots were chosen, the loans could total \$ 12.8 million and \$ 66,560,000, respectively.)

(d) *Conclusion.* Defendants did not receive a downpayment to cushion their position, and the first payment of principal was deferred for 3 years. Thus, "the contract leaves defendants with nothing but plaintiff's good faith and business judgment to insure them that they will ever receive anything for conveying their land." (65 C.2d 582.)

SUPPLEMENT: [This section is current through the latest supplement]
See C.E.B., 2 Real Property Sales Transactions 4th, §9.78.



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B. Subordination Agreements.

5. Enforcement of Executory Agreement.

b. Waiver of Invalid Clause.

4 *Witkin Sum. Cal. Law STRP* § 56

[§ 56] Waiver of Invalid Clause.

In *Reeder v. Longo* (1982) 131 C.A.3d 291, 182 C.R. 287, plaintiff agreed to purchase land from defendant for \$ 700,000 and to pay \$ 575,000 in cash, the balance to be represented by a first trust deed. The contract contained a clause subordinating the trust deed to a construction loan pursuant to a subordination agreement to be executed at close of escrow. In his action for specific performance of the contract, plaintiff agreed to waive the subordination clause (which was invalid for uncertainty; see *supra*, §55). The trial judge ruled that the clause could not be waived and that the entire contract was unenforceable. *Held*, judgment of dismissal reversed.

Under C.C. 3513 (1 *Summary* (10th), *Contracts*, §679), a contracting party may unconditionally waive a provision inserted solely for his or her benefit. (131 C.A.3d 296.) Here, the fact that the balance represented by the trust deed was less than one-fourth of the total price established that the subordination clause was solely for plaintiff buyer's benefit. And his waiver, which promised compliance with the original contract minus the subordination clause, was clearly unconditional. (131 C.A.3d 296.)

SUPPLEMENT: [This section is current through the latest supplement]



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III. PRIORITIES

B. Subordination Agreements.

6. Compliance With Terms of Agreement.

4 *Witkin Sum. Cal. Law STRP* § 57

[§ 57] Compliance With Terms of Agreement.

(1) *In General.* Even if the executory subordination agreement is valid (see *supra*, §56), the executed agreement may become unenforceable (i.e., the lender may lose the agreed priority) if the conditions of the agreement are violated. (See *Jones v. Sacramento Savings & Loan Assn.* (1967) 248 C.A.2d 522, 527, 528, 56 C.R. 741; *Miller v. Citizens Savings & Loan Assn.* (1967) 248 C.A.2d 655, 663, 56 C.R. 844 [part of loan advanced for purposes outside agreement, not entitled to priority]; *Ruth v. Lytton Savings & Loan Assn. of Northern Calif.* (1968) 266 C.A.2d 831, 839, 72 C.R. 521 [lender, with option to do so, increased interest rate on default to rate 20% higher than subordination agreement's interest limitation; priority lost]; C.E.B., 2 Real Property Sales Transactions 3d, §8.79 et seq.; 52 *Cal. L. Rev.* 164; 6 Santa Clara Lawyer 194; 13 *U.C.L.A. L. Rev.* 1306.)

(2) *Material Modification.* A lender and a borrower may not make a material modification in the loan to which the seller has subordinated, without the seller's knowledge and consent, if the modification materially affects the seller's rights. (*Gluskin v. Atlantic Savings & Loan Assn.* (1973) 32 C.A.3d 307, 314, 108 C.R. 318 [reduction of amount of note, increase in interest rate, and shortened maturity with balloon payment at end]; see *Lennar Northeast Partners v. Buice* (1996) 49 C.A.4th 1576, 1588, 57 C.R.2d 435 [remedy utilized in *Gluskin*--elevating junior lienholder to senior status--was not appropriate where senior lienholder, a bank, modified loan agreement with borrower by extending term and increasing interest rate and principal amount; junior lienholder, also a bank, could be restored to original position simply by subordinating modifications]; *Swiss Property Management Co. v. Southern Calif. IBEW-NECA Pension Plan* (1997) 60 C.A.4th 839, 846, 70 C.R.2d 587 [extension of loan term that did not adversely affect either sellers' rights or value of their security was not material modification and did not result in loss of priority].)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *In General.* See C.E.B., 2 Real Property Sales Transactions 4th, §9.83 et seq.



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B. Subordination Agreements.

7. Subordination by Prior Recordation.

4 Witkin Sum. Cal. Law STRP § 58

[§ 58] Subordination by Prior Recordation.

An "automatic subordination" occurs when, without an express executory agreement to subordinate on specified conditions, the escrow instructions provide that the lender's construction loan deed of trust is to be recorded prior to the vendor's purchase money deed of trust. In *Middlebrook-Anderson Co. v. Southwest Savings & Loan Assn.* (1971) 18 C.A.3d 1023, 1030, 96 C.R. 338, the court observed that "lending institutions may prefer the latter method over written subordination agreements because of the reluctance of courts to enforce express written agreements which are deemed to be unfair to the seller." (See C.E.B., 2 Real Property Sales Transactions 3d, §8.64; 13 U.C.L.A. L. Rev. 1301; 45 So. Cal. L. Rev. 1109 [Middlebrook].)

Whether the lender under this form of automatic subordination is subject to the same obligations as the lender under an express agreement (see *supra*, §57) was for a time in dispute. (See *Middlebrook-Anderson Co. v. Southwest Savings & Loan Assn.*, *supra*, 18 C.A.3d 1030.) But in *Middlebrook*, the court declared that no distinction was to be drawn in this respect between the two kinds of subordination arrangements.

Plaintiff vendor of lots alleged that it agreed to recordation of its purchase money deeds of trust after recordation of defendant lender's deed of trust for the construction loan to the purchasers; that thereafter, defendant lender, with full knowledge of plaintiff's subordinated lien, failed to control the use of funds for construction purposes, allowing them to be disbursed without limitation; and that, as a result, the property was sold under the senior trust deeds and plaintiff lost its security. *Held*, a cause of action was stated. The opinion exhaustively reviews the case law and opinions of commentators (18 C.A.3d 1031), and stresses the strong public policy reason set forth in *Handy v. Gordon* (1967) 65 C.2d 578, 581, 55 C.R. 769, 422 P.2d 329, *supra*, §55, for protecting the vendor in all subordination situations (18 C.A.3d 1036). It concludes:

"An implied agreement in the instant case can, and, in equity, should be spelled out from lender's alleged actual knowledge of the provisions of the seller's lien in general, and of the subordination therein in particular. In the superior position of a financial institution constantly engaged in professional construction lending, Southwestern had no reason to believe their trust deed conferred any lien to which the fee was subordinate other than to the extent of money spent for construction purposes. Its loan under the circumstances cannot be viewed other than as subject to the fair application of the construction funds. ... Its disinterest in the application of the funds not used for construction amounted to a failure to prevent the loss sustained by seller--who, in the vernacular of the market place, was 'wiped out.' The particular

equities discussed above incline us to the conviction that the philosophy of fair dealing as expressed in *Handy v. Gordon* ... is most appropriately invoked here." (18 C.A.3d 1037.) (See *Protective Equity Trust #83, Ltd. v. Bybee* (1991) 2 C.A.4th 139, 148, 150, 2 C.R.2d 864 [following *Middlebrook*; subordination agreement was unenforceable where loan was not used for construction, even though lenders never agreed to supervise use of loan proceeds]; *Swiss Property Management Co. v. Southern Calif. IBEW-NECA Pension Plan* (1997) 60 C.A.4th 839, 846, 70 C.R.2d 587 [distinguishing *Protective Equity* and *Middlebrook*; subsequent title insurance subordination agreements superseded prior restrictions on subordination stated in deed of trust]; *Brown v. Boren* (1999) 74 C.A.4th 1303, 1314, 88 C.R.2d 758, quoting the text [discussing *Middlebrook* and nature of automatic subordination].)

SUPPLEMENT: [This section is current through the latest supplement]
See C.E.B., 2 Real Property Sales Transactions 4th, §§9.86, 9.87.



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C. Real Mortgage and Tax Lien.

1. Priority of Tax Lien Over Mortgage.

4 *Witkin Sum. Cal. Law STRP* § 59

[§ 59] Priority of Tax Lien Over Mortgage.

Tax liens are generally preferred and, though later in time, are treated as superior to a preexisting mortgage or other private lien. However, this depends entirely on legislative intent. The Legislature may make the tax lien paramount either by express provision or by reasonable implication, but the question is one of construction in any particular case. (*California Loan & Trust Co. v. Weis* (1897) 118 C. 489, 492, 50 P. 697 [personal property tax lien held prior to earlier real mortgage]; see 9 *Cal. L. Rev.* 244; 3 *So. Cal. L. Rev.* 118; 4 *U.C.L.A. L. Rev.* 147; 75 *A.L.R.2d* 1121 [priority of local assessment lien]; on action by Attorney General, and court's jurisdiction to determine priority, see C.C. 2931c.)

To overcome an interpretation in a federal decision and to reaffirm the rule of *Weis*, the 1959 Legislature enacted Rev.C. 2192.1, as a *declaration of existing law*. The statute now states: "Every tax declared in this chapter to be a lien on real property, and every public improvement assessment declared by law to be a lien on real property, have priority over all other liens on the property, regardless of the time of their creation." (See *Redevelopment Agency of San Francisco v. Pacific Vegetable Oil Corp.* (1966) 241 *C.A.2d* 606, 612, 50 *C.R.* 676.) Further, a tax or assessment lien has priority over any recognizance, deed, judgment, debt, obligation, or responsibility for which the real property may be liable. (Rev.C. 2192.1.)

A delinquent sewage service charge is not a real property tax or public improvement assessment within the meaning of Rev.C. 2192.1, where a lien of a bona fide encumbrancer for value has been previously created. In this situation, *Pub.Util.C. 16470* specifically provides that these charges do not create a lien on the land. (*Butte v. North Burbank Public Util. Dist.* (1981) 124 *C.A.3d* 342, 346, 177 *C.R.* 282 [purchaser at foreclosure sale of property that had been encumbered in 1974 to secure debt was not liable for delinquent service charges imposed on property for 1978-1980].)

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C. Real Mortgage and Tax Lien.

2. Priorities Between Tax Liens.

a. Statutory Parity.

4 *Witkin Sum. Cal. Law STRP* § 60

[§ 60] Statutory Parity.

As between different tax liens or assessment liens, priority depends entirely on legislative intent. (See *La Mesa Lemon Grove & Spring Valley Irr. Dist. v. Hornbeck* (1932) 216 C. 730, 735, 17 P.2d 143; *Smith v. Addiego* (1942) 54 C.A.2d 230, 235, 129 P.2d 953; 5 Miller & Starr 3d, §11:143 et seq.) Prior to the enactment of the parity statute (infra, this section), street assessment and bond liens were ranked in the reverse order of creation, with the last in point of time being superior in rank and first in priority. (*Balaam v. Pacific States Savings & Loan Co.* (1933) 219 C. 612, 621, 28 P.2d 1053; *Cullinan v. Grey* (1941) 18 C.2d 247, 249, 115 P.2d 460; *Diehl v. Hanrahan* (1945) 68 C.A.2d 32, 36, 155 P.2d 853.)

State policy is that the final tax deed or deeds of all taxing agencies are on a parity with each other, and that regardless of when the levy of taxes or assessments is made, and regardless of when the final tax deed or assessment deed is taken by the taxing agency, the rights of all taxing agencies and all these deeds are equal and on a parity with each other. (Rev.C. 3713.)

In *Monheit v. Cigna* (1946) 28 C.2d 19, 168 P.2d 965, the court gave the predecessor to Rev.C. 3713 its full effect in the following language: "Not only do the tax deeds from the respective taxing agencies stand on a parity with relation to whether one destroys the other when we are not concerned with the time when the liens from which they flowed arose, but, moreover, in order that that parity and equality be made real and fully significant, it must follow that the time such liens arose or the deeds were executed with reference to each other, is immaterial." The court then proceeded to determine the respective rights of plaintiff, who bought tax-deeded land from the state, and defendant, who bought land under a street assessment bond sale. Neither can gain an advantage by attempting to pay off the other and acquire a clear title to the property; instead, they become tenants in common, each having an equitable lien against the property to the extent of his own payment, so that if the entire property is later sold, each will be entitled first to reimbursement for that payment before the excess is equally divided between them. (28 C.2d 26.) (See *Elbert, Ltd. v. Nolan* (1948) 32 C.2d 610, 613, 197 P.2d 537; *Kipp v. Kipp* (1954) 42 C.2d 724, 726, 269 P.2d 1; *Oswald v. Salter* (1947) 77 C.A.2d 599, 602, 176 P.2d 425; *Imperial Irr. Dist. v. Varney* (1948) 87 C.A.2d 264, 265, 196 P.2d 820.)

The statutory parity rule applies where the liens arise under *separate taxing agencies* (e.g., a district assessment and a general tax on land, or the assessments of different districts). But *Monheit* left open the question whether successive

tax or assessment liens *by the same taxing agency* are still ranked in the inverse order of creation, as held in *Cullinan v. Grey, supra*, and in *Raisch v. Myers* (1946) 27 C.2d 773, 775, 167 P.2d 198. (*Monheit v. Cigna, supra*, 28 C.2d 26, 27.)

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C. Real Mortgage and Tax Lien.

2. Priorities Between Tax Liens.

b. Priority of Tax Title.

4 *Witkin Sum. Cal. Law STRP* § 61

[§ 61] Priority of Tax Title.

Elbert, Ltd. v. Nolan (1948) 32 C.2d 610, 197 P.2d 537, held that, although tax liens, and tax titles based on them, are on a parity, a mere tax *lien* (here an unforeclosed bond lien) is not yet on a parity with a *tax title*. Thus, a *deed* received after foreclosure of a street assessment bond will rank equally with a deed received after a sale for delinquent general taxes, "but an unforeclosed lien manifestly does not represent a like state of finality, though, as the doctrine of parity envisages, it may achieve such status if the holder elects to enforce it through appropriate proceedings under the law." (32 C.2d 614.)

The significance of this distinction appeared in the result of the action that plaintiff, holder of the unforeclosed bond, brought for partition. Plaintiff was held not to be a tenant in common with defendant, the grantee under a tax deed. Plaintiff's only right of "parity" was to reimbursement for the amount due on its bond, equally with reimbursement of defendant for the amount paid for his tax title; thereafter, any excess resulting from the partition sale belonged to defendant, the holder of legal title to the land. (32 C.2d 619.) (See *Munden v. Hayes (1949) 89 C.A.2d 772, 774, 202 P.2d 112.*)

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C. Real Mortgage and Tax Lien.

2. Priorities Between Tax Liens.

c. Statute of Limitations.

4 *Witkin Sum. Cal. Law STRP* § 62

[§ 62] Statute of Limitations.

Parity of lien depends on its enforceability, and if the statute of limitations is a bar the parity is gone. No practical difficulties occur with respect to a lien for general taxes, for the statute of limitations does not run on the lien for 30 years (see 9 *Summary* (10th), *Taxation*, §252) and the private purchaser at a tax sale has a title and not a lien. It would seem, likewise, that no problem would arise in the case of district assessments where, after delinquency, the property is sold by the district to a purchaser. The situation is different, however, where the procedure is to issue *bonds* to cover the assessment. The bondholder, like a mortgagee, must foreclose the bond to collect the principal debt (the assessment). When the statute of limitations runs, what is the position of the bondholder?

The present rule was established in 1945. (1) The lien is extinguished by the lapse of time within which certain public officials may *sell property to satisfy a public improvement bond*. (2) The lien is presumed to have been extinguished at the expiration of 4 years after the due date of the bonds, or of the last installment, or of the last principal coupon attached to the bond. These presumptions are conclusive as to a bona fide purchaser for value after these dates. (C.C. 2911.) C.C.P. 330 also provides a 4-year statute of limitations on the exercise of a power of sale under improvement bonds, unless the particular act specifies a different period. (See *Scheas v. Robertson* (1951) 38 C.2d 119, 124, 126, 238 P.2d 982; *Rombotis v. Fink* (1948) 89 C.A.2d 378, 384, 201 P.2d 588; *Harless v. Winter* (1953) 116 C.A.2d 641, 647, 254 P.2d 168; cf. *Kipp v. Kipp* (1954) 42 C.2d 724, 727, 269 P.2d 1 [foreclosure action brought to judgment affirmatively demonstrated intent to assert and perfect lien; this activity on part of plaintiffs served to overcome disputable presumption of abandonment or extinguishment by inaction that might otherwise have been effective by the operation of C.C. 2911].)

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C. Real Mortgage and Tax Lien.

3. Federal Tax Lien.

a. In General.

4 *Witkin Sum. Cal. Law STRP* § 63

[§ 63] In General.

A federal tax lien attaches to the property of a delinquent taxpayer and, with certain exceptions, continues as a claim even though the property is transferred or encumbered. (See 5 Powell §39.05 et seq.; 41 *Cal. L. Rev.* 241 et seq.; 34 *Am.Jur.2d* (2004 ed.), *Federal Taxation* §71965 et seq.) The lien arises automatically on delinquency, but its priority dates from the time of filing in accordance with state laws. (See 26 *U.S.C.*, §6323(a), (f); 10 *Santa Clara Lawyer* 39; 34 *Am.Jur.2d* (2004 ed.), *Federal Taxation* §71992.)

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C. Real Mortgage and Tax Lien.

3. Federal Tax Lien.

b. Priority.

4 *Witkin Sum. Cal. Law STRP* § 64

[§ 64] Priority.

(1) *Priority in Time.* Where federal tax liens compete with private creditors and with state and local taxes and assessments, the basic rule of priority in time applies. (See *United States v. New Britain* (1954) 347 U.S. 81, 74 S.Ct. 367, 98 L.Ed. 520 [stating exception for priority of federal tax lien when debtor is insolvent]; *United States v. Brosnan* (1960) 363 U.S. 237, 80 S.Ct. 1108, 4 L.Ed.2d 1192; *United States v. McDermott* (1993) 507 U.S. 447, 113 S.Ct. 1526, 1528, 123 L.Ed.2d 128, 135, 136 [federal tax liens do not automatically have priority over all other liens]; 5 Miller & Starr 3d, §11:164 et seq.; 10 Santa Clara Lawyer 40; 13 *Stanf. L. Rev.* 389; 8 *U.C.L.A. L. Rev.* 339; 90 *A.L.R.2d* 1179 [priority as between federal tax lien and mortgage to secure future advances].)

However, a private lien does not gain priority until it is *perfected* "in the sense that there is nothing more to be done to have a choate lien--when the identity of the lienor, the property subject to the lien, and the amount of the lien are established." (*United States v. New Britain*, *supra*, 74 S.Ct. 369, 98 L.Ed. 525; *United States v. McDermott*, *supra*, 113 S.Ct. 1528, 123 L.Ed.2d 136 [quoting *New Britain*]; see 86 *Harv. L. Rev.* 1570; 14 *Hastings L. J.* 55; 10 Santa Clara Lawyer 32.) Thus, a mortgagee's priority over federal tax liens does not extend to attorney's fees incurred in foreclosure; even though the mortgage instrument that obligated the mortgagor to pay a reasonable attorneys' fee in the event of default was prior, "the amount of the lien for attorney's fees was undetermined and indefinite when the federal tax liens in question were filed." (*United States v. Pioneer Amer. Ins. Co.* (1963) 374 U.S. 84, 83 S.Ct. 1651, 1656, 10 L.Ed.2d 770, 775; *United States v. Equitable Life Assur. Soc. of the United States* (1966) 384 U.S. 323, 86 S.Ct. 1561, 1564, 16 L.Ed.2d 593, 597; see 94 *A.L.R.2d* 748 [liens competing with federal tax priorities as choate or inchoate].)

(2) *Perfecting Lien on After-Acquired Property.* In *United States v. McDermott*, *supra*, a bank claimed priority over the federal tax lien because it had the first lien of record against the debtor's property. *Held*, the federal tax lien had priority.

(a) Although the bank recorded its judgment lien before the federal tax lien was recorded, neither lien actually attached to the property at issue here until the delinquent taxpayers acquired rights in the property. However, under 26 U.S.C., §6323(a), "the filing of notice renders the federal tax lien extant for 'first in time' priority purposes regardless of whether it has yet attached to identifiable property." (113 S.Ct. 1530, 123 L.Ed.2d 137.)

(b) In rejecting the bank's theory of "first-to-record" presumption, the Court said: "Such a strong 'first-to-record' presumption may be appropriate for simultaneously perfected liens under ordinary statutes creating private liens, which ordinarily arise out of voluntary transactions. When two private lenders both exact from the same debtor security agreements with after-acquired-property clauses, the second lender knows, by reason of the earlier recording, that that category of property will be subject to another claim, and if the remaining security is inadequate he may avoid the difficulty by declining to extend credit. The Government, by contrast, cannot indulge the luxury of declining to hold the taxpayer liable for his taxes; notice of a previously filed security agreement covering after-acquired property does *not* enable the Government to protect itself. A strong 'first-to-record' presumption is particularly out of place under the present tax-lien statute, whose *general rule* is that the tax collector prevails even if he has not recorded *at all*. ... Thus, while we would hardly proclaim the statutory meaning we have discerned in this opinion to be 'clear,' it is evident enough for the purpose at hand. The federal tax lien must be given priority." (113 S.Ct. 1530, 123 L.Ed.2d 137.)

(3) *Application of State Law*. In actions brought to enforce federal tax liens, the federal courts follow state rules governing priority and divestiture of liens to avoid disturbing the "complex property relationships long since settled and regulated by state law." (*United States v. Brosnan, supra*, 80 S.Ct. 1111, 4 L.Ed.2d 1196.) But the federal courts are not required to accept state law that frustrates the priority of a federal tax lien by the "formalistic device of characterizing subsequently accruing local liens as expenses of mortgage foreclosure sale." (*United States v. Buffalo Savings Bank* (1963) 371 U.S. 228, 83 S.Ct. 314, 9 L.Ed.2d 283; see 77 Harv. L. Rev. 1485; 16 Stanf. L. Rev. 1101.)

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C. Real Mortgage and Tax Lien.

3. Federal Tax Lien.

c. Uniform Federal Lien Registration Act.

4 *Witkin Sum. Cal. Law STRP* § 65

[§ 65] Uniform Federal Lien Registration Act.

(1) *Nature and Scope of Act.* In 1967, California enacted the Uniform Federal Tax Lien Registration Act which established the procedure for filing federal tax liens. (See former Govt.C. 7200 et seq., 27330.) This Act was repealed in 1979 and replaced by its broader successor, the Uniform Federal Lien Registration Act. (*C.C.P.* 2100 et seq.; see 7A (Part I) U.L.A. (Master Ed.), p. 336.) The law applies to federal tax liens and to "other federal liens notices of which under any Act of Congress or any regulation adopted pursuant thereto are required or permitted to be filed in the same manner as notices of federal tax liens." (*C.C.P.* 2100.)

(2) *Procedure.* The notices and certificates must be filed in accordance with the statute, which covers (a) the place of filing (*C.C.P.* 2101); (b) execution of notices and certificates (*C.C.P.* 2102); (c) duties of the filing officer (*C.C.P.* 2103); (d) fees for filing and indexing (*C.C.P.* 2104); and (e) maintenance of a file containing notices filed on or before January 1, 1968 (*C.C.P.* 2105). (See *Stovall v. Andrews* (1998) 65 *C.A.4th* 240, 243, 75 *C.R.2d* 908 [California does not require attestation, certification, or acknowledgment of notice of tax lien as prerequisite to acceptance of lien for filing by recorder].)

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D. Real Mortgage and Secured Interest in Personal Property.

1. Growing Crops.

4 *Witkin Sum. Cal. Law STRP* § 66

[§ 66] Growing Crops.

(1) *Early Law.* Under the law governing chattel mortgages, as developed before the adoption of the Uniform Commercial Code, a real mortgage covering growing crops, but executed and recorded only as a real mortgage, did not prevail over a subsequent chattel mortgage on crops executed with the formalities required for chattel mortgages. The mortgagor could sever the crops at any time before foreclosure of the real mortgage, and could also give a valid chattel mortgage on them until the foreclosure. The chattel mortgagee would then prevail over the prior real mortgagee; and, even though the real mortgage was later foreclosed, the chattel mortgagee could claim and harvest the crops until expiration of the period of redemption from the foreclosure sale. (See *First Nat. Bank of Lindsay v. Garner* (1928) 91 C.A. 176, 182, 266 P. 849; 10 *Hastings L. J.* 171.)

This rule was subject to an exception where, after default by the mortgagor or trustor, the real mortgagee or trustee under a deed of trust entered into *actual physical possession* of the property, by consent of the mortgagor or trustor, or under authority contained in the instrument. A crop mortgagee whose mortgage was executed after this change of possession had *actual notice* of the claim of the prior real mortgagee or trustee, and did not prevail. (*Nelson v. Bowen* (1932) 124 C.A. 662, 671, 12 P.2d 1083.) But to constitute a "mortgagee or trustee in possession" (see *infra*, §95), there had to be a complete relinquishment by the mortgagor of control over the property; a mere constructive change, such as taking over the collection of rents, was ineffective to defeat the claim of the subsequent chattel mortgagee. (*Bank of America v. Bank of Amador County* (1933) 135 C.A. 714, 721, 28 P.2d 86.)

(2) *Uniform Commercial Code.* Growing crops are classified as goods, and therefore are subject to the filing provisions of the Uniform Commercial Code, Division 9. (See 4 *Summary* (10th), *Secured Transactions in Personal Property*, §23.) However, until 2001, Division 9 did not provide a rule of priority between a real mortgage and a security interest in growing crops. (See C.E.B., *Secured Transactions* 2d, §8.4 et seq.; 68A *Am.Jur.2d* (2003 ed.), *Secured Transactions* §798 et seq.) The Commercial Code now provides that a "perfected security interest in crops growing on real property has priority over a conflicting interest of an encumbrancer or owner of the real property if the debtor has an interest of record in, or is in possession of, the real property." (U.C.C. 9334(i).)

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D. Real Mortgage and Secured Interest in Personal Property.

2. Fixtures.

a. Subsequent Mortgage.

4 Witkin Sum. Cal. Law STRP § 67

[§ 67] Subsequent Mortgage.

(1) *Early Law.* Under the law governing *conditional sales*, prior to the Uniform Commercial Code, there was no requirement of recordation of a conditional sales contract, and so long as the goods remained personal property the reserved title of the conditional seller was protected even against bona fide purchasers. But where the goods were of such a type that they were afterwards affixed to the realty (see C.C. 660), they became *real property*. As between the *buyer and conditional seller*, they were treated as personal property, and title remained in the seller. But as to *third persons* without notice, the goods were part of the land or building, and, because the interest of the seller in that part of the building did not appear of record, it was ordinarily void as against *subsequent purchasers, mortgagees, or other encumbrancers*. (See *Oakland Bank of Savings v. California Pressed Brick Co.* (1920) 183 C. 295, 302, 191 P. 524; *R. Barcroft & Sons Co. v. Cullen* (1933) 217 C. 708, 713, 20 P.2d 665 [holder of mechanic's lien who furnished labor and materials without notice of conditional seller's interest].)

Similarly, where a loan was secured by a *chattel mortgage* on fixtures, and a subsequent real mortgage was made, the real mortgagee prevailed. The purchaser of realty was only bound to examine the records of title to realty, and, if the prior chattel mortgage was not recorded in a manner that indicated that it affected title to the particular real property, it imparted no constructive notice to the subsequent purchaser or encumbrancer of the realty. (See *Elliott v. Hudson* (1912) 18 C.A. 642, 646, 124 P. 103, 108.)

(2) *Historical Development Under Uniform Commercial Code.* The Code, as originally enacted in California, did not affect the existing rules of priority. Under former U.C.C. 9102(1)(c), Division 9 was applicable to fixtures treated as personalty, but, "as against third parties having or acquiring an interest in or a lien on the real property, the rights and duties of the parties to the secured transaction are governed by the law of this state relating to real property and fixtures." (See *EAC Credit Corp. v. Bass* (1971) 21 C.A.3d 645, 651, 98 C.R. 681 [discussing California modifications]; 8 U.C.L.A. L. Rev. 93.)

Legislation enacted in 1980 omitted U.C.C. 9102(1)(c), and restored the Uniform Commercial Code rules of priority by the addition of U.C.C. 9313. (See 9 Anderson 3d (1999 Rev. ed.), §9-313:1 et seq.; C.E.B., 1 Real Estate Finance Practice, §§4.17 et seq., 5.1 et seq.; 68A Am.Jur.2d (2003 ed.), *Secured Transactions* §885 et seq.; 4 Summary (10th), *Secured Transactions in Personal Property*, §131.) This statute was repealed and replaced by U.C.C. 9334 in

1999, effective July 1, 2001.

(3) *Current Statute.* U.C.C. 9334 deals with fixtures as follows:

(a) Although the statute does not define fixtures, it excludes "ordinary building materials incorporated into an improvement on land"; no security interest can exist as to these. (U.C.C. 9334(a); on definition of "fixture," see C.C. 660.)

(b) A security interest in fixtures is *subordinate* to the conflicting interest of an encumbrancer or owner of the related real estate who is not the debtor, unless the holder of the security interest in the fixtures comes within a specific provision of the statute. (U.C.C. 9334(c).)

(c) A perfected security interest in fixtures has priority over a real estate owner's or encumbrancer's conflicting interest if *any* of the following conditions is satisfied:

(1) The debtor has an interest of record in the real property or is in possession of the real property and both (a) the security interest is perfected by a fixture filing before the interest of the encumbrancer or owner of record; and (b) the security interest has priority over any conflicting interest of the owner's or encumbrancer's predecessor in title. (U.C.C. 9334(e)(1).)

(2) "The fixtures are readily removable factory or office machines or readily removable replacements of domestic appliances that are consumer goods." (U.C.C. 9334(e)(2).)

(3) "The conflicting interest is a lien on the real property obtained by legal or equitable proceedings after the security interest was perfected by any method permitted by" Division 9. (U.C.C. 9334(e)(3).)

(4) The security interest is both (a) created in a manufactured home in a manufactured home transaction, and (b) perfected pursuant to a statute described in U.C.C. 9311(a)(2). (U.C.C. 9334(e)(4).)

(d) A security interest in fixtures, whether or not perfected, has priority over a real estate owner's or encumbrancer's conflicting interest if either (1) the encumbrancer or owner has consented to the security interest or disclaimed an interest in the goods as fixtures, or (2) the debtor has a right to remove the goods as against the encumbrancer or owner. (U.C.C. 9334(f).) In the latter case, the priority of the security interest continues for a reasonable time if the debtor's right to remove the goods as against the encumbrancer or owner terminates. (U.C.C. 9334(g).) (On removal of improvements affixed by "mistake either of law or fact," see C.C. 1013.5, 13 *Summary* (10th), *Personal Property*, §98.)

(e) The statute "does not prevent creation of an encumbrance upon fixtures" pursuant to real estate law. (U.C.C. 9334(b).) In this case, as before, priority is determined by the recording laws. (See *supra*, §48 et seq.)

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III. PRIORITIES

D. Real Mortgage and Secured Interest in Personal Property.

2. Fixtures.

b. Prior Mortgage.

4 *Witkin Sum. Cal. Law STRP* § 68

[§ 68] Prior Mortgage.

(1) *Early Law*. The rule giving priority to the real mortgagee ordinarily applied only to parties whose interests were acquired *subsequent* to the installation of the fixture. If a person lent money and took a mortgage or deed of trust before the goods were bought, he or she advanced nothing on the faith of the goods, and there was no basis for an estoppel. Hence, the prior encumbrancer would ordinarily not be protected. (See generally 8 *U.C.L.A. L. Rev.* 934.)

But where the goods became such a basic part of the building that their removal would injure it so as substantially to impair the value of the security, the seller who knowingly attached them to the realty might lose his or her priority. (*Dauch v. Ginsburg* (1931) 214 C. 540, 545, 6 P.2d 952; *Hammel Radiator Corp. v. Mortgage Guarantee Co.* (1933) 129 C.A. 468, 471, 18 P.2d 993 [radiators]; *Pacific Mortg. Guaranty Co. v. Rosoff* (1937) 20 C.A.2d 383, 385, 67 P.2d 110 [linoleum, curtain rods, wall beds].)

(2) *Uniform Commercial Code*. Except as otherwise provided in U.C.C. 9334(e), (f) (*supra*, §67), "a security interest in fixtures is subordinate to a construction mortgage if a record of the mortgage is recorded before the goods become fixtures and the goods become fixtures before the completion of the construction." A mortgage that is given to refinance a construction mortgage has the same priority as a construction mortgage. (U.C.C. 9334(h).) (See C.E.B., 1 Real Estate Finance Practice, §7.1 et seq.; on historical development of U.C.C. 9334, see *supra*, §67.)

Except as provided in U.C.C. 9334(h), a perfected security interest in fixtures has priority over a real estate owner's or an encumbrancer's conflicting interest if the debtor has an interest of record in the real property, or is in possession, and all of the following conditions are satisfied:

(a) "The security interest is a purchase money security interest." (U.C.C. 9334(d)(1).)

(b) "The interest of the encumbrancer or owner arises before the goods become fixtures." (U.C.C. 9334(d)(2).)

(c) "The security interest is perfected by a fixture filing before the goods become fixtures or within 20 days thereafter." (U.C.C. 9334(d)(3).)

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E. Real Mortgage and Mechanic's Lien.
1. Basic Rule.

4 Witkin Sum. Cal. Law STRP § 69

[§ 69] Basic Rule.

(1) *In General.* Mechanics' liens are preferred (a) to any lien, mortgage, deed of trust, or other encumbrance that attaches *after* commencement of the work of improvement, and (b) "to any lien, mortgage, deed of trust, or other encumbrance of which the claimant had no notice and which was unrecorded at the time of commencement of the work of improvement." (C.C. 3134; see 5 Miller & Starr 3d, §11:120 et seq.; C.E.B., Mechanics' Liens 3d, §2.63 et seq.; on mortgagee's right to priority by recordation of bond to cover payment of lien claimants, see C.C. 3138; on what constitutes commencement of work, see *infra*, §70.)

Thus, if the mortgage or other encumbrance was recorded before commencement of the work, or the mechanic's lien claimant had notice of it at that time, general principles apply and give the mortgage priority. (See *San Pedro Lumber Co. v. Wilson* (1935) 4 C.A.2d 41, 42, 40 P.2d 605; *Barr Lumber Co. v. Shaffer* (1951) 108 C.A.2d 14, 21, 238 P.2d 99; 22 Cal. L. Rev. 312; 23 Cal. L. Rev. 636.) However, this rule may change where *future advances* are made by the mortgagee. (See *infra*, §§72, 73.)

(2) *Site Improvement Lien.* In addition to the priorities provided for mechanic's liens concerning mortgages, deeds of trust, and other encumbrances, a site improvement lien is preferred to an encumbrance "recorded before the commencement of the site improvement work which was given for the sole or primary purpose of financing such site improvements." However, the mortgage, deed of trust, or other encumbrance will have preference if the loan proceeds are controlled by the lender for the purpose of applying them to lien claimants' claims and it has been agreed that no part of the proceeds will be paid to the borrower without satisfactory evidence that (a) all the claims have been paid, (b) the time for recording claims has expired, or (c) no claims have been recorded. (C.C. 3137; see *Schmitt v. Tri Counties Bank* (1999) 70 C.A.4th 1234, 1243, 83 C.R.2d 257 [site improvement lien had priority over recorded deed of trust where bank failed to secure binding agreement referencing borrower's site improvement obligations and to control loan proceeds until all liens were paid, as required by C.C. 3137]; 5 Miller & Starr 3d, §11:126; C.E.B., Mechanics' Liens 3d, §2.70; on owner's and mortgagee's right to priority by recordation of bond to cover payment of lien claimants, see C.C. 3139; on site improvement as separate work of improvement for purposes of commencement of work, see *infra*, §70.)

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III. PRIORITIES
E. Real Mortgage and Mechanic's Lien.
2. Commencement of Work.

4 Witkin Sum. Cal. Law STRP § 70

[§ 70] Commencement of Work.

The older cases made a distinction based on whether there was or was not a general contract for the work, but the present statute abrogated that distinction. (See *K. & K. Brick Co. v. Brooke* (1931) 118 C.A. 192, 195, 5 P.2d 49; 5 So. Cal. L. Rev. 312.) Priority in both situations dates from *commencement of the work*. (C.C. 3134; see *supra*, §69; C.E.B., Mechanics' Liens 3d, §3.73.)

"Commencement of the work" requires some activity on the site to warn lenders that the mechanics' liens have arisen; the lien does not attach "unless and until *construction* has been undertaken by the doing of actual visible work on the land or the delivery of construction materials thereto." (*Walker v. Lytton Savings & Loan Assn.* (1970) 2 C.3d 152, 157, 84 C.R. 521, 465 P.2d 497 [rendition of architectural services is not commencement of construction]; see *Tracy Price Associates v. Hebard* (1968) 266 C.A.2d 778, 787, 72 C.R. 600; *South Bay Engineering Corp. v. Citizens Savings & Loan Assn.* (1975) 51 C.A.3d 453, 457, 124 C.R. 221 [engineering company's placement of markers and stakes on land was not work of improvement or site improvement; they were only devices to assist in preparing maps and plans]; 16 *Hastings L. J.* 155; 51 *Cal. L. Rev.* 341; 1 *A.L.R.3d* 822 [what constitutes commencement of building or improvement].)

Two policy reasons were stated in *Walker* for rejection of the theory that furnishing architectural services not involving work on the land should be deemed commencement of the work:

(1) If the date of furnishing plans were used as the time of commencement for architects then all the liens of materialmen and others would likewise relate back, and construction loans would be impossible to obtain. (2 C.3d 160.)

(2) The fact that the lender made use of the plans of plaintiff architects in making its appraisal for loan purposes was of no significance. This is common practice; and if this reliance is to work a change in prior rules the Legislature must make it. (2 C.3d 160.)

Where *site improvement* is provided for in a separate contract, that improvement is considered separately and its commencement does not constitute commencement of the work under C.C. 3134. (See C.C. 3135; *Lambert Steel Co. v. Heller Financial* (1993) 16 C.A.4th 1034, 1039, 20 C.R.2d 453 [demolition and site cleanup work under separate contract was not commencement of work under C.C. 3134 and 3135].)

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III. PRIORITIES

F. Real Mortgage and Design Professional's Lien.

4 Witkin Sum. Cal. Law STRP § 71

[§ 71] Real Mortgage and Design Professional's Lien.

C.C. 3081.9 states the priorities between a design professional's lien and the interest of a purchaser, lessee, or encumbrancer as follows:

(1) A design professional's lien does not "affect or take priority over the interest of record of a purchaser, lessee, or encumbrancer, if the interest of the purchaser, lessee, or encumbrancer in the real property was duly recorded before recordation of the design professionals' lien." (C.C. 3081.9(a).)

(2) A design professional's lien does not "affect or take priority over an encumbrance of a construction lender which funds the loan to commerce the work of improvement for which the design professional furnished services at the request of the landowner." (C.C. 3081.9(b).) (See C.E.B., Mechanics' Liens 3d, §2.77; on design professional's lien generally, see *supra*, §32.)

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III. PRIORITIES

G. Future Advances and Subsequent Liens.

1. Obligatory Advances.

4 Witkin Sum. Cal. Law STRP § 72

[§ 72] Obligatory Advances.

Mortgages sometimes provide that they are security for future advances by the mortgagee. (See *supra*, §44.) In a construction loan, e.g., it is common for the mortgagee to agree to furnish the necessary sum in installments as the work progresses. If a second mortgage is thereafter given, or, more commonly, mechanics' liens attach by reason of the commencement of the work on the building (*supra*, §69), is the mortgage prior not only as to the original amount lent, but also as to the future advances?

If the advances are obligatory, i.e., if the mortgagee has bound himself or herself to make them, the mortgage is prior even though at the time they are made the mortgagee has actual notice of the other liens. This notice makes no difference because the mortgagee cannot withhold the advances. (See *Fickling v. Jackman* (1928) 203 C. 657, 662, 265 P. 810; *Smith v. Anglo-Calif. Trust Co.* (1928) 205 C. 496, 500, 271 P. 898; *Hayward Lumber & Inv. Co. v. Corbett* (1934) 138 C.A. 644, 647, 33 P.2d 41; *Rest.3d, Property (Mortgages)* §2.1 et seq.; 5 Miller & Starr 3d, §11:100 et seq.)

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III. PRIORITIES

G. Future Advances and Subsequent Liens.

2. Optional Advances.

4 Witkin Sum. Cal. Law STRP § 73

[§ 73] Optional Advances.

(1) *In General: Notice of Other Liens.* Where the mortgagee is not bound to make the advances, priority is determined by the circumstances existing at the time the particular advance is made. If, at that time, the mortgagee has *actual notice* of other liens, they are prior. If he or she does not, the mortgage is prior. And mere constructive notice through recordation of subsequent liens will not destroy priority of the mortgage; the mortgagee is not required to search the record every time he or she makes an advance. (*Tapia v. Demartini* (1888) 77 C. 383, 387, 19 P. 641; *Fickling v. Jackman* (1928) 203 C. 657, 662, 265 P. 810; *W.P. Fuller & Co. v. McClure* (1920) 48 C.A. 185, 191, 191 P. 1027; *Yost-Linn Lumber Co. v. Williams* (1932) 121 C.A. 571, 575, 9 P.2d 324; *Lumber & Builders' Supply Co. v. Ritz* (1933) 134 C.A. 607, 610, 25 P.2d 1002; *Oaks v. Weingartner* (1951) 105 C.A.2d 598, 600, 234 P.2d 194; *Imhoff v. Title Ins. & Trust Co.* (1952) 113 C.A.2d 139, 143, 247 P.2d 851; see *Coast Cen. Credit Union v. Superior Court* (1989) 209 C.A.3d 703, 711, 257 C.R. 468 [nonobligatory disbursements by construction lender with senior deed of trust are junior to filed mechanic's lien]; 5 Miller & Starr 3d, §11:103 et seq.; C.E.B., Mortgage and Deed of Trust Practice 3d, §9.70; 80 A.L.R.2d 179 [priority between mechanics' liens and advances made under previously executed mortgage].)

(2) *Advances Used for Claims or Construction Costs.* Certain kinds of optional advances are accorded the same priority over mechanics' liens (see *supra*, §69) as obligatory advances: those "used in payment of any claim of lien which is recorded at the date or dates of such other advances and thereafter in payment of costs of the work of improvement." However, this priority cannot exceed the "original obligatory commitment of the lender as shown in such mortgage or deed of trust." (C.C. 3136; see C.E.B., Mechanics' Liens 3d, §§2.72, 2.73.)

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III. PRIORITIES

H. Purchase Money Mortgage.

1. In General.

4 Witkin Sum. Cal. Law STRP § 74

[§ 74] In General.

"A mortgage or deed of trust given for the price of real property, at the time of its conveyance, has priority over all other liens created against the purchaser, subject to the operation of the recording laws." (C.C. 2898.) The statute gives a purchase money mortgage priority, but only as to liens "created against the purchaser"; as to liens created against the seller or otherwise encumbering the property, the general priority rules (*supra*, §48 et seq.) apply. (See *Rest.3d, Property (Mortgages)* §7.2; 5 Miller & Starr 3d, §§11:97, 11:98; C.E.B., Mortgage and Deed of Trust Practice 3d, §9.47 et seq.; 51 Cal. L. Rev. 342 [priority as against mechanics' liens].)

The qualification "subject to the operation of the recording laws" does not limit the effect of the statute to purchase money mortgages recorded prior to the competing lien. "The deed and mortgage back are considered as contemporaneous acts and no lien or charge against the purchaser can be prior to the rights of the vendor under his mortgage." (*Walley v. P.M.C. Inv. Co. (1968)* 262 C.A.2d 218, 220, 68 C.R. 711 [purchase money mortgage has priority over previously recorded abstract of judgment]; see *Mercantile Collection Bureau v. Roach (1961)* 195 C.A.2d 355, 359, 15 C.R. 710 [priority over judgment lien]; *DMC v. Downey Savings & Loan Assn. (2002)* 99 C.A.4th 190, 195, 120 C.R.2d 761 [issue of first impression; when original owner repurchased property after nonjudicial foreclosure, new purchase money deed of trust that essentially replaced original senior lien retained priority over old junior lien that was wiped out by foreclosure and revived by owner's repurchase of property].)

The priority rule protects even *third persons* who furnish money, but only when it is loaned for the express purpose of paying for the property. (*Van Loben Sels v. Bunnell* (1898) 120 C. 680, 684, 53 P. 266; see *Stockton Savings & Loan Bank v. Massanet (1941)* 18 C.2d 200, 208, 114 P.2d 592 [same test for what constitutes purchase money mortgage is applied under C.C. 2898 and C.C.P. 580b, *infra*, §185]; *Mercantile Collection Bureau v. Roach, supra*, 195 C.A.2d 358; 55 A.L.R.2d 1119 [priority as between vendor's lien and mortgage or deed of trust to third person furnishing purchase money].)

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III. PRIORITIES

H. Purchase Money Mortgage.

2. Priority Over Vendor's Lien.

4 *Witkin Sum. Cal. Law STRP* § 75

[§ 75] Priority Over Vendor's Lien.

In *Brock v. First South Savings Assn.* (1992) 8 C.A.4th 661, 10 C.R.2d 700, plaintiff sold property to a buyer, accepting the buyer's unsecured promissory notes for part of the purchase price. The buyer obtained a loan for the balance from defendant bank, secured by a deed of trust on the property. After escrow closed, the buyer defaulted on both the loan and the promissory notes. Plaintiff brought an action against defendant asserting the priority of his vendor's lien over defendant's purchase money deed of trust. *Held*, the purchase money deed of trust prevailed.

(a) C.C. 3048 provides that a vendor's lien is valid against anyone claiming under the debtor except a purchaser or encumbrancer in good faith and for value. Defendant was not an encumbrancer in good faith, because defendant had notice and knowledge of the creation of the vendor's lien at the close of escrow. However, the dispute cannot be adjudicated by looking exclusively at C.C. 3048. (8 C.A.4th 667.)

(b) When a purchase money mortgage or deed of trust and a vendor's lien arise out of a single sales transaction, they are deemed to arise simultaneously. There is an apparent conflict between C.C. 3048 (vendors' liens) and C.C. 2898(a) (purchase money deed of trust), with each statute appearing to give priority to the lien it describes over all other claims. (8 C.A.4th 667.)

(c) Under common law, the vendor's lien was a purely equitable lien and was deemed subordinate to the legal purchase money mortgage or deed of trust where both liens arose simultaneously. California courts, in construing the statutes codifying the common law of liens, have treated the vendor's lien as an equitable lien notwithstanding its present basis in statute. Therefore, the common law principle of granting priority to the purchase-money lien over the vendor's lien still controls. (8 C.A.4th 675, 676.) (See 5 Miller & Starr 3d, §11:110; on vendors' liens generally, see *supra*, §19.)

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A. Reimbursement for Expenditures.

1. Payment of Taxes.

a. In General.

4 *Witkin Sum. Cal. Law STRP* § 76

[§ 76] In General.

(1) *Reimbursement on Foreclosure.* The mortgagor (or trustor), as legal owner, has the duty to pay taxes. If he or she fails to do so, the mortgagee may pay them to prevent loss of his or her security through a tax sale, and thereafter is entitled to reimbursement, usually by adding the amount to the mortgage debt and collecting it on foreclosure. (See C.C. 2876; *Weinreich v. Hensley* (1898) 121 C. 647, 656, 54 P. 254.)

Often the mortgage or deed of trust contains an express provision giving the mortgagee this power, and the additional power to declare the mortgagor in default and foreclose at once. In *Security-First Nat. Bank v. Lamb* (1931) 212 C. 64, 297 P. 550, the provision authorized the mortgagee to pay taxes or assessments without notice to the mortgagor, and made the mortgagee the sole judge of their legality. The mortgagee paid a street assessment, although the mortgagor had already commenced an action attacking its validity. *Held*, the provision was valid, and the mortgagee could foreclose for failure of the mortgagor to reimburse on demand. (212 C. 68.) (See *Rest., Restitution* §104; 4 Miller & Starr 3d, §10:59; C.E.B., 2 Mortgage and Deed of Trust Practice 3d, §§8.68, 8.69; 13 Am.Jur. Legal Forms 2d, §179:291; 18 Am.Jur. P.P. Forms (1997 ed.), Mortgages, §166 et seq.)

(2) *Invalid Purchase by Mortgagor.* If the taxes are not paid, and the property is sold for delinquency, the mortgagor cannot buy at the tax sale *free from the mortgage lien*. Two reasons are commonly given: First, the mortgagor cannot be permitted to take advantage of his or her own wrongful failure to perform the obligation to pay taxes imposed by the mortgage or by statute; second, the mortgagor is estopped to assert a title inconsistent with the mortgage lien. The second, broader ground appears to be the true basis for the rule. Accordingly, an heir of the mortgagor, though not personally liable for the taxes, was estopped to set up his title acquired by a tax sale against the mortgage lien or a title acquired by foreclosure of the mortgage. (*Dinkelman v. Harrison* (1943) 61 C.A.2d 258, 262, 142 P.2d 461.)

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(1) *Reimbursement on Foreclosure.* See 18 Am.Jur. P.P. Forms (2005 ed.), Mortgages, §106.



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A. Reimbursement for Expenditures.

1. Payment of Taxes.
- b. Action Against Mortgagor.

4 *Witkin Sum. Cal. Law STRP* § 77

[§ 77] Action Against Mortgagor.

A variation in the mortgagee's remedy for the mortgagor's failure to pay taxes (*supra*, §76) was considered in *Miller v. Bean* (1948) 87 C.A.2d 186, 196 P.2d 596. Plaintiff alleged that defendant mortgagors allowed 1931 taxes to become delinquent, so that the then usual enforcement procedure took place (tax sale to the state, followed by public tax sale, and purchase by a stranger in 1944). Plaintiff, holder of the note (long since barred by limitations) and the deed of trust, sued in 1946, but did not frame his complaint on the theory of breach of the covenant to pay taxes (breach occurred in 1931, barred by limitations). Instead, he alleged that defendant violated the covenant "to protect, preserve and defend said property and the title thereto." *Held*, the cause of action was not barred by limitations.

(a) The initial breach in 1931 could have been cured by redemption, and hence, would have justified an award only of nominal damages. (87 C.A.2d 190.)

(b) The actual damage occurred in 1944 when, by tax sale to a private purchaser, the title (and therefore plaintiff's security) was finally lost; the failure to redeem prior thereto was an independent breach of covenant giving rise to an independent cause of action. "[A] covenant to defend and protect the title of property serving as security for a debt, being prospective in operation, is analogous to a covenant of warranty or quiet enjoyment in a deed or lease, in respect to the breach of which it is well settled that the statute does not begin to run until actual injury has been sustained by way of eviction." (87 C.A.2d 190.)

The mortgagee is not, however, entitled to reimbursement if he or she pays taxes or sues *after* the mortgage is discharged. In *San Mateo County Bank v. Dupret* (1932) 124 C.A. 395, 12 P.2d 669, the mortgagee sold under a deed of trust, purchased at the sale, then paid taxes and sued for reimbursement. *Held*, he was not entitled. The theory is that the mortgagee may, before foreclosure, pay and add the amount to the debt; but if he or she does not, the mortgagee is in the same position as any other purchaser who buys the property subject to existing taxes. (124 C.A. 397.)

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A. Reimbursement for Expenditures.
2. Clearing Liens.

4 Witkin Sum. Cal. Law STRP § 78

[§ 78] Clearing Liens.

If the mortgagee, for the protection of his or her security, is compelled to satisfy a prior lien against the property, the mortgagee may add this amount to the mortgage debt and recover it through foreclosure. (See C.C. 2876.) An independent personal action for reimbursement against the mortgagor would doubtless be contrary to the limitations of the one form of action rule of *C.C.P.* 726 (infra, §124). (See *Windt v. Covert* (1907) 152 C. 350, 353, 93 P. 67; *Rest., Restitution* §104; 4 Miller & Starr 3d, §10:58; C.E.B., Mortgage and Deed of Trust Practice 3d, §§8.72, 8.73.)

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4 *Witkin Sum. Cal. Law STRP* § 79

[§ 79] Payment of Insurance Premiums.

(1) *Mortgagor's Duty To Procure Insurance.* Both the mortgagor and mortgagee have insurable interests in the secured real property. (See 32 *So. Cal. L. Rev.* 233; as to necessity of insurable interest, see 2 *Summary* (10th), *Insurance*, §76.) Usually, the mortgage will require the mortgagor to procure insurance for the benefit of both. A common provision requires the mortgagor to provide, maintain, and deliver fire insurance satisfactory to and with loss payable to the mortgagee. (See 4 *Miller & Starr* 3d, §10:60; C.E.B., 2 *Mortgage and Deed of Trust Practice* 3d, §8.51; 13 *Am.Jur. Legal Forms* 2d, §179.281 et seq.)

(2) *Mortgagor's Failure To Insure.* If the mortgagor fails to provide the insurance, the mortgagee, as in the case of nonpayment of taxes (*supra*, §78), may do so and add the cost of the premiums to the amount due on the underlying obligation. (*Freeman v. Lind* (1986) 181 *C.A.3d* 791, 806, 226 *C.R.* 515; see 4 *Powell* §37.24; 4 *Miller & Starr* 3d, §10:60; C.E.B., 2 *Mortgage and Deed of Trust Practice* 3d, §8.52; 42 *A.L.R.4th* 188 [mortgagee's duty to insure]; 60 *A.L.R.3d* 164 [right of mortgagee to notice by insurer of policy expiration]; 54 *A.Am.Jur.2d* (1996 ed.), *Mortgages* §252 et seq.)

(3) *Acceleration for Nonpayment.* Standard form mortgages also contain a provision permitting the mortgagee to accelerate the indebtedness and foreclose or sell on the mortgagor's default in the performance of any act required by the mortgage. *Freeman v. Lind*, *supra*, involved the question whether acceleration under such a clause was a permissible remedy for the mortgagee's failure to insure when the lack of insurance did not impair the security; i.e., the raw land was worth more than the underlying debt. "[A] trustee or beneficiary may not foreclose under an acceleration provision in a deed of trust when the trustor fails to provide fire insurance for the security property, unless the failure to provide fire insurance impairs the security of the deed of trust. It is a question of fact whether the lack of fire insurance impairs the security of the deed of trust." (181 *C.A.3d* 807, relying in part on cases dealing with the mortgagee's right to insurance proceeds, *infra*, §84.) (See 69 *A.L.R.3d* 774 [failure to keep up insurance as justifying foreclosure under acceleration provision].)

However, the result in *Freeman* was abrogated by the adoption of C.C. 2924.7 in 1988. A mortgage provision permitting acceleration for failure to pay insurance premiums, taxes, rents, assessments, or advances, as required by the mortgage "shall be enforceable whether or not impairment of the security interest in the property has resulted from the failure of the trustor or mortgagor to pay." (C.C. 2924.7(a).) (See 4 *Miller & Starr* 3d, §10:60; C.E.B., 2 *Mortgage and*

Deed of Trust Practice 3d, §8.52; *infra*, §84.)

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A. Reimbursement for Expenditures.
4. Impound Accounts.

4 Witkin Sum. Cal. Law STRP § 80

[§ 80] Impound Accounts.

To ensure that the mortgagor pays taxes (supra, §76) and insurance premiums (supra, §79) on the secured property, the mortgage may require the mortgagor to pay a monthly sum into an "impound" account from which the obligations are paid. (See 4 Miller & Starr 3d, §10:63; C.E.B., Real Estate Finance Practice, §§1.40, 1.88, 1.89; 13 Am.Jur. Legal Forms 2d, §179:296; on impound account payments as trust funds, see *Marsh v. Home Fed. Savings & Loan Assn.* (1977) 66 C.A.3d 674, 683, 136 C.R. 180, 13 Summary (10th), Trusts, §3.)

Impound accounts on mortgages are subject to federal and state legislation, much of which is applicable only to mortgages secured by residential property. The following are examples:

- (1) Impound accounts on federally related mortgage loans on one- to four-unit residential properties. (12 U.S.C., §2609.)
- (2) Impound account restrictions for mortgages secured by single-family, owner-occupied dwellings. (C.C. 2954(a); see *Kirk v. Source One Mortg. Services Corp.* (1996) 46 C.A.4th 483, 489, 54 C.R.2d 358 [where loan on single-family, owner-occupied home was not subject to mandatory impound account under C.C. 2954(a), account was voluntary and terminable at request of borrower, even though he initially signed form authorizing account].)
- (3) Maximum required deposits to and prohibited payments from impound accounts. (C.C. 2954.1.)
- (4) Interest required on impound accounts for nonfederally related mortgages on one- to four-unit residential properties. (C.C. 2954.8.)
- (5) Investment of impound account moneys. (C.C. 2955.)
- (6) Accounting and notice requirements. (See C.C. 2954(b), *infra*, §214.)

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B. Right to Condemnation Award.

4 Witkin Sum. Cal. Law STRP § 81

[§ 81] Right to Condemnation Award.

When mortgaged property is taken by eminent domain, provision must be made for the mortgagee's interest. (See *C.C.P. 1265.210* et seq.; 4 Miller & Starr 3d, §10:69; C.E.B., Mortgage and Deed of Trust Practice 3d, §8.62 et seq.; 8 *Summary* (10th), *Constitutional Law*, §1252.)

Condemnation of the entire mortgaged property in effect substitutes a money award for the security of the land mortgaged, and the mortgagee is ordinarily entitled to as much of the award as is necessary to satisfy the debt. (See *Sacramento & San Joaquin Drainage Dist. v. Truslow* (1954) 125 C.A.2d 478, 496, 270 P.2d 928.) If, however, the secured indebtedness is not due at the time the condemnation judgment is entered, the *condemnor* may elect to have the lien continue and the amount of the indebtedness deducted from the judgment. (*C.C.P. 1265.220*.)

Where only a portion of the property is taken, and there is no agreement to apportion, the mortgagee is entitled to share in the award only to the extent necessary to prevent an impairment of the security, and the lien continues on the property not taken. (*C.C.P. 1265.225*.) (On apportionment of award, see *Sacramento & San Joaquin Drainage Dist. v. Truslow*, *supra*; *American Savings & Loan Assn. v. Leeds* (1968) 68 C.2d 611, 616, 68 C.R. 453, 440 P.2d 933, *infra*, §197; *People v. Redwood Baseline, Ltd.* (1978) 84 C.A.3d 662, 685, 149 C.R. 11; see also *Milstein v. Security Pac. Nat. Bank* (1972) 27 C.A.3d 482, 486, 103 C.R. 16 [under certain mortgage clauses mortgagee may not be entitled to any proceeds where security is not impaired]; on partial taking of property encumbered by senior and junior liens, see *C.C.P. 1265.230*; 8 *Summary* (10th), *Constitutional Law*, §1251.)

The award cannot include a penalty for prepayment. (*C.C.P. 1265.240*.)

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C. Right to Insurance Proceeds.
1. Standard Provisions.

4 Witkin Sum. Cal. Law STRP § 82

[§ 82] Standard Provisions.

Mortgages commonly contain a clause permitting the mortgagee to apply insurance proceeds to any secured indebtedness and in any order, or, if the mortgagee elects, to release all or part of the proceeds to the mortgagor. (See *Rest.3d, Property (Mortgages) §4.7*; 4 Miller & Starr 3d, §10:61; C.E.B., 2 Mortgage and Deed of Trust Practice 3d, §8.56.)

The standard form of fire insurance policy also contains a provision on "Mortgagee interests and obligations," authorizing the mortgagee, on the insured's failure to make proof of loss, to do so himself or herself. (*Ins.C. 2071*.) (See 3 *Stanf. L. Rev.* 352 [whether mortgagee is bound by appraisal made by mortgagor and insurer pursuant to policy provisions]; 19 *A.L.R.4th* 778 [right of mortgagee who acquires title to mortgaged premises in satisfaction of mortgage, to recover under fire insurance policy covering him or her as "mortgagee"]; 10 *Am.Jur. Trials, Actions on Fire Insurance Policies* §7 et seq.; for comprehensive insurance provision, see 13 *Am.Jur. Legal Forms* 2d, §179:287.)

West's Key Number Digest, Mortgages k.201

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2. Lender Named as Loss Payee.

4 *Witkin Sum. Cal. Law STRP* § 83

[§ 83] Lender Named as Loss Payee.

In *Ziello v. Superior Court* (1995) 36 C.A.4th 321, 42 C.R.2d 251, the purchase money mortgage on plaintiff's home was secured by a deed of trust requiring plaintiff to maintain insurance against fire and other hazards. Although the deed of trust did not require her to obtain earthquake insurance, she obtained it from the same insurer providing fire insurance at her own expense. The insurer changed the original policy to include earthquake coverage, and, without consulting plaintiff, named the lender as a loss payee for the earthquake insurance. Plaintiff's home was seriously damaged in an earthquake. The following month she failed to make scheduled payments on her loan, and the lender recorded a notice of default. The insurer made out a check for the earthquake damage, jointly payable to plaintiff and the lender. Plaintiff brought suit, seeking a declaration that she had the exclusive right to the insurance proceeds. The trial judge granted summary judgment for the lender. *Held*, this was error.

(a) Because the policy did not require earthquake insurance, earthquake insurance was not a type of insurance described in that portion of the deed of trust requiring that insurance proceeds be applied to restoration or repair of the property damaged. (36 C.A.4th 327.) The fact that the lender was named as the loss payee on the policy did not determine its entitlement to the proceeds. A loss payable endorsement in an insurance policy defines the obligation of the insurer; it is intended to protect the insurer by permitting it to pay the named insured and to be thereafter free of claims by other persons who might have an interest in the property. The rights of the parties do not depend on the interpretation of the loss-payable clause of the policy. (36 C.A.4th 330.)

(b) Another portion of the deed of trust required the borrower to assign to the lender all sums received by judgment or settlement for injury to the property or in connection with the loan transaction. But this did not mean that plaintiff assigned her right to receive the benefits of her earthquake insurance policy. Payment on an insurance contract is not a judgment or settlement. (36 C.A.4th 329.)

(c) Likewise, the provision in the deed of trust requiring plaintiff to refrain from committing waste on the property did not give the lender direct access to the insurance proceeds. It simply provided a basis for suit should she breach this covenant and, under proper circumstances, for provisional and equitable relief. (36 C.A.4th 329.)

(d) "If, as borrower claims, the insurer unilaterally and erroneously named lender as loss payee of the earthquake insurance policy, that act does not create either a contractual or equitable right in lender to receive or control the

proceeds of that insurance. Instead it is borrower who would have an equitable claim to those proceeds. ... There is a material issue of fact on this question, and summary judgment should not have been granted as to this cause of action." (36 C.A.4th 330.) (See *Countrywide Home Loans v. Tutungi* (1998) 66 C.A.4th 727, 733, 78 C.R.2d 203 [having succeeded to borrowers' position as condominium unit owner and member of association on foreclosure after unit was damaged in earthquake, lender was entitled to share in insurance proceeds with other owner-members; distinguishing *Ziello*]; *Foothill Village Homeowners Assn. v. Bishop* (1999) 68 C.A.4th 1364, 1372, 1378, 81 C.R.2d 195 [distinguishing *Countrywide Home Loans* and applying *Ziello* to condominium owner who purchased assignments of defaulted loans on five other units in damaged complex but who never became owner of those units through nonjudicial foreclosure]; *Martin v. World Savings & Loan Assn.* (2001) 92 C.A.4th 803, 809, 112 C.R.2d 225 [distinguishing *Ziello* and *Foothill Village*; lender had right to control earthquake insurance proceeds where, although deed of trust did not require earthquake insurance, it did require lender to be named as loss payee if that insurance was obtained]; *JEM Enterprises v. Washington Mut. Bank* (2002) 99 C.A.4th 638, 645, 121 C.R.2d 458 [following *Martin*; deed of trust provided that lender had right to receive and control any insurance proceeds].)

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C. Right to Insurance Proceeds.
3. Security Need Not Be Impaired.

4 *Witkin Sum. Cal. Law STRP* § 84

[§ 84] Security Need Not Be Impaired.

(1) *Historical Development.* At one time, courts enforced provisions giving the mortgagee the right to determine the disposition of insurance proceeds. Thus, in *Lee v. Murphy* (1967) 253 C.A.2d 205, 61 C.R. 174, plaintiff made a \$ 78,000 note to S, trustee, for defendant M, beneficiary. A fire loss occurred, the insurer paid \$ 65,000, and defendant M used it to reduce the total indebtedness to \$ 13,000. Plaintiff, contending that it should have been kept and applied to maturing installments of the note as they became due, brought this action to restrain a foreclosure sale for default in the installments. This contention would have had merit in the absence of special provision in the deed of trust (253 C.A.2d 208), but the instrument expressly authorized application of the proceeds to the indebtedness. And, under this provision, there was no need to notify plaintiff of the manner of application, because on defendant's election the indebtedness was immediately extinguished pro tanto. (253 C.A.2d 210.) (See *Woody v. Lytton Savings & Loan Assn.* (1964) 229 C.A.2d 641, 648, 40 C.R. 560 [first mortgage or deed of trust may validly provide that insurance money may at option of mortgagee or beneficiary be applied on indebtedness, despite objection of holders of junior deeds of trust].)

Later cases limited the mortgagee's right to the proceeds. In *Schoolcraft v. Ross* (1978) 81 C.A.3d 75, 146 C.R. 57, a purchase money deed of trust on plaintiffs' home provided that (1) the trustor agreed to restore damaged property to protect the security, and (2) the beneficiary could apply fire insurance proceeds to the indebtedness or release them to the trustor. After a fire, plaintiff trustors elected to rebuild, and the insurance company made its check payable to them and defendant beneficiary; but defendant refused to allow the proceeds to be used for rebuilding. Plaintiffs, forced to rent living quarters, defaulted in payments on their note, and defendant instituted foreclosure proceedings and bought the property at the sale. Plaintiffs sued for damages and received a substantial award. *Held*, affirmed.

(a) "[T]he right of a beneficiary to apply insurance proceeds to the balance of a note secured by a deed of trust must be performed in good faith and with fair dealing." (81 C.A.3d 77.) This implied covenant of good faith and fair dealing is violated where the lender cuts off the borrower's right to use the insurance proceeds to rebuild unless the lender can show that his or her security would be impaired. (81 C.A.3d 80, citing the text and *Milstein v. Security Pac. Nat. Bank* (1972) 27 C.A.3d 482, 103 C.R. 16.)

(b) There was no evidence that the security was impaired by the fire or that plaintiffs were unwilling or unable to continue making payments. (81 C.A.3d 80.)

(c) The clauses in the deed must be construed to avoid unintended acceleration of the note. The parties intended that the purchase price would be paid in the ordinary course of events, and that plaintiffs would have the use of their home during the full period of the long-term loan. (81 C.A.3d 81.)

In *Kreshek v. Sperling* (1984) 157 C.A.3d 279, 204 C.R. 30, the issue was the proper apportionment of proceeds between a mortgagee and the mortgagor when the insured property was only partly destroyed, the mortgagor had no intent to rebuild, and, because the property had increased in value, the mortgagee's security interest had not been appreciably impaired. *Held*, the proceeds should be apportioned according to the extent that the mortgagee's security was impaired. (157 C.A.3d 282.)

(2) *Statutory Rule*. A deed of trust authorizing the beneficiary "to receive and control the disbursement of the proceeds of any policy of fire, flood, or other hazard insurance respecting the property shall be enforceable whether or not impairment of the security interest in the property has resulted from the event that caused the proceeds of the insurance policy to become payable." (C.C. 2924.7(b); see *Rest.3d, Property (Mortgages)* §4.8; C.E.B., 2 Mortgage and Deed of Trust Practice 3d, §8.57.)

The statute was not intended to abrogate the holding in *Schoolcraft* *supra*, "insofar as it provides that a lender may not prohibit the use of insurance proceeds for the restoration of the security property absent a showing that the lender's security interest in the property has been impaired." However, the intent was to abrogate the holdings in such cases as *Kreshek*, *supra*, and *Freeman v. Lind* (1986) 181 C.A.3d 791, 226 C.R. 515, *supra*, §79, "to the extent those holdings in any way restrict the right of a beneficiary or mortgagee under a deed of trust or mortgage on real property to enforce the express provisions of the deed of trust or mortgage." (Stats. 1988, Chap. 179, §3.)

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4 Witkin Sum. Cal. Law STRP § 85

[§ 85] Against Mortgagor.

The mortgagor, as legal owner of the property, may use it as he or she pleases (*Simpson v. Ferguson* (1896) 112 C. 180, 185, 40 P. 104, 44 P. 484), with one important qualification: If the use is so excessive or unreasonable as to amount to a destruction or such substantial impairment of the security as to make it inadequate, the mortgagee may recover damages, or, in a proper case, obtain an injunction. (See C.C. 2929; *Lavenson v. Standard Soap Co.* (1889) 80 C. 245, 247, 22 P. 184; *Easton v. Ash* (1941) 18 C.2d 530, 539, 116 P.2d 433 [mortgagor was liable in damages for removing timber, rendering security insufficient]; *Cornelison v. Kornbluth* (1975) 15 C.3d 590, 598, 599, 125 C.R. 557, 542 P.2d 981, *infra*, §197 [rule applies to deed of trust as well as to mortgage, and to grantee of mortgagor or trustor, whether or not grantee assumes mortgage debt]; *Sumitomo Bank v. Taurus Developers* (1986) 185 C.A.3d 211, 217, 229 C.R. 719, *infra*, §176 [full credit bid at trustee's sale bars mortgagee's action for impairment of security]; *Roos v. Kimmel* (1997) 55 C.A.4th 573, 596, 64 C.R.2d 177 [lender was entitled to full amount of note as damages for impairment of security where debtor delayed recording note for nearly 4 months while he further encumbered property, junior lienor foreclosed, and note included due on sale clause]; 4 *Miller & Starr* 3d, §10:53; C.E.B., 2 *Mortgage and Deed of Trust Practice* 3d, §8.63 *et seq.*; *Cal. Civil Practice*, 1 *Real Property Litigation*, §4:137 [complaint for waste impairing security], §4:138 [estoppel defense to waste claim]; 64 *Cal. L. Rev.* 1086 [mortgagee's remedies for waste; exhaustive discussion of traditional theories, covenants against waste, and desirable reforms]; *cf.* *Robinson v. Russell* (1864) 24 C. 467, 473 [recognizing rule but holding that no material injury to security was shown]; *Miller v. Waddingham* (1891) 91 C. 377, 381, 27 P. 750 [similar rule governs rights of vendor holding title as security for payment of purchase price]; on effect of anti-deficiency statute limiting mortgagee's rights after foreclosure, see *infra*, §197.) (On criminal liability for removal of fixtures, see P.C. 502.5; 2 *Cal. Crim. Law* (3d), *Crimes Against Property*, §20.)

