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# Receivership Sales of Troubled Projects: A Better Alternative To Foreclosure in California

By Alfred M. Clark, III

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In the world of California's troubled commercial real estate assets, alternatives to existing foreclosure procedures, many of which have been in place since the Great Depression, would better serve both borrowers and creditors. California's current real property foreclosure remedies involve the public auction of mortgages in default through either the established judicial or the nonjudicial foreclosure procedures. California's "one-action rule" provides that the creditor must first exhaust the real property collateral security before seeking recourse against the borrower. Although the foreclosing lienholder can collect a deficiency judgment following a judicial sale, the borrower retains post-sale redemption rights, and the court must also conduct a fair value hearing to determine the deficiency. The non-judicial foreclosure alternative enables the foreclosure purchaser to take title free and clear of the borrower's right to redeem the property, but does not allow a foreclosing lienholder to recover a deficiency judgment from the defaulting borrower. The California Legislature enacted the one-action rule and anti-deficiency and fair value provisions in the wake of the Great Depression to protect borrowers from unscrupulous lenders.

This article suggests that these borrower "protections" adversely impact the ability of both the judicial and nonjudicial foreclosure processes to generate a reasonable approximation of the encumbered property's market value. This failure can harm the creditor, the borrower, and the borrower's principals. However, there is an alternative. A sale through a receiver of commercial property encumbered by a mortgage in default offers benefits for all parties involved. Although all parties are likely to benefit from the sale by a receiver of real property subject to foreclosure, and the law would appear to allow such a result, a major practical limitation is that, absent agreement to the sale of all affected parties, including lender, receiver, borrower and junior lienholders, the availability of title insurance becomes problematic, as explained in detail below.

## I. FORECLOSURE PROCEDURES ESTABLISHED AS BORROWER PROTECTIONS

Before the onset of the Great Depression, a lender holding a mortgage in default could either foreclose its real property collateral, or waive the collateral and proceed on the note.<sup>1</sup> If the creditor sought to recover first from the security, it could proceed by judicial sale, or by private nonjudicial sale. But, in both circumstances, the creditor could recover a deficiency following the foreclosure sale.<sup>2</sup> Because the borrower had the right to redeem the property following the judicial foreclosure sale, it was to the creditor's advantage to pursue the nonjudicial sale procedure.<sup>3</sup>

The use of the nonjudicial sales procedure resulted in a substantial benefit to the foreclosing creditor, particularly in an era

such as the Great Depression of declining property values and a tight money supply. Under these circumstances, "a mortgagee was able to purchase the subject real property at the foreclosure sale at a depressed price far below its normal fair market value and thereafter to obtain a double recovery by holding the debtor for a large deficiency."<sup>4</sup>

This perceived unfairness led the California Legislature to enact fair value limitations applicable to both judicial and nonjudicial foreclosures.<sup>5</sup> These provisions limited any deficiency judgment to the difference between the fair value of the property at sale and the amount of the debt remaining unpaid after the sale. In 1940, the Legislature also enacted legislation precluding the collection of a deficiency judgment following a nonjudicial foreclosure sale<sup>6</sup> in order "to put judicial enforcement on a parity with private enforcement."<sup>7</sup> Thereafter, the creditor could collect a deficiency judgment following a judicial foreclosure sale, subject to the fair value limitations and borrower's redemption right, or the creditor could proceed with a nonjudicial sale without any right to a deficiency. As the California Supreme Court recognized "[i]n either case the debtor is protected."<sup>8</sup>

## II. MODERN COMMERCIAL FINANCING HAS IMPACTED THESE BORROWER PROTECTIONS

As commercial mortgage financing has evolved, it is questionable whether the Depression-era borrower protections legitimately protect borrowers. Common commercial financing practices of the last twenty-five years have provided borrowers and their principals with limited recourse. Further, virtually all of the capital markets financing has been to single asset, bankruptcy remote borrowers with limited recourse guarantees which, in certain circumstances, ripen into full payment and performance guarantees. These limited recourse obligations typically involve protecting lenders from losses from diversion of rents and security deposits, waste, failure to pay property taxes, and similar conduct often referred to as "bad boy" acts. The limited recourse provisions are transformed into full recourse for the entire loan upon fraud or willful misrepresentation, transfers in violation of the prohibited transfer provisions, breaches of the single asset covenants in the loan documents and borrower governing documents, and upon bankruptcy. Thus, these developments in financing conditions have limited borrower protections such that borrowers and their principals may face liability following a nonjudicial foreclosure sale.

Although borrowers cannot legally waive either the one-action rule or the anti-deficiency statutes, the California Court of Appeal ruled in *Union Bank v. Gradsky* that guarantors can waive those protections. There, in 1968, the Court considered a claim by a guarantor that the lender's decision to foreclose the guaranteed obligation through a nonjudicial foreclosure sale

exonerated the guarantor.<sup>9</sup> The guarantor's argument was that by electing a foreclosure remedy that precluded the lender from obtaining a deficiency judgment (i.e., a nonjudicial foreclosure), the lender cut off the guarantor's subrogation rights to collect any deficiency from the borrower that the guarantor would then be obligated to pay to the lender. While acknowledging that a guarantor could waive those subrogation rights, the court determined that the waiver contained in the guaranty in question was not adequate. Consequently, a lender could look to a guarantor for recovery of a deficiency even in the context of a nonjudicial foreclosure, provided the guarantor's waiver was sufficiently explicit to evidence the specific defense being waived. For almost twenty-five years following that court's decision, many appellate decisions have examined guarantors' waivers and, for the most part, concluded that the waivers were inadequate.

