BORROWERS' DEFENSES TO FORECLOSURE©

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This outline covers mainly Washington law, but an effort has been made to include information that will be useful in most foreclosure contexts. Bankruptcy and tax issues pervade foreclosures, but are beyond the scope of this article. The focus is upon residential foreclosures as opposed to commercial foreclosures although there is substantial overlap.

TABLE OF CONTENTS

BORROWER'S DEFENSES TO FORECLOSURES
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I. GENERAL CONSIDERATIONS

A. WHETHER TO REINSTATE, DEFEND OR GIVE-UP

By far the most important decision that must be initially made is whether the property is worth saving. This is often ignored and wasted effort is expended when there is no "equity" (realistic fair market value minus all debt, liens, property taxes, anticipated foreclosure costs, late fees, and selling costs) in the property.

The options are as follows:

1. Reinstatement. Pay the costs and late charges and stop the process. In most non-judicial foreclosures this is permitted up until the date of sale. In Washington the lender must allow reinstatement 10 days prior to the sale date. See RCW 61.24. Often a lender or relative will loan necessary funds and take a subordinate lien on the property to do so. The makes sense only if the new payments are within the means of the debtor.

2. Sell the Property. If there is equity, but no ability to reinstate, then immediately list and sell the property to recoup equity.

3. Obtain Foreclosure Relief. Most government insured loans (if, VA, FHA) have programs allowing (or requiring) lenders to assist defaulting borrowers. See discussion under §V infra. Check into these options immediately.

4. Give Up. This is actually an option as most state laws permit the debtor to remain in possession during the foreclosure process and redemption period rent-free. Most laws, especially in

non-judicial foreclosure states - do not allow (or at least limit) deficiencies. Debtors contemplating bankruptcy should take advantage of homestead rights and redemption rights. If there is no equity or negative equity and no ability to make payments, there is no economic reason to try to avoid foreclosure.

5. Defend the Foreclosure. After all of the above have been considered, defense of the foreclosure may be warranted. This outline discusses some defenses that may result in re-instatement of the mortgage or recovery of equity.

B. OFFENSIVE STRATEGY

In addition to defenses that may be raised, there may be affirmative claims that can be brought against the lender which should be immediately determined and raised in a counterclaim or set-off or, in the case of non-judicial foreclosure, brought by separate suit and coupled with an injunction against continuing the non-judicial foreclosure. These claims can also be brought in bankruptcy. See, e.g. In re Perkins, 106 BR 863 (1989).

A few examples of affirmative claims:

1. Truth-in-Lending Act Violations. Often lenders will hand the debtor a claim, which can turn a debt into an asset. If the Truth-in-Lending disclosure statement is less than one year old, there may be damage claims for improper disclosure. See, 15 U.S.C. 1635. More importantly, there may be a right of rescission, which can be exercised up to three years after the closing resulting in a tremendous advantage to the borrower. See, e.g., Beach v. Ocwen Fed Bank, 118 S. Ct. 1408 (1998).

2. Usury. If a state usury law applies (usually on seller financed real estate), this can

parlay a debt into an asset. Federal pre-emption generally prevents this, but there are exceptions. See, RCW 19.52.

3. Mortgage Broker Liability, Lender Liability, Unfair or Deceptive Acts or Practices. Numerous claims that arise in the mortgage financing context give rise to set-offs that can allow negotiation out of the foreclosure. See e.g. Mason v. Mortgage America, 114 Wn. 2d 842 (1990). Intentional breach of contract gives rise to emotional stress damages. See, Cooperstein v. Van Natter, 26 Wn. App. 91 (1980); Theis v. Federal Finance Co., 4 Wn. App. 146 (1971).

Under a new federal statute to regulate high interest, predatory loans, Congress enacted in 1994 the Home Ownership and Equity Protection Act (effective on loans after October 1, 1995). This amendment to the Truth-In-Lending Act requires greater disclosures in loans where a number of factors exist such as, points exceeding 8% and other excessive costs. Penalties include enhanced damages and rescission. See 15 U.S.C. 1602(u) and 15 U.S.C. 1640(a).

The Mortgage Broker Practices Act, RCW 31.04 and the Consumer Protection Act also have enhanced damages and attorney fees.

II. DEFENDING NONJUDICIAL DEED OF TRUST FORECLOSURES

A. INTRODUCTION

The deed of trust is currently one of the most common devices for securing conventional and government insured or guaranteed real estate loans. The deed of trust may be typically foreclosed either judicially as a mortgage or non-judicially. Set forth below are the jurisdictional variations in

security agreements and the most common foreclosure procedures[1]. Nonjudicial foreclosure is

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Jurisdiction	Customary Security Agreement	Customary Foreclosure Procedure
Alabama	Mortgage	Nonjudicial
Alaska	Deed of Trust	Nonjudicial
Arizona	Deed of Trust	Nonjudicial
Arkansas	Mortgage	Judicial
California	Deed of Trust	Nonjudicial
Colorado	Deed of Trust (Semi-judicial)	Public Trustee's Sale
Connecticut	Mortgage	Judicial-Strict Foreclosure
Delaware	Mortgage	Judicial
Dis. of Col.	Deed of Trust	Nonjudicial
Florida	Mortgage	Judicial
Georgia	Security Deed	Nonjudicial
Hawaii	Mortgage	Judicial
Idaho	Mortgage	Judicial & Nonjudicial
Illinois	Mtg. & D.T.	Judicial
Indiana	Mortgage	Judicial
Iowa	Mortgage	Judicial
Kansas	Mortgage	Judicial
Kentucky	Mortgage	Judicial
Louisiana	Mortgage	Judicial
Maine	Mortgage	Judicial (Nonjudicial for Corporate Borrower)
Maryland	Deed of Trust	Nonjudicial
Massachusetts	Mortgage	Nonjudicial
Michigan	Mortgage	Nonjudicial
Minnesota	Mortgage	Nonjudicial
Mississippi	Deed of Trust	Nonjudicial
Missouri	Deed of Trust	Nonjudicial
Montana	Instlmnt. Contract	Nonjudicial
Nebraska	Deed of Trust Mortgage	Judicial & Nonjudicial
Nevada	Deed of Trust	Nonjudicial
New Hampshire	Mortgage	Nonjudicial
New Jersey	Mortgage	Judicial
New Mexico	Mortgage	Judicial
New York	Mortgage	Judicial
North Carolina	Deed of Trust	Judicial
North Dakota	Mortgage	Judicial
Ohio	Mortgage	Judicial
Oklahoma	Mortgage	Judicial
Oregon	Deed of Trust	Nonjudicial
Pennsylvania	Mortgage	Judicial
Puerto Rico	Mortgage	Judicial
Rhode Island	Mortgage	Nonjudicial
South Carolina	Mortgage	Judicial
South Dakota	Mortgage	Judicial & Nonjudicial
Tennessee	Deed of Trust	Nonjudicial
Texas	Deed of Trust	Nonjudicial

allowed in approximately one-half of the states. Also listed are the states that permit nonjudicial foreclosure and their relevant statutes[2]. With nonjudicial foreclosure, it is not necessary to utilize the

Utah	Deed of Trust	Nonjudicial
Vermont	Mortgage	Strict Foreclosure
Virgin Islands	Mortgage	Judicial
Virginia	Deed of Trust	Nonjudicial
Washington	Deed of Trust	Nonjudicial
West Virginia	Deed of Trust	Nonjudicial
Wisconsin	Mortgage	Judicial
Wyoming	Mtg. & Installment Contracts	Judicial

2 *ALABAMA*: ALA. CODE §§35-10-1 TO 35-10-10; [FORECLOSURE AFTER 12/1988 §§35-10-11 TO 35-10-16] (1991).
Alaska: Alaska Stat. §§34.20.090 to 34.20.100 (1991).
Arizona: Ariz. Rev. Stat. Ann. §§33-807 to 33-814 (West 1991).
Arkansas: Ark. Code Ann. §§18-50-108; 18-50-116 (1987).
California: Cal. Civ. Code §§2924 to 2924(h) West 1992).
D.C.: D.C. Code Ann. §§45-715 to 45-718 (1991).
Georgia: Ga. Code Ann. §§9-13-141; 44-14-162.4; 44-14-48; 44-14-180 to 187 (Harrison 1991).
Idaho: Idaho Code §§6-101; 104; 45-1502 to 45-1506 (1991).
Iowa: Iowa Code Ann. §654.18 (West 1992).
Maine: Me. Rev. Stat. Ann. tit. 14, §§7-105; 7-202 (1988).
Massachusetts: Mass. Gen. Laws Ann. ch. 183, §§19, 21; ch. 244, §§11-15 (West 1992).
Michigan: Mich. Comp. Laws Ann. §§451-401 et seq.; 600.2431; 600.3201 et seq.; 600.3170 (West 1992).
Minnesota: Minn. Stat. Ann. §§580.01 to 580.30; 582.01 et seq. (West 1992).
Mississippi: Miss. Code Ann. §§11-5-111; 15-1-23; 89-1-55 (1972).
Missouri: Mo. Ann. Stat. §§442.290to 443.325 (Vernon 1992).
Montana: Mont. Code Ann. §§25-13-802; 71-1-111; 71-1-223 to 232, 71-1-311 to 317 (1991).
Nebraska: Neb. Rev. Stat. §§76-1001 to 1018 (1981).
Nevada: Nev. Rev. Stat. §§107.020; 107.025; 107.080 to 107.100; 40.050; 40.453 (Michie 1991).
New Hampshire: N.H. Rev. Stat. Ann. §§479:22 to 479:27 (1991).
New York: N.Y. Real Prop. Acts §§1401 to 1461 (McKinney 1992).
North Dakota: N.D. Cent. Code §35-22-01 (1992).
Oklahoma: Okla. Stat. Ann. tit. 46, §§40 to 49 (West 1992).
Oregon: Or. Rev. Stat. §§86.705 to 86.795 (1989).
Rhode Island: R.I. Gen. Laws §§34-11-22; 34-20-4; 34-23-3; 34-27-1 (1984).
South Dakota: S.D. Codified Laws Ann. §§21-48-1 to 21-48-26; 21-48A-1 to 21-48A-5 (1992).
Tennessee: Tenn. Code Ann. §§35-5-101 to 35-5-112 (1991). See, Note, *Power of Sale Foreclosures in Tennessee*, 8 Mem. St. U.L. Rev. 871 (1978).
Texas: Tex. Prop. Code Ann. §§51-002; 51.003; 51.005 (West 1992).
Utah: Utah Code Ann. §§57-1-23 to 57-1-34 (1986).
Vermont: Vt. Stat. Ann. tit. 12, §§4531a to 4533 (1991).
Virginia: Va. Code Ann. §§55-59.1 to 55-59.4; 55-61 to 55-66.7 (Michie 1991).
Washington: Wash. Rev. Code Ann. §§61.24.010 to 61.24.130 (West 1992).

