

The ABCs of California Foreclosure Law

THE REAL ESTATE MELTDOWN that began in late 2007 has resulted in an unprecedented number of loans in default and a substantial upsurge in foreclosures across the country. California continues to be one of the states hardest hit by the foreclosure crisis. Whether representing a borrower struggling to make its mortgage payments or a lender faced with a defaulted loan, it is essential for lawyers to have an understanding of the intricacies of California foreclosure law. The starting point for this understanding is the statutory framework for nonjudicial foreclosure as well as California's famous (or perhaps infamous) "one-action rule."

In California, a lender considering foreclosure may choose one of two avenues—judicial or nonjudicial foreclosure—although sometimes a lender elects to commence a judicial foreclosure and a nonjudicial foreclosure to preserve (for a time) both options. Judicial foreclosure, as the term suggests, begins with the lender filing a complaint against the borrower. As with most litigation, this process can be drawn out and expensive. Nonjudicial foreclosure, on the other hand, is relatively inexpensive and less time-consuming.

A critical distinction between judicial and nonjudicial foreclosure is the lender's ability to pursue the borrower for a deficiency judgment if the sale price is less than the full amount of the borrower's obligation. A deficiency judgment is an option only for lenders who choose judicial foreclosure.¹ For loans that are nonrecourse by statute² or that contain contractual nonrecourse clauses, it generally does not make sense for the lender to foreclose judicially, because the principal benefit of judicial foreclosure—the possibility of a deficiency judgment—is not available.

Nonjudicial Foreclosure

The remedy of nonjudicial foreclosure is found in a deed of trust. A deed of trust—the preferred instrument in California for securing a borrower's loan obligations with real property—almost always contains a "power of sale" clause that enables the trustee (typically a title insurance company) to sell the property to satisfy the borrower's obligations if a default occurs.³ Given the relative ease with which a nonjudicial foreclosure can be accomplished, most lenders opt for this approach.

The nonjudicial foreclosure rules are statutorily prescribed and require strict compliance. The rules endeavor to strike a balance among the varying interests of lenders, borrowers, other lien claimants, and trustees. Whereas lenders desire a speedy and inexpensive method of recovery, borrowers desire protection against wrongful loss of their property, junior lienholders want to protect their interests, and trustees simply need their responsibilities clearly delineated.

If any step in the foreclosure process violates the nonjudicial

foreclosure statute, the validity of the foreclosure sale may be challenged. The borrower may be able to enjoin the sale⁴ and recover damages from the lender.⁵

When a borrower defaults on an obligation secured by a deed of trust, the lender sometimes may prefer to restructure or "work out" a loan—for example, by reducing the interest rate and/or required periodic payments, or extending the maturity date. In other cases, the lender may decide that a workout is not realistic or in the lender's best interest. In such a case, the lender will elect to declare a default,⁶ which starts in motion the process for selling the property pursuant to the

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power-of-sale provision.⁷ The first step is for the lender to make a demand on the trustee to commence the foreclosure process.⁸

Notice of Default

One of the main components of the statutory scheme is the stringent notice requirements. Upon receipt of the lender's demand, the trustee initiates a nonjudicial foreclosure by recording a notice of default (NOD) in the county in which the property is located.⁹ The purpose of the NOD is to provide notice to the borrower, its successors, junior lienholders, and other interested persons—and notice to the world—that there has been a default.¹⁰ The NOD must identify the name of the borrower, include recording information for the deed of trust or the legal description of the property, specify the type of breach that has occurred and the specific dollar amount due, declare the lender's election to sell the property, and include the lender's contact information.¹¹

The NOD must also contain a statement notifying the borrower that the default can be cured by payment of the delinquencies within the prescribed reinstatement period.¹² However, if the note grants the lender the right to accelerate payment of the entire debt upon the borrower's default, the NOD does not need to articulate the lender's election to accelerate.¹³

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The trustee is required to mail a copy of the NOD to the borrower within 10 days of the recordation date and to all persons who have previously recorded a “request for special notice” of any default under the deed of trust. Within one month after recording the NOD, the trustee also must send a copy of the NOD to any successor of the borrower and any junior lienholders.¹⁴

Once the NOD is recorded, the foreclosure clock starts ticking. For the three months following recordation of the NOD, the borrower (and any successor), as well as any junior lienholder with a recorded lien, each has the opportunity to cure the default and “reinstate” the loan by paying all amounts in default and all reasonable costs and expenses incurred by the lender, including trustee’s and attorney’s fees, but excluding any portion of the principal that would not otherwise be due had the default not occurred. This exclusion allows the borrower to reinstate the loan without paying the entire debt. However, if the default resulted from the borrower’s failure to pay the entire principal balance at the maturity date, reinstatement is not possible.

The borrower, its successor, and any junior lienholder may exercise this reinstatement right beginning on the date of recordation of the NOD until five business days prior to the sale. If the default is cured, the borrower’s obligation is reinstated according to its original terms as if no default had occurred. Within 21 days following reinstatement, the lender must deliver to the trustee a notice of rescission of the NOD, which withdraws the declaration of default and demand for sale and advises the trustee of the reinstatement. The trustee must record the notice of rescission within 30 days after the trustee receives the notice and all fees and costs owing to the trustee.¹⁵

A minimum of three months must transpire after the NOD is recorded before the trustee may record a notice of sale (NOS).¹⁶ The NOS must specify the date, time, and location of the sale and include a description of the property and the deed of trust, the terms of the sale, the trustee’s contact information, the total amount of the unpaid balance of the obligation, and a reasonable estimate of costs incurred by the lender at the time of the initial publication of the NOS.¹⁷