In 1995, the California Legislature codified the *Gradsky* waivers in section 2856 of the Civil Code. Since then, commercial loan guarantors, typically principals of the borrowers, often face liability following a nonjudicial foreclosure sale despite the protections otherwise available to the borrowers.

### III. CONSEQUENCES OF FORECLOSURE SALE PROCEDURES

Because of the limitations inherent in both judicial and non-judicial sales procedures, sales prices are likely not as high as they would be in a traditional sale between buyer and seller. Both judicial and nonjudicial foreclosure sales occur through a public auction where interested purchasers must bid cash to the credit bids of foreclosing lienholders, and there is no mechanism for the usual property investigations by prospective bidders at the sale. As such, although it is difficult to construct a methodology for determining the magnitude of the effect, it is highly probable that the existing foreclosure sale process limits the prices generated at a foreclosure sale.<sup>10</sup>

Under both judicial and nonjudicial foreclosure sale scenarios, prospective bidders cannot perform the usual and customary due diligence investigations available to purchasers in negotiated sale transactions. For example, the prospective bidder is unable to investigate or determine such matters as property conditions (including potential environmental issues) and existing leases on the property. As a result, the price paid by a third party at a foreclosure sale will necessarily include some discount. Additionally, a prospective bidder is not able to secure conventional financing since the bids require cash at the sale and cannot be subject to arranging standard mortgagee protections. Consequently, the universe of bidders is limited to those with plentiful cash on hand. Furthermore, a purchaser at a judicial foreclosure sale will acquire the property subject to the statutory redemption rights of the former owner provided by sections 729.010 through 729.090 of the California Code of Civil Procedure. This creates a cloud on title that can extend for twelve months following the sale. Thus, the purchaser will likely discount the purchase price since "the lender who bids on the property is temporarily deprived of the difference between the property's 'fair value' and its market value as encumbered [by the redemption right]."<sup>11</sup>

These issues, which impact foreclosure sales conducted in stable economic times, can impose further burdens on prices in down commercial real estate markets where prices are unstable and cash is not readily available. The borrower facing fore-

closure may have limited interest in the amount of proceeds generated at a nonjudicial foreclosure sale, since it will not face continued liability following a nonjudicial sale as a result of the anti-deficiency protections afforded in section 580d of the California Code of Civil Procedure.<sup>12</sup> However, to the extent a principal of the borrower has provided a guaranty or where a judicial foreclosure is a real possibility, the borrower may be sufficiently motivated to improve the prospects for realizing greater value upon the sale of the encumbered property. Under either a judicial or nonjudicial sale, a creditor will have similar motivation to increase the value upon sale. A sale of such property by a court-appointed receiver may provide that opportunity.

## IV. RECEIVERSHIP SALES

### A. Courts Recognize General Receiver Authority

California law provides a framework allowing the use of receivers when a foreclosure action or trustee's sale is pending. Section 564(a) and (b) of the California Code of Civil Procedure provide that for certain types of legal actions, the court has the authority to appoint a receiver.<sup>13</sup> Both subsections 564(b)(2) and (b)(11) contemplate receiver appointments in connection with the foreclosure of a deed of trust. As one court has recognized, however, receivership is a means and not an end: "The appointment of a receiver is an ancillary proceeding concerned with the preservation of the property subject to litigation pending its ultimate disposition pursuant to final judgment."<sup>14</sup> For a lender to pursue the receivership remedy, it must have a judicial and/or a nonjudicial foreclosure pending.

Provided an action is pending, section 564 of the California Code of Civil Procedure establishes a number of circumstances where a court can appoint a receiver.<sup>15</sup> Section 564(a) provides that a receiver may be appointed by a court "in any case in which the court is empowered by law to appoint a receiver." Section 564(b) enumerates specific circumstances where a court may appoint a receiver including:

- in connection with a pending foreclosure where there may be a danger of property being lost, removed, or injured;
- where a condition of the mortgage being foreclosed has not been performed;
- where necessary to preserve the property or rights of any party; and
- in an action for specific performance or enforcement of an assignment of rents provision, either in a deed of trust or a separate assignment document.<sup>16</sup>

The receiver's sole role is as an agent and officer of the appointing court.<sup>17</sup> Importantly, the receiver does not possess unlimited authority. However, section 568 of the California Code of Civil Procedure expressly provides that "under the control of the court," the receiver has the "power to bring and defend actions in his own name, . . . to take and keep possession of the property, to receive rents, collect debts, to compound for and compromise the same, to make transfers, and generally to do such acts respecting the property as the court may authorize."<sup>18</sup> As the California Supreme Court recently

noted, “property in receivership remains under the court’s control and continuous supervision, and the importance of such supervision cannot be overstated.”<sup>19</sup>

