

**SETTING ASIDE NONJUDICIAL FORECLOSURE SALES:
EXTENDING THE RULE TO COVER BOTH INTRINSIC AND
EXTRINSIC FRAUD OR UNFAIRNESS**

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ABSTRACT

Twenty-nine states have enacted statutes allowing lenders to foreclose on a mortgage or deed of trust privately, under power of sale, without filing a lawsuit. These sales are wholly devoid of judicial oversight. Debtors who encounter irregularities or fraud in the sale process can seek to set the sale aside after it has already taken place. However, courts will only vacate the sale if the irregularities or fraud are intrinsic to the sale process itself, such as when collusive bidding takes place at the auction. This limitation poses significant problems for debtors who encounter irregularities or fraud outside the strict confines of the sale proceeding. The problem is especially relevant for debtors who need to refinance to avert the sale. Courts should extend the current rule to include situations of extrinsic fraud or unfairness for a number of reasons. Although an extension of the rule may theoretically pose some problems for creditors, the problems would likely not materialize. Moreover, in balancing the interests of creditors, debtors, and bona fide purchasers, it would be fairest to allocate the risk to creditors.

PREFACE

Imagine that you own a parcel of property that has been in your family for a hundred years. It consists of fifteen acres, formerly surrounded by orchards, in the heart of a sprawling urban area. You lease the real property to a tenant who has constructed a mobile home park on the property with your permission. The tenant, a sophisticated business person, runs the mobile home park and pays rent on the ground lease every month.

Five years ago, you borrowed \$700,000 from Bank A when you needed money for unrelated business projects, and you pledged the real property as collateral. Now you are having some cash flow problems and you are behind in your payments to the bank.

Bank A has started nonjudicial foreclosure proceedings and has set a date for the trustee's sale, which will occur in thirty days. But you're not worried because the property is worth \$2 million encumbered by a ground lease and \$10 million without it. You have good credit, sufficient equity in the property to use it as collateral for a new loan, and a good business relationship with the commercial loan officer at Bank B.

You decide to refinance the property at a much lower interest rate to pay off the existing mortgage that is currently in default. The refinance will give you lower monthly payments that you can manage with your current cash flow situation. You apply for a loan at Bank B, which conditionally approves your loan. The timeframe is tight, so escrow will close the day before the scheduled auction. The escrow agent will release the appropriate funds to Bank A on that same day. Bank A will cancel the sale upon receipt of those funds.

You will avoid the foreclosure sale and keep your family property if you get this new loan. Bank B has set just one condition for final approval of your loan. All you need is a Tenant Estoppel Certificate signed by your tenant to confirm the existence of a lease and the amount of the monthly rent payments.¹ By the time you receive notice of this condition, the auction is ten days away.

¹ Lenders often require a Tenant Estoppel Certificate to verify the current status of an existing lease on real property when the landlord wants to refinance. It is "ordinarily a simple form requesting information regarding the lease term, amount of rent, [and] amount of security deposit . . . [The form] asks the tenant to confirm that the lease is still in effect and that neither the tenant nor the landlord is in default under the lease." Kathryn Cochrane Murphy, *Estoppel Certificates and Subordination, Non-Disturbance, and Attornment*

You personally deliver the Tenant Estoppel Certificate to your tenant and ask him to sign it. The sale is nine days away. The tenant knows that you need the certificate to get the loan. He also knows that you need the loan to avoid the trustee's sale. You are not very concerned because the lease obligates the tenant to sign such a certificate. It seems like an innocuous request.

But, unbeknownst to you, the tenant wants you to lose the property at auction. The tenant wants to buy it. He knows a lot about real estate. He knows that he can buy the property cheaply at the auction, perhaps for sixty percent of its fair market value. So the tenant stalls in completing the certificate and tries to force the auction. But, all the while, he feigns pleasant cooperation to avoid raising suspicion.

The tenant tells you that he needs to send the Tenant Estoppel Certificate to his lawyer for review before he can sign it; he really wants to help and will work as fast as he can; he cannot get in touch with his lawyer but will keep trying; his lawyer wants to make some changes but the tenant does not know what they are; he understands your situation and will sign the certificate as soon as his lawyer approves. Almost a week passes and the sale is nearing. Escrow is supposed to close soon. You continue to follow up with your tenant.

You have known your tenant for twenty years. You are on friendly terms and know many of the same people. You have no reason to doubt his sincerity. You are confident that you will receive the document in time to close escrow. Bank B promises to fund the loan if it receives the Tenant Estoppel Certificate on or before the escrow date.

After more than a week of promises, just two days before the sale, the tenant leaves you a message stating that he has signed the Tenant Estoppel Certificate. Relieved, you call the tenant to ask when you can get it. The tenant does not answer the phone or return any of the multiple messages that you leave in the next twenty-four hours. The tenant is not at the property when you visit. In fact, the tenant never signed the estoppel certificate and has disappeared.

Frantic, the next morning, an hour before the sale, you and your lawyers make numerous attempts to locate your tenant. You also try unsuccessfully to

negotiate with Bank A and Bank B for more time. Unfortunately, the sale takes place as scheduled. Your tenant was the only bidder who appeared at the sale. He purchased the property for a mere \$700,000 (just seven percent of its unencumbered value).²

What can you do? Can you file a lawsuit to set the sale aside and reclaim your family property? Can you convince a court that your tenant's conduct is the kind of "fraud" or "unfairness" that would warrant a set aside of the sale? Probably not. The court will likely refuse to set the sale aside because the fraud or unfairness took place outside the sale proceedings themselves.

INTRODUCTION

This Article examines the distinction between intrinsic and extrinsic fraud or unfairness as a basis for setting aside nonjudicial foreclosure sales.³ The Article focuses on situations where the wrongdoer committing the fraud or unfairness ultimately purchases the property at auction.

As a general rule, courts have been persuaded to set aside nonjudicial foreclosure sales when they involve fraud or unfairness intrinsic to the sale itself. Courts have declined to set sales aside when the fraud or unfairness occurs "dehors" the sale proceeding.⁴ "Dehors" means "'out of; without; beyond; foreign to; unconnected with.'"⁵ Not one reported case involves the set aside of a trustee's sale based on fraud or unfairness that affected the sale but occurred outside the limited confines of the sale proceedings.

The first part of this Article identifies the problem confronting debtors who have lost real property at a nonjudicial foreclosure sale due to fraud or unfairness that occurs outside the sale proceeding itself. The Article begins by briefly describing the statutory grounds for nonjudicial foreclosure sales and, in general terms, the nonjudicial foreclosure sale process throughout the United States. The Article then provides the general rule for setting aside nonjudicial foreclosure sales, focusing on the requirement that the alleged fraud or unfairness relate directly to the sale proceedings.

² This scenario is based on a problem faced by a property owner in California several years ago.

³ This Article does not examine judicial foreclosure sales, which occur under court supervision within the context of a lawsuit.

⁴ See, e.g., *Nguyen v. Calhoun*, 129 Cal. Rptr. 2d 436, 447 (Cal. App. Ct. 2003).

⁵ *Id.*

The second part of this Article argues that courts should erase the distinction between extrinsic and intrinsic fraud or unfairness when determining whether to set aside a nonjudicial foreclosure sale. Extending the rule to include extrinsic fraud or unfairness makes sense because (1) the plain language of the set-aside rule does not itself preclude a set aside in cases of extrinsic fraud; (2) courts of equity already prohibit wrongdoers from profiting from their wrongs in other situations; (3) courts of equity already set aside judgments obtained by extrinsic fraud or mistake; (4) extending the rule comports with the policy of protecting debtors from wrongful loss of their property; (5) extending the rule will not diminish protections afforded to bona fide purchasers to provide finality in sales; and (6) although extending the rule may affect the creditor's ability to have a quick, inexpensive, and efficient remedy, at least to some degree, the courts should allocate this risk to the creditors as a matter of fairness to debtors.

