

Wrongful Foreclosure Is Difficult to Prove

In the recent decision in *Citrus El Dorado, LLC v. Chicago Title Company*, the California Court of Appeal held that while a beneficiary (lender) or trustee (bank or title company) under a deed of trust who conducts an illegal, fraudulent or willfully oppressive sale of property may be liable to the trustor (borrower) for wrongful foreclosure, a trustee has no duty to verify that the beneficiary received a valid assignment of the loan or to verify the authority of the person who signed a substitution of trustee.

In the *Citrus El Dorado* case, a commercial developer lost a parcel of real property in a trustee's sale following a nonjudicial foreclosure. It sued Chicago Title Company because it acted as the trustee in conducting the sale.

The Appellate Court concluded that the trustee in such a sale is subject to tort liability only for the violation of duties established by the deed of trust and governing statutes, unless the trustee has effectively taken on a different or modified duty by its actions.

According to Citrus's complaint, it purchased the property—an unimproved 9.25-acre parcel in La Quinta, California—with the intention of developing it into a residential housing tract. Citrus entered into a Construction Loan Agreement with First Heritage Bank to fund the construction, and First Heritage was to disburse to Citrus a total of \$13,394,000 in a series of incremental draws as construction of the development progressed, a standard provision. The loan was secured by a deed of trust on the property.

After Citrus received some, but not all, of the loan funds, First Heritage failed and was placed into a Federal Deposit Insurance Corporation (FDIC) receivership. The FDIC funded several more draw requests by Citrus. Then the FDIC notified Citrus that the loan had been assigned to Stearns Bank (Stearns) and that disbursements to Citrus would be handled by Stearns. But when Citrus submitted a draw request to Stearns, it was denied, even though there was an unfunded balance of at least \$609,000 in the budgeted loan funds for Citrus.

Stearns then sent Citrus a Notice of Event of Default and Demand for Immediate Payment. The notice stated that payments required under the loan had not been made, constituting an immediate Event of Default with no rights to cure. The notice gave Citrus several weeks to remit the total payoff balance of over \$13 million, including a principal balance of approximately \$12.7 million.

Chicago Title recorded a Substitution of Trustee, substituting Chicago Title as the new trustee under the deed of trust. The Substitution identified FNBN Rescon I, LLC (Rescon) as the present Beneficiary of the deed of trust, and it was executed by Stearns as Rescon's exclusive servicing agent.

Chicago Title then recorded a Notice of Default and Election to Sell that stated there remained an unpaid principal balance on the loan of approximately \$12.7 million, with a total balance due of over \$20 million.

Then Chicago Title issued a Notice of Trustee's Sale, stating that the property would be sold at public auction on March 3, 2015. A Trustee's Deed Upon Sale was recorded on March 6, 2015, and it indicated the public auction took place on March 5, 2015, and that Rescon was the highest bidder with a credit bid of \$7.2 million.

Citrus sued Chicago Title for (1) wrongful foreclosure; (2) wrongful disseisin and ouster; and (3) conspiracy. Citrus's wrongful foreclosure cause of action (like its other two causes of action) arose from allegations that Chicago Title:

- (1) was negligent in failing to verify that Rescon received a valid assignment of the loan;
- (2) was negligent in failing to verify the authority of the person who signed the substitution of trustee form; and
- (3) conducted the trustee's sale improperly in various respects, including by selling the property by way of a private sale purportedly to Rescon, rather than by public auction as required by California Civil Code section 2924g, and by accepting a purported credit bid that in fact amounted to giving the property to Rescon "literally . . . for free."

The Court of Appeal rejected the first two contentions because Chicago Title had no duty to make the inquiries Citrus asserted it should have made. The third contention failed to state a claim because it was not adequately supported by the facts.

