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THE NEW WAVE OF LITIGATION – CHALLENGES TO TRUSTEE’S SALES UNDER CIVIL CODE SECTION 2932.5

By Richard Simpson, Esq., Wright Finlay & Zak

Unfortunately, given the continuing decline in real estate values and the high level of non-judicial foreclosures borrowers have been challenging the validity of Trustee’s sales at an alarming rate. While the primary argument being posited remains compliance with *Civil Code* Section 2923.5 which requires an effort be made to contact the borrower to explore loan modification alternatives to foreclosure, we have recently encountered use of *Civil Code* Section 2932.5 as a means of voiding a completed Trustee’s sale when the assignment of the deed of trust is recorded after the Trustee’s sale.

California Civil Code Section 2932.5 (“CC 2932.5”) provides that, “where a power to sell real property is given to a mortgagee, or other encumbrancer, in an instrument intended to secure the payment of money, the power is part of the security and vests in any person who by assignment becomes entitled to payment of the money secured by the instrument. *The power of sale may be exercised by the assignee if the assignment is duly acknowledged and recorded.*” (Emphasis added.)

Simply stated, the purpose of CC 2932.5 is to provide public notice of who holds the power of sale in a *mortgage* rather than a deed of trust.¹ In a mortgage, which is used on rare occasion in California to secure repayment of a loan, the power of sale is held by the holder/owner of the mortgage. In a deed of trust, the power of sale is always held by the trustee. The sole purpose of Section 2932.5 is to make it abundantly clear from recorded documents who actually holds the power of sale in a mortgage *because the power of sale always resides with the holder of the*

secured debt obligation. Thus, CC 2932.5 requires recordation of the assignment of the mortgage as the means of identifying the holder of the all important power of sale. As noted in controlling California law, the reason behind identifying the holder of the mortgage with power of sale is that it must be clear who holds the power to sell the property so that the chain of title is complete upon the execution and delivery by the Mortgagee of the Mortgagee’s Deed Upon Sale.

In order to appreciate why CC 2932.5 applies to mortgages and not to deeds of trust, one must understand the technical difference between a mortgage and a deed of trust. A mortgage involves two parties: the borrower/mortgagor who grants the power of sale to the mortgagee/lender, and the mortgagee/lender who holds the beneficial interest in the mortgage as well as the power of sale.² The power of sale given in a mortgage is part of the mortgage and cannot be legally separated. A deed of trust, on the other hand, involves three parties: the borrower/trustor, the lender/beneficiary, and the trustee who is granted conditional title to the encumbered property as well as

the power of sale.³ Unlike a deed of trust, conditional title is not granted to the mortgagee/lender upon the creation of the mortgage unless the mortgage expressly provides for such transfer.

The functional equivalent of CC 2932.5 for a deed of trust is *Civil Code* section 2934a (“CC 2934a”), which generally requires that a substitution of trustee of a deed of trust be recorded before the power of sale can be carried out by the substituted trustee.

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This achieves the same goal as CC 2932.5 – it provides public notice of who holds the power of sale concerning the described deed of trust, thus satisfying the same salutary purpose of having a complete chain of title regarding the holder of the power of sale. This provides the same insurable chain of title regarding the all important Trustee's Deed Upon Sale.

Applying CC 2932.5 to an assignment of a deed of trust makes no sense in light of the Legislature's adoption of CC Section 2934a, which was enacted in 1934 at the same time as the Legislature allowed a beneficiary of a deed of trust to unilaterally substitute the original trustee without requiring the trustee's consent. Prior to 1934, trustees were rarely changed. Given the explicit requirement of recording a substitution of trustee, application of CC Section 2932.5 to assignments of deeds of trust makes no sense as the recordation is not necessary to achieve the all important complete chain of title with respect to the identity of the holder of the power of sale. Furthermore, applying CC Section 2932.5 to a deed of trust could potentially transfer the power of the trustee to the new beneficiary any time the beneficial interest of a deed of trust is assigned and recorded ("... The power of sale may be exercised by the assignee if the assignment is duly acknowledged and recorded").⁴ Clearly, it was not the intent of the Legislature to morph a deed of trust into a mortgage by requiring the recordation of the assignment of the beneficial interest in the deed of trust be recorded as a condition precedent to the new beneficiary having the right to direct the Trustee to exercise the power of sale.

Despite the obvious harmony between CC Sections 2932.5 and 2934a, counsel for defaulted and sold out Borrowers are trying to gain traction by confusing judges with citations to post 1933 California case law that holds mortgages and deeds of trust are functionally the same *security instruments*. Given these holdings, the argument is that the requirement to record a mortgage assignment has to apply equally to assignments of deeds of trust, especially given the use of "or other encumbrancer" in the body of CC Section 2932.5. This term is argued to include a beneficiary of a deed of trust, despite California decisional law that holds that said phrase does not apply to deeds of trust. Also, Borrower's counsel cite to recent Federal Court decisions that excoriate the MERS system of "hiding" the true identity of the note holder/beneficiary and by applying CC 2932.5 to deeds of trust it brings "transparency" to ownership of promis-

sory notes and the foreclosure process. Fortunately, so far we are aware of only two bankruptcy judges in the United States Bankruptcy Court, Central District of California who have ruled in favor of applying CC 2932.5 to deeds of trust. Both rulings are currently on appeal. Unfortunately, the impact of these decisions is the Trustee's sales are potentially void and therefore relief from the automatic stay must arguably be obtained in order to be able to conduct new Trustee's sales. This can be time consuming and expensive as well as problematic as bankruptcy judges have wide latitude in determining if relief from stay should be granted.

While we believe that the legislative history and case law support the non-application of CC 2932.5 to deeds of trust, the easiest way to avoid litigation on this issue is to simply record the assignment of the deed of trust *before* executing the Notice of Sale. That should make everyone's life a bit easier.

- 1 Stockwell v. Barnum (1908) 7 Cal.App.413, 416-417, holding that the term "other encumbrancer" does not include a beneficiary of a deed of trust.
- 2 *Witkin, Summary of California Law*, 10th Ed, Chapter VIII, Secured Transactions in Real Property, p. 795, Section 5(a).
- 3 *Cal. Jur.* 3rd, Vol.27, Deeds of Trust, Section 1, p. 21, citing *Siegal v. American Savings & Loan Ass'n* (1989) 210 Cal.App.3d 953 and *Kerivan v. Title Ins. & Trust Co.* (1983) 147 Cal.App.3d 225.
- 4 *California Civil Code* § 2932.5.



Richard Simpson is an associate with Wright Finlay & Zak, LLP. He specializes in litigation and representation involving UCC, mortgage banking, loan servicing, loan origination, foreclosure trustee defense, title issues, repurchase litigation, general business and real estate, as well as complex bankruptcy and eviction matters. He can be reached at rsimpson@wrightlegal.net.