I. THE STATUTORY GROUNDS FOR NONJUDICIAL FORECLOSURE SALES

Twenty-nine states have enacted statutes allowing lenders to foreclose on a mortgage or deed of trust privately, under power of sale, instead of filing a lawsuit.⁶ Those states are as follows: Alabama, Alaska, Arizona, Arkansas, California, Georgia, Hawaii, Idaho, Maine, Michigan, Minnesota, Mississippi, Missouri, Nebraska, Nevada, New Hampshire, New York, North Carolina, Oklahoma, Oregon, Rhode Island, South Dakota, Tennessee, Texas, Utah, Virginia, Washington, West Virginia, and Wyoming.⁷ Nonjudicial foreclosure

⁶ See, e.g., 1–8 BERGMAN ON NEW YORK MORTGAGE FORECLOSURES, § 8.01 (Matthew Bender 2005) (approximately half the states employ some form of nonjudicial foreclosure); see also *infra* note 7.

⁷ ALA. CODE §§ 35-10-11 to 16 (LexisNexis 1991); ALASKA STAT. §§ 34.20.070 to 130 (2004); ARIZ. REV. STAT. ANN. §§ 33-807 to 821 (2000 & Supp. 2005); ARK. CODE ANN. §§ 18-50-101 to 117 (2003); CAL. CIV. CODE §§ 2924-2924k (West 1993 & Supp. 2006); GA. CODE ANN. §§ 44-14-161 to 162.4 (2002); HAW. REV. STAT. §§ 667-5 to 10 (1993); IDAHO CODE ANN. §§ 45-1502 to 1515 (2003 & Supp. 2005); ME. REV. STAT. ANN. tit. 14 §§ 6201 to 6209 (2003); MICH. COMP. LAWS §§ 600.3201 to 3280 (2004 & Supp. 2006); MINN. STAT. ANN. §§ 580.01 to 30 (West 2000 & Supp. 2006); MISS. CODE ANN. §§ 89-1-55 to 63 (West 1999 & Supp. 2005); MO. REV. STAT. §§ 443.290 to 410 (West 2000); NEB. REV. STAT. §§ 76-1001 to 1018 (2003); NEV. REV. STAT. ANN. §§ 107.030 to 100 (LexisNexis 2001 & Supp. 2005); N.H. REV. STAT. ANN. §§ 479:22–27 (LexisNexis 2003); N.Y. REAL PROP. ACTS. § 1401-1421 (McKinney 1979 & Supp. 2006); N.C. GEN. STAT. §§ 45-21.1 to 33 (2005); OKLA. STAT. ANN. tit. 46, §§ 40-49 (West 1996); OR. REV. STAT. §§ 86.705-795 (2005); R.I. GEN. LAWS §§ 34-11-22, 34-27-1 to 5 (1995 & Supp. 2005); S.D. CODIFIED LAWS §§ 21-48 to 15 (1987 & Supp. 2003); TENN. CODE ANN. §§ 35-5-101 to 115 (2001 & Supp. 2005); TEX. PROP. CODE ANN. §§ 51.002-005 (Vernon 1995 & Supp. 2005); UTAH CODE ANN. §§ 57-1-19 to 36 (2000 & Supp. 2005); VA. CODE ANN. §§ 55-59 to 59.3 (2003 & Supp. 2006); WASH. REV. CODE ANN. §§ 61.24.005 to 130 (West 2004); W. VA. CODE ANN. §§ 38-1-1 to 15 (2005); WYO. STAT. ANN. §§ 34-4-101 to 113 (LexisNexis 2005).

sales are clearly not limited to any one geographical region. They occur on both coasts, in the midwest, and in the southern states.

Each of these states has a statutory scheme that delineates the rules for nonjudicial foreclosure sales, some in greater detail than others.⁸ Some states, notably Arizona, Arkansas, Nebraska, New York, North Carolina, and South Dakota, have very extensive and detailed statutory schemes that provide guidance in numerous situations that might arise with respect to a nonjudicial foreclosure sale.⁹ On the other end of the spectrum, other states, like Alabama, New Hampshire, Rhode Island, Texas, and Virginia, provide very little detailed guidance in their statutory schemes.¹⁰ However, all of the states provide, at the very least, for a foreclosure under power of sale with some sort of notice to the debtor required before the auction.¹¹ The sale process is described in Part II, below.

II. THE NONJUDICIAL FORECLOSURE PROCESS IN GENERAL¹²

A nonjudicial foreclosure sale, also known as a trustee's sale, is the private sale of secured property pursuant to a power of sale contained in a mortgage or deed of trust.¹³ A nonjudicial foreclosure sale occurs after a borrower defaults

⁸ ALA. CODE §§ 35-10-11 to 16; ALASKA STAT. §§ 34.20.070-130; ARIZ. REV. STAT. ANN. §§ 33-807 to 821; ARK. CODE ANN. §§ 18-50-101 to 117; CAL. CIV. CODE §§ 2924-2924k; GA. CODE ANN. §§ 44-14-161 to 162.4; HAW. REV. STAT. §§ 667-5 to 10; IDAHO CODE ANN. §§ 45-1502 to 1515; ME. REV. STAT. ANN. tit. 14 §§ 6201-6209; MICH. COMP. LAWS §§ 600.3201-3280; MINN. STAT. ANN. §§ 580.01-30; MISS. CODE ANN. §§ 89-1-55 at 63; MO. REV. STAT. §§ 443.290 to 410; NEB. REV. STAT. §§ 76-1001 to 1018; NEV. REV. STAT. ANN. §§ 107.030 to 100; N.H. REV. STAT. ANN. §§ 479:22-27; N.Y. REAL PROP. ACTS. §§ 1401-1421; N.C. GEN. STAT. §§ 45-21.1 to 33 (2005); OKLA. STAT. ANN. tit. 46, §§ 40-49; OR. REV. STAT. §§ 86.705 to 795; R.I. GEN. LAWS §§ 34-11-22, 34-27-1 to 5; S.D. CODIFIED LAWS §§ 21-48-1 to 15; TENN. CODE ANN. §§ 35-5-101 to 115; TEX. PROP. CODE ANN. §§ 51.002-51.005; UTAH CODE ANN. §§ 57-1-19 to 36; VA. CODE ANN. §§ 55-59 to 59.3; WASH. REV. CODE ANN. §§ 61.24.005 to 130; W. VA. CODE ANN. §§ 38-1-1 to 15; WYO. STAT. ANN. §§ 34-4-101 to 113.

⁹ ARIZ. REV. STAT. ANN. §§ 33-807 to 33-821; ARK. CODE ANN. §§ 18-50-101 to 117; NEB. REV. STAT. §§ 76-1001 to 1018; N.Y. REAL PROP. ACTS. §§ 1401-1421; OR. REV. STAT. §§ 86.705-795; S.D. CODIFIED LAWS §§ 21-48-1 to 15.

¹⁰ ALA. CODE §§ 35-10-11 to 16; N.H. REV. STAT. ANN. §§ 479:22-27; R.I. GEN. LAWS §§ 34-11-22, 34-27-1-5; TEX. PROP. CODE ANN. §§ 51.002-005; VA. CODE ANN. §§ 55-59 to 59.3.

¹¹ See, e.g., *infra* notes 25 and 27.

¹² This Part describes the nonjudicial foreclosure process in general terms based on the statutes enacted in states that allow it. There are, indeed, some general conclusions that can be drawn from a collective review of the statutes in the relevant states. However, the statutes in each state obviously differ in varying degrees. Practicing attorneys should review the specific statutes in the particular state in which they have a nonjudicial foreclosure proceeding pending.