At least 20 days prior to the sale, the trustee is required to record the NOS, mail the NOS to the borrower and all persons who requested special notice, post the NOS at the property itself and in one public place in the county in which the property is located—standard practice is to post the NOS at a courthouse—and publish the NOS in a newspaper of general circulation in the city in which the property is located. The NOS must be republished once a week for three

consecutive weeks.¹⁸

The sale can be postponed for a number of reasons at any point before a bid has been accepted on the day of the sale. The postponement period can last for up to one year from the date of the original sale, after which time a new NOS must be published, posted, mailed, and recorded. Reasons for postponement include 1) the borrower and lender mutually agree to postpone the sale, 2) the borrower files for bankruptcy protection, 3) a court enjoins the sale, 4) the lender decides unilaterally to postpone the sale, and 5) the trustee postpones the sale to protect the interests of either the borrower or lender.

If the sale is not postponed, it must take place at the location and time specified in the NOS and be open to the public.¹⁹ Any person, including the borrower and lender, may bid at the sale. The trustee will sell the property by auction to the highest bidder for cash, although the lender is entitled to “credit bid” up to the full amount of the indebtedness. The trustee has the right to require all prospective bidders to show evidence of funds prior to commencing the bidding (usually a cashier’s check in hand).²⁰ Upon completion of the sale, a trustee’s deed upon sale is recorded, transferring title to the successful bidder.

One-Action Rule

California’s one-action rule provides that there can be but one form of action for the recovery of any debt, or the enforcement of any right, secured by a mortgage upon real property.²¹ The word “one” in one-action rule is used qualitatively and not quantitatively and refers to the rule that the lender’s only option to recover a debt secured by a mortgage or deed of trust upon real property is to foreclose on the collateral securing the debt. It is crucial that a lender be advised of the requirements of the one-action rule, as certain conduct that does not on its face appear to constitute an “action,” such as a bank lender exercising a statutory right of offset against an account held by its borrower, may violate the rule.²²

The one-action rule has two elements. First, the lender must pursue foreclosure before taking any other action against the borrower for recovery of the debt.²³ Second, all the security must be exhausted before the lender sues the borrower directly on the debt.²⁴ However, since a deficiency judgment is unavailable in a nonjudicial foreclosure sale, the lender cannot pursue the borrower for a personal judgment if the sale proceeds from a trustee’s sale are not enough to satisfy the debt. In jurisdictions without such a rule, the borrower can be forced into the untenable position of simultaneously having to defend a personal action on the debt and a foreclo-

sure action on the real property.

The invocation of the one-action rule is at the borrower's option. When a lender initiates proceedings to collect a personal judgment against the borrower, the borrower can raise the one-action rule as a defense and compel the lender to foreclose and apply the sale proceeds to satisfy the debt.²⁵ In the alternative, the borrower can elect not to assert the defense, in which case the lender that has not foreclosed is deemed to have made an election of remedies. The lender can recover a personal judgment against the borrower—but at the price of losing its lien and therefore its right to foreclose on the real property.²⁶

The one-action rule is widely misunderstood. Moreover, a violation of the rule can result in devastating consequences for the lender. Before commencing a foreclosure—whether judicially or nonjudicially—a number of strategic considerations must be evaluated. Foreclosure can be a byzantine process for lenders and borrowers. It is the role of real estate counsel to provide guidance and demystify the complexities of California foreclosure law. ■

¹ CODE CIV. PROC. §580d. Note that §580d would not necessarily preclude an action against a guarantor of the loan for any deficiency if the guaranty contained properly drafted waivers.

² See *id.*

³ CIV. CODE §§2932-2933.

⁴ *Stockton v. Newman*, 148 Cal. App. 2d 558, 564 (1957).

⁵ *Meadows v. Bakersfield Sav. & Loan Ass'n*, 250 Cal. App. 2d 749, 755 (1967).

⁶ Prior to declaring a default, a lender should review the loan documents to confirm that all required notices have been properly given and that any cure periods have expired.

⁷ Note, however, that if the default is nonmonetary, foreclosure may not be an option unless the default consists of a material breach of a material covenant.

⁸ *Jones v. Sierra Verdugo Water Co.*, 63 Cal. App. 254, 262 (1923).

⁹ CIV. CODE §2924(a)(1).

¹⁰ See, e.g., *Little v. Harbor Pac. Mortgage Investors No. 79B*, 175 Cal. App. 3d 717, 720 (1985).

¹¹ CIV. CODE §§2924(a)(1), 2924c(b)(1).

¹² CIV. CODE §2924c(b)(1).

¹³ See, e.g., *Williams v. Koenig*, 219 Cal. 656, 659-60 (1934).

¹⁴ CIV. CODE §2924b.

¹⁵ CIV. CODE §2924c.

¹⁶ CIV. CODE §2924(a)(2)-(3).

¹⁷ CIV. CODE §2924f(b)(1).

¹⁸ CIV. CODE §§2924b(b)(2)-(3), 2924f(b)(1).

¹⁹ CIV. CODE §2924g.

²⁰ CIV. CODE §2924h(b).

²¹ CODE CIV. PROC. §726(a).

²² *Security Pac. Nat'l Bank v. Wozab*, 51 Cal. 3d 991, 1001-02 (1990).

²³ See, e.g., *Roseleaf Corp. v. Chierighino*, 59 Cal. 2d 35, 43-44 (1963).

²⁴ CODE CIV. PROC. §726.

²⁵ See, e.g., *Walker v. Community Bank*, 10 Cal. 3d 729, 734 (1974).

²⁶ See, e.g., *Wozab*, 51 Cal. 3d at 1004-05.

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