court for the foreclosure sale unless a deficiency judgment is sought. Nonjudicial foreclosure is often the preferred method of foreclosure because it is more efficient than judicial foreclosure and quicker. The nonjudicial foreclosure procedure has been found constitutional between private parties on the basis that there is no state action[3], but there is a serious question as to whether the government can direct a lender to use a nonjudicial procedure[4].

B. PROCEDURE FOR RESTRAINING TRUSTEE'S SALE

Anyone having an interest in the real property security, including the borrower, may restrain the non-judicial foreclosure of a deed of trust on any proper ground[5]. Proper grounds for enjoining a trustee's sale include: (1) there is no default on the obligation, Salot v. Wershow, 157 CA.2d 352, 320 P.2d 926 (1958), (2) the deed of trust has been reinstated, (3) the notice of default, notice of

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West Virginia: W. Va. Code §§38-1-3 to 38-1-12 (1991).
Wyoming: Wyo. Stat. §§34-4-101 to 34-4-113 (1991).

3 See Charmicor, Inc. v. Deaner, 572 F.2d 694 (9th Cir.1978); Northrip v. Federal National Mortgage Association, 527 F.2d 23 (6th Cir.1975); Barrera v. Security Building & Investment Corp., 519 F.2d 1166 (5th Cir. 1975); Bryant v. Jefferson Federal Savings & Loan Association, 509 F.2d 511 (D.C. Cir.1974); Lawson v. Smith, 402 F.Supp. 851 (N.D.Cal.1975); Global Industries, Inc. v. Harris, 376 F.Supp. 1379 (N.D.Ga.1974); Homestead Savings v. Darmiento, 230 Cal.App.3d 424, 281 Cal.Rptr. 367 (1991); Leininger v. Merchants & Farmers Bank, macon, 481 So.2d 1086 (Miss.1986); Wright v. Associates Financial Services Co. of Oregon, Inc., 59 Or.App.688, 651 P.2d 945 (1983), certiorari denied 464 U.S. 834, 104 S.Ct. 117, 78 L.Ed.2d 116 (1983); Kennebec Inc. v. Bank of the West, 88 Wash.2d 718, 565 P.2d 812 (1977); Dennison v. Jack, 172 W.Va. 147, 304 S.E.2d 300 (1983).

4 Island Financial, Inc. v. Ballman, 92 Md.App. 125, 607 A.2d 76 (1992); Turner v. Blackburn, 389 F.Supp. 1250 (W.D.N.C.1975); Vail v. Derwinski, 946 F.2d 589 (8th Cir.1991), amended by 956 F.2d 812 (8th Cir.1992) and Boley v. Brown, 10 F.3d 218 (4th Cir.1993) which held that the VA's control over the foreclosure process in VA guaranteed loan foreclosures constitutes sufficient governmental action to trigger due process protections. Accord, U.S. v. Whitney, 602 F. Supp. 722 (W.D. N.Y. 1985); U.S. v. Murdoch, 627 F. Supp. 272 (N.D. Ind. 1986). See Also Leen, Galbraith & Gant, Due Process and Deeds of Trust - Strange Bedfellows, 48 Wash.L.Rev. 763 (1973).

5 See, e.g., Reiserer v. Foothill Thrift and Loan, 208 Cal.App.3d 1082, 256 Cal.Rptr. 508 (1989) (unpublished opinion); Metropolitan Life Insurance Company v. La Mansion Hotels & Resorts, Ltd., 762 S.W.2d 646 (Tex.App.1988); Bekins Bar V Ranch v. Huth, 664 P.2d 455 (Utah 1983); National Life Insurance Co. v. Cady, 227 Ga. 475, 181 S.E.2d 382 (1971); Peoples National Bank v. Ostrander, 6 Wn.App. 28, 491 P.2d 1058 (1971). See, generally, note, Court Actions Contesting The Nonjudicial Foreclosure of Deeds of Trust in Washington, 59 Wash.L.Rev. 323 (1984); Restraining Orders in Non-Judicial Deed of Trust Foreclosures,

sale, or proposed conduct of the sale is defective, Crummer v. Whitehead, 230 CA.2d 264, 40 CR 826 (1964), (4) the lender has waived the right to foreclose, (5) a workout/settlement has been agreed to, (6) equitable reasons that would entitle a debtor to close a sale of the property or complete a refinance, (7) to enforce government relief programs, and trustee misconduct. Finally, there may be defenses to the debt (i.e. usury, truth in lending violations, misrepresentation of the seller, breach of warranty by the seller, etc.) or set-offs, which substantially reduce the debt.

1. Time for Filing Action

The action can presumably be filed any time before the scheduled trustee's sale, but the sooner the better. Under Washington law, if one seeks to restrain the sale, five days notice must be given to the trustee and the beneficiary. See the Revised Code of Washington (hereinafter "RCW") 61.24.130(2); Note, supra, footnote 4. A trustor in California has at least one hundred and ten days (after the recording of the notice of default) to seek to enjoin the sale. In California, fifteen days are required for noticing a motion for a preliminary injunction. See CCP section 1005.

2. Effect of Lis Pendens

Filing a lis pendens at the time the lawsuit is commenced constitutes constructive notice to purchasers and others dealing with the property of the claims and defenses asserted by the plaintiff[6]. Even if the plaintiff does not seek an order restraining the trustee's sale or a restraining order is denied, purchasers at the sale acquire the property subject to the pending litigation[7].

Property Law Reporter, June 1987 (Vol. 3 Nos. 4 & 5).

6 Putnam Sand & Gravel Co. v. Albers, 14 CA3d 722, 92 CR 636 (1971).

7 Avco Financial Services Loan, Inc. v. Hale, 36 Ohio App.3d 65, 520 N.E.2d 1378 (1987); Land Associates, Inc. v. Becker, 294 Or. 308, 656 P.2d 927 (1982), appeal after remand 74 Or.App. 444, 703 P.2d 1004 (1985).

3. Notice of Application for Restraining Order

In Washington, a person seeking to restrain a trustee's sale must give five days notice to the trustee setting forth when, where and before whom the application for the restraining order or injunction will be made. See RCW 61.24.130(2). See also Civil Rules 6 and 81 of the Civil Rules for Superior Court regarding computation of time.

4. Payment Obligation

When a preliminary injunction is sought, many states require the petitioner to post an injunction bond to protect the lender from injury because of the injunction[8]. Some courts require the party seeking the injunctive relief to pay to the court the amount due on the obligation[9]. If the amount due on the obligation is in dispute, most courts will require the borrower to tender at least what he/she acknowledges is due[10].

Under Washington law, if the default is in making the monthly payment of principal, interest and reserves, the court requires such sum to be paid into the court every thirty days. See RCW 61.24.130(1)(a). A practice tip: even if local law does not require this, it would advantageous to offer to make ongoing payments. Then the creditor loses nothing during the pendency of the suit. In the case of default on a balloon payment, the statute requires that payment of the amount of the

8 See Hummell v. Republic Federal Savings & Loan, 133 Cal.App.3d 49, 183 Cal.Rptr. 708 (4th Dist.1982); Broad & Locust Associates v. Locust-Broad Realty Co., 318 Pa.Super. 38, 464 A.2d 506 (1983); Strangis v. Metropolitan Bank, 385 N.W.2d 47 (Minn.App.1986); Franklin Savings Association v. Reese, 756 S.W.2d 14 (Tex.App.1988); Koegal v. Prudential Mutual Savings, Inc., 51 Wn.App. 108 (1988).