The failure of a mortgagor or trustor to pay taxes constitutes waste within the meaning of C.C. 2929, although the anti-deficiency statute bars the holder of a purchase money deed of trust from bringing an action except for "bad faith waste." (*Osuna v. Albertson* (1982) 134 C.A.3d 71, 75, 79, 184 C.R. 338 [extended discussion of *Cornelison*]; *The Nippon Credit Bank v. 1333 North Calif. Boulevard* (2001) 86 C.A.4th 486, 495, 499, 103 C.R.2d 421 [following *Osuna*; lender may recover for waste when security is substantially impaired by trustor's bad faith failure to pay property taxes].)

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D. Remedies for Impairment of Security.
2. Against Third Person.

4 Witkin Sum. Cal. Law STRP § 86

[§ 86] Against Third Person.

(1) *In General.* A third party who, either in conjunction with the mortgagor or separately, so injures the property as to impair the mortgagee's security, may be held liable in damages or enjoined in a suit by the mortgagee. (*Lavenson v. Standard Soap Co.* (1889) 80 C. 245, 247, 22 P. 184 [suit by mortgagee, after foreclosure, against mortgagor and third party for removing fixtures]; *Easton v. Ash* (1941) 18 C.2d 530, 539, 116 P.2d 433 [foreclosure action, also seeking damages against mortgagor and third person for removal of timber]; *American Savings & Loan Assn. v. Leeds* (1968) 68 C.2d 611, 614, footnote 2, 68 C.R. 453, 440 P.2d 933, *infra*, §197; see 4 Miller & Starr 3d, §10:54; C.E.B., 2 Mortgage and Deed of Trust Practice 3d, §8.63 *et seq.*)

(2) *Action Based on Negligence.* In *U.S. Financial v. Sullivan* (1974) 37 C.A.3d 5, 112 C.R. 18, plaintiff lender (beneficiary under a trust deed) was held entitled to sue a developer for damages for negligence in construction of houses that were security for the loan.

(a) The argument that the right of action exists only for an intentional tort is unsound; general principles of tort law, e.g., the liability of contractors to purchasers of real property, and the doctrine of *Rowland v. Christian* (1968) 69 C.2d 108, 70 C.R. 97, 443 P.2d 561, 6 Summary (10th), *Torts*, §1086, support liability for negligence. And it was reasonably foreseeable that defendant's negligence would result in impairment of plaintiff's security. (37 C.A.3d 13.)

(b) The argument that the mortgagee or beneficiary cannot recover without first foreclosing the security is likewise unsound. C.C.P. 726 (*infra*, §111 *et seq.*) applies only where the action is against the mortgagor or his or her successor in interest. (37 C.A.3d 15, *citing the text.*) Where the defendant is a third-party tortfeasor the reason for the rule disappears. (37 C.A.3d 15.)

(c) Policy reasons also call for rejection of a foreclosure requirement: (1) Damage may be caused by a third party's negligence when the mortgage is not in default and foreclosure could not be had. (2) The requirement would result in a circuitry and multiplicity of actions. The mortgagee would foreclose against an innocent mortgagor, and the latter would sue the negligent tortfeasor. (37 C.A.3d 16.)

(d) There is no danger of double recovery against the negligent wrongdoer, or overlapping damages in separate actions by the mortgagee and mortgagor. Both may sue, and each is entitled only to the damages suffered by him or her.

Thus, in the instant case: (1) Plaintiff, holder of a second deed of trust, seeks recovery of its out-of-pocket losses incurred in performing repairs and corrective works; (2) the holder of the first deed of trust seeks recovery for impairment of the value of its security, which may be shown by comparing the value of the property before the injury and after the repairs made by plaintiff. Also, defendant can move to have both joined as necessary parties. (*37 C.A.3d 17.*) (See *64 Cal. L. Rev. 1130.*)

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E. Acceleration on Sale or Encumbrance.
1. In General.

4 Witkin Sum. Cal. Law STRP § 87

[§ 87] In General.

Mortgages and their underlying notes commonly give the mortgagee the right to accelerate the indebtedness on a default in paying a required installment of principal or interest or in performing an agreement in the mortgage. (See *Rest.3d, Property (Mortgages) §8.1*; 4 Powell §37.24; 4 Miller & Starr 3d, §10:106 et seq.; C.E.B., 2 Mortgage and Deed of Trust Practice 3d, §8.2 et seq.; Cal. Civil Practice, 1 Real Property Litigation, §4:58 [allegation of acceleration on default]; 55 *Am.Jur.2d (1996 ed.), Mortgages §488* et seq.; on mortgagor's right to cure default in payment, see *infra*, §216; on acceleration for failure to pay taxes, see *supra*, §76; on acceleration for failure to pay insurance premiums, see *supra*, §79; on clauses giving mortgagee right to insurance proceeds or condemnation award, which in effect provide for acceleration, see *supra*, §82 et seq.)

In addition to providing for acceleration on default, the instruments may permit acceleration at the option of the mortgagee if the borrower sells the property (see *infra*, §88 et seq.) or further encumbers it (see *infra*, §91). This kind of provision may be termed a "due on" clause, although the clause is generally referred to according to the particular triggering event; i.e., if the particular case involves a sale, it is called a "due on sale" clause, and if it involves an encumbrance, it is a "due on encumbrance" clause. (See *Tucker v. Lassen Savings & Loan Assn. (1974) 12 C.3d 629, 631*, footnote 1, 116 C.R. 633, 526 P.2d 1169, *infra*, §89.)

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E. Acceleration on Sale or Encumbrance.

2. "Due on Sale" Clause.

a. In General.

4 Witkin Sum. Cal. Law STRP § 88

[§ 88] In General.

A "due on sale" clause authorizes a mortgagee, at his or her election, to accelerate the entire loan balance on a conveyance of the property by the mortgagor. The provision gives the mortgagee some control over a transfer of the property and serves several objectives. Primarily, the provision is designed to protect the lender's security interest by maintaining the direct responsibility of the parties on whose credit the loan was made. And when interest rates are rising and money is tight, the due on sale clause also permits the lender to accelerate and obtain funds to loan at the current higher rates, or to waive acceleration in exchange for the new owner's agreement to pay an assumption fee or interest at an increased rate. (See *Rooz v. Kimmel* (1997) 55 C.A.4th 573, 597, 64 C.R.2d 177 [damages for impairment of security caused by foreclosure of second trust deed should not be reduced to present value of note when note includes due on sale clause; full amount of note was due and owing at time judgment was entered].)

Originally held valid, due on sale clauses came under judicial attack as restraints against alienation (infra, §89), which continued until federal law preempted state law and again made the clauses generally valid (see infra, §90). However, a mortgagee may waive the right to enforce the clause by failing to foreclose and accepting payments from the purchaser with knowledge and without a reservation of rights. (See *Rubin v. Los Angeles Fed. Savings & Loan Assn.* (1984) 159 C.A.3d 292, 298, 205 C.R. 455; 13 Summary (10th), *Equity*, §193.) (See generally 4 Miller & Starr 3d, §10:106; C.E.B., 2 Mortgage and Deed of Trust Practice 3d, §8.8 et seq.; C.E.B., 2 Real Property Sales Transactions 3d, §8.47 et seq.; Cal. Civil Practice, 1 Real Property Litigation, §4:59 [allegation of acceleration on sale], §4:60 [affirmative defense stating exception to lender's right to exercise due on sale option]; 69 A.L.R.3d 713 [validity, construction, and application of due on sale clauses]; 92 A.L.R.3d 822 [validity, construction, and effect of clause entitling mortgagee to increase interest rate on transfer of property]; 22 A.L.R.4th 1266 [what transfers justify acceleration under due on sale clauses]; 61 A.L.R.4th 1070 [validity of due on sale clauses].)

For obvious reasons, the borrower should be made aware of the clause. To be enforceable, a due on sale clause applicable to mortgages on one- to four-unit residential properties must be included "in its entirety in both the body of the deed of trust or mortgage and the promissory note or other document evidencing the secured obligation." (C.C. 2924.5; see *Fernandez v. American Savings & Loan Assn.* (1984) 159 C.A.3d 667, 672, 205 C.R. 707 [addendum to promissory note adequately apprised mortgagor; hence, "technical noncompliance with section 2924.5 did not render" clause invalid per se].)

SUPPLEMENT: [This section is current through the latest supplement]
See C.E.B., 2 Real Property Sales Transactions 4th, §9.49 et seq.



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E. Acceleration on Sale or Encumbrance.

2. "Due on Sale" Clause.

b. Validity of Clause: California Cases.

4 Witkin Sum. Cal. Law STRP § 89

[§ 89] Validity of Clause: California Cases.

(1) *Validity of Clause Initially Upheld.* Due on sale clauses, whether used to accelerate the indebtedness or to obtain assumption fees or higher interest rates, originally were held reasonable and not violative of the rule against restraints on alienation. (See *Coast Bank v. Minderhout* (1964) 61 C.2d 311, 316, 38 C.R. 505, 392 P.2d 265; *Hellbaum v. Lytton Savings & Loan Assn.* (1969) 274 C.A.2d 456, 458, 459, 79 C.R. 9; *Cherry v. Home Savings & Loan Assn.* (1969) 276 C.A.2d 574, 579, 580, 81 C.R. 135; 22 *Hastings L. J.* 431; 35 *So. Cal. L. Rev.* 475; 12 *U.C.L.A. L. Rev.* 954; 6 *U.S.F. L. Rev.* 283; for rule against restraints on alienation, see 12 *Summary* (10th), *Real Property*, §190.)

(2) *Invalid Clause: Tucker Case.* In *Tucker v. Lassen Savings & Loan Assn.* (1974) 12 C.3d 629, 116 C.R. 633, 526 P.2d 1169, the due on sale clause in an installment sales contract (see *supra*, §24) was held invalid.

(a) The relationship between the justification for a particular restraint and the *quantum* of restraint governs the courts' "consideration of the enforcement of a 'due-on' clause in particular circumstances: To the degree that enforcement of the clause would result in an increased quantum of actual restraint on alienation in the particular case, a greater justification for such enforcement from the standpoint of the lender's legitimate interests will be required." (12 C.3d 636.)

(b) In an installment sale, the clause is enforceable "only when the beneficiary-obligee can demonstrate a threat to one of his legitimate interests sufficient to justify the restraint on alienation inherent in its enforcement." Preserving the security from waste or depreciation is an example of an interest that might justify the restraint. (12 C.3d 639.)

(c) The lender's desire to maintain its portfolio at current interest rates may support a mild restraint where there is an outright sale; but "it lacks all force in the case of the serious and extreme restraint which would result from the automatic enforcement of 'due on' clauses in the context of installment land contracts." (12 C.3d 639, footnote 10.) (See 64 *Cal. L. Rev.* 573, 1112; 11 *Cal. Western L. Rev.* 578; 27 *Hastings L. J.* 475; 7 *Loyola L.A. L. Rev.* 306; 3 *Pepperdine L. Rev.* 111; 27 *Stanf. L. Rev.* 1109; 28 *U.C.L.A. L. Rev.* 197; 10 *U.S.F. L. Rev.* 665; 7 *West L.A. L. Rev.* 258; 8 *West L.A. L. Rev.* 57.)

(3) *Invalid Clause: Wellenkamp Case.* In *Wellenkamp v. Bank of America* (1978) 21 C.3d 943, 148 C.R. 379, 582

P.2d 970, involving an outright sale in which the purchaser agreed to assume the mortgage, the due on sale clause was also held invalid.

(a) *Quantum of restraint in outright sale.* A dictum in *Tucker* suggested that the restraint from an outright sale was minimal. But the term "outright" sale was used to refer to transactions in which the seller received full payment from the buyer, usually through new financing of the purchase; here the term is used in the broader sense of any sale by which legal title (and usually possession) is transferred. (21 C.3d 949, 950.) When economic conditions make new financing either unavailable or economically unfeasible, the parties will normally agree that the buyer will assume the seller's loan. In this situation, enforcement of the due on sale clause results in a substantial restraint on alienation:

(1) If the lender is unwilling to permit assumption of the loan, transfer of the property may be prohibited entirely. (21 C.3d 950.)

(2) Even if the lender is willing to waive its right in return for assumption of the loan at an increased interest rate, transfer may be inhibited. The buyer may insist that the seller lower the purchase price, and the seller would be forced to choose between lowering the price and absorbing the loss with the resulting reduction in his or her equity interest, or refusing to go through with the sale. (21 C.3d 950.)

(b) *Factors advanced in justification.*

(1) Defendant contends that the risk of waste and default is significant because both possession and legal title are transferred and the seller has neither incentive nor ability to avoid the risks. "Although we have previously distinguished on this basis both the junior encumbrance, where neither possession nor legal title was transferred (*La Sala*), and the installment land contract, where possession but not legal title was transferred (*Tucker*), we are now convinced that, although the original borrower/seller no longer retains an interest in the property after transfer of legal title in an outright sale involving no secondary financing by the seller ... this fact does not necessarily increase the risk to the lender that waste or default will occur." (21 C.3d 951.) The buyer, in paying off the seller's equity, may make a large down-payment on the property, which gives the buyer an incentive not to commit waste or permit depreciation; and the buyer may be at least as good, if not a better credit risk than the original borrower. (21 C.3d 952.) Thus, "although circumstances may arise in which the interests of the lender may justify the enforcement of a due-on clause in the event of an outright sale, the mere fact of sale is not in itself sufficient to warrant enforcement." (21 C.3d 952.)

(2) Defendant's contention that the lender's interest in maintaining its loan portfolio at current interest rates justifies the restraint is also rejected. "[W]e believe that exercise of the due-on clause to protect against this kind of business risk would not further the purpose for which the due-on clause was legitimately designed, namely to protect against impairment of the lender's security. ... Economic risks such as those caused by an inflationary economy are among the general risks inherent in every lending transaction. They are neither unforeseeable nor unforeseen." (21 C.3d 952.)

(c) *Conclusion.* "[A] due-on clause contained in a promissory note or deed of trust cannot be enforced upon the occurrence of an outright sale unless the lender can demonstrate that enforcement is reasonably necessary to protect against impairment to its security or the risk of default." (21 C.3d 953, disapproving *Hellbaum* and *Cherry*, and overruling, to the extent inconsistent, *Coast Bank*, *supra*.) (See 67 Cal. L. Rev. 886; 10 Golden Gate L. Rev. 851; 31 Hastings L. J. 275; 13 Loyola L.A. L. Rev. 559; 17 San Diego L. Rev. 1047; 7 San Fernando Valley L. Rev. 173; 19 Santa Clara L. Rev. 253; 20 Santa Clara L. Rev. 219; 28 U.C.L.A. L. Rev. 197; 13 U.S.F. L. Rev. 639.)

(4) *Post-Wellenkamp Decisions.* Although *Wellenkamp* involved residential property and was expressly limited to institutional lenders, *Dawn Inv. Co. v. Superior Court* (1982) 30 C.3d 695, 700, 703, 180 C.R. 332, 639 P.2d 974, concluded that the *Wellenkamp* rule applied to private ("noninstitutional") lenders and to commercial as well as residential property. (See *Pas v. Hill* (1978) 87 C.A.3d 521, 529, 151 C.R. 98 [due on sale clause was not enforceable against junior lienor who took deed in lieu of foreclosure]; *Wilhite v. Callihan* (1982) 135 C.A.3d 295, 298, 185 C.R. 215 [following *Dawn*]; *Department of Veterans Affairs v. Duerksen* (1982) 138 C.A.3d 149, 153, 187 C.R. 832 [

Wellenkamp is inapplicable to "Cal-Vet contracts" (*Mil. & Vet.C. 987.50 et seq.*); *West v. Buffo* (1983) 139 C.A.3d 93, 96, 188 C.R. 535 [*Dawn* followed in case of individual homeowner]; *Miranda v. Macias* (1983) 141 C.A.3d 188, 191, 191 C.R. 177 [*Dawn* is fully retroactive]; *Santa Clara Savings & Loan Assn. v. Pereira* (1985) 164 C.A.3d 1089, 1093, 211 C.R. 54 [window period loan (*infra*, §90); burden imposed by *Wellenkamp* on lender necessarily implies duty on purchaser to provide relevant credit information requested by lender, and purchaser's refusal to provide the information justified acceleration under due on sale clause].)

SUPPLEMENT: [This section is current through the latest supplement]



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2. "Due on Sale" Clause.
c. Federal Preemption.

4 *Witkin Sum. Cal. Law STRP* § 90

[§ 90] Federal Preemption.

(1) *U.S. Supreme Court Decision.* The question whether the *Wellenkamp v. Bank of America* (1978) 21 C.3d 943, 148 C.R.379, 582 P.2d 970 restrictions on enforcement of due on sale clauses (see *supra*, §89) applied to federally chartered savings and loan associations was for a time the subject of considerable controversy. (See 19 Cal. Western L. Rev. 161; 10 Loyola L.A. L. Rev. 629; 11 Pacific L. J. 1085; 14 Pacific L. J. 1; 20 San Diego L. Rev. 897; 17 U.S.F. L. Rev. 355.)

Panko v. Pan Amer. Fed. Savings & Loan Assn. (1981) 119 C.A.3d 916, 174 C.R. 240, held that California law was not preempted by the federal Home Owners' Loan Act and regulations adopted under it. But in *Fidelity Fed. Savings & Loan Assn. v. de la Cuesta* (1982) 458 U.S. 141, 102 S.Ct. 3014, 73 L.Ed.2d 664, reversing a decision of the California Court of Appeal, the Supreme Court held that the Federal Home Loan Bank Board regulation permitting federal savings and loan associations to use the due on sale clauses preempted and displaced California decisional rules as to those institutions. (See *Rubin v. Los Angeles Fed. Savings & Loan Assn.* (1984) 159 C.A.3d 292, 298, 205 C.R. 455 [due on sale rights of federally chartered institution were enforceable during period prior to *de la Cuesta*]; 19 Cal. Western L. Rev. 161; 35 Hastings L. J. 243; 14 Pacific L. J. 1; 15 Pacific L. J. 217; 23 Santa Clara L. Rev. 291; 23 Santa Clara L. Rev. 353; on preemption doctrine, see *supra*, §36; 7 Summary (10th), *Constitutional Law*, §8.)

(2) *Federal Garn Act.* Section 341 of the Garn-St. Germain Depository Institutions Act (12 U.S.C., §1701j-3), effective October 15, 1982, preempted state laws and, with certain exceptions, made due on sale clauses enforceable by all lenders. (See 4 Miller & Starr 3d, §10:108 et seq.; 35 Hastings L. J. 243; 20 San Diego L. Rev. 897; 23 Santa Clara L. Rev. 353; 17 U.S.F. L. Rev. 355; 61 A.L.R.4th 1070 [validity of due on sale clauses].) The following are its important provisions:

(a) *General rule of enforceability.* Notwithstanding state laws or judicial decisions to the contrary, a lender may enter into or enforce a due on sale clause in a real property loan in accordance with the terms of the loan contract. (12 U.S.C., §1701j-3(b)(1), (b)(2).) (For definition and scope of terms "due on sale clause," "lender," and "real property loan," see 12 U.S.C., §1701j-3(a)(1), (a)(2), (a)(3); 17 U.S.F. L. Rev. 359, 369.)

(b) *Compromise terms acceptable.* In exercising their option under due on sale clauses, lenders are encouraged to permit assumption of the loan at the existing contract rate or at a rate at or below the average between the contract and

market rates. (12 U.S.C., §1701j-3(b)(3); see 17 U.S.F. L. Rev. 418.)

(c) *Exception for "window period loans."* The Act created, subject to restrictions, a "window period" extending from the date of any state law or decision prohibiting the exercise of due on sale clauses until the date of enactment of the Garn Act (October 15, 1982). Due on sale clauses in loans made or assumed during the window period were not enforceable until after October 15, 1985, unless either a state law or a regulation of the Comptroller of the Currency or National Credit Union Administration Board provided otherwise. (12 U.S.C., §1701j-3(c).)

(d) *Restrictions on exercise of due on sale clause.* The Garn Act lists eight specific situations where due on sale clauses are not enforceable, e.g., the creation of subordinate encumbrances (see *infra*, §91) and various transfers between family members. And the Act confers on the Federal Housing Finance Board authority to designate other situations. (12 U.S.C., §1701j-3(d).) (On regulations limiting these restrictions to loans secured by owner-occupied residences, see 12 C.F.R., §591.5; 23 *Santa Clara L. Rev.* 382; 17 U.S.F. L. Rev. 425.)

(e) *Implementing rules and regulations.* These may be issued by the Federal Housing Finance Board, in consultation with the Comptroller of the Currency and the National Credit Union Administration Board. (12 U.S.C., §1701j-3(e)(1); see 12 C.F.R., §591.1 et seq.) Despite the restrictions on the enforceability of due on sale clauses, the Board may permit enforcement with respect to loans giving the borrower the right to *future income*. (12 U.S.C., §1701j-3(e)(2).)

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4 *Witkin Sum. Cal. Law STRP* § 91

[§ 91] "Due on Encumbrance" Clause.

(1) *In General.* A "due on" clause (supra, §87), in addition to providing for acceleration on the sale of the property (supra, §88 et seq.), may also provide for acceleration at the option of the mortgagee should the mortgagor *further encumber* the property, or an interest in it, or agree to do so without the beneficiary's written consent. (See *La Sala v. American Savings & Loan Assn.* (1971) 5 C.3d 864, 869, 97 C.R. 849, 489 P.2d 1113; 4 Miller & Starr 3d, §10:109.)

(2) *Invalid Clause: La Sala Case.* The per se validity of due on clauses was first successfully challenged in *La Sala*. This case distinguished the due on sale clause, which at that time was considered a valid restraint on alienation (supra, §89), from the due on encumbrance clause: The due on encumbrance clause is not invalid in the abstract, but its *application may be an invalid restraint*. The clause is valid and enforceable only where it is found as a fact that it is necessary for protection of the lender's security. (5 C.3d 881, 882.) (See *Pas v. Hill* (1978) 87 C.A.3d 521, 526, 151 C.R. 98 [*La Sala* applied to transfer to junior lienor in lieu of foreclosure]; 60 Cal. L. Rev. 960; 4 Pacific L. J. 567; 6 U.S.F. L. Rev. 280; 12 Summary (10th), Real Property, §190.)

(3) *California Statutory Limitation.* The *La Sala* doctrine prohibiting unrestricted enforcement of a due on encumbrance clause without a factual inquiry into its effect on the lender's security was codified in 1972 for a deed of trust or mortgage on "a single-family, owner-occupied dwelling." No default or acceleration may be declared "solely" by reason of further encumbering. (C.C. 2949(a); see 4 Pacific L. J. 567.) A "single-family, owner-occupied dwelling" is defined as a dwelling owned and occupied by the borrower within 90 days of the execution of the mortgage or deed of trust. (C.C. 2949(b).)

(4) *Federal Garn Act.* Section 341 of the Garn-St. Germain Depository Institutions Act (12 U.S.C., §1701j-3), which preempted state laws and, with certain exceptions, made due on sale clauses enforceable *by all lenders* (see supra, §90), defines the due on sale clause broadly enough to include encumbrances, but prohibits acceleration pursuant to the clause in a mortgage on residential real property with one to four units on "the creation of a lien or other encumbrance subordinate to the lender's security instrument which does not relate to a transfer of rights of occupancy in the property." (12 U.S.C., §1701j-3(d); see 4 Miller & Starr 2d, §9:88; 35 Hastings L. J. 243, 269.)

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F. Prepayment Charges.
1. Nature and Effect.

4 *Witkin Sum. Cal. Law STRP* § 92

[§ 92] Nature and Effect.

Mortgages and deeds of trust commonly allow the borrower to prepay the indebtedness, but impose a special charge to compensate the lender for administrative costs and lost interest. A prepayment clause may make a prepayment charge due, not only on the mortgagor's voluntary prepayment, but whether the prepayment is voluntary or involuntary, including prepayment effected by the holder's exercise of an acceleration clause. (*Pacific Trust Co. TTEE v. Fidelity Fed. Savings & Loan Assn.* (1986) 184 C.A.3d 817, 824, 229 C.R. 269 [clause bound junior lienor paying off senior mortgage]; see *Lazzareschi Inv. Co. v. San Francisco Fed. Savings & Loan Assn.* (1971) 22 C.A.3d 303, 307, 99 C.R. 417, *infra*, §93; *Golden Forest Properties v. Columbia Savings & Loan Assn.* (1988) 202 C.A.3d 193, 196, 248 C.R. 316 [in accordance with trust deed provisions, prepayment penalty was properly included in full credit bid at trustee's sale]; 4 *Miller & Starr* 3d, §10:97 et seq.; C.E.B., 2 *Mortgage and Deed of Trust Practice* 3d, §8.32 et seq.; 51 *Cal. L. Rev.* 923; 22 *Hastings L. J.* 431; 40 *U.C.L.A. L. Rev.* 851 [Mortgage Prepayment Clauses: An Economic and Legal Analysis]; 6 *U.S.F. L. Rev.* 291; 70 *A.L.R.2d* 1334 [construction of prepayment clause]; 86 *A.L.R.3d* 599 [effect of clause authorizing prepayment on interest due]; 81 *A.L.R.4th* 423 [prohibition against prepayment for fixed period of time].)

The charge has been sustained against challenges of usury (see 1 *Summary* (10th), *Contracts*, §512), void liquidated damages (see *Meyers v. Home Savings & Loan Assn.* (1974) 38 C.A.3d 544, 546, 113 C.R. 358; *Pacific Trust Co. TTEE v. Fidelity Fed. Savings & Loan Assn.*, *supra*; 1 *Summary* (10th), *Contracts*, §482), and restraint on alienation (see *Sacramento Savings & Loan Assn. v. Superior Court* (1982) 137 C.A.3d 142, 147, 186 C.R. 823 [validity not affected by *Wellenkamp v. Bank of America* (1978) 21 C.3d 943, 148 C.R. 379, 582 P.2d 970, *supra*, §89]; 12 *Summary* (10th), *Real Property*, §190.).

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2. Amount of Penalty.

4 Witkin Sum. Cal. Law STRP § 93

[§ 93] Amount of Penalty.

In *Lazzareschi Inv. Co. v. San Francisco Fed. Savings & Loan Assn.* (1971) 22 C.A.3d 303, 99 C.R. 417, the loan was for \$ 300,000. Plaintiff purchased from a court-appointed receiver, and defendant lender demanded the prepayment charge of \$ 9,130.02, computed in accordance with the schedule in the note. Plaintiff contended that the charge was unenforceable because it bore no reasonable relationship to the loss supposedly sustained by defendant, and that in the instant case it was exorbitant because interest rates had risen and defendant could make new loans with the recovered funds at a greater return; i.e., defendant actually profited from the early payment. *Held*, summary judgment for defendant affirmed.

(a) A dictum in *Hellbaum v. Lytton Savings & Loan Assn. of Calif.* (1969) 274 C.A.2d 456, 459, 79 C.R. 9, suggests that a palpably exorbitant charge might be deemed an illegal penalty, and that a court might inquire into the matter. (22 C.A.3d 308, 309.) However, the note must be examined not as an isolated instrument but as one of many transactions in the course of the lender's business. "There is, of course, the matter of expense in all of the activities which lead to the decision to make the loan on a particular basis. Moreover, there is the matter of possible loss of time between repayment of the funds and placing them on loan anew. It would be impossible to trace the exact funds from one loan to another. The repaid monies surely would be used, but until the expiration of such time as would ordinarily be necessary to complete the new loan or loans (not identifiable), the funds, as part of the loanable resources of the lending institution, must remain in competition, as it were, with other resources of the lender and with the resources of similar institutions, awaiting settlement upon an acceptable borrower." (22 C.A.3d 309.) Thus, the claim of exorbitancy is not to be resolved by "a simple calculation at any one point of time of the difference between the interest rate on the repaid loan and that which might be available to the lending institution on a new loan of about the same size made to a new borrower." (22 C.A.3d 309.)

(b) The prepayment schedule in the note followed that of the Federal Home Loan Bank Board regulation: not more than 6 months' advance interest on prepayments in any 12-month period exceeding 20% of the principal. This regulation, applied to a favored borrower (purchaser of a home), is a persuasive indication of reasonableness of the clause in the note involved in this case. (22 C.A.3d 309, 310.)

The dicta in *Hellbaum* and *Lazzareschi* were limited in *Williams v. Fassler* (1980) 110 C.A.3d 7, 167 C.R. 545, where the court observed that no California case had invalidated an option-type prepayment penalty clause for

unreasonableness. (110 C.A.3d 12.) In *Williams*, a private lender, to protect himself against high tax liability from a large payment, specified a 50% prepayment penalty in the contract. Pointing out that *Lazzareschi* and *Hellbaum* dealt with commercial lenders, the court held that "in a transaction between private parties, an agreement specifying a 50 percent prepayment penalty is valid if the penalty is reasonably related to the obligee's anticipated risk of incurring increased tax liability upon the occurrence of the prepayment." (110 C.A.3d 13.) (See *Pacific Trust Co. TTEE v. Fidelity Fed. Savings & Loan Assn.* (1986) 184 C.A.3d 817, 823, 229 C.R. 269; *Biancalana v. Fleming* (1996) 45 C.A.4th 698, 701, 702, 53 C.R.2d 47 [prepayment clause providing that, if more than 15% above yearly total principal payments were made in any 1 year, "payor agrees to pay the additional income tax created by all excessive monies so paid," was enforceable where obligor defaulted and obligee accelerated].)

However, in *Ridgley v. Topa Thrift & Loan Assn.* (1998) 17 C.4th 970, 73 C.R.2d 378, 953 P.2d 484, 1 Summary (10th), *Contracts*, §512, the court held that a prepayment charge of 6 months' interest on the entire principal if any payment had been late or if plaintiffs defaulted on any other contractual obligation was not a reasonable attempt to anticipate the losses to be suffered by the lender from prepayment of the loan and was an unenforceable penalty. (17 C.4th 981.)

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3. Restrictive Legislation.

4 Witkin Sum. Cal. Law STRP § 94

[§ 94] Restrictive Legislation.

(1) *Federal Statutes.* Regulations of the Office of Thrift Supervision, which govern home loans by federally chartered savings and loans and preempt conflicting state law, permit imposition of a fee for prepayment of a loan, subject to the terms of the loan contract. (12 C.F.R., §560.34; see *Pacific Trust Co. TTEE v. Fidelity Fed. Savings & Loan Assn.* (1986) 184 C.A.3d 817, 821, 822, 229 C.R. 269; on federal preemption, see *supra*, §36.) However, regulations issued pursuant to the Garn Act and applicable to all lenders (*supra*, §90) prohibit imposition of a prepayment penalty in connection with exercise of a due on sale clause. (12 C.F.R., §591.5(b)(2).)

(2) *California Statutes.* The following statutes regulate the right to repay and the collection of prepayment fees under California statutes:

(a) *Right To Prepay.* Except as otherwise provided by statute, the borrower on a one- to four-unit residential property has an *absolute right to prepay*. The prepayment may be made at any time, of the whole or any part of the balance due, together with accrued interest. (C.C. 2954.9(a)(1) [conventional loan]; C.C. 2954.11(b) [installment loan].)

(b) *Prepayment Charge.* A prepayment charge may be made if there is a *written* agreement for the charge. (C.C. 2954.9(a)(2); C.C. 2954.11(b)(2) [no prepayment charge may be collected if prepayment is made in conjunction with sale of real property securing installment loan].)

(c) *Exception for Same Calendar Year.* An income-tax oriented exception to C.C. 2954.9 makes it inapplicable to the *calendar year* of a purchase money mortgage or deed of trust given back to the seller by the purchaser on account of the purchase price where the seller takes back less than four instruments in that calendar year. However, prepayment may still be made by written agreement with the lender. (C.C. 2954.9(a)(3); see *Donahue v. Le Vesque* (1985) 169 C.A.3d 620, 628, 215 C.R. 388, citing the text [C.C. 2954.9 only applies during calendar year of sale; after that, loan may be prepaid as provided in C.C. 2954.9(a)(1)].)

(d) *Owner-Occupied Buildings.* Special provisions apply to loans secured by small *owner-occupied* buildings. If the secured real property contains only a *single-family*, owner-occupied dwelling, *B. & P.C. 10242.6* applies and permits limited prepayment penalties during the 7 years following execution of the mortgage or deed of trust. For other owner-occupied residential real property containing four units or less, the applicable statutes are C.C. 2954.9(b)

(conventional note) and C.C. 2954.11(b) (installment loan), and limited prepayment penalties are permitted only during the 5 years following the execution of the mortgage or deed of trust. Under all of these statutes, prepayment penalties may be imposed only on prepayments exceeding 20% of the original principal amount during any 12-month period, and the charge cannot exceed "an amount equal to the payment of six months' advance interest" on the excess amount prepaid. (See *Garver v. Brace* (1996) 47 C.A.4th 995, 1002, 55 C.R.2d 220 [property was owner-occupied and residential within meaning of C.C. 2954.9(b), where it was unimproved at time of sale, but purchase contract and deed of trust obligated buyers to complete construction of single-family house on it within 1 year, and where, by time prepayment fee became issue, it was owner-occupied residential real property under any definition]; on prohibition against charging prepayment penalty where dwelling damaged by natural disaster for which state of emergency has been declared, see *B. & P.C. 10242.6(b)*, C.C. 2954.9(c), C.C. 2954.11(d).)

(e) *Acceleration of Loan*. A lender who, pursuant to contract, accelerates the maturity date of a loan on conveyance of any right, title, or interest in the secured property may not collect a prepayment charge. However, the statute does not apply to a loan (other than one secured by residential real property containing one to four units) in which the debtor has expressly waived the right to prepay without penalty or has expressly agreed to a prepayment penalty on acceleration. (C.C. 2954.10.)

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Witkin Summary of California Law IV. RIGHTS AND OBLIGATIONS OF MORTGAGEE

G. Right to Possession, Rents, and Profits.

1. In Absence of Express Agreement.

a. In General.

4 Witkin Sum. Cal. Law STRP § 95

[§ 95] In General.

In lien theory jurisdictions, the mortgagee is not entitled to possession of the property or to rents from the property except by agreement or through foreclosure or sale and purchase. (See C.C. 2927, 2920, 2923; *Freeman v. Campbell* (1895) 109 C. 360, 362, 42 P. 35; *Snyder v. Western Loan & Bldg. Co.* (1934) 1 C.2d 697, 701, 37 P.2d 86; *Lee v. Ski Run Apartments Associates* (1967) 249 C.A.2d 293, 297, 57 C.R. 496; *Turner v. Superior Court* (1977) 72 C.A.3d 804, 812, 140 C.R. 475 [without express agreement, court-appointed receiver may not collect rents]; 4 Miller & Starr 3d, §10:46; C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §6.1; 4 Powell §§37.25, 37.26; 54A Am.Jur.2d (1996 ed.), *Mortgages* §178.)

However, even in the absence of an express agreement, a mortgagee may become a "mortgagee in possession," as follows:

(1) The mortgagee may take possession with the implied consent or acquiescence of the mortgagor. (See *Cory v. Santa Ynez Land & Imp. Co.* (1907) 151 C. 778, 782, 91 P. 647.)

(2) The mortgagee may obtain possession, in good faith, without consent, but without wrongful act; e.g., the mortgagee (or a purchaser) may buy at an irregular foreclosure sale. (See *Burns v. Hiatt* (1906) 149 C. 617, 623, 87 P. 196.)

A mortgagee in possession is subject to certain special rules. (See *infra*, §§102, 103.) And where the rights of third persons are concerned, and the problem is one of priorities, the possession must be open and visible, so as to give notice. (See *Bank of America v. Bank of Amador County* (1933) 135 C.A. 714, 721, 28 P.2d 86, *supra*, §66.) (See C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §6.3 et seq.)

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1. In Absence of Express Agreement.
b. Rent Skimming.

4 *Witkin Sum. Cal. Law STRP* § 96

[§ 96] Rent Skimming.

C.C. 890 et seq. give certain mortgagees protection against "rent skimming." (See *18 Pacific L. J.* 716.)

(1) *Definitions.* "Rent skimming" means "using revenue received from the rental of a parcel of residential real property at any time during the first year period after acquiring that property without first applying the revenue or an equivalent amount to the payments due on all mortgages and deeds of trust encumbering that property." (C.C. 890(a)(1).) The term also means "receiving revenue from the rental of a parcel of residential real property where the person receiving that revenue, without the consent of the owner or owner's agent, asserted possession or ownership of the residential property, whether under a false claim of title, by trespass, or any other unauthorized means, rented the property to another, and collected rents from the other person for the rental of the property." (C.C. 890(a)(2).) (See C.C. 890(b) [defining "multiple rent skimming"].)

(2) *Who May Bring Action.* Purchase money mortgagees, sellers who reacquire property that has been the subject of rent skimming, mortgagees (if the seller has engaged in multiple rent skimming), and tenants required to move by a foreclosure, all may bring actions for rent skimming. (C.C. 891.)

(3) *Criminal Prosecution.* A person engaging in multiple acts of rent skimming is subject to criminal prosecution. (C.C. 892; see *People v. Bell* (1996) 45 C.A.4th 1030, 1042, 53 C.R.2d 156, 2 Cal. Crim. Law (3d), *Crimes Against Property*, §234 [defining elements of criminal rent skimming, and holding that statute is constitutional and violation requires only general intent].)

(4) *Affirmative Defense.* It is an affirmative defense to a civil or criminal action if the rental revenue was used within 30 days of receipt to pay for unforeseen and necessary medical expenses or to correct statutory violations with respect to the property, and the defendant had no other source of funds. (C.C. 893.) (See 4 Miller & Starr 3d, §10:62.)

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2. Under Rents and Profits Agreement.

a. Former Law: Distinction Between Absolute Assignment and Pledge as Additional Security.

1. In General.

4 Witkin Sum. Cal. Law STRP § 97

[§ 97] In General.

In *Kinnison v. Guaranty Liquidating Corp.* (1941) 18 C.2d 256, 115 P.2d 450, the mortgagor, who was in default, assigned all rents and profits from the secured property to plaintiff mortgagee, and made a separate agreement to collect the rentals on his behalf. Defendant, a judgment creditor of the mortgagor with knowledge of the assignment and the collection agreement, levied on the mortgagor's account in which the rents were kept. The trial judge ruled that plaintiff had a prior right to the rentals. *Held*, affirmed.

(a) "Whether the agreement ... is incorporated in the mortgage or deed of trust or whether it is in the form of a separate instrument is not controlling; the decisive question is whether the parties contemplated an assignment of the rentals or merely a pledge of the rentals for security purposes." (18 C.2d 262.)

(b) If the agreement merely pledges the rents as additional security, "the mortgagee must actually acquire possession of the mortgaged property by consent or lawful procedure or must secure the appointment of a receiver in order to perfect his claim to the rents." (18 C.2d 261.)

(c) If, however, the agreement provides that in the event of default the rents are assigned absolutely to the mortgagee, the provision "operates to transfer to the mortgagee the mortgagor's right to rentals upon the happening of the specified condition." (18 C.2d 261.)

(d) In this case, plaintiff held an absolute assignment. The agreement was phrased as a complete transfer of the mortgagor's interest in the rentals, and it contained no provision giving the mortgagor the right to enjoy the rentals or to regain the right to the rentals by curing the default. Hence, the assignment to plaintiff prevented defendant from seizing the rentals under its subsequent levy of execution. And the fact that the rents were in an account in the name of the mortgagor, who collected them as agent for plaintiff, did not give the mortgagor any interest in them subject to levy. (18 C.2d 262.) (See C.E.B., Real Estate Finance Practice, §§4.17 et seq., 5.1 et seq.)

West's Key Number Digest, Mortgages k.199

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2. Under Rents and Profits Agreement.

a. Former Law: Distinction Between Absolute Assignment and Pledge as Additional Security.

2. Absolute Assignment.

4 Witkin Sum. Cal. Law STRP § 98

[§ 98] Absolute Assignment.

(1) *In General.* As recognized in *Kinnison v. Guaranty Liquidating Corp.* (1941) 18 C.2d 256, 115 P.2d 450, *supra*, §97, an absolute assignment of rents may be made by a special provision in the mortgage, or by a separate agreement either before or after the mortgagor's default. However, when the assignment was made prior to default, it might have been construed as merely a pledge for additional security unless assignment was the clearly expressed intent. (See *Snyder v. Western Loan & Bldg. Co.* (1934) 1 C.2d 697, 702, 37 P.2d 86; *Title Guarantee & Trust Co. v. Monson* (1938) 11 C.2d 621, 627, 81 P.2d 944; *Childs Real Estate Co. v. Shelburne Realty Co.* (1943) 23 C.2d 263, 268, 143 P.2d 697 [absolute assignment is "enforced only when it is the clearly expressed intention of the parties"]; 4 Miller & Starr 3d, §10:47; 31 *Hastings L. J.* 1433, 1453 [discussing federal case applying California law and upholding clause against claim of bankruptcy trustee].)

While *Kinnison* indicated that an absolute assignment operated to transfer the right to rents to the mortgagee on the "happening of the specified event," i.e., on *default*, the courts have held that the mortgagee was entitled to the rents only from the date of his or her *demand*. Thus, in *Mortgage Guarantee Co. v. Sampsell* (1942) 51 C.A.2d 180, 124 P.2d 353, a deed of trust contained a rents and profits clause providing that the mortgagee was entitled, "without notice," to take possession of the property, collect the rents, and apply them to the secured indebtedness in the "event of any breach or default" by the mortgagor. Following the mortgagor's default, the mortgagee demanded possession and the rentals. When the demand was ignored, the mortgagee brought this action to enforce the assignment, and obtained the appointment of a receiver who collected the rents, including rents that had accrued prior to the mortgagor's default. The mortgagor was subsequently declared bankrupt, and the bankruptcy trustee claimed that the bankruptcy estate rather than the mortgagee was entitled to rents that had accrued prior to the receiver's appointment. *Held*, the mortgagee could not claim rents as far back as the time of the mortgagor's default, but was entitled to all accruing after *demand for possession and rents*, even though the receiver was not yet appointed or in possession. (51 C.A.2d 187.) (See *Title Guarantee & Trust Co. v. Monson* (1938) 11 C.2d 621, 81 P.2d 944; 31 *Hastings L. J.* 1433.)

The main feature that distinguished an absolute assignment from a pledge or assignment for additional security was that the mortgagee's right to the rents did not depend on possession. But while possession was not necessary to perfect

the lien, *open and visible* possession, or other notice, was probably necessary to succeed against an adverse claim resulting from detrimental reliance on the mortgagor's possession. (See *Bank of America v. Bank of Amador County* (1933) 135 C.A. 714, 721, 28 P.2d 86, supra, §66.)

(2) *Former Statutory Law.* Former C.C. 2938, added in 1991 and repealed in 1996, continues to govern contracts entered into before January 1, 1997, and actions and proceedings arising from those contracts. (C.C. 2938(i).) The statute was deemed to be declaratory of existing law. (Stats. 1991, Chap. 501, §2.) It provided that a written assignment of interest in rents, issues, and profits of real property, made in connection with a loan secured by real property and stating that it was absolute, constituted a present transfer of the assignor's interest in existing and future rents, issues, and profits. The transfer was effective on the assignor's execution and delivery of the assignment. (Former C.C. 2938(a).)

An assignment under former C.C. 2938(a), whether in a separate document or part of a mortgage or deed of trust, could be recorded with the county recorder of the county where the real property was located. When recorded in accordance with the methods, procedures, and requirements for recording conveyances of other interests in real property: (a) the assignment gave constructive notice of the content and effect of the assignment with the same force and effect as any other duly recorded conveyance of an interest in real property; and (b) the interest granted by the assignment was perfected as of the date of recordation, notwithstanding any provision of the assignment or law that would preclude or defer enforcement of the rights granted until the occurrence of a subsequent event, including a subsequent default of the assignor. (Former C.C. 2938(b).) (See *MDFC Loan Corp. v. Greenbrier Plaza Partners* (1994) 21 C.A.4th 1045, 1050, 26 C.R.2d 596 [under former C.C. 2938, lender who recorded trust deed with absolute assignment of rents clause obtained present and protected transfer of income effective on borrower's default]; *Federal Nat. Mortg. Assn. v. Bugna* (1997) 57 C.A.4th 529, 540, 67 C.R.2d 233, citing the text [enactment of former C.C. 2938 did not alter existing law requiring lender holding perfected security interest in rents to take some form of enforcement step to terminate borrower's right to postdefault rents; distinguishing *MDFC Loan Corp.*]; 31 *Loyola L.A. L. Rev.* 1453 [*Bugna*].) (For current statute, see *infra*, §100.)

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a. Former Law: Distinction Between Absolute Assignment and Pledge as Additional Security.

3. Assignment as Additional Security.

4 *Witkin Sum. Cal. Law STRP* § 99

[§ 99] Assignment as Additional Security.

(1) *In General.* If a rents and profits clause was interpreted as a pledge of the rents and profits as additional security, the mortgagee was not entitled to rents until he or she had perfected a lien by acquiring lawful possession of the property. The mortgagee could acquire possession with the acquiescence or consent of the mortgagor, either personally or by an agent, or by an action to enforce the pledge, in which case the mortgagee could seek possession through a court-appointed receiver (see *infra*, §101). Until the mortgagee perfected the lien, the rents belonged to the party that lawfully collected them, i.e., the mortgagor, a successor, or a junior lienor with a perfected lien on the rents. Once the mortgagee acquired possession of the property, he or she was entitled to all rents he or she thereafter collected. (See *Carlton v. J.G. Ruddle Properties* (1934) 2 C.2d 17, 38 P.2d 149 [senior lienor failed to intervene in junior lienor's action; junior lienor was entitled to rents collected by receiver]; *Kinnison v. Guaranty Liquidating Corp.* (1941) 18 C.2d 256, 261, 115 P.2d 450, *supra*, §97; *Childs Real Estate Co. v. Shelburne Realty Co.* (1943) 23 C.2d 263, 269, 143 P.2d 697 [once perfected by lawful possession, assignment of rents as additional security attached "to all accrued and uncollected rents"]; *Malsman v. Brandler* (1964) 230 C.A.2d 922, 925, 41 C.R. 438; *Santacroce Bros. v. Edgewater-Santa Clara* (1966) 242 C.A.2d 584, 588, 51 C.R. 613 [appointment of receiver]; *Lee v. Ski Run Apartments Associates* (1967) 249 C.A.2d 293, 297, 57 C.R. 496; 4 Miller & Starr 3d, §10:47.)

If the mortgagee takes possession personally or through an agent, the duties of a mortgagee in possession will apply (see *infra*, §102), but not if possession is obtained through a court-appointed receiver. (*Tourny v. Bryan* (1924) 66 C.A. 426, 431, 226 P. 21 [receiver appointed by court, not agent of mortgagee who sought his appointment]; see 4 Miller & Starr 3d, §10:46.)

(2) *Former Statutory Law.* Former C.C. 2938.1, added in 1992 and repealed in 1996, continues to govern contracts entered into before January 1, 1997, and actions and proceedings arising from those contracts. (C.C. 2938(i); for current statute, see *infra*, §100.) The statute allowed assignments of rents, issues, and profits given as additional security to be perfected by recordation. It provided as follows:

(a) Recordation alone would perfect the assignment; the beneficiary or mortgagee was not required to obtain possession of the real property, appoint a receiver, or take any other action. (Former C.C. 2938.1(a).) However, the beneficiary or mortgagee could not exercise any rights to collect the rents, issues, or profits until the trustor or mortgagor was in default of its obligation. (Former C.C. 2938.1(b).)

(b) Assignments as additional security could be contained in mortgages, deeds of trust, or other recorded instruments. (Former C.C. 2938.1(c).) The instrument granting the assignment was required to be recorded in the county where the real property was located. (Former C.C. 2938.1(a).)

(c) Former C.C. 2938.1 applied only to assignments executed on or after January 1, 1993, and did not invalidate assignments perfected by other means before that date. The statute did not apply to absolute assignments under former C.C. 2938 (supra, §98). (Former C.C. 2938.1(d).)

SUPPLEMENT: [This section is current through the latest supplement]



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2. Under Rents and Profits Agreement.

b. Distinction Abolished.

4 Witkin Sum. Cal. Law STRP § 100

[§ 100] Distinction Abolished.

(1) *In General.* C.C. 2938, added in 1996, replaces former C.C. 2938 and 2938.1 (see *supra*, §§98, 99). The statute does away with the distinction between absolute assignments of rent from real property and those given as additional security. It applies to contracts entered into on or after January 1, 1997. Contracts entered into before that date are governed by former C.C. 2938 and 2938.1 (*supra*, §§98, 99). (C.C. 2938(i).) (See 4 Miller & Starr 3d, §10:48 et seq.; 28 *Pacific L. J.* 939.)

(2) *Assignment as Additional Security.* No matter how it is described, a "written assignment of an interest in leases, rents, issues, or profits of real property made in connection with an obligation secured by real property" creates "a present security interest in existing and future leases, rents, issues, or profits of that real property." (C.C. 2938(a).)

(3) *Recordation.* Whether the assignment is in a separate document or is part of a mortgage or deed of trust, it may be recorded like any other real property conveyance. Recordation gives constructive notice of the assignment's contents and fully perfects the interest created by the assignment, notwithstanding any law or provision in the assignment that would otherwise preclude or defer enforcement of the rights granted. (C.C. 2938(b).)

(4) *Enforcement.* The assignee is entitled, on default, to all rents, issues, and profits that have accrued but not yet been paid, and all rents, issues, and profits that accrue on or after the date of default. (C.C. 2938(c).) The assignee can enforce this entitlement in one or more of four different ways:

(a) Appointment of a receiver. (C.C. 2938(c)(1).)

(b) Obtaining possession of the rents, issues, or profits. (C.C. 2938(c)(2).)

(c) Delivery to the tenants of a written demand for a "turnover of rents, issues, and profits" with a copy *delivered* to the assignor and *mailed* to each other assignee. (C.C. 2938(c)(3); see C.C. 2938(k) [form for demand].)

(d) Delivery of a written demand to the assignor, with a copy *mailed* to each other assignee. (C.C. 2938(c)(4).)

Except for amounts required to be paid toward maintaining the property (see *infra*, this section), the assignee must

apply the amount received to the debt or as required by the assignment or debt instrument. However, neither application of, nor failure to apply, the amount received (a) results in the loss of any lien or security interest in the underlying real property, (b) renders the obligation unenforceable, (c) constitutes a violation of the one-action rule of C.C.P. 726 (see *infra*, §124), or (d) otherwise limits the assignee's rights regarding the security. (C.C. 2938(c).)

If an assignee who was first to record takes steps to enforce its interest after a later assignee has already done so, the first assignee is entitled only to rents, issues, and profits that are accrued and unpaid as of the date of the first assignee's enforcement action and to rents, issues, and profits that accrue from that date forward. (C.C. 2938(h).)

(5) *Tenant's Obligation*. On receipt of a written demand, signed by the assignee under penalty of perjury, the tenant must comply unless it has already received a written demand, "valid on its face," from another assignee, or unless, "in good faith and in a manner which is not inconsistent with the lease," the tenant has already paid the rent to the assignor or pays it to the assignor within 10 days after receipt of the demand notice. Payment of rent to the assignee in accordance with the statutory requirements satisfies the tenant's obligations under the lease; if, in violation of these requirements, the tenant pays the assignor instead, the tenant is not relieved of the obligation to pay the assignee (unless the tenant is a residential occupant). The obligation to pay the assignee continues until the tenant receives a notice from the court directing otherwise or a written notice of cancellation from the assignee. (C.C. 2938(d).)

(6) *Consequences of Enforcement*. Under C.C. 2938(e), the application of sums received by the assignee satisfies the secured obligation to the extent of those sums. The sums received must also be credited against any amounts needed to cure default for purposes of reinstatement under C.C. 2924c (see *infra*, §216). However, enforcement *does not* do the following:

(a) Make the assignee a "mortgagee in possession" (unless the assignee obtains actual possession; see *supra*, §95) or an agent of the assignor. (C.C. 2938(e)(1).)

(b) Call the one-action rule into play so as to limit the assignee's rights with respect to the security. (C.C. 2938(e)(2).)

(c) Result in loss of the right to a deficiency judgment. (C.C. 2938(e)(3).)

(7) *Right to Cash Proceeds*. If the assignee has pursued enforcement by delivering a written demand to the tenants or assignor under C.C. 2938(c), *supra*, and the assignor or its agent has nevertheless received cash proceeds to which the assignee is entitled, those proceeds must be immediately turned over to the assignee, less any amount to be used for expenses as authorized in writing by the assignee. The assignee may bring an action to enforce this right, without foreclosing on the security interest or invoking the bar of the one-action rule. As against any third person and subject to C.C. 2938(h), *supra*, the assignee has a continuously perfected security interest in the cash proceeds to the extent they are identifiable. The proceeds are identifiable if they are segregated or, if not segregated, if they are traceable under the lowest intermediate balance principle. (C.C. 2938(f).)

(8) *Maintenance Expenses, Taxes, and Insurance*. Once an assignee exercises its enforcement right by means other than appointment of a receiver, the assignor or any other assignee may make a written demand on the assignee to pay "the reasonable costs of protecting and preserving the property, including payment of taxes and insurance and compliance with building and housing codes, if any." On receiving this demand, the assignee must comply, but compliance does not make the assignee a "mortgagee in possession," and he or she is not required to operate or manage the property. The assignee's obligation to pay protection and preservation costs continues until he or she obtains appointment of a receiver or ceases to enforce the assignment. (C.C. 2938(g).)

SUPPLEMENT: [This section is current through the latest supplement]

(5) *Tenant's Obligation*. In 2008, C.C. 2938(d) was amended to change *which* to *that* in the language quoted in the text.



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c. Receiver.

4 Witkin Sum. Cal. Law STRP § 101

[§ 101] Receiver.

A receiver may be appointed only as permitted by *C.C.P. 564*. (*Barclays Bank of Calif. v. Superior Court* (1977) 69 C.A.3d 593, 597, 137 C.R. 743 [court had jurisdiction to appoint receiver under *C.C.P. 564(7)* (now *C.C.P. 564(b)(8)*), the "usages of courts of equity" provision, without proof of inadequacy of security]; see *Santacroce Bros. v. Edgewater-Santa Clara* (1966) 242 C.A.2d 584, 588, 51 C.R. 613; 4 Miller & Starr 3d, §10:52; 82 A.L.R.2d 1075 [appointment of receiver during foreclosure action]; on limited possession and power of rents and profits receiver, see *Turner v. Superior Court* (1977) 72 C.A.3d 804, 140 C.R. 475, 6 Cal. Proc. (4th), *Provisional Remedies*, §452; on appointment of receiver generally, see 6 Cal. Proc. (4th), *Provisional Remedies*, §420 et seq.) The statute also authorizes appointment of a receiver in the following circumstances:

(1) In a foreclosure action when the security is inadequate or in jeopardy, or for lack of performance of a condition. (*C.C.P. 564(b)(2)*; see 6 Cal. Proc. (4th), *Provisional Remedies*, §427.)

(2) "In an action by a secured lender for specific performance of an assignment of rents provision in a deed of trust, mortgage, or separate assignment document." The appointment may be continued after entry of judgment for specific performance, if appropriate to protect, operate, or maintain the encumbered property or collect rents while a nonjudicial foreclosure is being completed. (*C.C.P. 564(b)(11)*.)

(3) "In a case brought by an assignee under an assignment of leases, rents, issues, or profits" under C.C. 2938(g) (see *supra*, §100). (*C.C.P. 564(b)(12)*.)

SUPPLEMENT: [This section is current through the latest supplement]
Turner case:

Cross-Reference: 6 Cal. Proc. (5th), *Provisional Remedies*, §456.

Appointment of receiver generally:

Cross-Reference: 6 Cal. Proc. (5th), *Provisional Remedies*, §423 et seq.

Foreclosure action:

Cross-Reference: 6 Cal. Proc. (5th), *Provisional Remedies*, §430.



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3. Mortgagee in Possession.

a. Duties of Mortgagee in Possession.

4 Witkin Sum. Cal. Law STRP § 102

[§ 102] Duties of Mortgagee in Possession.

(1) *Duty To Account for Rents and Profits.* The mortgagee in possession may collect rents and profits, but these must be applied to the debt, and consequently he or she must account for them to the mortgagor. The mortgagee has also a duty to make reasonable efforts to produce rents or profits, but is not held to the strict accountability of a trustee. (See *Murdock v. Clarke* (1891) 90 C. 427, 438, 27 P. 275; *Cowdery v. London & San Francisco Bank* (1903) 139 C. 298, 309, 73 P. 196; cf. *Anglo-Californian Bank, Ltd. v. Field* (1908) 154 C. 513, 517, 98 P. 267 [where first mortgagee purchased equity of redemption from mortgagor, he was not liable to junior lienholders; he was owner, not mortgagee in possession]; 4 Miller & Starr 3d, §10:46.)

(2) *Duty To Keep Premises in Repair.* The mortgagee in possession is under a duty to care for and preserve the property by making repairs that are strictly necessary. (See 4 Miller & Starr 3d, §10:46; 4 Powell §37.25; 54A *Am.Jur.2d* (1996 ed.), *Mortgages* §248; on credit for expenditures, see *infra*, §103.)

SUPPLEMENT: [This section is current through the latest supplement]

(2) *Duty To Keep Premises in Repair.*

(*New*) *Emergency foreclosure relief:* C.C. 2929.3, enacted in 2008 to help ameliorate the housing foreclosure crisis, requires the legal owner to maintain vacant residential property purchased at a foreclosure sale or acquired through foreclosure of a mortgage or deed of trust. A civil fine of up to \$ 1,000 per day may be imposed for a violation. (C.C. 2929.3(a)(1).) The governmental entity enforcing the statute must give the owner a 30-day period to remedy the violation prior to imposing the fine, and must provide for a hearing and an opportunity to contest any fine imposed. (C.C. 2929.3(a)(2).) "Failing to maintain" the property means failing to care for the exterior of the property, including allowing the growth of excessive foliage that diminishes the value of surrounding property, failing to take action to prevent the growth of mosquito larvae in standing water, and failing to take action to prevent trespassers or squatters from remaining on the property. (C.C. 2929.3(b).) This statute is subject to automatic repeal on January 1, 2013. (C.C. 2929.3(i).)



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IV. RIGHTS AND OBLIGATIONS OF MORTGAGEE

G. Right to Possession, Rents, and Profits.

3. Mortgagee in Possession.

b. Rights of Mortgagee in Possession.

4 Witkin Sum. Cal. Law STRP § 103

[§ 103] Rights of Mortgagee in Possession.

The mortgagee in possession is entitled to the rents. And, because he or she is under a duty to keep the premises in repair (see *supra*, §102), the mortgagee is entitled to a credit for those expenses. (See *54A Am.Jur.2d* (1996 ed.), *Mortgages* §218 et seq.) But this right extends only to repairs *necessary* to preserve the security, and the mortgagee in possession is not entitled to add to the debt the expense of repairs made merely for convenience. Likewise, a mortgagee in possession is not entitled to compensation for personal services expended in the care and management of the property, even if the parties have agreed otherwise. (See *Earp v. Earp* (1991) 231 C.A.3d 1008, 1014, 283 C.R. 43 [personal services did not involve much work, and mortgagee received benefit of maintaining control over preservation of own security interest]; cf. *Johns v. Moore* (1959) 168 C.A.2d 709, 714, 336 P.2d 579 [rule is not controlling where compensation is provided for by agreement; management fee paid to agent was included in provision for payment of "expenses of operation and collection"].)

The mortgagee may not charge the cost of *permanent improvements* even though they may enhance the value of the property. A power to make these charges might be abused by increasing the debt beyond the mortgagor's capacity to redeem. (See *Beckman v. Wilson* (1882) 61 C. 335; *Raynor v. Drew* (1887) 72 C. 307, 312, 13 P. 866; *Malone v. Roy* (1895) 107 C. 518, 523, 40 P. 1040; *54A Am.Jur.2d* (1996 ed.), *Mortgages* §220.)

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3. Mortgagee in Possession.
c. Possession After Statute of Limitations Runs.

4 Witkin Sum. Cal. Law STRP § 104

[§ 104] Possession After Statute of Limitations Runs.

(1) *Action by Mortgagor: Payment of Debt.* The mortgagee in possession is entitled to retain possession until the debt is paid. One theory is that, although he or she may have obtained possession under a void foreclosure sale, ousting the mortgagee would merely lead to circuity of action, for he or she could commence a new foreclosure suit. But this analysis is unsound where the statute of limitations has run on the mortgage debt and has thereby extinguished the lien. (See C.C. 2911.) The rule is actually a broad application of the equitable maxim that he who seeks equity must do equity; the court will give no relief, either quiet title or ejectment, to the mortgagor, unless the mortgagor offers to pay the debt. (*Burns v. Hiatt* (1906) 149 C. 617, 623, 87 P. 196; but see *Marshutz v. Seltzor* (1907) 5 C.A. 140, 144, 89 P. 877 [in action to quiet title, court's necessary denial of cross-complaint for foreclosure of outlawed mortgage practically removed cloud on the title].)

(2) *Action by Bona Fide Purchaser or Remote Taker.* In *Faxon v. All Persons* (1913) 166 C. 707, 137 P. 919, a mortgage with power of sale was barred by the statute of limitations. The mortgagee then sold to himself, under the power of sale, and took possession of the premises. Plaintiff was a bona fide purchaser from the grantee of the mortgagor. *Held*, plaintiff was entitled to quiet title. (a) The power of sale was a mere incident of the mortgage lien, agreed upon by the parties solely as a means of enforcing the lien; and when the lien no longer existed, the power of sale was gone. (b) The fact that the mortgagor was in possession was of no consequence, because the mortgage was outlawed before he went into possession, and his possession was not therefore under color of the mortgage. (c) The rule that the mortgagor cannot quiet title without paying the mortgage debt is based on equitable considerations, and will not be applied to an innocent purchaser who took the property when the record showed that the mortgage was extinguished, for to apply that rule would make it impossible to quiet title when there is an unsatisfied mortgage in the chain of title. (166 C. 721.)

In *Mix v. Sodd* (1981) 126 C.A.3d 386, 178 C.R. 736, the court declared that the essential issue is not whether the mortgagor's successor is a bona fide purchaser, but whether the "transferee ... is so removed from the original debtor that there is no good reason to disallow the remote taker from quieting title." (126 C.A.3d 392.) The property had been encumbered by two mortgages executed nearly 36 years before plaintiff's purchase, and no payments had ever been made on them. Plaintiff, a licensed real estate broker, knowing of the unpaid mortgages, relied on a legal opinion that they were unenforceable because of the statute of limitations. *Held*, plaintiff was entitled to quiet title. To deny this

relief to any but a bona fide purchaser would probably place a permanent cloud on the title, for in this state nearly every conveyance is preceded by a title search and it is unlikely that there would ever be a purchaser without constructive notice. (126 C.A.3d 392.)

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A. Transfer of Debt and Mortgage.
1. Assignment of Debt.

4 Witkin Sum. Cal. Law STRP § 105

[§ 105] Assignment of Debt.

(1) *In General.* The lien is an incident of the debt (*supra*, §47) and an assignment of the debt "carries with it the security." (C.C. 2936.) Hence, an attempted assignment of the mortgage (or trust deed), without the note, transfers nothing to the assignee; and a transfer of the note, without the mortgage, gives the assignee the right to the security. (See 4 Miller & Starr 3d, §10:38 et seq.) Thus, in *Adler v. Sargent* (1895) 109 C. 42, 41 P. 799, a mortgage and note were executed, and the mortgagee assigned both to a bank. The bank did not record the mortgage, but held the note. Subsequently, through various transactions, a bona fide purchaser received an assignment of the mortgage and a forged copy of the note. The bank still held the real note. *Held*, the bank prevailed. (109 C. 48.)

For the same reason, namely, that the mortgage is merely an incident of the debt, a holder in due course of a negotiable note takes both the note and the security free from defenses. Thus, in *Hayward Lumber & Inv. Co. v. Naslund* (1932) 125 C.A. 34, 13 P.2d 775, N made a note without consideration, secured by a deed of trust on a building. Both were negotiated to a holder in due course. Plaintiff claimed a mechanic's lien on the building. The deed of trust was recorded before plaintiff furnished materials, but plaintiff contended that it was not prior because no consideration passed at the time of recordation. *Held*, the negotiable note imparted its quality of freedom from defenses to the deed of trust. (125 C.A. 39.) (See 21 Cal. L. Rev. 287; 22 Cal. L. Rev. 677.)

(2) *Reassignments of Contracts Secured by Realty.* B. & P.C. 17350 prohibits financial institutions from contracting for the right to reassign contracts secured by realty on the default of one or more of the parties to the contract. (See B. & P.C. 17351(b) [definition of "reassignment"].) The term "financial institution" is broadly defined to include any "bank, savings and loan association, or credit union ... or any other person or organization making loans upon the security of real property." (B. & P.C. 17351(a).) The apparent purpose of the prohibition is to encourage lenders to investigate the credit risk of borrowers to reduce transactions in which the borrower is likely to lose his or her residence as a consequence of inability to meet the terms of the loan. (See 11 Pacific L. J. 391.)

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2. Assignment of Mortgage.

4 Witkin Sum. Cal. Law STRP § 106

[§ 106] Assignment of Mortgage.

(1) *In General.* An assignment of a mortgage or deed of trust may be recorded, and the recordation gives constructive notice to all persons. (C.C. 2934; see 4 Powell §37.27; C.E.B., 2 Mortgage and Deed of Trust Practice 3d, §9.118 et seq.) Recordation, however, does not invalidate payments made by the debtor to the holder of the note. (C.C. 2935.) After the note has been transferred, and the assignment of the mortgage has been recorded, the debtor is no longer protected in paying to the original creditor. (*Rodgers v. Peckham* (1898) 120 C. 238, 242, 52 P. 483.)

(2) *Notice of Change of Servicing Agent.* Written notice must be given to a borrower or subsequent obligor on a loan secured by a mortgage or deed of trust on real property containing one to four residential units when the note is transferred to a different servicing agent. (C.C. 2937(a).) Until the notice is given, the borrower or subsequent obligor is not obligated to make payments to the new servicing agent (C.C. 2937(b)) and is not liable for payments or late charges on payments made to the previous servicing agent (C.C. 2937(g)). If a notice of default has been recorded (see *infra*, §145) or a judicial foreclosure commenced (see *infra*, §139 et seq.), written notice of the change must be given to the trustee or the attorney named in the notice of default or judicial foreclosure. (C.C. 2937(c).) (See 20 *Pacific L. J.* 703.)

West's Key Number Digest, Mortgages k.219 et seq.

SUPPLEMENT: [This section is current through the latest supplement]



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B. Transfer of Property and Assumption of Mortgage.
1. In General.

4 *Witkin Sum. Cal. Law STRP* § 107

[§ 107] In General.

On the transfer of mortgaged property, the property still remains subject to the mortgage debt, but the grantee cannot be held personally liable for a deficiency judgment unless he or she has assumed the mortgage. Thus, A mortgages to B, then grants to C. B's rights cannot be impaired, so the grant is subject to the mortgage; i.e., the land is still subject to the lien. But, unless C agrees to assume the mortgage, C is not personally liable, and no deficiency judgment can be collected from C if the land should prove insufficient in value to cover the mortgage debt. The mortgagor, however, is still liable to the mortgagee, despite the grant. (*Ward v. De Oca* (1893) 120 C. 102, 105, 52 P. 130; on distinction between taking "subject to" mortgage, and assumption of debt, see *Snidow v. Hill* (1948) 87 C.A.2d 803, 807, 197 P.2d 801 [contract of sale]; *Cornelison v. Kornbluth* (1975) 15 C.3d 590, 596, 125 C.R. 557, 542 P.2d 981, *infra*, §197; and see *Rest.3d, Property (Mortgages)* §5.1; 4 Miller & Starr 3d, §10:35 et seq.; 55 *Am.Jur.2d* (1996 ed.), *Mortgages*, §1133 et seq.)

A grantee who assumes becomes the principal debtor, but the grantor (mortgagor) remains liable to the mortgagee as a surety for any deficiency resulting after the sale of the mortgaged property, unless there has been a complete novation. (See *Everts v. Matteson* (1942) 21 C.2d 437, 447, 132 P.2d 476; *Birkhofer v. Krumm* (1935) 4 C.A.2d 43, 50, 40 P.2d 553; *Rest.3d, Suretyship and Guaranty* §2, Comment e; *infra*, §109 et seq.) However, because the mortgagor is only a surety, the mortgagor is entitled to require that execution on any deficiency first issue against property of the grantee, and not against the mortgagor's property unless the grantee's property is insufficient. (*Hamburger v. Ellingson* (1934) 139 C.A. 311, 314, 33 P.2d 850.)

The assuming grantee is estopped to deny that the mortgage was a valid and subsisting obligation at the time he or she assumed it. (*Harris v. Whittier Bldg. & Loan Assn.* (1936) 18 C.A.2d 260, 267, 63 P.2d 840.) However, circumstances that occur *after* the assumption may give the grantee the right to contest it; e.g., the statute of limitations may run on the debt. (*Bogart v. George K. Porter Co.* (1924) 193 C. 197, 204, 223 P. 959; see 11 *Cal. L. Rev.* 429.)

West's Key Number Digest, Mortgages k.271 et seq.

SUPPLEMENT: [This section is current through the latest supplement]

Correction: Page 901, line 5, the date of *Ward v. De Oca* should be 1898.



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B. Transfer of Property and Assumption of Mortgage.
2. Manner and Requisites of Assumption.

4 Witkin Sum. Cal. Law STRP § 108

[§ 108] Manner and Requisites of Assumption.

