

# Commercial Mortgage Foreclosure (CA)

A Practical Guidance® Practice Note by  
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There are two ways to accomplish a commercial foreclosure in California: (1) nonjudicial foreclosure or (2) judicial foreclosure. This practice note provides an overview and general outline for complying with the relevant statutes, regulations, and state laws governing commercial mortgage foreclosures in California for both of these methods. This practice note is intended to help counsel for the lender ensure that all pre-foreclosure obligations are met to avoid any delays or defenses to a successful foreclosure. However, the note provides information that can be used by a borrower and its counsel as well.

There are many complexities surrounding foreclosures in California and given the differences in loan documentation and facts at hand, this practice note does not address all of the potential issues that can arise; however, it does provide the fundamental procedures and considerations for conducting a proper foreclosure.

In addition, notwithstanding the requirements and general timelines provided in this note, given the ever-changing impact of COVID-19 pandemic, a lender seeking to foreclose should first consider whether any statewide or local-level COVID-19 orders and restriction may prevent foreclosure proceedings from taking place.

For guidance on commercial real estate financing in California, see [Commercial Real Estate Financing \(CA\)](#) and [Commercial Real Estate Acquisition Loan Resource Kit \(CA\)](#).

For a California deed of trust form, see [Deed of Trust, Assignment of Rents, and Request for Notice \(Long Form\) \(CA\)](#). For California-specific deed of trust clauses, see [Deed of Trust Clauses \(Commercial\) \(CA\)](#).

## Nonjudicial vs. Judicial Foreclosures Explained

In California, both mortgages and deeds of trust may be used to secure real property loans, but a deed of trust is the preferred security instrument. Likewise, both nonjudicial and judicial foreclosure are available in California. Nonjudicial foreclosure (also referred to as a trustee sale) is one that proceeds outside of the courts and is conducted pursuant to Cal. Civ. Code §§ 2924–2924I. This process allows a lender who has a security instrument (as noted, typically a deed of trust) that contains power of sale language to foreclose on a commercial property through a step-by-step process that ultimately results in a foreclosure sale. (For purposes of ease and consistency, this note will use the term "lender" even though the foreclosing party, beneficiary under the deed of trust, or holder of the security instrument may not be a lender per se.)

## Nonjudicial Foreclosure

In California, recovery under a nonjudicial foreclosure is limited to the proceeds recovered from the foreclosure sale. If there are additional amounts owed on the loan—referred to as the "deficiency"—they will not be recoverable from the borrower. So, for example, if a property sells at a nonjudicial foreclosure sale for \$100,000 but the loan amount is \$150,000, the lender will not be able to pursue the deficiency amount of \$50,000. Nonjudicial foreclosures can be accomplished in a general time frame of four months (provided all processes are followed). In addition, a nonjudicial foreclosure is not subject to post-sale redemption rights and thus attract higher bids. Finally, a nonjudicial foreclosure is not subject to any statute of limitations (see *Nicolopoulos v. Superior Court*, 106 Cal. App. 4th 304 (2003)) but is subject to expiration regulations relating to the power to conduct a trustee sale (see Marketable Record Title Act, Cal. Civ. Code §§ 880.020–887.090).

## Judicial Foreclosure

Judicial foreclosure takes place in the courts through a formal complaint filed in the relevant jurisdiction. The main difference with a judicial foreclosure in California is a lender **can** recover the deficiency amount in a formal judgment which can later be enforced through collection efforts. Using the example provided above, this means a lender could obtain a judgment for the entire \$150,000 loan amount (which includes the \$50,000 deficiency amount). If a lender opts for a judicial foreclosure, there is also interim relief available such as injunctive relief to prevent the borrower from damaging or devaluing the property and the appointment of a receiver who can manage and protect the property and collect rents if there are tenants. With a judicial foreclosure, the lender can also record a lis

pendens which clouds title on the property. The timing of a judicial foreclosure procedure is much longer and is the same timing as a typical civil lawsuit. Thus, a lender would need to determine the typical length of a civil suit in the jurisdiction where the property is located to get a more accurate estimate of how long a judicial foreclosure could take. In general, a judicial foreclosure can take two to three years to complete in California. A judicial foreclosure is subject to a four-year statute of limitations and is subject to a post-sale redemption right unless the deficiency claim is waived. In a judicial foreclosure, a borrower can be reinstated if there was a curable default throughout the entire process.

## Double-Tracking

"Double-tracking" or "dual tracking" is a strategy where a lender initiates both nonjudicial and judicial foreclosure processes. Proceeding both judicially and nonjudicially at the beginning of the foreclosure process gives the lender time to evaluate whether there is a likely source of funds for payment of a deficiency judgment, if obtained, and whether the then value of the collateral is likely to be sufficient to make the lender whole if the lender waives its right to a deficiency judgment by proceeding nonjudicially. In the meantime, filing an action for judicial foreclosure often gives the lender some negotiating leverage with the borrower, as the guarantor is typically sued on the guaranty in the judicial foreclosure action. However, only one method can ultimately be carried through to completion given California's one-action rule and anti-deficiency statute (described further below). Failure to consider and abide by these rules can be disastrous and lead to the potential loss of the security altogether. Before embarking on this strategy, it is important to seek legal counsel to protect the security and avoid any pitfalls or waivers of rights.

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## Main Differences (Judicial and Nonjudicial Foreclosure)

The general differences between a judicial and nonjudicial foreclosure in California are as follows:

Issue	Judicial	Nonjudicial
Time to Complete	At least 12–18 months to complete.	Approximately four months from date of notice of default (NOD) to sale.
Cost	Expensive because it involves the filing and prosecution of a lawsuit.	Fairly inexpensive—includes trustee's fees, trustee sale guaranty (TSG) cost, and legal fees to monitor.