9 See Ginther-Davis Center, Limited v. Houston National Bank, 600 S.W.2d 856 (Tex.Civ.App. 1980), error refused n.r.e.; see also Tiffany, Real Property, § 1549 (3d Ed. 1939) for a list of cases; Thompson, Real Property § 5179 (1957). Cf. Grella v. Berry, 647 S.W.2d 15 (Tex.App.1982).

10 See Glines v. Theo R. Appel Realty Co., 201 Mo.App.596, 213 S.W. 498 (1919).

monthly interest at the new default rate shall be made to the court clerk every thirty days. See RCW 61.24.130 (1)(b). If the property secured by the deed of trust is an owner occupied single family dwelling, then the court must require the party seeking to restrain the trustee's sale to make the monthly payment of principal interest and reserves to the clerk of the court every 30 days. See RCW 61.24.130(1).

Although the amount that the party seeking to restrain the trustee's sale must pay as a condition of continuing the restraining order would ordinarily be the regular monthly payment on the obligation, RCW 61.24.130(1)(a), when there is a balloon payment past due, RCW 61.24.130(1)(b) provides:

> In the case of default in making payments of an obligation then fully payment by its terms, such sum shall be the amount of interest accruing monthly on said obligation at the non-default rate, paid to the clerk of the court every thirty days.

This is consistent with the intent to preserve the status quo while the lawsuit is pending and provide security only for prospective harm.

Failure to seek a restraint may constitute a waiver of all rights to challenge a sale for defects whenever the party who received notice of the right to enjoin the trustees sale, had actual or constructive knowledge of a defense to foreclosure prior to the sale, and failed to bring an action to enjoin the sale. The doctrine of waiver would thus preclude an action by a party to set aside a completed trustee's sale[11]. Finally, RCW 61.24.130 allows the court to consider the grantor's equity in determining the amount of security. This would significantly help a borrower avoid a costly bond.

11 Koegel v. Prudential Mutual Savings, Inc., 51 Wn. App. 108, 114 (1988); Steward v. Good, 51 Wn. App. 509, 515 (1988).

An appraisal showing equity should persuade a court that the lender is protected while the underlying dispute is resolved in court.

When a party knew or should have known that they might have a cause of action to set aside the sale but unreasonably delayed commencing the action, causing damage to the defendant, the doctrine of laches may bar the action[12].

C. DEFENSES BASED ON TRUSTEE MISCONDUCT

Most defenses that are available in judicial foreclosures are also available in nonjudicial foreclosures of deeds of trust. Defenses may include violation of Truth-in-Lending, usury statutes, other consumer protection legislation, or special requirements when the government is the lender, insurer, or guarantor, infra. Other defenses are unique to nonjudicial foreclosure of deeds of trust because they relate to the particular obligations imposed upon trustees who conduct the sale of the real property.

1. Breach of Fiduciary Duties

A trustee selling property at a nonjudicial foreclosure sale has strict obligations imposed by law. In most states, "a trustee is treated as a fiduciary for both the borrower and the lender."[13]

In McPherson v. Purdue, 21 Wn. App. 450, 452-3, 585 P.2d 830 (1978), the court approved the following statement describing the duties of a trustee from California law:

> Among those duties is that of bringing "the property to the hammer under every possible advantage to his cestui que trusts," using all reasonable diligence to obtain the best price.

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12 Carlson v. Gibraltar Savings, 50 Wn. App. 424, 429 (1988).

13 Baxter & Dunaway, The Law of Distressed Real Estate (Clark Boardman Company, Ltd., November 1990). See Spires v. Edgar, 513 S.W.2d 372 (Mo.1974).

In Cox v. Helenius, 103 Wn.2d 383, 388, 693 P.2d 683 (1985), the Washington Supreme Court adopted the following view:

> Because the deed of trust foreclosure process is conducted without review or confrontation by a court, the fiduciary duty imposed upon the trustee is "exceedingly high".

The court went on to illuminate four duties of the trustee:

(1) The trustee is bound by his office to use diligence in presenting the sale under every possible advantage to the debtor as well as the creditor;

(2) The trustee must take reasonable and appropriate steps to avoid sacrifice of the debtor's property and his interest;

(3) Once a course of conduct is undertaken that is reasonably calculated to instill a sense of reliance thereon by the grantor, that course of conduct can not be abandoned without notice to the grantor; and

(4) When an actual conflict of interest arises between the roles of attorney for the beneficiary and trustee, the attorney should withdraw from one position, thus preventing a breach of fiduciary duty.

In Blodgett v. Martsch, 590 P.2d 298 (UT 1978), it was stated that "the duty of the trustee under a trust deed is greater than the mere obligation to sell the pledged property, . . . it is a duty to treat the trustor fairly and in accordance with a high punctilio of honor." The Supreme Court in Blodgett went even further and found that the breach of this confidential duty may be regarded as

constructive fraud[14].

The general rule is summarized in Nelson & Whitman, Real Estate Finance Law, (West Publishing Co., 3d Ed. 1994), §7.21:

> . . . a trustee in a deed of trust is a fiduciary for both the mortgagor and mortgagee and must act impartially between them. As one leading decision has stated, "the trustee for sale is bound by his office to bring the estate to a sale under every possible advantage to the debtor as well as to the creditor, and he is bound to use not only good faith but also every requisite degree of diligence in conducting the sale and to attend equally to the interest of debtor and creditor alike, apprising both of the intention of selling, that each may take the means to procure an advantageous sale."

Mills v. Mutual Building & Loan Association, 216 N.C. 664, 669, 6 S.E.2d 549, 554 (1940).

The fiduciary duty of a trustee to obtain the best possible price for trust property that it sells has been discussed in nonjudicial and other contexts[15].

However, this "fiduciary" characterization of a trustee is not accepted in all jurisdictions. The California Supreme Court has stated,

> "The similarities between a trustee of an express trust and a trustee under a deed of trust end with the name. 'Just as a panda is not a true bear, a trustee of a deed of trust is not a true trustee.' *** [T]he trustee under a deed of trust does not have a true trustee's interest in, and control over, the trust property. Nor is it bound by the fiduciary duties that characterize a true trustee."

Monterey S.P. Partnership v. W.L. Bangham, Inc. 49 Cal.3d 454, 462, 261 Cal.Rptr. 587,592 (1989).

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14 See also McHugh v. Church, 583 P.2d 210, 214 (Alaska 1978).

15 See Cox v. Helenius, supra, at p. 389; Allard v. Pacific National Bank, 99 Wn. 2d 394, 405, 663 P.2d 104 (1983), modified by 99 Wn.2d 394, 773 P.2d 145 (1989). superseded by RCW 11.100.140 as stated in Conran v. Seafirst Bank, 1998 Wn.App. Lexis 156.. See also National Life Insurance Company v. Silverman, 454 F.2d 899, 915 (D.C. Cir. 1971), in which the court stated that the same good faith is required of trustees under a deed of trust of real estate as is required of other fiduciaries.

In most jurisdictions, a trustee cannot, without the express consent of the trustor, purchase at the sale that he conducts[16]. A court may impose additional affirmative duties (beyond the statutory requirements) upon the trustee in certain circumstances. This could include a requirement that a trustee's sale be continued, if necessary, to prevent a total loss of the debtor's equity. West v. Axtell, 322 Mo. 401, 17 S.W.2d 328 (1929). RCW 61.24.040(6) authorizes a trustee to continue a trustee's sale for a period or periods totaling 120 days for "any cause he deems advantageous."

However, the Washington Court of Appeals has ruled that the trustee need not exercise "due diligence" in notifying interested parties of an impending sale. Morrell v. Arctic Trading Co., 21 Wn. App. 302, 584 P.2d 983 (1978). Further, the general rule is that a trustee is not obligated to disclose liens or other interests which the purchaser could or should have discovered through his or her own investigation. Ivrey v. Karr, 182 Md. 463, 34 A.2d 847, 852 (1943). The Washington courts have held that even when a trustee is aware of defects in title, the trustee only undertakes an affirmative duty of full and accurate disclosure if s/he has made any representations or answered any questions concerning the title. McPherson v. Purdue, 21 Wn. App. 450, 453, 585 P.2d 830 (1978). However, despite this general rule, there is authority behind the proposition that a trustee has a fiduciary duty to restrain the sale due to defects known to the trustee. In Cox v. Helenius, 103 Wn.2d 383,*,693 P.2d 683 (1985), in which the trustee knew that the right to foreclose was disputed and that the attorney for the trustor had failed to restrain the sale, the court held that the trustee should have either informed the attorney for the trustor that she had failed to properly restrain the sale or

16 See Smith v. Credico Industrial Loan Company, 234 Va. 514, 362 S.E.2d 735 (1987); Whitlow v. Mountain Trust Bank, 215 Va. 149, 207 S.E.2d 837 (1974).

delayed foreclosure. As a result of the trustee's failure to do so, the sale was held void.

Trustees are not permitted to "chill the bidding" by making statements which would discourage bidding, for example, a statement that it is unlikely that the sale will be held because the debtor intends to reinstate[17]. If a trustee does engage in "chilled bidding", the sale is subject to being set aside[18].

2. Strict Construction of the Deed of Trust Statute

The nonjudicial foreclosure process is intended to be inexpensive and efficient while providing an adequate opportunity for preventing wrongful foreclosures and promoting the stability of land titles[19]. However, statutes allowing foreclosure under a power of sale contained within the trust deed or mortgage are usually strictly construed. Id. at 509.