In exercising this supervisory authority, courts are inclined to ratify the receiver’s actions when the receiver is appointed and acting in good faith. This is the case even when the receiver has acted without the court’s explicit authorization. As acknowledged by the California Supreme Court, “[w]here a receiver has acted in good faith and when what he has done has been beneficial to the interested parties, his acts, though taken without court authorization, should be subsequently approved.”<sup>20</sup>

Illustrating this reticence to second guess a receiver’s judgment, in *City of Santa Monica v. Gonzalez*,<sup>21</sup> the property owner challenged the receiver’s decision, authorized by the trial court, to demolish an apartment building. The building was both the principal residence of the property owner as well as a source of income, however it had a history of health and safety code violations which the property owner had failed to act upon. The property owner contended that rehabilitation rather than demolition was a better alternative. In its decision, the California Supreme Court acknowledged that it was unable to find a published decision in California establishing a standard for reviewing such a demolition by a receiver. However, it recognized the principle that courts generally provide great deference in receivership matters: “Such deference is the rule, even where the court confirms extraordinary action by the receiver, such as the sale of real property.”<sup>22</sup> Based upon this deferential standard, the Court upheld the receiver’s decision to demolish the building.

## B. Statutory Receiver Sales

The sale of property in a receivership estate is one of the most powerful tools available to a receiver, and correspondingly has detailed procedural requirements. As acknowledged by the Supreme Court in *City of Santa Monica v. Gonzalez*,<sup>23</sup> and as expressly permitted by section 568.5 of the California Code of Civil Procedure, a receiver may sell real property that is part of the receivership estate upon obtaining a court order.<sup>24</sup> Section 568.5 prescribes a sale procedure<sup>25</sup> involving the auction of the property to the highest bidder, which is the same procedure that governs sales under levy, as more particularly set forth in sections 701.540 to 701.680 of the California Code of Civil Procedure. This same procedure also governs judicial foreclosure sales.<sup>26</sup> Again, given the drawbacks of such a process, it is less likely a borrower and lender would pursue a receivership sale in the manner expressly contemplated by the statute, as doing so would offer no benefit over a judicial foreclosure sale. An alternative to the statutory procedure, on the other hand, offers clear benefits.

## C. Alternative Receiver Sale Procedures

Although the statutory sale procedure offers a clear roadmap for a receivership sale, there are other procedural options for a receivership sale. In *People v. Riverside University*,<sup>27</sup> the court reviewed the trial court’s decision to reject a receiver’s sale of certain estate assets in order to fund the receiver’s administration. In its decision, the trial court assumed it could not approve the sale because the sale was not conducted in accordance with the statutory procedure. The appellate court concluded “that assumption was erroneous.”<sup>28</sup> The court determined that, as

a general proposition, “if no good reason appears for refusing to confirm a receiver’s sale, such as chilling of bids or other misconduct or gross inadequacy of price, the sale should be confirmed.”<sup>29</sup> Indeed, the court concluded that a “court has power to confirm the sale although the terms of the decree of sale have not been strictly followed.”<sup>30</sup> This decision is consistent with the California Supreme Court holding in *City of Santa Monica* affirming deference to a receiver’s extraordinary action, including a sale.<sup>31</sup>

The *Riverside University* court took care to distinguish a receiver’s sale from a sale on execution of a levy. The court noted that a “ministerial officer” whose authority derives from the law and the writ conducts the execution sale.<sup>32</sup> Contrary to the limited authority of a ministerial officer in an execution sale, a receiver acts “under the control and continuous supervision of the court.”<sup>33</sup> The court held: “We interpret section 568.5 to mean that **unless the court prescribes a different mode of sale**, a receiver, when authorized, must sell property in the manner provided for sales on execution.”<sup>34</sup> Consequently, the court has the power to authorize the receiver’s actions unless otherwise precluded by statute.

The court also noted that it could not find a case authorizing a sale with a process other than that contemplated in the statute authorizing receivership sales. But, it did discuss receiver sales in two other cases, *Lesser & Son v. Seymour*<sup>35</sup> and *MacMorris Sales Corp. v. Kozak*.<sup>36</sup>

*Lesser* involved a challenge to a sale of partnership assets by a receiver in the context of a partnership dissolution. The court established a process involving a sale to the highest bidder within a specified time period. The receiver sought court confirmation of the bid, and at the confirmation hearing, the plaintiffs submitted a higher bid resulting in a sale to plaintiffs. Rejecting the defendant’s objection that the sale occurred after the specified time period had expired, the *Lesser* court acknowledged the broad powers of a court in equity. Recognizing that the sale procedures were instructions for the receiver, the court nonetheless noted that “[t]o effectively perform [the receiver’s] duty necessarily requires some flexibility and continuity of jurisdiction in giving instructions to the receiver as to the manner in which the property should be sold to meet the exigencies as they may arise.”<sup>37</sup> The court concluded its opinion with the recognition that “[t]here is wide discretion in the court in accepting a bid and confirming a judicial sale, and there was no fraud, unfairness or oppression in the sale.”<sup>38</sup> Therefore, the Court declined to set aside the sale as an abuse of discretion.