(1) *Writing Required.* Formerly, the assumption of a mortgage could be made by an oral agreement or could be implied from the circumstances under which the purchase was made. (See *White v. Schader* (1921) 185 C. 606, 607, 198 P. 19; *Epperson v. Cappellino* (1931) 113 C.A. 473, 477, 298 P. 533.) Under a 1937 amendment to the California statute of frauds, there cannot be an oral or implied assumption; the assumption agreement must be in writing or included in the conveyance. (C.C. 1624(a)(6); see 1 *Summary* (10th), *Contracts*, §400; on assumption agreement, see C.E.B., 2 Mortgage and Deed of Trust Practice 3d, §9.118 et seq.; C.E.B., 2 Real Property Sales Transactions 3d, §8.46; 55 *Am.Jur.2d* (1996 ed.), *Mortgages* §1134 et seq.)

(2) *Express Covenant Required.* If a deed merely recites that the land is "subject to the mortgage," and the grantee accepts it, this does not constitute an assumption of the mortgage debt. (*Hibernia Savings & Loan Soc. v. Dickinson* (1914) 167 C. 616, 623, 140 P. 265; see 8 *Cal. L. Rev.* 447.) On the other hand, if the deed contains an express covenant to pay the mortgage debt, acceptance of the deed with knowledge of the provision is sufficient to bind the grantee, without any further promise. (*Dutton v. Locke-Paddon* (1918) 37 C.A. 693, 694, 174 P. 674; *Merchants' Holding Corp. v. Grey* (1935) 6 C.A.2d 682, 685, 45 P.2d 253; *Everts v. Matteson* (1942) 21 C.2d 437, 444, 132 P.2d 476.) But in *Fishback v. J.C. Forkner Fig Gardens* (1934) 137 C.A. 211, 217, 30 P.2d 586, although the deed contained the covenant, defendant grantees testified that it was placed in the deed without their knowledge or assent, and the court held that mere acceptance of the deed did not bind them on the collateral promise to assume.

West's Key Number Digest, Mortgages k.279 et seq.

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Writing Required.* See C.E.B., 2 Real Property Sales Transactions 4th, §9.48.



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3. Mortgagor as Surety.
a. Release of Part of Property.

4 *Witkin Sum. Cal. Law STRP* § 109

[§ 109] Release of Part of Property.

After the mortgagor has conveyed the property to a third party who assumes the mortgage, the mortgagor's liability is that of a surety (*supra*, §107) and is governed by the rules of suretyship. (See C.C. 2787 et seq.; *Rest.3d, Suretyship and Guaranty* §1 et seq.) Hence, if the mortgagee releases part of the property, the mortgagor's obligation is proportionately reduced, because the property is the primary fund out of which the mortgage debt is to be paid, and the mortgagor's personal liability as surety arises only after a sale of all the property. The effect of the release is to absolve the mortgagor from liability to the extent of the value of the released portion. (*Woodward v. Brown* (1897) 119 C. 283, 291, 51 P. 542.) However, the mortgage may give the mortgagee the power to make partial releases without affecting the mortgagor's personal liability for the indebtedness. (*Thompson v. Thomas* (1919) 43 C.A. 588, 590, 185 P. 427.)

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3. Mortgagor as Surety.
b. Extension of Time to Grantee.

4 *Witkin Sum. Cal. Law STRP* § 110

[§ 110] Extension of Time to Grantee.

(1) *Discharge of Mortgagor.* The suretyship defense of extension of time is available to a mortgagor who becomes a surety by reason of the grantee's assumption of the mortgage (*supra*, §107). Hence, if the mortgagee gives an extension to the grantee, the mortgagor's liability is discharged. (*Braun v. Crew* (1920) 183 C. 728, 732, 192 P. 531; *Occidental Life Ins. Co. v. McCracken* (1937) 19 C.A.2d 239, 240, 65 P.2d 130; see 55 Am.Jur.2d (1996 ed.), *Mortgages* §1201 et seq.)

California formerly followed the general rule that only a binding extension discharges a surety. (See *Rest.3d, Suretyship and Guaranty* §40, Comment c; *Robson v. O'Toole* (1923) 60 C.A. 710, 712, 214 P. 278; *Edwards v. Mortgage Sec. of Santa Barbara* (1935) 6 C.A.2d 641, 644, 44 P.2d 1056.) However, under C.C. 2820, the rule is the opposite: the extension *need not be binding*. The statute provides that, for purposes of discharging a surety, the fact that a promise by a creditor is void, or voidable at the creditor's option, does not prevent the creditor from altering the obligation of the principal debtor, or impairing the remedy of the creditor. (C.C. 2820.) Thus, the fact that an extension is subject to rescission at the creditor's option does not preclude the creditor from discharging the surety. (*Wise v. Clapper* (1968) 257 C.A.2d 770, 775, 65 C.R. 231, citing the text.)

(2) *Definite Period Required.* C.C. 2820 does not dispense with the common law requirement of a definite period; hence, an extension that is not for a specified period is not a material alteration and does not discharge the surety. (*Wise v. Clapper*, *supra*, 257 C.A.2d 776.)

(3) *Uniform Commercial Code.* Formerly, an exception to the rule discharging the mortgagor-surety existed where the mortgagor was also the *maker of a negotiable note*, and enforcement was sought, not by the mortgagee, but by a holder in due course. The mortgagor was considered primarily liable on the face of the note, and could not set up the suretyship defense against the holder. (*Mortgage Guarantee Co. v. Chotiner* (1936) 8 C.2d 110, 114, 120, 64 P.2d 138; 10 So. Cal. L. Rev. 511.) This exception was eliminated by the adoption of the Commercial Code, which does not preclude suretyship defenses in this situation. (See 4 *Summary* (10th), *Negotiable Instruments*, §69 et seq.)

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3. Mortgagor as Surety.
c. Suretyship Right of Subrogation.

4 Witkin Sum. Cal. Law STRP § 111

[§ 111] Suretyship Right of Subrogation.

(1) *Mortgagor's Rights When Grantee Assumes.* If, after assumption by the grantee, the mortgagor-surety pays the note under compulsion or voluntarily acquires it by assignment, the note is discharged, even though the mortgagor was the original party primarily liable. The mortgagor has the suretyship right of subrogation, i.e., he or she acquires all the rights of the mortgagee, whom the mortgagor has paid, to pursue any indorsers on the note or to recover other securities given for the obligation. (*Sanders v. Magill* (1937) 9 C.2d 145, 150, 70 P.2d 159; *Union Bank v. Gradsky* (1968) 265 C.A.2d 40, 45, footnote 4, 71 C.R. 64, infra, §202 [following *Sanders*]; 4 Miller & Starr 3d, §§10:36, 10:37.)

(2) *Mortgagor's Rights When Grantee Does Not Assume.* This right of subrogation is also given to the mortgagor in a more limited form when the grantee does not assume the obligation, but merely takes subject to the mortgage. Where the grantee *assumes*, his or her personal liability becomes primary; where the grantee *does not assume*, although he or she undertakes no personal liability, the *security*, i.e., the land, is primarily liable for the debt. Hence, to the extent of the value of the security, the mortgagor and grantee are in a sort of suretyship relation. Accordingly, if the mortgagor pays the mortgagee, the mortgagor is subrogated to the mortgagee's right of *foreclosure* against the property, even though the mortgagor may have no personal claim against the grantee. (*Vincent v. Garland* (1936) 14 C.A.2d 725, 727, 58 P.2d 1320; see 4 Miller & Starr 3d, §§10:35, 10:37.)

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4. Failure of First Grantee To Assume.

4 Witkin Sum. Cal. Law STRP § 112

[§ 112] Failure of First Grantee To Assume.

The liability of an assuming grantee has been based on two theories: One is that the grantee is the promisor of a third party beneficiary contract in favor of the mortgagee. (See 1 *Summary* (10th), *Contracts*, §697.) The other is that the grantee's promise is an asset of the mortgagor, and the mortgagee, as the creditor of the mortgagor, is entitled in equity to reach that asset. This is sometimes called the *subrogation* or *equitable asset* theory. Either theory would seem to be a reasonable ground for enforcement of the grantee's promise in an action by the mortgagee. (See *Bogart v. George K. Porter Co.* (1924) 193 C. 197, 201, 223 P. 959; *Rest.3d, Property (Mortgages)* §5.2.)

In California, however, the third-party beneficiary theory has not been followed, and the rights of the mortgagee have been protected under the equitable asset theory alone. (*Case v. Egan* (1922) 57 C.A. 453, 455, 207 P. 388.) This choice of theories has an important result where more than one grantee is involved, and the first grantee fails to assume. Suppose, e.g., A mortgages to B, then grants to C, who does not assume. C grants to D, who does assume. Is D liable to B, the mortgagee? There is clearly a contract between C and D for the benefit of B, and on the first theory, D would be liable. But under the second theory, D is not liable. D's promise to C is not an asset of A, the mortgagor. Thus, the mortgagee must work out his or her right against the grantee *through the latter's grantor*; and, if the grantor is not liable to the mortgagee by reason of failure to assume, his or her grantee will not be liable even though the latter expressly promises the grantor that he or she will pay. (*Case v. Egan*, *supra*; *Ward v. De Oca* (1898) 120 C. 102, 105, 52 P. 130; see *Mottashed v. Central & Pac. Imp. Corp.* (1935) 8 C.A.2d 256, 259, 47 P.2d 525; *Dail v. Campbell* (1961) 191 C.A.2d 416, 421, 12 C.R. 739.)

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A. Extension or Renewal.

1. As Between Parties.

4 Witkin Sum. Cal. Law STRP § 113

[§ 113] As Between Parties.

An agreement extending the maturity date, or renewing the mortgage for an additional term, requires a writing executed with the same formalities as required for the creation of a mortgage. (C.C. 2922; see *Easton v. Ash* (1941) 18 C.2d 530, 537, 116 P.2d 433; *Bank of America v. Hollywood Imp. Co.* (1941) 46 C.A.2d 817, 820, 117 P.2d 13; 13 Am.Jur. Legal Forms 2d, §179:441; on consideration for extension, see 1 *Summary* (10th), *Contracts*, §213.) The technical distinction between the two acts is that *extension* gives the same instrument effect for an additional period, while *renewal* substitutes a new obligation and ordinarily requires execution of a new instrument. (See *Morello v. Metzenbaum* (1944) 25 C.2d 494, 500, 154 P.2d 670; 4 Powell §37:31.) However, it has been pointed out that the language of C.C. 2922 cannot be taken literally where a mere extension is involved. An extension of time given before the statute of limitations has run keeps the old debt alive and the same instrument in effect for an additional period without the formalities of renewal. (See *Southern Pac. Co. v. Prosser* (1898) 122 C. 413, 418, 52 P. 836; 3 *Cal. Proc.* (4th), *Actions*, §678.)

It is not necessary that both parties sign the agreement. An instrument signed by the *mortgagor* alone, and reciting his or her agreement to pay at the new date, is sufficient, just as his or her signature would be sufficient on the original note or mortgage. (See *Moore v. Gould* (1907) 151 C. 723, 726, 91 P. 616 [signed by mortgagor's authorized attorney in fact]; *General v. Anthony* (1940) 38 C.A.2d 321, 323, 100 P.2d 1087.) It has also been held that an extension of time for payment, signed only by the *mortgagee* (payee) is likewise valid and binding. So, where the mortgagee sued to foreclose after default under the extension agreement, the mortgagor who had not signed could not defend on the ground that the statute of limitations had run on the original period. (*Schwartz v. Edmunds* (1937) 20 C.A.2d 530, 532, 67 P.2d 351.)

SUPPLEMENT: [This section is current through the latest supplement]

Cross-Reference: 3 *Cal. Proc.* (5th), *Actions*, §752.



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Witkin Summary of California Law VI. EXTENSION, RENEWAL, AND DISCHARGE OF MORTGAGE AND DEED OF TRUST

A. Extension or Renewal. 2. Effect on Encumbrancers Before Renewal.

4 Witkin Sum. Cal. Law STRP § 114

[§ 114] Effect on Encumbrancers Before Renewal.

(1) *In General.* The renewal or extension of a note secured by a mortgage often presents an additional problem. The mortgage, *on the face of the record*, may be outlawed. Suppose the owner (mortgagor) desires to borrow additional money and offers the prospective creditor a mortgage. The prospective creditor finds the old mortgage of record, apparently barred by the statute of limitations. Is the new creditor safe in assuming that this old mortgage is no longer effective, or does the creditor take the risk of having the claim be inferior because of an extension or renewal in the interim?

The answer given by the courts distinguishes between encumbrancers before renewal or extension and those after. Prior encumbrancers will not be affected. The first mortgagee may agree to give the mortgagor further time for payment, and this extends the statute of limitations between the *mortgagor and first mortgagee*, so that the mortgagor cannot set it up against the first mortgagee. But no agreement between these parties can extend the statute as against junior encumbrancers, whose liens were acquired prior to the extension. They are not required to watch the record, and they can invoke the statute of limitations against the first mortgagee even though the mortgagor cannot. Hence, a second mortgagee may wait until the statute has run against the first mortgage, and then foreclose the second mortgage, free of the first. (*California Bank v. Brooks* (1899) 126 C. 198, 200, 59 P. 302; *Ekmann v. Plumas County Bank* (1932) 215 C. 671, 673, 12 P.2d 433; see 27 Cal. L. Rev. 66, 72.)

(2) *Modification of Rule.* This rule may be modified by special provision in the first instrument. In *Western Fruit Growers v. Security Title Ins. & Guarantee Co.* (1937) 20 C.A.2d 150, 66 P.2d 742, a first deed of trust provided that the time of payment of installments on the note could be extended by consent of the maker and holder of the note. A second deed of trust was made "subject to" the terms of the first "and any renewal or extension thereof." *Held*, an extension by the holder of the first deed of trust did not violate any right of the beneficiary under the second. (20 C.A.2d 154.)

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A. Extension or Renewal. 3. Effect on Encumbrancers or Purchasers After Renewal.

4 Witkin Sum. Cal. Law STRP § 115

[§ 115] Effect on Encumbrancers or Purchasers After Renewal.

The result of renewal or extension (*supra*, §114) is different where it takes place before the junior encumbrancer or subsequent purchaser acquires an interest. Encumbrancers are charged with knowledge that, notwithstanding the apparent running of the limitation period on the mortgage, renewal of the note may toll the statute. Hence, if they do not inquire as to this possibility, at the time they secure their liens, they have no complaint if the note has been renewed prior to the commencement of their rights. The first mortgage will retain its priority. (*Newhall v. Hatch* (1901) 134 C. 269, 273, 66 P. 266.)

In *Craig v. Dinwiddie* (1926) 77 C.A. 681, 247 P. 516, a new note and mortgage were executed for the purpose of renewing the original note and mortgage. The old instruments remained of record, unsatisfied. Plaintiff then purchased after the statute had apparently run on the old mortgage. *Held*, the new note and mortgage effected a continuation of the original obligation, and the priority of the mortgage was maintained. (77 C.A. 687.) (See *Wood v. Willey* (1934) 136 C.A. 197, 200, 28 P.2d 367; 27 Cal. L. Rev. 66, 73.)

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B. Discharge. 1. In General.

4 Witkin Sum. Cal. Law STRP § 116

[§ 116] In General.

A mortgage or deed of trust may be discharged in several ways:

- (1) *Payment*. Payment of the debt is the usual and obvious method to discharge. (See *infra*, §117 et seq.)
- (2) *Tender*. A valid tender, improperly refused, may effect a discharge. (See 1 *Summary* (10th), *Contracts*, §769.)
- (3) *Release of lien*. The mortgagee may release the lien, or the instrument may contain a partial release clause permitting the mortgagor to sell certain portions of the property free of the mortgage. (See *Houtz v. Beeman Inv. Corp.* (1935) 6 C.A.2d 645, 647, 44 P.2d 660; *Conley v. Poway Land & Inv. Co.* (1965) 232 C.A.2d 22, 28, 42 C.R. 636 [trustor was entitled to release where his right accrued before default, even though afterwards he was in default]; *Eldridge v. Burns* (1978) 76 C.A.3d 396, 409, 142 C.R. 845 [partial release clause]; *Drake v. Martin* (1994) 30 C.A.4th 984, 996, 36 C.R.2d 704 [partial release clause]; *Rest.3d, Property (Mortgages)* §5.3; 4 *Miller & Starr* 3d, §10:119 et seq.; 41 *A.L.R.3d* 7 [construction of partial release clauses]; 13 *Am.Jur. Legal Forms* 2d, §179:501.)
- (4) *Sale or foreclosure*. Sale under a power or foreclosure of a prior mortgage or deed of trust will extinguish any inferior mortgage lien. (See *Ferry v. Fisk* (1921) 54 C.A. 763, 765, 202 P. 964; *infra*, §130.)
- (5) *Merger*. In most cases, a merger of the legal and equitable interests operates as a discharge. (See *infra*, §120.)
- (6) *Statute of limitations*. Running of the statute of limitations extinguishes a mortgage lien and no action can be brought to foreclose or to exercise a power of sale. (See *infra*, §121.) The right to foreclose under a trust deed is also barred and the time during which a power of sale may be exercised is limited. (See *infra*, §122.)
- (7) *Termination of leasehold*. The "proper termination of a leasehold also extinguishes the lien interest of a third party in that leasehold." (*Glendale Fed. Bank v. Hadden* (1999) 73 C.A.4th 1150, 1155, 87 C.R.2d 102 ["question of whether, absent a contractual right, a mortgagee of a leasehold has any rights in the leased property upon termination or forfeiture of the lease has not been directly addressed in California"].)

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B. Discharge.

2. Payment and Satisfaction of Record.

a. In General.

4 Witkin Sum. Cal. Law STRP § 117

[§ 117] In General.

(1) *Right to Proof of Discharge.* On payment of the underlying obligation, the mortgagor is entitled to a certificate of discharge, and to have the mortgage cancelled or satisfied of record; and the trustor under a deed of trust is similarly entitled to a reconveyance from the trustee. (See C.C. 2939 et seq.; *Rest.3d, Property (Mortgages)* §6.4; 4 Powell §37.33; C.E.B., 2 Mortgage and Deed of Trust Practice 3d, §8.84; 13 Am.Jur. Legal Forms 2d, §179:511; on prepayment charges, see supra, §92 et seq.)

(2) *Trustee's Right to Indemnity Bond Where Original Note Is Lost.* The trustee is normally entitled to presentation of the original note. (See infra, §118.) Where the note is lost or destroyed, proof of its destruction is not sufficient; the trustee is entitled to adequate indemnity, and may properly insist on a corporate surety indemnity bond rather than a personal indemnity agreement. (*Huckell v. Matranga* (1979) 99 C.A.3d 471, 479, 480, 160 C.R. 177.)

West's Key Number Digest, Mortgages k.298 et seq.

SUPPLEMENT: [This section is current through the latest supplement]

(3) *(New) Distinction: Prepayment Under Affordable Housing Program.* In *Dieckmeyer v. Redevelopment Agency of Huntington Beach* (2005) 127 C.A.4th 248, 24 C.R.3d 895, petitioner purchased a housing unit from defendant city under an affordable housing program. The program included restrictions on initial and subsequent buyers' income and provided for equity sharing between the buyers and the city for a 30-year period. Petitioner sought to prepay the promissory note and obtain a reconveyance of the deed of trust securing the note. Held, partial performance of a secured obligation does not extinguish the lien. The deed of trust secured the note, the equity share agreement, and other promises listed in the Covenants, Conditions, and Restrictions; payment of the note did not extinguish the security for the other obligations. Hence, petitioner may prepay the note but is not entitled to reconveyance of the trust deed. (127 C.A.4th 258.)



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B. Discharge.

2. Payment and Satisfaction of Record.

b. Mortgagee's Duty.

4 Witkin Sum. Cal. Law STRP § 118

[§ 118] Mortgagee's Duty.

(1) *In General.* The mortgagee or beneficiary under a deed of trust is obligated to take the necessary action to clear the mortgagor's or trustor's title. The mortgagee or trustee has the burden of recording a certificate of discharge or reconveyance. No demand is necessary. (C.C. 2941.) (See *Drake v. Martin* (1994) 30 C.A.4th 984, 999, 36 C.R.2d 704 [where portion of parcel was to be released when 30% was paid toward principal balance, trustor's demand for performance was implied condition precedent to beneficiaries' obligation to request release and reconveyance from trustee]; 4 Miller & Starr 3d, §10:111 et seq.)

A beneficiary may substitute the title company conducting the escrow through which the obligation is satisfied for the trustee of record. The title company then assumes the obligation of a trustee and is entitled to the statutory fee. (C.C. 2941(b)(7).)

(2) *Time Limits.* Within 30 days after satisfaction of the secured obligation, the mortgagee or beneficiary must act to clear the mortgagor's title. (C.C. 2941; see *Serafin v. First Interstate Bank* (1997) 58 C.A.4th 785, 68 C.R.2d 297 [discussing beneficiary's duties under C.C. 2941].) C.C. 2941(b) sets forth further time limits for deeds of trust:

(a) *Execution and Delivery.* The beneficiary must execute and deliver to the trustee the *original* note, deed of trust, request for full conveyance, and other documents necessary for reconveyance. Within 21 days of receiving these documents and the fee, the trustee must execute and record a full reconveyance. (C.C. 2941(b)(1).) "Original" may include an optically imaged reproduction if specified requirements are met. (C.C. 2941(f).)

(b) *Substitution of Trustee.* If the trustee fails to have a full conveyance recorded *within 60 days* of satisfaction, the beneficiary, on written request, must substitute itself or another as trustee and issue a full reconveyance. (C.C. 2941(b)(2).)

(c) *Action by Title Company.* If no reconveyance has been recorded under C.C. 2941(b)(1) or 2941(b)(2), *within 75 days*, a title company may prepare and record a release of the obligation after giving at least 10 days' written notice to the trustee, trustor, and beneficiary. (C.C. 2941(b)(3); see C.C. 2941(b)(6) [title company's liability].) A title company

may also issue a release for an obligation secured by a deed of trust that was satisfied prior to July 1, 1989, if no reconveyance was recorded by October 1, 1989. (C.C. 2941(b)(4).)

(d) *No Excuse for Lack of Compliance.* C.C. 2941(b)(2) and 2941(b)(3) do not excuse the beneficiary or the trustee from compliance with C.C. 2941(b)(1); and C.C. 2941(b)(3) does not excuse the beneficiary from compliance with C.C. 2941(b)(2). (C.C. 2941(b)(5).)

C.C. 2941 "creates a hierarchical system in which title insurers are only permitted to record a release of obligation if both the lender/beneficiary and trustee, after proper request, have failed or refused to comply with their respective statutory duties within the specified time periods. ... [It does not create] a co-equal competing alternative to clear title which authorizes title insurers to bypass trustees and the reconveyance process." C.C. 2941(b)(3), authorizing title companies to prepare and record a release, is "to be employed as a last resort after the preferred methods have failed to reconvey title." (*Trustors Sec. Service v. Title Recon Tracking Service* (1996) 49 C.A.4th 592, 600, 601, 56 C.R.2d 793 [extensively reviewing legislative history of 1988 amendments to statute].)

(3) *Fees.* Fees for all services in connection with the reconveyance are permitted and may be made payable in advance. The fee is conclusively presumed to be reasonable if it does not exceed \$ 45. (C.C. 2941(e); see *Siegel v. American Savings & Loan Assn.* (1989) 210 C.A.3d 953, 957, 258 C.R. 746 [C.C. 2941 does not permit collection of reconveyance fee at time deed of trust is recorded]; 2 A.L.R.2d 1064 [requiring security as condition of cancellation].)

(4) *Damages.* Violation of C.C. 2941 subjects the violator (a) to liability for resulting damages and a statutory penalty of \$ 500 (C.C. 2941(d)), and (b) to criminal liability (C.C. 2941.5). (See *Pintor v. Ong* (1989) 211 C.A.3d 837, 259 C.R. 577, 3 Cal. Proc. (4th), Actions, §141 [damages for emotional distress were properly awarded for defendant's refusal to comply with C.C. 2941]; *Panagotacos v. Bank of America* (1998) 60 C.A.4th 851, 857, 70 C.R.2d 595 [because any emotional distress plaintiffs suffered was not sustained as result of defendant's failure to reconvey, recovery was limited to statutory penalty; distinguishing *Pintor*]; *Prudential Home Mortg. Co. v. Superior Court* (1998) 66 C.A.4th 1236, 1249, 78 C.R.2d 566 [statutory remedies preclude additional equitable relief for failure to record reconveyances]; 8 A.L.R.4th 853 [damages for refusal to discharge or give partial release].)

SUPPLEMENT: [This section is current through the latest supplement]

(4) *Damages.*

Pintor case:

Cross-Reference: 3 Cal. Proc. (5th), Actions, §146.



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2. Payment and Satisfaction of Record.

c. Release When Mortgagee Cannot Be Found or Refuses To Act.

4 Witkin Sum. Cal. Law STRP § 119

[§ 119] Release When Mortgagee Cannot Be Found or Refuses To Act.

C.C. 2941.7 sets forth a procedure for release of the lien of a mortgage or deed of trust when the mortgagee or beneficiary cannot be located after diligent search, or refuses to execute and deliver a proper certificate of discharge or request for reconveyance. The lien will be released when the mortgagor or trustor or his or her successor in interest records a corporate bond containing specified information, and an accompanying declaration. (See C.C. 2941.7; *12 Pacific L. J.* 542; on what constitutes "diligent search," see C.C. 2941.7(d).)

"The statute contemplates that a corporate security bond will substitute to some extent for the lender's security in the property, which is lost by reconveyance of the trust deed. The statute places upon the trustee the responsibility to determine if the bond is acceptable. ... The bond must be issued by a corporation lawfully authorized to issue surety bonds; the bond must be in a sum equal to twice the amount of the original obligation secured by the deed of trust." (*Carter v. Continental Land Title Co. (1991) 233 C.A.3d 1597, 1600, 285 C.R. 413.*)

In *Carter*, the trustor provided a bond that expired by its own terms 60 days following reconveyance. *Held*, the bond was insufficient, and defendant trustee, who reconveyed, became liable to plaintiff beneficiary. "The statute does not specify a particular duration for the bond, but we are satisfied that a bond which expires 60 days after the reconveyance is not adequate to protect the beneficiary's recovery in an action on the obligation secured by the deed of trust. This is not a reasonable length of time for the beneficiary to learn of the reconveyance and pursue remedies against the bond. A 60-day bond may be sufficient to protect the trustee's interest, but the statute requires the bond to protect the beneficiary's interest as well." (*233 C.A.3d 1600.*)

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B. Discharge.

3. Merger.

4 *Witkin Sum. Cal. Law STRP* § 120

[§ 120] Merger.

A mortgage (or deed of trust) may also be discharged by merger. Suppose A mortgages to B, then sells to B. B now has the entire legal and equitable interest in the property, and ordinarily the lien of the mortgage will be merged with the title. (*Anglo-Californian Bank, Ltd. v. Field* (1908) 154 C. 513, 514, 98 P. 267; *Jensen v. Burton* (1931) 117 C.A. 66, 69, 3 P.2d 324; cf. *Mortgage Guarantee Co. v. Lee* (1943) 61 C.A.2d 367, 375, 143 P.2d 98 [no merger unless entire legal and equitable estate is in one person]; *Strike v. Trans-West Discount Corp.* (1979) 92 C.A.3d 735, 743, 155 C.R. 132 [merger is question of intent; none found]; *Ostayan v. Serrano Reconveyance Co.* (2000) 77 C.A.4th 1411, 1420, 92 C.R.2d 577 [lender that held first and second trust deeds on same property and consolidated billing on two loans was not precluded by merger doctrine from foreclosing only on second trust deed]; *National Enterprises v. Woods* (2001) 94 C.A.4th 1217, 1228, 1229, 115 C.R.2d 37 [following *Ostayan*; merger would be contrary to terms of loan documents, and first and second deeds of trust were equal estates not subject to merger doctrine]; see *Rest.3d, Property (Mortgages)* §8.5; 4 *Miller & Starr* 3d, §10:41 et seq.; 4 *Powell* §37.32.)

If this rule were invariable, it would sometimes result in injustice to a purchasing first mortgagee. Suppose A, after giving the mortgage to B, gives a second mortgage to C, and then sells to B. If B's lien is merged in B's title, C becomes the first mortgagee, and B must pay C's claim before satisfying B's own prior lien. If the value of the land is less than the amount of both liens, B will suffer a loss. Because of this possibility, it will be presumed that the first mortgagee intends to keep his or her mortgage alive after the sale, even after the instrument has been cancelled; and *equity will prevent a merger* when necessary to protect the interests of the mortgagee. (*Sheldon v. La Brea Materials Co.* (1932) 216 C. 686, 691, 15 P.2d 1098.)

In *Hines v. Ward* (1898) 121 C. 115, 53 P. 427, an insolvent mortgagor deeded the property to the mortgagee in satisfaction of the mortgage. The mortgagor represented that there was no other lien, and the mortgagee consented to cancellation of the instrument. There was, in fact, a judgment lien of a third party. *Held*, the discharged mortgage would be kept alive in equity and made prior to the intervening lien. (121 C. 118.)

In *6424 Corporation v. Commercial Exchange Property, Ltd.* (1985) 171 C.A.3d 1221, 217 C.R. 803, real property was subject to a leasehold estate that was encumbered in favor of defendant mortgagees. In 1980, K acquired both the lessee's interest and the fee estate. In 1982, the property was sold to W who executed a mortgage on the fee. This

mortgage was assigned to plaintiff, who contended that K's concurrent ownership of the fee and leasehold merged the leasehold with the fee and extinguished defendants' mortgages. *Held*, there was no merger; the doctrine will not be applied where it would prejudice the rights of third parties. A concurring justice observed that, because plaintiff mortgagee had not acquired legal title to the leasehold, "the factual prerequisites to even a consideration of the doctrine of merger have yet to occur." (171 C.A.3d 1224.)

However, in *Wilson v. McLaughlin* (1937) 20 C.A.2d 608, 67 P.2d 710, the trustor gave six promissory notes totaling \$ 30,000, secured by a deed of trust. The beneficiary died, leaving the notes in equal shares to her two daughters, one of whom was the trustor's wife. The trustor granted the property to his wife, who expressly assumed the debt. Plaintiff, the other daughter, then sued the trustor's wife to quiet title to the notes and security. *Held*, plaintiff should prevail. The trustor's wife, as owner of one-half the notes, was a beneficiary under the trust deed. On the grant and her assumption of the debt, she became owner of the property and principal debtor as well. Her interest as beneficiary thereupon merged with her title, and there were no equitable circumstances to prevent merger, for under her assumption agreement, she was liable for the entire debt. (20 C.A.2d 611.)

SUPPLEMENT: [This section is current through the latest supplement]

See *Marion Drive, LLC v. Saladino* (2006) 136 C.A.4th 1432, 1438, 39 C.R.3d 695 [although bondholder and title owner of property purchased at tax sale ultimately became same company, merger doctrine did not apply to give lender priority over bondholder to excess fund from tax sale; right to recover excess fund vested at date of tax sale, and bond and property had different owners at that time].



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B. Discharge.

4. Running of Statute of Limitations on Principal Debt.

a. Mortgage.

4 Witkin Sum. Cal. Law STRP § 121

[§ 121] Mortgage.

(1) *Extinguishment of Lien.* Under C.C. 2911, a lien is extinguished by the running of the statute of limitations on the principal obligation. (See 3 *Cal. Proc.* (4th), *Actions*, §§405, 451, 609.) The statute is applicable to mortgages, and not only bars an action to foreclose, but also the exercise of a power of sale in a mortgage. (*Faxon v. All Persons* (1913) 166 C. 707, 716, 137 P. 919; see 4 Powell §37.34; on right of mortgagee in possession to retain possession, see *supra*, §104.)

C.C. 880.020 et seq., the Marketable Record Title Act, prescribe a maximum time for the enforcement of a mortgage or deed of trust not already barred by C.C. 2911. (See 12 *Summary* (10th), *Real Property*, §337; 4 Miller & Starr 3d, §10:130.) A mortgage or deed of trust is expired and may not be enforced after the later of the following times:

(a) Ten years from the "final maturity date or the last date fixed for payment or performance if that date is ascertainable from the record." (C.C. 882.020(a)(1).)

(b) Sixty years after the instrument was recorded, if a final maturity date or last date fixed for payment or performance is *not* ascertainable from the record. (C.C. 882.020(a)(2).)

(c) Ten years from the date a notice of intent to preserve the security is recorded (see C.C. 880.310 et seq.), if it is recorded within one of the above periods. (C.C. 882.020(a)(3).) (See C.C. 882.020(c) [extension by recorded waiver]; C.C. 882.040 [chapter applicable to all mortgages whenever recorded].)

Hence, under C.C. 882.020, enforcement of a mortgage will be barred even though--due to tolling, partial payment, or waiver--the statute of limitations has not run on the principal obligation. (Legislative Com. Comment.)

(2) *Acknowledgment or New Promise.* The bar of the statute may be avoided by an acknowledgment of the debt or a new promise to pay, before the period has completely run. An acknowledgment or new promise continues the life of the original obligation (see 1 *Summary* (10th), *Contracts*, §240; 3 *Cal. Proc.* (4th), *Actions*, §§676, 677), and consequently the mortgage lien likewise continues. (*Curtis v. Holee* (1921) 184 C. 726, 730, 195 P. 395.) The grantee of the

mortgagor may thus acknowledge and continue the life of the debt and mortgage, even though the grantee did not originally assume the obligation. The reason is that the land is primarily liable, and the grantee is interested in paying the debt and thereby preventing foreclosure. (*Curtis v. Holee*, supra; *Wood v. Willey* (1934) 136 C.A. 197, 200, 28 P.2d 367.)

But where the limitation period has run and the debt is completely barred, the mortgage lien is extinguished, and a revival of the barred debt by a new promise or acknowledgment will not revive the mortgage. It is necessary in this case to comply with the formalities of execution prescribed by C.C. 2922 (supra, §40). (*Sanford v. Bergin* (1909) 156 C. 43, 52, 103 P. 333.)

SUPPLEMENT: [This section is current through the latest supplement]

See 36 A.L.R.6th 387 [survival of creditor's rights created by mortgage as affected by running of limitations period for action on underlying note].

(1) *Extinguishment of Lien.*

Cross-Reference: 3 Cal. Proc. (5th), Actions, §§430, 484, 667.

Marketable Record Title Act:

(a) C.C. 882.020(a)(1) was amended in 2006 to provide for expiration 10 years from the final maturity date or the last date fixed for payment or performance of the obligation, if that date "is ascertainable from the recorded evidence of indebtedness."

(b) C.C. 882.020(a)(2) was amended in 2006 to provide for expiration 60 years from the date the instrument was recorded, if the final maturity date or the last date fixed for payment or performance of the obligation "is not ascertainable from the recorded evidence of indebtedness."

(2) *Acknowledgment or New Promise.*

Cross-Reference: 3 Cal. Proc. (5th), Actions, §§750, 751.



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B. Discharge.

4. Running of Statute of Limitations on Principal Debt.

b. Deed of Trust.

4 Witkin Sum. Cal. Law STRP § 122

[§ 122] Deed of Trust.

(1) *Former Law.* The general rule was established at an early date in California that a deed of trust "never outlaws," and that the power of sale could be exercised by the trustee, who held the title, even though the statute of limitations barred any action on the debt. (See *Grant v. Burr* (1880) 54 C. 298, 301; *Hohn v. Riverside County Flood Control & Water Conservation Dist.* (1964) 228 C.A.2d 605, 614, 39 C.R. 647, citing the text; cf. *Miller v. Bean* (1948) 87 C.A.2d 186, 196 P.2d 596, supra, §77 [although note was barred, holder of deed of trust could sue on covenant to protect title to property].) It necessarily followed that the holder (beneficiary) of a deed of trust could assign the deed of trust though the debt itself was barred, and the assignee could exercise the power of sale. (See *Sipe v. McKenna* (1948) 88 C.A.2d 1001, 1005, 200 P.2d 61.)

Though the remedy of sale remained, the statute did run on the personal obligation of the note. (*Hamaker v. Williams* (1937) 22 C.A.2d 256, 257, 70 P.2d 973.) And if the creditor, instead of selling at a trustee's sale, elected the alternative remedy of action to foreclose under C.C.P. 725a (infra, §137), the statute could be pleaded as a defense, for it ran not only on the personal obligation, but on the commencement of any action to enforce the creditor's rights against the security. (*Flack v. Boland* (1938) 11 C.2d 103, 106, 77 P.2d 1090.)

(2) *Abrogation of "Never Outlaws" Rule.* In 1982, the Legislature adopted the Marketable Record Title Act. (C.C. 880.020 et seq.; see 12 *Summary* (10th), *Real Property*, §337; 4 *Miller & Starr* 3d, §§10:31, 10:132.) As under former law, the running of the statute of limitations bars an action for judicial foreclosure; however, the rule that a power of sale "never outlaws" was abrogated by C.C. 882.020(a), which prescribes a maximum time for the enforcement of a mortgage or a deed of trust (supra, §121). (Legislative Com. Comment.) C.C. 882.030 also provides that the running of the enforcement period has the effect of a complete discharge, hence reversing the rule that a deed of trust barred by the statute of limitations could be equitably enforced. (Legislative Com. Comment.)

(3) *Unrecorded Payment Date.* In *Miller v. Provost* (1994) 26 C.A.4th 1703, 1708, 33 C.R.2d 288, plaintiffs brought a judicial foreclosure action to enforce a deed of trust. Defendants, who had borrowed money from plaintiffs' parents, purchased the collateral property and executed a promissory note and a deed of trust in December 1977. The deed of trust was recorded on December 20, 1977, but the promissory note, which specified a maturity date of February

20, 1978, was not recorded. No payments were made on the note and the deed of trust was not reconveyed. The statute of limitations on the promissory note expired in 1982; however, plaintiffs did not bring their action until 1992. *Held*, summary judgment for plaintiffs affirmed. Plaintiffs could exercise the private power of sale after the limitations period had expired, because the date for payment of the debt did not appear in the public records.

(a) While the time for filing a judicial foreclosure expired 4 years after the underlying obligation was due, C.C. 2911 does not preclude exercising the power of sale under the deed of trust. (26 C.A.4th 1708.)

(b) Under C.C. 882.020, the lien of a deed of trust expires 60 years after recordation of the deed, if the last date fixed for payment of the debt is not "ascertainable from the record." This phrase can only mean what it says; the recorded document must contain the requisite information. Even where the deed of trust makes reference to a promissory note, there is no duty to make a search outside the records. (26 C.A.4th 1709.) (See *Nicolopoulos v. Superior Court* (2003) 106 C.A.4th 304, 311, 130 C.R.2d 626 [following *Miller*; although C.C. 882.030 states that it does not limit application of equitable principles such as waiver and estoppel, lienholder's mere silence and lack of enforcement would not estop him from relying on 60-year limitations period in C.C. 882.020].)

SUPPLEMENT: [This section is current through the latest supplement]

See 36 A.L.R.6th 387 [survival of creditor's rights created by deed of trust as affected by running of limitations period for action on underlying note].

(2) *Abrogation of "Never Outlaws" Rule.* C.C. 882.030 must not be interpreted to nullify the time limits stated in C.C. 882.020(a). C.C. 882.030 makes unenforceable only the right of judicial enforcement under C.C.P. 725a, the only interest that is extinguished by C.C. 2911. (*Ung v. Koehler* (2005) 135 C.A.4th 186, 195, 196, 37 C.R.3d 311, 12 Summary (10th), *Real Property*, Supp., §338.)

(3) *Unrecorded Payment Date.* C.C. 882.020(a)(2) was amended in 2006 to provide that the 60-year expiration date applies when the final maturity date fixed for payment of the obligation is not "ascertainable from the recorded evidence of indebtedness."



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CHAPTER VIII - Security Transactions in Real Property

Witkin Summary of California Law VI. EXTENSION, RENEWAL, AND DISCHARGE OF MORTGAGE AND DEED OF TRUST

C. Revival of Discharged Mortgage.

4 *Witkin Sum. Cal. Law STRP* § 123

[§ 123] Revival of Discharged Mortgage.

Sometimes when a note secured by a mortgage becomes due the parties, instead of paying it, substitute a new note and mortgage for it, and record a satisfaction of the old mortgage. As between the parties, no harm is done by the substitution. But if, in the interim, other liens have arisen, the mortgagee may have lost his or her priority. To prevent this result, it is generally held that the discharge of an old mortgage and substitution of a new one do not subordinate the new mortgage to intervening liens where the result would be inequitable; or, as the rule is sometimes stated, equity will revive the discharged mortgage for the purpose of preserving its priority. (*Simon Newman Co. v. Fink* (1928) 206 C. 143, 147, 273 P. 565; *Pacific Nat. Agriculture Credit Corp. v. Wilbur* (1935) 2 C.2d 576, 585, 42 P.2d 314 [chattel mortgage]; *Bowden v. Bank of America* (1950) 36 C.2d 406, 409, 224 P.2d 713 [chattel mortgage]; see 43 A.L.R.5th 519 [discharge of mortgage and taking back of new mortgage as affecting intervening lien].)

In *Parker v. Tout* (1929) 207 C. 590, 279 P. 431, a bank held a deed of trust on land, and loaned additional money to the owner to make improvements. The work was commenced and then, to secure the new advances, the owner gave the bank a new note and a new deed of trust to supersede the old instruments and cover the entire loan. The bank recorded the new note and deed of trust, and at the same time recorded a satisfaction of the old note and deed of trust. Subsequently, a mechanic's lien was recorded. *Held*, because the work on which the mechanic's lien was based had been commenced before the recordation of the new note and deed of trust, the lienor took priority over the bank as to the new advances; but equity would protect the priority of the bank as to the original loan evidenced by the discharged note and deed of trust. (207 C. 593.)

In *McArthur v. Wellman* (1937) 20 C.A.2d 379, 66 P.2d 1226, a reconveyance under a deed of trust was made and recorded, the request therefor reciting that the debt had been paid and the note and deed of trust surrendered for cancellation. Actually there had been no payment, and the reconveyance was part of a transaction whereby a new note and trust deed were executed for the same obligation. After recordation of the original deed of trust, but before reconveyance, judgment creditors secured liens. *Held*, the deed of trust was prior. Taking the new note and deed of trust did not operate to discharge the original debt, but merely to extend the time; and the creditors whose liens attached prior to the reconveyance were not misled by the transaction. (20 C.A.2d 381.)

In *Copp v. Millen* (1938) 11 C.2d 122, 77 P.2d 1093, the doctrine was again applied, and the theory fully expounded. Defendant mortgaged to plaintiff, who recorded. Then defendant contracted to sell to R, who took

possession but did not record. The mortgage became due and, for purposes of extension of time, a new note and mortgage were given for the balance and the old mortgage was satisfied and discharged of record. Plaintiff mortgagee at this time had actual notice of R's contract. *Held*, plaintiff prevailed over R. (a) R, an encumbrancer *prior to renewal*, could have prevailed when the statute of limitations had run (see *supra*, §114), but failed to raise this point. (b) With the bar of the statute eliminated, the general rule applied that equity will look through form to substance, and will treat the mistaken discharge merely as a substitution of another instrument to extend time. (c) Plaintiff's knowledge of R's contract was immaterial, for R had no superior equity. Originally, his encumbrance was inferior, and he had no equitable claim to a superior position as a result of the mortgagee's mistake. (11 C.2d 126.) (See *Lawyers Title Ins. Corp. v. Feldsher* (1996) 42 C.A.4th 41, 51, 52, 49 C.R.2d 542, 13 Summary (10th), *Equity*, §187 [distinguishing *Copp*].)

SUPPLEMENT: [This section is current through the latest supplement]



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VII. REMEDIES OF MORTGAGEE AND TRUSTEE
A. One-Action Rule.
1. In General: C.C.P. 726.

4 Witkin Sum. Cal. Law STRP § 124

[§ 124] In General: C.C.P. 726.

(1) *One Form of Action.* "There can be but one form of action for the recovery of any debt or the enforcement of any right secured by mortgage upon real property or an estate for years therein." The action must be in accordance with the provisions of C.C.P. 725a et seq. (C.C.P. 726(a); on background and nature of statute, see *Martin v. Becker* (1915) 169 C. 301, 305, 146 P. 665; *Walker v. Community Bank* (1974) 10 C.3d 729, 734, 111 C.R. 897, 518 P.2d 329, infra, §132; *Bank of America v. Daily* (1984) 152 C.A.3d 767, 769, 199 C.R. 557, infra, §133; *Pacific Valley Bank v. Schwenke* (1987) 189 C.A.3d 134, 140, 234 C.R. 298, infra, §135; *Aplanalp v. Forte* (1990) 225 C.A.3d 609, 613, 275 C.R. 144; *Bank of America v. Graves* (1996) 51 C.A.4th 607, 59 C.R.2d 288, infra, §205 [junior lienor who filed notice of default and of trustee's sale was not required by "one action" rule to purchase at senior lienor's sale to protect its interest]; 64 Cal. L. Rev. 1122; 31 Cal. L. Rev. 429; 6 Hastings L. J. 248; 25 San Diego L. Rev. 1093 ["action" under C.C.P. 726]; 3 U.C.L.A. L. Rev. 192; for general discussions of the "one form of action" rule and its effect on creditors' remedies, see *Rest.3d, Property (Mortgages)* §8.2; 4 Miller & Starr 3d, §10:154 et seq.; C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §4.1 et seq.)

(2) *Remedy.* C.C.P. 725a et seq. provide for the remedy of *foreclosure* by judicial sale. As a result, no personal action may be brought against the maker of a note, when the note is secured by a mortgage or deed of trust. The purposes of the one action rule are to require exhaustion of the security and to protect the mortgagor from duplication of suits. (On effect of dual remedies of foreclosure and sale available to holder of deed of trust, see infra, §137.)

(3) *Scope of Statute.* C.C.P. 726 applies not only to notes secured by a mortgage or deed of trust, but to *any debt* so secured, such as a book account. (*Western Fuel Co. v. Stanford G. Lewald Co.* (1922) 190 C. 25, 27, 210 P. 419; see 11 Cal. L. Rev. 195.) It has also been held applicable where several parties give separate mortgages or trust deeds to secure a single debt evidenced by one instrument on which they are jointly and severally liable, even though the land involved is situated in different counties. (*Appel v. Hubbard* (1957) 155 C.A.2d 639, 643, 318 P.2d 164.)

Taylor v. Bouissiere (1987) 195 C.A.3d 1197, 1199, 241 C.R. 253, held that a security assignment of a leasehold interest was not a security interest in real property within the meaning of C.C.P. 726. However, the statute was extended to leasehold interests in 1989. The Legislature declared that the amendment was intended to make it clear that the one action rule of C.C.P. 726 applies to leasehold mortgages and that it "is specifically intended to abrogate the holding in *Taylor v. Bouissiere*." (Stats. 1989, Chap. 698, §15; see 21 Pacific L. J. 540.)

West's Key Number Digest, Mortgages k.329 et seq., 380 et seq.

SUPPLEMENT: [This section is current through the latest supplement]

(1) *One Form of Action*. See 26 California Lawyer 37 (Dec. 2006) [Foreclosures: California's One Action Rule].



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VII. REMEDIES OF MORTGAGEE AND TRUSTEE

A. One-Action Rule.

2. Where Rule Does Not Apply.

a. Security Is Not Mortgage.

4 *Witkin Sum. Cal. Law STRP* § 125

[§ 125] Security Is Not Mortgage.

(1) *In General.* C.C.P. 726 does not apply to (a) a pledge (*Jones v. Evans* (1907) 6 C.A. 88, 91, 91 P. 532), (b) a vendor's lien (*Schwartz v. Mead* (1931) 116 C.A. 606, 612, 3 P.2d 48), or (c) title reserved under a conditional sale (*People's Bank v. Porter* (1922) 58 C.A. 41, 46, 208 P. 200 [decided under pre-Commercial Code version of C.C.P. 726 applicable to mortgages of personal as well as real property]).

(2) *Independent Promise of Security.* C.C.P. 726 has no application to an unsecured promissory note, even though the maker independently promises to furnish security. In this case, the creditor might be able to establish an equitable lien on the contemplated security and foreclose, but he or she need not do so; the creditor may elect to treat the obligation as unsecured and sue directly on the note. (*Kogan v. Bergman* (1966) 244 C.A.2d 613, 621, 53 C.R. 371; but see *Kaiser Industries Corp. v. Taylor* (1971) 17 C.A.3d 346, 352, 94 C.R. 773 [debtor successfully contended that transaction constituted equitable mortgage and entitled him to protection of C.C.P. 726].)

(3) *Note Secured by Secured Note.* If a note is secured by a mortgage, the payee-mortgagee must pursue the remedy of foreclosure under C.C.P. 726 to enforce the obligation of the maker. But if the payee pledges or assigns the note as collateral security for his or her own note to a third person, the third person does not have to comply with C.C.P. 726 to enforce the primary obligation of the payee on his or her own note. (*Bank of California v. Leone* (1974) 37 C.A.3d 444, 448, 112 C.R. 394; on security interest in personal property or fixtures, see 4 *Summary* (10th), *Secured Transactions in Personal Property*, §36 et seq.)

(4) *Letters of Credit.* A pre- or post-judicial or nonjudicial foreclosure demand for payment under a letter of credit issued as additional collateral for an obligation secured by real property is not an action under C.C.P. 726(a), or a deficiency judgment under C.C.P. 580a, 580b, 580c, or 726(b). (C.C.P. 580.5(b); see *Western Sec. Bank v. Superior Court* (1997) 15 C.4th 232, 62 C.R.2d 243, 933 P.2d 507, 7 *Summary* (10th), *Constitutional Law*, §623 [tracing history of C.C.P. 580.5, and holding that Legislature intended it to apply to existing loan transactions supported by outstanding letters of credit]; 4 *Miller & Starr* 3d, §10:173; 31 *San Diego L. Rev.* 775 [vanishing utility of letters of credit in real estate transactions]; on definition of "letter of credit" as used in C.C.P. 580.5, see C.C.P. 580.5(a)(3) and U.C.C. 5102(a)(10); on unenforceability of letter of credit in loan transaction, where loan is secured by real property containing one to four residential units, see C.C.P. 580.7; on anti-deficiency statutes generally, see *infra*, §178 et seq.; on letters of

credit generally, see 4 *Summary* (10th), *Negotiable Instruments*, §136 et seq.)

SUPPLEMENT: [This section is current through the latest supplement]



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A. One-Action Rule.

2. Where Rule Does Not Apply.

b. Action Is Not To Recover Debt.

4 *Witkin Sum. Cal. Law STRP* § 126

[§ 126] Action Is Not To Recover Debt.

(1) *Action for Possession of Security.* C.C.P. 726 does not require that foreclosure proceedings be brought prior to an *unlawful detainer* action for failure to pay rent, even though a mortgage or deed of trust has been given as security for the payment. (*Ashcroft Estate Co. v. Nelson* (1915) 26 C.A. 400, 401, 147 P. 101; *Willys of Marin Co. v. Pierce* (1956) 140 C.A.2d 826, 829, 296 P.2d 25; on unlawful detainer, see 12 *Summary* (10th), *Real Property*, §703.)

If an obligation is secured by personal property or fixtures as well as real property, the mortgagee may proceed against the mortgagor *solely* with respect to the personal property or fixtures. (U.C.C. 9604(a)(1); see *infra*, §136.) If the mortgagee does so, the action will constitute an "action" under C.C.P. 726 only if the mortgagee seeks a money judgment against the mortgagor; and the mortgagee will be precluded from enforcing the real mortgage (see *infra*, §132) when a monetary judgment is obtained. (U.C.C. 9604(a)(3)(B); see *infra*, §136.)

(2) *Action for Conversion of Note.* In *Meyer v. Thomas* (1936) 18 C.A.2d 299, 63 P.2d 1176, plaintiff, holder of a secured note for \$ 6,500, pledged the note and deed of trust with defendant to secure a \$ 250 loan. Defendant surrendered the note to the debtor in return for a transfer of the land. *Held*, plaintiff could sue for conversion of the note without first seeking foreclosure or otherwise showing that the security was exhausted. (18 C.A.2d 302.)

(3) *Action for Rescission and Damages for Fraud.* A defrauded mortgagee or beneficiary under a trust deed may rescind for fraud and recover damages; the action is not to recover a debt or a deficiency judgment on the note. (*Kass v. Weber* (1968) 261 C.A.2d 417, 423, 67 C.R. 876; 4 *Miller & Starr* 3d, §§10:164, 10:165.)

(4) *Statutory Action for Fraud.* A mortgagee or beneficiary may bring an action for damages, including exemplary damages up to 50% of actual damages, against a borrower "where the action is based on fraud" under C.C. 1572 and "the fraudulent conduct by the borrower induced the original lender to make that loan." (C.C.P. 726(f); on C.C. 1572, see 1 *Summary* (10th), *Contracts*, §286.) Doing so does not constitute an action under C.C.P. 726, except regarding certain single-family, owner-occupied, residential real property. (C.C.P. 726(g).)

(5) *Enforcement of Judgment for Attorneys' Fees.* C.C.P. 726 does not bar post-sale enforcement of a judgment for attorneys' fees and costs awarded to the beneficiary in successfully defending the trustor's action to enjoin the trustee's

sale. (See *Passanisi v. Merit-McBride Realtors* (1987) 190 C.A.3d 1496, 1505, 236 C.R. 59, *infra*, §206; on exclusion of attorneys' fees from definition of "monetary judgment on the debt", see U.C.C. 9604(a)(6).)

(6) *Action for Breach of Environmental Provision*. An action for breach and enforcement of an environmental provision is not subject to C.C.P. 726. (See C.C.P. 736(a), *infra*, §211.)

SUPPLEMENT: [This section is current through the latest supplement]



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A. One-Action Rule.

2. Where Rule Does Not Apply.

c. Action Is Not Against Mortgagor.

4 *Witkin Sum. Cal. Law STRP* § 127

[§ 127] Action Is Not Against Mortgagor.

(1) *Secondary Liability for Debt. C.C.P. 726* is designed to protect the mortgagor. Others with independent obligations to pay the same debt are not protected, and the mortgagee may sue them directly, without foreclosure. These include indorsers, sureties, and guarantors. (*Carver v. Steele* (1897) 116 C. 116, 119, 47 P. 1007; *Kinsel v. Ballou* (1907) 151 C. 754, 760, 91 P. 620; *Loeb v. Christie* (1936) 6 C.2d 416, 419, 57 P.2d 1303; *Stephenson v. Lawn* (1957) 155 C.A.2d 669, 671, 318 P.2d 132; see *Paykar Const. v. Spilat Const. Corp.* (2001) 92 C.A.4th 488, 497, 111 C.R.2d 863 [where general contractor and property owner were jointly and severally liable to plaintiff subcontractor under unsecured subcontract, and owner settled with plaintiff, giving plaintiff separate secured obligation, plaintiff's foreclosure action against owner did not preclude subsequent action against general contractor because owner and general contractor were not jointly liable for same debt arising from secured transaction; distinguishing *Pacific Valley Bank v. Schwenke* (1987) 189 C.A.3d 134, 234 C.R. 298, *infra*, §135, and *Shin v. Superior Court* (1994) 26 C.A.4th 542, 31 C.R.2d 587, *infra*, §129].) But a secondary obligor may require the mortgagee to first exhaust his or her remedy against the principal (mortgagor). (See C.C. 2845; *Everts v. Matteson* (1942) 21 C.2d 437, 444, 132 P.2d 476; 4 Miller & Starr 3d, §10:168 et seq.; C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §4.29 et seq.; on effect of action against comaker, see *infra*, §135.)

If the secondary obligor executes a mortgage or deed of trust to secure his or her guaranty, the secondary obligor is entitled to the protection of C.C.P. 726. Thus in *Bayless v. Ames* (1929) 207 C. 54, 276 P. 1011, defendants guaranteed that X would have payments to plaintiffs, and gave plaintiffs a mortgage to secure this contract of guaranty. On the default of X and refusal of defendants to perform, plaintiffs brought suit against them on the contract of guaranty and received judgment. Later plaintiffs attempted to foreclose the mortgage given by defendants. *Held*, it could not be foreclosed. An action against X would not have been a bar to foreclosure against defendants, because X was not the mortgagor, even though he was the primary debtor; but the action against defendants was an action against mortgagors, and a second action was prohibited by C.C.P. 726. (207 C. 59.)

(2) *Third Party Is Subject to Mechanic's Lien.* Another exception is illustrated by *Martin v. Becker* (1915) 169 C. 301, 146 P. 665. A subcontractor furnished materials for a building, and took a mortgage on other property of the general contractor to secure payment. The general contractor became bankrupt, and the subcontractor filed a mechanic's lien against the building. It was objected that his debt was secured by a mortgage, and that this should first be

foreclosed. *Held*, the proceeding to enforce the mechanic's lien was not an action against the mortgagor directly affecting the mortgage contract, and *C.C.P.* 726 did not apply. (169 C. 304.)

(3) *Distinction: Assuming Grantee.* A grantee of the mortgagor who assumes the mortgage debt is in a position similar to that of a mortgagor, *even though the grantee signs a separate guaranty of payment*; i.e., the creditor cannot sue the grantee independently on the guaranty, but must proceed first against the property. (*Birkhofer v. Krumm* (1935) 4 C.A.2d 43, 50, 40 P.2d 553; see C.E.B., 2 Mortgage and Deed of Trust Practice 3d, §9.124.)

In *Security-First Nat. Bank of Los Angeles v. Chapman* (1939) 31 C.A.2d 182, 188, 87 P.2d 724, a mortgagor corporation had incurred bonded indebtedness secured by a mortgage. Another corporation assumed the obligation. The mortgagee sued the stockholders of the assuming corporation on their then independent liability for the debts of the corporation, without exhausting the security. *Held*, this was improper. (a) Under *C.C.P.* 726, the assuming corporation was liable only for a deficiency remaining after exhaustion of the security. (b) The stockholders of the mortgagor corporation could be held independently liable for the debt, but the stockholders of the assuming corporation were liable only for the exact obligation incurred by their corporation, i.e., the deficiency owed after exhaustion of the security. (See *Everts v. Matteson*, *supra*, 21 C.2d 448; *infra*, §179.)

(4) *Action for Damages Against Negligent Third-Party Tortfeasor.* A mortgagee may bring an independent action against a third party whose negligence damaged the security without violating *C.C.P.* 726. (See *U.S. Financial v. Sullivan* (1974) 37 C.A.3d 5, 112 C.R. 18, *supra*, §86.)

SUPPLEMENT: [This section is current through the latest supplement]



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VII. REMEDIES OF MORTGAGEE AND TRUSTEE

A. One-Action Rule.

2. Where Rule Does Not Apply.

d. Remedy Is Not Action.

4 *Witkin Sum. Cal. Law STRP* § 128

[§ 128] Remedy Is Not Action.

(1) *Sale Under Power of Sale Mortgage or Deed of Trust*. Exercise of a power of sale in a deed of trust or mortgage is not an action and does not violate C.C.P. 726. (See *Cosentino v. Coastal Const. Co.* (1994) 30 C.A.4th 1712, 1715, 36 C.R.2d 444, citing the text [Prob.C. 9391, requiring mortgage holder in action to enforce lien against estate to waive all recourse against other estate property, does not apply to private nonjudicial foreclosure]; *Birman v. Loeb* (1998) 64 C.A.4th 502, 509, 75 C.R.2d 294, *infra*, §187; 4 Miller & Starr 3d, §§10:162, 10:179; C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §§2:11, 4.17.)

(2) *Appointment of Receiver*. If the property is in danger of loss, removal, or material injury, or it is probably insufficient to discharge the debt, the mortgagee may seek the appointment of a receiver in the foreclosure action. (C.C.P. 564(b)(2); see 4 Miller & Starr 3d, §10:163; 82 A.L.R.2d 1075; 6 Cal. Proc. (4th), *Provisional Remedies*, §§426, 427.)

(3) *Order of Court To Exercise Right To Inspect for Hazardous Substances*. A petition by a secured lender to enforce a right to inspect for hazardous substances is not an action under C.C.P. 726(a). (C.C. 2929.5(d); C.C.P. 564(d) [appointment of receiver to enforce C.C. 2929.5(d)]; *infra*, §209.)

(4) *Enforcement of Assignment of Rents*. An action by an assignee of rents to enforce its security interest on the assignor's default is not an action within the meaning of C.C.P. 726. (C.C. 2938; see *supra*, §100.)

(5) *Distinction: Bank's Setoff Is Action*. Although technically a bank's setoff against a general deposit account does not come within the statutory definition of "action" (C.C.P. 22; see 3 Cal. Proc. (4th), *Actions*, §11), it was decided at an early date in California that this kind of setoff is an action for purposes of the one action rule of C.C.P. 726. (See *McKean v. German-Amer. Savings Bank* (1897) 118 C. 334, 50 P. 656; *Gnarini v. Swiss Amer. Bank of Locarno* (1912) 162 C. 181, 184, 121 P. 726; *Bank of America v. Daily* (1984) 152 C.A.3d 767, 771, 199 C.R. 557, *infra*, §133; *Security Pac. Nat. Bank v. Wozab* (1990) 51 C.3d 991, 1000, 275 C.R. 201, 800 P.2d 557, *infra*, §134 [reaffirming rule]; 4 *Summary* (10th), *Negotiable Instruments*, §82; on application of C.C.P. 726 to setoffs generally, see *infra*, §§133, 134.)

SUPPLEMENT: [This section is current through the latest supplement]

(2) *Appointment of Receiver.*

Cross-Reference: 6 Cal. Proc. (5th), *Provisional Remedies*, §§429, 430.

(5) *Distinction: Bank's Setoff Is Action.*

Cross-Reference: 3 Cal. Proc. (5th), *Actions*, §62.



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A. One-Action Rule.

2. Where Rule Does Not Apply.

e. Property or Mortgagor Is Outside State.

4 *Witkin Sum. Cal. Law STRP* § 129

[§ 129] Property or Mortgagor Is Outside State.

(1) *Property Outside State.* C.C.P. 726 applies to actions in California to foreclose mortgages on property in California. Land elsewhere is subject to the law of its situs. (See 12 *Summary* (10th), *Real Property*, §4; for contrary rule in action for deficiency judgment, see *supra*, §33.) In *Felton v. West* (1894) 102 C. 266, 36 P. 676, a mortgage was executed in California, on land in Oregon. The mortgagee foreclosed in Oregon, sold the property, and credited the proceeds on the note. The foreclosure was had by published summons; consequently no deficiency judgment was rendered. The mortgagee, who had already brought one action, sued for the deficiency in California. *Held*, he could recover. (102 C. 270.) (See *Maryland Cas. Co. v. Nottingham* (1936) 18 C.A.2d 135, 137, 63 P.2d 864; 25 Cal. L. Rev. 576, 581, 590.)

(2) *Mortgagor Outside State.* If the mortgagor is out of the state, personal service cannot be made within the jurisdiction. Formerly, a personal judgment could not be had for the deficiency should the land prove of less value than the amount of the debt, and the justice of allowing a second action was recognized in *Blumberg v. Birch* (1893) 99 C. 416, 34 P. 102, where the mortgagee foreclosed while the mortgagor was absent. (See 25 Cal. L. Rev. 576, 587.)

A personal judgment can now be obtained against a defendant *domiciled* in this state, though he or she is not present and is merely served with summons outside the state. (See 2 Cal. Proc. (4th), *Jurisdiction*, §129.) Where the mortgagor is an absent California resident, and a deficiency judgment could have been obtained, the reasoning of the *Blumberg* case may perhaps be open to reexamination. (For similar problem on statute of limitations, see 3 Cal. Proc. (4th), *Actions*, §§647, 648.)

(3) *Property in State and Action Brought Elsewhere.* Where the land is in California and a personal action is brought elsewhere, the action constitutes a waiver of the right to foreclose in California. (*Ould v. Stoddard* (1880) 54 C. 613; see 9 Cal. L. Rev. 503.) However, the mere commencement of the action is not a waiver if it is dismissed before judgment. (*Brice v. Walker* (1920) 50 C.A. 49, 54, 194 P. 721; see 25 Cal. L. Rev. 576, 585.)

In *Shin v. Superior Court* (1994) 26 C.A.4th 542, 31 C.R.2d 587, plaintiffs borrowed \$ 9.6 million from a bank, secured by a deed of trust on California real property. Plaintiffs then defaulted on the promissory note. The bank brought a judicial action in Korea, and obtained a prejudgment attachment order recorded against real property in Korea

owned by one of the plaintiffs. Subsequently, the bank filed an action in California and obtained a ruling that it was permitted to obtain judicial foreclosure and a deficiency judgment against plaintiffs. Plaintiffs sought review, contending that the bank had violated the one action rule. *Held*, plaintiffs were entitled to invoke the sanction of *C.C.P.* 726(a); the ruling permitting foreclosure and a deficiency judgment would be set aside.

(a) The filing in the Korean court constituted an action within *C.C.P.* 726(a) and *C.C.P.* 22. It was clear that the bank prosecuted its claim on the debt in a court of justice for the protection of its right to recover the claim evidenced by the secured promissory note. The bank was required to make only a minimal showing that plaintiff was indebted to the bank. Whether the bank was required to follow up with another action to foreclose was of no consequence, because either way the bank invoked the jurisdiction of the Korean court to protect its claim with an involuntary lien. (26 *C.A.4th* 546, 547.)

(b) The bank contended that the Korean action did not violate the one action rule because it did not proceed to judgment. Although the mere commencement by a creditor of an action that does not include foreclosure of all the real property security does not violate the rule, the recovery of a personal judgment against the debtor does so. The law is not clear when the creditor's conduct lies between these two extremes. However, if the exercise of an involuntary "banker's lien" in *Security Pac. Nat. Bank v. Wozab* (1990) 51 *C.3d* 991, 275 *C.R.* 201, 800 *P.2d* 557, *infra*, §134, constituted an election of remedies triggering forfeiture of the creditor's security interest, the initiation of an independent judicial proceeding to attach a debtor's unpledged personal assets should have the same effect. (26 *C.A.4th* 547, 548.) Although there is authority for the proposition that *C.C.P.* 726 is only triggered after the claim is reduced to judgment, application of this rule has been limited to cases where the debtor's unpledged assets have not been subjected to attachment, or where the attachment has been reduced to execution on the final judgment. (26 *C.A.4th* 551, citing the text.) Here, where the creditor brought an action only on the note without reference to the security and obtained a provisional remedy affecting the debtor's property, the situation is expanded substantially beyond the mere filing of a lawsuit. (26 *C.A.4th* 551.)

(c) The bank's contention that any violation of the one action rule would apply only to the plaintiff who owned the Korean property, and not to the comakers of the promissory note, is incorrect. The bank chose an instrument in which the promissory note and deed of trust composed one form of contract. By making this choice, the bank limited itself to the collection procedures prescribed by law, including the limitations imposed by *C.C.P.* 726. (26 *C.A.4th* 553.) A secured creditor cannot file and pursue actions against some of the borrowers and not others without risking the loss of the security. "To conclude otherwise would allow secured creditors to generate multiple lawsuits, coerce borrowers and delay or avoid altogether the exhaustion of the security for the loan." (26 *C.A.4th* 554.)

SUPPLEMENT: [This section is current through the latest supplement]

(2) *Mortgagor Outside State.*

Domicile in California:

Cross-Reference: 2 *Cal. Proc.* (5th), *Jurisdiction*, §127.

Problem on statute of limitations:

Cross-Reference: 3 *Cal. Proc.* (5th), *Actions*, §§713, 714.



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CHAPTER VIII - Security Transactions in Real Property

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VII. REMEDIES OF MORTGAGEE AND TRUSTEE

A. One-Action Rule.

2. Where Rule Does Not Apply.

f. Security Is Valueless.

4 *Witkin Sum. Cal. Law STRP* § 130

[§ 130] Security Is Valueless.

If the *mortgage* is void, it is no security at all, and an action may be brought directly on the note. Likewise, though the mortgage is valid, if the *property* has become valueless without the fault of the mortgagee, or the *security* of a junior lien becomes valueless by reason of prior encumbrances in an amount greater than the value of the property, foreclosure would be futile, and is not required. (*Savings Bank of San Diego County v. Central Market Co.* (1898) 122 C. 28, 36, 54 P. 273; *Ferry v. Fisk* (1921) 54 C.A. 763, 765, 202 P. 964 [mortgage lien was extinguished by sale under prior deed of trust]; *Ladd v. Mathis* (1932) 125 C.A. 535, 539, 13 P.2d 1012; see *Ghirardo v. Antonioli* (1996) 14 C.4th 39, 48, 57 C.R.2d 687, 924 P.2d 996, *infra*, §215 [exception to one form of action rule was inapplicable where trust deed beneficiary himself caused loss of security by submitting inaccurate payoff demand, accepting payoff, and reconveying deed of trust]; cf. *Brown v. Jensen* (1953) 41 C.2d 193, 196, 259 P.2d 425, *infra*, §192; *Roseleaf Corp. v. Chierighino* (1963) 59 C.2d 35, 39, 27 C.R. 873, 378 P.2d 97, *infra*, §181; see 4 Miller & Starr 3d, §10:158; C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §4.36 et seq.)

In *Otto v. Long* (1900) 127 C. 471, 59 P. 895, the mortgagor had no interest in the property when he executed the mortgage, and never acquired any afterwards. *Held*, the mortgagee could sue on the note. (127 C. 477.) (See *Dyer Law & Collection Co. v. Abbott* (1921) 52 C.A. 545, 199 P. 340.)

But a mortgagee who asserts that the property is valueless must show a change in value. If the mortgagee accepted property as security with knowledge of its insufficiency, and it did not decrease in value prior to suit, a personal action is improper. (*Giandini v. Ramirez* (1936) 11 C.A.2d 469, 471, 54 P.2d 91; see *Security-First Nat. Bank of Los Angeles v. Chapman* (1939) 31 C.A.2d 182, 194, 87 P.2d 724 [mere allegation that security was valueless or would become so was insufficient]; C.E.B., 1 Mortgage and Deed of Trust Practice §4.36 et seq.; 25 *Cal. L. Rev.* 469, 473.)

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VII. REMEDIES OF MORTGAGEE AND TRUSTEE
A. One-Action Rule.
3. Advance Waiver Is Invalid.

4 *Witkin Sum. Cal. Law STRP* § 131

[§ 131] Advance Waiver Is Invalid.