Recent decisions have moved away from the strict construction ruling, holding that some technical violations of statutes governing nonjudicial foreclosures will not serve as grounds for setting aside sale when the error was non-prejudicial and correctable. See Koegal, supra at 113. An example of a non-prejudicial and correctable error is noncompliance with the requirement that the trustee record the notice of sale 90-days prior to the actual sale when actual notice of the sale was given to the debtors 90-days prior to the sale and the lack of recording caused no harm. Steward, supra at 515. Further, inconsequential defects often involve minor discrepancies regarding the notice

17 See, Nelson & Whitman, supra, Section 7.21; Dingus, Mortgages-Redemption After Foreclosure Sale in Missouri, 25 Mo.L.REV. 261, 284 (1960).

18 Biddle v. National Old Line Ins. Co., 513 S.W.2d 135 (Tex.Civ.App.1974), error refused n.r.e.; Sullivan v. Federal Farm Mortgage Corp., 62 Ga.App.402, 8 S.E.2d 126 (1940).

19 Queen City Savings v. Manhalt, 111 Wn.2d 503 (1988).

of sale. In Bailey v. Pioneer Federal Savings and Loan Association, 210 Va. 558, 172 S.E.2d 730 (1970), where the first of four published notices omitted the place of the sale, the court held that since there was "substantial compliance" with the requirements specified by the deed of trust and since the parties were not affected in a "material way," the sale was valid[20]. In another case, where the notice of sale was sent by regular rather than by statutorily required certified or registered mail and the mortgagor had actual notice of the sale for more than the statutory period prior to the sale, the sale was deemed valid[21]. Clearly a grantor must show some prejudice.

D. POST-SALE REMEDIES

1. Statutory Presumptions

The Washington Deed of Trust Act contains statutory presumptions in connection with a trustee's sale that are similar to those found in most other states. [22] RCW 61.24.040(7) provides, in part:

> . . . the [trustee's] deed shall recite the facts showing that the sale was conducted in compliance with all of the requirements of this chapter and of the deed of trust, which recital shall be prima facie evidence of such compliance and conclusive evidence thereof in favor of bona fide purchasers and encumbrancers for value.

Such provisions are designed to protect bona fide purchasers and to assure that the title passed through a trustee's sale will be readily insurable. However, although the required recitals are

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20 See also Tarleton v. Griffin Federal Savings Bank, 202 Ga.App. 454, 415 S.E.2d 4 (1992); Concepts, Inc. v. First Security Realty Services, Inc., 743 P.2d 1158 (Utah 1987).

21 Macon-Atlanta State Bank v. Gall, 666 S.W.2d 934 (Mo.App.1984). For a complete list of defects considered "insubstantial", see Graham v. Oliver, 659 S.W.2d 601, 604 (Mo.App.1983).

22 See also Cal. Civ. Code § 2924 (West 1981); Utah Code Ann.1953, 57-1-28; West's Colo.Rev.Stat. Ann. §38-39-115; Or.Rev.Stat. 86.780; So.Dak.Compiled Laws 21-48-23.

described as "conclusive" in favor of bona fide purchasers and encumbrancers for value, there is extensive case law setting forth the basis for rebutting these presumptions. They also don't apply to a dispute between the grantor and grantee. See, generally, Nelson & Whitman, Real Estate Finance Law, (2d ed. 1985) § 7.21 ff. Some states employ other means of stabilizing titles, such as title insurance. Yet another means of stabilizing titles is to include a provision in the deed of trust that in the event of a trustee's sale, the recital will be conclusive proof of the facts. See, Johnson v. Johnson, 25 Wn. 2d 797 (1946); Glidden v. Municipal Authority, 111 Wn. 2d 341 (1988), modified By Glidden v. Municipal Authority, 764 P.2d 647 (1988).

2. The Bona Fide Purchaser

The law is well settled that a bona fide purchaser, in order to achieve that status, must have purchased the property "for value." See RCW 61.24.040(7).

The general rule is set forth in Phillips v. Latham, 523 S.W.2d 19, 24 (Tex. 1975):

> [The purchaser] cannot claim to be a good-faith purchaser for value because the jury found . . . that the sale price of $691.43 was grossly inadequate. These findings are not attacked for lack of evidence. Although good faith does not necessarily require payment of the full value of the property, a purchaser who pays a grossly inadequate price cannot be considered a good-faith purchaser for value.

Further, if a lis pendens has been recorded, it "will cause the purchaser to take subject to the plaintiff's claims." Bernhardt, California Mortgage & Deed of Trust Practice (2d Edition 1990). A purchaser will not then constitute a bona fide purchaser able to utilize the presumptions of regularity in recitals of the trustee's deed. See CC § 2924. The beneficiary of a deed of trust is not a bona fide purchaser. See Johnson, supra.

E. SETTING ASIDE THE TRUSTEE'S SALE

Setting aside a trustee's sale is largely a matter for the trial court's discretion. Crummer v. Whitehead, 230 Cal. App. 2d 264, 40 Cal. Rptr. 826 (1964); Brown v. Busch, 152 Ca. App. 2d 200, 313 P.2d 19 (1957). After a trustee's sale has taken place, a trustor or junior lienor may bring an action in equity to set aside the sale. See Crummer v. Whitehead, 230 Cal. App. 2d 264, 40 Cal. Rptr. 826 (1964); see also Note, "Court Actions Contesting The Nonjudicial Foreclosure of Deeds of Trust In Washington," 59 Wash.L.Rev. 323 (1984)[23].

An action may be brought to set aside a trustee's sale under circumstances where the trustee's sale is void. Cox v. Helenius, 103 Wn.2d 383, 693 P.2d 683 (1985). In those circumstances where the defect in the trustee's sale procedure does not render the trustee's sale void, the court will probably apply equitable principles in deciding what relief, if any, is available to the parties. A general discussion of equitable principles in contexts other than trustee's sale can be found in Eastlake Community Council v. Roanoake Associates, 82 Wn.2d 475, 513 P.2d 36 (1973) and Arnold v. Melani, 75 Wn.2d 143, 437 P.2d 908 (1968). Although it is preferable to raise any defenses to the obligations secured by the deed of trust or other defects in the nonjudicial foreclosure process prior to the trustee's sale, a trustee's sale can presumably be set aside if there was a good reason for not restraining it. Possible reasons could include those described below.

1. Breach of the Trustee's Duty

a. Inadequate Sale Price

The general rule on using inadequate sale price to set aside a deed of trust sale is stated in

23 Attempting to Set Aside Deed of Trust Foreclosure Because of Trustee's Fiduciary Breach, 53 Missouri L. Rev. 151 (1988).

Nelson & Whitman, supra, § 7.21:

> All jurisdictions adhere to the recognized rule that mere inadequacy of the foreclosure sale price will not invalidate a sale, absent fraud, unfairness, or other irregularity. Stating the rule in a slightly different manner, courts sometimes say that inadequacy of the sale price is an insufficient ground unless it is so gross as to shock the conscience of the court, warranting an inference of fraud or imposition[24].

In Cox v. Helenius, supra, at p. 388, the court indicated that the inadequate sale price coupled with the trustee's actions, would have resulted in a void sale, even if not restrained.

Generally, unless the sale price is grossly inadequate, other irregularities or unfairness must exist. However, considerable authority exists to support setting aside a sale when, coupled with an inadequate sale price, there is any other reason warranting equitable relief. Nelson & Whitman, Real Estate Finance Law, supra.

b. Hostility or Indifference to Rights of Debtor.

In Dingus, supra, at 289, it is stated:

> In an action to set aside a foreclosure sale under a deed of trust, evidence showing that the trustee was hostile and wholly indifferent to any right of the mortgagor warrants setting aside the sale. Lunsford v. Davis, 254 S.W. 878 (Mo. 1923).

CF. Cox v. Helenius, supra.

c. Other Trustee Misconduct

Other trustee misconduct that would give rise to grounds for setting aside a trustees sale could include "chilled bidding" where the trustee acts in a manner that discourages other parties

24 See also Dingus, Mortgages - Redemption After Foreclosure Sale in Missouri, 25 Mo.L.REV. 261, 262 (1960); California Mortgage and Deed of Trust Practice, Section 6.60 (University of California 1979).

from bidding on the property[25]. Actions by the trustee which lull the debtor into inaction may also give rise to grounds for avoiding the sale[26]. Particular note should also be made of the discussion in Cox v. Helenius, supra, at p.390 in which trustees who serve a dual role as trustee and attorney for the beneficiary are directed to transfer one role to another person where an actual conflict of interest arises.

2. Absence of Other Foreclosure Requisites

RCW 61.24.030 sets forth the requisites to non-judicial foreclosure. Failure to meet these requisites may render the trustee's sale void. In Cox v. Helenius, 103 Wn.2d 383, 693 P.2d 683 (1985), the court concluded that a trustee's sale was void under circumstances where the borrower had filed an action contesting the obligation and that action was pending at the time of the trustee's sale. The action was filed after service of the notice of default but before service of the notice of foreclosure and trustee's sale.