¹³ ALA. CODE § 35-10-12; ALASKA STAT. § 34.20.070(a); CAL. CIV. CODE § 2924; NEB. REV. STAT. § 76-1005; NEV. REV. STAT. ANN. § 107.080(1); N.H. REV. STAT. ANN. § 479:25; OKLA. STAT. ANN. tit. 46,

on a loan secured by real property.¹⁴ The act of default is often the borrower's nonrepayment of the loan, but it may be any act that contravenes the terms of the loan documents.¹⁵ The power of sale in the security instrument gives the lender the right to sell the property at auction without court supervision.¹⁶ However, the foreclosing mortgagee, the lender holding the power of sale, must sometimes initiate the foreclosure proceedings within the limitations period that would govern an action filed to enforce the obligation in court.¹⁷ The lender must also observe other statutory procedural requirements.¹⁸

Ordinarily, after the borrower defaults on the loan, the lender will make informal efforts to collect past due amounts by establishing a "workout" plan with the borrower.¹⁹ Lenders would prefer to help the borrower bring the loan current because a workout is cheaper and faster than a foreclosure.²⁰ The bank

§ 43(1), (2)(a); OR. REV. STAT. § 86.710 (2005); R.I. GEN. LAWS § 34-11-22; S.D. CODIFIED LAWS § 21-48-1; UTAH CODE ANN. § 57-1-23 (2000 & Supp. 2005); W. VA. CODE ANN. § 38-1-3 (LexisNexis 2005); WYO. STAT. ANN. § 34-4-101 (2005); 4 MILLER AND STARR CALIFORNIA REAL ESTATE 3D §10:179 (West 2003); *see also* UNIF. NONJUDICIAL FORECLOSURE ACT § 201, 14 U.L.A. 151 (2005).

¹⁴ ALASKA STAT. § 34.20.070(a); ARIZ. REV. STAT. ANN. § 33-807(A); ARK. CODE ANN. § 18-50-103(2); CAL. CIV. CODE § 2924; N.H. REV. STAT. ANN. § 479:25; N.Y. REAL PROP. ACTS § 1401(1.)(1); OR. REV. STAT. § 86.710 (2005); R.I. GEN. LAWS § 34-11-22 (1995 & Supp. 2005); S.D. CODIFIED LAWS §§ 21-48-1, 21-48-3; UTAH CODE ANN. § 57-1-23; W. VA. CODE ANN. § 38-1-3; WYO. STAT. ANN. § 34-4-103(a)(i); *see also* LLOYD M. SEGAL, STOP FORECLOSURE NOW IN CALIFORNIA 3/2 (Nolo Press 1997).

¹⁵ RealtyTrac, Foreclosure Overview, <http://www.realtytrac.com/education/noframes/overview.html> (last visited July 13, 2006) ("the foreclosure process begins when a borrower/owner defaults on loan payments (usually mortgage payments)"); *see, e.g.*, ALASKA STAT. § 34.20.070(b); CAL. CIV. CODE § 2924c(a)(1); NEB. REV. STAT. §§ 76-1006(1), 76-1012; NEV. REV. STAT. ANN. § 107.080(2)(a); N.Y. REAL PROP. ACTS. § 1402(2)(b); N.C. GEN. STAT. §§ 45-21.16(d); OKLA. STAT. ANN. tit. 46, § 44; OR. REV. STAT. §§ 86.745(4), 86.759(1); UTAH CODE ANN. § 57-1-31(1); WASH. REV. CODE ANN. § 61.24.030(3); *see also* SEGAL, *supra* note 14.

¹⁶ *See supra* note 8; *see also* ARIZ. REV. STAT. ANN. § 33-807(A) (distinction made between nonjudicial foreclosures and actions filed in court); N.Y. REAL PROP. ACTS § 1401(1.)(2) (distinction made between nonjudicial foreclosures and actions filed in court); OKLA. STAT. ANN. tit. 46, § 43(2)(a), (b) (distinction made between nonjudicial foreclosures and actions filed in court); OR. REV. STAT. § 86.735(4) (distinction made between nonjudicial foreclosures and actions filed in court); S.D. CODIFIED LAWS § 21-48-4 (distinction made between nonjudicial foreclosures and actions filed in court); WASH. REV. CODE ANN. § 61.24.030(4) (distinction made between nonjudicial foreclosures and actions filed in court); WYO. STAT. ANN. § 34-4-103(a)(ii) (distinction made between nonjudicial foreclosures and actions filed in court).

¹⁷ ARIZ. REV. STAT. ANN. § 33-816; N.Y. REAL PROP. ACTS § 1401(1.)(4); N.C. GEN. STAT. § 45-21.11; OR. REV. STAT. § 86.725; UTAH CODE ANN. § 57-1-34.

¹⁸ *See, e.g.*, UNIF. NONJUDICIAL FORECLOSURE ACT § 301 14 U.L.A. 167 (2005).

¹⁹ Trev E. Peterson, *The Nebraska Trust Deeds Act*, Knudsen, Berkheimer, Richardson, & Endacott, LLP, <http://www.knudsenlaw.com/index.pl?id=2245&isa=NewsArticle&op=show> (last visited July 14, 2006) ("[L]enders do not [normally] refer debt obligations . . . for collection until . . . [their] own internal collection efforts have failed."); Michael D. Larson, *Fending Off Foreclosure: You Don't Have to Lose Your Home*, Bankrate.com, <http://www.bankrate.com/brm/news/mtg/20001019.asp> (last visited July 12, 2006).

²⁰ Larson, *supra* note 19.

will often contact a borrower after a payment becomes sixteen days late and try to find a way to resolve the delinquency.²¹ For example, depending on the seriousness of the borrower's financial difficulties, the lender may offer a repayment plan or a modification of the loan to make the borrower's payments more manageable in size.²² After the first payment becomes thirty days late and the next payment appears to be at risk of delinquency, however, collection attempts become increasingly more serious.²³ After ninety or one hundred days, the lender will often refer the mortgage to an attorney or other professional for foreclosure.²⁴

To initiate the foreclosure process in the majority of states permitting nonjudicial foreclosure, the lender must serve a Notice of Default (sometimes called a Notice of Intention to Foreclose).²⁵ These notices alert the borrower to the existence of default and the possible loss of the borrower's property for failure to cure the default within a specified time frame.²⁶ In a minority of states, the lender skips the Notice of Default and initiates foreclosure proceedings with a simple Notice of Sale.²⁷ The Notice of Sale sets forth, among other things, the date, time, and place that the property will be sold at auction due to the borrower's default.²⁸ Notices of Sale are required in every jurisdiction. In states that require a Notice of Default as the initial step, rather than a Notice of Sale, the lenders issue a Notice of Sale as a subsequent step if the borrower fails to cure the default.²⁹

²¹ *Id.*

²² *Id.*

²³ *Id.*

²⁴ *Id.*

²⁵ ALASKA STAT. § 34.20.070(b) (2004); ARK. CODE ANN. §§ 18-50-103(3), 18-50-104(a), (b) (2003); NEB. REV. STAT. § 76-1006(1) (2003); NEV. REV. STAT. ANN. § 107.080(2)(b) (LexisNexis 2001 & Supp. 2005); N.Y. REAL PROP. ACTS §§ 1402(1), 1403(1) (New York requires a Notice of Pendency to be filed even before the Notice of Default); N.C. GEN. STAT. § 45-21.16(a), (c) (2005) (does not require a Notice of Default, but it requires a Notice of Hearing before the lender can serve a Notice of Sale; Notice of Hearing performs much the same function as the Notice of Default); *see also* OKLA. STAT. ANN. tit. 46, § 44 (West 1996); OR. REV. STAT. § 86.735(3) (2005); TEX. PROP. CODE ANN. § 51.002(d) (Vernon 1995 & Supp. 2005); UTAH CODE ANN. § 57-1-24(1) (2000 & Supp. 2005); VA. CODE ANN. § 55-59.1(A) (2003 & Supp. 2006); WASH. REV. CODE ANN. § 61.24.030(7) (West 2004); WYO. STAT. ANN. § 34-4-103(a)(iv) (2005 & Supp. 2006); UNIF. NONJUDICIAL FORECLOSURE ACT § 202 14 U.L.A. 151 (2005).