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<p>Procedures</p>	<p>File complaint and prosecute lawsuit, participate in discovery, etc.</p> <p>Must name and serve all parties who have an interest in the collateral being foreclosed.</p> <p>Lender can obtain a litigation guaranty to ensure all necessary parties are being name and that lender is insured against errors and omissions.</p>	<p>Lender records statutorily-prescribed NOD in county recorder's office of the county where property is located.</p> <p>Within 10 business days after recording, the NOD must be sent via registered or certified U.S. mail to borrower at last known address and various others.</p> <p>Obtain TSG.</p> <p>Ninety days after the NOD recorded, the lender must record a statutorily-prescribed notice of sale (NOS) setting date of sale for at least 20 days after NOS.</p> <p>After NOD recorded, borrower or any junior creditors have right to reinstate loan up until five business days prior to scheduled sale date.</p>
<p>Downsides</p>	<p>Takes longer and costs more.</p> <p>The court will conduct fair value hearing on value of collateral for purposes of calculating the deficiency judgment.</p> <p>The borrower then has a right of redemption for one year after foreclosure take place, which effectively freezes the asset for one year.</p>	<p>Except in limited circumstances, if the lender conducts a nonjudicial foreclosure sale, the lender will then be prohibited under Cal. Civ. Proc. Code § 580d from suing the borrower for additional amounts due under the loan.</p>
<p>Advantages</p>	<p>The lender can take title to the property and still be entitled to pursue the borrower for any "deficiency" between value of real property (per "fair value hearing") and unpaid amount of debt.</p> <p>Allows the lender to have a receiver appointed to collect rents and protect the collateral.</p>	<p>Quicker and less costly. The borrower has no right of redemption upon the conclusion of a nonjudicial foreclosure sale. The lender can immediately proceed to sell, develop, and/or operate the foreclosed property.</p>
<p>Effect on Deficiency</p>	<p>At end of judicial foreclosure action, the lender can seek to enforce any deficiency judgment entered against borrower.</p>	<p>No right to deficiency once the trustee sale occurs.</p>

The key to foreclosing properly either via a nonjudicial or judicial process is to be organized and follow the rules closely. Failure to follow each step and provide required notice can be detrimental to the success of a foreclosure or cause harmful delays.

## Pre-foreclosure Requirements

### Gather the Required Documents to Support the Foreclosure

The first step in preparing for a foreclosure in California, regardless of whether it is through a nonjudicial or judicial process, is to gather all the required documents:

- Promissory note or note (original preferably though not essential)
- Deed of trust
- Loan agreement (if there is a document separate from the note)
- Assignments or assumption documents
- Amendments/extensions including any loan modifications
- Substitutions of trustees
- Any documents relating to rents, fixtures, and receivers
- Cross-collateralization agreement
- Title insurance policy
- Guaranties
- Payment records

Other documents that are not required for the foreclosure but helpful nonetheless include:

- Appraisals
- Environmental reports
- Loan file and any foreclosure file

### Review the Documents Gathered to Support the Foreclosure

#### *Security Instrument*

Confirm there is a document that creates a security interest in favor of the lender on the specific property. Here, the relevant information and language are typically found in the deed of trust. Be sure to check that the deed of trust has been recorded in the county in which the property is located. Although the recordation is not necessarily required, it will set the priority of the lien if there are other liens recorded against the property. Cal. Civ. Code §§ 1214 and 1217. If the deed of trust was not recorded,

check the title report to see the present state of title and determine whether the lender should record the deed of trust before moving forward. A delayed recording may allow the borrower to avoid the security interest as a preference if the borrower files for bankruptcy.

#### *Power of Sale*

Check that there is a power of sale clause allowing the lender to sell the real property collateral on the default of the obligor. The documents to check for this language are the deed of trust and the assignment or assumption agreement. If there is no language giving power to the trustee to sell the property to the highest bidder, apply proceeds to the secured obligation, and distribute excess amounts, then the lender will not have the ability to foreclose on the property nonjudicially. Cal. Civ. Code §§ 2924g-2924k.

#### *Holder of the Note*

Confirm that the lender is the current holder of the note (this document may be titled "promissory note" or simply "note") and confirm the lender bringing foreclosure action has documentation to show its ability and power to foreclose. For the lender to be a proper holder of a negotiable note, the note must be endorsed to (1) the lender, (2) the lender's order, (3) the bearer, or (4) in blank and signed by the previous holder, and the holder must have acquired the note (1) for value, (2) in good faith, (3) without notice of default, (4) without evidence of forgery or alteration, and (5) without notice of any claim or defense. See Cal. Com. Code §§ 1201, 3302(a), 3305(a), and 3306. This also may require that you review any substitutions of trustees or assignments. Also, make sure that the property description contained in the deed of trust matches the one in the note.

#### *Negotiable Note*

Check that the note is negotiable. See Cal. Comm. Code § 3104 (defined). In other words, is it signed by the maker (borrower), does it contain an unconditional promise to pay a sum certain, is there language indicating the amounts are payable on demand or at a definite time, and does it specify that the amounts must be payable to order or to the bearer?

#### *Default*

Confirm there is default language in the documents that justifies foreclosure. Documents to check for this language are the note, loan agreement, or any other contract laying out the terms of the loan. In addition, check whether a particular event qualifies as a "default" under the terms of the loan.

### ***Amount of Debt***

Determine the amount of the debt owed (i.e., outstanding principal amount, interest, late charges, prepayment penalties, advances used to pay taxes or cure defaults on senior liens, attorney's fees). How much has already been paid? Be sure you have sufficient supporting documentation to confirm the amounts owed.

### ***Acceleration Clause***

Check to see that there is an acceleration clause in the loan documents. This acceleration clause will require a party who has defaulted on the loan terms to pay the outstanding balance due on the loan. The acceleration clause will also specify the reasons that can justify a demand to accelerate the balance of the amount due.

### ***Other Security***

Check the documents to see whether there is any other property (i.e., personal property, guaranties, indemnity agreements with parties unrelated to borrower, insurance) that act as security for the amounts borrowed.

### ***Cross-Collateralization***

Review any cross-collateralization agreements to make sure there is nothing there that might prohibit the foreclosure. A cross-collateralization agreement is another loan that is used to secure the loan on which the lender is foreclosing. For example, a lender might use a loan on a car or another property to secure the loan that is being foreclosed upon.