The decision in Cox was based on language in the Deed of Trust Act that made it a requisite to foreclosure that "no action is pending on an obligation secured by the deed of trust." That part of the Cox decision was legislative overruled by Chapter 193, Law of 1985, Reg. Sess., which amended RCW 61.24.030(4) to read as follows:

> That no action commenced by the beneficiary of the deed of trust is now pending to seek satisfaction of an obligation secured by the deed of trust in any court by reason of the grantor's default on the obligation secured;

As a result of the amendment, pendency of an action on the obligation brought by the grantor

25 Nelson & Whitman, supra, Section 7.21. Dingus, supra, at p. 274; see also Biddle v. National Old Line Insurance Co., 513 S.W.2d 135 (Tex.Civ.App. 1974).

does not render a subsequent trustee's sale void. Only pending actions commenced by the beneficiary to seek satisfaction of the obligation secured by the deed of trust operate as a bar to nonjudicial foreclosure. The trustee must be properly appointed and be appointed before the trustee has authority to act. When an eager trustee "jumps the gun" the actions are equally void.

F. ADDITIONAL STATUTORY REMEDIES

1. Confirmation of Sale Price.

Many states (but not Washington) require confirmation that the nonjudicial sale resulted in a fair value to the debtor. Below is listed the states that have adopted fair market value statutes[27]. Fair market value statutes are usually used to limit deficiency judgments to the difference between the fair market value and the debt. Failure to confirm the sale within the statutory period is usually a bar to a deficiency. For example, in Georgia the court must be petitioned for a confirmation of the sale if a deficiency judgment is sought.

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26 Dingus, supra, at pp. 272-73; Cox v. Helenius, supra, at p. 389.

27 *Arizona*: Ariz. Rev. Stat. Ann. §33-814(A) (1989).
California: Cal. Civ. Code §580a (1989); Id. §726 (1989); Kirkpatrick v. Stelling, 36 Cal. App.2d 658, 98 P.2d 566, appeal dismissed, 311 U.S. 607 (1940); Risenfeld, *California Legislation Curbing Deficiency Judgments*, 48 Calif. L. rev. 705 (1960). See *infra*, California jurisdictional summary in Part 1.
Georgia: Ga. Code Ann. §§44-14-161, -162 (1989).
Idaho: Idaho Code §§6-108, 45-1512 (1988).
Michigan: Mich. Comp. Laws Ann. §§600.3170, .3280 (1989).
Nebraska: Neb. Rev. Stat. §76-1013 (1989).
Nevada: Nev. Rev. Stat. §40.457 (1988).
New Jersey: N.J. Stat. Ann. §2A:50-3 (1989).
New York: N.Y. Real Prop. Acts Law §1371 (McKinney 1979 and Supp. 1990).
North Carolina: N.C. Gen. Stat. §45-21.36 (1988).
North Dakota: N.D. Cent. Code §32-19-06 (Supp. 1989).
Oklahoma: Okla. Stat. tit. 12, §686 (1990).
Pennsylvania: Pa. Stat. Ann. tit. 12 §§2621.1, .6 (Purdon 1967).
South Dakota: S.D. Comp. Laws Ann. §§21-47-16, -48-14 (1989).
Utah: Utah Code Ann. §57-1-32 (1989).
Washington: Wash. Rev. Code Ann. §61.12.060 (1989).
Wisconsin: Wis. Stat. §846.165 (1988).

2. Redemption in Nonjudicial Foreclosures.

Approximately one-half of the states allow for redemption after foreclosure, although not Washington. Some states allow redemption after a nonjudicial sale. See Minnesota Statutes Annotated § 580 et seq. Generally, the grantor can remain in possession during the redemption period, rent the property (retaining the rents) and/or sell the property (or sell the redemption rights).

G. RAISING DEFENSES IN THE UNLAWFUL DETAINER (EVICTION) ACTION

In Washington, RCW 61.24.060 specifies that the purchaser at a trustee's sale is entitled to possession of the property on the 20th day following the sale. If the grantor or person claiming through the grantor refuses to vacate the property, the purchaser is entitled to bring an action to recover possession of the property pursuant to the unlawful detainer statute, RCW 59.12. Ordinarily, parties in possession will not be allowed to raise some defenses in the unlawful detainer action that could have been raised prior to the trustee's sale[28]. In most states defenses in an eviction action are severely limited. Despite these early cases restricting defenses in unlawful detainer, e.g. Peoples National Bank v. Ostander, 6 Wn. App. 28 (1971), a more recent case, Cox v. Helenius, 103 Wash. 2d 208 (1985), allowed defenses to be raised that the sale was void because of defects in the foreclosure process itself. In fact, Cox v. Helenius was initially a unlawful detainer action in the King County Superior Court. In Savings Bank of Puget Sound v. Mink, 49 Wn. App. 204 (1987), Division One of the Court of Appeals, held that a number of

28 People's National Bank v. Ostrander, 6 Wn. App. 28, 491 P.2d 1058 (1970). See, however, Crummer v. Whitehead, 230 Cal. App. 2d 264 (1964) contra declined to follow by Eardley v. Greenberg, 160 Az.518, 774 P.2d 822 (Az.App. Div. 1 1989); MCA, Inc., v. Universal Diversified Enterprises Corp., 27 Cal. App. 3d 170 (1972). contra declined to follow by Eardley v. Greenberg, 160 Az.518, 774 P.2d 822 (Az.App. Div. 1 1989) But in a bankruptcy proceeding, defenses may be raised after the sale if the debtor is in possession.

defenses raised by the appellant (Truth-in-Lending violations, infliction of emotional distress, defamation, slander, etc.) were *not* properly assertable in an unlawful detainer action but ruled that:

> However, in *Cox v. Helenius*, *supra*, the Supreme Court recognized that there may be circumstances surrounding the foreclosure process that will void the sale and thus destroy any right to possession in the purchaser at the sale. In *Cox*, the Court recognized two bases for post sale relief: defects in the foreclosure process itself, i.e., failure to observe the statutory prescriptions and the existence of an actual conflict of interest on the part of the trustee…

B. <u>The Deed of Trust Act must be construed strictly against lenders and in favor of borrowers</u>.

Washington law is similarly clear that the Deed of Trust Act, being non-judicial in nature and without the scrutiny by courts until the unlawful detainer stage, is strictly construed against lenders and in favor of borrowers. <u>Queen City Savings and Loan v. Mannhalt</u>, 111

In order to avoid the jurisdictional and other problems that arise when trying to litigate claims in the unlawful detainer action, it is recommended that a separate action be filed to set aside the trustee's sale and that the two actions be consolidated.

H. DAMAGES FOR WRONGFUL FORECLOSURE

There is a damage claim for the tort of wrongful foreclosure. The claim may also exist as a breach of contract claim. See, <u>Theis v. Federal Finance Co.</u>, 4 Wn. App. 146 (1971); <u>Cox v. Helenius</u>, <u>supra</u>.

III. <u>DEFENDING JUDICIAL FORECLOSURES</u>

A. INTRODUCTION

The same range of defenses is generally available to the borrower in both nonjudicial and judicial foreclosures. Defenses may include fraud or misrepresentation, violations of Truth-in-Lending, violations of usury statutes, violations of other consumer protection acts, or failure to comply with applicable regulations when the government is the lender, insurer, or guarantor. Other defenses, however, are unique to judicial foreclosures and must be raised affirmatively. Most rights are set forth in statutes and they must be asserted in compliance with the particular requirements of the law. The judicial foreclosure statutes are set forth below[29].

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29 *Alabama*: Ala. Code §§6-9-140 to 150; 164; 35-10-2 to 35-10-12; (1977).
Alaska: Alaska Stat. §§90.45.170 to .220 (1991).
Arizona: Ariz. Rev. Stat. Ann. §§33-721 to 33-728 (1991).
Arkansas: Ark. Code Ann. §§18-49-103 to 106 (1987).
California: Cal. Civ. proc. §§725a to 730.5 (West 1991).
Colorado: Colo. Rev. Stat. Ann. §§38-38-101 to 38-38-111 (West 1991).
Connecticut: Conn. Gen. Stat. Ann. §§49-24 to 49-31 (West 1991).
Delaware: Del. Code Ann. tit. 10 §§5061 to 5067 (1991).
D.C.: D.C. Code Ann. §45-716 (1981).
Florida: Fla. Stat. Ann. §702.01 (West 1992).
Georgia: Ga. Code Ann. §§9-13-140; 44-14-48 to 44-14-49; 44-14-184; 187; 189 (1991).
Hawaii: Haw. Rev. Stat. §§667-1 to 667-7 (1991)
Idaho: Idaho Code §§6-101 to 6-103; 45-1502 to 45-1503 (1991).
Illinois: Ill. Ann. Stat. Ch. 10, para. 15-1404; 15-1501 to 15-1512 (Smith-Hurd 1987).
Indiana: Ind. Code Ann. §32-8-11-3 (Burns 1980)
Iowa: Iowa Code Ann. §654.18 (West 1992).
Kansas: Kan. Stat. Ann. §60-2410 (1990).
Kentucky: Ky. Rev. Stat. Ann. §§381.190; 426.525 (Michie 1991).
Louisiana: La. Code Civ. Proc. Ann. art. 2631 (West 1992).
Maine: Me. Rev. Stat. Ann. tit. 14, §§6321 to 6325 (West 1991).
Maryland: Md. Real Prop. Code Ann. §7-202 (1988).
Massachusetts: Mass. Gen. Laws Ann. ch. 244, §1 (West 1992).
Michigan: Mich. Comp. Laws Ann. §§600.3101 to 600.3130 (West 1992).
Minnesota: Minn. Stat. Ann. §§581.01 to 581.12 (1992).
Mississippi: Miss. Code Ann. §§89-1-53; 89-1-55 (1972).
Missouri: Mo. Ann. Stat. §§443.190 (Vernon 1992).
Montana: Mont. Code Ann. §§71-1-222; 232; 311; 25-13-802 (1991).
Nebraska: Neb. Rev. Stat. §§25-2137 to 25-2147 (1991).
Nevada: Nev. Rev. Ann. Stat. §§40.430; 40.435 (Michie 1991).
New Hampshire: N.H. Rev. Stat. Ann. §§479:19 to 479:27 (1991).
New Jersey: N.J. Stat. Ann. §2A:50-2 (West 1991).
New Mexico: N.M. Stat. Ann. §§39-5-1 to 39-5-23; 48-7-7 (1991).