In *MacMorris*, the court charged the receiver with liquidating the inventory of a used car business “in a manner designed to realize the maximum sum therefore.” The dealership ultimately objected to the sale of the automobiles because the receiver sold the automobiles for less than their wholesale value. The court rejected this objection out of hand for the lack of any evidence “that the receiver could have received a better price.”<sup>39</sup> The *Riverside University* court read this case to support its ruling that the process followed in the sale is of little import so long as the price is reasonably maximized.

Based upon its analysis and these two cases, the *Riverside University* court upheld a receivership sale that was not conducted pursuant to the statutory procedure, and which departed from the process expressly contemplated in the initial court

order authorizing the sale. The court determined both that a receiver has a statutory right to conduct a sale on execution subject to the approval of and an order from the court, and that the court has the flexibility to approve sales by receivers that do not follow sale on execution procedures if it does so to maximize the sales proceeds for the benefit of the estate and all interested persons.

The case law supporting a court's equitable powers to appoint a receiver, even where it has previously declined to do so, has further evolved and solidified in the more recent case of *Gold v. Gold*.<sup>40</sup> *Gold* presents a fact situation similar to the *Lesser* decision and supports the holding in *Riverside University*. The *Gold* case involved a dispute among family members involved in more than a decade of contentious litigation involving a court ordered sale of assets. The trial court had previously rejected a party's cause of action for involuntary dissolution of the corporations owned by the family members at odds with one another, and specifically rejected the idea of appointing a receiver "at this time." Nonetheless, the trial court expressly retained jurisdiction until completion of an orderly sale of the real estate owned by the corporations.<sup>41</sup> The trial court ultimately decided to appoint a receiver, almost seven years after its initial decision ordering a sale of such real estate. Certain parties challenged the receivership decision because it was inconsistent with the earlier order specifically declining appointment of a receiver. On appeal, the court noted that "[a] court has inherent equitable power to appoint a receiver on its own motion where essential to accomplish a judicial objective."<sup>42</sup>

The *Gold* court acknowledged that the appointment of the receiver to sell the property represented a departure from the original order,<sup>43</sup> but reminded the parties that "the court may change the mode or procedure in executing its decrees, although the decree specifies a particular method." Indeed, relying in substantial part upon the *Lesser* and *Riverside University* decisions, the *Gold* court recognized that in an equity proceeding the court "has the power to change the manner of sale of property in the custody of the receiver."<sup>44</sup> This flexibility is necessary because "the primary function of the court is to manage or dispose of the property in the best manner possible and for the best interests of the parties concerned."<sup>45</sup>

#### D. Judicial Determination of the Extent of a Receiver's Authority

Courts have grappled with the question of whether the statutory provisions governing the appointment of a receiver impose limitations on the authority of a court to appoint a receiver. In other words, if the borrower is in default, does the failure to plead that the property's value is probably insufficient to discharge the mortgage debt,<sup>46</sup> or the failure to otherwise satisfy the express conditions contemplated in section 564 of the Civil Procedure Code, limit the right of the lender to obtain a receiver?

##### 1. Impact of Statutory Requirements

The court in *Barclays Bank of California v. Superior Court*<sup>47</sup> specifically addressed this question. Barclays Bank involved a deed of trust securing an obligation that was in default. The deed of trust expressly provided that upon default the lender could "collect and enforce payment of all rents, issues and prof-

its" of the encumbered property, "or cause or permit a receiver appointed by the court to perform the same."<sup>48</sup> The trial court accepted the borrower's challenge to the receiver's appointment on the basis that the lender had not alleged that the value of the property was likely insufficient to satisfy the obligations.

The court of appeal acknowledged that, in the absence of such an allegation, the lender was not entitled to a receiver under section 564(b)(2).<sup>49</sup> The court then looked to section 564(b)(7) which permits courts to appoint receivers in accordance with "the usages of courts of equity."<sup>50</sup> Recognizing that the California Supreme Court had ruled that a "stipulation in the mortgage that a receiver may be appointed and directed to take possession and collect the rents and profits, enlarges the rights of the mortgagee – at least against the mortgagor,"<sup>51</sup> the *Barclays* court concluded that the express acknowledgement in a deed of trust of a right to the appointment of a receiver upon default "presents a prima facie, but rebuttable, evidentiary showing of the beneficiary's entitlement to appointment of a receiver."<sup>52</sup>

Even though it allowed the appointment of a receiver, the *Barclays* court did not address the impact of the statutory provisions on the scope of the receiver's authority. In an application for a receiver, does the failure to plead that the property's value is probably insufficient to discharge the mortgage debt limit the scope of the receivership and restrict the receiver's powers and duties solely to that of collecting and administering the property's rents and profits under section 564(b)(10)? It appears again that the answer is no. The case law suggests that once a court appoints a receiver, only those limitations expressly imposed by the court and those clear and unambiguous statutory provisions proscribing such authority will limit the receiver's authority.<sup>53</sup> The examples in Part IV.D.2 below serve to illustrate the potentially broad scope of the receiver's ability to sell property out of the estate. That scope, while broad, is not unlimited, as discussed in Part IV.D.3 below.