### ***Venue***

Confirm any venue provisions in the loan agreement, note, or deed of trust. If there is language setting a venue in a location that is other than where the property is located, conduct a legal analysis to make sure that the venue is proper.

### ***Receivership***

If the lender seeks a receiver, check for receivership language and confirm what document you found it in. For additional guidance on receiverships, see [Receivership in Real Estate Transactions](#).

### ***Guaranty***

Identify the individuals or entities who sign the guaranty. They will be included in any complaint as a defendant.

### ***Recourse***

Check the loan documents and guaranty to determine whether they are recourse.

### **Missing Documents**

Where a lender is unable to locate the required documents, there are certain factors to consider and analyze before moving forward with a foreclosure:

- If there is only a copy of the note, the lender should understand that there is no assurance that the note is still enforceable. Cal. Comm. Code §§ 3203–3204. It may, for example, have been canceled or transferred to someone else. If the note was transferred, the right to foreclose and the real property security has gone along with the note. Cal. Civ. Code § 2936. A lender can create an affidavit of lost note and, in California, most title company trustees will accept an indemnity or post a lost-instrument bond (which can be costly).
- If the lender does not have the original recorded deed of trust, it is not as critical. There may be a separate unrecorded deed of trust as well as the recorded copy, and the security follows the note. Cal. Civ. Code § 2936.

## **Nonjudicial Foreclosure Process**

A step-by-step explanation of how to conduct a nonjudicial foreclosure follows. Recommended or required timing, as applicable, is also provided.

### **Confirm the Default**

Confirm that there has been an actual default by borrower by reviewing the note and deed of trust to see what constitutes an "event of default." See Cal. Civ. Code § 2924.17. For example, has there been a missed payment (a typical event of default) or failure to comply with state or federal laws (i.e., violating a health and safety code)? The lender should carefully consider whether the default that has occurred is one that is curable or likely to be remedied.

Before proceeding with foreclosure processes, a lender also needs to review the loan documents to make sure all notices to cure have been provided to the borrower and the time to cure has expired. The lender should also check to make sure there is no forbearance agreement or modification efforts in place. Also, be sure to review the loan file for correspondence between the lender (or servicer) and borrower to make sure that the lender has not waived any default (by either accepting a late payment or misleading the borrower into thinking an action was okay). If that has taken place, give the borrower an opportunity to cure the default but be specific about what will happen if the default has not been cured. Notice should also be provided to any junior encumbrances who within the prior

five years provided the lender with either a written request for such notice or a renewal of the request. Cal. Civ. Code § 2924e(b).

### **Value the Real Property Security Interest**

Obtaining a valuation of the property to be foreclosed upon is important to understand whether the sale will result in sufficient amounts to pay off the debt owed. If, for example, the value of the property exceeds the amount of the loan balance, a nonjudicial foreclosure sale will likely produce enough proceeds to pay off the balance due. If the value of the property is less than the amount of the loan, there will be a "deficient" amount that the lender will not be able to recover under a nonjudicial foreclosure. It is also important to understand whether there are any other liens or competing deeds of trust on the property because if any are senior to the lender who wants to foreclose, it will also impact the amount of recovery after a foreclosure sale.

### **Select the Trustee**

(Suggested timing: 60 to 75 days prior to recording of the NOD)

A trustee is a party who is identified in the deed of trust and holds the real property in trust for the benefit of both the lender (beneficiary) and borrower (the trustor). Because of this role, a trustee is granted the power of sale. The trustee handles all the notices and the trustee sale of the property in a nonjudicial foreclosure. While the trustee is considered an agent of the beneficiary and trustor for the purposes of completing a nonjudicial foreclosure, the trustee is not an agent with fiduciary duties or obligations. Cal. Civ. Proc. Code § 369(a), Cal. Civ. Code § 2937.7. Often, in California, the deed of trust identifies the trustee as a title insurance company or foreclosure company or even a subsidiary of the lending institution. The beneficiary can also serve as a trustee but since potential conflicts of interest can arise, most beneficiaries do not designate themselves as a trustee.

Although the deed of trust may identify the trustee, before a nonjudicial foreclosure proceeds, the lender can choose to substitute a new trustee. If the lender decides to use the trustee identified in the deed of trust for the foreclosure process, no action is needed prior to recording the NOD.

There are several reasons that a lender may consider selecting a new trustee. The lender may have purchased or obtained the obligation from a prior lender and prefer a different trustee. Or, if a trustee was involved in the creation of the underlying loan documents, the lender may select a new trustee in case there are errors in the loan documents. If the lender chooses a new trustee, a

substitution of trustee must be recorded in the county recorder's office where each deed of trust is recorded. A substitution of trustee can be recorded at any time during the nonjudicial foreclosure process, but it is simpler to record the substitution prior to recordation of the NOD (this can be done essentially at the same time that the NOD is recorded, with the substitution being recorded immediately prior to recording the NOD). If the substitution is recorded after the NOD, additional affidavits and notices must be given, so recording prior to recordation of the NOD is recommended.

### **Contact Trustee about Process and Forms**

(Suggested timing: as soon as the trustee is selected)

Even though the nonjudicial foreclosure process is governed by statute, most experienced trustees have their own set of forms and requirements for moving through the process, and some trustees require that the lender use the trustee's forms for certain notices. These forms and requirements should be obtained as soon as possible so any issues unique to this loan can be identified and addressed.

### **Forward Originals or Certified Copies of Notes, Deeds of Trust, and Other Loan Documents to the Trustee**

(Suggested timing: 60 to 75 days prior to recordation of the NOD)

With high-dollar value of the negotiable instruments, the lender and trustee should discuss the possibility of the trustee using certified copies of the loan documents, rather than the originals, for its initial review. If the loan is complex, it will take the trustee some time to review and evaluate the loan documents prior to the commencement of the nonjudicial foreclosure proceeding, and it is in the best interests of the bank that the trustee have the time it needs to review the loan documents.