²⁶ *See supra* note 25.

²⁷ ALA. CODE § 35-10-13 (LexisNexis 1991); ARIZ. REV. STAT. ANN. § 33-808(A) (2000 & Supp. 2005); N.H. REV. STAT. ANN. § 479:25(I), (II) (LexisNexis 2003); R.I. GEN. LAWS §§ 34-11-22, 34-27-4(a) (1995 & Supp. 2005); S.D. CODIFIED LAWS §§ 21-48-6 to 6.1 (LexisNexis 1987 & Supp. 2003); TENN. CODE ANN. §§ 35-5-101 to 105 (2001); W. VA. CODE ANN. § 38-1-4 (LexisNexis 2005).

²⁸ *See supra* note 27.

²⁹ ALASKA STAT. § 34.20.080(a)(2); NEB. REV. STAT. § 76-1007(1); NEV. REV. STAT. ANN. § 107.080(4); N.Y. REAL PROP. ACTS. §§ 1404-1406; N.C. GEN. STAT. §§ 45-21.16A to 21.17; OKLA. STAT. ANN. tit. 46,

The Notice of Default and the Notice of Sale must be served in a specified manner, normally by certified mail with return receipt requested or by personal service, to all interested parties.³⁰ The Notice of Sale must also be published in the local newspaper once a week for three to five weeks and sometimes must be posted at the courthouse or on the premises.³¹ Specified periods of time must elapse between service of the notice initiating foreclosure proceedings and the sale date, anywhere between a mere twenty days³² and one hundred twenty days.³³

The borrower may usually cure the default anytime before a specified deadline, which may be as late as the start of bidding on the sale date³⁴ or as early as a month before the sale.³⁵ Sometimes lenders agree to postpone the sale to give the borrower more time to cure the default (or for reasons such as bad weather or low attendance at the sale), but such postponements must normally (1) be announced at the time and place last appointed for sale; or (2) be published in the newspaper.³⁶

If the borrower still fails to cure the default and does not successfully undertake legal action to halt the sale, then an auctioneer sells the property on

§ 45; OR. REV. STAT. §§ 86.745-86.750; TEX. PROP. CODE ANN. § 51.002(b); UTAH CODE ANN. § 57-1-25; VA. CODE ANN. § 55-59.3 (2003); WASH. REV. CODE ANN. §§ 61.24.030(7), 61.24.040(1), (3); WYO. STAT. ANN. §§ 34-4-104(a), 34-4-105; *see also* UNIF. NONJUDICIAL FORECLOSURE ACT §§ 203, 204, 14 U.L.A. 155, 157 (2005).

³⁰ ALASKA STAT. §§ 34.20.070(c), 34.20.080(d); ARIZ. REV. STAT. ANN. § 33-809(B)-(C); ARK. CODE ANN. § 18-50-104(b); CAL. CIV. CODE § 2924b(c)-(e) (West 1993 & Supp. 2006); NEV. REV. STAT. ANN. § 107.080(3), (4)(a); N.H. REV. STAT. ANN. § 479:25(II); N.Y. REAL PROP. ACTS. §§ 1402(1), (3), 1405(1), 1406; N.C. GEN. STAT. §§ 45-21.16(a)-(b), 45-21.17(4) (2005); OKLA. STAT. ANN. tit. 46, §§ 44, 45(B)(1); OR. REV. STAT. §§ 86.740(1), (3)(c), 86.750(1), (3); R.I. GEN. LAWS §§ 34-11-22, 34-27-4(b); S.D. CODIFIED LAWS § 21-48-6.1; W. VA. CODE ANN. § 38-1-4.

³¹ ALA. CODE § 35-10-13; ARIZ. REV. STAT. ANN. § 33-808(A); ARK. CODE ANN. § 18-50-105; NEB. REV. STAT. § 76-1007(1); NEV. REV. STAT. ANN. § 107.080(4)(b)-(c); N.H. REV. STAT. ANN. § 479:25(I); N.Y. REAL PROP. ACTS. § 1405(2); N.C. GEN. STAT. § 45-21.17(1)-(3); OKLA. STAT. ANN. tit. 46, § 45(B)(2); OR. REV. STAT. § 86.750(2); R.I. GEN. LAWS §§ 34-11-22, 34-27-4(a); S.D. CODIFIED LAWS § 21-48-6; TENN. CODE ANN. § 35-5-101; UTAH CODE ANN. § 57-1-25(1); VA. CODE ANN. § 55-59.2; WYO. STAT. ANN. § 34-4-104(a).

³² TENN. CODE ANN. § 35-5-101(b); W. VA. CODE ANN. § 38-1-4.

³³ OR. REV. STAT. § 86.740(1).

³⁴ ARK. CODE ANN. § 18-50-114; N.Y. REAL PROP. ACTS. § 410(1); N.C. GEN. STAT. § 45-21.20.

³⁵ NEB. REV. STAT. §§ 76-1007(1) to 1012.

³⁶ ALASKA STAT. § 34.20.080(e) (2004); ARIZ. REV. STAT. ANN. § 33-810(B)-(D); CAL. CIV. CODE § 2924g(a), (c)-(d) (West 1993 & Supp. 2006); NEB. REV. STAT. § 76-1009; NEV. REV. STAT. ANN. § 107.030(6); N.Y. REAL PROP. ACTS. § 1407; N.C. GEN. STAT. § 45-21.21; OKLA. STAT. ANN. tit. 46, § 46(B); OR. REV. STAT. § 86.755(6)-(7); R.I. GEN. LAWS § 34-11-22; S.D. CODIFIED LAWS § 21-48-11; UTAH CODE ANN. § 57-1-27(2); WYO. STAT. ANN. § 34-4-109.

behalf of the lender at a public sale on a specified date.³⁷ The auction often takes place on the steps of the local courthouse or on the premises being sold.³⁸ Many states require the auction to take place within specified business hours, often between 9 AM and 5 PM on weekdays.³⁹

The auctioneer generally sells the property to the highest bidder.⁴⁰ Normally, both the lender and borrower are permitted to purchase the property at the sale.⁴¹ Some states require the bidders to pay the entire purchase price immediately with cash, a cashier's check, or the equivalent.⁴² Other states allow the high bidder to pay just a percentage of the purchase price in cash immediately after the sale and to pay the remainder within a specified time frame.⁴³ Sometimes, the highest bidder may (1) take immediate possession of the premises upon full payment of the purchase price; or (2) obtain an order for immediate possession from the court.⁴⁴ The auctioneer normally provides the successful bidder with a trustee's deed upon receipt of full payment.⁴⁵ The trustee's deed conveys all of the mortgagor's interest in the property.⁴⁶ The trustee's deed may contain recitals of compliance with the statutes governing

³⁷ See ALA. CODE ANN. § 35-10-14 (LexisNexis 1991); NEB. REV. STAT. § 76-1007; N.H. REV. STAT. ANN. § 479:25 (LexisNexis 2003); N.Y. REAL PROP. ACTS. § 1408; OKLA. STAT. ANN. tit. 46, § 46(A).

³⁸ ALA. CODE ANN. § 35-10-14; ARIZ. REV. STAT. ANN. § 33-808(B); NEB. REV. STAT. § 76-1007(2); N.H. REV. STAT. ANN. § 479:25(III); N.Y. REAL PROP. ACTS. § 408(1); N.C. GEN. STAT. § 45-21.4 (2005); R.I. GEN. LAWS § 34-11-22; TEX. PROP. CODE ANN. § 51.002(a) (Vernon 1995 & Supp. 2005); WYO. STAT. ANN. § 34-4-106.