(1) *Former Law.* Prior to the enactment of C.C. 2953 in 1937, the validity of a waiver of C.C.P. 726 in the instrument was uncertain. (See *Martin v. Becker* (1915) 169 C. 301, 305, 146 P. 665 [object of statute is protection of mortgagor; therefore, under C.C. 3513, mortgagor could waive its benefit]; *Bank of Italy Nat. Trust & Savings Assn. v. Bentley* (1933) 217 C. 644, 658, 20 P.2d 940 [no waiver provision was involved; rule of first exhausting security is one of public policy]; *Winklemen v. Sides* (1939) 31 C.A.2d 387, 404, 88 P.2d 147 [waiver would be void]; *Security-First Nat. Bank of Los Angeles v. Chapman* (1939) 31 C.A.2d 182, 190, 87 P.2d 724 [question left open]; 27 Cal. L. Rev. 752; 8 So. Cal. L. Rev. 35.)

(2) *Express Advance Waiver Is Void.* With the exception of security interests securing certain corporate and public utility bonds, an express agreement waiving the protection of C.C.P. 726 is void if it is made by a borrower "at the time of or in connection with" making or renewing a loan secured by a deed of trust, mortgage, or other instrument creating a lien on real property. (C.C. 2953; see *Salter v. Ulrich* (1943) 22 C.2d 263, 267, 138 P.2d 7; *O'Neil v. General Sec. Corp.* (1992) 4 C.A.4th 587, 603, 5 C.R.2d 712, *infra*, §132; C.E.B., 1 Mortgage and Deed of Trust Practice §4.60 et seq.)

(2) *Distinction: Waiver by Guarantor.* Historically, a guarantor of a mortgagor's obligation relied not on C.C.P. 726 but on the similar protection of general suretyship principles, which require the creditor to exhaust his or her direct remedies before proceeding against the guarantor (see *supra*, §127). A guarantor may effectively waive this protection, and that of C.C.P. 726. (See C.C.P. 2856, *infra*, §204 [applying to waivers of rights or defenses under C.C.P. 726 that are executed on or after January 1, 1997]; *American Guaranty Corp. of Calif. v. Stoddy* (1964) 230 C.A.2d 390, 394, 41 C.R. 69, 1 Summary (10th), Contracts, §680; C.E.B., 2 Mortgage and Deed of Trust Practice 3d, §9.108.) And this waiver is not within the scope of C.C. 2953; thus, it may be given when the loan is made. (*Engelman v. Bookasta* (1968) 264 C.A.2d 915, 917, 71 C.R. 120.)

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VII. REMEDIES OF MORTGAGEE AND TRUSTEE

A. One-Action Rule.

4. Affirmative Defense and Election of Remedy.

a. In General.

4 Witkin Sum. Cal. Law STRP § 132

[§ 132] In General.

If the creditor sues on the note, disregarding the security, and the debtor allows personal judgment to go against him or her without objecting on that ground, (1) the debtor waives the protection of *C.C.P.* 726, and (2) the creditor elects the single remedy of a personal action and cannot thereafter foreclose or sell the security under a power of sale. (See *Salter v. Ulrich* (1943) 22 *C.2d* 263, 267, 138 *P.2d* 7; *Bank of America v. Daily* (1984) 152 *C.A.3d* 767, 772, 199 *C.R.* 557; *Ziello v. Superior Court* (1995) 36 *C.A.4th* 321, 331, 42 *C.R.2d* 251 [after home was damaged in earthquake and homeowner defaulted on loan, lender's resistance to homeowner's attempt to take control of earthquake insurance proceeds, paid jointly to homeowner and lender, did not constitute waiver of right to foreclose]; *Scalese v. Wong* (2000) 84 *C.A.4th* 863, 869, 870, 101 *C.R.2d* 40, citing the text; 4 *Miller & Starr* 3d, §10:156; *C.E.B.*, 1 Mortgage and Deed of Trust Practice 3d, §4.24 et seq.; 31 *Cal. L. Rev.* 429, 433.)

In *James v. P.C.S. Ginning Co.* (1969) 276 *C.A.2d* 19, 80 *C.R.* 457, citing the text, the creditor took security consisting of personal property and an equitable lien on a house of the debtors. The equitable lien was recorded prior to the debtors' declaration of homestead, and therefore was prior to the homestead interest. But the creditor elected to recover a personal money judgment, then levied execution on the house and purchased at the execution sale. In the present quiet title action by plaintiff debtors, defendant creditor argued that its title related back to the time of recordation of the mortgage. *Held*, judgment for plaintiffs affirmed; election to sue on the note was a waiver of priority of the lien. "Manifestly the purpose of sections 726 and 580a is to prevent a mortgagee from bidding-in property for a nominal sum and obtaining a large deficiency judgment effectuating a forfeiture. If a mortgage lien priority remains viable despite the mortgagee's election to obtain a personal judgment, the creditor has all the advantages of a foreclosure plus a deficiency judgment by simply ignoring statutory foreclosure requirements." (276 *C.A.2d* 23.)

In *Walker v. Community Bank* (1974) 10 *C.3d* 729, 111 *C.R.* 897, 518 *P.2d* 329, D Corp. borrowed \$ 153,946 from defendant bank, giving a note in that amount and a chattel mortgage as security. As additional security for the same loan, it gave the bank another note for \$ 40,000 secured by a trust deed on real property. D Corp. defaulted, and the following proceedings took place: First, the bank brought a judicial foreclosure of the chattel mortgage, a sale was had, and a deficiency judgment of \$ 93,470.83 was entered. Neither the bank nor D Corp. mentioned the other security. Then D Corp. sold the real property to plaintiff before entry of the deficiency judgment, and the bank commenced proceedings for a nonjudicial sale of that property. Plaintiff sued to quiet title and enjoin the trustee's sale. *Held*, he was

entitled to a judgment.

(a) *Dual application of C.C.P. 726.* Where the creditor seeks a money judgment without exhausting the security, *C.C.P. 726* may be invoked in two ways: (1) The debtor may raise it as an affirmative defense, forcing the creditor to exhaust the security before getting a deficiency judgment. (2) If the debtor does not raise the defense, the debtor may still invoke the statute as a sanction against the creditor, who has made an election of remedies and waived the security. (10 C.3d 734.)

(b) *Personal property and Commercial Code.* On the adoption of the Commercial Code, the reference in *C.C.P. 726* to personal property was deleted, and the subject is covered by the Commercial Code as follows: (1) When the security is solely personal property, U.C.C. 9501 (now U.C.C. 9601 et seq.) prescribes the enforcement procedures (see 4 Summary (10th), *Secured Transactions in Personal Property*, §160). (2) Where the security is both personal and real property, U.C.C. 9501(4) (now U.C.C. 9604; see *infra*, §136) governs: The creditor may proceed as to both and, in that event, must follow the real property security statutes; if, however, the creditor proceeds solely as to personal property, the effect of his or her election is determined by other state law. (10 C.3d 735.)

(c) *Personal property and C.C.P. 726.* The other state law is *C.C.P. 726*, and the deletion of any reference to personal property did not totally exempt this security from the one action rule. The rule still applies where personal and real property are security for a single debt, because the underlying reasons for the rule remain the same: prevention of a multiplicity of suits, compelling competitive bidding to test the value of all the security, and forcing the creditor to look to all the security as the primary fund before looking to the debtor. (10 C.3d 735.)

(d) *Rejection of bank's contention.* The bank argued that it could have first exhausted the real property by a private sale, then have had a judicial foreclosure of the chattel mortgage under U.C.C. 9501(4); why, therefore, cannot the order be reversed, as here? The answer is that by the first private sale it would not have obtained a deficiency judgment without exhausting all of its security. "If the Bank's position were approved, a creditor could foreclose solely on the personal property security under the Commercial Code and obtain a deficiency judgment against the debtor without first exhausting all the security, namely the additional real property security. This flies directly in the face of the clear purpose of section 726 of requiring a secured creditor to exhaust all security first." (10 C.3d 736.)

(e) *Conclusion.* "[W]here, as here, there is a single debt secured by both real and personal property and the creditor elects to judicially foreclose only on the personal property, he thereby loses his security interest in the real property as against all parties even though the debtor does not raise the one form of action rule (§ 726) as affirmative defense in the judicial foreclosure proceedings." (10 C.3d 741.) (See 63 Cal. L. Rev. 152; 14 Santa Clara Lawyer 890; 22 U.C.L.A. L. Rev. 753; on the anti-deficiency statutes, *C.C.P. 580a* and *580d*, see *infra*, §179 et seq.)

In *O'Neil v. General Sec. Corp.* (1992) 4 C.A.4th 587, 5 C.R.2d 712, a group of individuals ("Judgment Creditors") loaned money to a partnership ("Borrowers") and received a promissory note secured by real property. Borrowers defaulted on the note, but were able to obtain new lenders ("Refinancers") to insure repayment of Judgment Creditors' loan. At the insistence of Refinancers, Judgment Creditors agreed to subordinate their trust deed. Borrowers then defaulted on both notes. Judgment Creditors brought an action against Borrowers, resulting in a settlement agreement. The settlement stipulated to a *personal* judgment against Borrowers for a certain sum, but purported to preserve the right of Judgment Creditors to proceed with a nonjudicial foreclosure of their subordinated deed of trust. In a subsequent judicial foreclosure of Refinancers' deed of trust, Judgment Creditors cross-complained, claiming that their trust deed was senior to Refinancers' because the subordination agreement was invalid. *Held*, entry of personal judgment in the prior action barred Judgment Creditors' from further pursuing their security interest as against Refinancers.

(a) Judgment Creditors pursued a course analogous to that of the creditor in *Walker v. Community Bank*, *supra*. Judgment Creditors prosecuted an action resulting in a personal deficiency judgment on a note without first exhausting the security through judicial foreclosure proceedings, and now seek to realize on the security interest under a "retained"

right to nonjudicially foreclose. The only distinction between this case and *Walker* is the debtor's waiver of the sanction aspect of *C.C.P.* 726. (4 *C.A.4th* 598.)

(b) The waiver was not enforceable against Refinancers, a nonconsenting third party. Refinancers' status as beneficiaries of a trust deed gives them a sufficient interest in the property to protect them under *C.C.P.* 726. Under *Walker* and *Salter*, the sanction aspect of *C.C.P.* 726 operates "for the benefit of both the primary debtor and third parties claiming an interest in the property, whether as successors-in-interest or third party lienholders." A waiver by one party does not forfeit the benefits enjoyed by other protected parties. (4 *C.A.4th* 599, 600.) To permit waiver of the sanction aspect of *C.C.P.* 726 would frustrate the purposes of the statutory scheme. (4 *C.A.4th* 603.)

(c) By taking a personal judgment on the note, Judgment Creditors exhausted all of their remedies under both the note and trust deed, limiting their rights to those of any other ordinary judgment creditor. Although Judgment Creditors could levy on the property by writ of execution, the resulting lien would not relate back to the priority enjoyed by the original trust deed. (4 *C.A.4th* 602.)

In *Kirkpatrick v. Westamerica Bank* (1998) 65 *C.A.4th* 982, 76 *C.R.2d* 876, the court applied the election of remedies doctrine to the one action rule. The sanction of loss of security may apply if the conduct of a creditor in prosecuting an action "amounts to an election of a remedy other than foreclosure or if other conduct is analogous to such an election of a remedy." (65 *C.A.4th* 990.) Here, the conduct of defendant bank "in litigating the count of its complaint for damages for breach of a claimed implied obligation under the loan agreement to sell off apartment units as condominiums to the point of an adverse partial summary judgment does not constitute an election of remedies under the res judicata branch of election of remedies doctrine. That occurs at the point the judgment attains finality when the claim is merged in the judgment." (65 *C.A.4th* 990.) Further, there was not sufficient prejudice attributable to the defendant's failure to pursue the proper remedy of foreclosure to create an estoppel, the other branch of the election of remedies doctrine. (65 *C.A.4th* 991.)

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A. One-Action Rule.

4. Affirmative Defense and Election of Remedy.

b. Effect of Setoff.

4 *Witkin Sum. Cal. Law STRP* § 133

[§ 133] Effect of Setoff.

Exercise of the right of equitable setoff is an action that invokes the sanction of *C.C.P. 726*. (*Aplanalp v. Forte* (1990) 225 C.A.3d 609, 614, 615, 275 C.R. 144 [discussing *Walker v. Community Bank* (1974) 10 C.3d 729, 111 C.R. 897, 518 P.2d 329, supra, §132]; see 4 Miller & Starr 3d, §10:167; cf. *Birman v. Loeb* (1998) 64 C.A.4th 502, 509, 511, 75 C.R.2d 294, infra, §187 [although setoff action following nonjudicial foreclosure was only action involved, it would not be allowed where it contravened economic policy considerations behind anti-deficiency statutes]; on bank's setoff as action generally, see supra, §128.)

In *Bank of America v. Daily* (1984) 152 C.A.3d 767, 199 C.R. 557, defendant debtors owed accrued interest on a delinquent loan secured by their deed of trust. Plaintiff bank, the creditor, unilaterally set off the amount due from the debtors' checking account, and later obtained judgment in an action to judicially foreclose the deed of trust. Because the setoff was an action within the scope of *C.C.P. 726* (see supra, §124), the question was what sanction would be appropriate for the Bank's *C.C.P. 726* violation. (152 C.A.3d 772.) *Held*, judgment reversed with directions to enter judgment for defendants together with attorneys' fees and costs.

(a) "Arguably the fairest sanction is to require the Bank to refund to the Dailys the money taken from their checking account plus accrued interest as a condition to proceeding with the judicial foreclosure. This approach returns the parties to the position they were in before the setoff and avoids the harshness of precluding the Bank from foreclosing on its security. Moreover, since the security presumably is worth more than the setoff, this approach also prevents the Dailys from unfairly benefiting from the Bank's setoff action. Otherwise, that action will relieve the Dailys of their obligation to pay the full amount of a debt on which they have personal liability." (152 C.A.3d 772.)

(b) But the harshness flowing from applying *C.C.P. 726* as a sanction is necessary to uphold the statutory policy of protecting debtors' rights. The defaulting mortgagor is not viewed as a wrongdoer; in addition to *C.C.P. 726*, the statutes limiting deficiency judgments give the mortgagor substantial protection against lenders. (152 C.A.3d 772.)

(c) "Here, the Bank's self-help in setting off the Dailys' checking account reversed the mandated statutory procedure. In effect, the Bank was attempting to collect the projected deficiency *before* the judicial foreclosure and *before* the court hearing at which the fair market value of the Carlsbad property was to be determined. As a practical

matter, by its presale setoff action, the Bank reduced the likelihood it would even seek a later money judgment. This approach not only deprived the Dailys of their funds pending eventual judicial determination of the deficiency, if any, but it also reduced the Bank's incentive to seek the highest possible price for the Carlsbad property at the foreclosure sale. Although that defect could have been judicially corrected had the Bank later attempted to obtain a money judgment, the Bank's commercial decision in setting off the Dailys' checking account placed the entire financial burden pending foreclosure on the Dailys instead of on the Bank. That result is completely contrary to the primary purpose of section 726 of requiring secured creditors to exhaust their security before proceeding against their debtors. ... Thus, to allow the Bank's setoff action to go unsanctioned would have the effect of encouraging future violations of section 726, thereby diluting the statutory protections afforded debtors." (152 C.A.3d 773.) (See 26 Santa Clara L. Rev. 533 [Daily criticized; legislative reform proposed]; 25 San Diego L. Rev. 1093 [same].)

The *Daily* dictum that the creditor waives any claim to the unpaid balance of the debt was disapproved in *Security Pac. Nat. Bank v. Wozab* (1990) 51 C.3d 991, 275 C.R. 201, 800 P.2d 557, *infra*, §134.

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A. One-Action Rule.

4. Affirmative Defense and Election of Remedy.

c. Distinction: No Waiver of Underlying Debt.

4 Witkin Sum. Cal. Law STRP § 134

[§ 134] Distinction: No Waiver of Underlying Debt.

In *Security Pac. Nat. Bank v. Wozab* (1990) 51 C.3d 991, 275 C.R. 201, 800 P.2d 557, defendant Ws had a term savings account and demand deposit accounts with plaintiff bank. They executed (1) *guaranties* of loans to A Corp., and (2) a deed of trust on their residence as security for their continuing guaranties. Plaintiff bank, concerned that A might become bankrupt, set off \$ 110,635.19 in A's demand deposit accounts and \$ 2,804.82 in the Ws' demand deposit and term savings accounts against A's indebtedness of \$ 1,090,015.96, leaving a balance due the bank of \$ 976,575.95. A then filed a bankruptcy petition. Thereafter, in discussions between the bank and the Ws on liability under their guaranties, the Ws contended that the bank's setoff without foreclosing on the real property was a waiver of its security interest under the deed of trust. The bank then reconveyed the deed of trust to the Ws (thus eliminating the security) and brought the present action for approximately \$ 976,000. The trial judge, relying on *Bank of America v. Daily* (1984) 152 C.A.3d 767, 199 C.R. 557, supra, §133, gave summary judgment for defendants on the ground that the setoff waived not only the security interest but the underlying debt as well. The Court of Appeal affirmed, but the Supreme Court reversed.

(a) *One action rule of C.C.P. 726*. The statute provides that there can be only one form of action for recovery of a debt secured by a mortgage (construed to include a deed of trust). (51 C.3d 997, 998, citing the text.) The setoff, however, was not an action or proceeding within the meaning of C.C.P. 22, and setoff was not prohibited by that part of the one action rule. (51 C.3d 998.) But C.C.P. 726 is part of a broader statutory scheme to protect debtors; it establishes the "security-first" rule, requiring the secured creditor to proceed against the security before enforcing the underlying debt. (51 C.3d 999, citing *McKean v. German-Amer. Savings Bank* (1897) 118 C. 334, 50 P. 656 §128, and cases following it.) Hence: "We reaffirm the long-standing rule that under section 726(a) a bank is not allowed to take a unilateral setoff of funds in a depositor's demand account against a debt secured by the depositor's interest in real property." (51 C.3d 1000.)

(b) *Limited effect of waiver by improper setoff*. The law does not require the "draconian sanction" of a forfeiture of the underlying debt. (51 C.3d 1002.)

(1) No prior case has held that an improper bank setoff resulted in a loss of the debt. *McKean*, did not reach the issue, nor did later cases until *Daily*. And the statement in *Daily*, that the creditor waives any claim to the unpaid

balance of the debt, was dictum. (51 C.3d 1003, 1004.)

(2) On this issue of first impression, "[w]e conclude there is no forfeiture." (51 C.3d 1004.) When the bank set off the Ws' account, "they were in the same functional position as a debtor defending a judicial action on the debt. They could have demanded that the bank proceed against the security before resorting to their personal assets, i.e., their bank deposits. Instead, they notified the bank that in their view the setoff had waived the security interest. The [Ws] then accepted the bank's reconveyance to them of the deed of trust. ... By doing so they voluntarily relinquished the protection of the security-first rule." The bank erred in taking the setoff. The Ws seized of the opportunity to reclaim their deed of trust, preventing the bank from first proceeding against the security as required by C.C.P. 726. Their belated claim that the bank should have foreclosed before seeking a personal judgment is without merit. They acquiesced in the bank's decision not to foreclose. To allow them now "to claim they were deprived of the benefits of the rule would be to encourage gamesmanship--demanding reconveyance of the security and then demanding that the creditor resort to the security. The two demands are mutually inconsistent." (51 C.3d 1005.)

(3) The result sought by the Ws would be a gross injustice to the bank and a corresponding windfall to them: "They voluntarily executed their personal guaranties and the trust deed to further *their* substantial business interests. *They* promised to pay, if necessary, the money loaned to *their* business for *their* benefit. *They* induced the bank to rely on this promise by executing the deed of trust. The [Ws] got what they wanted, money for their business. They now want to deprive the bank, however, of *its* benefit of the bargain. They have their property free and clear of the security interest and thus far have avoided the debt almost entirely--having paid only \$ 2,804.82 and leaving unpaid a balance of \$ 976,575.95. Such result would violate the notion of simple morality that 'He who takes the benefit must take the burden.' " (51 C.3d 1005, citing C.C. 3521.)

(4) The result urged would also be so harsh as to be punitive, imposing a penalty against the bank 300 times greater than the amount of the setoff. (51 C.3d 1006.)

(c) *Conclusion.* "The result we reach is also fair and workable in future cases. Because a debtor can object to an improper setoff and require the bank to return it and proceed first against the security interest, a bank cannot *unilaterally* waive its security interest by taking an improper setoff and then proceeding directly on the underlying debt. The debtor retains the right to require the bank to return the improper setoff and proceed against the security interest before the bank attempts to recover on the underlying debt. Of course, if the bank refused the debtor's demand and retained the setoff funds, the security-first rule ... would preclude the bank from foreclosing the security interest or proceeding on the underlying debt. Conversely, if the bank complied with the debtor's demand to return the funds and to proceed first against the security, the debtor could not thereafter assert that the bank had waived its security interest." (51 C.3d 1006.)

Three justices joined in a strong dissent, disagreeing with the reasoning and conclusion of the majority opinion, and supporting the position taken by the Court of *Appeal*. (51 C.3d 1006.) (See 4 Miller & Starr 3d, §§10:167, 10:178; C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §§4.27, 4.28; 79 Cal. L. Rev. 1601; 18 Pepperdine L. Rev. 1206.)

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VII. REMEDIES OF MORTGAGEE AND TRUSTEE

A. One-Action Rule.

4. Affirmative Defense and Election of Remedy.

d. Action Against Co-maker.

4 Witkin Sum. Cal. Law STRP § 135

[§ 135] Action Against Co-maker.

A secured creditor cannot file and pursue actions against some of the borrowers and not others without risking the loss of the security. (*Shin v. Superior Court* (1994) 26 C.A.4th 542, 554, 31 C.R.2d 587, supra, §129.)

In *Pacific Valley Bank v. Schwenke* (1987) 189 C.A.3d 134, 234 C.R. 298, defendant was a co-maker with O on a \$ 59,000 promissory note in favor of plaintiff bank. The note was secured by deeds of trust on property owned by O. About the time the note was made, defendant and O entered into a separate oral agreement providing that, as part of the dissolution of their partnership, defendant would be responsible for the \$ 59,000 obligation. Without defendant's knowledge, plaintiff subsequently reconveyed the secured properties to O. Plaintiff sued on the note, and the trial court entered judgment against defendant. *Held*, reversed.

(a) A co-maker of a promissory note is entitled to the protection of C.C.P. 726 even though he or she is not a party to the deed of trust securing the debt. (189 C.A.3d 137, 140.) The note and deed of trust together form one loan contract. By choosing this form of debt instrument, plaintiff placed itself within the ambit of rules governing deeds of trust including C.C.P. 726; similarly, defendant, by signing the note secured by the deed of trust, was entitled to rely on those laws. (189 C.A.3d 141.)

(b) "[A]n arrangement between a trustor and his beneficiary whereby the beneficiary relinquishes the security without retiring the note, while unusual, does not violate the statute." Because C.C.P. 726 is designed for the protection of the debtor, the debtor is entitled to waive it. (189 C.A.3d 141; see supra, §131.) Hence, as between plaintiff and O, C.C.P. 726 does not bar plaintiff's action against O on the note. (189 C.A.3d 142.)

(c) However, defendant did not consent to the reconveyances. As to him, plaintiff's dealings with O "amounted to a unilateral divestment of security in contravention of the protections" of C.C.P. 726, which thus relieved defendant of any personal liability on the promissory note. (189 C.A.3d 142, 146.) (See C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §4.30.)

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e. Mixed Collateral: Real and Personal Property.

4 Witkin Sum. Cal. Law STRP § 136

[§ 136] Mixed Collateral: Real and Personal Property.

U.C.C. 9604(a), based on former U.C.C. 9501(4), deals with mixed-collateral situations in which the obligation is secured by personal property as well as real property. (See 4 Miller & Starr 3d, §10:169; C.E.B., 2 Mortgage and Deed of Trust Practice 3d, §9.12 et seq.; 17 *Pacific L. J.* 642.)

(1) *Permissible Procedures.* The statute permits the secured party to do any of the following:

(a) Proceed, in any sequence, against the real property pursuant to real property law (see *infra*, §139 et seq.), and against the personal property or fixtures in accordance with U.C.C. 9601 et seq. (see 4 *Summary* (10th), *Secured Transactions in Personal Property*, §171 et seq.). (U.C.C. 9604(a)(1)(A).)

(b) Proceed, in any sequence, against some or all of the real property and some or all of the personal property or fixtures pursuant to real property law by including all or part of the personal property in a judicial or nonjudicial foreclosure of the real property; proceeding under this option is not an irrevocable election until there has been a unified sale (judicial or nonjudicial) and then only as to the particular property sold. (U.C.C. 9604(a)(1)(B).)

This "unified foreclosure" option is intended to apply only where a debt is secured by collateral that consists of closely related elements of real property and personal property, such as business premises plus the fixtures and inventory of the business located on the premises. Further, under former U.C.C. 9504(3) (now U.C.C. 9610), a secured creditor's sale of repossessed collateral must be conducted in a commercially reasonable manner. Thus, the unified sale option can be used only where it is commercially reasonable to conduct a unified foreclosure sale of both personal and real property collateral. (*Aspen Enterprises v. Bodge* (1995) 37 C.A.4th 1811, 1818, 1819, 44 C.R.2d 763 [after creditor suing on promissory note repossessed inventory of new tires, its amendment of complaint to add foreclosure of residential property did not constitute election of unified sale option; it would not be commercially reasonable to sell tires and residential property together].)

(c) Proceed, in any sequence, as to part of the personal property or fixtures in accordance with the Commercial Code, and as to the remainder by including it in a judicial or nonjudicial foreclosure of the real property. (U.C.C. 9604(a)(1)(C).)

(2) *Applicability of Real Property Limitations.* Real property limitations (including *C.C.P.* 726) do not apply to either (a) personal property or fixtures other than those to which the secured party has proceeded or is proceeding in accordance with U.C.C. 9604(a)(1)(B), or (b) the obligation. (U.C.C. 9604(a)(2)(A).) If an obligation secured by personal property or fixtures would otherwise become unenforceable by reason of *C.C.P.* 726 or a requirement that a creditor resort first to its security, then the obligation nevertheless remains enforceable as necessary to permit the secured party to proceed against the personal property or fixtures securing the obligation. (U.C.C. 9604(a)(2)(B).) The following *exceptions* are stated:

(a) The application of *C.C.P.* 580b, which prohibits deficiency judgments on purchase money mortgages, is unaffected. (U.C.C. 9604(a)(3)(A); see *infra*, §182 et seq.)

(b) If the secured party commences an action seeking a monetary judgment on the debt, the debtor is not prevented from asserting "the right to require inclusion in the action of any interest in real property or an estate therein securing the debt." Furthermore, if a monetary judgment on the debt is entered in the action, the debtor is not prevented from asserting the subsequent unenforceability of the encumbrance on any estate or interest in real property securing the debt that was not included in the action. (U.C.C. 9604(a)(3)(B); for definition of "money judgment on the debt," see U.C.C. 9604(a)(6).) Hence, the result of *Walker v. Community Bank* (1974) 10 C.3d 729, 735, 111 C.R. 897, 518 P.2d 329, *supra*, §132, in which *C.C.P.* 726 was applied because the mortgagee obtained a deficiency judgment in an action against the personal property before proceeding against the real property, is unaffected by the statute.

(c) Although unaffected as a prerequisite to the nonjudicial sale of real property, C.C. 2924c (*infra*, §216) "has no application to the right of a secured party to proceed as to personal property or fixtures," except to the extent the secured party is proceeding as to personal property or fixtures in a unified sale under U.C.C. 9604(a)(1)(B). (U.C.C. 9604(a)(3)(C).)

(d) The debtor is not deprived of the protection of *C.C.P.* 580d against a deficiency judgment following a sale of real property collateral pursuant to a power of sale. (U.C.C. 9604(a)(3)(D); see *infra*, §144 et seq.)

(e) Special provisions applicable to "a loan or credit sale made to any individual primarily for personal, family, or household purposes" are unaffected. (U.C.C. 9604(a)(3)(E); see *infra*, §148.)

(f) The debtor is not deprived of protection under *C.C.P.* 580a following a sale of real property collateral. (U.C.C. 9604(a)(3)(F); see *infra*, §179.)

(g) The secured party is not prevented from correcting a violation of a statute or rule requiring a creditor to resort first to its security before resorting to property that does not secure the obligation. Further, the debtor is not prevented from asserting the subsequent unenforceability of the encumbrance or obligation except to the extent the obligation is preserved by U.C.C. 9604(a)(2)(B). (U.C.C. 9604(a)(3)(G).)

(3) *Effect of No Monetary Judgment.* Notwithstanding *C.C.P.* 726 or any rule against splitting causes of action, a judicial action which neither seeks nor results in a monetary judgment on the debt does not preclude a subsequent action seeking monetary or other relief. (U.C.C. 9604(a)(5).)

(4) *Effect of C.C.P. 726 Time Limitations.* In *Florio v. Lau* (1998) 68 C.A.4th 637, 639, 80 C.R.2d 409, a case of first impression, the court addressed the question: "When a debtor secures a single obligation with 'mixed collateral' ... and when the secured creditor would otherwise be entitled to a deficiency judgment upon default, may the debtor successfully defend under *Code of Civil Procedure* section 726, which requires creditors to seek deficiency judgments within three months after a real property foreclosure sale, even if the personal property collateral has not yet been sold?" *Held*, the defense is inapplicable.

C.C.P. 726 only applies to real property actions. (68 C.A.4th 647.) Former U.C.C. 9501(4)(b)(i) (now U.C.C. 9604(a)(2)(A)) "relieves a mixed collateral creditor entirely" from complying with the 3-month time limit of *C.C.P.* 726

. That time limit is a "provision" or "limitation" of a law respecting real property and, under former U.C.C. 9501 (now U.C.C. 9604), these limitations "do not in any way apply" to the obligation. "Were we to hold otherwise, the obligation to pay a personal judgment could be limited by the real property rule" of *C.C.P.* 726 in contravention of former U.C.C. 9501 (now U.C.C. 9604). (68 *C.A.4th* 653.)

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A. One-Action Rule.

5. Dual Remedies for Deed of Trust.

a. In General.

4 Witkin Sum. Cal. Law STRP § 137

[§ 137] In General.

(1) *No Independent Action on Note.* Because the deed of trust is not a mortgage, it does not come within the express terms of *C.C.P.* 726, and it was for some time an open question whether the creditor could sue separately on the debt. (For argument in favor of this right, see *Herbert Kraft Co. v. Bryan* (1903) 140 C. 73, 81, 73 P. 745; 1 *Cal. L. Rev.* 297; 9 *Cal. L. Rev.* 387, 425; see also 20 *Cal. L. Rev.* 318; 5 *So. Cal. L. Rev.* 227.)

In *Bank of Italy Nat. Trust & Savings Assn. v. Bentley* (1933) 217 C. 644, 658, 20 P.2d 940, the court finally determined the point, declaring that "either by reason of implied agreement or by reason of public policy, the holder of a note secured by a deed of trust must first exhaust the security before resorting to the personal liability of the trustor." (See 21 *Cal. L. Rev.* 471 [note]; 8 *So. Cal. L. Rev.* 35.)

(2) *Foreclosure of Deed of Trust.* In addition to the remedy of sale under the power contained in the instrument, the creditor under a deed of trust has a statutory foreclosure remedy. The beneficiary or trustee named in a deed of trust on real property, or any interest therein, to secure a debt or other obligation, or their successors in interest, have the right to bring a foreclosure action in the manner and subject to the provisions, rights, and remedies relating to the foreclosure of a mortgage on the property. (*C.C.P.* 725a; see 21 *Cal. L. Rev.* 471; 8 *So. Cal. L. Rev.* 35; 9 *So. Cal. L. Rev.* 65.) Thus, the beneficiary under a nonpurchase money deed of trust may avoid the restrictions on deficiency judgments after nonjudicial sale (see *infra*, §199) by adopting the alternative remedy of judicial foreclosure under *C.C.P.* 725a. (See *Investcal Realty Corp. v. Edgar H. Mueller Const. Co.* (1966) 247 C.A.2d 190, 198, 55 C.R. 475; C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §3.1 et seq.)

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5. Dual Remedies for Deed of Trust.

b. Change of Remedies.

4 *Witkin Sum. Cal. Law STRP* § 138

[§ 138] Change of Remedies.

The dual remedies of foreclosure and sale, available to the holder of a deed of trust or power of sale mortgage, raise the problem of *election of remedies*. It has been held that the mere *commencement* of a foreclosure action is not such an election as to prevent subsequent exercise of the power of sale; the change in remedies does not become a binding election in the absence of estoppel, i.e., unless there is prejudice to the opposing party. (*Commercial Centre Realty Co. v. Superior Court* (1936) 7 C.2d 121, 129, 59 P.2d 978 [power of sale mortgage]; see 25 Cal. L. Rev. 477; 3 Cal. Proc. (4th), Actions, §181.) Likewise, it has been held that the creditor may cancel an election to sell and bring a foreclosure proceeding. (*Carpenter v. Hamilton* (1943) 59 C.A.2d 146, 148, 138 P.2d 353 [deed of trust].)

The question had been expressly left open, however, whether a trustee, after prosecuting a foreclosure action to *final judgment*, may thereafter proceed to sell. (*Flack v. Boland* (1938) 11 C.2d 103, 108, 77 P.2d 1090; see 27 Cal. L. Rev. 66; C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §§2.8, 2.10, 3.11; on effect of personal action on note as election, see *supra*, §132 et seq.) However, *Vlahovich v. Cruz* (1989) 213 C.A.3d 317, 261 C.R. 565, held that a trust deed beneficiary who obtained a judgment for judicial foreclosure was precluded from thereafter requesting a modification of that judgment to permit a private trustee's sale. "In our opinion, it would be extremely unfair to permit respondent to proceed to judgment in a judicial foreclosure action--thereby preserving his right to a deficiency judgment--and then, three years later, change his course of action to gain the benefit of the inflated value of San Francisco real estate and at the same time obliterate appellant's extant right of redemption." (213 C.A.3d 323.) (See *C.J.A. Corp. v. Trans-Action Financial Corp.* (2001) 86 C.A.4th 664, 669, 103 C.R.2d 538 [following *Vlahovich*; once junior lienholder knowingly and unequivocally pursued its judicial foreclosure action to judgment, it was estopped from changing course to seek money judgment to debtors' detriment].)

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Cross-Reference: 3 Cal. Proc. (5th), Actions, §186.



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B. Enforcement Procedure.

1. Judicial Foreclosure.

a. Parties.

1. Who Should Be Joined.

4 Witkin Sum. Cal. Law STRP § 139

[§ 139] Who Should Be Joined.

The object of foreclosure is to sell the right, title, and interest in the property that the mortgagor had at the time of the execution of the mortgage. The rights of the parties properly joined are concluded by the action, except that they are entitled to any surplus after payment of the first mortgage, and they may redeem. Hence, the senior mortgagee should join in the foreclosure action the mortgagor and all parties of record claiming under him or her subsequent to the date of the mortgage. This includes grantees of the mortgagor, junior mortgagees, and creditors with recorded liens provided that their claims are subsequent to the mortgage. (*Beronio v. Ventura County Lumber Co.* (1900) 129 C. 232, 237, 61 P. 958; *Palm v. Ashton* (1933) 132 C.A. 660, 662, 23 P.2d 426; see *Hurt v. Pico Inv. Co.* (1934) 136 C.A. 390, 392, 29 P.2d 310; *Johnson v. Home Owners' Loan Corp.* (1941) 46 C.A.2d 546, 548, 116 P.2d 167; *Diamond Benefits Life Ins. Co. v. Troll* (1998) 66 C.A.4th 1, 7, 77 C.R.2d 581, *infra*, §141 [grantee of easement]; 4 Miller & Starr 3d, §10:233; C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §3.23 *et seq.*; on general principles of joinder, see 4 *Cal. Proc.* (4th), *Pleading*, §155 *et seq.*)

However, if the conveyances or liens of these parties do not appear of record at the time the action is commenced, they need not be joined. (C.C.P. 726(c).) This is so even though the plaintiff has actual knowledge of their existence. (*Redondo Imp. Co. v. O'shaughnessy* (1914) 168 C. 323, 327, 143 P. 538.)

Where there is a homestead on the premises, the spouse of the mortgagor should be joined. (See *Winn v. Torr* (1938) 27 C.A.2d 623, 628, 81 P.2d 457.) And where there are state tax liens other than liens for real property taxes, the state may be made a party to determine priorities. (C.C. 2931a.)

If the grantee of the mortgagor who has duly recorded his or her deed is joined, should the *mortgagor* also be joined? (1) Where the mortgagor has made an effective, absolute grant, he or she need not be joined unless the mortgagee seeks a personal deficiency judgment against the mortgagor. (2) Where the mortgagor has made a purported absolute grant, intended only as a mortgage, the answer depends on whether the mortgagee has knowledge of the defeasible character of the grant. A mortgagee who has this knowledge must join the mortgagor. (See *Johnson v. Home Owners' Loan Corp.*, *supra*, 46 C.A.2d 549 [decided under former joinder rules].)

West's Key Number Digest, Mortgages k.426 et seq.

SUPPLEMENT: [This section is current through the latest supplement]

Cross-Reference: 4 *Cal. Proc.* (5th), *Pleading*, §173 et seq.



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1. Judicial Foreclosure.

a. Parties.

2. Who Should Not Be Joined.

4 Witkin Sum. Cal. Law STRP § 140

[§ 140] Who Should Not Be Joined.

Because the object of the foreclosure action is to sell the estate the mortgagor had when he or she executed the mortgage, only parties claiming under the mortgagor should be joined. Paramount or adverse claims should not be litigated in the action and are unaffected by it. In *McComb v. Spangler* (1886) 71 C. 418, 12 P. 347, the wife executed a mortgage of community property in which her husband did not join. In the action to foreclose, the husband did not appear to assert his claim, and a decree of foreclosure was given. *Held*, the title of the husband was paramount and could not be affected by the decree. It was not a proper issue to raise in the foreclosure action, because that action was solely to determine the interest of the mortgagor (the wife). (17 C. 423.)

If, however, a party with an adverse claim voluntarily proceeds to litigate it in the foreclosure action, and the court considers and determines the question of that party's interest, the determination is valid and binding. (*Dobbins v. Economic Gas Co.* (1920) 182 C. 616, 622, 189 P. 1073; see *Barrow v. Santa Monica Builders Supply Co.* (1937) 9 C.2d 601, 604, 71 P.2d 1108.)

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1. Judicial Foreclosure.

a. Parties.

3. Failure To Join Parties.

4 Witkin Sum. Cal. Law STRP § 141

[§ 141] Failure To Join Parties.

Parties whose interests appear of record and who are not joined are unaffected by the decree of foreclosure. (See 4 *Cal. Proc.* (4th), *Pleading*, §158; 5 *Cal. Proc.* (4th), *Pleading*, §637.)

(1) *Junior Encumbrancers.* Holders of security interests junior to the mortgage being foreclosed have, in addition to the right of redemption and the right to the surplus (*Fox v. California Title Ins. Co.* (1932) 120 C.A. 264, 266, 7 P.2d 722), the following alternative remedies: (a) They can intervene in the foreclosure action, under C.C.P. 387, thus in effect remedying the failure to join them. (See 4 *Cal. Proc.* (4th), *Pleading*, §212.) (b) They may wait until after the sale, and any one of them may foreclose his or her lien against the land in the hands of the person who purchased at the foreclosure sale. (*Frates v. Sears* (1904) 144 C. 246, 249, 77 P. 905.)

The junior encumbrancer would normally be required to satisfy the prior lien of the first mortgage. If, however, the junior encumbrancer waits until the statute of limitations runs on the debt secured by the first mortgage, he or she may foreclose without satisfying it. (*Frates v. Sears*, *supra*; see *Brandenstein v. Johnson* (1903) 140 C. 29, 30, 73 P. 744; *Foster v. Butler* (1913) 164 C. 623, 626, 130 P. 6; *Redondo Imp. Co. v. O'shaughnessy* (1914) 168 C. 323, 325, 143 P. 538; on same rule applied in action to foreclose mechanic's lien, see *Paramount Sec. Co. v. Daze* (1933) 128 C.A. 515, 516, 17 P.2d 1049; *Riley v. Peters* (1961) 194 C.A.2d 296, 298, 15 C.R. 41; *Kane v. Hozz* (1964) 230 C.A.2d 75, 77, 40 C.R. 701; 21 *Cal. L. Rev.* 624.)

(2) *Grantee of Mortgagor.* Failure to join a grantee of the mortgagor has a different result. The grantee does not, of course, lose title, but neither does his or her land escape liability for the mortgage debt. The grantee stands in the shoes of the mortgagor, and a grantee who wishes to quiet title or oust the mortgagee must first do equity by paying the debt. (*Burns v. Hiatt* (1906) 149 C. 617, 621, 87 P. 196; *Tutt v. Van Voast* (1939) 36 C.A.2d 282, 286, 97 P.2d 869; see *Diamond Benefits Life Ins. Co. v. Troll* (1998) 66 C.A.4th 1, 9, 77 C.R.2d 581 [following *Burns*; junior easement holder who was not named in judicial foreclosure proceeding but was named in subsequent quiet title action was entitled to be placed in same position as if he had been named as party in original proceeding and thus was entitled to equitable right of redemption].)

(3) *New Action To Foreclose*. Where the *mortgagee*, after the decree is rendered, discovers that he or she has failed to join a party with a record interest, the mortgagee may disregard the ineffectual decree and bring a new action to foreclose against that party. (*Hurt v. Pico Inv. Co. (1934) 136 C.A. 390, 392, 29 P.2d 310; Winn v. Torr (1938) 27 C.A.2d 623, 628, 81 P.2d 457.*) And this rule applies to a junior easement holder. (*Diamond Benefits Life Ins. Co. v. Troll, supra*, 66 C.A.4th 7 [issue of first impression].)

SUPPLEMENT: [This section is current through the latest supplement]

Cross-Reference: 4 Cal. Proc. (5th), *Pleading*, §176; 5 Cal. Proc. (5th), *Pleading*, §678.

(1) *Junior Encumbrancers*.

Cross-Reference: 4 Cal. Proc. (5th), *Pleading*, §232.



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B. Enforcement Procedure.

1. Judicial Foreclosure.

b. Pleading and Decree.

4 *Witkin Sum. Cal. Law STRP* § 142

[§ 142] Pleading and Decree.

The complaint in a foreclosure action has been discussed elsewhere. (See 5 *Cal. Proc.* (4th), *Pleading*, §634 et seq.)

The judgment or decree must declare the amount due, and, unless a deficiency is waived, must determine the personal liability of any defendant. (*C.C.P.* 726(b); see *infra*, §178 et seq.) In addition, the judgment or decree may do the following:

(1) Direct the sale of the property or as much as is necessary, and application of the proceeds to payment of court costs, expenses of sale, and the amount due plaintiff. (*C.C.P.* 726(a).)

(2) Appoint a receiver to conduct the sale. (*C.C.P.* 712.060; see *infra*, §143.)

(3) Award attorneys' fees, where the mortgage so provides, but only in an amount that the court finds reasonable. (*C.C.P.* 726, 730; see *Chase Manhattan Mortg. Corp. v. Lessel* (1997) 55 *C.A.4th* 10, 13, 64 *C.R.2d* 113 [*C.C.P.* 730 does not require award of attorneys' fees or entitle party to award]; *C.E.B.*, 1 Mortgage and Deed of Trust Practice 3d, §3.39 et seq.; 7 *Cal. Proc.* (4th), *Judgment*, §158 [attorneys' fees].)

SUPPLEMENT: [This section is current through the latest supplement]

Complaint:

Cross-Reference: 5 *Cal. Proc.* (5th), *Pleading*, §675 et seq.

(3) *Attorneys' fees:*

Cross-Reference: 7 *Cal. Proc.* (5th), *Judgment*, §167.



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1. Judicial Foreclosure.

c. Manner of Sale.

4 Witkin Sum. Cal. Law STRP § 143

[§ 143] Manner of Sale.

The last step in the judicial foreclosure of a mortgage is the sale of the property. (On foreclosure and judicial sales, see 4 Miller & Starr 3d, §10:226; C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §3.65 et seq.; 54 A.L.R.3d 1242 [mortgagor's physical interference with property subject to order of foreclosure sale as contempt of court]; 4 A.L.R.5th 693 [propriety of setting minimum or "upset" price for sale of property at judicial foreclosure]; 47 Am.Jur.2d (1995 ed.), Judicial Sales §1 et seq.; 55 Am.Jur.2d (1996 ed.), Mortgages §717 et seq.; 18 Am.Jur. P.P. Forms (1997 ed.), Mortgages, §166 et seq.; on doctrines of marshaling assets and sale in inverse order of alienation, see C.C. 2899, 3433; *Epperson v. Cappellino* (1931) 113 C.A. 473, 298 P. 533; 13 Summary (10th), Equity, §23.) The following procedure applies:

(1) A receiver may be appointed to sell the property. (C.C.P. 712.060.)

(2) If a deficiency judgment is waived or prohibited, the property is sold as provided in C.C.P. 716.020 for execution of writ of sale. (C.C.P. 726(e); see 8 Cal. Proc. (4th), Enforcement of Judgment, §330.)

(3) If a deficiency judgment is *not* waived or prohibited, the property is sold subject to the statutory right of redemption as provided in C.C.P. 729.010 et seq. (C.C.P. 726(e); see *infra*, §232 et seq.)

(4) Where the property is sold subject to the right of redemption, the sale is governed by C.C.P. 716.020 (execution of writ of sale), with specified differences relating to the notice of sale. (C.C.P. 729.010(b); see 8 Cal. Proc. (4th), Enforcement of Judgment, §330.)

SUPPLEMENT: [This section is current through the latest supplement]

See 18 Am.Jur. P.P. Forms (2005 ed.), Mortgages, §137 et seq.; 47 Am.Jur.2d (2006 ed.), Judicial Sales §1 et seq.

(2) *Property sold for execution of writ of sale:*

Cross-Reference: 8 Cal. Proc. (5th), Enforcement of Judgment, §338.(4) *Property sold subject to right of redemption:*

Cross-Reference: 8 Cal. Proc. (5th), *Enforcement of Judgment*, §338.



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a. In General.

4 Witkin Sum. Cal. Law STRP § 144

[§ 144] In General.

(1) *Power of Sale*. The power of sale in a deed of trust, power of sale mortgage, or real property sales contract allows a mortgagee or beneficiary recourse to the security without the necessity of a judicial action. (See *MCA v. Universal Diversified Enterprises Corp.* (1972) 27 C.A.3d 170, 174, 103 C.R. 522 [no violation of due process in trustor's waiver of right to judicial enforcement proceeding].) After exercise of the power, the debtor has no statutory right of redemption (see *infra*, §§232, 233) and the creditor is prohibited from recovering a deficiency judgment (see *infra*, §199). (See *Passanisi v. Merit-McBride Realtors* (1987) 190 C.A.3d 1496, 1502, 236 C.R. 59 [overview of sale under power of sale]; *Rest.3d, Property (Mortgages)* §8.1 et seq.; 4 Miller & Starr 3d, §10:179 et seq.; C.E.B., 1 Mortgage and Deed of Trust Practice 3d, Chap. 2; 68 So. Cal. L. Rev. 947 [criticizing proposals to make foreclosure sale more like ordinary sale]; 55 Am.Jur.2d (1996 ed.), *Mortgages* §532 et seq.; 18 Am.Jur. P.P. Forms (1997 ed.), *Mortgages*, §166 et seq.)

(2) *Statutory Regulation*. C.C. 2924 et seq. set forth requirements for the notice of default (*infra*, §145 et seq.), the notice of time and place of sale (*infra*, §150 et seq.), the manner of conducting the sale (*infra*, §155 et seq.), and the distribution of proceeds (*infra*, §§162, 163). A real property sales contract (*supra*, §§24, 25) containing a power of sale is a "mortgage" for purposes of C.C. 2924 et seq. (C.C. 2920(b).)

(3) *Constitutionality of Statutes*. The constitutionality of the nonjudicial sales procedure was upheld in *Garfinkle v. Superior Court* (1978) 21 C.3d 268, 146 C.R. 208, 578 P.2d 925, 7 Summary (10th), *Constitutional Law*, §621. (See *Strutt v. Ontario Savings & Loan Assn.* (1972) 28 C.A.3d 866, 877, 105 C.R. 395, and *U.S. Hertz v. Niobrara Farms* (1974) 41 C.A.3d 68, 87, 116 C.R. 44, rejecting challenge based on *Sniadach v. Family Finance Corp. of Bay View* (1969) 395 U.S. 337, 89 S.Ct. 1820, 23 L.Ed.2d 349, and pointing out that no state action is involved in procedure governed by private agreement; 7 Summary (10th), *Constitutional Law*, §§646, 647; 67 Cal. L. Rev. 684 [Garfinkle]; 9 Cal. Western L. Rev. 290 [California's Nonjudicial Foreclosure Notice Requirements and "The Sniadach Progeny"].)

West's Key Number Digest, Mortgages k.329 et seq.

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Power of Sale*. See 18 Am.Jur. P.P. Forms (2005 ed.), *Mortgages*, §182 et seq.



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aa. In General.

4 Witkin Sum. Cal. Law STRP § 145

[§ 145] In General.

A notice of default must be filed for record in the county in which the property is located at least 3 months before notice of sale (see *infra*, §150 et seq.) is given. The notice must identify the mortgage or deed of trust by stating the mortgagor's or trustor's name and giving the book and page, or instrument number, where it is recorded, or a description of the mortgaged or trust property. It must contain "a statement that a breach of the obligation for which the mortgage or transfer in trust is security has occurred," and set forth "the nature of each breach actually known to the beneficiary and of his or her election to sell or cause to be sold the property to satisfy that obligation and any other obligation secured by the deed of trust or mortgage that is in default." Where the default is curable under C.C. 2924c, the notice must contain the statement specified in C.C. 2924c(b)(1) (see *infra*, §147). (C.C. 2924; see *Perkins v. Chad Dev. Corp.* (1979) 95 C.A.3d 645, 649, 651, 157 C.R. 201 [under principles of agency and cotenancy, cobeneficiary has power to give notice]; 4 Miller & Starr 3d, §10:198 et seq.; C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §2:19 et seq.; Cal. Civil Practice, Real Property Litigation, §4:97 [request for notice of default and notice of sale], §4:98 [notice of default].)

After notice of default and election to sell, acceptance by the beneficiary of a small sum on the interest or principal will not constitute a waiver of the default. (*Harris v. Whittier Bldg. & Loan Assn.* (1936) 18 C.A.2d 260, 268, 63 P.2d 840; *Sellman v. Crosby* (1937) 20 C.A.2d 562, 564, 67 P.2d 706.) But where four substantial payments were accepted, this, together with other facts, gave rise to both a waiver and estoppel to sell. (*Altman v. McCollum* (1951) 107 C.A.2d Supp. 847, 857, 236 P.2d 914.)

West's Key Number Digest, Mortgages k.352 et seq.

SUPPLEMENT: [This section is current through the latest supplement]

(*New*) *Emergency foreclosure relief*: C.C. 2923.5, enacted in 2008 to help ameliorate the housing foreclosure crisis, requires lenders to delay sending a notice of default until 30 days after contacting a defaulting borrower or after satisfying the due diligence requirements of C.C. 2923.5(g). (C.C. 2923.5(a)(1).) The mortgagee, beneficiary, or authorized agent must contact the borrower in person or by telephone to assess the borrower's financial situation and to

explore options to avoid foreclosure. The borrower must be advised of the right to request a subsequent meeting, which must be scheduled within 14 days of the request. The borrower also must be given the toll-free number provided by the Department of Housing and Urban Development to locate certified housing counseling agencies. (C.C. 2923.5(a)(2).) C.C. 2923.5(a) does not apply if the borrower has (1) surrendered the property, (2) contracted with a person or organization whose primary business is advising borrowers how to extend the foreclosure process and avoid their contractual obligations, or (3) filed for bankruptcy, if the proceedings have not been finalized. (C.C. 2923.5(h).) This statute applies to loans made from January 1, 2003, to December 31, 2007, secured by owner-occupied, residential real property. (C.C. 2923.5(i).) It is subject to automatic repeal on January 1, 2013. (C.C. 2923.5(j).)



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1. Notice of Default and Election To Sell.

bb. Statement of Breach.

4 Witkin Sum. Cal. Law STRP § 146

[§ 146] Statement of Breach.

(1) *In General.* A full and accurate statement of the nature of the breach is necessary to enable the debtor to cure the default and obtain reinstatement of the obligations within 3 months (*infra*, §216 et seq.). Hence, strict compliance with this requirement has been demanded. (See *Bisno v. Sax* (1959) 175 C.A.2d 714, 720, 346 P.2d 814; *Tomczak v. Ortega* (1966) 240 C.A.2d 902, 904, 50 C.R. 20; *System Inv. Corp. v. Union Bank* (1971) 21 C.A.3d 137, 152, 98 C.R. 735; *Miller v. Cote* (1982) 127 C.A.3d 888, 894, 179 C.R. 753; *Little v. Harbor Pac. Mortg. Investors* (1985) 175 C.A.3d 717, 720, 221 C.R. 59 [notice of default on second deed of trust failed to demand payment on delinquent prior deed of trust].)

Minor inaccuracies, however, do not render the notice fatally defective; substantial compliance with the statute is sufficient. (See *Williams v. Koenig* (1934) 219 C. 656, 660, 28 P.2d 351 [failure to include statutory recital]; *Birkhofer v. Krumm* (1938) 27 C.A.2d 513, 522, 81 P.2d 609 [correct statement of two substantial breaches but erroneous statement of other, cumulative breaches]; *Hanlon v. Western Loan & Bldg. Co.* (1941) 46 C.A.2d 580, 587, 599, 116 P.2d 465 [minor inaccuracies in description of property]; *Sohn v. California Pac. Title Ins. Co.* (1954) 124 C.A.2d 757, 763, 269 P.2d 223 [failure to explicitly state election to accelerate].)

(2) *Contingent or Missing Assertions of Default.* In *Anderson v. Heart Fed. Savings & Loan Assn.* (1989) 208 C.A.3d 202, 256 C.R. 180, plaintiff's property was sold at a nonjudicial foreclosure based on a notice of default that included not only plaintiff's default in payment of principal and interest, but also his failure to pay "delinquent taxes and/or assessments, if any." Plaintiff sought to set aside the sale, claiming in part that defendant beneficiary improperly rejected his tender on the morning of sale. Plaintiff conceded that the amount tendered was less than the sum owing on the note *plus* the amount of delinquent taxes then owing. The trial judge granted defendant's motion for summary judgment. *Held*, reversed. "[T]he exercise of a power of sale in a deed of trust may not be predicated upon breaches in the payment of secured obligations which are listed in the notice of default as conditioned by 'if any.' These contingent assertions fail to state that a default 'has occurred,' as required by *Civil Code* 2924, and the beneficiary cannot insist that such equivocal 'defaults' be cured as a condition of avoiding a foreclosure sale." (208 C.A.3d 205.)

In 1990, the Legislature amended C.C. 2924 and C.C. 2924c (infra, §216) to nullify *Anderson*, "to the extent that the decision restricted the ability of mortgagees and beneficiaries under trust deeds to demand payment of all amounts in default under the terms of an obligation secured by a mortgage or trust deed as a condition to reinstatement of the obligation and avoidance of a sale of the security property to satisfy the obligation." (Stats. 1990, Chap. 657, §3.)

The notice of default must set forth the beneficiary's intent to sell the property to satisfy the obligation breached "and any other obligation secured by the deed of trust or mortgage that is in default." There is "a rebuttable presumption that the beneficiary actually knew of all unpaid loan payments on the obligation owed to the beneficiary and secured by the deed of trust or mortgage subject to the notice of default. However, the failure to include an actually known default shall not invalidate the notice of sale and the beneficiary shall not be precluded from asserting a claim to this omitted default or defaults in a separate notice of default." (C.C. 2924.)

SUPPLEMENT: [This section is current through the latest supplement]

(2) *Contingent or Missing Assertions of Default.* C.C. 2924 was subdivided in 2006. The rebuttable presumption stated in the text is now found in C.C. 2924(e).



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cc. Warning and Notice of Borrower's Rights.

4 Witkin Sum. Cal. Law STRP § 147

[§ 147] Warning and Notice of Borrower's Rights.

C.C. 2924c(b)(1) requires a warning at the head of the notice of default, in 14-point boldface type if printed, or in capital letters if typed: "Important Notice. If your property is in foreclosure because you are behind in your payments, it may be sold without any court action."

The notice continues with a warning to the borrower of the following:

(1) You have the legal right to bring the account in good standing by paying past due amounts plus permitted costs and expenses within the time allowed by law, normally 5 business days prior to the sale date.

(2) The accelerated amount demanded may not need to be paid, but all amounts in default must be paid.

(3) A different arrangement for curing the default may be obtained by a written agreement with the beneficiary or mortgagee.

(4) After the time for reinstatement has passed, you can stop foreclosure only by paying the entire amount.

(5) To find the amount to be paid or to stop foreclosure, you may contact the beneficiary or mortgagee at a specified address and phone.

The notice closes with a repetition of the warning: "Remember, you may lose legal rights if you do not take prompt action." (On reinstatement, see *infra*, §216 et seq.)

SUPPLEMENT: [This section is current through the latest supplement]



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- 2. Special Notice for Unruh Act Mortgages.

4 Witkin Sum. Cal. Law STRP § 148

[§ 148] Special Notice for Unruh Act Mortgages.

Special requirements apply to nonjudicial sales of single-family, owner-occupied residences being sold as the result of a contract for goods or services subject to the Unruh Act (see 4 *Summary* (10th), *Sales*, §263.). (C.C. 2924f(c)(1).)

If a default with respect to an Unruh Act mortgage has not been cured within 30 days after recordation of the notice of default, the statute requires this notice to be mailed to the last known address of the trustor or mortgagor: "You are in default under a ____ (Deed of Trust or Mortgage), dated _____. Unless you take action to protect your property, it may be sold at a public sale. If you need an explanation of the nature of the proceeding against you, you should contact a lawyer." (C.C. 2924f(c)(3); for other special provisions applicable to Unruh Act mortgages, see *infra*, §§155, 160.)

SUPPLEMENT: [This section is current through the latest supplement]



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4 Witkin Sum. Cal. Law STRP § 149

[§ 149] Notice to Junior Lienor of Uncured Default.

The mortgagee or beneficiary under a *junior deed of trust or mortgage* on property (a) containing one to four residential units, or (b) securing an original obligation not exceeding \$ 300,000, may request notice of delinquencies of 4 months or more on senior liens. (C.C. 2924e.)

(1) To obtain this notice, the junior mortgagee must send a written request by certified mail to the senior lienor or its agent for the receipt of loan payments. The request must contain specified information concerning the junior and senior liens, and must be accompanied by the written consent of the mortgagor and a \$ 40 fee. The request is effective for 5 years from the date the request is mailed or recorded, whichever is later, and it may be renewed. (C.C. 2924e(a), (b).)

(2) Rights and obligations under the statute pass to or inure to the benefit of successors in interest of the parties. A successor in interest to a junior mortgagee is entitled to the notice on filing a request with the senior mortgagee and paying a fee of \$ 15; no new written consent from the mortgagor is required. (C.C. 2924e(b).)

(3) The senior lienor must give written notice to the requestor of the fact and amount of any delinquency that is not cured within "15 days following the end of four months" of its occurrence, but no further notice is required once a notice of default has been recorded (see *supra*, §145). (C.C. 2924e(c).) Failure to provide this notice may subject the senior lienor to liability for damages that the requestor sustains from the date notice should have been given until the notice is given or a notice of default is filed, *plus* \$ 300, unless it is shown that the failure resulted from a bona fide error notwithstanding reasonable procedures to avoid errors. (C.C. 2924e(d).)

(4) Failure to comply with the statute does not affect the validity of a sale in favor of a bona fide purchaser for value or the rights of an encumbrancer for value and without notice. (C.C. 2924e(f).)

(5) On satisfaction of an obligation secured by a junior lien with respect to which a notice request under the statute was made, the beneficiary or mortgagee who made the request must notify the senior lienholder in a writing that specifies that the notice is no longer required. (C.C. 2924e(g).)

SUPPLEMENT: [This section is current through the latest supplement]



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 - 4. Notice of Time and Place of Sale.
 - aa. Content and Time of Notice.

4 Witkin Sum. Cal. Law STRP § 150

[§ 150] Content and Time of Notice.

Notice of the time and the place of sale is a prerequisite to a sale under a power of sale. (C.C. 2924, 2924f; see *Tully v. World Savings & Loan Assn.* (1997) 56 C.A.4th 654, 664, 65 C.R.2d 545 [if secured creditor fully complies with C.C. 2924f before debtor files for bankruptcy, no further notice is required as matter of law]; Cal. Civil Practice, 1 Real Property Litigation, §4:99 [notice of sale].)

(1) *Time of Notice.* The notice must be given at least 20 days before the sale (C.C. 2924f) and at least 3 months after notice of default; i.e., the notice of sale may *not* be given within the 3-month period. (C.C. 2924.)

(2) *Description of Property.* The notice must describe the property to be sold. In addition to any other description, the notice must contain an assessor's parcel number and describe the property by street address or other common designation. If the property has no street address or other designation, the notice must contain a legal description of the property, the name and address of the beneficiary, and a statement that directions may be obtained by written request to the beneficiary within 10 days from the first publication of notice. Directions will be deemed reasonably sufficient if information is given by reference to the direction and approximate distance from the nearest crossroads, frontage road, or access road. (C.C. 2924f(b)(1).)

(3) *Amount of Balance and Estimated Costs.* The notice must contain a statement of the total amount of the unpaid balance of the secured obligation and a reasonable estimate of the costs, expenses, and advances as of the initial publication of the notice of sale. (C.C. 2924f(b)(1).)

(4) *Identification of Trustor and Trustee.* The notice must contain the name of the original trustor and the name, street address, and telephone number of the trustee or other person conducting the sale. (C.C. 2924f(b)(1).)

(5) *Statement for Unruh Act Trustors.* The separate statement required by C.C. 2924f(c)(3) for Unruh Act trustors and mortgagors (see *supra*, §148) must be provided. (C.C. 2924f(b)(1).)

(6) *Unified Sale*. If the sale is to be a unified sale under U.C.C. 9604(a)(1)(B) (*supra*, §136), the notice must contain a description of the personal property or fixtures to be sold. If all of the personal property or fixtures are to be sold, the description in the securing document or financing statement is sufficient. Otherwise, the description must meet the requirements of U.C.C. 9108 (see 4 *Summary* (10th), *Secured Transactions in Personal Property*, §48). (C.C. 2924f(b)(2).)

West's Key Number Digest, Mortgages k.350, 351

SUPPLEMENT: [This section is current through the latest supplement]



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 - bb. Posting, Publication, and Recording.

4 Witkin Sum. Cal. Law STRP § 151

[§ 151] Posting, Publication, and Recording.

(1) *Posting.* The notice must be posted "in one public place" in the city or judicial district where the property is to be sold. (C.C. 2924f; see 90 A.L.R.2d 1210 [what is "public place"].) A copy must be posted in some conspicuous place on the property to be sold "where possible and where not restricted for any reason." (C.C. 2924f(b)(1).) But in a sale under a deed of trust covering 1,087 lots, it was held unnecessary to post notice on each lot. (*Peterson v. Corporation of America* (1937) 21 C.A.2d 527, 530, 69 P.2d 904; on multiple notices, see *Security-First Nat. Bank of Los Angeles v. De La Cuesta* (1936) 15 C.A.2d 302, 305, 59 P.2d 542.)

If the property is a *single-family residence*, the notice must be posted on a door, or, if that is not possible or is restricted, on some conspicuous place on the property; if access to the property is limited by a guard gate or similar impediment, the notice may be posted there. (C.C. 2924f(b)(1).)

(2) *Publication.* A copy must be published once a week for "three consecutive calendar weeks, the first publication to be at least 20 days before the date of sale" in a newspaper of general circulation in the city or judicial district "in which the property or some part thereof is situated." (C.C. 2924f(b)(1); see *Hotchkiss v. Darling* (1933) 130 C.A. 625, 626, 20 P.2d 343.) Where the property consisted of separate parcels in two different cities, it was held that notice published in one city was enough. (*Crandall v. Title Guarantee & Trust Co.* (1934) 2 C.A.2d 96, 97, 37 P.2d 519.)

(3) *Recording.* The notice of sale must be recorded with the county recorder of the county in which the property or some of it is located at least 14 days prior to the date of sale. (C.C. 2924f(b)(1).)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Posting.*

(*New*) *Emergency foreclosure relief:* C.C. 2924.8, enacted in 2008 to help ameliorate the housing foreclosure crisis, requires lenders, when a mortgage note is secured by residential real property and the billing address for the note is different than the property address, to post the notice of sale on the property to be sold. At the same time, the lender

must mail a notice in English and the languages specified in C.C. 1632 (see Supp., *infra*, §229) addressed to the "Resident of property subject to foreclosure sale" in the following language:

"Foreclosure process has begun on this property, which may affect your right to continue to live in this property. Twenty days or more after the date of this notice, this property may be sold at foreclosure. If you are renting this property, the new property owner may either give you a new lease or rental agreement or provide you with a 60-day eviction notice. However, other laws may prohibit an eviction in this circumstance or provide you with a longer notice before eviction. You may wish to contact a lawyer or your local legal aid or housing counseling agency to discuss any rights you may have." (C.C. 2924.8(a).)

This statute is subject to automatic repeal on January 1, 2013. (C.C. 2924.8(e).)



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 - cc. Effect of Noncompliance.

4 Witkin Sum. Cal. Law STRP § 152

[§ 152] Effect of Noncompliance.

(1) *Errors Not Affecting Validity of Sale.* If the legal description or the county assessor's parcel number and either a street address or another common designation of the property are given, the validity of the sale is not affected by an erroneous or omitted street address, common designation, beneficiary's name or address, or directions. Further, a good faith error in stating the unpaid balance or estimated costs and expenses, or the failure to post the notice of sale on a door do not affect the validity of a sale to a bona fide purchaser for value. (C.C. 2924f(b)(1).)

In *Knapp v. Doherty* (2004) 123 C.A.4th 76, 20 C.R.3d 1, the court decided an issue of first impression: "whether a slight deviation from statutory notice requirements may invalidate a foreclosure sale, where the trustee otherwise complies fully with the Civil Code." (123 C.A.4th 93.) *Held*, the trustee's sale was not subject to attack. Under C.C. 2924, notice of sale must be given only after the lapse of 3 months following recordation of the notice of default. Here, notice was served slightly less than 3 months after recordation, but it provided the borrowers with 29 days' notice of sale, which was more than the 20 days mandated in C.C. 2924b(b)(2). Even assuming that the sales price was grossly inadequate (see *infra*, §165), "the slight procedural irregularity in the service of the sale notice did *not* cause any injury to Borrowers. They had notice of the original sale date; the trustee's sale did not go forward until almost *one year after* the date noticed. There was no *prejudicial* procedural irregularity. Likewise, there was no evidence that the premature service ... had any impact whatsoever on the ultimate sales price." (123 C.A.4th 94.)

(2) *Voidable Sale.* Where proper notice is not given, the sale is ordinarily only *voidable*, not void, and the mortgagor cannot sue to set it aside or quiet title without offering to do equity by paying the debt. (*Leonard v. Bank of America* (1936) 16 C.A.2d 341, 346, 60 P.2d 325; see 55 Am.Jur.2d, *Mortgages* (1996 ed.), §597.) This rule seemingly applies even though the defect is a substantial one, where the recitals in the trustee's deed create a statutory presumption of compliance. (See *Little v. CFS Service Corp.* (1987) 188 C.A.3d 1354, 1359, 233 C.R. 923; *infra*, §164.)

(3) *Void Sale.* Where there is *no trustee's deed reciting compliance*, and the defect is substantial, the deed may be held void. In *Little*, no notice was given to the trustor, the junior lienor, and the judgment creditor, who had duly filed for notice. The trustee discovered the defect, explained the error to the purchasers, and returned the money paid with

interest. "[T]his case involves a serious notice defect which was directly prejudicial to individuals who could reasonably have relied on the statutory notice requirements for protection of their interests; a prompt halt to completion of the transaction as soon as the notice defect became evident; and an immediate restoration of the parties to the status quo, including payment of interest to the purported buyer for the time during which his money was unavailable to him for his use. ... Under all these circumstances, the trial court properly declared the purported sale to be void." (188 C.A.3d 1361.)

Scott v. Security Title Ins. & Guarantee Co. (1937) 9 C.2d 606, 72 P.2d 143, held that the trustee was not liable in damages to the debtors where, because of failure to post notice, the first sale was void, and later the value of the property depreciated so that a deficiency judgment was entered against plaintiffs. The court observed that there was no showing of fraud or failure to exercise due care. (9 C.2d 613.)

SUPPLEMENT: [This section is current through the latest supplement]



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CHAPTER VIII - Security Transactions in Real Property

Witkin Summary of California Law VII. REMEDIES OF MORTGAGEE AND TRUSTEE

- B. Enforcement Procedure.
 - 2. Nonjudicial Foreclosure.
 - b. Notices.
- 5. Personal Notice on Request.

4 Witkin Sum. Cal. Law STRP § 153

[§ 153] Personal Notice on Request.

(1) *In General.* C.C. 2924b requires *mailed notice*, on request, to any person desiring a copy of a notice of default and of sale. (See 4 Miller & Starr 3d, §10:199; C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §2.25; 21 *Cal. L. Rev.* 475.) Requests for notice are governed by the following rules:

(a) After recordation of the mortgage or deed of trust and before notice of default, a person may record a request for notice. (C.C. 2924b(a) [providing form for request]; C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §2.25.)

(b) If a request for notice is filed, a copy of the notice of default must be sent by the mortgagee, trustee, or other authorized person to the requesting person by registered mail within 10 business days after it is filed, and a copy of the notice of sale must be sent to the requesting person by registered or certified mail at least 20 days before the sale. (C.C. 2924b(b).)

(c) The deed of trust or power of sale mortgage may contain a request for notice on behalf of a party. (C.C. 2924b(d); see *Govt.C.* 27321.5 [requiring this request as a prerequisite to recording].)