B. HOMESTEAD RIGHTS

If the plaintiff's complaint seeks possession of the property at the sheriff's sale and the homeowner wishes to remain on the premises during the redemption period, then the homeowner should plead the existence of homestead rights in the answer so as not to waive them. State, ex rel., O'Brien v. Superior Court, 173 Wash. 679, 24 P.2d 117 (1933); State, ex rel., White v. Douglas, 6 Wn.2d 356, 107 P.2d 593 (1940).

C. UPSET PRICE

Some states authorize the court to establish an upset price (or minimum bid amount) in a foreclosure sale. In Washington, RCW 61.12.060 authorizes the court where a deficiency is sought, in ordering a sheriff's sale, to take judicial notice of economic conditions and, after a proper hearing, fix a minimum or upset price for which the mortgaged premises must be sold before the sale will be confirmed. If a depressed real estate market justifies seeking an upset price, then the mortgagor

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New York: N.Y. Real Prop. Acts Law §§1321; 1325 to 1355 (McKinney 1992).
North Carolina: N.C. Gen. Stat. §§45-21.16; 45-21.17; 45-38 (1991).
North Dakota: N.D. Cent. Code §32-19-01 to 32-19-40 (1992).
Ohio: Ohio Rev. Code Ann. §2323.07 (Anderson 1984).
Oklahoma: Okla. Stat. Ann. tit. 12, §686 (West 1992).
Oregon: Or. Rev. Stat. §§88.010 et seq. (1989).
Pennsylvania: Pa. Stat. Ann. tit. 21, §§274; 715; Pa. Rules Civ. Proc. Rules 1141 to 1150; 3180 to 3183; 3232; 3244; 3256; 3257.
Rhode Island: R.I. Gen. Laws §34-27-1 (1984).
South Carolina: S.C. Code Ann. §§15-7-10; 29-3-650 (Law Co-op 1990).
South Dakota: S.D. Codified Laws Ann. §§21-47-1 to 25; 21-48A-4 (1991).
Tennessee: Tenn. Code Ann. §21-1-803 (1991).
Texas: Tex. Prop. Code Ann. §§51-002; 51.004; 51.005 (West 1992).
Utah: Utah Code Ann. §§78-37-1 to 78-37-9 (1986).
Vermont: Vt. Stat. Ann. tit. 12, §4528 (1991).
Virgin Islands: V.I. Code Ann. tit. 28, §531 to 535 (1991).
Virginia: Va. Code Ann. §§55-59.4; 55-61 (Michie 1981).
Washington: Wash. Rev. Code Ann. §§61.12.040; 61.12.060 (West 1992).
West Virginia: W. Va. Code §§55-12-1 to 55-12-8 (1991).
Wisconsin: Wis. Stat. Ann. §§846.01 to 846.25 (West 1991 (Repealed).

should request in the answer that one be set. See, McClure v. Delguzzi, 53 Wn. App. 404 (1989). Some states give this power to the courts with any sale without reference to any other valuation method. See e.g. Kan. Stat. §60-2415(b) (1988); Mich. Comp. Laws Ann. §600.3155 (1919). The court has great discretion in arriving at and setting an upset price if the statute fails to specify the method to be used in calculating the price. There is always the danger that in the absence of statutory standards, the power to set the upset price will be abused[30].

D. DEFICIENCY JUDGMENTS

A deficiency judgment results when the amount for which the property is sold at the sheriff's sale is less than the amount of the judgment entered in the foreclosure action. A deficiency judgment in connection with a foreclosure is enforceable like any other money judgment. If the mortgage or other instrument contains an express agreement for the payment of money, then the lender may seek a deficiency judgment. See RCW 61.12.070. In Thompson v. Smith, 58 Wn. App. 361 (1990), Division I, held the acceptance of a deed in lieu of foreclosure triggers the anti-deficiency provisions of the Deed of Trust Act, 61.24.100. The procedural requirements for obtaining a deficiency judgment vary, but must be strictly adhered to or the right will be lost. In general, an action must be brought within a statutorily set amount of time following the foreclosure sale. For example, California Civ. Proc. Code § 726 (Supp. 1984) (three months); N.Y. Real Prop. Acts. Law § 1371 (2) (McKinney 1979) (ninety days); and Pennsylvania Stat. Ann. tit. 12, section 2621.7 (1967) (six months). Many states also have time limits for the completion of the execution of a deficiency. Maryland Rules, Rule W75 (b)(3) (1984) (three years); and Ohio Rev. Code Ann. §

Wyoming: Wyo. Stat. §§1-18-101 to 1-18-112 (199).

2329.08 (Anderson 1981) (two years on land with dwelling for two families or less or used as a farm dwelling). Some states have longer redemption periods when a deficiency is sought. e.g. Wisconsin (6-12 months); Washington (8-12 months).

E. REDEMPTION RIGHTS

Approximately one-half of the states have statutes that give a borrower the right to redeem the property after the foreclosure sale. This right has specific statutory time limits. The time period for redemption varies from thirty days to three years after the foreclosure sale. Strict compliance with the statutory requirements is mandatory.

Under Washington law, if the lender seeks a deficiency judgment or if the mortgage does not contain a clause that the property is not for agricultural purposes, then the redemption period is one year from the date of the sheriff's sale. See RCW 6.23.020.

If the lender does not seek a deficiency judgment and the mortgage contains a clause that the property is not being used for agricultural purposes, than the redemption period is eight months. Id.

There is no statutory redemption period if there is a structure on the land and the court finds that the property has been abandoned for six months prior to the decree of foreclosure. See RCW 61.12.093. This section is not applicable to property that is used primarily for agricultural purposes. RCW 61.12.095.

The purchaser at the sheriff's sale, or the purchaser's assignee, must send notice to the judgment debtor every two months that the redemption period is expiring. Failure to give any of the notices in the manner and containing the information required by statute will operate to extend the

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30 See Michigan Trust Co. v. Dutmers, 265 Mich. 651, 252 N.W. 478 (1933).

redemption period. RCW 6.23.080.

Any party seeking to redeem must give the sheriff at least five days written notice of the intention to apply to the sheriff for that purpose. RCW 6.23.080(1). The amount necessary to redeem is the amount of the bid at the sheriff's sale, interest thereon at the rate provided in the judgment to the time of redemption, any assessment or taxes which the purchaser has paid after circumstances, other sums that were paid on prior liens or obligations. RCW 6.23.020.

Redemption rights are freely alienable and a property owner can sell the homestead during the redemption period free of judgment liens. Great Northwest Federal Savings and Loan Association v. T.B. and R.F. Jones, Inc., 23 Wn. App. 55, 596 P.2d 1059 (1979). This is an important right and is often overlooked. For example, in VA loans the sale price is very low because the VA deducts its anticipated costs of holding and resale. Therefore, the property can be redeemed for that amount. There, lenders routinely advise debtors to move out at the beginning of the period, which they do not legally have to do.

The debtor can sometimes rent the property and the rents retained during the redemption period.

F. POSSESSION AFTER SALE

If the homeowner exercises his redemption rights and there is a purchaser in possession, then the homeowner can apply for a writ of assistance to secure possession of the property anytime before the expiration of the redemption period. If the homeowner has no right to claim a homestead or is not occupying the property as a homestead during redemption period, then the lender can apply for a writ of assistance at the time of the foreclosure decree to obtain possession of the property. A writ

of assistance is similar to a writ of restitution and is executed by the sheriff. The purchaser at the sheriff's sale normally has no right to possession until after receipt of a sheriff's deed[31].

G. POST FORECLOSURE RELIEF

A foreclosure can be vacated under rules allowing vacating judgments, e.g. F.R.Civ.P 60(b); See also Godsden & Farba, Under What Circumstances Can a Foreclosure Sale be Set Aside Under New York Law, New York State Bar Journal (May 1993).