³⁹ ALA. CODE ANN. § 35-10-14; ARIZ. REV. STAT. ANN. § 33-808(B); CAL. CIV. CODE § 2924g(a); NEB. REV. STAT. § 76-1007(2); N.Y. REAL PROP. ACTS. § 1408(1); S.D. CODIFIED LAWS § 21-48-10; TENN. CODE ANN. § 35-5-109 (2001 & Supp. 2005); UTAH CODE ANN. § 57-1-25(2)(a)-(b); WYO. STAT. ANN. § 34-4-106.

⁴⁰ ALASKA STAT. § 34.20.080(b); ARIZ. REV. STAT. ANN. § 33-810(A); CAL. CIV. CODE § 2924g(a); NEB. REV. STAT. § 76-1009; N.Y. REAL PROP. ACTS. § 1408 ("successful bidder"); OKLA. STAT. ANN. tit. 46, § 46(A) (West 1996); OR. REV. STAT. § 86.755(1); S.D. CODIFIED LAWS § 21-48-10; UTAH CODE ANN. § 57-1-25(1)(a); WYO. STAT. ANN. § 34-4-106; UNIF. NONJUDICIAL FORECLOSURE ACT § 308(a)(2), 14 U.L.A. 173.

⁴¹ ALASKA STAT. § 34.20.080(b); ARIZ. REV. STAT. ANN. § 33-810(A); N.Y. REAL PROP. ACTS. § 1409; OKLA. STAT. ANN. tit. 46, § 46(A); OR. REV. STAT. § 86.755(1); R.I. GEN. LAWS § 34-27-2; S.D. CODIFIED LAWS § 21-48-13; UTAH CODE ANN. § 57-1-27(1)(a); WYO. STAT. ANN. § 34-4-108.

⁴² CAL. CIV. CODE § 2924h(b)-(c); OR. REV. STAT. § 86.755(3).

⁴³ ARIZ. REV. STAT. ANN. §§ 33-810(A), 33-811(A), (B); N.Y. REAL PROP. ACTS. § 1408(4)-(5); N.C. GEN. STAT. § 45-21.10; OKLA. STAT. ANN. tit. 46, § 46(A); VA. CODE ANN. § 55-59.4(2); W. VA. CODE ANN. § 38-1-5 (2005); UNIF. NONJUDICIAL FORECLOSURE ACT §§ 309-310, 14 U.L.A. 174.

⁴⁴ ARK. CODE ANN. § 18-50-107(e); N.C. STAT. § 45-21.29(k)(1) (2005).

⁴⁵ ALASKA STAT. § 34.20.080(2)(b); ARIZ. REV. STAT. ANN. § 33-811(B); NEB. REV. STAT. § 76-1010(1); OKLA. STAT. ANN. tit. 46, § 47(A); OR. REV. STAT. § 86.755; S.D. CODIFIED LAWS § 21-48-19(4); UTAH CODE ANN. § 57-1-(2)(a)(i); W. VA. CODE ANN. § 38-1-6.

⁴⁶ ALA. CODE § 35-10-15 (LexisNexis 1991); ALASKA STAT. § 34.20.090(a); ARK. CODE ANN. § 18-50-111(b); N.Y. REAL PROP. ACTS. § 1412(1); OR. REV. STAT. § 86.770(1); R.I. GEN. LAWS § 34-11-22.

nonjudicial foreclosure sales.⁴⁷ These recitals are prima facie evidence of compliance with such requirements and are conclusive with respect to a bona fide purchaser.⁴⁸

The vast majority of states allow the lender to pursue a deficiency judgment against the borrower, with some restrictions, after the nonjudicial foreclosure sale if the sale fails to fully satisfy the debt.⁴⁹ A few states entirely prohibit the lender from pursuing deficiency judgments.⁵⁰ In any event, the sale proceeds normally, though not always, are distributed in the following order: (1) to cover taxes and the costs of sale, including reasonable trustee or attorneys' fees; (2) to fulfill the obligation giving rise to the sale; (3) to pay junior lienholders; and (4) to repay the borrower if any proceeds remain after making the other payments.⁵¹

III. THE THREEFOLD PURPOSE BEHIND STATUTORY NONJUDICIAL FORECLOSURE SCHEMES

Nonjudicial foreclosure sales are more efficient and less expensive than judicial foreclosure sales.⁵² Judicial foreclosure sales, even uncontested ones, can drag on for years because of court overcrowding and obstreperous litigation techniques.⁵³ On the other hand, nonjudicial foreclosure sales can be

⁴⁷ ALASKA STAT. § 34.20.090(c); ARIZ. REV. STAT. ANN. § 33-811(B); ARK. CODE ANN. § 18-50-111(a); CAL. CIV. CODE § 2924; NEB. REV. STAT. § 76-1010(1); OKLA. STAT. ANN. tit. 46, § 47(A); OR. REV. STAT. § 86.780; S.D. CODIFIED LAWS § 21-48-19 (requires a recital of facts of sale); UTAH CODE ANN. § 57-1-28(a)-(c).

⁴⁸ ALASKA STAT. § 34.20.090(c); ARIZ. REV. STAT. ANN. § 33-811(B); ARK. CODE ANN. § 18-50-111(a)(2); CAL. CIV. CODE § 2924; NEB. REV. STAT. § 76-1010(1); OKLA. STAT. ANN. tit. 46, § 47(A); OR. REV. STAT. § 86.780; UTAH CODE ANN. § 57-1-28(a)-(c).

⁴⁹ ARIZ. REV. STAT. ANN. § 33-814; ARK. CODE ANN. § 18-50-112; GA. CODE ANN. § 44-14-161(a); NEB. REV. STAT. § 76-1013; N.Y. REAL PROP. ACTS. § 1419(2); OKLA. STAT. ANN. tit. 46, § 43(A)(2)(d); S.D. CODIFIED LAWS § 21-48-14; TEX. PROP. CODE ANN. § 51.003 (Vernon 1995); UTAH CODE ANN. § 57-1-32; Nev. Land & Mortgage Co. v. Hidden Wells Ranch, 435 P.2d 198, 200 (Nev. 1967).

⁵⁰ ALASKA STAT. § 34.20.100; CAL. CIV. PROC. CODE § 580d; OR. REV. STAT. § 86.770(2), (4).

⁵¹ ARIZ. REV. STAT. ANN. § 33-812(A); ARK. CODE ANN. § 18-50-109; N.Y. REAL PROP. ACTS. § 1413(1); N.C. GEN. STAT. § 45-21.31(a); OKLA. STAT. ANN. tit. 46, § 48(A); OR. REV. STAT. § 86.765; R.I. GEN. LAWS § 34-11-22; UTAH CODE ANN. § 57-1-29(1); VA. CODE ANN. § 55-59.4(A)(3); W. VA. CODE ANN. § 38-1-7; WYO. STAT. ANN. § 34-4-113(a).

⁵² Gilroy v. Ryberg, 667 N.W.2d 544, 553 (Neb. 2003); Fed. Home Loan Mortgage Corp. v. Bauer, 950 P.2d 399, 400 (Or. Ct. App. 1997) (nonjudicial foreclosure is the most efficient means of foreclosure); S. 588-D, 221st Leg., Reg. Sess. (N.Y. 1998), available at <http://www.westlaw.com> (enter search term NY Bill Jacket, 1998 S.B. 588, Ch. 231).