Wrongful foreclosure is a common law tort claim, and the elements of a cause of action are:

- (1) The trustee or mortgagee caused an illegal, fraudulent, or willfully oppressive sale of real property pursuant to a power of sale in a mortgage or deed of trust;
- (2) the party attacking the sale (usually but not always the trustor, who is the borrower or mortgagor) was prejudiced or harmed; and
- (3) in cases where the trustor or mortgagor challenges the sale, the trustor or mortgagor tendered the amount of the secured indebtedness or was excused from tendering.

The third element is the most difficult for the borrower to establish because it requires a sufficient amount of money the borrower normally does not have, and it is a standard defense argument by the lender that is often effective in having the case dismissed.

A beneficiary *or trustee* under a deed of trust who conducts an illegal, fraudulent or willfully oppressive sale of property may be liable to the borrower for wrongful foreclosure. Nevertheless, the trustee of a deed of trust is not a true trustee with fiduciary obligations, but acts merely as an agent for the borrower-trustor and lender-beneficiary.

The trustee's common agency for both the borrower and lender is a passive one, for the limited purpose of conducting a sale in the event of the borrower's default or reconveying the property upon satisfaction of the debt.

The rights and powers of trustees in nonjudicial foreclosure proceedings are strictly limited and defined by the contract of the parties and the statutes. The scope and nature of the trustee's duties are exclusively defined by the deed of trust and the governing statutes.

No other common law duties exist. The trustee's only duties are: (1) upon default to undertake the steps necessary to foreclose the deed of trust; or (2) upon satisfaction of the secured debt to reconvey the deed of trust.

The trustee generally has no duty to take any action except on the express instruction of the parties or as expressly provided in the deed of trust and the applicable statutes.

Applying these principles, the Appellate Court rejected Citrus's arguments that Chicago Title had a duty to verify that the beneficiary received a valid assignment of the loan or to verify the authority of the person who signed the substitution of trustee. Such an inquiry was beyond the scope of the trustee's duties as defined by the deed of trust and the applicable statutes, and there was no appropriate basis for imposing tort liability on Chicago Title for failing to take actions that were beyond the scope of its duties.

To successfully challenge a foreclosure sale based on a procedural irregularity, the plaintiff must show that there was a failure to comply with the procedural requirements for the foreclosure sale, *and* that the irregularity prejudiced the plaintiff.

Citrus alleged that the trustee's sale of the property was noticed for March 3, 2015, but the property was not sold until March 5, 2015. Citrus further alleged that the property was, according to the trustee's deed, sold to Rescon for a \$7.2 million credit bid.

But those facts, without more, did not support Citrus's assertions that Chicago Title failed to properly declare the date, time, and place for the sale; that the sale was made by private sale, rather than public auction; or that the purported credit bid was essentially a fraud and in fact Chicago Title literally gave the property away to Rescon for free.

Citrus needed facts showing that the postponement of the trustee's sale was not performed in accordance with statutory requirements. It presented no facts showing that the sale was not conducted as a public auction, and it presented no facts showing that the credit bid made by Rescon was fraudulent or in any other way improper.

Moreover, Citrus presented no facts demonstrating any prejudice flowing from the purported defects in the notice of default, or demonstrating that the defect impaired Citrus's ability to protect its interest in the property. Although Citrus complained it was never able to engage in any meaningful discussion with the lender concerning the notice of default, there were no facts that this failure to communicate was a result of any inaccuracies in the contact information in the notice of default.

Although Citrus alleged that the notice of default stated a wrongfully inflated redemption figure, Citrus did not establish that it intended at any point to exercise its redemption rights, regardless of the amount.

LESSONS:

1. Proving wrongful foreclosure is difficult because the foreclosing trustee is typically compliant with the statutory requirements.
2. The borrower must show that there was a failure to comply with the procedural requirements for the foreclosure sale, *and* that the irregularity prejudiced the plaintiff.
3. Facts demonstrating at most mere technical violations of the foreclosure process, do not give rise to a tort claim against the foreclosing trustee.