##### 2. Broad Authority

In *Cal-American Income Property Fund IV v. Brown Development Corporation*,<sup>54</sup> the parties stipulated to the appointment of a receiver, and the court's order authorized the receiver to "generally to do such acts respecting the property as the court might authorize or the parties, by stipulation, could agree upon without prejudice to any further order."<sup>55</sup> The borrower challenged the court's ex parte order authorizing the receiver to engage an appraiser to establish the fair market value of the property, and an order shortening time to confirm the sale of the property. The borrower argued that the express provisions of the order of appointment limited the receiver's authority and the order at issue contemplated a receivership to collect and administer the rents and profits of the property.<sup>56</sup> The court, however, rejected that contention and concluded that a "receiver's functions and powers are controlled by statute, by the order appointing him and by the court's subsequent orders."<sup>57</sup> Acknowledging that the order of appointment did not expressly authorize the sale of property by the receiver, the court noted that the order also did not expressly exclude it. The order authorized the receiver "generally to do such acts respecting the property as the court may authorize."<sup>58</sup> The *Cal-American* court supported its conclusion with the acknowledgement, articulated in *Riverside University*,<sup>59</sup> that a court's confirmation of a receiver's sale "rests

upon the appointing court's sound discretion exercised in view of all of the surrounding facts and circumstances and in the interest of fairness, justice, and the rights of the respective parties."<sup>60</sup>

In *Resolution Trust Corporation v. Bayside Developers*,<sup>61</sup> the Ninth Circuit, applying California law, echoed this expanded view of a receiver's authority. In *Bayside*, the developer challenged the receiver's proposed final accounting that contemplated disbursing to the lender sales proceeds received from unit sales from a condominium project closed by the receiver. The developer based its challenge on two grounds: (1) the receiver's actions exceeded the scope of the court's appointment (for specific performance of the rents, issues, and profits provision in the lender's deed of trust); and (2) the lender was in violation of California's one-action rule and anti-deficiency protections by receiving sales proceeds collected by the receiver, after it had already completed its nonjudicial foreclosure sale.<sup>62</sup> The court rejected the first ground on the basis that the receiver's order specifically included the authority to "perform all acts to protect conserve and maintain said real property in the same manner as would the owner protect the property's best interest."<sup>63</sup> This broad authority necessarily includes the right to carry out pending sales obligations by closing pending sales escrows.

Similarly, in *J & J Sports Productions, Inc. v. Heuzo*,<sup>64</sup> the judgment creditor sought the appointment of a receiver to take control of the defendants' liquor license as part of its efforts to collect on a judgment. The district court noted that the Federal Rules of Civil Procedure permit a court to appoint a receiver,<sup>65</sup> but no federal law addresses the procedure for appointing a receiver for the sale of a liquor license. The court noted that section 708.620 of the California Code of Civil Procedure authorizes the appointment of a receiver to enforce a judgment where the moving creditor establishes "the appointment of a receiver is a reasonable method to obtain the fair and orderly satisfaction of the judgment."<sup>66</sup> Furthermore, because section 708.630 of the California Code of Civil Procedure provides that a liquor license is not subject to levy under a writ of execution, and California law sets forth a detailed procedure for transfers of such licenses, the court determined that the appointment of a receiver is "appropriate for the sale of such a license to satisfy a money judgment."<sup>67</sup> These cases confirm the broad power which courts are willing to concede to a duly appointed receiver.

### 3. A Narrower View

Recently, a trial court in Northern California, over the objections of the borrower, declined to approve the lender's request for an order authorizing a receivership sale of its shopping center collateral.<sup>68</sup> The borrower opposed the sale, asserting that the sale process was not open and transparent and excluded the borrower from participating in the negotiations.<sup>69</sup> The court's opinion provided that "[p]ending a settlement agreement, final judgment or foreclosure decree, the October 12, 2010 order granting the receiver the authority to sell the receivership property, etc., is premature," and that any sale must be pursuant to the judicial foreclosure procedure established under section 726(e) of the Code of Civil Procedure.<sup>70</sup> The court did not address the statutory receivership sales expressly permitted under section 568.5 of the Code of Civil Procedure, and the broad authority permitting receivership sales conducted under alternative proce-

dures. However, the "settlement agreement" qualification in the order might be construed as an acknowledgement that where the parties agree upon a sale process, the receiver's authority to sell will be upheld by the court. It is unclear why the court ignored the statutory receivership sale procedure contemplated in section 568.5 of the Code of Civil Procedure.