⁵³ S. 588-D, 221st Leg., Reg. Sess. (N.Y. 1998), available at <http://www.westlaw.com> (enter search term NY Bill Jacket, 1998 S.B. 588, Ch. 231).

completed in twenty to one hundred twenty days, depending on the statutorily required waiting period between service of the initial notice to the debtor and the auction.⁵⁴

At the same time, nonjudicial foreclosure sales are harsh remedies because debtors lose their property in a proceeding devoid of judicial oversight.⁵⁵ Additionally, parties who purchase the distressed properties at the public sale want to be sure that the sales are final and will not be subjected to unnecessary, protracted litigation.⁵⁶

Consequently, the statutory schemes governing nonjudicial foreclosures are intended to serve three interrelated objectives. First, the nonjudicial foreclosure process should protect the debtor from a wrongful loss of property; second, the process should ensure that properly conducted sales are final between the parties and conclusive as to bona fide purchasers; and third, the process should give creditors a quick, inexpensive remedy against defaulting debtors.⁵⁷

IV. GROUNDS FOR SETTING ASIDE NONJUDICIAL FORECLOSURE SALES

This Part first analyzes the few state statutes that address a party's ability to set aside nonjudicial foreclosure sales. It then analyzes the common-law rules with regard to setting aside nonjudicial foreclosure sales, focusing on the requirement that the fraud or unfairness arise from the sale proceedings themselves. Finally, this Part explains why the existing set-aside rules pose significant problems for debtors.

⁵⁴ See, e.g., ALASKA STAT. § 34.20.070(b) (2004) (lender must serve Notice of Default thirty days after default and three months before sale); OR. REV. STAT. § 86.740(1) (2005) (Notice of Sale must be served after Notice of Default and at least 120 days before sale); TENN. CODE ANN. § 35-5-101(b) (2001) (lender must publish Notice of Sale at least twenty days before sale); W. VA. CODE ANN. § 38-1-4 (lender must publish Notice of Sale at least twenty days before sale).

⁵⁵ See, e.g., *Syst. Inv. Corp. v. Union Bank*, 98 Cal. Rptr. 735, 745 (Cal. Ct. App. 1971).

⁵⁶ See *Gilroy*, 667 N.W.2d at 553 (courts limit set asides of nonjudicial foreclosure sales because the resulting uncertainty and increase in litigation will deter bidders).

⁵⁷ *Cox v. Helenius*, 693 P.2d 683, 685-86 (Wash. 1985); see also *Koegel v. Prudential Mut. Sav. Bank*, 752 P.2d 385, 388 (Wash. 1988); *Moeller v. Lien*, 30 Cal. Rptr. 2d 777, 782 (Cal. Ct. App. 1994).

A. *Statutory Rules Relating to the Set Aside of Nonjudicial Foreclosure Sales*

Very few states have statutes addressing the penalties for failing to follow property procedure when conducting nonjudicial foreclosure sales.⁵⁸ Indeed, only Arizona, Oregon, Tennessee, and Nevada have such statutes.⁵⁹ As it turns out, courts in Arizona, Tennessee, and Nevada have set sales aside under the common-law rules discussed in the next Part,⁶⁰ so the state set-aside statutes do not seem to have played a significant role in the jurisprudence of those states. It is not clear that Oregon courts have set any sales aside under the common-law rules.

Of the four states with set aside statutes, Arizona, Oregon, and Tennessee attempt to make it difficult for debtors (or anyone) to set such sales aside.⁶¹ Arizona law provides, for example, that an error in the notice of sale “shall not invalidate a trustee’s sale” unless the error involves “the legal description of the trust property or an error in the date, time or place of sale.”⁶² Even if an error appears in the legal description of the trust property, the sale will only be set aside if “the trust property cannot be identified.”⁶³

Oregon and Tennessee attempt to limit the remedy to monetary damages instead of a set aside of the sale. For example, Oregon law provides that a person who failed to receive notice of the sale from the trustee and who should have received such notice may commence an action for damages against the trustee.⁶⁴ The omitted person must prove, among other things, that (1) the trustee failed to give notice as required; and (2) the omitted person could and would have cured the default.⁶⁵ The omitted person must prove by clear and convincing evidence that he or she had the financial ability to cure the default prior to the date of the trustee’s sale.⁶⁶

⁵⁸ See, e.g., ARIZ. REV. STAT. ANN. § 33-808(E) (2000 & Supp. 2005); NEV. REV. STAT. ANN. § 107.080(5) (LexisNexis 2001 & Supp. 2005); OR. REV. STAT. § 86.742 (2005); TENN. CODE ANN. §§ 35-5-106 to 107 (2001).

⁵⁹ See *supra* note 58.

⁶⁰ *In re Hills*, 299 B.R. 581, 586 (Bankr. D. Ariz. 2002); *In re Krohn*, 52 P.3d 774, 783 (Ariz. 2002); *Nev. Land & Mortgage Co. v. Hidden Wells Ranch, Inc.*, 435 P.2d 198, 200 (Nev. 1967); *Pugh v. Richmond*, 425 S.W.2d 789, 796 (Tenn. Ct. App. 1968).

⁶¹ ARIZ. REV. STAT. ANN. § 33-808(E); OR. REV. STAT. § 86.742(2); TENN. CODE ANN. § 35-5-106.

⁶² ARIZ. REV. STAT. ANN. § 33-808(E).

⁶³ *Id.*

⁶⁴ OR. REV. STAT. § 86.742(2).

⁶⁵ *Id.*

⁶⁶ OR. REV. STAT. § 86.742(3).

Similarly, Tennessee law provides that “[s]hould the officer, or other person making the sale, proceed to sell without pursuing the provisions of this chapter, the sale shall not, on that account, be either void or voidable.”⁶⁷ Instead, failure to comply with the statutory requirements can make the noncompliant party liable “for all damages resulting from the failure.”⁶⁸ Failure to comply with the statutory requirements is also a misdemeanor in Tennessee.⁶⁹

Although these three states purport to make it more difficult to set aside trustee’s sales by statute, the courts in Arizona and Tennessee have set sales aside under the equitable common-law rules discussed in the following Part.⁷⁰ Thus, apart from the statutes in Oregon, in which the courts do not appear to set sales aside under common-law rules, the state statutes are not as restrictive as they might first appear.

Nevada is the final state with a statute addressing set asides of nonjudicial foreclosure sales. Nevada law is much friendlier to debtors. It provides that “the sale may be declared void if the trustee or other person authorized to make the sale does not substantially comply with the provisions of this section.”⁷¹ Even with this expansive statutory rule, the Nevada courts have set sales aside under the equitable common-law rules discussed in the following Part.⁷² Thus, the common-law rules appear to have a far greater impact than the statutory rules.

⁶⁷ TENN. CODE ANN. § 35-5-106.

⁶⁸ *Id.* § 35-5-107.

⁶⁹ *Id.*

⁷⁰ *In re Hills*, 299 B.R. 581, 586 (Bankr. D. Ariz. 2002); *In re Krohn*, 52 P.3d 774, 783 (Ariz. 2002); *Pugh v. Richmond*, 425 S.W.2d 789, 796 (Tenn. Ct. App. 1968) (sales under a power of sale are “much liable to abuse” and are “jealously watched by courts of equity, and upon slight proof of unfair conduct they will be set aside”); John A. Walker, Jr., *Simple Real Estate Foreclosures Made Complex: The Byzantine Tennessee Process*, 62 TENN. L. REV. 231, 249 (1995) (although, in Tennessee, failure to follow the statutes may only result in damages, failure to follow the terms of the deed of trust will result in a set aside of the sale).

⁷¹ NEV. REV. STAT. ANN. § 107.080(5) (LexisNexis 2001 & Supp. 2005).

⁷² *Nev. Land & Mortgage Co. v. Hidden Wells Ranch*, 435 P.2d 198, 200 (Nev. 1967) (“[T]he trial court may set aside a trustee’s sale upon the grounds of fraud or unfairness.”).