IV. MISCELLANEOUS ISSUES

A. BANKRUPTCY

Bankruptcy has a significant impact on real estate foreclosures and is beyond the scope of this outline. Under section 362 (a) of the Bankruptcy Code, filing any of the three types of bankruptcy stays all foreclosure proceedings. See 11 U.S.C.A. § 362 (a)(4); Murphy, The Automatic Stay in Bankruptcy, 34 Clev.St.L.Rev. 597 (1986). A stay has been held to apply to a possessory interest after foreclosure to allow a challenge to the validity of the foreclosure in an adversary action in bankruptcy court. In re Campos, No. 93-04719 (W.D. WN-B.Ct, Order of July 9, 1993). The stay applies to both judicial and nonjudicial foreclosures and it also applies whether or not the foreclosure was begun before the bankruptcy. See 11 U.S.C.A. § 362 (a). The only notable exception to the automatic stay is for foreclosures brought by the Secretary of HUD on federally insured mortgages for real estate involving five or more units. See 11 U.S.C.A. § 362 (b)(8).

A trustee in a bankruptcy may also undo a foreclosure as a fraudulent transfer if a creditor

31 Norlin v. Montgomery, 59 Wn.2d 268, 357 P.2d 621 (1961). The mortgagee's right to possession of the property is not lost through default or abandonment. overruled on other grounds. Howard v. Edgren, 62 Wn.2d 884, 385 P.2d 41 (1963).

gets a windfall. See II U.S.C. §547 and §548, within 90 days or within one year if an "insider" forecloses[32].

A portion of the equity under state or federal law may be protected from creditors, although not from secured creditors.

B. WORKOUTS (DEED IN LIEU)

A deed is sometimes given by a mortgagor in lieu of foreclosure and in satisfaction of a mortgage debt. Such a workout "is subject to close scrutiny in an effort to determine whether it was voluntarily entered into on the part of the mortgagor under conditions free of undue influence, oppression, unfairness or unconscientious advantage. Further the burden of proving the fairness rests with the mortgagee." Robar v. Ellingson, 301 N.W.2d 653, 657-658 (N.D.1981) (insufficient threshold evidence of oppression or unfairness to trigger mortgagee's burden of proof). Courts also tend to find the deed in lieu of foreclosure to be another mortgage transaction in the form of an absolute deed. Peugh v. Davis, 96 U.S. (6 Otto) 332, 24 L.Ed. 775 (1877). See also, Noelker v. Wehmeyer, 392 S.W.2d 409 (Mo.App.1965). When a mortgagee takes a deed in lieu there is the possibility that the conveyance will be avoided under bankruptcy laws. It should be noted that if other liens have been created against a property after the time of the original mortgage, the deed in lieu will not cut off those liens. See Note, 31 Mo.L.Rev. 312, 314 (1966). A deed in lieu should contain a comprehensive agreement regarding any deficiency claims, etc.

C. LENDER LIABILITY

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32 See Durrett v. Washington National Ins., 621 F.2d 201 (5th Cir. 1980); cf. In re Madrid, 725 F.2d 1197 (9th Cir. 1984). Compare state fraudulent conveyances statutes, e.g, RCW 19.40.031.

It is possible to use theories of lender liability to assist in successfully negotiating a workout, or an avoidance of foreclosure. This principally occurs in commercial foreclosures but there are some strategies that apply to the residential setting. This may involve persuading the lender that failing to reach a workout agreement may result in a claim against the lender, absolving the borrower from liability on the loan and/or granting an affirmative judgment against the lender. Some of the useful theories of lender liability are breach of agreement to lend, breach of loan agreement, failure to renew term note/wrongful termination, promissory estoppel, lender interference, and negligent loan management. Some of the common law defenses for a borrower are fraud, duress, usury and negligence. Further, because banks are so closely regulated, a borrower should also explore statutory violations. For a detailed treatment of workouts, see Dunaway, supra, (Vol. 1, Chapter 4B)[33].

D. MOBILE HOME FORECLOSURES

Generally, mobile homes are repossessed under Article 9-503 of the Uniform Commercial Code, and are beyond the scope of this outline. Many states limit deficiencies in purchase money security agreements and/or allow reinstatement. There are many abuses in the sales of mobile homes and the various consumer protection laws (and usury laws) provide a fertile source of potential defenses. See generally, Unfair and Deceptive Practices, National Consumer Law Center (2nd ed.), paragraph 5.4.8.

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33 See also, Penthouse International v. Dominion Fed. S&L, 665 F. Supp. 301 (S.D. N.Y. 1987, rev. 855 F.2d 963 (2nd Cir. 1988); Joques v. First National, 515 A.2d 756 (Md. 1976); KMC v. Irving Trust, 757 F.2d 752 (6th Cir. 1985); Douglas-Hamilton, Creditor Libilities Resulting From Improper Interference with Financially Troubled Debtor, 31 Bus. Law J. 343 (1975).

E. TAX CONSEQUENCES OF FORECLOSURE

Although beyond the scope of this outline, there are tax consequences when property is foreclosed, particularly in commercial transactions.

First, a foreclosure or deed in lieu of foreclosure is treated as a sale or exchange. Treas. Rep. 1-001-2; Rev. Ruling 73-36, 1973-1 CB 372. The amount realized (gained) is the greater of the sales proceeds or the debt satisfied. Parker v. Delaney, 186 F.2d 455 (1st Cir. 1950). When debt is cancelled (such as by an anti-deficiency statute), a gain may be generated. IRS Code §61(a).

Second, when home equity debt plus purchase debts exceeds the value of the property, a taxable gain can be generated. Finally, if the debtor is "insolvent" when the foreclosure occurs, §108(a)(1)(A) of the IRS Code excludes income (gain) to the extent the debtor is insolvent. This is complicated and a tax expert should be consulted to analyze any potential tax bite upon foreclosure. See generally, Dunaway, supra, for a detailed analysis of the tax consequences of foreclosure.

V. THE GOVERNMENT AS INSURER, GUARANTOR OR LENDER

A. INTRODUCTION

There are a variety of federal home ownership programs that may provide special protections for homeowners who are faced with the prospect of foreclosure. These protections generally apply regardless of whether the security divide used is a mortgage or deed of trust. The programs range from home loans insured by the Department of Housing and Urban Development (HUD) or guaranteed by the Veteran's Administration (VA) to programs such as the Farmer's Home

Administration (FmHA) home ownership program where the government acts as a direct lender. The procedures which must be followed by loan servicers and applicable governmental agencies are described below. Also, Fannie Mae published in 1997 a Foreclosure Manual for loan services, which outlines various workouts and other loss mitigation procedures.

When the government controls the loan (or the lender) its actions are subject to the protection of the due process provision of the Fifth Amendment to the U.S. Constitution[34]. This calls into question the use of nonjudicial foreclosure as there is no opportunity to be heard and notice is usually deficient or, at best, minimal.

B. HUD WORKOUT OPTIONS

1. Applicability

Homeowners who have a HUD insured mortgage or deed of trust may be eligible for relief through the HUD foreclosure prevention program. HUD regulations also require that lenders meet certain servicing responsibilities before proceeding with foreclosure. Regulations for loss mitigation are found at 24 C.F.R. Sec. 203.605.

2. Procedure when the Homeowner is in Default

a. Delinquency Required for Foreclosure.

The servicer shall not turn the action over for foreclosure until at least three full monthly payments are unpaid after application of any partial payments. 24 C.F.R. Sec. 203. The servicer is required to send a HUD brochure on avoiding foreclosure to the borrower informing them

34 See Vail v. Brown, 946 F.2d 589 (8th Cir. 1991); Johnson v. U.S. Dept. of Agriculture, 734 F.2d 774 (11th Cir. 1984); United States v. Murdoch, 627 F. Supp. 272 (N.D. Ind. 1985); Boley v. Brown, 10 F.3d 218 (4th Cir. 1993).

of their right to seek various alternatives to foreclosure.

The servicer must allow reinstatement even after foreclosure has been started if the homeowner tenders all amounts to bring the account current, including costs and attorney fees. 24 C.F.R. Sec. 203.

b. Forbearance Relief.

The homeowner may be eligible for special forbearance relief if it is found that the default was due to circumstances beyond the homeowners' control. 24 C.F.R. Sec. 203. The homeowner and the lender are authorized to enter into a forbearance agreement providing for:

i. Increase, reduction, or suspension of regular payments for a specified period;

ii. Resumption of regular payments after expiration of the forbearance period;

iii. Arrangements for payment of the delinquent amount before the maturity date of the mortgage or at a subsequent date.

Suspension or reduction or payments shall not exceed 18 months under these special forbearance relief provisions.

c. Recasting of Mortgage.

HUD has the authority to approve a recasting agreement to extend the term of the mortgage and reduce the monthly payments. 24 C.F.R. Sec. 203.

HUD's actions may be declared unlawful and set aside if the court finds it to be arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law. See Federal National Mortgage Association v. Rathgens, 595 F. Supp. 552 (S.D. Ohio 1984); Butler v. Secretary of Housing and Urban Development, 595 F. Supp. 1041 (E.D. Pa. 1984). See, generally, Ferrell v.

Pierce, 560 F. Supp. 1344 (N.D. Ill. 1983).

In Brown v. Kemp, 714 F. Supp. 445 (W.D. Wash. 1989) the court found HUD's decision for an assignment program application to be informal agency action and thus reviewable under the "arbitrary" and "capricious" standard.