## V. LIMITS TO A RECEIVER'S AUTHORITY

### A. Express Statutory Limitations

There are of course statutory and practical limitations to the court's deference in considering the actions of lawfully appointed receivers, including a receiver's efforts to maximize proceeds from sales of assets within the receivership estate. In one recent appellate decision, *Wells Fargo Financial Leasing v. D & M Cabinets*,<sup>71</sup> a party challenged the appointment of a receiver to sell the principal residence of a business owner's ex-spouse in order to foreclose a judgment lien against the business. Following default after a forbearance agreement, Wells Fargo sought the appointment of a receiver to sell the residence in a procedure that was different than that contemplated in the Enforcement of Judgments Law,<sup>72</sup> which sets forth strict procedures for sales of personal residences intended to protect homestead exemptions.<sup>73</sup>

Wells Fargo sought to justify a receivership sale without following the public auction process contemplated in the statutory procedure. It argued that sheriff's sales are "poorly noticed, attract almost no bidders, and are extremely expensive" in part because of the large fees charged by the sheriff "and the sales prices are, in a word, abysmal."<sup>74</sup> By contrast, receivership sales are "more efficient and assets are sold for far higher prices because the receiver can employ brokers and otherwise advertise the sale in a commercially reasonable manner, and obtain a sale according to normal practices in the real estate industry."<sup>75</sup>

Appellant challenged the proposed receivership sale claiming that the statutory sale procedure protects the owner's homestead exemption. In particular, appellant relied upon section 704.740 of the Code of Civil Procedure which provides in relevant part "the interest of a natural person in a dwelling may not be sold under this division . . . to enforce a money judgment except pursuant to a court order for sale obtained under this article and the dwelling exemption shall be determined under this article."<sup>76</sup>

The court acknowledged that the procedure outlined in section 704.740 contemplates a detailed process, including determination by the court of the existence of a homestead exemption. If the exemption exists, the court then determines the amount of the exemption and the fair market value of the residence, and whether the residence can be sold for an amount likely to satisfy a portion of the amount due on the judgment. If the court determines the residence can be sold for an adequate amount, the court will fashion an order for sale.<sup>77</sup> If no bid exceeds the homestead exemption plus all liens and encumbrances, or if no bid is received that is at least ninety percent of the fair market value of the residence, no sale will occur without further court order.<sup>78</sup>

Relying upon the acknowledgement in *Riverside University* that "unless regulated by statute, the court has full power to order the receiver to dispose of property in such manner as the

court may deem in the best interest of the parties concerned,”<sup>79</sup> the *Wells Fargo* court concluded that the circumstances before it fit clearly within the “unless regulated by statute” limitation. Thus, the court concluded that “[Code of Civil Procedure] Section 704.740 unambiguously states that a dwelling subject to a homestead exemption ‘may not be sold under this division [citation omitted] to enforce a money judgment except pursuant to a court order for sale obtained under this article.’”<sup>80</sup>

Unfortunately, the *Wells Fargo* court declined to include in its opinion an acknowledgement that the sale under scrutiny involved homestead exemptions and was therefore expressly governed and limited by section 704.740. The court went on to observe that “the receiver statutes contemplate that sales by receivers to enforce judgments will be conducted in accordance with the [Enforcement of Judgments Law’s] provisions on execution sales.”<sup>81</sup> So does this put a nail in the coffin for receivership sales conducted in a process other than as provided in the Enforcement of Judgments Law? Clearly, the answer is no.

The *Wells Fargo* decision rested substantially upon the express and unambiguous prohibition of sales of personal residences to enforce judgment liens other than as expressly contemplated in section 704.740. Indeed, the court acknowledged the decision of *Riverside University* which “held that the trial court had the power to authorize sales by methods other than execution sales, and therefore possessed the power to approve sales so made without prior authorization.”<sup>82</sup> In addition, the court recognized the Supreme Court’s decision in the *City of Santa Monica* case, which it distinguished as having “nothing to do with the [Enforcement of Judgments Law].”<sup>83</sup>

However, the court acknowledged, “[w]here a statute is clear and unambiguous . . . we apply the statute as written, unless it leads to an absurd result contrary to the legislative intent.”<sup>84</sup> The court felt bound by the clear statutory provisions enacted to protect homestead exemptions for personal residences. By comparison, Section 568.5 more generally provides that a receiver “may” sell the property, pursuant to court order “upon the notice and in the manner prescribed by” the Enforcement of Judgments Law.<sup>85</sup> As a result, the status of the law in California remains that, in the absence of a circumstance involving the enforcement of a judgment implicating a homestead on a personal residence, a receiver may fashion a sale of property which is part of a receivership estate, and the court will likely approve that sale, so long as the receiver made his or her decision in good faith and for the benefit of all parties involved.

## B. Title Insurance Requirements

Although the law would appear to support receiver sales of encumbered commercial property which are approved by a court over objections from the borrower, there is a practical impediment to the use of receivership sales in connection with foreclosure of real property collateral. An important consideration in evaluating the effectiveness of the receivership sale alternative to foreclosure of real property encumbered by a mortgage in default is the ability of the purchaser at the receivership sale to obtain title insurance. The inability to obtain title insurance could reduce the pool of potential purchasers, or result in a discount of the price due to uncertainty of marketable title.