B. The Common-Law Rule Governing the Set Aside of Nonjudicial Foreclosure Sales

Actions to set aside a nonjudicial foreclosure sale are equitable in nature.⁷³ The overwhelming majority of states that permit nonjudicial foreclosure adhere to some version of the same general rule regarding set asides. The general rule is that the court has the equitable power to set aside a nonjudicial foreclosure sale if (1) the property was purchased for an inadequate price at auction; and (2) the debtor can show irregularity, unfairness, or fraud (sometimes collectively referred to as “fraud” herein)⁷⁴ in connection with the sale.⁷⁵ A similar rule exists for judicial foreclosure sales.⁷⁶

⁷³ See, e.g., *In re Worcester*, 811 F.2d 1224, 1230 n.6 (9th Cir. 1987); *Gilroy v. Ryberg*, 667 N.W.2d 544, 552 (Neb. 2003); *Loomis v. Stoddard*, 173 N.W. 859, 861 (S.D. 1919).

⁷⁴ Because any irregularity attendant to a sale is unfair to the debtor, the two terms are often collectively referred to as “unfairness” or “irregularity.”

⁷⁵ See, e.g., *Fed. Deposit Ins. Corp. v. Dye*, 642 F.2d 837, 842 (5th Cir. 1981); *McHugh v. Church*, 583 P.2d 210, 213 (Alaska 1978) (“If the price realized was inadequate, courts have been willing to scrutinize the transaction and to set aside the sale if it is tainted with any unfairness or fraud.”); *In re Krohn*, 52 P.3d 774, 776 (Ariz. 2002) (“A sale may be set aside . . . for inadequate price combined with other irregularity or for grossly inadequate price.”); *Henson v. Fleet Mortgage Co.*, 892 S.W.2d 250, 253 (Ark. 1995) (a sale under power of sale without complying with relevant statutes is invalid); *Lo v. Jensen*, 106 Cal. Rptr. 2d 443, 446 (Cal. Ct. App. 2001) (sale may be set aside “where the sale has been improperly, unfairly or unlawfully conducted, or is tainted by fraud”) (quoting *Bank of America Nat’l Trust & Sav. & Trust Ass’n v. Reidy*, 101 P.2d 77, 80 (Cal. 1940)); *Whitman v. Transtate Title Co.*, 211 Cal. Rptr. 582, 589 (Cal. Ct. App. 1985) (sale may be set aside for inadequate price coupled with unfairness or irregularity); *Crummer v. Whitehead*, 40 Cal. Rptr. 826, 828 (Cal. Ct. App. 1964) (sale may be set aside for inadequate price coupled with fraud, unfairness or oppression); *Handy v. Rogers*, 351 P.2d 819, 822 (Colo. 1960); *Jackson v. Fuller*, 85 F.2d 816, 818 (D.C. Cir. 1936) (sale can be set aside if inadequacy of price “is such ‘as to shock the conscience and of itself suggest fraud or misconduct’”); *Giordano v. Stubbs*, 184 S.E.2d 165, 168–69 (Ga. 1971) (only when the inadequacy of price is accompanied by fraud, mistake, misapprehension, surprise, or other circumstance will the sale be set aside); *W. Roxbury Co-op. Bank v. Bowser*, 87 N.E.2d 113 (Mass. 1949) (burden on the mortgagor to prove that mortgagee failed to act in good faith); *Kantack v. Kreuer*, 158 N.W.2d 842, 847–48 (Minn. 1968) (“[T]he general rule is that a foreclosure sale free from fraud or irregularity will not be held invalid for inadequacy of the price.”); *Gilroy*, 667 N.W. 2d at 554 (party seeking to set sale aside must show defect and prejudice); *Nev. Land & Mortgage Co.*, 435 P.2d at 200 (“[T]he trial court may set aside a trustee’s sale upon the grounds of fraud or unfairness.”); *Murphy v. Fin. Dev. Corp.*, 495 A.2d 1245, 1249–50 (N.H. 1985); *Dime Sav. Bank of N.Y., FSB v. Zapala*, 680 N.Y.S.2d 665, 666 (N.Y. App. Div. 1998) (“In the exercise of its equitable powers, a court may set aside a foreclosure sale where there is evidence of fraud, collusion, mistake, or misconduct. Absent such conduct, the mere inadequacy of price is an insufficient reason to set aside a sale unless the price is so inadequate as to shock the court’s conscience.”); *Hill v. Albemarle Fertilizer Co.*, 187 S.E. 577, 579 (N.C. 1936); *Griffin v. Roberts*, 364 S.E.2d 698, 699 (N.C. Ct. App. 1988) (to set sale aside, inadequate price must be coupled with some other irregularity in the sale, such as fraud, oppression, or unfairness); *Meador v. Johnson*, 112 P. 1121, 1124 (Okla. 1910) (“Before the sale will be set aside, it must appear that the interests of the debtor have been sacrificed, or that there was some attending fraud or unfair dealing.”); *Cedrone v. Warwick Fed. Sav. & Loan Ass’n*, 459 A.2d 944, 946 (R.I. 1983) (court will not set sale aside unless there is some attendant circumstance which, coupled with a price disparity, indicates that the sale was unjust, unfair or inequitable); *Woolley v. Tougas*, 1 A.2d 92, 94 (R.I. 1938); *Lipsey*

Although the rule may sound quite broad, in reality, courts do not set aside a foreclosure sale unless the irregularity, unfairness, or fraud is intrinsic to the sale proceedings themselves. In other words, if the irregularity, unfairness, or fraud exists dehors the sale proceeding, then the courts will not set aside the sale.⁷⁷ Events “intrinsic” to the sale proceeding, and thus able to serve as a basis for a set aside, would likely include the statutorily required notices, the bidding process at the sale, issuance of the trustee’s deed, and other such steps in the sale process.⁷⁸

v. Crosser, 257 N.W. 125, 128 (S.D. 1934) (mere inadequacy of consideration will not invalidate sale without fraud, bad faith, or undue advantage); *Pugh*, 425 S.W.2d at 796 (inadequate price alone will not invalidate sale unless it shocks the conscience, but it may be sufficient when coupled with unfairness, misconduct, fraud, or even bad management); *Pentad Joint Venture v. First Nat’l Bank of La Grange*, 797 S.W.2d 92, 95–96 (Tex. App. 1990) (“There must . . . be evidence of some irregularity, though slight, that caused or contributed to a sale for a grossly inadequate price.”) (citing *Am. Sav. & Loan Ass’n v. Musick*, 531 S.W.2d 581, 587 (Tex. 1975)); *Jinkins v. Chambers*, 622 S.W.2d 614, 615 (Tex. App. 1981) (to set aside a trustee’s sale, there must be inadequate price, irregularity, misconduct, fraud, or unfairness); *Concepts, Inc. v. First Sec. Realty Servs., Inc.*, 743 P.2d 1158, 1159 (Utah 1987); *Occidental/Neb. Fed. Sav. Bank v. Mehr*, 791 P.2d 217, 221 (Utah Ct. App. 1990) (“A party may have an apparently valid trustee’s sale set aside for irregularity, want of notice or fraud.”); *Lovejoy v. Americus*, 191 P. 790, 791 (Wash. 1920) (great inadequacy of price requires only slight unfairness in the conduct of the party benefited by the sale to raise the presumption of fraud); *Reed v. Bachman*, 78 S.E. 695, 697 (W. Va. 1913) (a party who seeks to have trustee sale set aside for irregularity, want of notice, or fraud, has the burden of proving that contention); *McNeill Family Trust v. Centura Bank*, 60 P.3d 1277, 1284 (Wyo. 2003) (set aside for inadequate price along with fraud or irregularity).