Failure to follow servicing requirements or comply with the HUD assignment regulations or handbook provisions may also constitute an equitable defense to foreclosure[35].

C. THE VA HOME LOAN PROGRAM

1. Applicability

Homeowners who have a VA guaranteed mortgage or deed of trust may be eligible for relief through a VA recommended forbearance program or "refunding" of the loan. Regulations promulgated at 38 C.F.R. Sec. 36.4300, et seq., and VA servicing handbooks establish a policy of forbearance when a loan is in default. The VA is reluctant to enforce these regulations against lenders.

2. Forbearance Relief

Lenders are officially encouraged to grant forbearance relief for mortgagors who default on their loans due to circumstances beyond their control. Lender's Handbook, VA Pamphlet No. 26-7 (Revised) and VA Manual 26-3. These rights should be pursued with the lender immediately.

3. Refunding Loans

35 See, Bankers Life Company v. Denton, 120 Ill. App. 3d 676, 458 N.E.2d 203 (1983); Brown v. Lynn, 385 F. Supp. 986 (N.D. Ill. 1974); GNMA v. Screen, 379 N.Y.S.2d 327 (1976); Cross v. FNMA, 359 So.2d 464 (1978); FNMA v. Ricks, 372 N.Y.S.2d 485 (1975); contra, Robert v. Cameron Brown Co., 556 F.2d 356 (5th

The Veteran's Administration is authorized to "refund" loans when borrowers meet certain criteria. Refunding the loan is when the VA pays the lender in full and takes an assignment of the loan and security in cases where the loan is in default. The VA then owns the loan and the veteran makes payments to the VA directly. Although 38 C.F.R. Sec. 36.4318 authorize refunding, the regulations are much more vague than those promulgated in connection with the HUD assignment program.

4. Judicial Review

The VA decision to deny assignment of a VA loan is committed to agency discretion within the meaning of the federal Administrative Procedures Act, 5 U.S.C. Sec. 701(a)(2), and is not reviewable. Rank v. Nimmo, 677 F.2d 692 (9th Cir. 1982).

The courts have ruled that a borrower has no express or implied right of action in federal court to enforce duties, which VA or lenders might have under VA publications with respect to forbearance assistance. See, Rank v. Nimmo, supra; Gatter v. Nimmo, 672 P.2d 343 (3rd Cir. 1982); Simpson v. Clelend, 640 F.2d 1354 (D.C. Cir. 1981). But, see, Union National Bank v. Cobbs, 567 A.2d 719 (1989) (failure to follow VA Handbook an equitable defense).

Failure to follow VA publications, however, may be an equitable defense to foreclosure under state law. See, Simpson v. Cleland, supra.

5. Waiver of Debt/Release of Liability

Federal statutes, VA regulations and guidelines require the VA to waive a deficiency (or indemnity) debt, after a foreclosure, when equity and good conscience require it. 38 C.F.R.

Cir. 1977); Hernandez v. Prudential Mortgage Corporation, 553 F.2d 241 (1st Cir. 1977).

§1.965(a)(3). The VA is reluctant to follow its own regulations and must be pressed. The Court of Veterans Appeals (CVA) reverses over 50% of denial of waivers - an astonishing measure of the VA's failure to follow clear federal law! See The Veterans Advocate, Vol. 5, No. 10, P. 93 (June 1994). The VA urged its regional offices to avoid CVA rulings until forced to retract this directive. See The Veterans Advocate, supra. The VA also ignores the six-year statute of limitations when demanding payment. 28 U.S.C. 2415.

Secondly, the VA can determine that the claimed debt is invalid, such as when the veteran is eligible for a retroactive release of liability. This occurs when the VA would have released the veterans when the property was sold to a qualifying purchaser who assumes the debt. 38 U.S.C. 3713(b); Travelstead v. Derwinski, 978 F.2d 1244 (Fed. Cir. 1992).

The VA has the burden to determine whether the veteran should be released.

6. Deficiency Judgments and VA Loans

It is the policy of VA to order an appraisal prior to a judicial or nonjudicial foreclosure sale and to instruct the lender to bid the amount of the appraisal at the sale. This "appraisal" is always below fair market value and includes the VA's anticipated costs of holding and liquidating the property. 38 U.S.C. 3732(c); 38 C.F.R. §36.4320. Ordinarily, on pre-1989 laws, VA will not waive its right to seek a deficiency judgment in a judicial foreclosure and will reserve its right to seek a deficiency against a borrower, even in the case of a nonjudicial foreclosure of a deed of trust, notwithstanding the anti-deficiency language of RCW 61.24.100. On loans made after 1989 changes in the VA program, deficiencies are not sought.

Although, United States v. Shimer, 367 U.S. 374 (1960) appears to authorize this VA

deficiency policy, the Washington non-judicial deed of trust foreclosure procedure which retains judicial foreclosure and preservation of the right to seek a deficiency judgment as an option, seems to make United States v. Shimer, distinguishable.

In United States v. Vallejo, 660 F. Supp. 535 (1987), the court held that the VA must follow Washington foreclosure law, including the anti-deficiency provisions of the Deed of Trust Act as the "federal common law". This ruling was subsequently followed in a class action, Whitehead v. Derwinski, 904 F.2d 1362 (9th Cir. 1990), wherein the VA has been permanently enjoined from collecting $63 million in claims and ordered to repay millions in illegally collected deficiencies. This issue of the application of various state laws as to federally insured loans is not clear, as the Ninth Circuit overruled Whitehead in Carter v. Derwinski, 987 F.2d 611 (9th Cir. - en banc - 1993). Subsequent decisions still create doubt as to whether United States v. Shimer, supra, is still good law[36].

At the very least, if the lender is instructed by the VA to preserve the right to seek a deficiency against the borrower, then the lender should be required to foreclose the deed of trust judicially as a mortgage.

D. RURAL HOUSING SECTION 502 LOANS

1. Applicability

The Rural Housing Service (RHS) formerly, the Farmer's Home Administration, is authorized to grant interest credit and provide moratorium relief for homeowners who fall behind on their loan

36 See, United States v. Yazell, 382 U.S. 341 (1966); United States v. Kimbell Foods, Inc., 440 U.S. 715 (1979); United States v. Ellis. 714 F.2d 953 (9th Cir. 1983); United States v. Haddon Haciendas Co., 541 F.2d 777 (9th Cir. 1976).

payments due to circumstances beyond their control. Regulations for moratorium relief and interest credit are found at 7 C.F.R. Sec. 3550 et seq and must be complied with prior to foreclosure. United States v. Rodriguez, 453 F. Supp. 21 (E.D. Wn. 1978). See, 42 U.S.C. §1472. All servicing of RHS loans is handled at the Centralized Servicing Center in St. Louis, MO (phone: 1-800-793-8861).

2. Interest Credit

If a homeowner falls behind on his RHS loan because of circumstances beyond his or her control, then RHS has the authority to accept principal only and waive the interest payments. Although RHS is supposed to use this remedy before considering moratorium relief, it rarely does.

3. Moratorium Relief

If a homeowner falls behind in loan payments because of circumstances beyond his or her control, RHS may suspend payments or reduce payments for six months. Moratorium relief may be extended for additional six-month segments up to a total of three years[37].

Once a homeowner has been granted moratorium relief, RHS cannot grant it again for five years. If a homeowner cannot resume payments in three years from when moratorium relief began, then it will begin foreclosure proceedings.

After moratorium relief has been extended, the homeowner can make additional partial payments to catch up the delinquent amount or, the loan can be reamortized. RHS will restructure the loan, 7 U.S.C. 2001.

4. Waiver of Redemption and Homestead Rights

37 See generally, Note, Agricultural Law: FmHA Farm Foreclosures, An Analysis of Deferral Relief, 23 Washburn L.J. 287 (Winter 1984); Newborne, Defenses to a FmHA Foreclosure, 15 NYU Review of Law and Social Change, 313 (1987).

Form mortgages used by RHS purported to waive the homeowner's redemption rights and homestead rights in the event of foreclosure. It is questionable whether such a waiver is enforceable[38].

5. Homestead Protection

See, 7 U.S.C. 2000.

6. Lease/Buy-Back

See, 7 U.S.C. 1985 (e).

VI. RESOURCES

The following treatises are excellent sources of basic information about all aspects of the foreclosure process. Dunaway, The Law of Distressed Property (4 volumes - Clark Boardman Co. 1994 and suppls.; Nelson & Whitman, Real Estate Finance Law (West 3rd Ed. 1994); Bernhardt, California Mortgages and Deed of Trust Practice, (3rd ed. 2000 University of Calif.), Repossessions and Foreclosures (4th ed. 2000) National Consumer Law Center. See also, Fuchs, Defending Non-Judicial Residential Foreclosures, Texas Bar J (November 1984).

38 See, United States v. Kimbell Foods, Inc., 440 U.S. 715 (1979); United States v. Haddon Haciendas, 541 F.2d 777 (9th Cir. 1976); United States v. MacKenzie, 510 F.2d 39 (9th Cir. 1975); United States v. Stadium Apts., Inc., 425 F.2d 358 (9th Cir.), (1970), cert. den. 400 U.S. 926, 91 S. Ct. 187 (1970); Phillips v. Blaser, 13 Wn.2d 439, 125 P.2d 291 (1942).