(d) No request for notice affects title to the property, nor is it notice of any claim of an interest in the property. (C.C. 2924b(f).)

Except for specified persons (see *infra*, §154), the statute calls for personal notice only where the request is filed in accordance with its terms; where no request is made, no notice need be given. (*Lancaster Sec. Inv. Corp. v. Kessler* (1958) 159 *C.A.2d* 649, 653, 324 *P.2d* 634; *McClatchey v. Rudd* (1966) 239 *C.A.2d* 605, 608, 48 *C.R.* 783.)

(2) *Addresses.* Except for the trustor or mortgagor, the notices are to be "directed to the address designated in the request." The trustor's or mortgagor's notices are to be mailed to his or her last known address, if different from that specified in the deed of trust or mortgage. (C.C. 2924b(b)(2); see *Estate of Yates* (1994) 25 *C.A.4th* 511, 521, 32 *C.R.2d* 53 [where trustee had actual knowledge that trustor had died and that his estate was being administered by public administrator, administrator was entitled to notice under C.C. 2924b(b), which should have been sent to administrator's

office instead of trustor's home address].)

In *Lupertino v. Carbahal* (1973) 35 C.A.3d 742, 111 C.R. 112, the court, holding the notice defective, laid down the following rules:

(a) The only requirements for a valid notice are those expressly prescribed by C.C. 2924b or the instrument. Hence, a trustor who changes his or her address and neglects to comply with the statute cannot complain of failure to receive a duly mailed notice. (35 C.A.3d 748.)

(b) However, if the trustee actually communicates with the trustor at a given address, leading the trustor to believe that this address is the receiving point of communication, the trustee cannot later refuse to recognize the new address and send notice to the old one. The prior communication, calculated to instill a sense of reliance by a trustor in default, gives rise to an estoppel. (35 C.A.3d 749, 750.)

In *I.E. Associates v. Safeco Title Ins. Co.* (1985) 39 C.3d 281, 216 C.R. 438, 702 P.2d 596, a limited partnership whose property was foreclosed contended that the trustee had a common law duty under agency principles to take reasonable steps to provide *actual notice* to a defaulting trustor. The court explained its rejection of the contention as follows:

(a) "In short, there is no authority for the proposition that a trustee under a deed of trust owes any duties with respect to exercise of the power of sale beyond those specified in the deed and the statutes. There are, moreover, persuasive policy reasons which militate against a judicial expansion of those duties. The nonjudicial foreclosure statutes--an alternative to judicial foreclosure--reflect a carefully crafted balancing of the interests of beneficiaries, trustors, and trustees. Beneficiaries, of course, want quick and inexpensive recovery of amounts due under promissory notes in default. Trustors, on the other hand, need protection against the forfeiture of valuable property rights. Trustees, the middlemen, need to have clearly defined responsibilities to enable them to discharge their duties efficiently and to avoid embroiling the parties in time-consuming and costly litigation. In taking all of these concerns into account, the statutes strike an overall balance favoring the protection of trustors." (39 C.3d 288.)

(b) The beneficiary ordinarily would know if the trustor has moved, and the statute requires the beneficiary to notify the trustee of any known, new address. It is a simple task for the trustor to keep the beneficiary and trustee informed of his or her current address; but imposing on the trustee a duty to take reasonable steps to discover that address would make litigation likely whenever a person failed to receive actual notice. (39 C.3d 289.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *In General.*

(d) *No request affects title to property:* C.C. 2924b(f) was relettered C.C. 2924b(g) in 2008.

(e) *(New) Request by homeowners association:* A homeowners association may request that the mortgagee, trustee, or other person authorized to record a notice of default regarding separate interests governed by the association be mailed a copy of a trustee's deed on a sale concerning a separate interest. (C.C. 2924b(f), added in 2008.)



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- 6. Personal Notice to Others.

4 Witkin Sum. Cal. Law STRP § 154

[§ 154] Personal Notice to Others.

(1) *Notice of Default.* In addition to complying with requests for notices of default and of sale (*supra*, §153), the trustee, mortgagee, or other authorized person must mail notice of default to certain persons *shown by recorded instruments* to have interests that are subject to the deed of trust or mortgage being foreclosed. The persons specified are (a) successors to the trustor or mortgagor, including lessees, vendees under contracts of sale, and their respective successors; (b) holders of subsequent or subordinate mortgages and deeds of trust, and their assignees; and (c) when a notice of lien for postponed property taxes has been filed, the State Controller's Office. (C.C. 2924b(c); see *Perez v. 222 Sutter St. Partners* (1990) 222 C.A.3d 938, 943, 272 C.R. 119 [easement holder is not successor in interest entitled to notice under C.C. 2924b(c)]; *Estate of Yates* (1994) 25 C.A.4th 511, 521, 32 C.R.2d 53 [public administrator is not deceased trustor's successor in interest for purposes of notice under C.C. 2924b(c), because he or she does not generally acquire interest in property by recordable instrument].)

(2) *Notice of Sale.* Notice of sale must be given to any state taxing authority that recorded a notice of tax lien before the notice of default was recorded. (C.C. 2924b(c)(3).) Notice of sale also must be given to the Internal Revenue Service in accordance with 26 U.S.C., §7425, if a notice of federal tax lien has been recorded against the property subsequent to foreclosure. Failure to provide a copy of the notice to the IRS is "sufficient cause to rescind the trustee's sale and invalidate the trustee's deed, at the option of either the successful bidder at the trustee's sale or the trustee, and in either case with the consent of the beneficiary." However, the option to rescind must be exercised before a "transfer of the property by the successful bidder to a bona fide purchaser for value." (C.C. 2924b(c)(4); see *Diediker v. Peelle Financial Corp.* (1997) 60 C.A.4th 288, 293, 70 C.R.2d 442 [decided prior to adoption of C.C. 2924b(c)(4); if notice is not given to IRS, then lien still exists]; 4 Miller & Starr 3d, §10:200.)

SUPPLEMENT: [This section is current through the latest supplement]



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c. Conduct of Sale.

1. In General.

4 Witkin Sum. Cal. Law STRP § 155

[§ 155] In General.

The sale must be held in the county where the property or some part of it is located, on any business day, Monday through Friday, between the hours of 9 a.m. and 5 p.m. It must be by auction to the highest bidder. (C.C. 2924g(a); on conduct of sale generally, see 4 Miller & Starr 3d, §10:202; C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §2.56 et seq.) If a deed of trust gives a power of sale to the trustee, the attorney for the trustee may conduct the sale and act as the auctioneer. (C.C. 2924a; *Orloff v. Pece* (1933) 134 C.A. 434, 436, 25 P.2d 484.)

The trustee's fiduciary duty to the trustor, to conduct the sale fairly and openly and obtain the best possible price, is enforceable only by the trustor; but a prospective bidder may maintain a tort action against a trustee who fraudulently conducts a secret sham sale to others below the fair market value. (*Block v. Tobin* (1975) 45 C.A.3d 214, 221, 119 C.R. 288; on beneficiary's duty to disclose known facts materially affecting value of property, see *Karoutas v. Homefed Bank* (1991) 232 C.A.3d 767, 771, 283 C.R. 809, *infra*, §165; see 30 A.L.R.4th 732 [right of trustee to purchase on own behalf].)

Sales of single-family, owner-occupied residences pursuant to a contract for goods or services subject to the Unruh Act (see 4 *Summary* (10th), *Sales*, §263.) must be held in the county where the residential property is located. (C.C. 2924f(c)(4).)

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SUPPLEMENT: [This section is current through the latest supplement]

If the power of sale is conferred on the trustee, the attorney or a "duly authorized agent" may conduct the sale and act as the auctioneer. (C.C. 2924a, as amended in 2006.)



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2. Postponement.

aa. In General.

4 Witkin Sum. Cal. Law STRP § 156

[§ 156] In General.

(1) *By Unilateral Action.* A sale may be postponed (a) in the discretion of the trustee, or (b) on the beneficiary's instruction. (C.C. 2924g(c)(1); see *Hatch v. Collins* (1990) 225 C.A.3d 1104, 1113, 275 C.R. 476 [trustee has discretionary authority to postpone sale to protect either trustor's or beneficiary's interest]; 4 Miller & Starr 3d, §10:201.)

(2) *By Court Order, Operation of Law, or Mutual Agreement.* A trustee must postpone a scheduled sale (a) on a court order, (b) where the sale is stayed by operation of law, or (c) by mutual agreement, "whether oral or in writing, of any trustor and any beneficiary or any mortgagor and any mortgagee." (C.C. 2924g(c)(2); 4 Miller & Starr 3d, §10:201; 23 Western State L. Rev. 303 [procedures for delaying nonjudicial foreclosure].)

No sale may occur any sooner than the *seventh day* after the earlier of (a) dismissal of the action, or (b) expiration of the injunction, restraining order, or stay requiring postponement of the sale, unless the injunction, restraining order, or subsequent order expressly directs a sale within that period. If a sale has been scheduled to occur within this 7-day period, a new notice of postponement is required. (C.C. 2924g(d); see *Abdallah v. United Savings Bank* (1996) 43 C.A.4th 1101, 1108, 51 C.R.2d 286 [bankruptcy order, which was effective on filing instead of on entry, and which lifted automatic stay and allowed immediate foreclosure sale, did not violate C.C. 2924g(d), which authorizes court to allow sale within 7-day period after stay is terminated whether by entry of order or otherwise; order constituted termination otherwise than by entry].) Notwithstanding these time periods, if postponement is based on a stay imposed under Title 11 of the United States Code (bankruptcy), the sale must be conducted no sooner than the expiration of the stay imposed by Title 11, and the 7-day provision of C.C. 2924g(d) will not apply. (C.C. 2924g(e).) (On invalidity of sale held and trustee's deed issued notwithstanding an injunction or stay, see *infra*, §167.)

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SUPPLEMENT: [This section is current through the latest supplement]

(3) *(New) Time Limitation for Postponement.* Postponements of the sale proceedings may be made "at any time prior to

the completion of the sale for any period of time not to exceed a total of 365 days from the date set forth in the notice of sale." (C.C. 2924g(c)(1), as amended in 2005.)



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 - 2. Postponement.
 - bb. Announcements and Notices.

4 Witkin Sum. Cal. Law STRP § 157

[§ 157] Announcements and Notices.

(1) *Announcements.* Postponements must be announced at the time and place *last* noticed for the sale (except for unilaterally requested postponements pursuant to C.C. 2924g(c)(1), *supra*, §156, which are permitted until the sale is completed). (C.C. 2924g(a), (d).) If multiple sales have been scheduled for the same time and place by one trustee, postponement announcements must be at the noticed time prior to any sales. (C.C. 2924g(a).)

The notice of postponement must be by a public declaration by the trustee setting forth the new date, time, and place of the sale, with the place required to be the same as originally fixed. The trustee must maintain records of each postponement and the reason for it. (C.C. 2924g(d).)

(2) *When New Notice of Sale Is Required.* A maximum of three postponements is permitted; if a sale is postponed more than three times, scheduling a further sale requires a new notice of sale (see *supra*, §150 et seq.). However, the following are not counted against this three-postponement limitation: (a) postponements under court order, by operation of law, or by mutual agreement; (b) postponement required by C.C. 2924g(d) during the 7-day period following the expiration of a court order or postponement by operation of law; and (c) one postponement by the trustee based on a reasonable belief that a petition for bankruptcy has been filed. (C.C. 2924g(c)(2); see *California Livestock Production Credit Assn. v. Sutfin* (1985) 165 C.A.3d 136, 140, 211 C.R. 152 [automatic stay under bankruptcy law]; *Royal Thrift & Loan Co. v. County Escrow* (2004) 123 C.A.4th 24, 35, 20 C.R.3d 37 [issue of first impression; automatic stay rule for appeals applies to nonjudicial foreclosure proceedings].)

SUPPLEMENT: [This section is current through the latest supplement]

(2) *When New Notice of Sale Is Required.* C.C. 2924g(c)(2), as amended in 2005, no longer limits the number of postponements. Instead, postponements can be made at any time prior to the completion of the sale within a 365-day period. (See C.C. 2924g(c)(1), *Supp.*, *supra*, §156.) If the postponements go beyond this 365-day period, a new notice of sale, with new fees, must be given before scheduling further sale proceedings. (C.C. 2924g(c)(2).)



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3. Multiple Parcels.

4 *Witkin Sum. Cal. Law STRP* § 158

[§ 158] Multiple Parcels.

The instrument may authorize the trustee to sell a part of the premises or to hold separate sales of different parcels. (See *Security-First Nat. Bank of Los Angeles v. J.G. Ruddle Properties* (1933) 218 C. 435, 443, 23 P.2d 1016 [provision for sale as an entirety unless "impracticable"]; *Davidow v. Corporation of America* (1936) 16 C.A.2d 6, 12, 60 P.2d 132.)

When the property consists of "several known lots or parcels" (1) they must be sold separately unless the instrument provides otherwise; (2) when a portion is claimed by a third person who requires it to be sold separately, it may be thus sold; and (3) the trustor, if present, may, unless the instrument provides otherwise, direct the order in which the parcels are sold when they may be sold to advantage separately. Once sufficient property has been sold to satisfy the indebtedness, no more can be sold. (C.C. 2924g(b).)

SUPPLEMENT: [This section is current through the latest supplement]



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- 4. Terms of Sale and Creditors' Offsets.

4 Witkin Sum. Cal. Law STRP § 159

[§ 159] Terms of Sale and Creditors' Offsets.

(1) *Terms of Sale.* The trustee may require payment by the successful bidder to be in "cash, a cashier's check drawn on a state or national bank, a check drawn by a state or federal credit union, or a check drawn by a state or federal savings and loan association, savings association, or savings bank ... authorized to do business in this state, or a cash equivalent which has been designated in the notice of sale as acceptable to the trustee." (C.C. 2924h(b).) If payment is not made in cash or by a cashier's check drawn on a state or national bank, the trustee may wait to issue the deed until good funds are available. (C.C. 2924h(c).)

(2) *Creditors' Offsets.* The mortgagee may offset his or her bid "only to the extent of the total amount due ... including the trustee's fees and expenses." (C.C. 2924h(b).) *Junior* lienors bidding at a senior lienor's sale may not "bid" credit on claims against the mortgagor. (*Nomellini Const. Co. v. Modesto Savings & Loan Assn. (1969) 275 C.A.2d 114, 115, 79 C.R. 717*; see C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §2.60.)

In *Nomellini*, the sale was held under a first deed of trust. Plaintiff, holder of a third deed of trust and a judgment lien, bid \$ 65,000 cash plus a cancellation of \$ 10,000 on the obligations to him. The trustee rejected this bid in favor of defendants' bid of \$ 68,000 cash. *Held*, plaintiff's bid was properly rejected as not being the highest *cash* bid. Although it would in theory have given the trustor the greatest credit on all secured obligations, the trustee would be subjected to an onerous burden if required to appraise the items and determine the relative value of cash versus cash and credit bids. (275 C.A.2d 115.)

SUPPLEMENT: [This section is current through the latest supplement]



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 - 5. Bidding and Payment.

4 Witkin Sum. Cal. Law STRP § 160

[§ 160] Bidding and Payment.

(1) *In General.* Each bid at the auction is an irrevocable offer to purchase the property. (C.C. 2924h(a).) A bid is cancelled by a subsequent bid for a higher amount or by a postponement or discontinuance of the sale proceeding. (C.C. 2924h(a), (e); see *Hatch v. Collins* (1990) 225 C.A.3d 1104, 1113, 275 C.R. 476 [postponement automatically cancelled bid; trustee had no authority to compel bidder to make same bid once sale recommenced].) Otherwise, acceptance of the bid completes the sale, and the trustee issues a "Declaration of Sale" so declaring. (*Ballengee v. Sadlier* (1986) 179 C.A.3d 1, 4, 5, 224 C.R. 301; *Angell v. Superior Court* (1999) 73 C.A.4th 691, 701, 86 C.R.2d 657, *infra*, §165 [distinguishing *Ballengee*; general rule that property is sold at moment of acceptance is not applicable when defective notice of default renders sale void].) If the last and highest bidder on completion of the sale has not previously deposited payment, he or she must do so on demand. Failure to do so subjects the bidder to liability for all damages sustained by the trustee as a result of the refusal to pay, and wilful failure may result in a fine of up to \$ 2,500. (C.C. 2924h(d).)

The trustee's sale is deemed final on acceptance of the last and highest bid, and is "deemed perfected as of 8 a.m. on the actual date of the sale if the trustee's deed is recorded within 15 calendar days after the sale." (C.C. 2924h(c); on passage of title, see *infra*, §169.)

(2) *Rescission and Cancellation.* Although the sale is final on acceptance of the last and highest bid, the sale is subject to automatic rescission for failure of consideration if the funds are not available to the payee or endorsee as a matter of right. The trustee must send a notice of rescission for failure of consideration to the last and highest bidder submitting the check or alternative instrument, if his or her address is known to the trustee. If a sale results in an automatic right of rescission for failure of consideration, "the interest of any lienholder shall be reinstated in the same priority as if the previous sale had not occurred." (C.C. 2924h(c); on notice of rescission for invalidity of trustee's deed, see *infra*, §167.)

"In the event the last and highest bidder cancels an instrument submitted to the trustee as a cash equivalent," the trustee must provide a new notice of sale under C.C. 2924f (see *supra*, §150) and is entitled to recover the costs of the sale as provided in C.C. 2924c (see *infra*, §216). (C.C. 2924h(d).)

(3) *Illegal Bidding*. It is a misdemeanor, punishable by a fine of not more than \$ 10,000, imprisonment of not more than 1 year, or both, for any person (a) "to offer to accept or accept from another" consideration not to bid, or (b) "to fix or restrain bidding in any manner." It is not unlawful to state that a property subject to a recorded notice of default or sale is being sold in an "as-is" condition. (C.C. 2924h(g); see *Bank of Seoul & Trust Co. v. Marcione* (1988) 198 C.A.3d 113, 119, 244 C.R. 1 [any effort by trustee and beneficiary to thwart competitive bidding at foreclosure sale contradicts purposes of C.C. 2924h]; *Lo v. Jensen* (2001) 88 C.A.4th 1093, 1097, 106 C.R.2d 443 [competitors who agreed not to compete but to join together to buy property cheaply, violated C.C. 2924h(g)].)

Although *sham bidding*, or an attempt to restrict competition in bidding, is a ground for vacating the sale (infra, §165), there is no requirement that the mortgagee bid small amounts and raise the sum gradually. The mortgagee may bid the amount of the debt, even though this exceeds the value of the property at the time of sale and it is done to discourage bidding or redemption by junior encumbrancers. (*Bank of America v. Reidy* (1940) 15 C.2d 243, 248, 101 P.2d 77.)

(4) *Unruh Act Mortgages*. An additional bidding procedure is available if the property is a single-family, owner-occupied residence being sold under a contract for goods or services subject to the Unruh Act (see 4 *Summary* (10th), *Sales*, §263). The trustee may receive offers during the 10-day period prior to the sale; and, if an offer is accepted in writing by both the mortgagor and the mortgagee, the sale will be postponed to allow the mortgagor to sell in accordance with the offer, at which time the notice of sale is deemed revoked. (C.C. 2924f(c)(4).)

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SUPPLEMENT: [This section is current through the latest supplement]

(2) *Rescission and Cancellation*. See *California Golf, L.L.C. v. Cooper* (2008) 163 C.A.4th 1053, 1067, 78 C.R.3d 153 [cashier's check is not "cash equivalent" under C.C. 2924h; hence, trial court erred in holding that plaintiff's recovery under C.C. 2924h(d) against winning bidder, who stopped payment on cashier's checks submitted at foreclosure sale, was limited to costs of new sale].



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6. Costs and Fees.

4 Witkin Sum. Cal. Law STRP § 161

[§ 161] Costs and Fees.

(1) *In General.* To the extent allowed by C.C. 2924c(c) (see *infra*, §216), a beneficiary, trustee, or mortgagee may recover reasonable costs and expenses during the period from the date notice of sale is mailed until the property is sold pursuant to the power of sale. (C.C. 2924d(a); see *Walker v. Countrywide Home Loans* (2002) 98 C.A.4th 1158, 1173, 121 C.R.2d 79 [C.C. 2924d does not prohibit charging monthly inspection fees to delinquent borrower before notice of default is recorded].) Trustees' or attorneys' fees may also be recovered, but they may not exceed \$ 425 where the unpaid principal is \$ 150,000 or less, and \$ 360 where the unpaid principal exceeds \$ 150,000, plus one percent of unpaid principal of \$ 50,001-\$ 150,000, plus one-half of one percent of unpaid principal of \$ 150,001-\$ 500,000, plus one-quarter of one percent of unpaid principal exceeding \$ 500,000. (C.C. 2924d(a).)

On sale of the property, a trustee may recover, or deduct from the proceeds of the sale, the reasonable costs and expenses incurred in enforcing the obligation, subject to the limits imposed by C.C. 2924c(c). (C.C. 2924d(b).) The trustee also may recover trustees' or attorneys' fees, not to exceed \$ 425 or one percent of the unpaid balance, whichever is greater. (C.C. 2924d(b).) Any charges for these fees, however, must be *in lieu of* the charges authorized by C.C. 2924d(a) and C.C. 2924c(d) (see *infra*, §216). (C.C. 2924d(b).)

(2) *Unruh Act Mortgages.* If the property is a single-family, owner-occupied residence being sold under a contract for goods or services subject to the Unruh Act (see 4 *Summary* (10th), *Sales*, §263), the trustee is entitled to an additional fee of \$ 50. (C.C. 2924f(c)(5).)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *In General.* See *Jones v. Union Bank of Calif.* (2005) 127 C.A.4th 542, 548, 25 C.R.3d 783 [where lender successfully defended action to set aside foreclosure sale, C.C. 2924c and 2924d did not limit amount of fees court could award].



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d. Distribution of Proceeds.

1. Order of Priority.

4 *Witkin Sum. Cal. Law STRP* § 162

[§ 162] Order of Priority.

Proceeds of the sale must be distributed in the following order:

(1) To permitted costs, expenses, and fees (see *supra*, §161). (C.C. 2924k(a)(1).)

(2) To payment of the obligations secured by the foreclosed deed of trust or mortgage. (C.C. 2924k(a)(2).)

(3) To satisfaction of junior liens or encumbrances in the order of their priority. (C.C. 2924k(a)(3).)

(4) To the trustor, or if the property has been sold or transferred, then to the vested owner of record of the property at the time of the trustee's sale. (C.C. 2924k(a)(4).) (See *Smith v. James A. Merrill* (1998) 64 C.A.4th 94, 98, 75 C.R.2d 108 [effect of homestead declaration and judgment lien on distribution of proceeds]; *South Bay Bldg. Enterprises v. Riviera Lend-Lease* (1999) 72 C.A.4th 1111, 1124, 85 C.R.2d 647 [trustee's failure to perform statutory obligation to distribute excess amount to junior lienor could be imputed to senior lienor based on agent-principal relationship, and junior lienor had right of action against senior for money due under C.C. 2924k]; 4 Miller & Starr 3d, §10:213.)

SUPPLEMENT: [This section is current through the latest supplement]

See *Cal-Western Reconveyance Corp. v. Reed* (2007) 152 C.A.4th 1308, 1317, 62 C.R.3d 244 [C.C. 2924k authorizes distribution of proceeds of sale only to satisfy secured obligations; wife was not entitled to distribution from surplus proceeds for attorneys' fees and equalization payment awarded to her in judgment of dissolution of marriage].



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CHAPTER VIII - Security Transactions in Real Property

Witkin Summary of California Law VII. REMEDIES OF MORTGAGEE AND TRUSTEE

B. Enforcement Procedure.

2. Nonjudicial Foreclosure.

d. Distribution of Proceeds.

2. Conflicting Claims.

4 *Witkin Sum. Cal. Law STRP* § 163

[§ 163] Conflicting Claims.

(1) *Notice of Conflicting Claims.* Unless an interpleader has been filed, within 30 days of executing the trustee's deed resulting from a sale in which there are proceeds remaining after payment of the amounts required by C.C. 2924k(a)(1), (a)(2) (*supra*, §162), the trustee must send written notice to all persons with recorded interests in the real property as of the date immediately prior to the trustee's sale who would be entitled to notice under C.C. 2924b(b), (c) (*supra*, §§153, 154). (C.C. 2924j(a).) The notice must be sent by first-class mail as provided in C.C. 2924b(c)(1), and must inform the addressee that (a) there has been a trustee's sale of described real property; (b) the noticed person may have a claim to sale proceeds that remain after payment of the amounts required by C.C. 2924k(a)(1), (a)(2); (c) the noticed person may contact the trustee to pursue a potential claim; and (d) to pursue a claim, the noticed person may be required to prove that he or she holds the beneficial and security interests in the obligation, and must submit a written claim that must be received by the trustee no later than 30 days after the date the trustee's notice was sent. (C.C. 2924j(a).) The claim must be executed under penalty of perjury and must include the amount of the claim to the date of the trustee's sale and an itemized statement of the principal, interest, and other charges. (C.C. 2924j(a)(4).)

(2) *Trustee's Duty To Resolve Conflicting Claims.* The trustee must "exercise due diligence to determine the priority of the written claims received." (C.C. 2924j(b); see C.C. 2924j(f) ["due diligence" defined].) Proceeds must be paid within 30 days after the conclusion of the notice period if there is no dispute as to the priority of the written claims submitted to the trustee. If the trustee fails to determine the priority of written claims within the statutory period, then within 10 days thereafter, the trustee must deposit the funds with the clerk of the court pursuant to C.C. 2924j(c) (*infra*, this section) or file an interpleader action pursuant to C.C. 2924j(e) (*infra*, this section). Nothing in the statute precludes a "person from pursuing other remedies or claims as to surplus proceeds." (C.C. 2924j(b).)

(3) *Unresolved Claims: Deposit With Superior Court.* If, after due diligence, the trustee is unable to determine the priority of the written claims received or if the trustee determines that there is a conflict between potential claimants, he or she may file a declaration of the unresolved claims and deposit the undistributed proceeds, less any fees charged by the clerk, with the clerk of the superior court of the county where the sale occurred. (C.C. 2924j(c).)

The trustee's declaration must specify the following: (a) the date of the trustee's sale; (b) the property description;

(c) the names and addresses of all persons who were sent notice under C.C. 2924j(a); (d) that the trustee exercised due diligence under C.C. 2924j(b); (e) that the trustee provided written notice as required by C.C. 2924j(a) and C.C. 2924j(d); and (f) the amount of the sale proceeds deposited by the trustee with the superior court. (C.C. 2924j(c).)

Before depositing the funds with the clerk of the court, the trustee must send written notice by first-class mail, postage prepaid, to all persons described in C.C. 2924j(a) informing them that the trustee intends to deposit the funds "and that a claim for the funds must be filed with the court within 30 days from the date of the notice, providing the address of the court in which the funds were deposited, and a telephone number for obtaining further information." (C.C. 2924j(d).) The trustee must file proof of service of this notice and also submit a copy of the trustee's sales guarantee and any information relevant to the identity, location, and priority of the potential claimants. (C.C. 2924j(c).)

The deposit may be either for the total proceeds of the trustee's sale if a conflict exists with respect to the total proceeds, or that portion that cannot be distributed after due diligence, less any fees charged by the clerk. Once that portion of the sale proceeds that cannot be distributed by due diligence is deposited with the court, the trustee is discharged of further responsibility for disbursement of the sale proceeds. (C.C. 2924j(c).)

The Judicial Council has adopted a form for mandatory use regarding unresolved claims: Judicial Council Form No. MC-095 [Petition and Declaration Regarding Unresolved Claims and Deposit of Undistributed Surplus Proceeds of Trustee's Sale].

(4) *Superior Court Action*. The superior court clerk may charge a reasonable fee equal to the fee for filing an interpleader action under *Govt.C. 26820 et seq.*, and the clerk must deposit the amount with the county treasurer subject to order of the superior court upon the application of any interested party. (C.C. 2924j(c).)

Within 90 days after deposit with the clerk, the court must consider claims filed at least 15 days before the scheduled hearing date, and the clerk must "serve written notice of the hearing by first-class mail on all claimants identified in the trustee's declaration at the addresses specified." The court distributes the deposited funds to the claimants entitled thereto. (C.C. 2924j(d).)

(5) *Unresolved Claims: Interpleader*. C.C. 2924j does not restrict the trustee from filing an interpleader action to resolve a dispute about the proceeds. Once an interpleader action is filed, the provisions of C.C. 2924j do not apply. (C.C. 2924j(e).)

SUPPLEMENT: [This section is current through the latest supplement]

(3) *Unresolved Claims: Deposit With Superior Court*. See *CTC Real Estate Services v. Lepe (2006) 140 C.A.4th 856, 861, 44 C.R.3d 823* [victim of identity theft whose personal information was used to obtain loan secured by real property was entitled to recover undistributed surplus proceeds after trustee sale of property]. (4) *Superior Court Action*. C.C. 2924j(c), as amended in 2005, provides for the clerk to deposit the amount either with the county treasurer or in a bank account established for moneys held in trust.



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Witkin Summary of California Law
VII. REMEDIES OF MORTGAGEE AND TRUSTEE

B. Enforcement Procedure.
2. Nonjudicial Foreclosure.
e. Effect of Recitals in Trustee's Deed.

4 Witkin Sum. Cal. Law STRP § 164

[§ 164] Effect of Recitals in Trustee's Deed.

(1) *In General*. It has been held that, by provision in the deed of trust, recitals in a trustee's deed may be made proof of the regularity of the sale, and no further evidence is necessary to establish the title and right to possession of the purchaser. (See *Sorensen v. Hall* (1934) 219 C. 680, 682, 28 P.2d 667; *Cobb v. California Bank* (1936) 6 C.2d 389, 390, 57 P.2d 924; *Pacific States Savings & Loan Co. v. O'Neill* (1936) 7 C.2d 596, 599, 61 P.2d 1160; *Karrell v. First Thrift of Los Angeles* (1951) 104 C.A.2d 536, 539, 232 P.2d 1.)

(2) *Statutory Presumptions*. C.C. 2924 covers this subject by two presumptions, as follows: "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." (See *Wolfe v. Lipsy* (1985) 163 C.A.3d 633, 639, 640, 209 C.R. 801 ["prima facie evidence" (rebuttable presumption) was overcome by evidence showing invalid postponement and nonexistent trustee's sale; "it is questionable whether section 2924 applies to the conduct of the sale itself"].)

In *Leonard v. Bank of America* (1936) 16 C.A.2d 341, 345, 60 P.2d 325, the court declared that such a provision in a trust deed amounted to a *waiver of the benefits of C.C. 2924*, and that the waiver was valid under the general doctrine that statutory rights may be waived except where contrary to public policy. (See 1 *Summary* (10th), *Contracts*, §679.) But C.C. 2953, enacted in 1937, prohibits advance waiver of rights under C.C. 2924. Assuming the correctness of the theory expressed in *Leonard*, does the statute nullify the provisions in deeds of trust making recitals in the trustee's deed conclusive as to compliance with procedural requirements?

It might be argued that C.C. 2953 prohibits *express agreements* relieving the creditor from the duty of complying with the statutes, while the recital clause merely operates as a rule of evidence, furnishing proof of actual compliance. This view is reasonable where the recitals have merely a *prima facie* effect, and cast on the debtor the burden of showing failure to comply. But if a bona fide purchaser is involved and the recitals are *conclusive*, no evidence to contradict them may be received; the debtor is prevented from showing that his or her statutory rights were violated, and thus, it would seem, the debtor has, by the trust deed provision, made an invalid waiver. This conclusion may, however,

be avoided by regarding the rule on conclusiveness of recitals as in the nature of a *time provision*; i.e., the debtor cannot agree to waive compliance with the statutes, and therefore may object to holding the sale or delivering the deed unless the proper procedure is followed; but his or her right to object ends when the trustee's deed is delivered to the purchaser. As in the case of *notice of claim* or *incontestable clauses* (1 *Summary* (10th), *Contracts*, §679, 2 *Summary* (10th), *Insurance*, §226), an absolute waiver would be void, but a provision giving up the right to object or contest after lapse of a reasonable time would be valid.

This latter result was reached on a different theory in *Pierson v. Fischer* (1955) 131 C.A.2d 208, 280 P.2d 491: "[A]ppellant, by the instrument he executed, declared that the recitals in a deed made by his trustee that all of the duties of the trust respecting the sale had been complied with should bind him. In short, he thereby made the trustee his agent with such powers that the trustee could bind him, notwithstanding he had not carried out the provisions of his trust. ... As against a purchaser who does not participate in or know of the failure of the trustee to perform his duties, the recital that he has been true to his trust binds the trustee's principal and such purchaser may rely upon those provisions in purchasing at the sale." (131 C.A.2d 216.) (See *Moeller v. Lien* (1994) 25 C.A.4th 822, 833, 30 C.R.2d 777 [nonjudicial foreclosure sale; conclusive presumption under C.C. 2924 applied to protect bona fide purchasers]; 4 Miller & Starr 3d, §10:211.)

(3) *Time When Presumptions Attach*. The presumptions of regularity do not attach until the deed is delivered. (*Angell v. Superior Court* (1999) 73 C.A.4th 691, 700, 702, 86 C.R.2d 657, *infra*, §165 [following *Moeller*].)

(4) *Constitutionality of Conclusive Presumption in Favor of Bona Fide Purchaser*. In *Homestead Savings v. Darmiento* (1991) 230 C.A.3d 424, 281 C.R. 367, the court rejected due process challenges to the presumption. In a nonjudicial foreclosure, defendant, a bona fide purchaser, received a trustee's deed to the property he purchased. Plaintiff, a junior lienholder, brought this action to set aside the sale for failure of the trustee to comply with the statutory notice requirements. *Held*, summary judgment for defendant affirmed.

(a) The challenged conduct did not involve state action. The state does not participate in a sale under a deed of trust; and the fact that the state has chosen to regulate the manner in which the trustee may proceed does not convert the creditor's decision to exercise a contractual right into state action. (230 C.A.3d 432, 433; see 7 *Summary* (10th), *Constitutional Law*, §619.) "If the mere denial of judicial relief is considered sufficient encouragement to make the State responsible for those private acts, all private deprivations of property would be converted into public acts whenever the State, for whatever reason, denies relief sought by the putative property owner." (230 C.A.3d 434, quoting *Flagg Bros. v. Brooks* (1978) 436 U.S. 149, 98 S.Ct. 1729, 56 L.Ed.2d 185, 7 *Summary* (10th), *Constitutional Law*, §619.)

(b) Plaintiff also contended that, as a junior lienholder, it was not bound by the contractual provisions in the foreclosing deed. However, a successor in interest to the trustor or a junior lienholder takes an interest in the property subject to the prior deed, which in this case involves a power of sale. (230 C.A.3d 435.)

SUPPLEMENT: [This section is current through the latest supplement]

(2) *Statutory Presumptions*. C.C. 2924 was subdivided in 2006. The statutory presumptions stated in the text are now found in C.C. 2924(c).

The presumptions in C.C. 2924 regarding the propriety of a foreclosure sale "pertain only to notice requirements, not to every defect or inadequacy short of fraud." Thus, a foreclosure sale performed in error after the trustor and beneficiary had mutually agreed to cure the default and reinstate the loan was invalid even though the deed was delivered to the buyer and recorded. Because the beneficiary had no right to sell, the statutory presumption of valid title that would have been applicable had the sale been proper did not apply. (*Bank of America v. La Jolla Group II* (2005) 129 C.A.4th 706, 714, 28 C.R.3d 825 [criticizing *Moeller v. Lien* (1994) 25 C.A.4th 822, 30 C.R.2d 777, text, p. 963; deed of trust only authorized rebuttable presumption in favor of truth of recitals in trustee's deed, and recital that uncured default existed was rebutted by fact that trustor and beneficiary entered into agreement to cure default].)



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- B. Enforcement Procedure.
 - 2. Nonjudicial Foreclosure.
 - f. Setting Aside Sale for Irregularity.
 - 1. Grounds.

4 Witkin Sum. Cal. Law STRP § 165

[§ 165] Grounds.

(1) *In General.* Irregularities in a trustee's sale may be grounds for setting it aside. (See *Pierson v. Fischer* (1955) 131 C.A.2d 208, 213, 280 P.2d 491; *Karlsen v. American Savings & Loan Assn.* (1971) 15 C.A.3d 112, 116, footnote 3, 92 C.R. 851 [purchase by trustee at his own sale is voidable and trustor may redeem]; *Systems Inv. Corp. v. Union Bank* (1971) 21 C.A.3d 137, 152, 98 C.R. 735; *Wolfe v. Lipsy* (1985) 163 C.A.3d 633, 639, 209 C.R. 801; *Anderson v. Heart Fed. Savings & Loan Assn.* (1989) 208 C.A.3d 202, 256 C.R. 180, supra, §146 [sale may not be based on contingent default]; *Dimock v. Emerald Properties LLC* (2000) 81 C.A.4th 868, 876, 97 C.R.2d 255 [when new trustee has been substituted, subsequent sale by former trustee is void, and not merely voidable]; *Nguyen v. Calhoun* (2003) 105 C.A.4th 428, 443, 445, 129 C.R.2d 436 [where plaintiff attempted to purchase property from owners in default during foreclosure period, but foreclosure sale to bona fide purchaser occurred before plaintiff's funds were received in escrow, foreclosure sale could not be challenged on ground that debt was paid and lien thereby extinguished; failed communications between lender and title company regarding plaintiff's purchase were outside statutory proceeding and thus did not constitute "irregularity" in foreclosure sale that would invalidate it]; 4 Miller & Starr 3d, §10:210; Cal. Civil Practice, 1 Real Property Litigation, §4:100 [complaint for injunctive and declaratory relief attacking validity of nonjudicial sale], §4:101 [complaint to set aside nonjudicial sale]; C.E.B., 2 Mortgage and Deed of Trust Practice 3d, §7.52 et seq.; on rescinding trustee's sale for failure to give IRS notice of sale when federal tax lien has been recorded against property subsequent to foreclosure, see supra, §154; on attack on execution sales generally, see 8 Cal. Proc. (4th), *Enforcement of Judgment*, §155.)

(2) *Effect of Discovery of Mistake Before Deed Is Delivered.* Presumptions of regularity do not attach until a deed is delivered. (See supra, §164.) Thus "a material mistake which is discovered after the acceptance of a bid but before issuance of a trustee's deed justifies the trustee's refusal to complete the sale." (*Angell v. Superior Court* (1999) 73 C.A.4th 691, 695, 86 C.R.2d 657.)

(3) *Sham Bidding.* Sham bidding, or an attempt to restrict competition in bidding, is a ground for vacating the sale. (*Bank of America v. Reidy* (1940) 15 C.2d 243, 248, 101 P.2d 77 [it is not sham bidding for mortgagee to bid amount of debt, even though this exceeds value of property at time of sale and it is done to discourage bidding or redemption by junior encumbrancers]; *Lo v. Jensen* (2001) 88 C.A.4th 1093, 1097, 106 C.R.2d 443 [sale would be set aside where

competitors joined together to buy property cheaply, in violation of C.C. 2924h(g) (supra, §160)].)

(4) *Inadequacy of Price*. Inadequacy of price, however gross, is not enough by itself to invalidate the sale. (*Jones v. Sierra Verdugo Water Co.* (1923) 63 C.A. 254, 263, 218 P. 454; *Stafford v. Russell* (1953) 117 C.A.2d 326, 333, 255 P.2d 814; *Moeller v. Lien* (1994) 25 C.A.4th 822, 833, 30 C.R.2d 777 [sale to bona fide purchaser for 25% of property's value would not be set aside where there was no irregularity in procedure]; *Knapp v. Doherty* (2004) 123 C.A.4th 76, 93, 20 C.R.3d 1, supra, §152.) But where the price obtained "is greatly disproportionate to the actual value, very slight evidence of unfairness or irregularity will suffice to authorize the granting of relief." (*Sargent v. Shumaker* (1924) 193 C. 122, 129, 223 P. 464; see *Winbigler v. Sherman* (1917) 175 C. 270, 277, 165 P. 943; *Rastelli v. Zaca Mining Corp.* (1942) 52 C.A.2d 507, 511, 126 P.2d 368; *Foge v. Schmidt* (1951) 101 C.A.2d 681, 683, 226 P.2d 73; *Bank of Seoul & Trust Co. v. Marcione* (1988) 198 C.A.3d 113, 118, 244 C.R. 1 [trustee failed to ascertain meaning of junior lienor's announcement, "we bid"; trustee's breach of duty imputed to beneficiary]; *6 Angels v. Stuart-Wright Mortg.* (2001) 85 C.A.4th 1279, 1285, 102 C.R.2d 711 [clerical error regarding price at which property was offered was outside sale proceedings and, in absence of procedural error independent of inadequacy of price, summary adjudication to high bidder at first trustee's sale was properly granted]; 53 So. Cal. L. Rev. 843 [The Judicial and Legislative Response to Price Inadequacy in Mortgage Foreclosure Sales]; 8 Cal. Proc. (4th), *Enforcement of Judgment*, §156.)

(5) *Failure To Grant Postponement*. A trustee's failure to grant a postponement could constitute unfairness which, coupled with an inadequate price, could justify setting aside the sale. (See *Winbigler v. Sherman*, supra, 175 C. 277 [mortgagor belatedly learned of sale and sought reasonable postponement to raise cash]; *Foge v. Schmidt*, supra, 101 C.A.2d 683 [mortgagor sought time to meet condition of cash bid].) But the trustor's lack of knowledge about the (former) statutory right to a 1-day postponement did not constitute an irregularity in the proceeding calling for the sale to be set aside. (See *Moeller v. Lien*, supra, 25 C.A.4th 833.)

(6) *Failure To Disclose Material Facts*. In *Karoutas v. Homefed Bank* (1991) 232 C.A.3d 767, 283 C.R. 809, plaintiffs sought to rescind their purchase of property at a trustee's sale. The complaint alleged that defendant beneficiary failed to disclose soil conditions and other defects, which could not be corrected except by extraordinary repair costs. The trial court gave judgment for defendant on demurrer, on the ground that defendant owed no duty to disclose the facts to plaintiff. *Held*, reversed.

(a) Where material facts are known only to the defendant and the plaintiff cannot reasonably discover them, the defendant has a common law duty to disclose. (232 C.A.3d 771; see 5 *Summary* (10th), *Torts*, §§796, 797.) Plaintiff contended that the comprehensive nonjudicial foreclosure statutes, which do not impose such a duty on a beneficiary, eliminated the common law duty alleged in this case. This is unsound. The silence of the statute cannot take away rights established by the common law. (232 C.A.3d 772, citing *Block v. Tobin* (1975) 45 C.A.3d 214, 119 C.R. 288, supra, §155.) Former C.C. 1102.1(c) (now C.C. 1102.2(c)), which excludes certain transfers from the residential property disclosure requirements of C.C. 1102 et seq., does not purport to eliminate any duties imposed in connection with transfers not covered by those statutes. (232 C.A.3d 773, 774.)

(b) Defendant further contended that the imposition of a duty to disclose in this case would be contrary to the public interest in speedy disposition of property under deeds of trust. But "[w]e cannot believe that the Legislature, in enacting section 2924 et seq., intended to immunize beneficiaries from liability for deceit, or to expand the risks borne by purchasers to include the assumption of damages resulting from a beneficiary's fraud." (232 C.A.3d 775.) (See *Ostayan v. Serrano Reconveyance Co.* (2000) 77 C.A.4th 1411, 1418, 1420, 92 C.R.2d 577 [trial court did not err in granting summary judgment against plaintiff on claim of being misled into purchasing property at foreclosure sale where plaintiff ignored auctioneer's statement of belief that there was senior lien on property and relied instead on title report he obtained in own investigation; foreclosing trustee has no duty "to bidders ... to provide sua sponte detailed explanations concerning recorded encumbrances"].)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *In General.* See *Melendrez v. D & I Inv.* (2005) 127 C.A.4th 1238, 1253, 26 C.R.3d 413 [borrower had no right to set aside trustee's sale and cancel trustee's deed based on claim that sale was in violation of repayment agreement in absence of procedural irregularity and where sale was to bona fide purchaser; fact that buyer was speculator with experience in buying foreclosure properties and that buyer purchased for less than fair market value did not preclude buyer from being bona fide purchaser under C.C. 2924].

Cross-Reference: 8 Cal. Proc. (5th), *Enforcement of Judgment*, §164.(5) *Failure To Grant Postponement*.

Cross-Reference: 8 Cal. Proc. (5th), *Enforcement of Judgment*, §165. *Correction:* Page 964, line 5 of section, "*Systems Inv. Corp. v. Union Bank*" should be "*System Inv. Corp. v. Union Bank*".



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 - f. Setting Aside Sale for Irregularity.
 - 2. Tender of Payment.

4 *Witkin Sum. Cal. Law STRP* § 166

[§ 166] Tender of Payment.

A mortgagor who seeks to set aside a voidable sale must make a valid tender of payment of the indebtedness. (*Karlsen v. American Savings & Loan Assn.* (1971) 15 C.A.3d 112, 117, 92 C.R. 851 [pleading defective; no showing of ability to pay]; see *Onofrio v. Rice* (1997) 55 C.A.4th 413, 424, 64 C.R.2d 74 [tender may not be required where it would be inequitable to do so]; on determining redemption price after sale is set aside, see *Systems Inv. Corp. v. Union Bank* (1971) 21 C.A.3d 137, 155, 98 C.R. 735.) And a junior lienor who seeks to set aside a trustee's sale for irregularities must first tender the full amount owing on the mortgage. (*Arnolds Management Corp. v. Eischen* (1984) 158 C.A.3d 575, 578, 205 C.R. 15; see *FPCI RE-HAB 01 v. E & G Inv., Ltd.* (1989) 207 C.A.3d 1018, 1021, 255 C.R. 157 [following *Arnolds*]; for analysis and criticism of *Arnolds*, see *United States Cold Storage v. Great Western Savings & Loan Assn.* (1985) 165 C.A.3d 1214, 1222, 212 C.R. 232.)

SUPPLEMENT: [This section is current through the latest supplement]

Correction: Page 964, line 7 of section, "*Systems Inv. Corp. v. Union Bank*" should be "*System Inv. Corp. v. Union Bank*".



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B. Enforcement Procedure.

2. Nonjudicial Foreclosure.

g. Notice of Rescission.

4 Witkin Sum. Cal. Law STRP § 167

[§ 167] Notice of Rescission.

When a trustee's deed is "invalidated by a pending bankruptcy or otherwise," the trustee or beneficiary who caused the trustee's deed to be recorded may record a notice of rescission. This notice must identify: (1) the deed of trust by the identification numbers used by the recorder or the books and pages where the deed and deed of trust are recorded; (2) the names of all trustors and beneficiaries; and (3) the location of the property. Further, the notice must state the reason for the rescission. This recordation restores "the condition of record title to the real property described in the trustee's deed and the existence and priority of all lienholders to the status quo prior to the recordation of the trustee's deed upon sale." (C.C. 1058.5(b); on rescission for failure of bidder's consideration, see *supra*, §160.)

SUPPLEMENT: [This section is current through the latest supplement]



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- B. Enforcement Procedure.
- 2. Nonjudicial Foreclosure.
- h. Damages for Wrongful Sale.

4 *Witkin Sum. Cal. Law STRP* § 168

[§ 168] Damages for Wrongful Sale.

(1) *In General.* In *Munger v. Moore* (1970) 11 C.A.3d 1, 89 C.R. 323, defendant was the beneficiary under a subordinated second deed of trust on R's property. Plaintiff made a \$ 15,000 construction loan to R and took a third deed of trust as security. Later, plaintiff made a \$ 10,000 additional loan to R and took a grant deed containing an option in R to repurchase for \$ 25,000. R defaulted and defendant gave notice of breach and intention to sell under the second deed of trust. Plaintiff, pursuant to C.C. 2924c (infra, §216), made a valid and timely tender of the amount due; but the trustee, acting under the direction of defendant beneficiary, refused the tender and held a trustee's sale. Defendant bought the property at the sale for \$ 57,920.94, and several years later sold it for \$ 475,000. Plaintiff sued for damages and received judgment for \$ 30,000. *Held*, affirmed.

(a) *Availability of tort action.* The traditional remedy to attack a wrongful sale is an equitable action to set it aside; but, under general principles of tort liability, and decisions in other jurisdictions, the trustee or mortgagee may be held liable in damages. (11 C.A.3d 7.)

(b) *Who may sue, and be sued.* The action may be brought by the mortgagor or trustor, or by his or her successor in interest--plaintiff here. (11 C.A.3d 7.) It may be brought against the trustee who makes the sale, and the beneficiary where the beneficiary directs the trustee's wrongful act. (11 C.A.3d 8.)

(c) *Measure of damages.* Defendant contended that R's grant to plaintiff was intended only as security, and therefore that plaintiff was entitled only to damages recoverable by a mortgagee for loss of the security (see supra, §§85, 86). This was unsound: (1) The claim that a deed is in effect a mortgage can only be made by the parties to the transaction and those claiming under them; defendant was not a party to the transaction between R and plaintiff and his security was not affected by that transaction. (11 C.A.3d 8.) (2) Even if he could make the claim, the testimony of plaintiff that R's indebtedness was cancelled supported the trial judge's conclusion that the deed was a conveyance of title. (11 C.A.3d 10.) Hence, the proper measure of damages was applied--the value of the property in excess of the encumbrances; and the finding that the value was \$ 30,000 more than the liens and encumbrances on the date of sale supported the judgment. (11 C.A.3d 11.)

(2) *Statutory Limitation.* In performing a nonjudicial foreclosure, the trustee is not liable "for any good faith error

resulting from reliance on information provided in good faith by the beneficiary regarding the nature and the amount of the default under the secured obligation, deed of trust, or mortgage." (C.C. 2924.)

(3) *Restitution as Adequate Remedy.* In *Residential Capital v. Cal-Western Reconveyance Corp.* (2003) 108 C.A.4th 807, 134 C.R.2d 162, plaintiff was the high bidder at a nonjudicial foreclosure sale. However, the day after the bidding, the trustee discovered that the trustor and the beneficiary had previously agreed to postpone the sale. The trustee advised plaintiff that it did not have the authority to conduct the sale and would not be issuing a deed. The trustee returned plaintiff's cashier's checks plus 3 days' interest on the sale amount. Plaintiff brought an action claiming benefit-of-the-bargain damages against the trustee and the beneficiary for breach of contract, breach of the implied covenant of good faith and fair dealing, negligence, and negligent misrepresentation. The trial court granted defendants' motion for summary judgment. *Held*, affirmed.

(a) Issues relating to nonjudicial foreclosure sales should not be analyzed under common law contract principles. (108 C.A.4th 820.) These sales involve more than just the two parties to the sale and their interests, and C.C. 2924 et seq. provide a comprehensive and exhaustive statutory scheme to govern nonjudicial foreclosure sales. (108 C.A.4th 821.) This scheme includes the trustor's right to postpone a foreclosure sale by agreement with the beneficiary. (108 C.A.4th 822.)

(b) Restitution is an adequate remedy when a foreclosure sale is not held in compliance with the statutory requirements. The same is true here. The discovery of the agreement to postpone the sale before the trustee's deed was issued limits plaintiff's relief to return of its money plus interest. Had the trustee's deed been issued, the result might be different because plaintiff might have been considered a bona fide purchaser entitled to a conclusive presumption of title under C.C. 2924. (108 C.A.4th 823.)

(c) The comprehensive statutory scheme regulating nonjudicial foreclosure sales does not permit grafting on a tort remedy for negligence in the absence of a compelling justification to do so. (108 C.A.4th 827.) Neither does it allow "the imposition of a misrepresentation-based tort duty under these factual circumstances." (108 C.A.4th 829.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *In General.* See *Heritage Oaks Partners v. First Amer. Title Ins. Co.* (2007) 155 C.A.4th 339, 346, 66 C.R.3d 510 [in conducting foreclosure sale, trustee under deed of trust has no duty to subsequent purchasers of property being sold; hence, trustee who was allegedly negligent in believing that it was trustee of record, and who conveyed title to successful bidder, was not liable to indemnify subsequent purchaser for attorneys' fees and other damages suffered in litigation relating to validity of sale].



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VII. REMEDIES OF MORTGAGEE AND TRUSTEE
B. Enforcement Procedure.
3. Passage of Title.

4 Witkin Sum. Cal. Law STRP § 169

[§ 169] Passage of Title.

(1) *Judicial Foreclosure*. The title passes at the time of the sale, subject to a limited right of redemption if a deficiency judgment has been obtained (see *infra*, §232 et seq.). The purchaser acquires any interest of the mortgagor in the property sold "(1) that is held on the effective date of the lien under which the property was sold or (2) that is acquired between such effective date and the date of sale." (C.C.P. 701.640.)

(2) *Sale Under Deed of Trust*. In a deed of trust, title passes to the trustees at the time the instrument is originally executed. (*Bryant v. Hobert* (1919) 44 C.A. 315, 317, 186 P. 379.) Subsequent events affecting the trustor's capacity to convey do not deprive the trustee of the power to hold the sale and convey title. (See *Strutt v. Ontario Savings & Loan Assn.* (1970) 11 C.A.3d 547, 553, 90 C.R. 69 [supervening insanity].) Nor can acts of the trustor adversely affect the trustee's title and security interest. (See *Homestead Savings v. Darmiento* (1991) 230 C.A.3d 424, 437, 281 C.R. 367, *supra*, §164 [title passes free of interest subsequent to foreclosed deed of trust].)

In *First Nat. Bank in Santa Ana v. Coast Consol. Oil Co.* (1948) 84 C.A.2d 250, 190 P.2d 214, the owner-lessor made an oil lease to defendant, then gave a deed of trust to plaintiff, which later purchased at a foreclosure sale. *Held*, the lessor and lessee could not, after the date of execution of the trust deed, modify the lease to the detriment of plaintiff. (84 C.A.2d 254.) (See *R-Ranch Markets #2 v. Old Stone Bank* (1993) 16 C.A.4th 1323, 1327, 1328, 21 C.R.2d 21 [following *First Nat. Bank*; lease executed before deed of trust was not extinguished by foreclosure, but amendment executed after deed of trust was extinguished]; *San Francisco Design Center Associates v. Portman Cos.* (1995) 41 C.A.4th 29, 45, 46, 50 C.R.2d 716 [foreclosure of property resulted in extinguishment of lease agreement where lease was subordinate to deed of trust; extinguishment principle was applicable even though agreement contained conditions precedent and lessee was not yet tenant in possession].)

On the trustee's sale of the property, the purchaser acquires the trustor's interest in the property as of the date that the deed of trust was originally executed. (See *Sain v. Silvestre* (1978) 78 C.A.3d 461, 471, 144 C.R. 478 [purchaser acquired title free of equitable servitudes that had been recorded subsequent to recording of deed of trust]; *Dover Mobile Estates v. Fiber Form Products* (1990) 220 C.A.3d 1494, 1498, 270 C.R. 183 ["Title conveyed by a trustee's deed relates back to the date when the deed of trust was executed"].) As with judicial foreclosures, where the trustor, after execution of the deed of trust, makes improvements or acquires fixtures or appurtenances, these pass to the purchaser at the trustee's sale as an incident to the land. (*Harper v. Buckles* (1937) 19 C.A.2d 481, 486, 65 P.2d 947,

supra, §34.)

SUPPLEMENT: [This section is current through the latest supplement]



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B. Enforcement Procedure.
4. Possession, Rents, and Profits.

4 Witkin Sum. Cal. Law STRP § 170

[§ 170] Possession, Rents, and Profits.

(1) *After Judicial Foreclosure.* If the property is sold subject to a right of redemption (see *infra*, §232 et seq.), the mortgagor may remain in possession during the redemption period. The purchaser is, however, "entitled to enter the property during reasonable hours to repair and maintain the premises and is entitled to an order restraining waste on the property." (C.C.P. 729.090(c).) And the purchaser is entitled to the rents and profits during this period, unless the mortgagor later redeems, in which case they are credited on the redemption money to be paid. (C.C.P. 729.090(a), (b), 729.060(c); see 8 Cal. Proc. (4th), *Enforcement of Judgment*, §13.)

C.C.P. 564(b)(4) authorizes appointment of a receiver during the redemption period after the sale of real property under foreclosure, to collect rents and disburse them as directed by the court or provided by law. (See 8 Cal. Proc. (4th), *Enforcement of Judgment*, §302.)

In the absence of a special agreement, the purchaser is not entitled to possession until after the period of redemption and delivery of the sheriff's or commissioner's deed; hence, the statutory period for adverse possession does not begin to run against the purchaser in favor of a *mortgagor* or his or her transferee. (*Comstock v. Finn* (1936) 13 C.A.2d 151, 157, 56 P.2d 957.) On principle, the same rule should apply to adverse possession by a stranger. (See 25 Cal. L. Rev. 357; 12 Summary (10th), *Real Property*, §217.)

(2) *After Nonjudicial Sale.* The purchaser gets the right to possession on receiving the trustee's deed. The purchaser is then entitled to unsevered crops. (*Penryn Fruit Co. v. Sherman-Worrell Fruit Co.* (1904) 142 C. 643, 645, 76 P. 484; *Phillips v. Pacific Land & Cattle Co.* (1931) 116 C.A. 290, 292, 2 P.2d 566.) But where a receiver appointed on default collects rents, and the proceeds of the sale satisfy the indebtedness, the debtor-trustor is entitled to the rent money collected. (*Eastland Savings & Loan Assn. v. Thornhill & Bruce* (1968) 260 C.A.2d 259, 262, 66 C.R. 901.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *After Judicial Foreclosure.*

Right to rents and profits:

Cross-Reference: 8 Cal. Proc. (5th), *Enforcement of Judgment*, §20.

Appointment of receiver:

Cross-Reference: 8 Cal. Proc. (5th), *Enforcement of Judgment*, §310.



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B. Enforcement Procedure.
5. Unlawful Detainer.
a. In General.

4 *Witkin Sum. Cal. Law STRP* § 171

[§ 171] In General.

(1) *Right to Remedy*. Although the ordinary action for recovery of possession may also be brought, the summary remedy of unlawful detainer is available against persons holding over after sales under a writ of execution, a writ of sale on foreclosure, or a power of sale contained in a mortgage or deed of trust, after title under foreclosure or sale has been duly perfected. (*C.C.P. 1161a(b)*); see *Duckett v. Adolph Wexler Bldg. & Finance Corp.* (1935) 2 C.2d 263, 265, 40 P.2d 506; *American Nat. Bank of Santa Monica v. Johnson* (1932) 124 C.A. Supp. 783, 787, 11 P.2d 916; *Hewitt v. Justice's Court of Brooklyn Township* (1933) 131 C.A. 439, 441, 21 P.2d 641; *Nineteenth Realty Co. v. Diggs* (1933) 134 C.A. 278, 288, 25 P.2d 522; *Bliss v. Security-First Nat. Bank of Los Angeles* (1947) 81 C.A.2d 50, 58, 183 P.2d 312; *Stephens, Partain & Cunningham v. Hollis* (1987) 196 C.A.3d 948, 952, 242 C.R. 251 [general discussion]; 5 *Cal. Proc.* (4th), *Pleading*, §607.)

(2) *Appointment of Receiver*. A receiver may be appointed in a proceeding for unlawful detainer. (*C.C.P. 564(b)(6)*); see *Pacific States Savings & Loan Co. v. Hoffman* (1933) 134 C.A. 601, 602, 25 P.2d 1006.)

(3) *Notice to Residential Tenants*. If the property is a rental housing unit occupied by a tenant or subtenant renting on either a periodic basis or for a fixed period of time, the unlawful detainer action must be preceded by a written notice to quit, at least as long as the term of the hiring, but not to exceed 30 days. (*C.C.P. 1161a(c)*.) Moreover, if the property is located in a city with a rent control ordinance, the purchaser is subject to the ordinance's restrictions on evictions. (*Gross v. Superior Court* (1985) 171 C.A.3d 265, 270, 272, 217 C.R. 284.)

(4) *Availability of Defense of Retaliatory Eviction*. The tenant's defense of retaliatory eviction (see 12 *Summary* (10th), *Real Property*, §706.) is not available against a purchaser where the purchaser's title is lawfully perfected; thus, even if the trustor is able to show a wrongful motive, he or she cannot establish a right to remain in possession after default and valid foreclosure. (*California Livestock Production Credit Assn. v. Sutfin* (1985) 165 C.A.3d 136, 142, 211 C.R. 152.)

(5) *Who May Bring Action*. *C.C.P. 1161a(b)* specifies the events that give rise to the cause of action for unlawful detainer and the persons against whom the action may be brought; it is silent on *who* may bring the action. In *Evans v. Superior Court* (1977) 67 C.A.3d 162, 136 C.R. 596, the question was whether a purchaser from the purchaser at the

sale could do so; and the court held that he could: "We find that the policy the statute is designed to implement would be served by allowing a subsequent purchaser to maintain the action. We find that no alteration in the summary nature of the cause of action would thereby occur, and that the occupant of the premises would not thereby be deprived of otherwise available defenses." (67 C.A.3d 169.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Right to Remedy*.

Cross-Reference: 5 Cal. Proc. (5th), *Pleading*, §648.



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B. Enforcement Procedure.

5. Unlawful Detainer.

b. Litigation of Title Issue.

1. Validity of Sale.

4 Witkin Sum. Cal. Law STRP § 172

[§ 172] Validity of Sale.

Unlawful detainer is a *summary proceeding*; the right to possession alone is involved, and the question of title cannot be raised by the defendant by cross-complaint or affirmative defense. But *C.C.P. 1161a(b)(3)* gives the remedy to the purchaser where the property has been sold or foreclosed and the title "has been duly perfected." In *Cheney v. Trauzettel* (1937) 9 C.2d 158, 69 P.2d 832, plaintiff purchaser brought unlawful detainer and defendant answered and cross-complained. The cross-complaint was in the usual form of a complaint to quiet title; the answer set up the defense that the sale was merely colorable, to preserve the property from execution, and alleged the pendency of another action to quiet title. But compliance with the statutory procedure in the sale was admitted. The trial court struck out the cross-complaint and special defenses and gave judgment for plaintiff. *Held*, this was proper; the purchaser must prove his acquisition of title by purchase at the sale, but only to this limited extent may title be litigated.

The court said: "Irrespective of the merits of the defenses raised by the answer, the alleged equitable grounds of attack on plaintiff's title have no place in the present summary proceeding, for if such issues are permissible, the proceeding entirely loses its summary character. In our opinion the plaintiff need only prove a sale in compliance with the statute and deed of trust, followed by purchase at such sale, and the defendant may raise objections only on that phase of the issue of title. Matters affecting the validity of the trust deed or primary obligation itself, or other basic defects in the plaintiff's title, are neither properly raised in this summary proceeding for possession, nor are they concluded by the judgment." (9 C.2d 160.) (See *Seidell v. Anglo-Calif. Trust Co.* (1942) 55 C.A.2d 913, 920, 132 P.2d 12 [challenge to regularity of sale proceedings is within limited attack on title permitted by C.C.P. 1161a]; *Kartheiser v. Superior Court* (1959) 174 C.A.2d 617, 620, 345 P.2d 135 [same]; *Evans v. Superior Court* (1977) 67 C.A.3d 162, 136 C.R. 596, supra, §171 [issue should be raised in quiet title action, which may be maintained simultaneously]; *California Livestock Production Credit Assn. v. Sutfin* (1985) 165 C.A.3d 136, 140, footnote 2, 211 C.R. 152, citing the text; *Old Nat. Financial Services v. Seibert* (1987) 194 C.A.3d 460, 464, 239 C.R. 728 [trial judge properly denied requested stay of unlawful detainer action pending resolution of defendant's unrelated fraud action against plaintiff]; *Stephens, Partain & Cunningham v. Hollis* (1987) 196 C.A.3d 948, 952, 242 C.R. 251 [rule stated, but other defenses that were considered by trial judge without objection were considered on appeal].)

SUPPLEMENT: [This section is current through the latest supplement]



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- B. Enforcement Procedure.
 - 5. Unlawful Detainer.
 - b. Litigation of Title Issue.
- 2. Fraud in Acquisition of Title.

4 Witkin Sum. Cal. Law STRP § 173

[§ 173] Fraud in Acquisition of Title.

Normally, the defendant in an unlawful detainer action may not raise equitable defenses to the plaintiff's claim of title. (See *Gonzales v. Gem Properties* (1974) 37 C.A.3d 1029, 1034, 112 C.R. 884, *infra*, §174; *Vella v. Hudgins* (1977) 20 C.3d 251, 256, 142 C.R. 414, 572 P.2d 28, 7 Cal. Proc. (4th), *Judgment*, §369.) But in unlawful detainer actions brought by landlords against tenants, the tenants have been allowed to set up defenses of retaliatory eviction and breach of the implied warranty of habitability. (See 12 *Summary* (10th), *Real Property*, §§624, 706.) On the analogy of these decisions, *Asuncion v. Superior Court* (1980) 108 C.A.3d 141, 166 C.R. 306, involving an equity purchaser (see *infra*, §222 *et seq.*), held that a homeowner defendant could raise the affirmative defense of plaintiff's fraudulent acquisition of title. (108 C.A.3d 146.)

In *Mehr v. Superior Court* (1983) 139 C.A.3d 1044, 189 C.R. 138, plaintiff, purchaser of defendants' residence at a trustee's sale, brought an unlawful detainer proceeding. Defendants, in the unlawful detainer proceeding and by separate action, set up defenses of fraud and failure to comply with statutory provisions. The trial judge gave judgment for plaintiff in the unlawful detainer proceeding, stating that his finding on the issue of fraudulent acquisition of title was subject to retrial in the separate action. Defendants appealed, and moved for a stay of execution on appeal, which the trial court denied. *Held*, denial of a stay was an abuse of discretion, and mandamus issued to compel granting of the motion.

(a) *C.C.P.* 1176(a) provides that an appeal by the defendant does not stay proceedings on the judgment unless the judge so directs. Many decisions have construed this section strictly, holding that supersedeas, mandamus, or prohibition will not lie to compel a stay. (139 C.A.3d 1048, and footnote 3, listing the cases.)

(b) Because of its summary character, an unlawful detainer action is not a suitable proceeding for the trial of complicated ownership issues involving allegations of fraud; and, although title may be litigated to a limited extent, *C.C.P.* 1161a does not require the defendant to do so within the statutory time constraints. Hence, in the absence of a record establishing that the issue was fully litigated, it is not foreclosed by an adverse judgment in the summary proceeding. (139 C.A.3d 1049, citing *Vella v. Hudgins*, *supra*.)

(c) *Asuncion v. Superior Court, supra*, held that a homeowner cannot be evicted without being permitted to raise affirmative defenses which, if proved, would maintain his or her possession and ownership; and the court suggested the use of existing procedural devices "to facilitate accommodating an unlawful detainer action with a separately filed fraud action" (e.g., a stay of the unlawful detainer action until trial of the fraud action, or consolidation of the actions). (139 C.A.3d 1049.)

(d) Defendants, by their affirmative defenses in the unlawful detainer proceeding and their allegations in the separate equity action, have shown that a substantial question will be raised on appeal; that they will suffer irreparable injury by an eviction from their home pending appeal, and that plaintiff will not be solely prejudiced by a stay. Hence, the trial court abused its discretion in denying the motion. (139 C.A.3d 1050.)

SUPPLEMENT: [This section is current through the latest supplement]
Vella case:

Cross-Reference: 7 Cal. Proc. (5th), *Judgment*, §431.



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B. Enforcement Procedure.

5. Unlawful Detainer.

b. Litigation of Title Issue.

3. Effect of Judgment.

4 Witkin Sum. Cal. Law STRP § 174

[§ 174] Effect of Judgment.

If the defendant raises equitable defenses and they are tried without objection, the judgment will be binding on the issues raised and determined. (See 7 *Cal. Proc.* (4th), *Judgment*, §363.) But where the defendant did not have an opportunity to present an equitable defense, such as fraud, the judgment will not bar a subsequent action to set aside the sale.

Thus, in *Gonzales v. Gem Properties* (1974) 37 C.A.3d 1029, 112 C.R. 884, plaintiff, in 1962, gave a note and second deed of trust on his residence to secure a loan of \$ 3,100. In 1967, when the balance was \$ 691.88, a dispute arose between plaintiff and the collection agent as to payments. The collection agent refused plaintiff's tender and recorded notice of default and election to sell. Defendants, owners of a corporation in the business of purchasing obligations in default, acquired the note. When plaintiff discovered the transfer, he attempted to tender the money owed, but they evaded him, discouraged bidding, and bought the property for \$ 691.88, a sum greatly below its value. Then they brought an unlawful detainer action in the municipal court, and plaintiff sued in the superior court to set aside the sale. The municipal court judge refused to transfer the case to the superior court, struck plaintiff's cross-complaint setting up equitable defenses, and entered judgment for defendant purchasers, finding the sale regular and the trustee's deed valid. The appellate department affirmed and plaintiff was dispossessed. The superior court action then came to trial. The superior court judge rejected the defense of *res judicata*, and found that defendants had acted fraudulently and maliciously to obtain plaintiff's property at a minimal price. Judgment was given for plaintiff, declaring the sale and the trustee's deed invalid, and awarding \$ 5,000 in punitive damages. *Held*, affirmed in part.

(a) Cases since *Cheney v. Trauzettel* (1937) 9 C.2d 158, 69 P.2d 832, *supra*, §172, have taken various positions on the duty of a municipal court in an unlawful detainer action to consider equitable defenses. Some have held that when the defendant had the opportunity to litigate or actually litigated his or her claim to title, the judgment is *res judicata*. (37 C.A.3d 1035.) The test is whether the unlawful detainer defendant (plaintiff herein) had a fair adversary hearing which resulted in a judgment on the merits. This is unlikely where the defense is a fraudulent scheme to deprive the defendant of his or her property; investigation and discovery are not always possible within the time limits of unlawful detainer proceedings. (37 C.A.3d 1036.)

(b) In the instant case, it did not appear that the municipal court, in the exercise of its limited power, could have received and considered evidence of the fraud. Hence, the judgment was not res judicata. (37 C.A.3d 1036.)

(c) The superior court judgment merely declared the sale void. If a bona fide purchaser now has the property, it cannot be restored to plaintiff, and in that event compensatory damages should be awarded to plaintiff. Hence, the judgment is affirmed as to its determination of invalidity of the sale and trustee's deed, but is remanded for the purpose of modification to grant the additional relief to which plaintiff is entitled. (37 C.A.3d 1037.)