Based upon the decisions cited in this article where courts have upheld receivership sales over the objections of property

owners, a title company could insure title to a property sold pursuant to court order through a receiver sale, whether or not the sale was approved by the borrower or any junior lienholder, subject to the expiration of any appeal period, so long as the receiver was properly appointed and “acted in good faith and when what he has done has been beneficial to the interested parties.”<sup>86</sup>

In any event, current practice among most title companies operating in California appears to be that title will be insured provided the sale is approved by lender, the receiver, and the borrower, and that approval is incorporated into an order issued by the court where the receivership is pending. At this point, title companies have expressed an unwillingness to insure title where the borrower or the junior lienholder objects.<sup>87</sup> Title companies’ reluctance to insure over borrower or junior lienholder objections limits the effectiveness of the receiver sale remedy to those circumstances or sales where all parties agree to such a sale process.

## VI. CONCLUSION

The one-action rule and the anti-deficiency protections intended to benefit borrowers, and the consequences presented by the two established foreclosure procedures, have long constrained commercial mortgage lenders in California. The Legislature originally contemplated these principles as debtor protection provisions by preventing a deficiency following a nonjudicial foreclosure sale, and by providing a meaningful statutory right of redemption following a judicial foreclosure sale. However, these procedures proscribe a sale where the prospective buyer necessarily lacks the full and complete understanding of the project that it would have in a negotiated purchase transaction. The buyer must be prepared to bid cash against a credit bid of an uncertain amount. This imposes a limitation on the pool of likely bidders at the sale, and ensures that sales proceeds will reflect a significant discount from proceeds that could be generated from a negotiated purchase, where the buyer has the opportunity for due diligence and to arrange financing to facilitate the purchase.

A negotiated receiver sale would be preferable to all involved parties in many instances. The receiver would manage and conduct the sale, subject to the review and approval of both lender and borrower. The property could be publicly marketed and exposed to multiple potential buyers. Those buyers would have the opportunity to contract for a commercially reasonable period to perform a due and diligent investigation of property conditions, financial operations, and leases. In addition, those buyers would be able to arrange conventional financing, with the lender advancing loan proceeds for the purchase price which will be released only when the loan is fully secured by the property. While the right of redemption is still an issue, such a process is far more likely to generate increased sales proceeds than in a conventional foreclosure sale. In any event, if such a negotiated sale does not materialize, the lender will be able to complete the foreclosure recognizing that the receiver’s possession and control of the property during the foreclosure process has likely minimized lender’s risk of being prejudiced by a loss of meaningful time in acquiring a deteriorating asset.

At the very least, a receivership sale is an alternative that counsel to borrower, guarantors, lender, and the receiver should

carefully consider to determine whether a mutually acceptable outcome is likely. Although it may be possible for a court to endorse a receivership sale supported by the primary secured lender over the objection of the borrower or a junior lienholder, it is likely that a court would only approve such a sale provided the borrower retained its post-sale redemption rights. A sale with such a qualification would have an obvious detrimental impact upon the price prospective purchasers would be willing to pay. However, the prospects for a receivership sale improve significantly with the approval of all interested parties. Such negotiated sales would likely prohibit a right to seek any deficiency against the primary obligor, and similarly might limit the deficiency that the lender could assert against a third party guarantor. The lender of course must take care to preserve any claim it may want to assert against any guarantor following such a sale, but that is for another article. In any event, the end result could be a sale with a higher price which would benefit the creditor and, in many instances, the borrower and its principals.



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## ENDNOTES

- 1 *Cornelison v. Kornbluth*, 15 Cal. 3d 590, 600 (1975).
- 2 *Roseleaf v. Chierighino*, 59 Cal. 2d 35, 43 (1963).
- 3 *Cornelison*, 15 Cal. 3d at 602.
- 4 *Id.* at 600.
- 5 CAL. CIV. PROC. CODE §§ 580a, 726.
- 6 *Roseleaf*, 59 Cal. 2d at 44.
- 7 *Id.* at 43.
- 8 *Id.* at 44.
- 9 *Union Bank v. Gradsky*, 265 Cal. App. 2d 40 (1968).
- 10 Indeed, counsel for a judgment lienholder addressed the practical realities of the impact of the judicial foreclosure process on sale prices in *Wells Fargo Financial Leasing v. D & M Cabinets*, 177 Cal. App. 4th 59 (2009). See discussion *infra* notes 71-84.
- 11 *Rainier Mortgage v. Silverwood, Ltd.*, 163 Cal. App. 3d 359, 367 (1985).
- 12 CAL. CIV. PROC. CODE § 580d.
- 13 *Id.* § 564.
- 14 *Maggiora v. Palo Alto Inn, Inc.*, 249 Cal. App. 2d 706, 711-12 (1967); see also *Ward v. Internal Revenue Service*, 224 F.2d 547, 550 (9th Cir. 1955); *Steinberg v. Goldstein*, 129 Cal. App. 2d 682, 686 (1954).
- 15 CAL. CIV. PROC. CODE § 564.
- 16 *Id.*
- 17 *Id.* § 568.
- 18 *Id.*
- 19 *City of Santa Monica v. Gonzalez*, 43 Cal. 4th 905, 930

