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Reformation: A Proposition to Consider When a Former Trustee Conducts a Foreclosure Sale

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The majority of the trustee world remembers the *Dimock*[1] case, where the California Court of Appeals voided a foreclosure sale held by the former trustee after a new trustee had been substituted in under the deed of trust.

Dimock's harsh ruling for a mere administrative oversight is seemingly inequitable. Yet, the court's order is consistent with *Civil Code* § 2934a, in that the only statutory means of changing a recorded substitution of trustee is the recording of another substitution. The court reasoned that the code is coherent with practical necessity, as multiple trustees retaining the power to sell a borrower's property would "create inestimable levels of confusion, chaos and litigation…"[2]

> ***"…in the face of an invalid sale, when such mistakes arise, reformation may be a way around the seemingly inflexible Dimock decision."***

However, while recently dealing with this exact issue in a case, we came across a gem of a case – *Jones v. First American Title Ins. Co.*[3]

BACKGROUND

Jones demonstrates how a technical defect, such as inadvertently substituting the wrong trustee, can be cured through reformation of a written instrument, which is an equitable remedy, as opposed to the statutory remedy applied in *Dimock.*

In *Jones,* the borrowers obtained a loan for $8,7000,000 to purchase property in Simi Valley, California. The borrowers defaulted on the loan and pledged two more properties as security. When the borrowers defaulted for a second time, the bank commenced foreclosure proceedings. First American Title was substituted as trustee of the deed of trust. The borrowers and the bank then entered into a forbearance agreement wherein the borrowers agreed to make a payment on the loan of $1,200,000 in exchange for the release of one of the secured properties.

The bank then recorded a "Substitution of Trustee and Partial Reconveyance" to release the parcel, with the intent of substituting itself as trustee for only the released parcel, but the document effectively subbed the bank in as trustee for all parcels secured by the deed of trust.

The borrowers defaulted once again, and the bank foreclosed on the remaining properties. First American Title was the foreclosing trustee, however, they had not been substituted back in as trustee after the bank had substituted themselves as trustee to do the partial reconveyance.

Two years after the foreclosure, when the

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properties had greatly increased in value, the borrowers filed suit to challenge the foreclosure sale based on the failure to substitute First American in as trustee prior to the foreclosure sale. The borrowers relied on *Dimock* for the proposition that a foreclosure sale held by a former trustee is void. The Court of Appeal in *Jones,* recognized the *Dimock* decision, but held that reliance on *Dimock* is misplaced since the court in its ruling did not consider reformation.[4]

REFORMATION

Civil Code § 3399 provides that, "[w]hen, through fraud or a mutual mistake of the parties, or a mistake of one party, which the other at the time knew or suspected, a written contract does not truly express the intention of the parties, it may be revised on the application of a party aggrieved, so as to express that intention, so far as it can be done without prejudice to rights acquired by third person, in good faith and for value."

In *Jones,* the court emphasizes that "mistake is an ingredient of reformation, but not its essence. The essential purpose of reformation is to reflect the intent of the parties." [5] The parties in *Jones* entered into a complex set of agreements, which included the bank's right to foreclose if the borrowers did not perform. The substitution of trustee, one of the documents to effectuate this agreement was deficient. Therefore, the court determined that to carry out the intent of the parties, reformation of the substitution was necessary. [6]

In reaching this conclusion, the court considered several factors. First, there was undisputed evidence of mutual mistake because the parties believed that the documents were sufficient to carry out the intent of the parties. Second, there was no showing that the parties were prejudiced by the former trustee's conduct of the foreclosure sale, since the borrowers did not raise the issue until two years after the foreclosure, when the properties greatly increased in value. Finally, failure to apply reformation would result in a windfall to the borrowers and a significant injustice to the banks. [7]
Moreover, the Court held that reformation, which would essentially waive the requirements of §2934a, would not violate public policy. [8] This is because parties of a deed of trust may negotiate a form of substitution other than that provided in § 2934a. [9] Further, there is no statute that expressly prohibits the waiver of § 2934a. [10]

Taking all circumstances into consideration, the Court decided that reformation is the most reasonable disposition because it will validate the foreclosure and carry out the intent of the parties under the deed of trust.

CONCLUSION

As *Jones* points out, the failure to have a recorded trustee foreclose on the property does not justify reformation in every case. As with most equitable remedies, each case must be evaluated on its own facts. But, in the face of an invalid sale, when such mistakes arise, reformation may be a way around the seemingly inflexible *Dimock* decision.

1 Dimock v. Emerald Properties (2000) 81 Cal.App.4th 868, 97 Cal.Rptr.2d 255,
2 Id. at 876.
3 Jones v. First American Title Insurance Company (2003) 107 Cal.App.4th 381.
4 Id. at 390.
5 Jones, 107 Cal.App.4th 381, 389.
6 Id.
7 Id.
8 Id. at 390.
9 Id. at 390, citing Pacific S. L. Co. v. N. American etc. Co. (1940) 37 Cal.App.2d 307, 309-311.
10 Id.
11 Id.

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