Vella v. Hudgins (1977) 20 C.3d 251, 142 C.R. 414, 572 P.2d 28, reaches a similar conclusion. Where no fair adversary hearing takes place, matters affecting the primary obligation or other defects in the plaintiff's title are not concluded by the judgment. (20 C.3d 257; see 7 Cal. Proc. (4th), Judgment, §369.)

SUPPLEMENT: [This section is current through the latest supplement]
Binding effect:

Cross-Reference: 7 Cal. Proc. (5th), Judgment, §424.*Vella case:*

Cross-Reference: 7 Cal. Proc. (5th), Judgment, §431.



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B. Enforcement Procedure.
6. Effect of Purchase by Beneficiary.
a. In General.

4 *Witkin Sum. Cal. Law STRP* § 175

[§ 175] In General.

(1) *Full Credit Bid*. When the beneficiary causes a trustee's sale to be held and purchases the property for the full amount of the debt, the debt and lien are extinguished. (C.C. 2910.) This purchase is called a "full credit bid." If the mortgagee makes a full credit bid, that "establishes the value of the security as being equal to the outstanding indebtedness and ipso facto the nonexistence of any impairment of security." (*Cornelison v. Kornbluth* (1975) 15 C.3d 590, 606, 125 C.R. 557, 542 P.2d 981, *infra*, §197; see *Sumitomo Bank v. Taurus Developers* (1986) 185 C.A.3d 211, 218, 229 C.R. 719, *infra*, §176.) Thus, the beneficiary cannot subsequently recover insurance proceeds payable for damage to the property. (*Duarte v. Lake Gregory Land & Water Co.* (1974) 39 C.A.3d 101, 103, 113 C.R. 893 [rule was not changed by deed of trust provision that "[a]ny award of damages in connection with any ... injury to said property or any part thereof is hereby assigned to Beneficiary"].)

In *Caruso v. Great Western Savings* (1991) 229 C.A.3d 667, 280 C.R. 322, an action for declaratory relief was brought by a senior lienholder against former property owners concerning disposition of insurance proceeds. Junior lienholders filed a complaint in intervention seeking to block a foreclosure sale by the senior lienholder. G, a trustee in bankruptcy, had sold the property to R and W, who obtained insurance. Subsequent land movement made the property uninhabitable. G then executed an agreement providing that his lien would be subordinated to that of the senior lienholder, whose lien arose when R and W executed a \$ 200,000 note secured by a deed of trust. After paying a separate sum to R and W, the insurer paid \$ 200,000 jointly to them and to the senior lienholder.

A dispute arose concerning application of the insurance proceeds, and was temporarily resolved by placing \$ 190,000 into a joint account held by R, W, and the senior lienholder. G then assigned his lien to the junior lienholders. After R and W abandoned the property, the junior lienholders made a full credit bid at the foreclosure sale, and became sole owners, subject only to the senior lien. When the junior lienholders refused to make payments, the senior lienholder foreclosed. The trial judge ruled that the junior lienholders had no interest in the insurance proceeds. *Held*, affirmed.

(a) The junior lienholders argued that, as successors to R's and W's title by virtue of having foreclosed on the property, they had standing to challenge disposition of the insurance proceeds. Specifically, they contended that the proceeds should have been subtracted from the principal amount on the senior lienholder's note, and that the senior lienholder's delay in doing so prevented the junior lienholders from saving interest and related charges. However, under

Cornelison v. Kornbluth, *supra*, the junior lienholders had no interest in the insurance proceeds because they had made a full credit bid for the property, thereby extinguishing their lien. (229 C.A.3d 672, 673.)

(b) The junior lienholders could have preserved their right to obtain the benefit of the insurance proceeds by not making a full credit bid. Had the junior lienholders made a low bid, a deficiency balance would have remained, which the junior lienholders could have sought to satisfy out of a share in the insurance proceeds. (229 C.A.3d 673, 674.)

Further, when there is a full credit bid, the beneficiary cannot recover net rent proceeds (*supra*, §170), or damages for waste (*infra*, §197; but see *infra*, §198, on damages for "bad faith" waste). (See *Pacific Inland Bank v. Ainsworth* (1995) 41 C.A.4th 277, 282, 283, 48 C.R.2d 489 [lender that made full credit bid at nonjudicial foreclosure sale was precluded from recovering damages from appraiser for breach of contract and negligence in preparing appraisals that resulted in loan being undersecured; despite rule of *Alliance Mortg. Co. v. Rothwell* (1995) 10 C.4th 1226, 44 C.R.2d 352, 900 P.2d 601, *infra*, §177, full credit bid rule bars *nonfraud* claims against third parties]; *Bank of America v. Quackenbush* (1997) 56 C.A.4th 1167, 1173, 66 C.R.2d 81 [lender that made full credit bids at nonjudicial foreclosure was precluded from having underlying security valued by appraisal as provided by *Ins.C. 1029, 1030*]; *Kolodge v. Boyd* (2001) 88 C.A.4th 349, 358, 105 C.R.2d 749 [there was triable issue whether lender made full credit bid, even though he bid amount stated in trustee's deed, which was to be "in full satisfaction" of indebtedness, where there was conflicting evidence on amount of debt at time of sale]; *Rest.3d, Property (Mortgages)* §7.8; 4 Miller & Starr 3d, §10:216.)

(2) *Less Than Full Credit Bid*. If a beneficiary bids less than the full amount of obligation owing to him or her, a deficiency balance of the debt remains to which the beneficiary may seek entitlement from insurance proceeds. (*Armsey v. Channel Associates* (1986) 184 C.A.3d 833, 836, 229 C.R. 509.) *Armsey* involved a purchase by the beneficiary at the foreclosure sale for less than the amount of the indebtedness. The property was encumbered by two deeds of trust. Plaintiff mortgagee sold it to defendant for \$ 700,000, with \$ 600,000 secured by an all-inclusive "wrap around" deed of trust obligating plaintiff to make the payments on the senior trust deeds. After a fire destroyed the building on the property, defendant mortgagor defaulted in making payments. At the ensuing foreclosure sale, plaintiff, who had kept the senior liens current, purchased the property subject to the senior liens with a credit bid equal to the total indebtedness minus the amounts owing on the senior liens. The trial judge ruled that the balance on the senior trust deeds was indebtedness remaining after the foreclosure sale, and thus plaintiff was entitled to satisfy the deficiency judgment from the insurance proceeds. *Held*, judgment for plaintiff affirmed.

(a) *C.C.P. 580b* (*infra*, §182 et seq.) does not prevent plaintiff from realizing on the insurance policy, which was additional security for the loan (*supra*, §84), up to the amount of the indebtedness remaining after the foreclosure sale. (184 C.A.3d 837.)

(b) Plaintiff foreclosed his own equity interest, but, as the entire indebtedness under the note and all-inclusive deed of trust exceeded the amount bid, the indebtedness was not extinguished. (184 C.A.3d 838, 839.) Plaintiff is entitled to the full benefit of his security interest, and there is no injustice in awarding him the insurance proceeds. He parted with land and building worth \$ 700,000 and received land with no building but with the obligation to pay senior encumbrances. (184 C.A.3d 839.)

SUPPLEMENT: [This section is current through the latest supplement]



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6. Effect of Purchase by Beneficiary.
b. Negligence Claims.

4 *Witkin Sum. Cal. Law STRP* § 176

[§ 176] Negligence Claims.

The beneficiary purchaser at a trustee's sale may state a negligence claim against a builder, independent of an impairment of security claim. (*Sumitomo Bank v. Taurus Developers* (1986) 185 C.A.3d 211, 215, 229 C.R. 719.) In *Sumitomo*, plaintiff loaned defendant money secured by a deed of trust to build a condominium project. Following defendant's default, plaintiff had the property sold under the power of sale and, at the trustee's sale, purchased the property for a full credit bid. Plaintiff thereafter discovered construction defects that caused it to expend \$ 400,000 for repairs. Plaintiff sued defendant on various theories including breach of the loan contract, bad faith waste, fraud, and negligence. The trial judge dismissed all causes of action. *Held*, reversed as to the negligence cause of action, and otherwise affirmed.

(a) Plaintiff's breach of contract, bad faith waste, and fraud causes of action are all factually based on the lender-borrower transaction: the breach of contract arises from defendant's failure to inspect for and notify of defects as required by the loan agreement; the bad faith waste arises from the same acts which impaired the security (C.C. 2929); and the fraud arises from making promises with no intention to perform them so as to induce plaintiff to make the loan, and misrepresentations regarding inspections and lack of defects so as to induce continued disbursements. (185 C.A.3d 217.) Plaintiff's measure of damages under all these theories is the amount of the impairment of the security, i.e., the amount by which the value of the security is less than the outstanding indebtedness. (185 C.A.3d 217, 218.) Hence, because plaintiff made a full credit bid, its security was not impaired. (185 C.A.3d 219, citing *Cornelison v. Kornbluth* (1975) 15 C.3d 590, 125 C.R. 557, 542 P.2d 981, *infra*, §197.)

(b) In its negligence cause of action, plaintiff alleges that defendant's negligence in building or supervising the project resulted in the sale to plaintiff of a defective product. (185 C.A.3d 211; see 6 *Summary* (10th), *Torts*, §§1160, 1509.) A third-party purchaser at a trustee's sale may bring an action for negligent construction, and there is no reason for barring a mortgagee purchaser from asserting this action. *Cornelison* and other cases holding that a full credit bid bars a subsequent action against the mortgagor are not concerned with the distinct public policy concern on which negligent construction principles rest. Nor do these cases involve causes of action that are available to third-party, nonbeneficiary purchasers. (185 C.A.3d 225.)

SUPPLEMENT: [This section is current through the latest supplement]



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CHAPTER VIII - Security Transactions in Real Property

Witkin Summary of California Law
VII. REMEDIES OF MORTGAGEE AND TRUSTEE

B. Enforcement Procedure.
6. Effect of Purchase by Beneficiary.
c. Claims Against Third Parties.

4 *Witkin Sum. Cal. Law STRP* § 177

[§ 177] Claims Against Third Parties.

(1) *Fraud Claims.* In *Alliance Mortg. Co. v. Rothwell* (1995) 10 C.4th 1226, 44 C.R.2d 352, 900 P.2d 601, the question was "whether a lender's acquisition of security property by full credit bid at a nonjudicial foreclosure sale bars the lender from maintaining a *fraud* action to recover damages from third parties who fraudulently induced the lender to make the loans." (10 C.4th 1241.) Plaintiff lender sued a real estate appraiser and broker, a title insurer, and others, alleging that defendants had fraudulently induced plaintiff to issue loans on nine residential properties. Defendants moved to strike portions of the complaint on the ground that they were barred by plaintiff's full credit bids on the subject properties. The trial judge granted the motions to strike, agreeing with defendants that plaintiff's full credit bids barred claims for damages from fraudulent representations as to the adequacy of the security. The Court of Appeal reversed, concluding that the fraud claims were not barred and expressly disagreeing with *Western Fed. Savings & Loan Assn. v. Sawyer* (1992) 10 C.A.4th 1615, 13 C.R.2d 639, and *GN Mortg. Corp. v. Fidelity Nat. Title Ins. Co.* (1994) 21 C.A.4th 1802, 27 C.R.2d 47. *Held*, judgment of the Court of Appeal affirmed.

(a) The full credit bids do not preclude plaintiff from demonstrating either justifiable reliance or actual damages. "[T]o the extent Alliance's full credit bids were proximately caused by defendants' fraudulent misrepresentations, and this reliance without independent or additional inquiry was either appropriate given the context of the relationship or was not otherwise manifestly unreasonable, Alliance's bids cannot be deemed an admission of the properties' value. ... Hence, the full credit bid rule would not apply. ... [T]o the extent Alliance's full credit bids were not proximately caused by defendant's fraudulent misrepresentations, or its reliance without independent or additional inquiry was either inappropriate given the context of the relationship or was otherwise manifestly unreasonable," the rule would apply. Plaintiff would not be entitled to recover the difference between its bid and the actual value of the property, but it could still recover any other damages flowing from defendants' fraud. (10 C.4th 1247.)

(b) Defendants' argument that plaintiff has failed to allege actual damages assumes that the measure of damages for fraudulent inducement of a loan is the impairment of the lender's security or the balance of the outstanding indebtedness, but this is not so. Plaintiff's allegations are not that defendants damaged or impaired the security interest, but that they deceived plaintiff at the outset as to what the security was. In this situation, plaintiff's loss is measured not by the outstanding indebtedness, but either by its out-of-pocket and consequential damages under C.C. 3343 or under C.C. 3333, depending on whether defendants stood in a fiduciary relationship to plaintiff. (10 C.4th 1249; on measure

of damages for fraud, see 6 *Summary* (10th), *Torts*, §1710.) Accordingly, plaintiff's full credit bids do not establish as a matter of law that it sustained no actual damages. (10 C.4th 1250.) (See *Romo v. Stewart Title of Calif.* (1995) 35 C.A.4th 1609, 1617, 1619, 42 C.R.2d 414 [full credit bid barred seller's recovery of amounts owing on second and third deeds of trust, but did not bar fraud cause of action against escrow company for recovery of real estate commission]; 4 Miller & Starr 3d, §10:216; 23 *Pepperdine L. Rev.* 1429 [*Alliance Mortgage*].)

The *Alliance* exception was held inapplicable in *Michelson v. Camp* (1999) 72 C.A.4th 955, 85 C.R.2d 539. "[T]o avoid the full credit bid rule, the lender must have been induced to enter into the loan by the false representation, and still be under the mistaken belief that the representation was true at the time it makes the full credit bid." (72 C.A.4th 969.) Here, the lender's reliance "on an old appraisal when a recent one had been prepared expressly to resolve the issue of value at the time of foreclosure is manifestly unreasonable." (72 C.A.4th 969.)

(2) *Other Claims.* In *Pacific Inland Bank v. Ainsworth* (1995) 41 C.A.4th 277, 282, 283, 48 C.R.2d 489, the court held that the full credit bid rule still bars *nonfraud* claims against third parties despite the rule of *Alliance Mortgage*. Thus, a lender that made a full credit bid at a nonjudicial foreclosure sale was precluded from recovering damages from an appraiser for breach of contract and negligence in preparing appraisals that resulted in the loan being undersecured. (72 C.A.4th 969.) (See *First Commercial Mortg. Co. v. Reece* (2001) 89 C.A.4th 731, 744, 108 C.R.2d 23 [following *Alliance Mortgage* and distinguishing *Pacific Inland Bank*; original lender was not precluded from bringing action against appraiser and loan broker for negligent misrepresentation and breach of contract by full credit bid of foreclosing lender which, in purchasing loan, had contractually required original lender to indemnify it for any losses suffered in foreclosure].)

However, in *Kolodge v. Boyd* (2001) 88 C.A.4th 349, 105 C.R.2d 749, the court declined to follow *Pacific Inland Bank*, declaring that it was wrongly decided. The purpose of the full credit bid rule, "which is to insure the integrity of foreclosure sales in situations covered by the antideficiency statutes, relates only to the debtor-creditor relationship. The bar of the rule was not to relieve third parties of the consequences of tortious conduct." (88 C.A.4th 370.) "What the *Alliance* court said about a suit for intentional misrepresentation can be said with equal force about a suit for negligent misrepresentation." (88 C.A.4th 365.) Thus, a lender's causes of action against an appraiser for negligence and negligent misrepresentation "are not as a matter of law barred by the full credit bid rule." (88 C.A.4th 372.) (See *Track Mortg. Group v. Crusader Ins. Co.* (2002) 98 C.A.4th 857, 864, 120 C.R.2d 228 [following *Alliance Mortgage* and distinguishing *Kolodge* and *Reece*; damages of lender named as loss payee on property insurance policy are limited by credit bid rule to difference between amount secured by deed of trust and amount of lender's credit bid at foreclosure sale; rule also limits lender's tort damages against insurer in absence of showing that insurer caused lender to make that credit bid, although lender may still be entitled to recover other consequential tort damages like interest and attorneys' fees].)

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Witkin Summary of California Law VII. REMEDIES OF MORTGAGEE AND TRUSTEE

C. Deficiency Judgment.

1. Foreclosure of Ordinary Mortgage.

a. Right to Deficiency Judgment.

4 Witkin Sum. Cal. Law STRP § 178

[§ 178] Right to Deficiency Judgment.

(1) *In General.* As an incident to the equitable relief sought in a foreclosure action on an ordinary mortgage, a deficiency judgment will be entered against the mortgagor if the sale is for less than the amount of the debt. (*C.C.P. 726(b)*; see *Brichetto v. Raney* (1926) 76 C.A. 232, 240, 245 P. 235; *Korea Exchange Bank v. Yang* (1988) 200 C.A.3d 1471, 1474, 246 C.R. 619 [deficiency judgment was proper against person served with summons and complaint by substituted service; *C.C.P. 726(b)*, requiring notice of application for deficiency judgment, is not applicable to defendant who does not appear]; *Rest.3d, Property (Mortgages) §8.4*; 4 Powell §§37.50, 37.51; 4 Miller & Starr 3d, §10:233; C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §3.4; Cal. Civil Practice, 1 Real Property Litigation, §4:82 et seq. [forms]; 73 Cal. L. Rev. 1332 [application of anti-deficiency statutes in conflict of laws context].)

(2) *Against Personal Representative or Estate.* However, no deficiency judgment generally is allowed against a decedent's personal representative or estate. But where the mortgage, deed of trust, or lien is a renewal or substitution for one subsisting at the decedent's death, and is an approved claim, the part of the indebtedness remaining unsatisfied is classed with other established claims. (*Prob.C. 9807*; see 14 *Summary* (10th), *Wills and Probate*, §494.)

(3) *Waiver of Requirement of Exhaustion of Security.* The right to a deficiency judgment against the mortgagor depends on exhaustion of the security (*C.C.P. 726(a)*, supra, §124 et seq.), but a partial and excusable failure in this respect may be waived by the debtor. In *United Calif. Bank v. Tijerina* (1972) 25 C.A.3d 963, 102 C.R. 234, plaintiffs brought an action against defendant debtor to foreclose a mortgage and obtain a deficiency judgment. They moved for summary judgment, defendant offered no opposition, and the judgment was entered, ordering sale and reserving for a further proceeding the determination of the amount of the deficiency. Defendant did not appeal. The properties were sold, plaintiffs sought a deficiency judgment, and at this point defendant contended that the right had been waived because a parcel of real property and two other items of the security had not been listed in the complaint. Plaintiffs proved that the omission was due to inadvertence. *Held*, a deficiency judgment was properly entered.

(a) *C.C.P. 726* contemplates a *two-stage proceeding*: the *first*, culminating in the foreclosure decree, orders sale of the mortgaged property and determines the liability for a deficiency judgment; the *second* is concerned solely with the issue of the amount of the deficiency--all other issues are to be adjudicated prior to entry of the decree. (25 C.A.3d 968.)

(b) A creditor who fails to exhaust all of his or her security in one action waives both the right to the balance of the security and the right to a deficiency judgment. But defendant debtor, with knowledge of the extent of the security, has an affirmative duty to raise the fact of omission of a parcel before rendition of the decree. *C.C.P.* 726 clearly calls for this timely objection by providing that in the event of a waiver by the creditor of the right to a deficiency "the decree shall so declare." (25 *C.A.3d* 967, 968.) Defendant debtor, who ignored the statutory procedure, could not take advantage of his own silence by a belated attack on the deficiency judgment, after it became final and res judicata. (25 *C.A.3d* 968, 969.)

West's Key Number Digest, Mortgages k.555 et seq.

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C. Deficiency Judgment.

1. Foreclosure of Ordinary Mortgage.

b. Limitation on Amount.

1. Nature and Scope of Statutes.

4 Witkin Sum. Cal. Law STRP § 179

[§ 179] Nature and Scope of Statutes.

(1) *In General.* The amount of a deficiency judgment is limited to the *difference* between the *total debt* and the *fair value* of the property at the date of sale, but not exceeding the difference between the *total debt* and the *sale price*. (*C.C.P. 726(b)* [judicial foreclosure]; *C.C.P. 580a* [nonjudicial sale].) The importance of *C.C.P. 580a* was greatly diminished by the passage of *C.C.P. 580d* (*infra*, §199 *et seq.*), prohibiting a deficiency judgment following a nonjudicial sale, but it is still applied when a junior lienor purchases at the sale. (See *Walter E. Heller Western v. Bloxham* (1985) 176 *C.A.3d* 266, 272, 221 *C.R.* 425, *infra*, §181; 26 *Santa Clara L. Rev.* 533 [review of anti-deficiency statutes with proposals for reform].)

The fair value limitations prevent a mortgagee from realizing a double recovery by buying in at a depressed price and then obtaining a large personal judgment. (See *Roseleaf Corp. v. Chierighino* (1963) 59 *C.2d* 35, 40, 27 *C.R.* 873, 378 *P.2d* 97, *infra*, §181; *C.E.B.*, 1 Mortgage and Deed of Trust Practice 3d, §3.82; for prohibition of advance waiver, see *C.C.* 2953, *supra*, §131.)

It has been held that an assuming grantee is entitled to the protection of the limitations on deficiency judgments, even though he or she signs a separate guaranty of payment on the note. As the primary debtor, the assuming grantee is liable only after exhaustion of the security in compliance with *C.C.P. 580a*. (*Everts v. Matteson* (1942) 21 *C.2d* 437, 448, 132 *P.2d* 476; see 3 *U.C.L.A. L. Rev.* 203.)

(2) *Sales Under Bankruptcy Code.* In *Coppola v. Superior Court* (1989) 211 *C.A.3d* 848, 259 *C.R.* 811, plaintiff sued defendant on a guaranty executed by defendant and E and secured by a deed of trust on property owned by E. The secured property was thereafter sold in a Chapter 11 bankruptcy proceeding "free and clear of liens" under 11 *U.S.C.*, §363(f). Defendant contended that this sale was equivalent to a foreclosure sale to satisfy a most senior lien under California law; hence, that the fair value provisions of *C.C.P. 580a* and *C.C.P. 726* applied and provided a defense. *Held*, the fair value provisions of *C.C.P. 580a* and 726 were inapplicable.

The fair value limitations apply only to judicial foreclosure sales (*C.C.P. 725a*, 726) and nonjudicial foreclosure sales (*C.C.P. 580a*); a sale under 11 *U.S.C.*, §363(f) is neither a judicial nor a nonjudicial foreclosure sale. (211 *C.A.3d*

857, 865, 869, 873.) And principles of equity do not compel the application of the fair value provisions to such a sale. (211 C.A.3d 857, 874.) Hence, defendant's complaint about the alleged unfairness of the bankruptcy sale price of the property must be presented in the bankruptcy proceedings. (211 C.A.3d 877.)

(3) *Statutory Fraud Action*. An action for fraud maintained under C.C.P. 726(f) (see supra, §126) does not constitute a money judgment for deficiency, or a deficiency judgment under C.C.P. 580a. (C.C.P. 726(h).)

(4) *Action for Breach of Environmental Provision*. An action under C.C.P. 736 to enforce an environmental provision is not subject to the limitations of C.C.P. 580a, 580b, 580d. (C.C.P. 736(a); see infra, §211.)

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(2) *Sales Under Bankruptcy Code*. See 22 A.L.R. Fed 2d 579 [sales of property, other than in ordinary course of business, of bankruptcy estate free and clear of liens, claims, and encumbrances under 42 U.S.C., §363(f)].



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C. Deficiency Judgment.

1. Foreclosure of Ordinary Mortgage.

b. Limitation on Amount.

2. Determining Fair Value.

4 Witkin Sum. Cal. Law STRP § 180

[§ 180] Determining Fair Value.

(1) *In General.* The following procedure is mandated for determining fair value: The foreclosure sale is conducted; within 3 months after that sale the plaintiff applies for a hearing; notice is served on all defendants at least 15 days before the hearing; either party may present evidence of the fair value of the property *as of the date of sale*. On application of either party at least 10 days before the hearing or on the court's motion at any time, a probate referee (see *Prob.C. 8900* et seq.) will be appointed to make an appraisal, which is admissible in evidence. (*C.C.P. 726(b)*; see *Rest.3d, Property (Mortgages) §8.3*; 4 Miller & Starr 3d, §10:234; C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §3.82.)

The requirement of *C.C.P. 726(b)* that a creditor's application for a fair determination be made within 3 months of the date of the foreclosure sale means within 3 months of the date when the sale is effected, i.e., when the highest bid is received at the auction. (*Paykar Const. v. Bedrosian* (1999) 71 C.A.4th 803, 808, 84 C.R.2d 135.) The statute provides a 3-month statute of limitations for seeking a deficiency judgment. Thus, relief under *C.C.P. 473* is not available to a lender that neglects to apply for a hearing within that limitations period. (*Life Savings Bank v. Wilhelm* (2000) 84 C.A.4th 174, 178, 100 C.R.2d 657; see *Citrus State Bank v. McKendrick* (1989) 215 C.A.3d 941, 945, 263 C.R. 781 [3-month limitation period applies to action for deficiency judgment by junior trust deed holder who has purchased secured property at foreclosure sale of more senior trust deed; relying on *Walter E. Heller Western v. Bloxham* (1985) 176 C.A.3d 266, 221 C.R. 425, *infra*, §181].)

(2) *Effect of Cloud on Title.* Fair value is to be determined on a consideration of all of the circumstances, including the state of the title and its merchantability. Hence, though fair value is ordinarily the price a willing purchaser would pay to a willing seller in the open market, where the title is clouded by a third party's action and a recorded *lis pendens*, this fact must be considered by the expert witnesses in making their appraisals. (*Nelson v. Orosco* (1981) 117 C.A.3d 73, 77, 79, 172 C.R. 457; see *Luther Burbank Savings & Loan Assn. v. Community Const.* (1998) 64 C.A.4th 652, 658, 75 C.R.2d 367 [following *Nelson v. Orosco*; court properly arrived at fair value by subtracting amount of tax lien from unencumbered value of property].)

(3) *Fair Value as Intrinsic Value.* In *Rainer Mortg. v. Silverwood, Ltd.* (1985) 163 C.A.3d 359, 209 C.R. 294, the

court, on an extended examination of the legislative history, rejected the contention of plaintiff lender that fair value must take into consideration the impact of foreclosure proceedings. "[T]he Legislature found it necessary to credit the borrower with the intrinsic or underlying value of the property. The fair market value of the property was deemed an insufficient measure as circumstances might conspire to render valueless property which under normal conditions would have significant value. The Legislature therefore determined not to let the protection afforded a foreclosed mortgagor depend entirely on the vagaries of the marketplace. ... The 'fair value' of foreclosed property is thus its intrinsic value. Under normal conditions this intrinsic value will often coincide with its fair market value; the value a willing purchaser will pay to a willing seller in an open market. ... This correlation is not fixed, however, and *market value* is only one factor the court should consider when determining 'fair value.' ... '[F]air value' is to be determined by all the circumstances affecting the intrinsic value of the property at the time of the sale. This necessarily excludes the circumstances of the foreclosure sale. These are not factors that affect the intrinsic worth of the property. Most notably, the right of redemption is limited to a year. After that time, it no longer serves to depress the marketability of the property." (163 C.A.3d 366.) (See *San Paolo U.S. Holding Co. v. 816 South Figueroa Co.* (1998) 62 C.A.4th 1010, 1026, 73 C.R.2d 272 [applying definition of "fair value" in *Rainer Mortg.*, except to extent term "intrinsic value" could be read as meaning more than fair market value of property without reduction for temporary price-reducing effect of judicial foreclosure and 1-year period of redemption].)

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- C. Deficiency Judgment.
 - 1. Foreclosure of Ordinary Mortgage.
 - b. Limitation on Amount.
 - 3. Sold-Out Junior Lienor.

4 Witkin Sum. Cal. Law STRP § 181

[§ 181] Sold-Out Junior Lienor.

(1) *Where Junior Lienor Does Not Purchase at Senior's Sale.* In *Roseleaf Corp. v. Chierighino* (1963) 59 C.2d 35, 27 C.R. 873, 378 P.2d 97, *infra*, §205, plaintiff sold a hotel to defendant C and his family. The consideration was a note and first deed of trust on the hotel and other land of C, made to strangers (to raise cash for part of the price), and notes to plaintiff secured by a second deed of trust on C's other land. The holders of the first deed of trust enforced their claim by a sale of this land, and the interest of plaintiff was thereby rendered valueless. In this action on the notes, judgment for plaintiff was affirmed; the requirement of exhaustion of the security has no application to a "sold-out junior lienor," and the same is true of restrictions on deficiency judgments.

"The position of a junior lienor whose security is lost through a senior sale is different from that of a selling senior lienor. A selling senior can make certain that the security brings an amount equal to his claim against the debtor or the fair market value, whichever is less, simply by bidding in for that amount. He need not invest any additional funds. The junior lienor, however, is in no better position to protect himself than is the debtor. Either would have to invest additional funds to redeem or buy in at the sale. Equitable considerations favor placing this burden on the debtor, not only because it is his default that provokes the senior sale, but also because he has the benefit of his bargain with the junior lienor who, unlike the selling senior, might otherwise end up with nothing." (59 C.2d 41.) (See *Bank of America v. Graves* (1996) 51 C.A.4th 607, 59 C.R.2d 288, *infra*, §205 [junior lienor who filed notice of default and of trustee's sale was not required under "one action rule" (see *supra*, §124) to purchase at senior's sale to protect its interest].)

(2) *Where Junior Lienor Purchases.* In *Walter E. Heller Western v. Bloxham* (1985) 176 C.A.3d 266, 221 C.R. 425, plaintiff, holder of a subordinated purchase money deed of trust purchased the secured property at the senior lienor's nonjudicial sale and then sought a deficiency judgment for the full amount due on its deed of trust. *Held*, following *Roseleaf*, the deficiency judgment was not barred by C.C.P. 580d, but the amount of the deficiency judgment would be limited by the fair value limitations of C.C.P. 580a. "The junior in *Roseleaf* did not purchase at the senior's sale. To apply the fair value limitations to that junior would result in the amount of his deficiency being limited by the amount of someone else's bid, a factor over which he has no control. However, once a junior chooses to purchase, it is equitable to apply the fair value limitations to him. Any loss to him as creditor by his own underbidding is gained by him as purchaser for a bargain price." (176 C.A.3d 273.) (See *Citrus State Bank v. McKendrick* (1989) 215 C.A.3d 941, 945,

263 C.R. 781 [relying on *Walter E. Heller Western* in applying 3-month limitation period of C.C.P. 580a (see supra, §179)]; 23 *Loyola L.A. L. Rev.* 313 [fair value limitations applied to sold-out junior lienors].)

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C. Deficiency Judgment.

2. Foreclosure of Purchase Money Mortgage: C.C.P. 580b.

a. Deficiency Judgment Prohibited.

1. Nature and Purpose of Statute.

4 Witkin Sum. Cal. Law STRP § 182

[§ 182] Nature and Purpose of Statute.

"No deficiency judgment shall lie in any event after a sale of real property or an estate for years therein for failure of the purchaser to complete his or her contract of sale, or under a deed of trust or mortgage given to the vendor to secure payment of the balance of the purchase price of that real property or estate for years therein, or under a deed of trust or mortgage on a dwelling for not more than four families given to a lender to secure repayment of a loan which was in fact used to pay all or part of the purchase price of that dwelling occupied, entirely or in part, by the purchaser." (C.C.P. 580b.)

The legislative purpose of this special exemption of one class of debtors from liability for deficiency judgments has been variously described and applied. (See *Kerrigan v. Maloof* (1950) 98 C.A.2d 605, 616, 221 P.2d 153 ["to prevent creditors from buying in property for a nominal sum, after the debtor had defaulted, and then holding the defaulting debtor for a large deficiency judgment"]; *Brown v. Jensen* (1953) 41 C.2d 193, 197, 259 P.2d 425, *infra*, §192 [the anti-deficiency statutes "indicate a considered course on the part of the Legislature to limit strictly the right to recover ... on the debt more than the value of the security"]; *Cornelison v. Kornbluth* (1975) 15 C.3d 590, 601, 125 C.R. 557, 542 P.2d 981, *infra*, §197; *Nickerman v. Ryan* (1979) 93 C.A.3d 564, 572, 155 C.R. 830; *Shepherd v. Robinson* (1981) 128 C.A.3d 615, 623, 180 C.R. 342; *LaForgia v. Kolsky* (1987) 196 C.A.3d 1103, 1108, 242 C.R. 282, *infra*, §186; *Palm v. Schilling* (1988) 199 C.A.3d 63, 69, 244 C.R. 600, *infra*, §183; *Conley v. Matthes* (1997) 56 C.A.4th 1453, 1462, 66 C.R.2d 518 [one of owners of two properties who marketed them to buyers, assisted buyers in obtaining financing for first trust deeds, and loaned buyers money necessary to complete transaction, was "vendor" for purposes of C.C.P. 580b]; *Jones v. Wagner* (2001) 90 C.A.4th 466, 480, 108 C.R.2d 669 [C.C.P. 580b is not applicable where note is not purchase money obligation and creditor is not seller of property].)

Roseleaf Corp. v. Chierighino (1963) 59 C.2d 35, 27 C.R. 873, 378 P.2d 97, *infra*, §205, is instructive. "A vendor is thus discouraged from overvaluing the security. Precarious land promotion schemes are discouraged, for the security value of the land gives purchasers a clue as to its true market value. ... If inadequacy of the security results, not from overvaluing, but from a decline in property values during a general or local depression, section 580b prevents the aggravation of the downturn that would result if defaulting purchasers were burdened with large personal liability. Section 580b thus serves as a stabilizing factor in land sales." (59 C.2d 42.) (See *Guardian Savings & Loan Assn. v. MD*

Associates (1998) 64 C.A.4th 309, 322, 75 C.R.2d 151, 1 Summary (10th), *Contracts*, §69 [following *Roseleaf Corp.*; statutory policy of C.C.P. 580b is "fundamental" within meaning of Rest., Conflicts §187 as to proper choice of law].)

Commentary on the statute is extensive. (See 4 Miller & Starr 3d, §10:236 et seq.; C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §5.24 et seq.; 37 *Cal. L. Rev.* 690; 48 *Cal. L. Rev.* 705; 51 *Cal. L. Rev.* 1; 53 *Cal. L. Rev.* 159; 3 Santa Clara Lawyer 187; 15 *Stanf. L. Rev.* 121; 3 *U.C.L.A. L. Rev.* 195; 22 *U.C.L.A. L. Rev.* 753 [Deficiency Judgments in California: The Supreme Court Tries Again]; 43 *U.C.L.A. L. Rev.* 2077 [arguing that protections of C.C.P. 580b should extend to refinancings, even with different lender]; 26 *U.S.F. L. Rev.* 93 [legislative purpose of C.C.P. 580b; arguing that family farm should be characterized as residential property, entitling owner to protection from deficiency judgment].)

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VII. REMEDIES OF MORTGAGEE AND TRUSTEE

C. Deficiency Judgment.

2. Foreclosure of Purchase Money Mortgage: C.C.P. 580b.

a. Deficiency Judgment Prohibited.

2. Waiver of Protection.

4 *Witkin Sum. Cal. Law STRP* § 183

[§ 183] Waiver of Protection.

The prohibition of C.C.P. 580b, enacted for a public policy reason, cannot be waived in advance. (*Valinda Builders v. Bissner* (1964) 230 C.A.2d 106, 112, 40 C.R. 735, *infra*, §195; see 5 Santa Clara Lawyer 99.) However, it was held at one time that the protective provisions could be waived by subsequent conduct of the debtor. (See *Russell v. Roberts* (1974) 39 C.A.3d 390, 395, 114 C.R. 305 [agreement with creditor for extension of time to pay installment on note, in consideration of unconditional promise to pay note even though holder should release security]; *Goodyear v. Mack* (1984) 159 C.A.3d 654, 659, 660, 205 C.R. 702 [purchase money mortgage status lost where note was paid, deed of trust reconveyed, and new note executed, secured by other property].)

This view was challenged in *Palm v. Schilling* (1988) 199 C.A.3d 63, 244 C.R. 600. Plaintiff beneficiaries agreed to subordinate their purchase-money deed of trust in exchange for defendant trustors' waiver of C.C.P. 580b. Following foreclosure by a senior lender, plaintiffs sought a deficiency judgment. The trial judge held the waiver valid under *Russell* and granted judgment for plaintiffs. *Held*, reversed.

(a) Unlike the single-action rule of C.C.P. 726, the 90-day limitation period for initiation of an action required by C.C.P. 580a, or the fair-value provisions of either statute, C.C.P. 580b *applies* to sold-out junior creditors. (199 C.A.3d 68, 69; see *infra*, §192.)

(b) Under the Supreme Court's "narrow view of purchase money mortgages," a mortgage securing the purchase price of property will be subject to C.C.P. 580b only if it "suberves the purposes" of the statute as explicated in *Roseleaf Corp. v. Chierighino* (1963) 59 C.2d 35, 27 C.R. 873, 378 P.2d 97, *supra*, §181, and *Bargioni v. Hill* (1963) 59 C.2d 121, 28 C.R. 321, 378 P.2d 593, *infra*, §190. (199 C.A.3d 69, quoting *Spangler v. Memel* (1972) 7 C.3d 603, 102 C.R. 807, 498 P.2d 1055, *infra*, §193.) "If the transaction does not meet that criterion, the closed out creditor is not recognized as a purchase money obligee and will be permitted to pursue a deficiency judgment, consistent with the statutory provisions applying to nonpurchase money obligations." (199 C.A.3d 69.)

(c) Like *Spangler* and *Roseleaf*, *Goodyear v. Mack*, *supra*, is an example of what appears to be a purchase money mortgage but is not for the purposes of C.C.P. 580b. Hence, the statement in *Goodyear* that the benefits of C.C.P. 580b

may be waived subsequent to the sale was irrelevant, unnecessary, and incorrect. (199 C.A.3d 72.)

(d) The holding that the protection of *C.C.P. 580b* may be subsequently waived by contract was necessary to the decision in *Russell v. Roberts, supra*, which involved a standard purchase money mortgage and is factually indistinguishable from the present case. *Russell* relied on *Salter v. Ulrich* (1943) 22 C.2d 263, 138 P.2d 7, *Morello v. Metzenbaum* (1944) 25 C.2d 494, 154 P.2d 670, and *Freedland v. Greco* (1955) 45 C.2d 462, 289 P.2d 463, *infra*, §200, for the proposition that the necessity that often drives debtors to make ruinous concessions when a loan is needed does not exist after the loan is made, when all rights have been established and there remains only the enforcement of those rights. "Our review of *Salter*, *Morello*, and *Freedland*, however, convinces us none supports the notion that section 580b may be contractually waived after the buyer has burdened his property with a purchase money mortgage. 'Ruinous concessions' are, if anything, easier to obtain when the debtor is in default. Then, the temptation to 'press the bet' is likely to be stronger than the poor decision to purchase the property in the first instance." (199 C.A.3d 73.)

(e) "The explicit language of section 580b brooks no interpretation other than that deficiency judgments are prohibited by a purchase money mortgagee so long as a purchase money mortgage or deed of trust is in effect on the original real property. To allow a purchase money creditor to circumvent the absolute rule by enforcing a purported waiver of section 580b in exchange for other concessions would flaunt the very purpose of the rule. If the purchase money creditor retains an interest in the original property, the debtor cannot be held for a deficiency. If the purchase money creditor does not wish to accept the risk that the property will be lost through foreclosure by another secured creditor, the remedy is to either foreclose himself or destroy the purchase money nature of the transaction by reconveying the deed or mortgage on the original real estate in exchange for the substitution of other security. ... Contractual waiver as the quid pro quo for any other concession is contrary to public policy." (199 C.A.3d 76.) (See *Jack Erickson & Associates v. Hesselgesser* (1996) 50 C.A.4th 182, 188, 57 C.R.2d 591 [debtor waived protection of *C.C.P. 580b* when he had junior lienor subordinate to construction loan; second waiver occurred when debtor induced junior lienor to execute deed of reconveyance and sold property; distinguishing *Palm*].)

Russell and the dicta in *Goodyear* were disapproved in *DeBerard Properties, Ltd. v. Lim* (1999) 20 C.4th 659, 671, 85 C.R.2d 292, 976 P.2d 843. Defendants purchased a shopping center from plaintiff, assuming a first trust deed held by a bank and signing a promissory note secured by a second trust deed in favor of plaintiff. When defendants could no longer make payments on the obligations, they renegotiated the terms of both loans. Plaintiff lowered the monthly payments and interest rate, and agreed to subordinate its trust deed to any modification of the bank loan. In exchange, defendants waived the anti-deficiency protection of *C.C.P. 580b*. When the bank foreclosed, extinguishing plaintiff's junior security interest, plaintiff sought a deficiency judgment. The trial court held the waiver valid. The Court of Appeal reversed, holding that *C.C.P. 580b* precludes waiver. *Held*, the statute may not be waived in the circumstances of this case.

(a) *C.C.P. 580b* is plain. "A vendor is barred from obtaining a deficiency judgment against a purchaser in a purchase money secured land transaction." (20 C.4th 663.)

(b) *Spangler v. Memel, supra*, created "only a narrow exception" to the scope of *C.C.P. 580b*, and "we decline to create another one here." (20 C.4th 664.) *Spangler* "is limited to those situations in which a pronounced intensification of the property's anticipated post-sale use both requires and eventually results in construction financing that dwarfs the property's value at the time of sale. Furthermore, the purchaser must be in a much better position than the vendor to assess the property's possible value and to understand the risks involved in capitalizing on the property's potential." Finally, the protection of *C.C.P. 580b* "must unfairly thrust 'the risk of the failure of the commercial development ... upon the vendor' " because the venture's success depends on the developing purchaser's competence, diligence, and good faith. (20 C.4th 666.)

(c) Although *Spangler* has been the object of criticism, the Legislature failed to abrogate the decision when it amended the statute in 1989, "and within its narrow confines that decision remains the law." (20 C.4th 667.) However, this case is not like *Spangler*. "[W]e cannot justify permitting a waiver ... just because DeBerard eased the terms of the

Lims' obligation to it. The fact is that the same property secured its note. ... And there was no large construction loan in furtherance of an intensified use. Nor do we agree that there was a dramatic change in the financial arrangements that might conceivably bring this case within *Spangler*'s ambit." (20 C.4th 667.) (See *Lawler v. Jacobs* (2000) 83 C.A.4th 723, 735, 100 C.R.2d 52 [seller subordination based on waiver of anti-deficiency law did not fall within *Spangler* exception for nonstandard transaction where seller's subordination only reached portion of purchase price and related costs, there was no "pronounced intensification" of postsale use, and seller knew risks involved in development; following *DeBerard*]; *Cadle Co. II v. Harvey* (2000) 83 C.A.4th 927, 934, 100 C.R.2d 150 [principal obligor cannot validly waive protections of C.C.P. 580b even by postorigination agreements; following *DeBerard*].)

SUPPLEMENT: [This section is current through the latest supplement]



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C. Deficiency Judgment.

2. Foreclosure of Purchase Money Mortgage: C.C.P. 580b.

a. Deficiency Judgment Prohibited.

3. Distinctions.

4 *Witkin Sum. Cal. Law STRP* § 184

[§ 184] Distinctions.

(1) *In General.* C.C.P. 580b prohibits only a deficiency judgment in the strict sense, i.e., a personal judgment against the debtor. It does not prevent the creditor from realizing on additional security, such as a chattel mortgage, pledge, or assignment of rents. (*Mortgage Guarantee Co. v. Sampsell* (1942) 51 C.A.2d 180, 124 P.2d 353; see *Hatch v. Security-First Nat. Bank of Los Angeles* (1942) 19 C.2d 254, 120 P.2d 869 [same holding as to C.C.P. 580a]; *Hodges v. Mark* (1996) 49 C.A.4th 651, 657, 56 C.R.2d 700, citing the text; *Dreyfuss v. Union Bank of Calif.* (2000) 24 C.4th 400, 406, 408, 101 C.R.2d 29, 11 P.3d 383 [pursuit of additional security is not pursuit of deficiency judgment; "creditor may proceed seriatim in foreclosing against multiple items of collateral without commencing a judicial action to determine the fair market value of each item sold, and crediting that amount to the debt, before proceeding with foreclosure sales of any additional collateral"]; cf. *Freedland v. Greco* (1955) 45 C.2d 462, 466, 289 P.2d 463, *infra*, §200; 3 U.C.L.A. L. Rev. 205.)

(2) *Fraud Actions.* The defenses of C.C.P. 580b and C.C.P. 580d (*infra*, §199) are not available to the mortgagor or trustor where the mortgagee or beneficiary sues for damages for fraud; i.e., the tort action is not one to recover a deficiency judgment. (*Glendale Fed. Savings & Loan Assn. v. Marina View Heights Dev. Co.* (1977) 66 C.A.3d 101, 139, 135 C.R. 802; *Manson v. Reed* (1986) 186 C.A.3d 1493, 1501, 1503, 231 C.R. 446 [false promise]; *Bell v. Roy* (1986) 187 C.A.3d 694, 700, 232 C.R. 83; *Webber v. Inland Empire Inv.* (1999) 74 C.A.4th 884, 903, 88 C.R.2d 594 [anti-deficiency statute did not prevent tort action by sold-out junior lienor]; see *Lawler v. Jacobs* (2000) 83 C.A.4th 723, 737, 100 C.R.2d 52 [buyers' promise of full recourse without restriction of anti-deficiency laws was unenforceable waiver of C.C.P. 580b and it could not serve as basis for action for breach of contract and fraud; distinguishing *Alliance Mortg. Co. v. Rothwell* (1995) 10 C.4th 1226, 44 C.R.2d 352, 900 P.2d 601, *supra*, §177, on effect of full credit bid on action for fraud against third party].)

Fin.C. 779 and *7460* permit banks and savings and loan associations, respectively, to bring fraud actions where the borrower's fraudulent conduct induced the making of the secured loan. The statutes specifically provide that these actions are permitted *notwithstanding* C.C.P. 726 (see *supra*, §124 et seq.) and do not constitute actions for deficiency judgments within the meaning of C.C.P. 580a, 580b, or 580d. (*Fin.C. 779(a)*, (c), *7460(a)*, (c).) However, the statutes do not apply where the loan is secured by single-family, owner-occupied residential real property, actually occupied by

the borrower as represented to the lender, and the loan is for \$ 150,000 or less, as adjusted annually by the Consumer Price Index. (*Fin.C. 779(b), 7460(b).*) (See *Guild Mortg. Co. v. Heller* (1987) 193 C.A.3d 1505, 1509, 239 C.R. 59 [action for fraud in inducement of loan was not barred, notwithstanding that alleged misrepresentations were not directly related to value of property]; *Lassar & Gross Int. v. Dunham* (1987) 196 C.A.3d 496, 499, 241 C.R. 854 [action for damages for fraud in sale of second trust deeds]; 17 *Pacific L. J.* 623.)

An action for fraud under *C.C.P. 726(f)* (see *supra*, §126) does not constitute a money judgment for deficiency, or a deficiency judgment within the meaning of *C.C.P. 580b*. (*C.C.P. 726(h)*; see *C.C.P. 726(g)* [excepting certain single-family, owner-occupied, residential real property].)

(3) *Action for Unjust Enrichment*. Recovery for unjust enrichment is not the same as recovery of a deficiency judgment. (*First Nationwide Savings v. Perry* (1992) 11 C.A.4th 1657, 1664, 15 C.R.2d 173, 1 *Summary* (10th), *Contracts*, §1023 [permitting action against former owner of property for unjust enrichment following mistaken reconveyance by trustee]; *Ghirardo v. Antonioli* (1996) 14 C.4th 39, 50, 57 C.R.2d 687, 924 P.2d 996, *infra*, §215.)

SUPPLEMENT: [This section is current through the latest supplement]

(2) *Fraud Actions*. *Fin.C. 779* was repealed in 2008. Comparable provisions are now in *Fin.C. 551*, added in 2008.



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C. Deficiency Judgment.

2. Foreclosure of Purchase Money Mortgage: C.C.P. 580b.

b. Scope of Statute.

1. Standard Transactions.

4 Witkin Sum. Cal. Law STRP § 185

[§ 185] Standard Transactions.

(1) *Definition: Standard Transaction.* The ordinary purchase money mortgage is easy to define and recognize; it is a mortgage given by the purchaser at the time of conveyance of land, to secure the unpaid balance of the price. (See *Stockton Savings & Loan Bank v. Massanet* (1941) 18 C.2d 200, 207, 114 P.2d 592; *Bargioni v. Hill* (1963) 59 C.2d 121, 123, 28 C.R. 321, 378 P.2d 593, *infra*, §190 [junior deed of trust to secure note for broker's commission, where commission was part of purchase price]; *BMP Property Dev. v. Melvin* (1988) 198 C.A.3d 526, 529, 243 C.R. 715 [following *Bargioni*; loans that vendor made by separate escrow to consummate trade of condominium project for other property were properly found to be purchase money obligations]; 4 Miller & Starr 3d, §10:242; C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §5.26 et seq.; 48 Cal. L. Rev. 711.)

(2) *Effect of Chattel Mortgage.* There is no statutory bar to a deficiency judgment after default of an indebtedness secured by *personal property* (see 4 Summary (10th), *Secured Transactions in Personal Property*, §186), and attempts were made by purchase money lenders to bypass C.C.P. 580b by taking a chattel mortgage as additional security for a purchase money loan and satisfying any deficiency in an action to foreclose the chattel mortgage. (See *Peterson v. Wilson* (1948) 88 C.A.2d 617, 632, 199 P.2d 757.) But this circumvention was expressly disapproved by the Supreme Court in *Freedland v. Greco* (1955) 45 C.2d 462, 466, 289 P.2d 463, and prohibited by amendments to C.C.P. 580b which added the following: "Where both a chattel mortgage and a deed of trust or mortgage have been given to secure payment of the balance of the combined purchase price of both real and personal property, no deficiency judgment shall lie at any time under any one thereof if no deficiency judgment would lie under the deed of trust or mortgage on the real property or estate for years therein." (See 37 Cal. L. Rev. 690, 696; 23 So. Cal. L. Rev. 35; 3 U.C.L.A. L. Rev. 206.)

Thus where the vendor of a medical practice and the vendor of a medical building sold their properties in the same transaction, taking back from the buyer a single purchase money promissory note secured by a deed of trust on the real property and by a security agreement on the personal property, the vendor of the medical practice was barred from seeking a deficiency judgment against the buyers under C.C.P. 580b. The fact that the medical practice *could* have been sold separately to bypass the statute had no effect on the applicability of statute. (*Sherwood-Trimble Med. Group v. 10001 Venice Boulevard Partnership* (1999) 75 C.A.4th 872, 879, 882, 89 C.R.2d 533 [case of first impression; distinguishing *Kistler v. Vasi* (1969) 71 C.2d 261, 78 C.R. 170, 455 P.2d 106, and *Spangler v. Memel* (1972) 7 C.3d

603, 102 C.R. 807, 498 P.2d 1055, *infra*, §193].)

(3) *Equitable Mortgage*. An equitable mortgage (*supra*, §14 *et seq.*) securing payment of a purchase money note is subject to *C.C.P. 580b*. (See *Clayton Dev. Co. v. Falvey* (1988) 206 C.A.3d 438, 444, 253 C.R. 609.)

(4) *Straw Man Exchange*. Structuring a sale of property to qualify as a tax-free exchange for the vendor's advantage by purporting to pass the purchase money through a third-party straw man does not remove the bar of *C.C.P. 580b*. (See *Ziegler v. Barnes* (1988) 200 C.A.3d 224, 228, 246 C.R. 69.)

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2. Foreclosure of Purchase Money Mortgage: C.C.P. 580b.

b. Scope of Statute.

2. Variations on Standard Transaction.

4 *Witkin Sum. Cal. Law STRP* § 186

[§ 186] Variations on Standard Transaction.

Variations on the standard transaction are subject to *C.C.P. 580b* only if the factual circumstances come within the purpose of that section. (*Roseleaf Corp. v. Chierighino* (1963) 59 C.2d 35, 41, 27 C.R. 873, 378 P.2d 97, *infra*, §189; *Spangler v. Memel* (1972) 7 C.3d 603, 610, 102 C.R. 807, 498 P.2d 1055, *infra*, §193 [statute did not apply to sold-out junior lienor who had subordinated to large construction loan]; see *Union Bank v. Anderson* (1991) 232 C.A.3d 941, 945, 283 C.R. 823 [sale of stock in farming corporation secured by shareholders' deeds of trust is variation on standard purchase money transaction subject to *C.C.P. 580b*]; *Conley v. Matthes* (1997) 56 C.A.4th 1453, 1463, 66 C.R.2d 518 [although loan on one of two apartment buildings sold to buyers was recorded against other building, it constituted purchase money loan because two sales were essentially one transaction, and note, therefore, was not recorded on "other" property foreign to transaction]; on what are not purchase money mortgages, see *infra*, §189.)

In *LaForgia v. Kolsky* (1987) 196 C.A.3d 1103, 242 C.R. 282, plaintiffs held a second deed of trust and defendants held a third deed of trust on property owned by W. After the holder of the first deed of trust filed a notice of default, W filed a Chapter 11 petition in bankruptcy court. Subsequently, the bankruptcy court approved the stipulation of all parties for a sale of the property to defendants at more than its appraised value. As part of this transaction plaintiffs received a second deed of trust on the property, securing a new note from defendants for the amount of the unpaid balance on plaintiffs' original note from W. Both plaintiffs and defendants attempted to sell the property, but it was eventually sold at a private foreclosure sale to the holder of the first deed of trust. The trial judge ruled that plaintiffs were entitled to a deficiency judgment. *Held*, reversed.

(a) The transaction was a variation of the standard purchase money mortgage transaction. Plaintiff's original loan to W was not for the purchase of real property, and plaintiffs were not the legal owners of the property sold to defendants. (196 C.A.3d 1108.)

(b) One of the purposes of *C.C.P. 580b* is to prevent overvaluation of land by placing the risk of inadequate security on the purchase money mortgagee. Because the sales transaction to defendants was a mutual effort by the creditors to stop the bankruptcy and give them a chance to recoup their money by seeking a new buyer, defendants should not bear the entire loss arising from the inadequate security after the attempt to resell failed. (196 C.A.3d 1109.)

(c) The term "vendor" in *C.C.P. 580b* has been liberally construed. (196 *C.A.3d 1109*.) And "there is no flat rule that the nature of a loan secured by a trust deed *never* changes in subsequent sales transactions." (196 *C.A.3d 1112*.) Plaintiffs' original loan was transmuted into the equivalent of a purchase money mortgage when rewritten. Defendants have lost the property and their investment, and thus are in a position equivalent to the one *C.C.P. 580b* was designed to protect against: losing the property yet remaining liable for the purchase price. Moreover, because plaintiffs' security interest was already threatened, if not worthless, at the time of the sale to defendants, it is not inequitable for them to share in the loss. By relinquishing their existing, valueless, security position vis-a'-vis W "in an effort to place themselves in an improved financial posture with a new owner to induce the sale," plaintiffs entered a new security relationship on different terms with a new borrower. (196 *C.A.3d 1112*.)

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b. Scope of Statute.

3. Transactions in Nature of Deficiency Judgment.

4 Witkin Sum. Cal. Law STRP § 187

[§ 187] Transactions in Nature of Deficiency Judgment.

In *Birman v. Loeb* (1998) 64 C.A.4th 502, 509, 75 C.R.2d 294, the trial court granted an equitable setoff of attorneys' fees and costs awarded to plaintiff debtors in a tort action against defendant creditors against the unsecured balance remaining due to defendants after foreclosure of a purchase money deed. *Held*, the setoff was the functional equivalent of a deficiency judgment, and contravened the economic policy considerations underlying C.C.P. 580b. (64 C.A.4th 510.)

"To allow the judgment against defendants and in favor of plaintiffs to be set off against the deficiency remaining following the nonjudicial foreclosure sale under the purchase money trust deed would improperly" (a) shift the risk of inadequate security from defendant, where it belongs, to plaintiffs, (b) "allow defendants to recover more than fair market value of the property at the time of foreclosure," (c) "cause plaintiffs to lose the property yet still be liable for the purchase price," and (d) "allow defendants to look beyond the security for recovery of the debt." (64 C.A.4th 513.) This would abrogate C.C.P. 580b. (64 C.A.4th 518.)

In *Frangipani v. Boecker* (1998) 64 C.A.4th 860, 75 C.R.2d 407, defendant purchased real property subject to an existing purchase money deed of trust. When he defaulted on the payments, plaintiff sellers gave the original beneficiary a \$ 10,000 promissory note to cancel the foreclosure to protect plaintiffs' own credit. The trial court entered judgment against the defaulting defendant for the amount of the note. *Held*, judgment reversed. Plaintiffs' execution of the promissory note was voluntary, and a judgment reimbursing them for the amount of the note would violate anti-deficiency legislation. (64 C.A.4th 862.)

Although the parties disagreed whether defendant purchased the property "subject to" the existing trust deeds, or "assumed" them, defendant was protected by C.C.P. 580b. If the original beneficiary had foreclosed, he could not have proceeded against either defendant or plaintiffs for a deficiency, assuming there was one, and he could not have avoided that result by pursuing defendant or plaintiffs personally without foreclosing. Because the beneficiary could not have pursued this course, neither can plaintiff. (64 C.A.4th 864.) The trial court's decision to award plaintiffs damages for breach of defendant's alleged agreement to honor his assumption of the note "is in the nature of a deficiency judgment" and is barred by C.C.P. 580b. (64 C.A.4th 865.)

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2. Foreclosure of Purchase Money Mortgage: C.C.P. 580b.

b. Scope of Statute.

4. Contract of Sale.

4 Witkin Sum. Cal. Law STRP § 188

[§ 188] Contract of Sale.

A vendor who sells land on credit may either convey title and take a purchase money mortgage for the price, or reserve title and give the purchaser a contract providing for installment payments and a deed after their completion. The mortgage and the long-term installment contract both serve the same purpose of giving the vendor security for the purchase price. Accordingly, *C.C.P. 580b* applies to both; i.e., it also prohibits a deficiency judgment after any sale of real property "for failure of the purchaser to complete his or her contract of sale." (See *C.E.B.*, 1 Mortgage and Deed of Trust Practice 3d, §5.44 et seq.; 3 *U.C.L.A. L. Rev.* 198; on the installment land sales contract, see *C.E.B.*, 1 Mortgage and Deed of Trust Practice 3d, §1.28; supra, §§24, 25.)

The natural and normal construction of *C.C.P. 580b* is that "it only applies to contracts of sale where *credit* is involved." (*Kerrigan v. Maloof* (1950) 98 *C.A.2d* 605, 616, 221 *P.2d* 153.) In *Kerrigan*, the purchaser at a partition sale refused to pay, and the referee resold at a lower price and sued for the difference. *Held*, *C.C.P. 580b*, aimed at private credit sales, was inapplicable to a *cash judicial sale*. (98 *C.A.2d* 616.)

In *Goldsworthy v. Dobbins* (1952) 110 *C.A.2d* 802, 243 *P.2d* 883, plaintiff vendors agreed to sell real property for a cash down payment and the assumption of trust deeds, and delivered the deed in escrow, but defendants defaulted. *Held*, plaintiffs were entitled to specific performance, i.e., judgment for the price. The objection that plaintiffs might enforce the money judgment by execution, and thereby obtain the equivalent of a deficiency judgment, was answered on the theory of the *Kerrigan* case that the statute does not apply to sales for cash. (110 *C.A.2d* 808.)

In *Venable v. Harmon* (1965) 233 *C.A.2d* 297, 43 *C.R.* 490, plaintiff vendors contracted to sell a parcel of land for \$ 55,000. Defendant purchasers were to take possession and pay \$ 575 monthly, of which \$ 145 was to be applied to the principal until \$ 10,000 was accumulated, following which the sale would be consummated with defendants assuming a first deed of trust and executing a second deed of trust to plaintiffs. On default in monthly payments, plaintiffs sued for past installments. *Held*, *C.C.P. 580b* applied and barred the action. (a) The parties intended that this instrument serve as a security device. (233 *C.A.2d* 300.) (b) *C.C.P. 580b* ordinarily operates when there has been a sale of the property under foreclosure, thus exhausting the security. Here there was no sale, but that is not a controlling factor under *Brown v. Jensen* (1953) 41 *C.2d* 193, 259 *P.2d* 425, *infra*, §192; *Roseleaf Corp. v. Chierighino* (1963) 59 *C.2d* 35, 27 *C.R.* 873,

378 P.2d 97, *supra*, §181; and *Heckes v. Sapp* (1964) 229 C.A.2d 549, 40 C.R. 485, *infra*, §194:

"Thus, when the vendor under a security-type contract for the sale of land receives a personal money judgment against the vendee for breach of this contract without first going against the security, he is, in effect, receiving a deficiency judgment. Since only the land can be called upon to satisfy the debt, under *Brown*, the fact that there has not been a prior sale is of no moment. It should also be noted that to allow the vendor to recover this judgment places him in a better position than under a trust deed or mortgage. It would allow him to recover a personal judgment and retain title to the land. This would accomplish the exact result which *Heckes* states the statute was designed to prevent." (233 C.A.2d 302.)

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b. Scope of Statute.

5. What Are Not Purchase Money Mortgages.

4 Witkin Sum. Cal. Law STRP § 189

[§ 189] What Are Not Purchase Money Mortgages.

C.C.P. 580b "was apparently drafted in contemplation of the standard purchase money mortgage transaction, in which the vendor of real property retains an interest in the land sold to secure payment of part of the purchase price."

Variations on the standard are subject to the statute only if they come within its purpose. (*Roseleaf Corp. v. Chierighino* (1963) 59 C.2d 35, 41, 27 C.R. 873, 378 P.2d 97; see supra, §186; *Comstock v. Fiorella* (1968) 260 C.A.2d 262, 266, 67 C.R. 104 [note secured by trust deed, given by one partner to another as part of the distribution of assets on dissolution of partnership, was not within *C.C.P. 580b*]; *Nickerman v. Ryan* (1979) 93 C.A.3d 564, 567, 576, 155 C.R. 830 [note and deed of trust given to equalize division of former community property between ex-spouses holding as tenants in common]; 4 Miller & Starr 3d, §10:243 et seq.; C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §5.30; 51 Cal. L. Rev. 17.)

The following credit arrangements have been held to be outside the scope of *C.C.P. 580b*:

(1) *Note Secured by Other Real Property*. If a purchaser who owns parcel A mortgages it to raise funds to purchase parcel B, *C.C.P. 580b* does not bar a deficiency judgment after foreclosure of the mortgage on parcel A. (*Roseleaf Corp. v. Chierighino*, supra; see *Sosna v. Baranov* (1966) 240 C.A.2d 460, 464, 49 C.R. 621; *Syrek v. Gould* (1966) 244 C.A.2d 149, 151, 52 C.R. 827 [original purchase money deeds of trust replaced by others]; *Goodyear v. Mack* (1984) 159 C.A.3d 654, 659, 205 C.R. 702 [new note, proceeds of which paid off purchase money note, secured by other property]; *Conley v. Matthes* (1997) 56 C.A.4th 1453, 1463, 66 C.R.2d 518 [although loan on one of two apartment buildings sold to buyers was recorded against other building, it constituted purchase money loan because two sales were essentially one transaction, and note, therefore, was not recorded on "other" property foreign to transaction; distinguishing *Roseleaf Corp.*]; *Kurtz v. Calvo* (1999) 75 C.A.4th 191, 194, 89 C.R.2d 99 [anti-deficiency statute did not apply where trust deed securing note was recorded against property purchased 3 years earlier in separate transaction; distinguishing *Conley*]; 4 Miller & Starr 3d, §§10:247, 10:248; on implications of this rule as device for avoiding *C.C.P. 580b*, see C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §5.40.)

(2) *Unsecured Note*. An unsecured lender is not subject to the limitations of *C.C.P. 580b* even though the proceeds of the loan are part of the purchase price of property. (See *Van Vleck Realty v. Gaunt* (1967) 250 C.A.2d 81, 83, 58 C.R.

246; *Jonathan Manor v. Artisan* (1967) 247 C.A.2d 651, 653, 56 C.R. 14; *Nevin v. Salk* (1975) 45 C.A.3d 331, 342, 119 C.R. 370; 4 Miller & Starr 3d, §10:249; C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §5.51.)

In *Christopherson v. Allen* (1961) 190 C.A.2d 848, 12 C.R. 658, plaintiff gave \$ 4,500 cash and lots worth \$ 17,050 in exchange for defendant's boat worth \$ 12,000, \$ 3,852 worth of notes secured by deeds of trust on the lots, and a \$ 5,700 unsecured note. On defendant's default, plaintiff foreclosed the deeds of trust on the lots, and then brought this action on the unsecured note. *Held*, he was entitled to recover. After stating defendant's contention that this type of transaction might become a device to defeat the statutory purpose, the court said: "There are three answers to that: (1) The Legislature has not seen fit to consider unsecured portions of the purchase price of real property as being within the purview of the section. (2) The 'device' can only exist if the purchaser is willing to adopt that method of purchasing the property. (3) A seller who takes unsecured notes for the purchase price, is taking his chance as to whether, if the notes are defaulted, he may be able to collect any judgment he may obtain on the notes. The buyer, immediately upon purchasing the property, may dispose of it; if he does that, he may have no assets which could be attached when the notes become due. Hence, as a 'device,' the procedure would be a rather dangerous one." (190 C.A.2d 852.)

(3) *Purchase of Stock in Corporation With Real Property Assets*. In *Union Bank v. Anderson* (1991) 232 C.A.3d 941, 283 C.R. 823, defendants purchased all of the stock in a farming corporation, the assets of which included land, buildings, equipment, growing crops, and other property. Defendants executed a note representing part of the purchase price, and later executed two second trust deeds on the corporation's real property to secure payment of the note. Defendants subsequently defaulted on the note, which had been acquired by plaintiff bank. *Held*, C.C.P. 580b, barring a deficiency judgment, did not apply to the note. The transaction here was not merely a variation on the standard purchase money transaction. Defendants purchased all of the outstanding shares of stock in order to retain federal water rights on the acreage, which a purchase of the corporation, and acquisition of its real property, would not have provided. (232 C.A.3d 950.)

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b. Scope of Statute.

6. Third-Party Lenders.

4 *Witkin Sum. Cal. Law STRP* § 190

[§ 190] Third-Party Lenders.

In *Bargioni v. Hill* (1963) 59 C.2d 121, 123, 28 C.R. 321, 378 P.2d 593, the court declared that the statutory purposes of C.C.P. 580b, as set forth in *Roseleaf Corp. v. Chierighino* (1963) 59 C.2d 35, 41, 27 C.R. 873, 378 P.2d 97, supra, §181, "are served by relieving the purchaser of personal liability to any person who finances the purchase and takes as security a trust deed or mortgage on the property purchased, provided the financier intended the loan to be used to pay all or part of the purchase price." (See 51 Cal. L. Rev. 15.)

This rule, which treated any third-party purchase money lender as a purchase money vendor-mortgagee, was modified by a 1963 amendment to C.C.P. 580b, allowing a *commercial lender* to recover a deficiency judgment. The statute now provides, as to third-party lenders, that no deficiency judgment will lie "under a deed of trust or mortgage on a dwelling for not more than *four families* given to a lender to secure repayment of a loan which was in fact used to pay all or part of the purchase price of that dwelling *occupied*, entirely or in part, by the purchaser." (See *Kistler v. Vasi* (1969) 71 C.2d 261, 263, 78 C.R. 170, 455 P.2d 106 [because property was unimproved commercial property, C.C.P. 580b did not preclude third-party lenders of purchase money from obtaining deficiency judgment]; *Jackson v. Taylor* (1969) 272 C.A.2d 1, 4, 76 C.R. 891; C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §5.28.)

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7. Construction Loan on Owned Land.

4 Witkin Sum. Cal. Law STRP § 191

[§ 191] Construction Loan on Owned Land.

In *Prunty v. Bank of America* (1974) 37 C.A.3d 430, 112 C.R. 370, plaintiffs owned land. They gave a deed of trust to defendant bank for a construction loan, and built a residence, which was demolished in a natural disaster. They then brought this action against the bank and trustee to obtain a declaratory judgment that C.C.P. 580b would apply and bar a deficiency judgment in the event of their default and judicial foreclosure. *Held*, judgment for plaintiffs affirmed.

(a) *Paramount Savings & Loan Assn. v. Barber* (1968) 263 C.A.2d 166, 69 C.R. 390, holding that C.C.P. 580b was not applicable to loans for the improvement of the secured property, was decided on the pre-1963 language of the statute, and is not controlling. (37 C.A.3d 437.)

(b) Under the present language (see *supra*, §190), liberally construed to effectuate the legislative purpose (37 C.A.3d 436), the words "purchase" and "purchaser" are sufficiently flexible to cover the owner who finances and builds a dwelling as well as the person who acquires the land itself. (37 C.A.3d 440.) The amended statute's application to residential construction borrowers also serves the statutory purpose of avoiding the aggravation of a depression in land values that would result if defaulting purchasers lost the land and were burdened with personal liability. "We perceive no real distinction between the present situation, where the value of the security has been diminished by a natural disaster, and a case where the same result has occurred by reason of cyclical economic decline." (37 C.A.3d 441; see *Allstate Savings & Loan Assn. v. Murphy* (1979) 98 C.A.3d 761, 783, 159 C.R. 663 [*Prunty* holding applies to loan for construction of personal dwelling, not to loan for construction of swimming pool]; 12 Cal. Western L. Rev. 142.)

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c. Action by Sold-Out Junior Lienor.

1. In General.

4 Witkin Sum. Cal. Law STRP § 192

[§ 192] In General.

If two creditors finance the purchase of real property, and both loans are secured by purchase money mortgages on the property, the first mortgagee may foreclose and wipe out the second mortgagee's security. In that event, the second mortgagee is remediless unless he or she is allowed to sue on the note. Nevertheless, in *Brown v. Jensen* (1953) 41 C.2d 193, 259 P.2d 425, the court held C.C.P. 580b applicable and denied recovery.