- (2008).
- 20 *People v. Riverside University*, 35 Cal. App. 3d 572, 582 (1973).
- 21 *City of Santa Monica*, 43 Cal. 4th at 930.
- 22 *Id.* at 931.
- 23 *Id.* at 905.
- 24 CAL. CIV. PROC. CODE § 568.5.
- 25 *Id.*
- 26 CAL. CIV. PROC. CODE § 701.540; see also *id.* §§ 712.010, 716.010, 729.010.
- 27 *Riverside University*, 35 Cal. App. 3d 572.
- 28 *Id.* at 579.
- 29 *Id.* at 582 (citing 2 RALPH EWING CLARK, TREATISE ON THE LAW AND PRACTICE OF RECEIVERS § 517 (3d ed. 1959)).
- 30 *Id.*
- 31 See *supra* note 19.
- 32 *Riverside University*, 35 Cal. App. 3d at 583.
- 33 *Id.*
- 34 *Id.* at 585 (emphasis added).
- 35 *Lesser & Son v. Seymour*, 35 Cal. 2d 494 (1950).
- 36 *MacMorris Sales Corp. v. Kozak*, 249 Cal. App. 2d 998 (1967).
- 37 *Lesser*, 35 Cal. 2d at 499.
- 38 *Id.* at 503-04.
- 39 *MacMorris Sales Corp.*, 249 Cal. App. 2d at 1004.
- 40 *Gold v. Gold*, 114 Cal. App. 4th 791 (2003).
- 41 *Id.* at 796.
- 42 *Id.* at 802.
- 43 *Id.* at 803.
- 44 *Id.* at 806.
- 45 *Id.*
- 46 CAL. CIV. PROC. CODE § 564(b)(2).
- 47 *Barclays Bank of California v. Superior Court*, 69 Cal. App. 3d 593 (1977). The court decided this case before the 1995 amendment to section 564, which added the circumstance involving specific performance of an assignment of rents provision in a deed of trust.
- 48 *Id.* at 596.
- 49 *Id.* at 597.
- 50 *Id.* at 598.
- 51 *Id.* at 601 (quoting *Scott v. Hotchkiss*, 115 Cal. 89, 94 (1896)).
- 52 *Id.* at 601.
- 53 *Cal-American Income Property Fund VII v. Brown Development Corp.*, 138 Cal App. 3d 268 (1982).
- 54 *Id.*
- 55 *Id.* at 272 n.1.
- 56 *Id.* at 273.
- 57 *Id.*
- 58 *Id.* at 274.
- 59 See *supra* note 20.
- 60 *Cal-American*, 138 Cal. App. 3d at 274.
- 61 *Resolution Trust Corp. v. Bayside Developers*, 43 F.3d 1230 (9th Cir. 1994).
- 62 The Ninth Circuit decision follows a published opinion from the federal trial court decided a year earlier which contains a more detailed explanation of the facts. See *Resolution Trust Corp. v. Bayside Developers*, 817 F. Supp. 822 (N.D. Cal. 1993).

63 *Bayside Developers*, 43 F.3d at 1242. The court also dismissed the one-action and anti-deficiency claim with the acknowledgement that the lender's lien encompassed virtually all of the developer's property, including the units subject to the pending sales, and the lender could receive the collateral represented by sales proceeds held by the receiver following a nonjudicial foreclosure sale. *Id.* at 1243.

64 2011 U.S. Dist. Lexis 37328 (N.D. Cal. Mar. 25, 2011)

65 FED. R. CIV. P. 66.

66 2011 U.S. Dist. Lexis 37328, at \*4.

67 *Id.* at \*5.

68 Order re Motion to Modify Instructions to the Receiver Regarding Sale of Real Property Security for the Sunnyvale Town Center; Motion for Order Confirming Proposed Sale of Receivership Property, *Wachovia Bank, N.A. v. Downtown Sunnyvale Residential, LLC*, No. 1-109-CV-153447, at 2 (Cal. Super. Ct. for County of Santa Clara June 15, 2011).

69 Petra Pasternak, *Foreclosure Sales Can't Be Made by Receiver, Judge Rules*, THE RECORDER, June 10, 2011.

70 *See supra* note 68.

71 *Wells Fargo Financial Leasing v. D & M Cabinets*, 177 Cal. App. 4th 59 (2009)

72 CAL. CIV. PROC. CODE § 680.010.

73 *Id.* § 704.740.

74 *Wells Fargo*, 177 Cal. App. 4th at 65.

75 *Id.*

76 *Id.* at 63 n.4.

77 *Id.*

78 *Id.*

79 *Id.* at 70 (citing *Riverside University*, 35 Cal. App. 3d at 583-84).

80 *Id.* at 72.

81 *Id.* at 71.

82 *Id.* at 76.

83 *Id.*

84 *Id.* at 72.

85 CAL. CIV. PROC. CODE § 568.5.

86 *Riverside University*, 35 Cal. App. 3d at 582.

87 I have spoken with senior title counsel for several major national title insurers who, although unwilling to be quoted for this article, have confirmed that their standard policy is to insure title to a receivership sale approved by all of the parties, including lender, receiver, borrower and junior lienholders, provided such sale is endorsed by court order.