### **Obtain a Trustee Sale Guaranty (TSG) from the Trustee / Title Company**

(Suggested timing: at least 60 days prior to recordation of the NOD)

A TSG is issued at the beginning of a foreclosure and is a title guaranty that provides essential information that is necessary to ensure compliance with California state foreclosure statutes. The TSG should provide the following crucial information that is needed to execute a valid foreclosure:

- Current owner of record vesting
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- Judgments
- Liens and encumbrances
- Priority of foreclosing mortgage
- Bankruptcy case information that might impact the foreclosure
- Property tax information
- Parties required by law to receive notice of the foreclosure
- Property address verification –and–
- Newspaper entities for publication

The TSG should name both the lender and the trustee as assureds so that the lender has direct recourse against the TSG if the information is incorrect or incomplete. Depending on the number of parties who will need to receive notice of the NOD, the TSG should initially be obtained 60 days prior to recordation of the NOD and then title company should do a "date down" (or update) just prior to sending the NOD. Note that if the lender follows the dual tracking approach (discussed further below), it can order a litigation guaranty that guarantees the accuracy of the same information provided in a TSG for purposes of a judicial foreclosure.

### **Prepare and Deliver a Formal Demand to Commence Foreclosure to the Trustee**

Ten days before you plan to record the NOD, the lender should prepare and deliver to the trustee a formal demand to start the foreclosure. This delivery should coincide with the expiration of the borrower's cure period that is set forth in the loan documents. The trustee may require that this notice be given on the trustee's form. If not, this can be done by a letter to the trustee.

### **Draft the Notice of Default (NOD)**

(Suggested timing: 30 days before recording any NOD)

The NOD must be distributed and recorded before the trustee can schedule a sale of the property. Cal. Civ. Code §§ 2924 and 2924b. As such, the lender should work with the trustee to prepare the NOD approximately 30 days before the NOD is recorded. The trustee should prepare the NOD on the form required by statute, and the lender and its counsel should review and approve the form of the NOD before it is recorded. A copy of the NOD must be served on all parties that hold junior rights, interests, and liens in the real property being foreclosed. Cal. Civ. Code § 2924(a)(1). The borrower, usually the property owner, has no obligation at law to notify the holders of junior interests

of the commencement of the foreclosure proceeding. A reputable and experienced trustee will have the required NOD language which should include the following:

- A complete and accurate description of the nature of the breaches that are known to the lender –and–
- A statement that the lender is electing to sell the property to satisfy (1) the specific defaults described in the notice and (2) any obligation secured by the deed of trust that is in default

Cal. Civ. Code § 2924.

### **Record and Mail the NOD**

The trustee must record the NOD in the county recorder's office in the county where the property is located. Cal. Civ. Code § 2924. Within 10 days after recording the NOD, a copy showing the recording date must be mailed by registered or certified mail, postage prepaid, to each person identified in any recorded request for notice and each trustor identified in the deed of trust (at the address provided and the last known address). See Cal. Civ. Code § 2924b. The lender should also consider sending the notice to all possible addresses of a trustor and any guarantors or others possibly affected, even if they are not contained in recorded requests for notice.

Within 30 days after the NOD is recorded, the trustee must mail copies of the NOD to all persons and entities who are entitled to notice, including:

- The borrower's successors and assigns
- Junior lienholders and their successors and assigns
- Tenants under any leases that are junior or subordinated to the deed of trust, and their successors and assigns
- Buyers under installment sale contracts recorded junior to the deed of trust (or subordinated) –and–
- The state controller if a real property tax lien has been recorded for delinquent real property taxes

Identities of these individuals and/or entities should be included in the TSG or litigation guaranty. A trustee has no liability for failing to send the NOD to someone it has no actual knowledge of.

### **Respond to Requests for Beneficiary's Statement / Statement of Condition**

Under Cal. Civ. Code § 2943(a)(2), the borrower, any successor in interest to the borrower, junior lienholders, and escrow agents handling transactions involving the collateral real property may request a statement from the lender

showing the unpaid balance of the loan, the applicable interest rate, the amounts of all overdue installments, and other key information regarding the loan status. These requests may be made:

- Any time prior to the recordation of a NOD
- Within two months after the recordation of a NOD – and–
- No later than 31 days prior to entry of judgment in a judicial foreclosure action

A lender must respond to any such request within 21 days after receipt or, if the lender requests evidence that the requester is a party entitled to a beneficiary's statement, then within 21 days after such evidence is received by the lender. The requester has the right to rely on the beneficiary's statement provided, but if conditions change or the lender discovers an error in the beneficiary's statement, it is important that the lender provide an amended beneficiary statement to the requester.

### **Be Mindful of Timing**

Once the NOD is filed, no less than three months must pass before any NOS can be given. Cal. Civ. Code § 2924(a)(2). Be sure to follow the requirements set forth in Cal. Civ. Code § 2924c.

### **Draft the Notice of Trustee Sale (NOS)**

Three months after the NOD is filed and recorded, the trustee can send the NOS, which must provide the following information:

- The time and place of the sale
- The trustee's name and contact information
- The name of the original trustor
- The property description (with county assessor's parcel number)
- The unpaid balance
- A reasonable estimate of costs, expenses, and advances –and–
- The required payment form

Cal. Civ. Code § 2924(a)(3).

### **Record the NOS**

The trustee should record the NOS in the county where the property is located up to five days before the lapse of the three-month period described in Cal. Civ. Code § 2924(a)(2), provided the sale date is no earlier than three months and twenty days after recording the NOD. Cal. Civ. Code §§ 2924(a)(4) and 2924f.

### **Mail the NOS**

The NOS must be sent by registered or certified mail to (1) the trustor, (2) each person who has recorded a request for such notice, (3) persons and entities who were to receive the NOD, and (4) the Sacramento office of any state taxing agency that recorded a notice of tax lien before the NOD was recorded. Cal. Civ. Code §§ 2924(a)(4) and 2924f.