The dissenting opinion argued that the words "deficiency judgment" were used in their ordinary meaning of a judgment for the balance due *following a sale*; that the legislative purpose was simply to prevent creditors from bidding in the property at a nominal figure and then holding the debtor liable for a large proportion of the original debt; and that here plaintiff never held a sale under her second deed of trust, and did not bid on the property. (41 C.2d 199 et seq.) The majority, heavily stressing the underlying policy of the statutes, answered: "[T]he section speaks of a deficiency judgment after sale of the security but that means after an actual sale or a situation where a sale would be an idle act, where, as here, the security has been exhausted. The deficiency judgment which cannot be obtained is still a deficiency judgment even though it may consist of the whole debt because a deficiency is nothing more than the difference between the security and the debt. ... The section states that in *no event* shall there be a deficiency judgment, that is, whether there is a sale under the power of sale or sale under foreclosure, or no sale because the security has become valueless or is exhausted. The purpose of the 'after sale' reference in the section is that the security be exhausted and that result follows after a sale under the first trust deed." (41 C.2d 197.) One peculiar result of the decision, as pointed out in the dissenting opinion, is to place the holder of a purchase money note and deed of trust in a less favorable position than the holder of an unsecured note for the purchase price. (41 C.2d 201.)

The result in *Brown* has been criticized. (See 6 *Hastings L. J.* 248; cf. *Roseleaf Corp. v. Chierighino* (1963) 59 C.2d 35, 42, 27 C.R. 873, 378 P.2d 97, supra, §181 [distinguishing *Brown*, and explaining purpose and effect of C.C.P. 580b in accordance with dissent in *Brown*]; and see 51 *Cal. L. Rev.* 1, 7, 11; 3 Santa Clara Lawyer 187.) Despite the criticisms, the *Brown* rule has been regularly followed in cases involving standard purchase money mortgages. (See *Barash v. Wood* (1969) 3 C.A.3d 248, 250, 83 C.R. 153 [reviewing the cases and observations of commentators]; C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §§5.41, 5.42.)

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2. Exception for Subordinated Junior Lien.

4 *Witkin Sum. Cal. Law STRP* § 193

[§ 193] Exception for Subordinated Junior Lien.

In *Spangler v. Memel* (1972) 7 C.3d 603, 102 C.R. 807, 498 P.2d 1055, cross-complainant S sold a lot with a single-family residence on it to defendant partners, who intended to develop it for commercial purposes. The price was \$ 90,000; \$ 26,100 was paid in cash and the \$ 63,900 balance was secured by a purchase money deed of trust, with a clause subordinating it to a construction loan up to \$ 2 million. S, in consideration of her agreement to subordinate, obtained a personal guaranty from each of the partners. Defendants received a \$ 408,000 loan from Union Bank, which took a first deed of trust from them and an express subordination agreement from S. An office building was constructed, but the project failed, Union Bank foreclosed, and the security was wiped out. S then sought to hold defendant partners on the note. *Held*, she was entitled to recover; C.C.P. 580b did not apply.

(a) The rule of *Brown v. Jensen* (1953) 41 C.2d 193, 259 P.2d 425, *supra*, §192, that C.C.P. 580b applies to a sold-out junior lienor, is still controlling, and applies to all standard purchase money transactions. (7 C.3d 610.)

(b) The *Brown* rule does not automatically govern in variant situations; C.C.P. 580b applies to those cases only if the factual circumstances bring them within the purposes of the statute. (7 C.3d 610; see *supra*, §186.)

(c) A sale of real property for commercial development, in which the vendor agrees to subordinate his or her senior lien to the construction lien, is a variation. In the standard transaction the purchaser plans on making the same or a similar use of the property, and its present security value is a reliable indicator of its fair market value; but where the purchaser intends a different use with a contemplated improvement, the value will be determined by the success of the venture. (7 C.3d 611, 613.) In this case, preventing the vendor from suing on the note improperly places the risk of failure of the commercial development on the vendor, instead of on the purchaser-developer. (7 C.3d 613.) Moreover, construction loans are usually so large that the typical vendor cannot possibly raise the money to buy in at the senior sale and thereby protect his or her junior security interest; a personal action is the vendor's only effective remedy. (7 C.3d 614.) (See 61 Cal. L. Rev. 536; 24 Hastings L. J. 453; 30 San Diego L. Rev. 509 [criticizing *Spangler*]; 13 Santa Clara Lawyer 170.)

Spangler has been followed in numerous cases. (See *Long v. Superior Court* (1985) 170 C.A.3d 499, 503, 505, 216

C.R. 337; Ziegler v. Barnes (1988) 200 C.A.3d 224, 231, 246 C.R. 69 [subordinated trustor did not lose *Spangler* protection by agreeing to increase in size of construction loan]; *Wright v. Johnston (1988) 206 C.A.3d 333, 337, 253 C.R. 418* [continued subordination of purchase money deed of trust when senior deed was refinanced, generating proceeds not tied to secured property; *Spangler* exception applicable].)

In *Roffinella v. Sherinian (1986) 179 C.A.3d 230, 224 C.R. 502*, cross-complainant sellers sold vandalized commercial and residential property to cross-defendants for \$ 390,000, with \$ 112,000 paid in cash and the remainder by a note secured by a deed of trust. The contract of sale and the sellers' escrow instructions included an agreement to subordinate to a later construction loan. Neither the deed nor the deed of trust contained a subordination clause, but cross-complainants later executed an agreement subordinating their lien to that of a \$ 4.5 million construction loan, which was subsequently foreclosed. *Held*, cross-complainants were entitled to judgment against cross-defendants for the deficiency.

(a) "The *Spangler* exception applies when, in the sale of real property for *commercial development*, the seller subordinates his or her lien to a construction loan pursuant to an agreement of sale, and then loses his or her interest when the senior lienholder forecloses on the property." (*179 C.A.3d 238.*) Here, the conclusion that the property was purchased for commercial development was supported by evidence that, within weeks of the sale, cross-defendants contacted the bank regarding a construction loan to finance a condominium development and that, shortly thereafter, architectural plans were drafted and the process of obtaining city approval was begun. (*179 C.A.3d 238.*)

(b) The trial court properly found an enforceable promise to subordinate. "The subsequent agreement regarding subordination supplied the missing terms." (*179 C.A.3d 239.*)

(c) Although the subordination did not occur in the original escrow, there was substantial evidence to support the court's implicit finding that cross-complainants subordinated pursuant to the agreement of sale. The parties intended the subordination to occur in an escrow, cross-defendants admitted at trial that it was impossible for them to secure a construction loan while the purchase was in escrow, and a cross-complainant testified that he subordinated the deed of trust to the construction loan because he had promised to do so in the agreement of sale. (*179 C.A.3d 239.*)

(d) The risk of loss should fall on cross-defendants because the size of the loan to which the deed of trust was subordinated prevented cross-complainants from foreclosing when defaults occurred. (*179 C.A.3d 239.*)

In *Boyle v. Sweeney (1989) 207 C.A.3d 998, 255 C.R. 153*, a deficiency judgment was awarded plaintiff on a note secured by a sold-out purchase money deed of trust that had been subordinated to a construction loan. The loan had been used by defendants to replace the single-family residence on the property with a three-unit condominium project. Defendants contended that *Spangler* and its progeny apply only if the purchasers intend a change in use, such as from residential to commercial, and not to this case where the change was in the intensity of a single use. *Held*, affirmed.

"[T]he crucial distinction is not between commercial and residential land uses, but between standard purchase money transactions and variations on this standard transaction. ... *Spangler* and its progeny instruct us that a variation of the standard purchase money transaction occurs when, after the vendor agrees to subordinate his or her deed of trust to a construction lender's deed of trust, the underlying property is to be developed for a more intensive use that makes the present value of the property an unreliable indicator of its actual fair market value." (*207 C.A.3d 1005.*)

In a number of decisions involving subordination the *Spangler* exception was not applicable and *C.C.P. 580b* applied to preclude a deficiency judgment. (See *Budget Realty v. Hunter (1984) 157 C.A.3d 511, 204 C.R. 48* [unexercised subordination provision does not take purchase money loan outside protection of *C.C.P. 580b*]; *Thompson v. Allert (1991) 233 C.A.3d 1462, 1466, 285 C.R. 367* [statute was applicable where subordination was part of standard purchase money situation]; *Costanzo v. Ganguly (1993) 12 C.A.4th 1085, 1092, 16 C.R.2d 55* [*C.C.P. 580b* barred action by assignee of promissory notes, originally payable to party who was not owner of property; applying *Spangler* analysis due to nonstandard nature of transaction]; on variations of standard purchase money transaction generally, see

supra, §186; *Crookall v. Davis, Punelli, Keathley & Willard* (1998) 65 C.A.4th 1048, 1065, 77 C.R.2d 250 [seller who holds first deed of trust and agrees to subordinate, but who never does subordinate, is not junior lienholder, and is barred from seeking deficiency judgment; distinguishing *Spangler*, and following *Thompson* and *Budget Realty*]; *Webber v. Inland Empire Inv.* (1999) 74 C.A.4th 884, 915, 88 C.R.2d 594 [although transaction was "nonstandard" as defined in *Spangler* because it involved subordination situation, anti-deficiency provision was applicable because construction financing was never obtained; following *Budget Realty*.)]

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d. Action on Guaranty.

1. True Guaranty.

4 Witkin Sum. Cal. Law STRP § 194

[§ 194] True Guaranty.

In *Heckes v. Sapp* (1964) 229 C.A.2d 549, 40 C.R. 485, J Corp. bought real property from plaintiffs and gave a purchase money note and deed of trust to secure the price. Defendants, directors and sole shareholders of J Corp., also signed the note as individual guarantors. A senior deed of trust was later foreclosed and the land sold, rendering plaintiffs' security worthless. Accordingly they sued defendants on their guaranty. *Held*, C.C.P. 580b was not a bar.

(a) As suggested in *Roseleaf Corp. v. Chierighino* (1963) 59 C.2d 35, 27 C.R. 873, 378 P.2d 97, *supra*, §181, the main purpose of the statute was to prevent aggravation of the downturn in depression times. (229 C.A.2d 552.) This purpose would not be served by protecting the guarantor. (229 C.A.2d 553.)

(b) Additional security may be reached, notwithstanding C.C.P. 580b, and a guarantor's obligation is simply additional security. (229 C.A.2d 553.) The argument that, if held liable for a deficiency judgment, the guarantor could get reimbursement from the principal under C.C. 2847, thus indirectly making the principal liable, is untenable. The court would strike down a scheme aimed at evading the legislation by the use of a formal intermediate surety. (229 C.A.2d 555.)

This rule, that a "true" guarantor of a purchase money mortgage is not entitled to the protection of C.C.P. 580b, has been repeatedly affirmed. (See *Roberts v. Graves* (1969) 269 C.A.2d 410, 416, 75 C.R. 130; *Bauman v. Castle* (1971) 15 C.A.3d 990, 993, 93 C.R. 565; 51 Cal. L. Rev. 23; 57 Cal. L. Rev. 218; 38 So. Cal. L. Rev. 720; 17 U.C.L.A. L. Rev. 245; for *purported guaranty* distinction, see *infra*, §195; on statutory waiver of guarantor's rights and defenses, see C.C. 2856, *infra*, §204.)

In *Gottschalk v. Draper Cos.* (1972) 23 C.A.3d 828, 830, 100 C.R. 434, defendant guarantors, conceding that C.C.P. 580b was not a defense, invoked the rule of C.C. 2810, that a surety is not liable if the liability of the principal ceases. The court held the rule inapplicable on three grounds:

(a) The sale under a deed of trust does not erase the indebtedness; the debt itself survives, and C.C.P. 580b only bars the remedy against the debtor; and, under general principles of suretyship, the bar of the *remedy* against the

principal debtor does not preclude recovery against the guarantor. (23 C.A.3d 831.)

(b) Even if it were assumed that the foreclosure sale terminated the *liability* of the debtor, the exception to C.C. 2810 would apply. Under C.C. 2825, a surety is not exonerated where the discharge of the principal is "by operation of law." The discharge of the debtor by operation of *C.C.P. 580b* is obviously a discharge by operation of law. (23 C.A.3d 831.)

(c) Another exception to the rule of C.C. 2810 is applicable here. A surety is not exonerated where the defense is personal. Because *C.C.P. 580b* protects only the debtor, the defense of that section is personal to the principal obligor. (23 C.A.3d 832.)

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d. Action on Guaranty.

2. Purported Guaranty.

4 Witkin Sum. Cal. Law STRP § 195

[§ 195] Purported Guaranty.

In *Valinda Builders v. Bissner* (1964) 230 C.A.2d 106, 40 C.R. 735, defendants B and L, subdividers, purchased a tract from plaintiff, giving a note and deed of trust. The instruments were executed by Trend Homes, a nominal close corporation organized by defendants with no working capital, and defendants signed a guaranty of payment. The venture failed, and plaintiff sued defendants on the guaranty. *Held*, C.C.P. 580b was a bar to a personal judgment. The purchase agreement expressly contemplated formation of a partnership or corporation through which defendants would operate. And, because Trend Homes was a "mere shell," the purported guaranty of its obligation was merely a promise by defendants to pay their own debt. (230 C.A.2d 110.) (See *River Bank America v. Diller* (1995) 38 C.A.4th 1400, 1422, 1424, 45 C.R.2d 790, *infra*, §203 [citing *Valinda Builders*]; C.E.B., 2 Mortgage and Deed of Trust Practice 3d, §9.103 et seq.; 5 Santa Clara Lawyer 99; 38 So. Cal. L. Rev. 718; for similar rule under C.C.P. 580d, see *infra*, §203.)

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e. Action on Indorsement.

4 Witkin Sum. Cal. Law STRP § 196

[§ 196] Action on Indorsement.

In *Lange v. Aver* (1966) 241 C.A.2d 793, 50 C.R. 847, the purchasers gave a note and purchase money second deed of trust. The vendors indorsed and assigned to defendant H, who indorsed and assigned to plaintiffs. Sale under the first deed of trust exhausted the security, the makers of the note (purchasers) refused to pay, and plaintiffs sued H as indorser. *Held*, judgment for plaintiffs affirmed; the theory of the guarantor cases (*supra*, §194) was applicable to the independent liability of an indorser. (241 C.A.2d 798.) The court briefly disposed of the contention that, because the maker (principal debtor) is immune under C.C.P. 580b, the instrument is discharged (see 4 *Summary* (10th), *Negotiable Instruments*, §65 et seq.): Recovery against the maker is barred, but the note is not discharged. (241 C.A.2d 799.) (See C.E.B., 2 Mortgage and Deed of Trust Practice 3d, §9.14 et seq.)

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f. Action for Impairment of Security.

1. In General.

4 Witkin Sum. Cal. Law STRP § 197

[§ 197] In General.

An ingenious theory to overcome the anti-deficiency statutes was unsuccessfully advanced in *American Savings & Loan Assn. v. Leeds* (1968) 68 C.2d 611, 68 C.R. 453, 440 P.2d 933. Plaintiff's complaint alleged the following: The Sheridans sold their home to the Leeds for \$ 122,500. The Leeds borrowed \$ 85,000 of the purchase price from plaintiff, giving their note secured by a first deed of trust. Two actions were instituted: (1) The Leeds sued the Sheridans for damages for fraudulent concealment of improperly filled soil. The defects were concealed when plaintiff's agent inspected the property to determine whether it was suitable security. This action was settled for an unknown amount. (2) Plaintiff sued the Sheridans and the Leeds. One count was for the Sheridans' fraud rendering the property of no value as security; another was to impose a trust on the amount the Leeds obtained as settlement in their suit against the Sheridans, to the extent of plaintiff's loan; another was against the Leeds for the amount of the loan, on the theory that the Leeds destroyed the security by failure to keep the property in good condition and repair. *Held*, judgment for defendants on demurrer affirmed.

(a) *Mortgagee's remedies for injury to security.* Remedies for injury to security (*supra*, §§85, 86) were not available here. The damage to the property did not result from any act of defendant mortgagor or others occurring after the sale; it was caused by the failure to compact the fill, making the property less valuable than the parties believed. Both mortgagor and mortgagee were damaged by the fraud of the vendors (Sheridans), and neither could properly shift his loss to the other. (68 C.2d 615.)

(b) *Deficiency judgment restrictions.* Even if the trust deed's provision that the mortgagor agreed to keep the property in good condition and repair could be interpreted to include an obligation to correct the fill condition and repair damage caused by it, C.C.P. 580b would preclude that interpretation. It prohibits a deficiency judgment after sale of the property under a purchase money mortgage or deed of trust, thus placing the full risk of inadequate security on the purchase money lender. To require defendant mortgagor to correct the condition of property existing at the time of sale would shift to him a risk that C.C.P. 580b requires the mortgagee to bear. (68 C.2d 615.)

(c) *Trust deed provision for damages.* A provision for damages was arguably limited to a condemnation award. But even if applied to physical damage by a private tortfeasor, it could not include the settlement in the Sheridan action,

which was not for injury to property but for fraud or negligent wrong, i.e., economic loss suffered by inducement to buy property not worth the price. (68 C.2d 616).

(d) *Distinction*. If the Sheridans had in settlement paid defendant the full purchase price, plaintiff would have been entitled to a constructive trust to the extent of its debt. But plaintiff did not allege that defendant received more in settlement than his own damages. (68 C.2d 616.)

Schumacher v. Gaines (1971) 18 C.A.3d 994, 96 C.R. 223, reaches the same result on shocking facts. Plaintiff sold a ranch to defendants and took a purchase money deed of trust. Defendants defaulted at the end of the first year, having committed serious waste. After notice of default was recorded, they dismantled and gutted the interior of a building, greatly depreciating the value of the property. Plaintiff held a trustee's sale and purchased the property for the amount due. However, one day before the sale he filed the present action for damages for waste and breach of the trust deed covenants to keep the property in good condition. A substantial judgment was entered for breach of contract, waste, and punitive damages. *Held*, reversed; under C.C.P. 580b as interpreted in *Brown v. Jensen* (1953) 41 C.2d 193, 259 P.2d 425, supra, §192, the mortgagee has no remedy other than the right to reach the security. (18 C.A.3d 999.) A dissenting justice describes the majority opinion as "an open invitation" to defaulting mortgagors to "lay waste" to the security before vacating, and contends that there is no relationship between the mortgagor's liability for waste and the statutory provisions on enforcement of the mortgagee's security interest. (18 C.A.3d 1001 et seq.) (For view that *Schumacher* has been disapproved, see *infra*, §198.)

The effect of the anti-deficiency statutes on actions relating to the impairment of the security was exhaustively examined in *Cornelison v. Kornbluth* (1975) 15 C.3d 590, 125 C.R. 557, 542 P.2d 981. Plaintiff sold a home to Mr. and Mrs. C, taking back a note secured by a deed of trust, which contained covenants including one for care and maintenance of the property. Mr. and Mrs. C conveyed to defendant by a grant deed with no such covenants, and defendant did not sign an assumption agreement. Mr. and Mrs. C defaulted, plaintiff had a trustee's sale, and plaintiff purchased the property for \$ 21,921.42, the full balance due on the note plus foreclosure costs. Plaintiff then sued defendant for damages for breach of the covenants and for failing to care for the premises. *Held*, summary judgment for defendant affirmed.

(a) *Relationship between judgments for waste and for deficiency*. Judgments for waste and for deficiency are interrelated and may often reflect identical amounts. If property values are declining, they would be identical up to the point where the harm caused is equal to or less than the general decline. If property values are rising, there will be no deficiency unless the property was originally overvalued, and no damages for waste unless the impairment exceeded the general increase in values. (15 C.3d 603.)

(b) *Purchase money mortgage*. Allowing damages for waste would often frustrate the purpose of C.C.P. 580b, for the defaulting purchaser may lack the resources to keep up payments and also maintain the property. But if he or she acts intentionally or recklessly (in "bad faith") the mortgagee should have a remedy. The statute "should apply to bar recovery in actions for waste following foreclosure sale in the first instance but should not so apply in the second instance of 'bad faith' waste." It "is within the province of the trier of fact to determine on a case by case basis to what, if any, extent the impairment of the mortgagee's security has been caused (as in the first instance) by the general decline in property values and to what, if any, extent (as in the second instance) by the bad faith acts of the mortgagor, such determination, in either instance, being subject to review under the established rule of appellate review." (15 C.3d 604; see *infra*, §198.)

(c) *Nonjudicial sale*. To allow damages for waste would give the mortgagee the double benefits of an irredeemable title and a personal judgment against the mortgagor, destroying the parity between judicial and private foreclosure where the cause was general economic conditions. In situations arising under C.C.P. 580d (*infra*, §199 et seq.), recovery for waste against the mortgagor following nonjudicial foreclosure sale is barred by the "proscription against deficiency judgments when the waste actually results from the depressed condition of the general real estate market but not when the waste is caused by the 'bad faith' acts of the mortgagor." (15 C.3d 605.)

(d) *Where mortgagee purchases by full credit bid.* Even though defendant might have been held liable for "bad faith" waste (a question not resolved), a plaintiff cannot recover after his or her purchase by a full credit bid. "If the beneficiary or mortgagee at the foreclosure sale enters a bid for the full amount of the obligation owing to him together with the costs and fees due in connection with the sale, he cannot recover damages for waste, since he cannot establish any impairment of security, the lien of the deed of trust or mortgage having been theretofore extinguished by his full credit bid and all his security interest in the property thereby nullified. If, however, he bids less than the full amount of the obligation and thereby acquires the property valued at less than the full amount, his security has been impaired and he may recover damages for waste in an amount not exceeding the difference between the amount of his bid and the full amount of the outstanding indebtedness immediately prior to the foreclosure sale." (15 C.3d 607.)

(e) *Successors in interest.* The protections of the mortgagor under C.C.P. 580b and 580d extend to his or her successors in interest, whether they assume or don't assume. (15 C.3d 605.) (See *Krone v. Goff* (1975) 53 C.A.3d 191, 194, 195, 127 C.R. 390 [following *Leeds* holding that waste does not embrace breach of covenant to repair; here damage caused by earthquake]; *Brown v. Critchfield* (1980) 100 C.A.3d 858, 868, 161 C.R. 342 [following *Cornelison* holding that full credit bid establishes that there was no impairment of security]; *Sumitomo Bank v. Taurus Developers* (1986) 185 C.A.3d 211, 217, 229 C.R. 719, supra, §176 [causes of action for impairment of security were barred by full credit bid; following *Cornelison*]; *Evans v. California Trailer Court* (1994) 28 C.A.4th 540, 552, 553, 33 C.R.2d 646, infra, §198; 64 Cal. L. Rev. 1109; cf. *Alliance Mortg. Co. v. Rothwell* (1995) 10 C.4th 1226, 44 C.R.2d 352, 900 P.2d 601, supra, §177 [lender's acquisition of security property by full credit bid at nonjudicial foreclosure sale does not bar lender from maintaining *fraud* action to recover damages from third parties who fraudulently induced lender to make loans]; see 64 Cal. L. Rev. 1137 [*Cornelison*]; 65 Cal. L. Rev. 450; 7 Golden Gate L. Rev. 619.)

SUPPLEMENT: [This section is current through the latest supplement]



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VII. REMEDIES OF MORTGAGEE AND TRUSTEE

C. Deficiency Judgment.

2. Foreclosure of Purchase Money Mortgage: C.C.P. 580b.

f. Action for Impairment of Security.

2. Bad Faith Waste.

4 *Witkin Sum. Cal. Law STRP* § 198

[§ 198] Bad Faith Waste.

The dictum in *Cornelison v. Kornbluth* (1975) 15 C.3d 590, 604, 125 C.R. 557, 542 P.2d 981, supra, §197, became the holding in *Hickman v. Mulder* (1976) 58 C.A.3d 900, 130 C.R. 304. A purchase money deed of trust was given on grapefruit orchards and vineyards. Plaintiff beneficiaries held a nonjudicial foreclosure sale, purchased for less than the amount of the default, and then brought this suit against the trustors for damages for waste. The complaint alleged that defendants were guilty of "willful mismanagement" of the property, and that they "failed to cultivate, irrigate, fertilize, fumigate, prune and do all other acts necessary to preserve said citrus trees and vines." (58 C.A.3d 903.) The trial judge sustained a demurrer and plaintiffs appealed from the resulting judgment of dismissal. *Held*, reversed.

(a) The *Cornelison* dictum makes it clear that C.C.P. 580b does not bar recovery for waste committed by "the bad faith acts" of the mortgagor, and that it is a question of fact for the trial court to determine whether the decline in the value of the security has been the result of bad faith waste. (58 C.A.3d 907.)

(b) *Cornelison* also held that a mortgagee or beneficiary who makes a full-credit bid for the security extinguishes the obligation and cannot recover even for bad faith waste (see supra, §197). The opinion also states, however, that a mortgagee or beneficiary who acquires the property at less than the full amount of the obligation can sue for damages for bad faith waste; this is the situation here. (58 C.A.3d 908.)

(c) The argument that the *Cornelison* test of bad faith waste calls for reckless or intentional conduct, and does not cover the acts of omission alleged here, is untenable. The language referred to was illustrative only. Where agricultural lands are concerned, inaction such as that alleged in the complaint can be considered wilful and amount to waste. (58 C.A.3d 909.)

(d) The *Cornelison* dictum constitutes disapproval of the holding in *Schumacher v. Gaines* (1971) 18 C.A.3d 994, 96 C.R. 223, supra, §197, and an adoption of the views expressed in the dissenting opinion in that case. (58 C.A.3d 910.)

In *Evans v. California Trailer Court* (1994) 28 C.A.4th 540, 33 C.R.2d 646, plaintiffs sold their trailer park to defendants, taking back two promissory notes. Each note was secured by a separate deed of trust on the real property.

The sales contract included a nonassignment clause, an attorney fees provision, a promise to maintain the property in good repair, and an assignment of rents clause. Defendants made payments on the notes until, without the consent of plaintiffs, they transferred the property to a third party who defaulted on both notes. Plaintiffs sought contract and tort damages, and alleged that defendants allowed the property to deteriorate. However, plaintiffs also exercised their power of sale on the first deed of trust and reacquired the property for the amount due on the senior note plus foreclosure costs, an amount less than the amount secured by the combined notes. Defendants asserted that the claims were barred by the anti-deficiency statutes, and the trial judge granted judgment on the pleadings for defendants. *Held*, affirmed as to plaintiffs' contract claims, but reversed as to plaintiffs' tort claims and claims for waste.

(a) Plaintiffs, who held both deeds of trust on the same property, were not entitled to the rule allowing a sold-out junior to seek judgment for the obligation secured by the junior deed of trust. To the extent that the contract claims sought recovery on the remaining debt secured by the junior deed of trust, they were barred by *C.C.P. 580d*. (28 C.A.4th 552; see *infra*, §205.) However, the anti-deficiency statutes do not apply to actions against the trustor seeking damages for tortious conduct, even if the amount of damages may be similar to the amount recoverable in an action on the note. (28 C.A.4th 552, 553.)

(b) Nor do the anti-deficiency statutes apply when the borrower has committed bad faith waste resulting in impairment of the security. Bad faith waste is reckless, intentional, or malicious injury to the property and is distinguishable from waste caused by mortgagors who are subject to the economic pressures of a market depression. Plaintiffs' allegations that defendants allowed the property to become seriously dilapidated and in a state of gross disrepair, and that all of the acts were wilful, wanton, malicious, and oppressive sufficiently raised the issue of bad faith waste. (28 C.A.4th 553.)

(c) The trial judge concluded that because plaintiffs made a full credit bid when foreclosing their senior deed of trust, plaintiffs eliminated any claims for damages arising from waste. However, plaintiffs did not make a full credit bid, because the bid included only the amount secured by their senior deed of trust and did not include any portion of the debt secured by the junior lien. There was no reason to assume that the only obligation owing was that secured by the senior trust deed, or that the amount of the bid should somehow be deemed increased to include the amount owing on the junior encumbrance. (28 C.A.4th 554, 555.) For the same reasons, the tort causes of action are not precluded. (24 C.A.4th 556.) (See *Alliance Mortg. Co. v. Rothwell* (1995) 10 C.4th 1226, 1243, 44 C.R.2d 352, 900 P.2d 601, *supra*, §177 [disagreeing with *Evans* court's statement that both fraud and conversion claims are subject to full credit bid rule]; *Aozora Bank, Ltd. v. 1333 North Calif. Boulevard* (2004) 119 C.A.4th 1291, 1294, 15 C.R.3d 340 [to recover attorneys' fees in bad faith waste action, contractual language must be express; nonrecourse provision excepting liability "if and to the extent that" party commits waste was not sufficiently express to allow award of attorneys' fees].)

SUPPLEMENT: [This section is current through the latest supplement]



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VII. REMEDIES OF MORTGAGEE AND TRUSTEE

C. Deficiency Judgment.

3. Nonjudicial Sale: C.C.P. 580d.

a. Deficiency Prohibited.

1. In General.

4 Witkin Sum. Cal. Law STRP § 199

[§ 199] In General.

(1) *Abolition of Deficiency Judgments.* Since 1939, a deficiency judgment on a note after sale under a power of sale in a mortgage or deed of trust has been prohibited by C.C.P. 580d. Thus, the beneficiary of a deed of trust cannot hold the debtor for a deficiency unless he or she uses the remedy of judicial foreclosure (supra, §137) with its accompanying right of redemption (infra, §233). (See *Morello v. Metzenbaum* (1944) 25 C.2d 494, 500, 154 P.2d 670 [note secured by assignment of landowner's oil royalty; security was real property, and, after pledge sale of interest, C.C.P. 580d was bar to deficiency judgment]; *Jensen v. Friedman* (1947) 79 C.A.2d 494, 507, 179 P.2d 855 [statute applied where "mortgagee" was grantee under absolute deed, which court held to be mortgage]; *Union Bank v. Gradsky* (1968) 265 C.A.2d 40, 43, 71 C.R. 64, infra, §202; *Cornelison v. Kornbluth* (1975) 15 C.3d 590, 605, 125 C.R. 557, 542 P.2d 981, supra, §197; *Union Bank v. Wendland* (1976) 54 C.A.3d 393, 399, 400, 126 C.R. 549 [holding C.C.P. 580b inapplicable but C.C.P. 580d applicable]; *Ballengee v. Sadlier* (1986) 179 C.A.3d 1, 4, 224 C.R. 301 [nonjudicial sale by holder of second trust deed triggered bar of C.C.P. 580d even though no trustee's deed was issued]; *Rettner v. Shepherd* (1991) 231 C.A.3d 943, 950, 282 C.R. 687 [unsecured original judgment became secured obligation when plaintiff accepted note and deed of trust in satisfaction of that judgment; thus, plaintiff was secured creditor subject to C.C.P. 580d, not judgment creditor on unsecured debt who was given additional security]; *Hodges v. Mark* (1996) 49 C.A.4th 651, 655, 657, 56 C.R.2d 700, citing the text [bar of C.C.P. 580d did not apply where seller foreclosed nonjudicially on apartment building as to which buyers had defaulted and then initiated foreclosure against other property securing severable portion of building's purchase price]; 51 Cal. L. Rev. 32; cf. *Willys of Marin Co. v. Pierce* (1956) 140 C.A.2d 826, 831, 296 P.2d 25 [statute only applies to note; it does not preclude judgment for rent in action on lease even though rent is secured by trust deed]; see also C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §5.4 et seq.)

(2) *Exception for Fraud Actions.* C.C.P. 580d is not a defense to a tort action for fraud. (*Glendale Fed. Savings & Loan Assn. v. Marina View Heights Dev. Co.* (1977) 66 C.A.3d 101, 139, 135 C.R. 802; see supra, §184.) And an action for borrower fraud under C.C.P. 726(f) (see supra, §126) "shall not constitute a money judgment for deficiency, or a deficiency judgment within the meaning of" C.C.P. 580d. (C.C.P. 726(h).) With exceptions for loans secured by certain owner-occupied, residential real property, banks and savings and loans are permitted to bring fraud actions where the borrower's fraudulent conduct induced the making of the secured loan. (*Fin.C. 779(a), (c), 7460(a), (c)*; see supra,

§184.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Abolition of Deficiency Judgments.* See *Jones v. Union Bank of Calif.* (2005) 127 C.A.4th 542, 546, 25 C.R.3d 783 [anti-deficiency provisions of C.C.P. 580d did not prohibit award of attorneys' fees where lender successfully defended action to set aside foreclosure sale]. (2) *Exception for Fraud Actions.* *Fin.C.* 779 was repealed in 2008. Comparable provisions are now in *Fin.C.* 551, added in 2008.

(3) (New) *Exception for Indemnity Actions.* In *Trust One Mortg. Corp. v. Invest America Mortg. Corp.* (2005) 134 C.A.4th 1302, 37 C.R.3d 83, the court applied the waiver/substantial identity test of *Commonwealth Mortg. Assur. Co. v. Superior Court* (1989) 211 C.A.3d 508, 259 C.R. 425, text, §202, in upholding liability under an indemnification provision in a broker's agreement between defendant mortgage broker and plaintiff mortgage lender. The provision required defendant to indemnify losses or repurchase loans in the event of a borrower's fraud or early default. Here, unlike in *Commonwealth*, a third party unrelated to the borrower executed the indemnification provision. "That distinction is critical." Defendant was not the primary obligor or a related entity. The broker's agreement was not executed as part of the loans to the borrower, but was made well in advance of them. The purpose and effect of the indemnification provision "were not to recover a deficiency from the borrower in violation of the antideficiency laws." (134 C.A.4th 1313.)



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Witkin Summary of California Law VII. REMEDIES OF MORTGAGEE AND TRUSTEE

- C. Deficiency Judgment.
 - 3. Nonjudicial Sale: C.C.P. 580d.
 - a. Deficiency Prohibited.
 - 2. Where Additional Security Is Given.

4 Witkin Sum. Cal. Law STRP § 200

[§ 200] Where Additional Security Is Given.

(1) *In General. C.C.P. 580d* cannot be circumvented by the device of *additional security*. In *Freedland v. Greco* (1955) 45 C.2d 462, 289 P.2d 463, plaintiffs sold their business to defendant, for part cash and a balance of \$ 7,000 represented by two notes of the same date, each for \$ 7,000, one secured by a second trust deed and the other by a chattel mortgage. On defendant's default, plaintiff sold under the second trust deed, netting \$ 740.35. Then plaintiff foreclosed the chattel mortgage, netting \$ 444.55, and the lower court entered a deficiency judgment for \$ 6,671.96. *Held*, reversed as to the deficiency. (a) Where there is additional security the creditor may reach it; i.e., exhaustion of the additional security is not a deficiency judgment. (See *supra*, §184.) (b) But the creditor has no right to a deficiency judgment on that additional security; so, if there had been *one note* secured by a trust deed and chattel mortgage, *C.C.P. 580d* would clearly preclude the personal judgment. (c) The situation is not changed by the execution of *two notes* with separate security for each. There was a single obligation for \$ 7,000, and the device of separate notes was an attempt to nullify the statutory protection. (45 C.2d 467.) (See 3 U.C.L.A. L. Rev. 206.)

Freedland was distinguished in *Hodges v. Mark* (1996) 49 C.A.4th 651, 656, 56 C.R.2d 700, where, after foreclosing nonjudicially on an apartment building, the seller-creditor was permitted also to foreclose on other property securing a severable portion of the building's purchase price. The anti-deficiency laws do not preclude a creditor from pursuing all security given to collateralize an indebtedness.

(2) *Distinction: Assignment of Income*. In *MDFC Loan Corp. v. Greenbrier Plaza Partners* (1994) 21 C.A.4th 1045, 26 C.R.2d 596, plaintiff lender in a multiple security situation received not only a deed of trust with an assignment of rents, but also a standby letter of credit and an assignment of the property's leases. When defendants defaulted, plaintiff was granted appointment of a receiver to assume control and collect rents and profits. Defendant failed to transfer income received after appointment of the receiver, but was required to deposit the income with the court during later proceedings and it was thereafter transferred to the receiver. Plaintiff purchased the property at a nonjudicial foreclosure sale and then sought the funds in the receiver's possession. The trial judge disbursed the funds to defendants. *Held*, reversed with directions to order disbursement of the funds to plaintiff. *C.C.P. 580d* does not bar a lender from recovering income under an absolute assignment of rents recorded under former C.C. 2938 (see *supra*, §98). Thus, the transfer of rental proceeds did not constitute a deficiency judgment. "By including an absolute assignment of

rents clause in the trust deed and recording that instrument, plaintiff obtained a present and perfected transfer of the property's income" effective on defendant's default. (21 C.A.4th 1054.)

C.C. 2938, added in 1996 and replacing the former statute applied in *MDFC*, abolished the distinction between absolute assignments of rent and rent assignments intended only for additional security. It makes all assignments of this type, no matter how described in the assignment agreement or loan documents, assignments for security, and provides that enforcement of the security interest as authorized by the statute does not create any bar to a deficiency judgment, even though it may result in a reduction of the indebtedness. (C.C. 2938(e)(3); see *supra*, §100.)

(3) *Letters of Credit*. Whether made before or after a judicial or nonjudicial foreclosure, a demand for payment under a letter of credit issued as additional collateral for an obligation secured by real property is permissible under all of California's anti-deficiency laws, including C.C.P. 580d. (C.C.P. 580.5(b); see *Western Sec. Bank v. Superior Court* (1997) 15 C.4th 232, 62 C.R.2d 243, 933 P.2d 507, 7 Summary (10th), *Constitutional Law*, §624 [tracing history of C.C.P. 580.5, and holding that Legislature intended it to apply to existing loan transactions supported by outstanding letters of credit]; on definition of "letter of credit" as used in C.C.P. 580.5, see C.C.P. 580.5(a)(3) and U.C.C. 5102(a)(10); on letters of credit generally, see 4 Summary (10th), *Negotiable Instruments*, §136 et seq.)

However, a letter of credit is not enforceable by any party thereto in a loan transaction where all the following conditions exist:

(a) The customer is a natural person. (C.C.P. 580.7(b)(1).)

(b) The letter of credit is issued to the beneficiary to avoid a default of an existing loan. (C.C.P. 580.7(b)(2).)

(c) The loan is secured by a purchase money deed of trust or mortgage on residential property of one to four units, at least one of which is occupied by the customer. (C.C.P. 580.7(b)(3).)

SUPPLEMENT: [This section is current through the latest supplement]



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- C. Deficiency Judgment.
- 3. Nonjudicial Sale: C.C.P. 580d.
 - a. Deficiency Prohibited.
- 3. Where Part of Note Unsecured.

4 Witkin Sum. Cal. Law STRP § 201

[§ 201] Where Part of Note Unsecured.

The statute cannot be circumvented by characterizing part of a note as unsecured. In *Loretz v. Cal-Coast Dev. Corp.* (1967) 249 C.A.2d 176, 57 C.R. 188, plaintiffs sold a motel to defendant purchasers, who gave a \$ 25,000 note as a partial consideration. The note was secured by a deed of trust on other land, reciting that "the valuation" of the other land was \$ 8,000. On default plaintiffs sold under the deed of trust for \$ 2,500, and sued for a deficiency judgment. Their theory was that the agreed valuation was intended to set a point above which the note would be considered unsecured (i.e., the difference between \$ 25,000 and \$ 8,000, or \$ 17,000). *Held*, judgment for plaintiffs reversed. (a) The valuation provision could have been intended to refer to value if a deficiency judgment had been properly sought after judicial foreclosure; hence, the conclusion that its only purpose was to create two notes--one unsecured--was not compelled. (249 C.A.2d 179.) (b) To permit a valuation clause to produce an unsecured excess free from the prohibition of C.C.P. 580d would be equivalent to an invalid advance waiver of the statute. (249 C.A.2d 179.)

SUPPLEMENT: [This section is current through the latest supplement]



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VII. REMEDIES OF MORTGAGEE AND TRUSTEE

- C. Deficiency Judgment.
- 3. Nonjudicial Sale: C.C.P. 580d.
 - b. Action Against Guarantor.
 - 1. In General.

4 Witkin Sum. Cal. Law STRP § 202

[§ 202] In General.

In *Union Bank v. Gradsky* (1968) 265 C.A.2d 40, 71 C.R. 64, B obtained a building loan, and made a note for \$ 112,500 to plaintiff Bank, secured by a first deed of trust. Defendant M, the contractor, executed a written guaranty of B's obligations, containing the following clause: "I waive ... any right to require the holder of this within instrument to proceed against the maker or against any other person or to apply any security it may hold or to pursue any other remedy." (265 C.A.2d 41.) B defaulted. The Bank elected to sell at a nonjudicial trustee's sale, and bid in the property for \$ 112,500, the fair market value. The unpaid amount (for taxes, costs, interest and principal) was \$ 11,565.97, and the Bank sued M, the guarantor, for this sum. *Held*, judgment for defendant affirmed. C.C.P. 580d contemplated a two-party transaction. In the three-party transaction (with a guarantor), legislative intent must be found in an examination of remedies and the effect of the statute on them.

(a) *First situation*: Election of creditor to sue guarantor without proceeding against debtor or security. The creditor may sue the guarantor. (1) C.C.P. 726 is inapplicable to an action against a guarantor, endorser, or other surety. (See supra, §127.) (2) C.C. 2809 and 2845 provide that a surety's obligation cannot be more burdensome than the principal's, and that the surety may require the creditor to exhaust his or her remedies against the debtor, but the guarantor here waived the benefits of those sections. (See supra, §131.) In this situation, C.C.P. 580d would not protect the guarantor. It only prevents an action for a deficiency; an action against a guarantor without exhausting the security is not an action for a deficiency. (265 C.A.2d 44.) Nevertheless, C.C.P. 580d would have a critical effect on rights of the parties. If the guarantor pays the debt, he or she has, by subrogation, all rights formerly held by the creditor. Hence, the guarantor could elect either a judicial or nonjudicial sale of the security, obtaining a deficiency judgment by the former and none by the latter. (265 C.A.2d 45.)

(b) *Second situation*: Election of creditor to hold nonjudicial sale of security (this case). If the guarantor has to pay the creditor the unpaid balance, the guarantor doesn't get any subrogation rights against the principal debtor because the creditor lost the right to a deficiency and there is no longer any security. To allow the guarantor subrogation would circumvent the prohibition against deficiency judgments. On whom should this loss fall? The creditor had an election of remedies; it also has a statutory duty under C.C. 2810, 2819 not to impair the guarantor's remedies against the principal debtor. When the Bank elected to pursue a remedy that destroyed both the security and the guarantor's right of

reimbursement from the principal debtor, the Bank was estopped to recover the deficiency from the guarantor. "The result follows not because section 580d ... prevents recovery of a deficiency judgment against the guarantor, but because the section prevents a deficiency judgment by the guarantor against the debtor." (265 C.A.2d 47.) Did the guarantor give up this defense? No: The clause did not specifically waive the defense based on the creditor's election of remedies which destroyed the guarantor's subrogation and reimbursement rights. (265 C.A.2d 48.)

(c) Thus, the creditor's recovery is not directly barred by C.C.P. 580d. "It is barred by applying the principles of estoppel. The estoppel is raised as a matter of law to prevent the creditor from recovering from the guarantor after the creditor has exercised an election of remedies which destroys the guarantor's subrogation rights against the principal debtor. The destruction of the guarantor's subrogation rights follows from the combination of the creditor's election to subject the security to nonjudicial sale and the operation of section 580d, which prevents both the creditor and the guarantor from obtaining any deficiency judgment against the debtor after nonjudicial sale of the security." (265 C.A.2d 41.)

The *Gradsky* holding has been applied in a number of subsequent cases. (See *Union Bank v. Brummell* (1969) 269 C.A.2d 836, 838, 75 C.R. 234; *Indusco Management Corp. v. Robertson* (1974) 40 C.A.3d 456, 461, 114 C.R. 47; *Consolidated Capital Income Trust v. Khaloghli* (1986) 183 C.A.3d 107, 111, 227 C.R. 879 [question of fact whether guarantor had subrogation rights adversely affected by nonjudicial sale]; 4 Miller & Starr 3d, §§10:267, 10:268; C.E.B., 2 Mortgage and Deed of Trust Practice 3d, §9.99; 57 Cal. L. Rev. 218; 28 Cal. Western L. Rev. 51 [application of C.C.P. 580d to guaranty secured by real property]; 20 Pacific L. J. 127 [guarantors and anti-deficiency legislation]; 38 Santa Clara L. Rev. 329 [overview of defenses available to guarantors]; 17 U.C.L.A. L. Rev. 245; 37 U.C.L.A. L. Rev. 225 [carry and completion guarantees and anti-deficiency legislation]; but see *Mariners Savings & Loan Assn. v. Neil* (1971) 22 C.A.3d 232, 235, 99 C.R. 238 [distinguishing *Gradsky* on facts showing express waiver and waiver by conduct by guarantor].)

In *Commonwealth Mortg. Assur. Co. v. Superior Court* (1989) 211 C.A.3d 508, 259 C.R. 425, the trust deed beneficiary required defendant trustors to obtain mortgage guaranty insurance, insuring payment on the purchase money notes. Plaintiff issued the insurance, and concurrently defendants executed agreements to indemnify plaintiff from all losses it might suffer under the mortgage guaranty policies. Following defendants' default on the deed of trust and the nonjudicial sale of the property, plaintiff paid the beneficiary approximately \$ 175,000. After defendants refused plaintiff's demand for payment under the indemnity contracts, plaintiff sued for breach of contract. The trial judge granted defendants' motion for summary adjudication, ruling that C.C.P. 580d rendered the contracts void and unenforceable. Plaintiffs petitioned for mandamus. *Held*, petition denied.

(a) The mortgage guaranty insurance policies issued by plaintiff serve the same purpose as the guaranty in *Gradsky*. Had there been no indemnity agreements, and had plaintiff sought reimbursement from defendants under principles of subrogation, recovery would be barred for the reasons set out in *Gradsky*. The execution of the indemnity agreements does not sufficiently distinguish defendants from the debtors in *Gradsky*. The indemnity agreements add nothing to the liability defendants incurred as obligors on the notes. (211 C.A.3d 517.)

(b) Construing the entire transaction as one contract, the indemnity agreements are simply attempts to have defendants waive in advance the protection of C.C.P. 580d. Such a waiver is against public policy and void. To splinter the transactions and view the indemnity agreements as separate and independent obligations would impermissibly thwart the purpose of C.C.P. 580d by subterfuge. (211 C.A.3d 517.)

SUPPLEMENT: [This section is current through the latest supplement]

For exception to anti-deficiency laws for true indemnity action, see *Trust One Mortg. Corp. v. Invest America Mortg. Corp.* (2005) 134 C.A.4th 1302, 37 C.R.3d 83, Supp., supra, §199.

See *Talbott v. Hustwit* (2008) 164 C.A.4th 148, 151, 78 C.R.3d 703 [distinguishing *Torrey Pines Bank v. Hoffman* (1991) 231 C.A.3d 308, 282 C.R. 354, text, §203; defendant loan guarantors were true guarantors where, although they

were settlors of trust that had defaulted on payments, they were secondary, not primary, beneficiaries, and they had used limited liability company as trustee, thus limiting their personal liability for obligations of trust; trial court did not err in refusing to require appraisal of real property security under *C.C.P. 580a* before issuance of deficiency judgment because statute does not apply to actions against guarantors].



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VII. REMEDIES OF MORTGAGEE AND TRUSTEE

- C. Deficiency Judgment.
 - 3. Nonjudicial Sale: C.C.P. 580d.
 - b. Action Against Guarantor.
- 2. Where Purported Guarantor Is Principal.

4 Witkin Sum. Cal. Law STRP § 203

[§ 203] Where Purported Guarantor Is Principal.

In *Torrey Pines Bank v. Hoffman* (1991) 231 C.A.3d 308, 282 C.R. 354, plaintiff bank sought a deficiency against defendant trustees of a revocable living trust to whom the bank had made a construction loan secured by a deed of trust. Defendants had personally guaranteed the loan. *Held*, defendants were the alter egos of themselves as trustees and primary obligors, to whom anti-deficiency protection applied, rather than separate and distinct "true guarantors" of the trust's debt.

(a) Where a principal obligor purports to take on additional liability as a guarantor, nothing is added to the primary obligation. Here, the evidence demonstrated substantial identity between the individual guarantors and the debtor trustees, because the guarantors created, administered, and benefited from the trust. The bank was presented with substantially the same financial information for both the trust and the individual guarantors as an inducement to make the loan. It had a copy of the trust document naming the trustees as settlors and beneficiaries. Although the guaranties were signed by the trustees as individuals, the bank was aware of their trust capacities, and should have been familiar with the nature of the inter vivos trust device. (231 C.A.3d 319, 320.)

(b) Under the law in effect at the time the loan was made, the trustees were personally liable on the contract they entered into on behalf of the trust, because the contract did not provide that the trustees were not liable. (231 C.A.3d 321; cf. *Prob.C. 18000* [general rule that trustee is not personally liable; see 13 *Summary* (10th), *Trusts*, §244].) The trust was a "mere instrumentality" through which they operated, but which did not remove them from the status of primary obligors. (231 C.A.3d 321.)

(c) *Prob.C. 15209(b)* provides an exception to the doctrine of the merger of legal and equitable interests held by the same person where there is more than one settlor, at least one settlor is a trustee, the settlor has a lifetime beneficial interest, and successor beneficiaries have been named. This provision was designed to define those situations where a trust will be terminated, and does not apply here to preserve the separation of interests between the primary obligors and the guarantors necessary to defeat anti-deficiency protection. (231 C.A.3d 321, 322.) (See *Union Bank v. Dorn* (1967) 254 C.A.2d 157, 158, 61 C.R. 893; *Cadle Co. II v. Harvey* (2000) 83 C.A.4th 927, 933, 100 C.R.2d 150 [following *Torrey Pines*].)

In *River Bank America v. Diller* (1995) 38 C.A.4th 1400, 45 C.R.2d 790, plaintiff bank brought an action to enforce guaranty agreements executed as security for nonrecourse construction loans to a limited partnership. The debtor's general partner was a corporation that the individual guarantors fully owned and controlled. The limited partners were a revocable family trust, of which the guarantors were the trustees, and another limited partnership. The guarantors had effective control over the entire debtor partnership. In denying plaintiff's motion for summary adjudication, the trial judge ruled that the guarantors raised triable issues of material fact whether their guaranties were unenforceable "sham guaranties" in that plaintiff actually regarded the guarantors as the primary obligors. *Held*, this ruling was correct.

(a) According to the declaration of one guarantor, plaintiff never inquired about the financial standing of the general partner and relied instead on extensive financial statements reflecting the financial strength of the guarantors. It was these persons to whom plaintiff at all times actually looked as the "borrowers." (38 C.A.4th 1423.)

(b) In determining whether purported guarantors are the primary obligors, the relevant inquiry is whether the purpose and effect of the guaranty agreement was to avoid the anti-deficiency preclusion of C.C.P. 580d. There is evidence in the present case that this was the very reason why plaintiff insisted on the general partner's being a corporation fully controlled by the guarantors. (38 C.A.4th 1423, citing *Torrey Pines*.) That the general partner was a long-standing corporation adhering to all formalities does not mandate a conclusion that the guaranties are enforceable. The "sham guaranty" doctrine may apply even under these circumstances, if the goal was to circumvent the anti-deficiency laws. (38 C.A.4th 1423, 1424, citing *Valinda Builders v. Bissner* (1964) 230 C.A.2d 106, 40 C.R. 735, supra, §195, and *Union Bank v. Brummell* (1969) 269 C.A.2d 836, 75 C.R. 234.)

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- C. Deficiency Judgment.
- 3. Nonjudicial Sale: C.C.P. 580d.
- b. Action Against Guarantor.
- 3. Waiver of Defenses.

4 Witkin Sum. Cal. Law STRP § 204

[§ 204] Waiver of Defenses.

(1) *Waivable Rights.* At one time, a guarantor's waiver had to be cast in special language. (See *Cathay Bank v. Lee* (1993) 14 C.A.4th 1533, 1538, 18 C.R.2d 420.) The subject is now covered by statute. Under C.C. 2856(a), a guarantor of a note or other obligation secured by real property or an estate for years may waive:

(a) The guarantor's rights of subrogation, reimbursement, indemnification, and contribution, and any other rights available under C.C. 2787 et seq. (see 1 *Summary* (10th), *Contracts*, §372; 13 *Summary* (10th), *Equity*, §178). (C.C. 2856(a)(1).)

(b) Any rights or defenses the guarantor may have as a result of the creditor's election of remedies (see *Union Bank v. Gradsky* (1968) 265 C.A.2d 40, 71 C.R. 64, supra, §202). (C.C. 2856(a)(2).)

(c) Any rights or defenses the guarantor may have because the security is real property or an estate for years, including rights or defenses arising because of the application of C.C.P. 580a, 580b, 580d (deficiency provisions; see supra, §179 et seq.) and C.C.P. 726 (one-action rule; see supra, §124) to the principal's note or obligation. (C.C. 2856(a)(3).)

(2) *Language of Waiver.* Any language that expressly sets forth an intent to waive the rights or defenses described in C.C. 2856(a) is effective whether or not it contains references to statutory provisions or judicial decisions. (C.C. 2856(b).)

(3) *Form Waivers.* The statute provides two form waivers, which, if used, will be effective to waive the specified rights:

(a) *A waiver of all rights or defenses arising because the obligation is secured by real property:* "The guarantor waives all rights and defenses that the guarantor may have because the debtor's debt is secured by real property. This means, among other things: (1) The creditor may collect from the guarantor without first foreclosing on any real or personal property collateral pledged by the debtor. (2) If the creditor forecloses on any real property collateral pledged

by the debtor: (A) The amount of the debt may be reduced only by the price for which that collateral is sold at the foreclosure sale, even if the collateral is worth more than the sale price. (B) The creditor may collect from the guarantor even if the creditor, by foreclosing on the real property collateral, has destroyed any right the guarantor may have to collect from the debtor. This is an unconditional and irrevocable waiver of any rights and defenses the guarantor may have because the debtor's debt is secured by real property. These rights and defenses include, but are not limited to, any rights or defenses" based on *C.C.P. 580a, 580b, 580d*, or 726. (C.C. 2856(c).)

(b) *A waiver of only the rights or defenses arising because of the creditor's election of remedies*: "The guarantor waives all rights and defenses arising out of an election of remedies by the creditor, even though that election of remedies, such as a nonjudicial foreclosure with respect to security for a guaranteed obligation, has destroyed the guarantor's rights of subrogation and reimbursement against the principal" by the operation of *C.C.P. 580d* or otherwise. (C.C. 2856(d).)

(4) *Exception for Owner-Occupied Dwellings*. The provisions regarding the language of the waiver (C.C. 2856(b)-(d)) are inapplicable to guaranties of loans secured by a mortgage or deed of trust on a dwelling for not more than four families, if the dwelling is, in whole or in part, occupied by the borrower and the loan was in fact used to pay all or part of the purchase price. (C.C. 2856(e).)

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C. Deficiency Judgment.
3. Nonjudicial Sale: C.C.P. 580d.
c. Action by Sold-Out Junior Lienor.

4 *Witkin Sum. Cal. Law STRP* § 205

[§ 205] Action by Sold-Out Junior Lienor.

(1) *In General: C.C.P. 580d Is Inapplicable.* *C.C.P. 580d* was held inapplicable to an action by a sold-out junior lienor, in *Roseleaf Corp. v. Chierighino* (1963) 59 C.2d 35, 27 C.R. 873, 378 P.2d 97, *supra*, §181. The court declared that the statutory purpose was to put judicial enforcement on a parity with private enforcement, for the right to redeem and the prohibition of deficiency judgments both have the effect of making the security satisfy a realistic share of the debt. "If the creditor wishes a deficiency judgment, his sale is subject to statutory redemption rights. If he wishes a sale resulting in nonredeemable title, he must forego the right to a deficiency judgment. In either case the debtor is protected." (59 C.2d 43.)

This purpose would not be served by applying *C.C.P. 580d* to the sold-out junior lienor. "After a senior private sale, the junior has no right to redeem. This disparity of rights would be aggravated were he also denied a right to a deficiency judgment by section 580d. There is no purpose in denying the junior his single remedy after a senior private sale while leaving him with two alternative remedies after a senior judicial sale. The junior's right to recover should not be controlled by the whim of the senior, and there is no reason to extend the language of section 580d to reach that result." (59 C.2d 44.) (See *Walter E. Heller Western v. Bloxham* (1985) 176 C.A.3d 266, 221 C.R. 425, *supra*, §181.)

In *Bank of America v. Graves* (1996) 51 C.A.4th 607, 59 C.R.2d 288, plaintiff bank recorded a notice of default and election to sell under its second trust deed. Upon hearing that the senior lienor had also instituted foreclosure proceedings, plaintiff postponed its trustee's sale. The senior lienor was the highest bidder at the sale and became the owner of the property. Plaintiff then sued defendant borrowers for amounts due on an account stated. Defendant contended that plaintiff was not a sold-out junior lienor because its own action in postponing its trustee's sale deprived it of that status. *Held*, plaintiff was not barred by the "one action rule" of *C.C.P. 726* (see *supra*, §124) from suing its borrowers directly on the underlying obligation.

(a) Plaintiff did not fail to perform some legally required act which failure would deprive it of the right to foreclose the mortgage. (51 C.A.4th 613.)

(b) Defendant's contention that plaintiff had no alternative except to assume the senior obligation, or pay it off, in order to protect its junior lien, is against public policy. A junior lienor must be allowed to make a business decision

whether: (1) to foreclose a junior priority deed of trust, investing additional funds to bring and keep the senior lien current, or (2) to postpone its foreclosure sale and allow itself to be closed out. (51 C.A.4th 615.) Under defendant's proposed rule, banks would have no bargaining room on default. They would be forced to start and, without interruption, complete foreclosure "lest their hesitancy cause them to lose their secured position." (51 C.A.4th 616.) Further, requiring a lender to assume the first position would alter the practice of banks in extending equity loans, leading to higher notes and the tightening of credit. (51 C.A.4th 616.)

(2) *Distinction: Junior Lienor Who Is Also Senior Lienor.* In *Simon v. Superior Court* (1992) 4 C.A.4th 63, 5 C.R.2d 428, plaintiff bank loaned defendant borrowers a sum of money for which defendants gave plaintiff two separate promissory notes, dated several days apart. Both notes were secured by the same real property. After defendants defaulted on the senior note, plaintiff foreclosed on the senior deed of trust, bought the property on a credit bid, and sold it to a third party. Plaintiff then brought an action for money claimed due on the junior note. *Held*, plaintiff's action was barred by C.C.P. 580d.

(a) Unlike the situation in *Roseleaf*, plaintiff could not be considered a sold-out junior lienor. As the holder of both the junior and senior liens, plaintiff was able to protect its secured position. Holding both liens eliminated the possibility that plaintiff might end up with no interest in the secured property, the principal rationale of the decision in *Roseleaf*. (4 C.A.4th 72.)

(b) A lender may not circumvent C.C.P. 580d by creating multiple trust deeds on the same property to secure loans represented by successive promissory notes from the same debtor. "The elevation of the form of such a contrived procedure over its easily perceived substance would deal a mortal blow to the antideficiency legislation of this state." (4 C.A.4th 77.) (See *Evans v. California Trailer Court* (1994) 28 C.A.4th 540, 552, 33 C.R.2d 646, *supra*, §198; *In re Marriage of Oropallo* (1998) 68 C.A.4th 997, 1005, 80 C.R.2d 669 [following *Simon* and distinguishing *Roseleaf*; wife who took promissory note secured by second deeds of trust on six properties as part of marital dissolution and who later nonjudicially foreclosed was precluded under C.C.P. 580d from seeking deficiency judgment against husband even though senior lienholder had foreclosed on one or two of properties]; *National Enterprises v. Woods* (2001) 94 C.A.4th 1217, 1232, 115 C.R.2d 37 [distinguishing *Simon*; one-action rule does not "require two different creditors who hold separate debts to join in a single action, even if the two debts were once held by a single creditor--at least in the absence of evidence of a scheme to circumvent the rule"].)

SUPPLEMENT: [This section is current through the latest supplement]



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C. Deficiency Judgment.
3. Nonjudicial Sale: C.C.P. 580d.
d. Defense of Action To Enjoin Sale.

4 Witkin Sum. Cal. Law STRP § 206

[§ 206] Defense of Action To Enjoin Sale.

In *Passanisi v. Merit-McBride Realtors* (1987) 190 C.A.3d 1496, 236 C.R. 59, plaintiffs were the trustors on a deed of trust in favor of defendants. Following plaintiffs' default on the underlying obligation, defendants directed the trustee to exercise the power of sale. Plaintiffs brought an action to enjoin the sale, but defendants prevailed at trial and were awarded a judgment for attorneys' fees and costs. Defendants were the successful bidders at the ensuing trustee's sale with a bid that did not include the judgment. Plaintiffs then moved for an order under C.C.P. 724.050 (see 8 Cal. Proc. (4th), *Enforcement of Judgment*, §381) requiring defendants to acknowledge the satisfaction of the judgment. The trial judge denied the motion. *Held*, the judgment was not rendered unenforceable by virtue of C.C.P. 580d, for that statute does not by its express terms apply to cases such as this, nor does the policy behind the statute preclude enforcement of the judgment.

"Enforcement of the judgment for attorney's fees and costs is not simply a subterfuge for the collection of a deficiency on the secured note. The award for attorney's fees and costs is neither measured by, nor interrelated to, a deficiency on the note. Such an award is not attributable to a general condition of the real estate market, but is the result of the debtor-trustor's voluntary act in bringing an unmeritorious suit which the creditor-beneficiary was required to make expenditures to defend. The judgment for attorney's fees and costs is entirely independent of the problems encompassed by antideficiency legislation and the enforcement of such a judgment will not affect the parity of remedies such legislation is intended to foster." (190 C.A.3d 1509.) (See *Flynn v. Page* (1990) 218 C.A.3d 342, 349, 266 C.R. 830 [following *Passanisi*, where foreclosure sale preceded attorneys' fee award].)

SUPPLEMENT: [This section is current through the latest supplement]
Cross-Reference: 8 Cal. Proc. (5th), *Enforcement of Judgment*, §389.



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C. Deficiency Judgment.
4. Constitutionality of Restrictions.

4 Witkin Sum. Cal. Law STRP § 207

[§ 207] Constitutionality of Restrictions.

(1) *Validity of Prospective Limitations.* The general constitutionality of statutes operating prospectively to give relief to mortgage debtors in the form of limitations on deficiency judgments is settled. Attacks based upon the Contract Clause of the federal Constitution have been rejected. (See *Kirkpatrick v. Stelling* (1940) 36 C.A.2d 658, 672, 98 P.2d 566; 4 Powell §37.49; 22 Cal. L. Rev. 170; 48 Cal. L. Rev. 707; 8 Summary (10th), *Constitutional Law*, §1278.)

(2) *Retroactive Procedural Changes.* Former C.C. 29241/2 required 1 year's notice of breach and election to sell. This statute was held invalid where applied to instruments executed before its enactment. (*Brown v. Ferdon* (1936) 5 C.2d 226, 236, 54 P.2d 712; *Craemer v. Norton Realty Co.* (1939) 33 C.A.2d 340, 91 P.2d 644.) But the 3-month statute of limitations on actions for deficiency (supra, §199) was held applicable to instruments executed prior to 1933, where the sale took place after 1933. (*Ware v. Heller* (1944) 63 C.A.2d 817, 824, 148 P.2d 410.)

(3) *Retroactive Limitation on Amount.* The 1933 amendments of C.C.P. 580a and C.C.P. 726, limiting deficiency judgments to fair market value (supra, §§179, 202), were held inapplicable to instruments executed prior to their enactment, even though the sale was held after 1933. The cases reached this conclusion on the double ground that the limitation of the amount recoverable impaired the obligation of the contract, and that the statute should be interpreted prospectively because of an absence of any showing of legislative intent that it be retroactively applied. (See *Bennett v. Superior Court* (1935) 5 C.A.2d 13, 14, 42 P.2d 80; *Birkhofer v. Krumm* (1938) 27 C.A.2d 513, 533, 81 P.2d 609; *Bank of America v. Burg Bros.* (1939) 31 C.A.2d 352, 353, 88 P.2d 196; *Drapeau v. Smith* (1939) 34 C.A.2d 84, 85, 93 P.2d 157; *Ware v. Heller*, supra, 63 C.A.2d 820; 3 U.C.L.A. L. Rev. 200.)

In the foregoing cases, the statute would have cut down an existing right to a deficiency. A special problem, however, arose where a deed of trust was foreclosed. The legislation permitting the lien of a deed of trust to be foreclosed (C.C.P. 725a, supra, §137) was first enacted in 1933, and the restrictions on deficiency judgments were adopted at the same time. The question then was whether the right to foreclose a deed of trust, first given in 1933, was subject to the statutory limitations *contemporaneously enacted*. This was not a constitutional problem, but simply one of interpretation. If the Legislature in granting the remedy of foreclosure intended to do so subject to certain restrictions, its power thus to condition an alternative remedy could not be questioned. The substantive rights of the holder of the deed of trust, enforceable by sale under the terms of the instrument, with the right thereafter to recover the entire deficiency, would remain unimpaired. This was the conclusion reached in *Miller v. Hart* (1938) 11 C.2d 739, 742, 81

P.2d 923, disapproving contrary language in *Wilson v. Superior Court* (1935) 8 *C.A.2d* 14, 47 *P.2d* 331. The creditor, pursuing the new, alternative remedy of foreclosure, does so voluntarily, and must take the remedy as it existed at its inception, with its limitation on deficiency judgments. (See 13 *So. Cal. L. Rev.* 119.)

(4) *Retroactive Abolition of Deficiency*. The abolition of deficiency judgments under purchase money mortgages or deeds of trust (*C.C.P.* 580*b*; *supra*, §182) was held ineffective as to instruments executed before the law. (*Hales v. Snowden* (1937) 19 *C.A.2d* 366, 369, 65 *P.2d* 847; *Birkhofer v. Krumm*, *supra*, 27 *C.A.2d* 533; see 3 *U.C.L.A. L. Rev.* 200.) No problem arose in connection with the later abolition of deficiency judgments under any deed of trust or power of sale mortgage after a nonjudicial sale, for the statute (*C.C.P.* 580*d*) was expressly prospective.

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D. Environmentally Impaired Property.
1. Nature and Scope of Legislation.

4 Witkin Sum. Cal. Law STRP § 208

[§ 208] Nature and Scope of Legislation.

(1) *In General.* "Secured lenders" have the following statutory rights and remedies with respect to secured real property that is "environmentally impaired" or an "affected parcel":

(a) A right to inspect for "hazardous substances." (C.C. 2929.5; C.C.P. 564(c); *infra*, §209.)

(b) A right to elect to waive the lien and exercise the rights and remedies of an unsecured creditor. (C.C.P. 726.5; *infra*, §210.)

(c) An action against a borrower for breach of an "environmental provision" relating to the property. (C.C.P. 736(a); *infra*, §211.)

(2) *Definitions.* The following definitions apply:

(a) *Secured Lender.* A "secured lender" includes a beneficiary under a deed of trust, a mortgagee, and their successors in interest. (C.C. 2929.5(e).)

(b) *Environmentally Impaired.* "Environmentally impaired" means that the estimated costs to clean up and remedy a past, present, or threatened release of a hazardous substance exceed 25% of the higher of the aggregate fair market value of all security for the loan (1) at the time of making the loan or extension of credit, or (2) at the time of the discovery of the release or threatened release by the secured lender. In addition, any property included in the National Priorities List under 42 U.S.C., §9605, or in any list published by the State Department of Health Services under *Health & Saf.C.* 25356(b) is deemed to be environmentally impaired. (C.C.P. 726.5(e)(3).)

(c) *Hazardous Substances.* "Hazardous substances" are defined identically in C.C. 2929.5(e)(2), C.C.P. 564(e)(2), C.C.P. 726.5(e)(4), and C.C.P. 736(f)(3) to mean (1) hazardous substances as defined in *Health & Saf.C.* 25281(h); (2) "waste" as defined in *Water C.* 13050(d); or (3) petroleum or natural gas products, synthetic gas, or any mixture of them.

(d) *Environmental Provision.* An "environmental provision" is a written representation "relating to the existence, location, nature, use, generation, manufacture, storage, disposal, handling, or past, present, or future release or

threatened release, of any hazardous substance into, onto, beneath, or from the real property security, or to past, present, or future compliance with any law relating thereto," made by a borrower in conjunction with the making, renewal, or modification of a loan or guaranty. (C.C.P. 736(f)(2).)

(e) *Affected Parcel*. An "affected parcel" is a portion of the real property security that is (1) contiguous to the environmentally impaired parcel, even if separated by a street, utility easement, or railroad right-of-way; (2) part of the same approved or proposed subdivision as the environmentally impaired parcel; or (3) within 2,000 feet of the environmentally impaired parcel. (C.C.P. 726.5(e)(1).)

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D. Environmentally Impaired Property.
2. Inspection of Property.

4 Witkin Sum. Cal. Law STRP § 209

[§ 209] Inspection of Property.

(1) *Right To Inspect.* A secured lender has the right to enter and inspect the real property security to determine the existence, location, nature, and magnitude of any past, present, or threatened release of a hazardous substance "into, onto, beneath, or from" the property. (C.C. 2929.5(a).) This right may be exercised in either of the following circumstances:

(a) Where there is a reasonable belief that there exists a past, present, or threatened release of a hazardous substance that was "not previously disclosed in writing to the secured lender in conjunction with the making, renewal, or modification of a loan, extension of credit, guaranty, or other obligation involving the borrower." (C.C. 2929.5(a)(1).)

(b) "After the commencement of nonjudicial or judicial foreclosure proceedings against the real property security." (C.C. 2929.5(a)(2).)

The secured lender must not abuse the right of entry and inspection, or use it to harass the borrower or tenant. (C.C. 2929.5(b).)

(2) *Notice.* Except where there is an emergency, when the property has been abandoned, or where it is impracticable, the secured lender must give the borrower or tenant reasonable notice of his or her intent to enter. The secured lender may enter only during the borrower's or tenant's normal business hours. (C.C. 2929.5(b) [stating that 24 hours' notice is presumed reasonable in the absence of contrary evidence].)

(3) *Reimbursement.* The secured lender must reimburse the borrower for the cost of repairing any physical injury to the property caused by the entry and inspection. (C.C. 2929.5(c).)

(4) *Action To Enforce Right.* The secured lender may petition for a court order if refused the right of entry and inspection, or if "otherwise unable to enter and inspect the property without a breach of the peace." A receiver may be appointed in the action (C.C.P. 564(c)), which is not an action under C.C.P. 726(a) (one action rule). (C.C. 2929.5(d); C.C.P. 564(d); on one action rule, see *supra*, §124.)

SUPPLEMENT: [This section is current through the latest supplement]



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D. Environmentally Impaired Property.
3. Waiver of Lien.

4 *Witkin Sum. Cal. Law STRP* § 210

[§ 210] Waiver of Lien.

(1) *Election To Waive*. When real property security is *environmentally impaired* or is an *affected parcel* (see *supra*, §208), and the borrower's obligations to the secured lender are in default, the mortgagee may elect to waive the lien against the property and exercise the rights and remedies of an unsecured creditor. (*C.C.P.* 726.5(a).)

(2) *Steps Before Waiver*. Before the secured lender may waive its lien against the property, it must (a) provide the borrower with written notice of default, and (b) establish the value of the property and have its environmentally impaired status confirmed by court order in an action brought by the secured lender against the borrower. The complaint for a valuation and confirmation action may include causes of action for a money judgment for all or part of the secured obligation. If that cause of action is included, waiver of the secured lender's liens under *C.C.P.* 726.5(a)(1) results only if a final money judgment is obtained against the borrower. (*C.C.P.* 726.5(b).)

(3) *Foreclosure Against Additional Collateral*. If the secured lender elects to waive, and the borrower's obligations are also secured by other real property security, fixtures, or personal property, the secured lender must "first foreclose against the additional collateral to the extent required by applicable law." In this case, the amount of the secured lender's judgment is limited to the extent *C.C.P.* 580a, *C.C.P.* 580d, or *C.C.P.* 726(b) "apply to the foreclosures of additional real property security." (*C.C.P.* 726.5(c).) The borrower may waive or modify the foreclosure requirements of *C.C.P.* 726(c) "provided that the waiver or modification is in writing and signed by the borrower after default." (*C.C.P.* 726.5(c).)

(4) *Limitation on Election To Waive*. The election to waive under *C.C.P.* 726.5(a) is inapplicable if both of the following are true:

(a) The release or threatened release was not knowingly or negligently caused or contributed to, or knowingly or wilfully permitted or acquiesced to, by the borrower, any affiliate or agent of the borrower, or any related party. (*C.C.P.* 726.5(d).)

(b) In conjunction with the making, renewal, or modification of the loan or other obligation secured by the property, (1) neither the borrower, an affiliate or agent, nor a related party had actual knowledge of the release, or if he or she did have knowledge, that party disclosed the information in writing to the secured lender after the secured

lender's written request for information concerning the environmental condition of the property; or (2) the secured lender otherwise obtained actual knowledge of the release prior to the making, renewal, or modification of the obligation. (*C.C.P.* 726.5(*d*).)

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4. Breach of Environmental Provision.

4 Witkin Sum. Cal. Law STRP § 211

[§ 211] Breach of Environmental Provision.

(1) *Action To Enforce.* A secured lender "may bring an action for breach of contract against a borrower for breach of any environmental provision made by the borrower relating to the real property security, for the recovery of damages, and for the enforcement of the environmental provision." (*C.C.P. 736(a)*; for definition of "environmental provision," see *supra*, §208.)

An "environmental provision" is defined as a written representation "relating to the existence, location, nature, use, generation, manufacture, storage, disposal, handling, or past, present, or future release or threatened release, of any hazardous substance into, onto, beneath, or from the real property security, or to past, present, or future compliance with any law relating thereto," made by a borrower in conjunction with the making, renewal, or modification of a loan or guaranty. (*C.C.P. 736(f)(2)*.)

An action under *C.C.P. 736(a)* or a "failure to foreclose first against collateral" is not subject to the limitations of *C.C.P. 726(a), 726(b), 580a, 580b, 580d*. (*C.C.P. 736(a)*; see *supra*, §§124 et seq., 178 et seq.)

C.C.P. 736 applies only to "environmental provisions contracted in conjunction with loans, extensions of credit, guaranties, or other obligations made, renewed, or modified on or after January 1, 1992." (*C.C.P. 736(e)*.) The statute does not "validate, invalidate, or otherwise affect in any manner the rights and obligations of the parties to, or the enforcement of, environmental provisions" contracted before that date. (*C.C.P. 736(e)*.)

(2) *Limits on Injunction.* An injunction for the enforcement of an environmental provision may not be issued after (a) the obligation secured by the real property security has been fully satisfied, or (b) all of the borrower's rights, title, and interest in the real property security has been transferred for fair value in a bona fide transaction to an unaffiliated third party. (*C.C.P. 736(a)*.)

(3) *Damages Recoverable.* The damages a secured lender may recover under *C.C.P. 736(a)* are limited to:

(a) Reimbursement for reasonable cleanup or remediation costs (whether or not acting in response to a federal, state, or local governmental agency order). (*C.C.P. 736(b)(1), (b)(2)*.)

(b) Indemnification against all liability to any third party relating to the breach of an environmental provision. (

C.C.P. 736(b)(3).)

(c) Attorneys' fees and costs incurred by the secured lender relating to the breach. (*C.C.P. 736(b)(4).*)

The damages cannot include principal or accrued interest on the secured obligation, "except for any amounts advanced by the secured lender to cure or mitigate the breach of the environmental provision that are added to the principal amount, and contractual interest thereon." Neither may the secured lender recover for costs relating to a release the secured lender knowingly permitted or caused. (*C.C.P. 736(b).*)

(4) *Limitation on Recovery.* A secured lender may not recover these damages against a borrower if all the following are true:

(a) The original principal amount of the secured obligation did not exceed \$ 200,000. (*C.C.P. 736(c)(1).*)

(b) In accepting the environmental provision, "the secured lender agreed in writing to accept the real property security on the basis of a completed environmental site assessment and other relevant information from the borrower." (*C.C.P. 736(c)(2).*)

(c) "The borrower did not permit, cause, or contribute to the release or threatened release." (*C.C.P. 736(c)(3).*)

(d) The deed of trust or mortgage "has not been discharged, reconveyed, or foreclosed upon." (*C.C.P. 736(c)(4).*)

(5) *Other Actions Not Affected.* *C.C.P. 736* does not "establish, abrogate, modify, limit, or otherwise affect" any cause of action, other than that provided by *C.C.P. 736(a)*, that a secured lender may have against a borrower under an environmental provision. (*C.C.P. 736(d).*)

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A. In General.

4 Witkin Sum. Cal. Law STRP § 212

[§ 212] In General.

The mortgage debtor has the judicially recognized equity of redemption (*infra*, §213), and a number of statutory protections (*infra*, §214 et seq.).

The Soldiers and Sailors Civil Relief Act adds an additional protection: a stay of proceedings against servicemen to enforce mortgages, trust deeds, or other security on real or personal property. (50 U.S.C., App. §532; see C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §2.17; 40 A.L.R.2d 1262 [Act as affecting foreclosure]; 53A Am.Jur.2d (1996 ed.), Military and Civil Defense §411 et seq.)

Members of the National Guard called to active state or federal service and reservists called to full-time active duty are protected by state law. (See *Mil. & Vet.C. 400* et seq.) The statute prohibits the sale, foreclosure, or seizure of property for nonpayment by these service members of obligations secured by a mortgage, deed of trust, or other security on property owned by the service member at the commencement of the military service. Violation of the statute is a misdemeanor. (*Mil. & Vet.C. 408.*)

West's Key Number Digest, Mortgages k.591

SUPPLEMENT: [This section is current through the latest supplement]
See 53A Am.Jur.2d (2006 ed.), *Military and Civil Defense* §352 et seq.

(New) Emergency foreclosure relief: In an effort to ameliorate the housing foreclosure crisis, the 2008 Legislature enacted statutes requiring lenders to communicate with defaulting borrowers prior to sending notice of default (C.C. 2923.5; Supp., *supra*, §145) and encouraging lenders to offer loan modification or workout plans (C.C. 2923.6). These statutes are subject to automatic repeal on January 1, 2013.



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B. Equity of Redemption.

4 *Witkin Sum. Cal. Law STRP* § 213

[§ 213] Equity of Redemption.

Special statutes provide for reinstatement of a loan after default (*infra*, §216 et seq.) and redemption of property after foreclosure (*infra*, §232 et seq.). These do not supersede the long established equitable doctrine that every person having an interest in property subject to a lien can redeem it at any time before foreclosure, by offering to perform the act and to pay for damage caused by delay. This rule applies to real and personal property, and the right may be exercised by encumbrancers junior to the first mortgagee, as well as by the debtor. (C.C. 2903 et seq.; see *Rest.3d, Property (Mortgages)* §3.1; 4 Powell §§37.30, 37.46; C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §§1.29, 2.55; 48 *U.C.L.A. L. Rev.* 1633 [Subrogation of Mortgages in California: A Comparison With the Restatement and Proposals for Change].)

No such right is recognized, however, where the object is fraudulent. In *Lee v. Joseph* (1968) 267 C.A.2d 30, 72 C.R. 471, plaintiff sought to redeem land subject to three prior deeds of trust, an attachment lien, and a judgment lien. But it appeared that W, the owner, had never actually loaned money to plaintiff, that plaintiff was not really a bona fide junior lienholder, and that the money he was tendering to redeem was really the owner's money. "It appears that the scheme was one intended to squeeze out intermediate junior lienholders." (267 C.A.2d 35.) Judgment for defendant, holder of the senior lien, was therefore affirmed. (On waiver of right to redemption, see *infra*, §236.)

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C. Accountings and Notices by Mortgagee.
1. In General.

4 Witkin Sum. Cal. Law STRP § 214

[§ 214] In General.

(1) *Payments on Interest and Principal.* A mortgagor may request an annual, itemized accounting of money received for interest and principal repayment, and the mortgagee must supply an accounting, without charge, within 60 days after the end of each calendar year. The mortgagee, however, may satisfy this requirement by giving a monthly statement or passbook that shows the required information. On request and payment of a small fee the mortgagor is entitled to additional similar accountings for one or more months. (C.C. 2954(b).)

(2) *Payments into Impound Account.* A mortgagor who makes payments into an impound or trust account for taxes, insurance, or other purposes (see *supra*, §80) may require an annual accounting of money received, held in, or disbursed from that account. Before any increase in the monthly rate of payment the mortgagee must provide a special accounting, a statement of the new rate, and an explanation of the factors necessitating the increase. (C.C. 2954(b).)

(3) *Special Charges.* Before a mortgagee may assess any default, delinquency or late payment charge and before the mortgagor becomes obligated to pay it, the mortgagor must either (a) be notified in writing and given at least 10 days to cure the deficiency, or (b) be informed "by a billing or notice sent for each payment due," of the date on which the charge will accrue. (C.C. 2954.5(a).) However, failure of the mortgagee to comply with this requirement does not affect any obligation of the mortgagor other than the obligation to pay a late payment charge. (C.C. 2954.5(e); see 2 *Pacific L. J.* 335.)

(4) *Automatic Accounting on Residential Loans.* A mortgagee of property containing only a one- to four-family residence must furnish the mortgagor with an annual accounting of payments on interest and principal, late charges, and the receipts, disbursements, credited interest, and balance of any impound account. The statement must be provided within 60 days of the end of the year *without charge and without request*, and must include a notification in 10-point type of the mortgagor's right to request additional accountings under C.C. 2954. (C.C. 2954.2; see 8 *Pacific L. J.* 205.)

(5) *Mortgage Guaranty Insurance.* If private mortgage insurance or mortgage guaranty insurance (*Ins.C. 12640.02(a)*) is required as a condition of a security transaction, the lender or person arranging the loan must provide the borrower with specified written information about canceling the insurance. (C.C. 2954.6; see 20 *Pacific L. J.* 702.) (On borrower's right to terminate future premium payments, see C.C. 2954.7, 2954.12; on insurer's duty to refund unused premium on cancellation, see C.C. 2954.65; 22 *Pacific L. J.* 675.)

(6) *General Status of Loan.* The mortgagor, junior lienors, or licensed escrowholder, as an "entitled person" (see C.C. 2943(a)(4)), may require preparation and delivery of a copy of the note; a beneficiary statement describing the amount of the unpaid balance, overdue installments, and other information on the status of the loan; and a payoff demand statement. The mortgagee must respond within 21 days after receipt of a written demand or after receipt of requested proof that the person demanding the statement is entitled to it. Demand for the beneficiary statement may be made at any time before or up to 2 months after recording a notice of default or up to 30 days prior to entry of a decree of foreclosure. (C.C. 2943(b); on effect of erroneous payoff statement, see *infra*, §215.)

Except for mortgages insured by the Federal Housing Administrator or guaranteed by the Administrator of Veterans Affairs, the statute provides that a beneficiary may charge a fee not to exceed \$ 30 for furnishing each required statement. (C.C. 2943(e)(6).) However, this portion of the statute is preempted by federal law. (*Lopez v. World Savings & Loan Assn.* (2003) 105 C.A.4th 729, 737, 130 C.R.2d 42.) If no payoff demand statement is issued pursuant to C.C. 2943, nothing in C.C. 2941 (see *supra*, §118) prohibits charging a reconveyance fee. (C.C. 2941.1.)

C.C. 2943 was construed and applied in *Black v. Sullivan* (1975) 48 C.A.3d 557, 122 C.R. 119. The requirements and penalties imposed on mortgagees and beneficiaries do not extend to assignees for security of the note and deed of trust. However, these assignees may be liable as coconspirators in an effort to deprive the borrower of the information necessary to discharge the loan. The exact total amount necessary to discharge the loan is a part of the information required by C.C. 2943. (48 C.A.3d 562.)

(7) *Penalties for Noncompliance.* Wilful or repeated violations of the requirements concerning annual accountings subjects the mortgagee to a fine of \$ 50 to \$ 200. (C.C. 2954(b).) A mortgagee also forfeits \$ 300 to an entitled person to whom he or she wilfully refuses to supply the requested beneficiary or payoff demand statements, and is additionally liable to that person "for all damages which he or she may sustain by reason of the refusal." (C.C. 2943(e)(4).)

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2. Erroneous Payoff Statement.

4 Witkin Sum. Cal. Law STRP § 215

[§ 215] Erroneous Payoff Statement.

In *Freedom Financial Thrift & Loan v. Golden Pac. Bank* (1993) 20 C.A.4th 1305, 25 C.R.2d 235, plaintiff lending institution accepted an assignment of equipment leases secured by real property in connection with a loan to lessee and its partners. Plaintiff later received a request for a payoff statement from a bank that had extended a debt consolidation loan to the lessee. Plaintiff sent the bank a payoff statement that erroneously understated the payoff amount. A bank representative noticed a discrepancy, but sent a check for the lesser amount, which plaintiff accepted. Plaintiff realized its error the next day and demanded the balance due on the loan, but received no response. Plaintiff filed suit against the bank and the lessee for the loan balance. The trial judge found that there was no privity of contract between plaintiff and the bank, and dismissed the bank from the action. *Held*, affirmed; C.C. 2943 does not permit actions against parties other than the obligor.

(a) C.C. 2943 governs the payoff of secured loans, and C.C. 2943(d)(3) sets forth a beneficiary's remedies in the event a mistake in a payoff demand statement results in an underpayment of the amount actually due on the note. The statute states that when a beneficiary, for whatever reason, understates the amount necessary to retire a loan in a payoff demand statement, the beneficiary may recover any sums still owing from the obligor as an unsecured debt. In this case the "obligor" would only be the lessee and its partners, because they were the only ones who executed the note and promised to repay the loan. (20 C.A.4th 1310, 1311.)

(b) The lessee argued that, because the statute provides a remedy against an obligor in the event of an erroneous payoff demand statement, the statute is remedial and should be liberally construed to include remedies against third parties. However, the statute does not create a new remedy or expand an old one; it represents a restricted version of existing common law, which permitted recovery under theories of unjust enrichment, mistake, or estoppel. The statute therefore is not remedial, and not subject to expansive interpretation. (20 C.A.4th 1314, 1316.) (See *Cathay Bank v. Fidelity Nat. Title Ins. Co.* (1996) 46 C.A.4th 266, 271, 53 C.R.2d 595 [where bank sent erroneous payoff statement to title company, title company could not be held liable for loss of bank's security for recording trust deed release following payoff; bank's loss occurred earlier, when, on payoff, unpaid amount became unsecured obligation; citing *Freedom Financial*].)

In *Ghirardo v. Antonioli* (1996) 14 C.4th 39, 57 C.R.2d 687, 924 P.2d 996, purchasers of real property subject to a purchase money deed of trust asked the seller to make a payoff demand for the amount that would fully satisfy the

obligation on the underlying note. The seller submitted a demand, the purchasers paid the sum demanded, and the deed of trust was reconveyed. When he realized he had mistakenly demanded an amount less than the full obligation, the seller contacted the purchasers, requesting that they pay the difference. The purchasers refused, and in the ensuing litigation, the seller cross-complained for the balance still allegedly due. The trial judge denied relief on the cross-complaint, finding that recovery was barred under the one form of action rule of *C.C.P.* 726 (see *supra*, §124). The Court of Appeal concluded that *C.C.P.* 726 was inapplicable because the seller was not seeking a true deficiency judgment; the governing statute was *C.C.* 2943, but that statute too barred recovery because, in the case of purchase money obligations, amounts excluded from the lender's payoff demand are not collectible. *Held*, reversed; the seller was entitled to relief.

(a) The seller cannot obtain a true deficiency judgment. To have done so, the seller would have had to proceed by judicial foreclosure, and if the foreclosure proceeds were insufficient, he could have sought a personal judgment from the purchasers, unless a deficiency judgment was otherwise prohibited by *C.C.P.* 580b. Because these were not the circumstances--there was no foreclosure--the one form of action rule bars a deficiency judgment. Even if it did not, *C.C.P.* 580b would do so, because the purchasers' note, although part of a complicated transaction involving other parties, amounted to a purchase money obligation. (14 *C.4th* 48, 49.)

(b) The Court of Appeal erred in concluding that *C.C.* 2943 was the governing statute. *C.C.* 2943(d)(3) had not been enacted at the time of the payoff and reconveyance at issue here. However, the common law concept of unjust enrichment, which *C.C.* 2943 incorporates, is applicable. Although there are strong economic policy reasons for protecting a purchase money mortgagor from a deficiency judgment, they do not justify precluding a mortgagee from recovering sums omitted, through a mistake of fact, from a payoff statement demand. The fact that an unjust enrichment recovery may not exceed the property's value ensures that the policy of requiring the mortgagee to rely on the property for security is respected. It also ensures that a mortgagee is not encouraged to try to obtain a deficiency judgment through trickery (i.e., by releasing its security after accepting payment on an understated payoff demand and then suing for unjust enrichment), because the mortgagee would have nothing to gain. (14 *C.4th* 50, 53; disapproving *Freedom Financial* to the extent it states, in dictum, that amounts excluded from payoff demand statement are not collectible under *C.C.* 2943 if debt is purchase money mortgage.)

(c) The purchasers pleaded numerous equitable defenses at trial, but, despite an opportunity to do so, they did not prove any of them. The seller is entitled to recover the amount he omitted by mistake from the payoff demand. (14 *C.4th* 54.) (Cf. *California Nat. Bank v. Havis* (2004) 120 *C.A.4th* 1122, 1134, 16 *C.R.3d* 245 [bank's letter to escrow agent stating that bank had "received payoff funds" in particular amount but also stating that no reconveyance could be recorded until 10 days after receipt of "payoff check" did not constitute payoff demand so as to extinguish bank's security interest in property].)

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D. Reinstatement of Loan After Default.
1. In General.

4 Witkin Sum. Cal. Law STRP § 216

[§ 216] In General.

Where a secured debt has become accelerated by default in the payment of interest, principal, taxes, assessments, insurance premiums, or advances, the mortgagor or trustor and all junior lienors have a special right to cure the default by payment of (1) the entire amount due (excluding accelerated principal) "at the time payment is tendered" that is shown in the notice of default, (2) "all amounts in default on recurring obligations not shown in the notice of default," (3) reasonable costs and expenses actually incurred in enforcing the obligation, and (4) trustees' or attorneys' fees. (C.C. 2924c(a)(1) [defining "recurring obligation" as including payments of principal and interest due or advanced after recordation of notice of default, and payments of taxes, assessments, and hazard insurance advanced after recordation of notice of default]; on costs and attorneys' fees, see *infra*, §218.) Amounts received by a lender when it enforces its interest under an agreement for assignment of rents must be credited by the lender against amounts needed to reinstate under C.C. 2924c. (C.C. 2938(e), *supra*, §100.)

On payment of all amounts due, the loan is *reinstated* and all proceedings are dismissed. (C.C. 2924c(a)(1).) The beneficiary or mortgagee, or his or her agent, must execute and deliver a notice to the trustee rescinding the declaration of default and demand for sale within 21 days following reinstatement. The trustee must then record the notice within 30 days of receipt. (C.C. 2924c(a)(2).)

The right to reinstatement under C.C. 2924c may not be waived in advance. (See C.C. 2953; C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §§2.34 et seq., 3.62; on inclusion of required notice of right to cure in notice of default, see *supra*, §147.)

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D. Reinstatement of Loan After Default.
2. Time Limits.

4 *Witkin Sum. Cal. Law STRP* § 217

[§ 217] Time Limits.

(1) *Judicial Foreclosure*. In cases of judicial foreclosure, payment to cure must be made "prior to entry of the decree of foreclosure." (C.C. 2924c(a)(1).)

(2) *Nonjudicial Foreclosure*. As to nonjudicial foreclosures, payment must be made "within the period commencing with the date of recordation of the notice of default until 5 *business days* prior to the date of sale set forth in the initial recorded notice of sale." The right to cure is revived if the sale is not held, a subsequent recorded notice of sale is required, or the sale is postponed for more than 5 business days. The revived right continues until 5 business days prior to the date of sale set forth in the subsequently recorded notice or declared at the postponement. There is no right to reinstatement during the 5 business days prior to the sale. (C.C. 2924c(e).) (See *Hicks v. E.T. Legg & Associates* (2001) 89 C.A.4th 496, 507, 108 C.R.2d 10 [expired reinstatement right is not revived by subsequent successive postponements of foreclosure sale for 5 or fewer days during period sale is precluded by injunction or bankruptcy stay].)

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4 Witkin Sum. Cal. Law STRP § 218

[§ 218] Costs and Attorneys' Fees.

The amount needed to cure a default includes, subject to limitations, reasonable costs and expenses actually incurred in enforcing the terms of the obligation, deed of trust or mortgage, and trustees' or attorneys' fees. (C.C. 2924c(a)(1).)

(1) Costs and expenses that may be charged are limited to the costs incurred for recording, mailing, publishing, and posting required notices, for postponements (not to exceed \$ 50 per postponement), and for the trustee's sale or litigation guarantee. (C.C. 2924c(c); see *Walker v. Countrywide Home Loans* (2002) 98 C.A.4th 1158, 1173, 121 C.R.2d 79 [C.C. 2924c does not prohibit charging monthly inspection fees to delinquent borrower before notice of default is recorded].)

(2) Trustees' and attorneys' fees are limited to a base amount of \$ 300 for an unpaid principal of \$ 150,000 or less, and \$ 250 on unpaid principal exceeding \$ 150,000, plus one-half of one percent of unpaid principal of \$ 50,000 to \$ 150,000, plus one-fourth of one percent of unpaid principal of \$ 150,001 to \$ 500,000, plus one-eighth of one percent of unpaid balance exceeding \$ 500,000. (C.C. 2924c(d).) These limitations apply to both judicial and nonjudicial foreclosures. (*Bruntz v. Alfaro* (1989) 212 C.A.3d 411, 419, 260 C.R. 488 [judicial foreclosure].) Authorized charges within the statutory limits are *conclusively presumed to be lawful and valid*. (C.C. 2924c(d).) (On trial judge's discretion to award lesser fee where amount required to cure is disputed, see *Sweatt v. Foreclosure Co.* (1985) 166 C.A.3d 273, 278, 212 C.R. 350.)

In *Buck v. Barb* (1983) 147 C.A.3d 920, 195 C.R. 461, the deed of trust expressly authorized the beneficiary to "protect the security," and in doing so to "employ counsel and pay his reasonable fees." It then required the trustor "to pay immediately and without demand all sums so expended" by the beneficiary. The court, quoting C.E.B., Real Estate Secured Transactions, said: "If the beneficiary has incurred additional attorney's fees for other services related to the deed of trust that are recoverable under the deed of trust, he may also be entitled to recover them from the trustor as a condition of reinstatement, if they are included in the notice of default." (147 C.A.3d 925.)

SUPPLEMENT: [This section is current through the latest supplement]



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D. Reinstatement of Loan After Default.
4. Payment or Tender.

4 *Witkin Sum. Cal. Law STRP* § 219

[§ 219] Payment or Tender.

In *Tomczak v. Ortega* (1966) 240 C.A.2d 902, 50 C.R. 20, compliance with C.C. 2924c was found where the payment was in the exact amount (\$ 7,680) stated by the trust deed beneficiary's attorney in court on a proceeding to enjoin the sale, even though a computation later showed it to be short by \$ 56.69. The mortgagee treated it as sufficient, accepted subsequent interest payments, and suffered no loss. (240 C.A.2d 906.)

Although the statute states that the debtor "may pay," the usual rule applies that a valid *tender* will be sufficient. Where the tender is improperly refused, it is not necessary to go further and complete payment by depositing the money in an account under C.C. 1500. (*Magnus v. Morrison* (1949) 93 C.A.2d 1, 2, 208 P.2d 407; see *Munger v. Moore* (1970) 11 C.A.3d 1, 8, 89 C.R. 323, supra, §168 [beneficiary was liable for wrongful sale after refusal of tender]; *Anderson v. Heart Fed. Savings & Loan Assn.* (1989) 208 C.A.3d 202, 215, 256 C.R. 180, supra, §146 [where amount of trustor's tender falls short due to beneficiary's failure to meet burden under C.C. 2924 and 2924c of informing trustor of amounts then due, tender is deemed sufficient]; C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §2.39.) (On equitable relief when tender is insufficient, see *Bisno v. Sax* (1959) 175 C.A.2d 714, 730, 346 P.2d 814, infra, §220.)

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E. Equitable Relief Against Forfeiture.
1. In General.

4 Witkin Sum. Cal. Law STRP § 220

[§ 220] In General.

C.C. 2924c provides a procedure for reinstatement of a loan, even though the entire debt has been accelerated, by payment of the currently overdue amounts and certain expenses, before entry of a foreclosure decree (see *supra*, §219). In *Bisno v. Sax* (1959) 175 C.A.2d 714, 346 P.2d 814, the tender was defective (\$ 1,173 instead of \$ 1,250), and did not comply with the statute. However, at the time of the trial of this action by plaintiff trustors for an injunction and declaratory relief, all defaults had been cured by payment or tender, except the accelerated entire debt. The trustee held a sale and K purchased. *Held*, judgment for defendants reversed.

(a) Apart from the statute, it is generally held that tender of the amount in default does not prevent completion of a pending foreclosure after the entire debt has been accelerated; hence, defendants were technically entitled to make the sale because of failure to tender the whole debt. (175 C.A.2d 724.)

(b) However, where strict enforcement of a legal right may involve a penalty or forfeiture, equitable relief may be granted (see 13 *Summary* (10th), *Equity*, §20.). California cases are in conflict on whether an acceleration clause in a mortgage or trust deed is a penalty or merely a provision on the due date of a debt. But there is authority supporting the view that it is a penalty which may be relieved, and such a provision in a land purchase contract is so regarded. (175 C.A.2d 725, 726.) Accordingly, the equitable doctrine should be applicable to a trust deed foreclosure. (175 C.A.2d 726.)

(c) The facts justifying equitable relief were present here. The property belonged to plaintiff wife, and was homesteaded. Plaintiff husband was bankrupt, plaintiff wife had no independent income, their attempt to refinance had failed, and the equity lost by foreclosure was \$ 23,000. "We conclude that the facts of the instant case warrant and require that appellants be relieved of the effect of the acceleration declared by the beneficiary and trustee, whether it be deemed a forfeiture or not; that basic equitable principles so demand. The trial judge should have granted such relief upon the facts before him." (175 C.A.2d 730.)

Although *Bisno* has been subsequently cited without disapproval (see *Carpenter v. Kilgour* (1965) 236 C.A.2d 651, 657, 46 C.R. 115, distinguishing it on facts), the decision can hardly be reconciled with language in *Smith v. Allen* (1968) 68 C.2d 93, 65 C.R. 153, 436 P.2d 65. The court held that, where the contract has been executed by conveyance of title, the rights of the parties are determined exclusively by the statutory provisions designed to protect the debtor

against forfeitures; and that the Legislature intended that "a properly conducted foreclosure sale should constitute a final adjudication of the rights of the borrower and the lender." (68 C.2d 96.) (See 13 *Summary* (10th), *Equity*, §20.)

SUPPLEMENT: [This section is current through the latest supplement]

See *Bank of America v. La Jolla Group II* (2005) 129 C.A.4th 706, 712, 28 C.R.3d 825, Supp., supra, §164 [following *Bisno v. Sax* (1959) 175 C.A.2d 714, 346 P.2d 814, text, p. 1038; C.C. 2924c did not invalidate cure of default that was made fewer than 5 days before sale where trustor and beneficiary mutually agreed to cure default and reinstate loan after statutory period].



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2. Effect of Minor Defaults.

4 *Witkin Sum. Cal. Law STRP* § 221

[§ 221] Effect of Minor Defaults.

In *Baypoint Mortg. Corp. v. Crest Premium Real Estate Inv. Retirement Trust* (1985) 168 C.A.3d 818, 214 C.R. 531, plaintiff, trustor under a number of all-inclusive deeds of trust, sought to enjoin a nonjudicial foreclosure commenced by defendant beneficiary. The underlying notes called for installment payments on the first of each month, and provided for a 10% late fee on any payment not received by the 10th day of the month. The deed of trust provided that failure to make the payments required by the notes was a default, and that acceptance of late payments was not a waiver of the beneficiary's right to require prompt payment thereafter. Plaintiff made payments between the 5th and 13th of each month and periodically defendant would send notices that late charges had been accrued. In November 1983, defendant sent plaintiff a certified letter stating that if payments were not received on the 1st of each month foreclosure proceedings would be commenced. On December 1 no payments were received, and on December 5 defendant recorded notices of default. Plaintiff mailed the December payments on December 6; defendant alleged they were not received until December 12; however, notwithstanding the foreclosure, defendant accepted the checks. The trial court granted a preliminary injunction prohibiting defendant from proceeding with the foreclosure. *Held*, affirmed.

(a) The trial court properly exercised its discretion when it balanced the hardships and concluded that plaintiff faced greater harm from denial of the injunction than defendant would from its issuance. Should defendant prevail at trial the worst that it will have suffered will have been some delay in foreclosure; the bond that plaintiff was required to post will secure defendant against additional or further losses; and defendant will be in a position at that time to recoup any late fees the court determines were actually owed. Plaintiff, on the other hand, stands to lose all of its trust deeds as well as being chargeable with the foreclosure expenses which may amount to \$ 15,000; his prayer for a permanent injunction against the foreclosure, if granted, would be useless because the trust deeds already would have been sold, and much of the other relief he seeks in the main action likewise would be rendered irrelevant. "Given the drastic implications of a foreclosure, it is not surprising to find courts quite frequently granting preliminary injunctions to forestall this remedy while the court considers a case testing whether it is justified under the facts and law." (168 C.A.3d 825, citing *Bisno v. Sax* (1959) 175 C.A.2d 714, 346 P.2d 814, *supra*, §220.)

(b) There is a reasonable probability that plaintiff's failure to make the December payments before the 5th when foreclosure was commenced will be found not to have been a default justifying foreclosure. The provision for a late fee if payment was not received by the 10th, should be construed "*to define what shall constitute timely performance*" of the notes' payment terms. (168 C.A.3d 827.) "We hold it negates a finding payment on the so-called 'due date' to be the

essence of these loans. Consequently, equity will not allow the drastic sanction of foreclosure to be used to enforce compliance with payment on the 'due date.' " (168 C.A.3d 827.)

(c) Even assuming that payment on the 1st day of the month was the essence of the loans, "it is reasonably probable under the circumstances ... that equity will not allow foreclosure to be used as a means of enforcing such precise compliance with this term of the loan." (168 C.A.3d 827.) Evidence at the trial will probably indicate that defendant persists in the foreclosure action to create a financial penalty to coerce future payments on the first day of the month. "[T]his constitutes a penalty analogous to an excessive late payment fee and therefore equity will not permit foreclosure for this purpose." (168 C.A.3d 829.)

(d) "One of the most important functions of the law is to maintain a proper balance between creditor and debtor. To this end, it attempts to match the creditor's remedy to the debtor's default. Major defaults justify drastic remedies; minor defaults only warrant lesser remedies. Thus, where the debtor is unable or unwilling to pay at all the creditor is entitled to recapture the security the debtor gave for the loan. By threatening this ultimate loss, the creditor often succeeds in pressuring the recalcitrant debtor into coming up with the money to pay the debt after all. If not, the creditor is at least made whole or as nearly whole as he can be by return of the property the debtor put up to secure the loan." (168 C.A.3d 831.) "To allow creditors to impose foreclosure--and its attendant expenses--whenever a debtor is a few days late in a monthly payment would open up thousands or perhaps millions of California homeowners and other debtors to an extraordinary additional financial burden. Moreover, the threat of such a severe penalty would place undue pressure on debtors thus destroying the important but delicate balance between creditors and debtors." (168 C.A.3d 832.)

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F. Protection Against Unfair Home Equity Purchase.
1. Nature and Purpose of Legislation.

4 *Witkin Sum. Cal. Law STRP* § 222

[§ 222] Nature and Purpose of Legislation.

(1) *In General.* The business of buying home equities during foreclosure is regulated by legislation first enacted in 1979. (See C.C. 1695 et seq.; C.E.B., 1 Mortgage and Deed of Trust Practice 3d, §2.6; C.E.B., Real Property Sales Transactions 3d, §5.55 et seq.; 29 *McGeorge L. Rev.* 469 [Consumer Protection Measures for Homeowners Strengthened]; 11 *Pacific L. J.* 584; 12 *Pacific L. J.* 537 [1980 amendments].) The statute includes protections for homeowners whose residences are in foreclosure from being subjected to fraud, deception, and unfair dealing by home equity purchasers. The intent and purposes of the statute include preserving home equities for homeowners; providing homeowners with information necessary to make informed and intelligent decisions regarding the sale of their homes to equity purchasers; prohibiting misleading representations and unfair contract terms; and affording homeowners with "a reasonable and meaningful opportunity to rescind sales to equity purchasers." (C.C. 1695.)

(2) *No Waiver of Rights.* Any waiver of the provisions of the statute is contrary to public policy and void. (C.C. 1695.10.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *In General.* See C.E.B., 1 Real Property Sales Transactions 4th, §6.107 et seq.



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4 Witkin Sum. Cal. Law STRP § 223

[§ 223] Definitions.

The following definitions apply to C.C. 1695 et seq.:

(1) *Residence in Foreclosure or Residential Real Property in Foreclosure.* A residence consisting of one to four family dwelling units, one of which the owner *occupies as his or her personal residence*, that is subject to an outstanding notice of default (see *supra*, §145). (C.C. 1695.1(b); see *In re Phelps* (2001) 93 C.A.4th 451, 455, 113 C.R.2d 217 [statute does not apply if owner does not occupy premises when transaction otherwise governed by statute occurs].)

(2) *Equity Seller.* A seller of a residence in foreclosure. (C.C. 1695.1(c).)

(3) *Equity Purchaser.* A person who acquires title to a residence in foreclosure, except one who acquires title (a) for use as a personal residence; (b) by a deed in lieu of foreclosure of a voluntary lien or encumbrance of record; (c) by a deed from a trustee acting under a power of sale in a deed of trust or mortgage; (d) at a sale authorized by statute; (e) by order or judgment of a court; or (f) from a spouse, blood relative, or blood relative of a spouse. (C.C. 1695.1(a).)

In *Segura v. McBride* (1992) 5 C.A.4th 1028, 7 C.R.2d 436, plaintiff, who had defaulted on a loan and was facing foreclosure, approached defendant for assistance in keeping his property. Defendant was a friend of plaintiff's and was not in the business of buying home equities. Plaintiff executed a grant deed conveying all his property to defendant, who then paid the arrearages to prevent foreclosure. Although both parties expected that defendant would transfer title back to plaintiff within a relatively short time, they disagreed on the conditions of the transfer and did not put their agreement in writing. Defendant charged plaintiff rent, which he fell behind on. Defendant then conveyed the property to relatives, who refused a tender by plaintiff to buy the property back, and later sold the property to other buyers. Plaintiff brought an action under C.C. 1695 et seq. and was awarded damages. Defendant appealed, claiming that the statutes did not apply to her. *Held*, affirmed as to liability; reversed as to measure of damages (see *infra*, §226).

(a) Under C.C. 1695 et seq., an "equity purchaser" includes all persons who purchase a residence subject to an outstanding notice of default, regardless of whether they routinely engage in these transactions, and regardless of whether the distressed buyer initiates the negotiations. There was no evidence of a legislative intent to exempt individuals such as defendant from regulation. (5 C.A.4th 1031, 1036.)

(b) Here, although defendant was not an unscrupulous person engaged in the business of buying home equities at a discount, she was nonetheless an "equity purchaser" because she acquired title to plaintiff's residence while it was in foreclosure. Plaintiff lost his home and his equity based on agreements that were never reduced to writing, the very situation the Act was intended to prevent. (5 C.A.4th 1038.) (See *Boquilon v. Beckwith* (1996) 49 C.A.4th 1697, 1712, 57 C.R.2d 503, *infra*, §226 [following *Segura*; defendant "violated the Act in precisely the same ways"].)

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3. Rights of Seller and Obligations of Purchaser.

4 Witkin Sum. Cal. Law STRP § 224

[§ 224] Rights of Seller and Obligations of Purchaser.

(1) *Contract Between Equity Purchaser and Equity Seller.* The contract must be provided by the equity purchaser (C.C. 1695.6(a)), and its form and content are specified (C.C. 1695.2, 1695.3, 1695.5). The significant requirements are a conspicuous statement of the right to cancel, with an attached form of notice of cancellation (C.C. 1695.5), and a notice that until the right to cancel has ended the equity purchaser cannot ask the equity seller to sign a deed or other document (C.C. 1695.3(h)). The purchaser must provide the seller with a copy of the agreement and notice of cancellation. (C.C. 1695.5(c).)

Any provision that attempts or purports to require arbitration of a dispute arising under C.C. 1695 et seq. "shall be void at the option of the equity seller only upon grounds as exist for the revocation of any contract." (C.C. 1695.16.)

(2) *Rights of Rescission and Cancellation.* The equity seller may cancel the contract until midnight of the 5th business day following the signing, or until 8 a.m. on the day scheduled for sale under a power of sale, whichever occurs first. (C.C. 1695.4(a).) And an equity seller may cancel the contract until the equity purchaser has complied with C.C. 1695.5, regarding the seller's right to cancel. (C.C. 1695.5(d).)

Cancellation need not be in any particular form. It occurs when the equity seller personally delivers written notice of cancellation, or sends a telegram indicating cancellation, to the address specified in the contract. (C.C. 1695.4(b), (c).) Within 10 days following receipt of the notice, the equity purchaser must return the original contract and any other documents signed by the equity seller. (C.C. 1695.6(c).)

(3) *False Representations by Purchaser.* "An equity purchaser shall make no untrue or misleading statements regarding the value of the residence in foreclosure, the amount of proceeds the equity seller will receive after a foreclosure sale, any contract term, the equity seller's rights or obligations incident to or arising out of the sale transaction, the nature of any document which the equity purchaser induces the equity seller to sign, or any other untrue or misleading statement concerning the sale of the residence in foreclosure to the equity purchaser." (C.C. 1695.6(d).)

(4) *Taking Unconscionable Advantage.* "It is unlawful for any person to initiate, enter into, negotiate, or consummate any transaction involving residential real property in foreclosure" if that person, by the terms of the transaction, "takes unconscionable advantage of the property owner in foreclosure." (C.C. 1695.13.)

(5) *Restrictions on Purchaser's Rights During Cancellation Period.* Until the expiration of the time within which the equity seller may cancel, the equity purchaser must not (a) accept or induce the execution of a conveyance of any interest in the residence; (b) record any document signed by the equity seller; (c) transfer or encumber any interest in the residence to a third party (but a grant to a bona fide purchaser or encumbrancer without notice of a violation of C.C. 1695 et seq. will not be defeated); or (d) pay the equity seller any consideration. (C.C. 1695.6(b).)

(6) *Seller's Reservation of Option To Repurchase.* When an equity seller grants the residence by a purported absolute conveyance with a reserved option to repurchase, (a) the equity purchaser must not encumber the property or grant an interest in it without the written consent of the equity seller (C.C. 1695.6(e)); and (b) the purported absolute conveyance will be deemed a mortgage (C.C. 1695.12).

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4. Purchaser's Representative.

4 Witkin Sum. Cal. Law STRP § 225

[§ 225] Purchaser's Representative.

(1) *Obligations of Representative.* A purchaser's representative is "deemed to be the agent or employee, or both the agent and the employee of the equity purchaser." (C.C. 1695.17(a).) "Representative" is defined as "a person who in any manner solicits, induces, or causes any property owner to transfer title or solicits any member of the property owner's family or household to induce or cause any property owner to transfer title to the residence in foreclosure to the equity purchaser." (C.C. 1695.15(b).) The representative must do both of the following: (a) provide the equity seller with written proof that the representative has a valid current California Real Estate Sales License and is duly bonded in an amount equal to twice the fair market value of the real property which is the subject of the contract (C.C. 1695.17(a)(1)); and (b) provide a written statement of compliance with C.C. 1695.17(a)(1) to all parties to the contract prior to any transfer (C.C. 1695.17(a)(2)).

A failure to comply with C.C. 1695.17(a) renders the contract void at the option of the equity seller. (C.C. 1695.17(b).)

(2) *Liability for Representations and Acts of Purchaser's Representative.* "An equity purchaser is liable for all damages resulting from any statement made or act committed by the equity purchaser's representative in any manner connected with the equity purchaser's acquisition of a residence in foreclosure, receipt of any consideration or property from or on behalf of the equity seller, or the performance of any act prohibited by" C.C. 1695 et seq. (C.C. 1695.15(a).)

(3) *Limitation of Liability Is Void.* Any provision of a contract entered into on or after January 1, 1991, that attempts or purports to limit the liability of the equity purchaser under C.C. 1695.15 is void. (C.C. 1695.16.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Obligations of Representative.* The requirement of C.C. 1695.17(a)(1), requiring proof that the representative is bonded in an amount equal to twice the fair market value of the real property that is the subject of the contract, is void for vagueness under the Due Process Clause and may not be enforced. However, this provision is severable, and the remainder of the Home Equity Sales Contract Act remains valid. (*Schweitzer v. Westminster Inv. (2007) 157 C.A.4th 1195, 1211, 69 C.R.3d 472* [bonding requirement provided no guidance on amount, obligee, beneficiaries, terms and conditions of bond, delivery and acceptance requirements, or enforcement mechanisms].)



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5. Penalties and Seller's Remedies.

4 *Witkin Sum. Cal. Law STRP* § 226

[§ 226] Penalties and Seller's Remedies.

(1) *Fine and Imprisonment.* Each violation of the statute requiring the equity purchaser to provide a proper contract and prohibiting various acts during the cancellation period (C.C. 1695.6; supra, §224), or any fraudulent practice directed against an equity seller, is punishable by (a) a fine of not more than \$ 25,000; (b) imprisonment in the county jail for not more than 1 year or in the state prison; or (c) by both that fine and imprisonment. (C.C. 1695.8.)

(2) *Damages and Fees.* Within 4 years after the date of the alleged violation, the equity seller may recover damages, attorneys' fees, and costs, or receive equitable relief, for a violation of C.C. 1695.6 (supra, §224) or the statute prohibiting unconscionable transactions (C.C. 1695.13, supra, §224). The equity seller may also be awarded exemplary damages in the court's discretion. If the violation is for transferring or encumbering an interest in the residence in foreclosure, or purporting to do so (C.C. 1695.6(b)(3), supra, §224), or for making an unconscionable contract (C.C. 1695.13), the court may award either exemplary damages of not less than three times the actual damages or a civil penalty up to \$ 2500. (C.C. 1695.7.)

The mandatory treble damages provision applies where an equity purchaser has given the required notices but, nevertheless, violates C.C. 1695.6(b)(3) by transferring or encumbering the property within the statutory cancellation period. It does not apply to an innocent and ignorant equity purchaser who, in violation of C.C. 1695.6(e), fails to provide a written contract or completely fulfill the other technical statutory requirements and then deals with the property as the new owner by encumbering or transferring any interest in it. (*Boquilon v. Beckwith* (1996) 49 C.A.4th 1697, 1713, 1728, 57 C.R.2d 503 [trial judge properly refused to award treble damages where defendant's violation fell "squarely" within C.C. 1695.6(e) (see supra, §224); strong dissent argues that C.C. 1695.6(e) and C.C. 1695.6(b)(3) overlap and there is no need for "judicial selection of one violation or the other"].) C.C. 1695.6(e) was amended in 1997 to specify that it does not preclude the application of C.C. 1695.6(b)(3).

An equity purchaser is also liable for damages resulting from his or her representative's statements and acts (C.C. 1695.15(a); see supra, §225), and for all damages proximately caused by the representative's failure to comply with C.C. 1695.17(a) (C.C. 1695.17(b); see supra, §225).

Damages based on a homeowner's lost equity should be assessed as of the date of the violation. If the equity seller seeks lost appreciation, proof of damages must include proof that the seller would have had a colorable chance of

holding onto the property in order to realize the appreciation. If the equity seller seeks damages for breach of his or her repurchase rights, those damages should be assessed at the time the equity purchaser transfers the property without obtaining the seller's written consent. (*Segura v. McBride* (1992) 5 C.A.4th 1028, 1038, 7 C.R.2d 436, supra, §223.)

(3) *Rescission*. An *unconscionable* transaction involving residential real property in foreclosure (see C.C. 1695.13, supra, §224) may be rescinded by the seller within 2 years of the date the conveyance of the property was recorded. (C.C. 1695.14(a).) Rescission is effected by giving written notice to the purchaser and his or her successor, and recording that notice; the purchaser and successor then have 20 days to reconvey, and if they fail to do so an action to enforce the rescission and for cancellation of the deed may be brought. (C.C. 1695.14(b).) The right to rescind does not affect the interest of a bona fide purchaser or encumbrancer for value, if the purchase or encumbrance occurred before the notice of rescission was recorded. (C.C. 1695.14(c).)

(4) *Other Remedies Preserved*. The statutory remedies and penalties are in addition to any others provided by law. (C.C. 1695.9, 1695.14(e).)

SUPPLEMENT: [This section is current through the latest supplement]



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G. Mortgage Foreclosure Consultants.
1. Nature and Purpose of Legislation.

4 *Witkin Sum. Cal. Law STRP* § 227

[§ 227] Nature and Purpose of Legislation.

(1) *In General.* As an integral part of the regulation of home equity sales contracts (*supra*, §222 et seq.), the 1979 Legislature adopted stringent rules to govern activities of mortgage foreclosure consultants. (C.C. 2945 et seq.; see 29 *McGeorge L. Rev.* 469 [Consumer Protection Measures for Homeowners Strengthened]; 11 *Pacific L. J.* 584; 12 *Pacific L. J.* 537.) The statutes include protections for homeowners whose residences are in foreclosure from being subjected "to fraud, deception, harassment, and unfair dealing by foreclosure consultants from the time a Notice of Default is recorded" under C.C. 2924 until the foreclosure sale. The statutes require foreclosure consultant service agreements to be expressed in writing, and permit rescission of foreclosure consultation contracts. (C.C. 2945.)

(2) *No Waiver of Rights.* Any waiver by an owner of the provisions of the statute is contrary to public policy and void; and any attempt by a foreclosure consultant to induce an owner to waive his or her rights is a violation of the statute. (C.C. 2945.5.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *In General.* Before undertaking any of the activities of a foreclosure consultant specified in C.C. 2945.1(a) (see text, §228), a person must register with the Department of Justice and obtain a certificate. The registration form must be accompanied by a copy of a \$ 100,000 surety bond in favor of the State of California. (C.C. 2945.45, enacted in 2008, effective July 1, 2009.)



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Witkin Summary of California Law
VIII. SPECIAL RIGHTS OF MORTGAGOR AND SUBORDINATE LIENORS
G. Mortgage Foreclosure Consultants.
2. Foreclosure Consultant.

4 Witkin Sum. Cal. Law STRP § 228

[§ 228] Foreclosure Consultant.

(1) *Definitions.* A foreclosure consultant is defined in C.C. 2945.1(a) as "any person who makes any solicitation, representation, or offer to any owner to perform for compensation or who, for compensation, performs any service which the person in any manner represents will in any manner do any of the following":

- (a) Stop or postpone the foreclosure sale.
- (b) Obtain forbearance from any beneficiary or mortgagee.
- (c) Assist the owner to exercise the right of reinstatement under C.C. 2924c (*supra*, §216 et seq.).
- (d) Obtain an extension of time to reinstate.
- (e) Obtain a waiver of an acceleration clause in a note, deed of trust, or mortgage on a residence in foreclosure.
- (f) Assist the owner to obtain a loan or advance of funds.
- (g) Avoid or ameliorate impairment of the owner's credit resulting from recording a notice of default or conducting a foreclosure sale.
- (h) Save the owner's residence from foreclosure.
- (i) Assist the owner in obtaining the remaining proceeds from the foreclosure sale from the beneficiary, mortgagee, trustee, or counsel. (C.C. 2945.1(a)(9).) Notwithstanding the exclusions in C.C. 2945.1(b), a person providing these services "is a foreclosure consultant unless he or she is the owner's attorney." (C.C. 2945.1(c).)

A "person" is defined as "any individual, partnership, corporation, limited liability company, association or other group, however organized." (C.C. 2945.1(d).)

(2) *Exclusions.* C.C. 2945.1(b) excludes the following persons from the definition of "foreclosure consultant":

- (a) Attorneys rendering legal services.

(b) Persons licensed under the Check Sellers, Bill Payers and Proraters Law (*Fin.C. 12000* et seq.) when acting as proraters as defined in *Fin.C. 12002.1* (those who for compensation receive money for the purpose of distributing it to creditors).

(c) Persons licensed under the Real Estate Law (*B. & P.C. 10000* et seq.) when making a direct loan (a loan of the broker's own funds secured by a deed of trust on the residence in foreclosure meeting specified conditions), or when those persons (1) perform licensed services, (2) are entitled to compensation for licensed services performed in connection with the sale of a residence in foreclosure or with arranging a loan secured by a lien on such a residence, (3) do not claim or receive compensation until the licensed services are performed or cannot, for specified reasons, be performed, and (4) acquire no interest in a residence in foreclosure directly from an owner for whom licensed services have been performed, other than an interest as a trustee or beneficiary under a deed of trust securing payment of a loan or such compensation. (See *Onofrio v. Rice* (1997) 55 C.A.4th 413, 418, 64 C.R.2d 74 [B. & P.C. 10131 et seq., governing real estate brokers, and C.C. 2945 et seq., governing foreclosure consultants, are not mutually exclusive].)

(d) Licensed accountants performing accounting services.

(e) Persons or their agents acting under the authority or approval of the Department of Housing and Urban Development or other agency of the United States or California.

(f) Persons who hold or are owed an obligation secured by a lien on a residence in foreclosure when performing services in connection with the obligation or lien.

(g) Persons licensed under the Personal Property Brokers Law (*Fin.C. 22000* et seq.), the Consumer Finance Lenders Law (*Fin.C. 24000*), or the Commercial Finance Lenders Law (*Fin.C. 26000* et seq.), subject to the authority of the Commissioner of Corporations to terminate this exclusion as to a licensee found to have engaged in the practices described in C.C. 2945(a) (supra, §227). (C.C. 2945.1(b)(7).) The 1994 Legislature repealed these Financial Code provisions and replaced them with the California Finance Lenders Law. (See *Fin.C. 22000* et seq.)

Fin.C. 22000 et seq. create a class of exempt persons under Cal. Const., Art. XV, §1 (usury exemption; see 1 *Summary* (10th), *Contracts*, §§457, 458). The statutes preserve existing exemptions under Cal. Const., Art. XV, §1 for lenders formerly regulated by the Personal Property Brokers Law, the Consumers Finance Lenders Law, and the Commercial Finance Lenders Law. These lenders remain exempt even if a particular provision of the statutes is found to be invalid with respect to a particular lender or class of lenders. (*Fin.C. 22002*.) (On consumer loans, see *Fin.C. 22200* et seq.; on commercial loans, see *Fin.C. 22500* et seq.; on license revocation and penalties, see *Fin.C. 22700* et seq.; on the Act generally, see 1 *Summary* (10th), *Contracts*, §462 et seq.)

(h) Persons or entities doing business under any California or federal law relating to banks, trust companies, savings and loan associations, industrial loan companies, pension trusts, credit unions, insurance companies; persons or entities authorized by California law to conduct a title or escrow business; mortgagees, and any subsidiaries or affiliates, approved by the Department of Housing and Urban Development; and agents or employees of the aforementioned persons or entities.

(i) Persons licensed as residential mortgage lenders and servicers.

SUPPLEMENT: [This section is current through the latest supplement]



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3. Rights of Owner and Obligations of Consultant.

4 Witkin Sum. Cal. Law STRP § 229

[§ 229] Rights of Owner and Obligations of Consultant.

(1) *Contracts Between Foreclosure Consultant and Owner.* The contract must be in writing. It must disclose the nature of services to be provided and the compensation to be paid. (C.C. 2945.3(a).) It must contain a statement of the right to cancel with an attached form of notice of cancellation (see C.C. 2945.3(e)), a notice that the foreclosure consultant cannot take money until he or she has done what he or she has promised, and a statement that the consultant may not ask the owner to sign a lien, deed of trust, or deed. (C.C. 2945.3(b).) The foreclosure consultant must provide the owner with a copy of the contract and the attached notice of cancellation. (C.C. 2945.3(f).)

After the 65-day period following the foreclosure sale, the consultant may contract with the owner to assist in arranging the release of surplus funds remaining after the sale. Prior to entering into the contract, the consultant must give the owner a statutory notice regarding the owner's right to recover the funds without paying fees to a third party. The consultant must obtain a receipt from the owner, signed before a notary, acknowledging a copy of the notice. (C.C. 2945.3(h).)

(2) *Cancellation.* In addition to any other right to rescind, the owner may cancel the contract until midnight of the third day following the signing. (C.C. 2945.2(a).) And the owner may cancel the contract until the foreclosure consultant has complied with C.C. 2945.3. (C.C. 2945.3(g).)

Cancellation occurs when the owner gives written notice at the address specified in the contract. If mailed, notice properly addressed with the postage prepaid is effective on mailing. The cancellation need not be in any specific form so long as it evidences the owner's intention not to be bound by the contract. (C.C. 2945.2(b), (c), (d).)

(3) *Prohibited Acts.* The foreclosure consultant must not (a) claim or receive compensation until he or she has fully performed all services pursuant to the contract or representation; (b) claim or receive a fee or other compensation in excess of 10% per annum of the amount of any loan made to the owner; (c) take a wage assignment or other security to secure payment of compensation (this security is void); (d) receive consideration from a third party for service rendered to an owner without full disclosure to the owner; (e) acquire an interest in a residence in foreclosure from an owner with whom he or she has a contract (this interest is voidable, except as against a bona fide purchaser or encumbrancer); (f) take a power of attorney from the owner except to inspect documents as provided by law; (g) induce or attempt to induce the owner to enter into a contract that does not comply with C.C. 2945.2 and 2945.3; (h) contract to assist the

owner in arranging release of surplus funds prior to 65 days after the trustee's sale. (C.C. 2945.4.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Contracts Between Foreclosure Consultant and Owner.* A foreclosure consulting contract subject to C.C. 2945 et seq. must be made available to clients in Spanish, Chinese, Tagalog, Vietnamese, or Korean by consultants who negotiate primarily in those languages. (C.C. 1632(b)(7), added in 2008, effective July 1, 2009.) Even if English is the language principally used by the foreclosure consultant in negotiating the contract, the consultant must notify the owner orally and in writing before the contract is signed that the owner has a right to a completed copy of the contract in one of the specified languages. (C.C. 2945.3(c), as amended in 2008, effective July 1, 2009.)

C.C. 2945.3(e) (notice of cancellation) and C.C. 2945.3(f) (copy of contract and notice of cancellation) were relettered C.C. 2945.3(f) and 2945.3(g), respectively, in 2008, effective July 1, 2009.

C.C. 2945.3(h), discussed in the text, was deleted in 2008, effective July 1, 2009.

(2) *Cancellation.* C.C. 2945.2(a), as amended in 2008, effective July 1, 2009, provides for cancellation until midnight of the *fifth* business day after signing. C.C. 2945.3(g) (right to cancel until compliance) was relettered C.C. 2945.3(h) in 2008, effective July 1, 2009.

Notice of cancellation given by fax or by electronic mail is effective when successfully transmitted. (C.C. 2945.2(c), as amended in 2008, effective July 1, 2009.) (3) *Prohibited Acts.* C.C. 2945.4(f), as amended in 2008, effective July 1, 2009, prohibits taking a power of attorney from the owner for any purpose. C.C. 2945.4(h), as amended in 2008, effective July 1, 2009, prohibits entering into an agreement to assist the owner in arranging the release of surplus funds *at any time* after the trustee's sale.



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4. Consultant's Representative.

4 Witkin Sum. Cal. Law STRP § 230

[§ 230] Consultant's Representative.

(1) *Definition.* A foreclosure consultant's "representative" is "a person who in any manner solicits, induces, or causes (1) any owner to contract with a foreclosure consultant, (2) any owner to pay any consideration or transfer title to the residence in foreclosure to the foreclosure consultant, or (3) any member of the owner's family or household to induce or cause any owner to pay any consideration or transfer title to the residence in foreclosure to the foreclosure consultant." (C.C. 2945.9(b).)

(2) *Obligations of Representative.* A representative is deemed to be the agent or employee, or both, of the foreclosure consultant. The representative must do both of the following: (a) provide the owner with written proof that the representative has a valid current California Real Estate Sales License and is duly bonded in an amount equal to twice the fair market value of the real property that is the subject of the contract (C.C. 2945.11(a)(1)); and (b) provide a written statement of compliance with C.C. 2945.11(a)(1) to all parties to the contract prior to any transfer (C.C. 2945.11(a)(2)). (C.C. 2945.11.)

(3) *Liability for Representative's Act.* A foreclosure consultant is liable for any statement or act of his or her representative that is connected with the foreclosure consultant's "performance, offer to perform, or contract to perform any of the services" described in C.C. 2945.1(a) (supra, §228), "receipt of any consideration or property from or on behalf of an owner," or performance of any prohibited acts (supra, §229). (C.C. 2945.9.)

(4) *Limitation of Liability Void.* An owner may declare the contract void because of any contract provision that "attempts or purports to limit the liability of the foreclosure consultant under" C.C. 2945.9. (C.C. 2945.10(a).) A failure to comply with C.C. 2945.11(a) also renders the contract void at the option of the owner. (C.C. 2945.11(b).)

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5. Penalties and Owner's Remedies.

4 *Witkin Sum. Cal. Law STRP* § 231

[§ 231] Penalties and Owner's Remedies.

(1) *Fine and Imprisonment.* A violation of C.C. 2945.4 (supra, §229) is a felony-misdemeanor punishable by a fine of not more than \$ 10,000, by imprisonment in the county jail for not more than 1 year or in the state prison, or by both fine and imprisonment, in addition to any other legal remedies or penalties. (C.C. 2945.7.)

A foreclosure consultant also is liable for damages resulting from a representative's statements and acts (C.C. 2945.9; see supra, §230), and for all damages proximately caused by the representative's failure to comply with C.C. 2945.11(a) (C.C. 2945.11(b); see supra, §230).

(2) *Damages and Fees.* In addition to any other remedies, an owner may bring an action against a foreclosure consultant within 4 years from the date of any alleged violation, and may recover a judgment for actual damages, reasonable attorney's fees, and costs. The owner may also be awarded exemplary damages in the court's discretion, and the court *must* award exemplary damages of at least three times the compensation received in violation of C.C. 2945.4(a), (b), or (d), and three times the owner's actual damages for any violation of C.C. 2945.4(c), (e), or (g) (supra, §229). (C.C. 2945.6; see *Onofrio v. Rice* (1997) 55 C.A.4th 413, 423, 64 C.R.2d 74 [applying C.C. 2945.4, 2945.6].)

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H. Statutory Right of Redemption.
1. Former Law.

4 *Witkin Sum. Cal. Law STRP* § 232

[§ 232] Former Law.

Under former C.C.P. 700a et seq., a judgment debtor, mortgagor, or trustor, or his or her successor in interest, or a *redemption* (any creditor with a lien on the property, including a junior encumbrancer), could redeem land sold under foreclosure or execution at any time within 12 months after the sale. The judgment debtor was entitled to notice of his or her redemption rights within 1 week after the sale. (See *Bateman v. Kellogg* (1922) 59 C.A. 464, 472, 211 P. 46; *Peterson v. Gilbert* (1927) 83 C.A. 542, 546, 257 P. 140 [sufficiency of tender].) There was no statutory right of redemption after a nonjudicial sale under a deed of trust. (See *Penryn Fruit Co. v. Sherman-Worrell Fruit Co.* (1904) 142 C. 643, 645, 76 P. 484; 3 Cal. L. Rev. 381; 26 Cal. L. Rev. 206, 215, 216.)

C.C.P. 700a et seq. were repealed in 1982, thereby eliminating the statutory right of redemption on *execution sales of real property*. (See 8 Cal. Proc. (4th), *Enforcement of Judgment*, §13.)

SUPPLEMENT: [This section is current through the latest supplement]
Cross-Reference: 8 Cal. Proc. (5th), *Enforcement of Judgment*, §20.



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4 *Witkin Sum. Cal. Law STRP* § 233

[§ 233] Scope and Manner of Exercise.

(1) *In General.* C.C.P. 729.010 et seq. authorize the right of redemption after *judicial* foreclosure (except for leasehold interests under 2 years); but the right exists only if the decree of foreclosure determines that a deficiency judgment may be ordered against the defendant (C.C.P. 729.010(a)), and it may be exercised only by the judgment debtor or his or her successor in interest, which does not include the purchaser at the foreclosure sale. (C.C.P. 729.020.) Thus, junior lienors are not entitled to redeem as under former law (see *supra*, §232). (See 66 Proof of Facts 3d 267 [sufficiency of manner and timeliness of redemption].)

(2) *Effect of Redemption.* Redemption has the effect of terminating the sale and restoring the judgment debtor or his or her successor in interest to the estate sold at the sale. (C.C.P. 729.080(d).) However, "[l]iens extinguished by the sale ... do not reattach to the property after redemption and the property that was subject to the extinguished lien may not be applied to the satisfaction of the claim or judgment under which the lien was created." (C.C.P. 729.080(e).)

Cases decided under the former statutes held that if the judgment debtor redeems after he or she *has transferred title to another*, title inures to the grantee. (*Huling v. Seccombe* (1928) 88 C.A. 238, 241, 263 P. 362; see *Call v. Thunderbird Mortg. Co.* (1962) 58 C.2d 542, 550, 25 C.R. 265, 375 P.2d 169 [redemption by mortgagor's transferee].)

(3) *Period of Redemption.* The period of redemption extends for 3 months if the sale proceeds are sufficient to satisfy the secured indebtedness with interest and costs, and for 12 months if the proceeds are insufficient for this purpose. (C.C.P. 729.030.)

Cases decided under the former statutes held that on a showing of fraud, mistake, or other grounds for equitable relief, the court may allow redemption even after the statutory period has expired. (*Webb v. Vercoe* (1927) 201 C. 754, 765, 258 P. 1099; see *Smith v. Schuler-Knox Co.* (1948) 85 C.A.2d 96, 102, 192 P.2d 34 [only on showing of fraud or mutual mistake].)

(4) *Notices.* Promptly after sale, the judgment debtor must be served personally or by mail with notice of the right of redemption. (C.C.P. 729.050.) The certificate of sale delivered to the purchaser must state that the property is subject to the right of redemption. (C.C.P. 729.040(b)(3).)

(5) *Redemption Price*. The redemption price, which must be deposited with the levying officer who conducted the sale, is the sum of (a) the purchase price at the sale; (b) the amount of assessments or taxes and reasonable amounts for fire insurance, maintenance, upkeep and repair; (c) the amount paid by the purchaser "on a prior obligation secured by the property to the extent that the payment was necessary" to protect the purchaser's interest; (d) interest on the preceding amounts from the time paid until the date of deposit; (e) if the purchaser has any subordinate liens on the property, the amount of the purchaser's lien, plus interest from the date of sale until the date of deposit. (*C.C.P.* 729.060(a), (b).) The judgment debtor or his or her successor in interest may offset from the redemption price the rents and profits paid to the purchaser or the value to the purchaser of the use and occupation of the property. (*C.C.P.* 729.060(c).) (On procedure for obtaining summary court determination of right or amount of redemption if there is dispute on either question, see *C.C.P.* 729.070; and see 37 *A.L.R.4th* 286 [sufficiency of defaulting vendee's redemption tender].)

West's Key Number Digest, Mortgages k.592 et seq.

SUPPLEMENT: [This section is current through the latest supplement]

(4) *Notices*. *C.C.P.* 729.040(b)(3) was relettered as *C.C.P.* 729.040(c)(3) in 2006.



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H. Statutory Right of Redemption.
3. Pro Tanto Redemption.

4 Witkin Sum. Cal. Law STRP § 234

[§ 234] Pro Tanto Redemption.

When there is more than one mortgagor, or more than one person claiming under a mortgagor, some of whom are not entitled to redeem, "any one of them who is entitled to maintain such an action may redeem therein a divided or undivided part of the mortgaged premises, according as his interest may appear and have an accounting, for a part of the rents and profits proportionate to his interest in the mortgaged premises, on payment of a part of the mortgage-money, bearing the same proportion to the whole of such money as the value of his divided or undivided interest in the premises bears to the whole of such premises." (*C.C.P. 347*; see *Diamond Benefits Life Ins. Co. v. Troll* (1998) 66 C.A.4th 1, 11, 77 C.R.2d 581 [*C.C.P. 347* was inapplicable to junior easement holder where there were no multiple parties claiming under mortgagor and most of easement rights impacted entire parcel].)

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4. Foreclosure Decree Denying Redemption.

4 Witkin Sum. Cal. Law STRP § 235

[§ 235] Foreclosure Decree Denying Redemption.

Even where the statutory right of redemption is applicable, under some circumstances, the equitable powers of a court will be sufficient to justify a sale without the right of redemption.

In *Title Ins. & Trust Co. v. California Dev. Co.* (1915) 171 C. 173, 152 P. 542, a deed of trust and a mortgage covered the real and personal property of a canal system. Each part was necessary for the whole, and dismemberment would have greatly impaired the usefulness and value of what was left. The court therefore decreed a sale of all the property, real and personal, without any right of redemption. It was held that the former redemption statute should not apply to cases involving the sale of the property of a railroad corporation, a water company, or an irrigation system. The test is not whether it is a public service company, but whether the system is so unified that a sale which is not absolute will lead to its destruction and to great resulting loss. (171 C. 202.) (See *Erich v. Dunkly* (1947) 79 C.A.2d 345, 348, 179 P.2d 638 [mortgage of trout farm, including leasehold, buildings, equipment, and trout; dismemberment would practically destroy value, and foreclosure without right of redemption was proper]; 4 Cal. L. Rev. 216.)

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I. Waiver or Sale of Right of Redemption.

4 *Witkin Sum. Cal. Law STRP* § 236

[§ 236] Waiver or Sale of Right of Redemption.

(1) *Contemporaneous Waiver Is Void.* It has long been a rule of equity that any provision in a mortgage or a separate but contemporaneous agreement that materially restricts the mortgagor's right to pay off the debt and thus redeem the property is void. The familiar example is a *strict foreclosure* clause, i.e., a provision that, on default on the due date, title passes to the mortgagee. (See *Rest., Security* §55 [same rule as to pledge].) The rule is stated as follows: "All contracts for the forfeiture of property subject to a lien, in satisfaction of the obligation secured thereby, and all contracts in restraint of the right of redemption from a lien, are void." (C.C. 2889; see *Hamud v. Hawthorne* (1959) 52 C.2d 78, 84, 338 P.2d 387 [contemporaneous quitclaim deed with escrow holder authorized to record on default].)

(2) *Validity of Subsequent Sale of Right.* The object of the foregoing rule is, of course, to protect the mortgagor from imposition at the time he or she is compelled to borrow the money. Once the mortgagor has obtained the loan under a valid arrangement that gives the mortgagor time to pay and time to redeem, he or she is free to deal with his or her property rights, and may agree to sell the right of redemption for an additional consideration. Even here, however, the mortgagor is protected by the rule that the agreement must be reasonable, and will be upheld only if, on close examination, no unfairness or oppression appears. (See *Phelan v. De Martin* (1890) 85 C. 365, 368, 24 P. 725; *Watson v. Edwards* (1894) 105 C. 70, 76, 38 P. 527; *Bradbury v. Davenport* (1896) 114 C. 593, 599, 600, 46 P. 1062; *Collette v. Sarrasin* (1924) 69 C.A. 114, 122, 230 P. 464; *Deming v. Smith* (1937) 19 C.A.2d 683, 689, 66 P.2d 454.)

(3) *Options Permitted.* The question whether a grant by a mortgagor to the mortgagee of an option to acquire an interest in the real property violates the rule against contemporaneous waiver of the right of redemption received a partial answer in C.C. 2906, enacted in 1984:

(a) *Nonresidential property.* Where the subject of the option is *not* residential property containing one to four units, neither the common law rule nor C.C. 2889 invalidates the option "if the right to exercise the option is not dependent upon the occurrence of a default" with respect to the mortgage.

(b) *Residential property.* As to residential property containing one to four units, *no inference* "as to the validity or application of common law" is to be drawn from the statute. (See 16 *Pacific L. J.* 714.)

SUPPLEMENT: [This section is current through the latest supplement]