### **Publish the NOS**

A copy of the NOS must be published once a week for three consecutive calendar weeks with the first publication taking place at least 20 days before the date of the sale. Publication must be in a newspaper of general circulation published in the city or in the district or county if the property is not in the city. Cal. Civ. Code §§ 2924(a)(4) and 2924f.

### **Post the NOS**

A copy of the NOS must be posted at least 20 days before the sale in a public place. A courthouse's notice board is sufficient to constitute a "public place." In addition to the public place, a copy of the NOS must be posted at the property either on the front door, a common entrance, guard gate to the development, or conspicuous place on the property. Documenting the posting can be done through a declaration and accompanying photographs. Id.

### **Postponements of the Sale**

Once the NOS has been duly given, the trustee of the deed of trust may postpone the sale from time to time for up to one year from the sale date indicated in the NOS without being required to record a new NOS. During the one-year period, any number of postponements may take place. Cal. Civ. Code § 2924g(c)(1).

### **Effect of Bankruptcy**

There is some uncertainty on the question of whether a new NOS must be given when a postponed sale is rescheduled following the dismissal of the borrower's bankruptcy or after the Bankruptcy Court grants the lender relief from the automatic bankruptcy stay in the borrower's bankruptcy proceeding. Under Cal. Civ. Code §§ 2924g(d) and 2924c(e), a trustee of a deed of trust may orally postpone a trustee's sale for successive periods of up to five business days after relief from stay without being required to record a new NOS, so long as the sale ultimately takes place within the one-year period.

### **Reinstatement or Cure before the Trustee Sale**

A borrower can cure a monetary default and reinstate the obligation to pay back the loan (1) before the trustee sale



and the lender and borrower agree, or (2) after the NOD is recorded and until five business days (which includes Saturdays but not Sundays or holidays) before the trustee sale. See Cal. Civ. Code §§ 2924c(a)(1), 2924c(e), and Bank of Am. v. La Jolla Grp. II, 129 Cal. App. 4th 706 (2005). If a foreclosure sale is postponed, the reinstatement period is automatically revived, and the borrower may reinstate up to five business days before the new sale date. Id. To have the loan reinstated, the borrower must pay (or offer to pay) the following to the lender:

- Defaults described in the NOD
- Defaults on recurring obligations not described in the NOD
- Reasonable costs and expenses incurred by the lender in the foreclosure proceeding
- Fees by the trustee and attorneys provided by statute and if permitted by the loan documents –and–
- Other costs and expenses, if provided for in the security instruments

A lender should be careful not to accept partial payments unless the borrower provides in writing that acceptance of the partial payment does not waive the default. Tully v. World Sav. & Loan Ass'n, 56 Cal. App. 4th 654 (1997); Melendrez v. D & I Inv., Inc., 127 Cal. App. 4th 1238 (2005).

### **Equity of Redemption**

Before a foreclosure sale occurs, the borrower or another interested party may pay off all of the obligations and extinguish the lien. Cal. Civ. Code §§ 2903–2906. Not only must the principal balance due be paid off, but any accrued interest, foreclosure costs, late charges, prepayment penalties, and trustee and attorney's fees.

### **The Trustee Sale**

The trustee sale may take place only in the county where the property is located (Cal. Civ. Code § 2924g(a)), at the time and location specified in the NOS (Cal. Civ. Code § 2924g(a)), and no sooner than 20 days after mailing the NOS and 20 days after the recording of the NOS. At the trustee sale, a lender is obligated to inform the prospective bidders about any facts that are known to the lender and not known or reasonably discoverable to the buyer. The lender must also identify any facts that may have a significant and measurable effect on the value of the property. It is possible for a lender to sell the property "as is." Cal. Civ. Code § 2924h(g). At the trustee sale, either the

trustee or a professional auctioneer hired by the trustee will conduct the sale and follow a script. After the sale, a report will be prepared to identify the purchaser and sale price.

### **Trustee's Deed upon Sale**

The trustee will prepare a Trustee's Deed Upon Sale (Trustee's Deed) which identifies the total indebtedness at issue and the final sale price. This document will be recorded a day or two after the sale. A copy of the Trustee's Deed is sent to the lender and eventually the original is mailed by the office of the county recorder.

### **Distribution of Sales Proceeds**

There is a specific order in which the sales proceeds must be distributed by the trustee. Cal. Civ. Code § 2924k. It is as follows:

- The trustee is reimbursed for its own costs and expenses for the sale and handling of the proceeds.
- The debt is satisfied.
- Junior lienholders are paid in their order of priority.
- Any surplus is distributed to the borrower or successor.

### **Send NOS to the Internal Revenue Service**

If there is an IRS lien on the property (recorded at least 30 days before the sale), the IRS has the right to pay other lienholders and take title to the property. Internal Revenue Code (26 U.S.C. § 7425). The IRS has a right of redemption within 120 days after the sale.

## **Judicial Foreclosure Process**

Judicial foreclosure takes place through the courts through the filing of a complaint.

### **Preliminary Requirements**

A judicial foreclosure may only be filed if:

- It is filed within four years after the maturity date of the debt and any installment payment to be enforced by the action (see Code of Civ. Proc. §§ 338 and 360)
- The debt is recourse (meaning the borrower can have personal liability for any deficiency) –and–
- The loan is not a purchase money loan

Note that the judicial foreclosure process must be used if the deed of trust lacks a power of sale clause or if the security instrument is not conventionally structured.

## **Preparation of the Foreclosure Complaint and Related Documents**

### ***Litigation Guaranty***

As discussed above, a litigation guaranty provides the essential information a lender will need to conduct a judicial foreclosure including confirmation about the security interest and priority and the necessary parties.

### ***Necessary Parties***

The litigation guaranty and loan documents (specifically the note and deed of trust) will provide the identity of the proper parties to a judicial foreclosure complaint. Make sure the proper plaintiff is named and include the status of the plaintiff (e.g., is the plaintiff a mortgagee, beneficiary, trustee, successor in interest, etc.). Identify each defendant and specify whether they are the present record owner, original mortgagor, trustor, borrower, fractional share owner, junior lienholder, or anyone having an interest in the property that was recorded after the deed of trust being foreclosed upon. Also explain which defendants from which a deficiency judgment will be sought including, but not limited to, the trustor, borrower, assuming grantee, endorser, and guarantor.

### ***Jurisdiction and Venue***

California courts have subject matter jurisdiction over actions to foreclose a lien on real property and have jurisdiction only over California real property. If property crosses multiple states, California courts can foreclose only on the part of the property located in the state. Foreclosure actions are usually filed in state court unless the defendant is the United States (where the action can be brought in Federal Court). The proper venue for a foreclosure action is in the county where the property (or part of it) is located. Cal. Civ. Proc. § 392(a)(2). If property is located in multiple counties, then venue is proper in any of the counties.

### ***Statute of Limitations***

Check to make sure the complaint is timely. If the statute of limitations runs on the underlying obligation, a lender cannot file a judicial foreclosure action. However, a nonjudicial foreclosure under a *deed of trust* is not impacted by any statute of limitations. *Flack v. Boland*, 11 Cal. 2d 103 (1938); *Sipe v. McKenna*, 88 Cal. App. 2d 1001 (1948). That said, a nonjudicial enforcement of a *mortgage* that is tried after the expiration of the statute of limitations is barred.

### ***Facts Supporting the Foreclosure***

Make sure to properly allege the following facts relating to the obligation:

- Defendants' obligation (that was executed, delivered, and/or assumed)
- The principal amounts, unpaid amounts due, and any accelerated amounts
- The provisions in the loan documents that support the foreclosure (e.g., the applicable default provision, acceleration provisions, etc.) –and–
- Supporting allegations to justify pursuit of any deficiency

### ***Attachment of Relevant Documents***

In addition to signed copies of the note and security agreement, also consider attaching any notices of default as exhibits to the complaint.

### ***Remedies***

Specify what remedies are being sought (e.g., amount due, attorney's fees, appointment of a receiver, specific performance of the rents-assignment clause).

### ***Causes of Action***

Causes of action to include in a judicial foreclosure complaint include judicial foreclosure, specific performance, declaratory relief, and enforcement of guaranty (if applicable).

### ***Lis Pendens***

It is a good practice to prepare, serve, and record a lis pendens to provide constructive notice that a legal action which impacts the real property has been filed. This way defendants, anyone who the borrower transfers the property to after the lis pendens is recorded, and anyone acquiring an interest in the property after the lis pendens is recorded, are on notice that litigation impacting the real property is pending. Without a recorded lis pendens, it is possible that a court may determine a new party's interest is superior.

### ***Post-judgment Activities***

After entry of judgment of a judicial foreclosure by a trial court, the lender must immediately stop any nonjudicial proceedings (see further discussion in Double or Dual Tracking below).

To execute on a judgment of foreclosure, a lender needs to (1) obtain a writ of sale from the clerk; (2) deliver the court-issued writ of sale to a levying officer (who can be a sheriff, the sheriff's staff, or a receiver with experience in selling real property) for execution; and (3) follow the right of redemption rules if pursuing a deficiency judgment. In terms of the notices and timing, if a deficiency has been waived or is prohibited:

- **Notice of levy.** A levying officer must wait 120 days after serving the notice of levy on the judgment debtor before serving an NOS. Cal. Civ. Proc. Code §§ 700.015 and 701.545.
- **Notice of sale.** The 20 days' notice of the sale (once the 120 days after the notice of levy is served) must be provided. Note that this is not the same form as in a nonjudicial sale.
- **Right of redemption.** One of the major downsides of pursuing a judicial foreclosure is that the debtor has statutory post-sale redemption rights under Cal. Civ. Proc. Code §§ 726(e), 729.010–729.090. Under these redemption rights, a debtor can recover the property by paying the redemption price based on the final bid price at a judicial sale (as opposed to the amount of the remaining loan balance). This is even if a purchaser has successfully bid at the judicial foreclosure sale. The only way for a lender to avoid the post-sale redemption rights is to waive its claim to a deficiency judgment (which is one of the primary reasons to judicially foreclose). During the redemption period, the purchaser does not take possession but is entitled to rents and profits received during the redemption period, can enter the property during reasonable hours to repair and maintain the property, and get a court order to restrain any waste occurring at the property.

If a deficiency is permitted, there is no waiting period between serving the notice of levy and notice of sale, although the notice of levy and notice of sale still must be recorded and served. See Cal. Civ. Proc. Code §§ 729.010(b)(2), 701.540. The notice of sale can be given immediately upon the entry of the judgment. Id. Do not execute on any money portion of the judgment by executing on the property other than through the foreclosure sale or the one-action rule will be violated.

After a sale is conducted, if the property is sold without the right of redemption (i.e., where the deficiency is waived or unavailable), the levying officer executes and delivers to the buyer a deed of sale, records that deed with the county recorder, and provides any paid documentary transfer tax to the local government. If the property is sold subject to the right of redemption, the levying officer executes and delivers to the buyer a service of sale and also advises of the right of redemption and provides the applicable redemption period.

## Double or Dual Tracking

A lender can initiate both nonjudicial and judicial foreclosure to take advantages of certain aspects of both processes. As discussed above, a nonjudicial foreclosure can be completed fairly quickly if there are no issues with the documentation and no effective defenses that can be raised by the borrower. A judicial foreclosure, however, enables the lender to obtain provisional remedies in the form of injunctive relief and the appointment of a receiver. If the double or dual tracking approach is taken, it is critical to not allow the entry of judgment in the judicial foreclosure action before the trustee sale date in the nonjudicial foreclosure process or the lender will run afoul of the one-action rule and anti-deficiency statute, which can have an extremely negative impact on the recovery of the amounts due. (See California's Anti-deficiency Legislation – The One-Action Rule and the Anti-deficiency Statute below.) Note that there is the possible strategy of using a receiver to sell the property, but close attention must be paid in doing so and the best practice is to have a stipulated court order entered. Furthermore, the mere entry of a default in a judicial foreclosure action without a final judgment will not constitute an election of remedies.

Once a trustee sale takes place, a lender must immediately cease prosecuting the cause of action for judicial foreclosure. *Vlahvich v. Cruz*, 213 Cal. App. 3d 317 (1989). There may be other causes of action that may be able to proceed like one for a receivership and for a money judgment against a guarantor.

## California's Anti-deficiency Legislation – The One-Action Rule and the Anti-deficiency Statute

In any loan transaction secured in whole or in part by a deed of trust encumbering real property located in the state of California, the lender's rights and remedies are limited by California's anti-deficiency legislation (California Code of Civil Procedure §§ 580a, 580b, 580d, and 726). The anti-deficiency legislation has the effect of severely limiting or prohibiting the personal liability of the borrower by requiring that the proceeds from the sale of the real property security be used first, and in many cases exclusively, to satisfy the loan obligation. For the most part, the anti-deficiency restrictions only come into play when the loan goes into default, at which time, the lender must

consider the limitations imposed by the anti-deficiency legislation prior to moving forward, and as it continues to move forward, to enforce its remedies under the loan documents.

These anti-deficiency restrictions embody two principles: (1) the "one-action" rule, which protects against creditor harassment and promotes judicial economy by precluding a lender from filing multiple actions to recover amounts due on a loan secured by real property and (2) the security-first principle, which requires exhaustion of collateral before tying up the debtors' other assets.

## The One-Action Rule – Code of Civil Procedure § 726

The one-action rule is set forth in Cal. Civ. Proc. Code § 726, which states as follows:

There can be but one form of action for the recovery of any debt or the enforcement of any right secured by mortgage upon real property or an estate for years therein, which action shall be in accordance with the provisions of this chapter.

What this means is that, in the event of default, a secured creditor must, in a single action, first exhaust all its security as a condition of obtaining a monetary deficiency judgment against the debtor personally. The one-action rule applies to any proceeding by a creditor for recovery of a debt, or enforcement of a right, that is secured by a trust deed or mortgage. If judicial foreclosure is selected over nonjudicial foreclosure, the creditor may seek deficiency in the court action that may be subject to fair value limitations and redemption rights. If nonjudicial foreclosure is sought, the creditor is barred from seeking a deficiency judgment. If a party completed a judicial foreclosure and then tried to pursue a nonjudicial foreclosure, the one-action rule would bar the nonjudicial foreclosure. Another way the one-action rule can work to detrimentally impact a lender's interest in security is if a lender filed a lawsuit for breach of contract on the loan agreement and obtained a judgment for damages. The lender then would not be able to pursue a foreclosure, judicial or nonjudicial.

Certain activities do not trigger the negative impacts of the one-action rule. For example, if a borrower authorizes the automatic deduction of payments to the lender from the borrower's unpledged bank account under a trial loan modification, it does not trigger the one-action rule. See *Toneman v. United States Bank*, 628 Fed. Appx. 523 (C.D. Cal. 2013). Merely filing a lawsuit is also not enough to violate the one-action rule. *Kirkpatrick v. Westamerica*

*Bank*, 65 Cal. App. 4th 982 (1998). Nor does appointment of a rents receiver or an order compelling the turnover of possession of the real property before the foreclosure is held trigger the one-action rule. *Title Guar. & Trust Co. v. Monson*, 11 Cal.2d 621 (1938).

Despite these exceptions, best practice is to thoroughly analyze and confirm whether the action under consideration might trigger the one-action rule and detrimentally impact the lender's recovery on a defaulted loan.

## The Anti-deficiency Statute – Cal. Civ. Proc. Code § 580d

Enforcement of the note against the borrower is generally only permitted where the lender has elected to proceed by judicial foreclosure and then only to the extent of any deficiency judgment obtained. Thus, while a typical deed of trust does ultimately allow the lender to take ownership of the real property security (subject to any senior liens), the security-first rule restricts the lender's ability to collect directly from the borrower. Cal. Civ. Proc. Code § 580d provides as follows:

No judgment shall be rendered for any deficiency upon a note secured by a deed of trust or mortgage upon real property or an estate for years therein hereafter executed in any case in which the real property or estate for years therein has been sold by the mortgagee or trustee under power of sale contained in the mortgage or deed of trust. [¶] This section does not apply to any deed of trust, mortgage or other lien given to secure the payment of bonds or other evidences of indebtedness authorized or permitted to be issued by the Commissioner of Corporations, or which is made by a public utility subject to the Public Utilities Act (Part 1 (commencing with Section 201) of Division 1 of the Public Utilities Code).

In other words, once a nonjudicial foreclosure sale has been concluded, the lender is barred from pursuing the borrower for any deficiency between the amounts due under the loan documents and the value of the collateral foreclosed.

### The One-Action Rule and Junior Lienholders

Where a senior lienholder forecloses, a junior lienholder loses its security interest in the property but is not barred by the one-action rule and can sue the borrower personally on its note. If a lender has multiple deeds of trust on a property (with different priority, i.e., senior and junior), the California Supreme Court recently held, in *Black Sky Capital, LLC v. Cobb*, 7 Cal. 5th 156 (2019), that the holder can

generally seek a deficiency judgment on the extinguished junior lien unless the loans are separated by a substantial time period. Prior to *Black Sky*, if a lender with multiple deeds nonjudicially foreclosed on the senior deed of trust, it could not collect the deficiency on the sold-out junior debt because of the anti-deficiency statute.

## **The One-Action Rule and Actions against Guarantors**

Where loans are guaranteed by a guarantor who is not already directly liable for repayment of the loan (e.g., the borrower is a partnership and the guarantor is a general partner and thus already liable as a borrower), a lender can sue the guarantor to enforce a guaranty without being subject to the one-action rule. Indeed, the one-action rule and security-first rules of Code of Civil Procedure Section 726(a) do not bar a creditor from seeking recovery against a guarantor prior to foreclosing on the real property or to include a guarantor in an action against a debtor or the security. See *Security First National Bank v. Chapman*, 31 Cal. App. 2d 182, 186 (1939); *Loeb v. Christie*, 6 Cal. 2d 416, 419 (1936). Furthermore, most guaranties contain extensive waivers of such protections. See Cal. Civ. Code § 2856; *Union Bank v. Gradsky*, 265 Cal. App. 2d 40 (1968); *Bank of America v. Stonehaven Manor, LLC*, 186 Cal. App. 4th 719 (2010). Note that waivers are limited to those legal and statutory defenses expressly set out in the agreement and do not release all defenses such as equitable defenses. *California Bank & Trust v. DelPonti*, 232 Cal. App. 4th 162 (2014).

The effectiveness of a guaranty can be affected in some jurisdictions by the relationship of the guarantor and the borrower. Although the one-action rule does not usually protect independent party obligors (unless their obligations are secured by real property interests), the legal relationship of the guarantor to the borrower may determine the enforceability of a guaranty given the one-action rule limitations. Under California law, not much is gained by obtaining the guaranty from a party related or closely tied to the borrower. See, e.g., *Union Bank v. Dorn*, 254 Cal. App. 2d 157 (1967) (after nonjudicial foreclosure, lender barred from seeking recovery from guarantors who were principal obligors under a different name). A guaranty from a principal debtor, a general partner in a principal debtor partnership or an alter ego shareholder, is subject to the one-action rule in California. Such guaranties add nothing to the loan obligations of the parties. However, an unsecured independent guaranty or the guaranty of a limited partner or of a shareholder of a corporation that is not an alter ego should be effective in avoiding the one-action rule.

## ***Senior Lender Remedies under Guaranties Post-foreclosure***

In terms of the one-action rule, the *Union Bank v. Gradsky*, 265 Cal. App. 2d 40 (1968) case held that the one-action rule does not apply to a suit by a secured creditor against the guarantor, endorser, or surety. Thus, the one-action rule should not bar the senior holders' attempts to pursue rights under the guaranties unless the guarantors' obligations are secured by real property interest or if the guarantors are deemed to be a "sham" (i.e., principal obligors under a different name, principal debtor, general partner in a principal general partnership, or an alter ego shareholder). An unsecured independent guaranty or guaranty of a limited partner or of a shareholder of a corporation that is not an alter ego should be effective in avoiding the one-action rule.

In terms of the anti-deficiency principle, per the *Gradsky* case, if a senior lender forecloses in a nonjudicial sale of the real property, it will be estopped from recovering from the guarantors the unpaid balance owed under the loan. However, per the *Gradsky* case, the anti-deficiency defense can be waived by explicit language. In addition, per *Bauman v. Castle*, 15 Cal. App. 3d 990 (1971), the anti-deficiency statute will not act as a bar to pursue amounts owed under the guaranty given the deed of trust was a purchase money security. The *Bauman* court distinguished *Gradsky* and held that there the loan involved a nonpurchase money security (deed of trust executed for a construction loan).

## ***Senior Lender Remedies under Guaranties Pre-foreclosure***

Conversely, if a lender pursues its rights under a related guaranty, upon the borrower's default, and before the action is final forecloses on the real property, the subsequent foreclosure does not affect the lender's rights under any guaranty. Per *Krueger v. Bank of Am.*, 145 Cal. App. 3d 204 (1983), the court would not extend *Gradsky* where a creditor proceeded against the guaranty first and thereafter elected to conduct a nonjudicial foreclosure of the secured real property.

## ***Gradsky Waivers***

Waivers of the anti-deficiency statute guaranties are generally effective and enforceable under California law if they are drafted correctly. See Cal. Civ. Code § 2856, which sets forth specific acceptable language. Note that without the waiver, a guaranty (this term, in California, is used interchangeably with surety) may require that a creditor proceed against the principal or pursue any other available remedy that is not available to the surety and would reduce the surety's burden.

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## The One-Action Rule and UCC Sales

If a loan is secured by an equity interest, the Uniform Commercial Code (UCC) governs and neither the one-action rule nor anti-deficiency statute applies (as they only apply to real property). See *In re Kearns* (2004) 314 B.R. 819 for the interplay between the UCC and the one-action rule. The *Kearns* decision dealt directly with the issue of whether the exercise of nonjudicial remedies against personal property collateral (a car in this case) under Cal. Com. Code § 9604 renders unenforceable a lien on real property under Cal. Civ. Proc. Code § 726. (The lender had liens on the car and real property.) The lender took the car and nonjudicially foreclosed on that lien. Borrower tried to apply the one-action rule / security-first rule to argue that the lender could not seek to foreclose on deed of trust. Reading the California statutes together, the *Kearns* court held that Cal. Com. Code § 9604(a) clarifies (even for consumer loans) the security-first principle of Cal. Civ. Proc. Code § 726 by providing that mixed real and personal property security may, so long as the debt is not reduced to judgment, be pursued *nonjudicially* in any sequence without rendering unenforceable a real property lien. Since the creditor did not offend the one-action aspect of Cal. Civ. Proc. Code § 726 when it nonjudicially took and sold personal property collateral and had done nothing other than resort to security, the court affirmed summary judgment in favor of lender determining that the lender's/ creditor's real property lien was not forfeited.

## Receiverships

A receiver can be appointed by a court in connection with a judicial foreclosure and is often pursued where there is concern about the ongoing management and condition of the property pending the judicial foreclosure. In this way, the dual tracking method is useful so that a receiver can be appointed to take care of the property while a lender pursues a nonjudicial foreclosure (while also maintaining a judicial foreclosure action in court). A receiver can be a "rents-and-profits" receiver who is charge of collecting rents from tenants, managing the property, and making sure there is no waste or damage to protect the value of the property. The downside of a receivership is that it can be costly; receivers typically are paid an hourly rate similar to attorney's fees and also may hire their own counsel if that becomes necessary.

For more on obtaining receiverships, see [Receivership in Real Estate Transactions](#).

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