⁷⁶ *See, e.g., Schroeder v. Young*, 161 U.S. 334, 337–38 (1896) (“If the sale has been attended by any irregularity, . . . if any undue advantage has been taken to the prejudice of the owner of the property, . . . and the property has been sold at a greatly inadequate price, the sale may be set aside”); *Burge v. Fid. Bond & Mortgage Co.*, 648 A.2d 414, 419 (Del. 1994) (trial court must consider adequacy of price along with “whether there was ‘some defect or irregularity in the process . . . or misconduct’”); *Arlt v. Buchanan*, 190 So.2d 575, 577 (Fla. 1966) (“[W]here the inadequacy [of price] is gross and is shown to result from any mistake, accident, surprise, fraud, misconduct or irregularity upon the part of either the purchaser or other person connected with the sale, with resulting injustice to the complaining party, equity will act to prevent the wrong result.”); *Sellers v. Johnson*, 63 S.E.2d 904, 906 (Ga. 1951) (cause to set aside a sale requires inadequacy of price and fraud, mistake, or surprise); *Nat’l Oil & Gas, Inc. v. Gingrich*, 716 N.E.2d 491, 495 (Ind. 1999) (“[A] court of equity will not hesitate to set aside a sheriff’s sale where there is a gross inadequacy of price and circumstances showing fraud, irregularity or great unfairness.”); *Polish Nat’l Alliance v. White Eagle Hall*, 470 N.Y.S.2d 642, 648 (N.Y. App. Div. 1983) (court may exercise equitable powers to set judicial sale aside if there exists fraud, mistake, unfairness, or an inadequate price that shocks the conscience).

⁷⁷ *See, e.g., Nguyen v. Calhoun*, 129 Cal. Rptr. 2d 436, 450 (Cal. Ct. App. 2003) (court declined to set aside sale because trustee’s mistake occurred dehors the sale and, to vacate the sale, the irregularity must arise from the foreclosure proceeding itself); *Brunzell v. Woodbury*, 449 P.2d 158, 159 (Nev. 1969) (a set aside requires inadequate price and “fraud, oppression or unfairness in procedure at the foreclosure sale.”); *Dime Sav. Bank v. Zapala*, 680 N.Y.S.2d 665, 666 (N.Y. App. Div. 1998) (court declined to set aside sale due to mistake dehors sale proceedings, specifically a miscommunication between debtors and bank regarding refinance that could avert sale); *Griffin v. Roberts*, 364 S.E.2d 698, 700 (N.C. Ct. App. 1988) (no set aside because there was no actual fraud, oppression, or unfairness by the trustee in fulfilling his duties).

⁷⁸ *See, e.g., Nguyen*, 129 Cal. Rptr. 2d at 450 (irregularity did not relate to statutorily required notices or bidding process at the sale and thus was dehors the sale).

California courts explicitly state the rule that the fraud, unfairness, or irregularity must be intrinsic to the sale.⁷⁹ Although courts in other jurisdictions do not explicitly state that the irregularity must occur within the sale proceedings, every reported case in which a court set a sale aside appears to involve an intrinsic irregularity.⁸⁰ Thus, the effect is the same. The only reported case in which the court suggests that it would consider setting aside a sale for extrinsic fraud involves a *judicial* foreclosure sale that took place within the context of a bankruptcy proceeding.⁸¹ Even in that case, the court did not set the sale aside because the evidence did not support the allegations of fraud.⁸² Thus, it seems clear that courts will not set aside a nonjudicial foreclosure sale if the alleged irregularity occurred de hors the sale proceeding.

C. The Existing Rules Requiring Intrinsic Irregularity Pose Significant Problems for Debtors

The courts' requirement that the fraud or unfairness occur within the sale proceeding poses significant problems for debtors who encounter irregularity, unfairness, or fraud outside the strict confines of the sale proceeding. The problem is especially relevant for debtors who need to refinance to avert the sale because this situation most lends itself to the possibility of extrinsic unfairness or fraud that would affect the sale. Little time elapses between the lender's initiation of foreclosure proceedings and the sale itself, often a period

⁷⁹ See, e.g., *6 Angels, Inc. v. Stuart-Wright Mortgage, Inc.*, 102 Cal. Rptr. 2d 711, 715 (Cal. Ct. App. 2001) (no set aside because beneficiary's mistake in setting opening bid occurred de hors sale proceeding); *Crofoot v. Tarman*, 305 P.2d 56, 59 (Cal. Dist. Ct. App. 1957); *Nguyen*, 129 Cal. Rptr. 2d at 450 (no set aside because miscommunication regarding postponement did not relate to statutorily required notices or bidding process at sale and thus was de hors the sale; irregularity must arise from foreclosure proceeding itself).

⁸⁰ See, e.g., *Lo v. Jensen*, 106 Cal. Rptr. 2d 443, 444 (Cal. Ct. App. 2001) (collusive bidding takes place at sale); *Residential Capital, LLC v. Cal-Western Reconveyance Corp.*, 134 Cal. Rptr. 2d 162, 174 (Cal. Ct. App. 2003) (trustee wrongfully fails to postpone sale); *Sys. Inv. Corp. v. Union Bank*, 98 Cal. Rptr. 735, 745 (Cal. Ct. App. 1971) (Notice of Default unclear on amount owed); see also *supra* note 75.

⁸¹ *In re Transcon. Energy Corp.*, 1 B.R. 460, 462–63 (Bank. D. Nev. 1979). In *In re Transcontinental Energy Corp.*, the plaintiffs, a combination of shareholders of the corporate borrower and junior creditors, sought to set aside a judicial sale based on collusion between the buyer and the corporate borrower's president. Plaintiffs alleged that the borrower had employed the buyer's principal to manage an oil well subject to the judicial foreclosure proceeding. Plaintiffs believed that this employment had given the buyer information that created a superior bargaining position at the sale. More importantly, plaintiffs alleged that the buyer had falsified production figures at the oil well prior to the sale to lessen its value before the auction. The court stated that "[i]f Pygmalionic wish alone could render truth of Counsel's pleadings, this Court would not hesitate in the least to exercise its equitable powers to nullify the Trustee's sale." However, the evidence did not support the allegations of extrinsic fraud. *Id.* at 463.

⁸² *Id.* at 466.

of mere weeks.⁸³ Few banks are eager to loan money to refinance a property in foreclosure without substantial documentation and investigation.⁸⁴ Negotiating such a loan is complicated and takes time.⁸⁵ Under ideal circumstances, refinancing even a nondistressed property often takes between fourteen and forty-five days.⁸⁶ Thus, the debtor is often frantic and working down to the wire to avert the sale—the perfect backdrop for extrinsic fraud and unfairness to occur.⁸⁷

There are many scenarios in which an irregularity occurring dehors the sale could cause a debtor to lose real property that may have both economic and sentimental value to the borrower. Such scenarios are not far-fetched and can occur simply as a result of human nature and interpersonal dynamics.

For example, as in the scenario described at the beginning of this Article, a debtor's tenant may secretly want to purchase the real property at auction and surreptitiously work to precipitate the sale (as by refusing to sign a tenant estoppel certificate or to permit an inspection of the property required by the refinancing bank).⁸⁸ There are many benefits available to owners of real

⁸³ See, e.g., ALA. CODE § 35-10-13 (LexisNexis 1991); HAW. REV. STAT. § 667-5 (1993); N.H. REV. STAT. ANN. § 479:25(I), (II) (LexisNexis 2003); S.D. CODIFIED LAWS § 21-48-6.1 (Supp. 2003); TENN. CODE ANN. § 35-5-101(b) (2001); W. VA. CODE ANN. § 38-1-4 (LexisNexis 2005).

⁸⁴ Real Estate Funding Solutions, Nothing But the Truth About Foreclosure!, <http://www.angelfire.com/nc3/btal.com/preforeclosure.html> (last visited July 26, 2006) (refinance of real property in foreclosure considered a high risk loan); RealtyTrac, What Information Will I Need to Supply When Seeking Loan Approval?, <http://realtytrac.com/education/noframes/documentation/financing.html?answer=a6> (last visited July 26, 2006) (obtaining a loan even on a nondistressed property requires substantial documentation, such as pay stubs, income tax forms, other verification of income and expenses, proof of recent payment of creditors, explanations for current and past credit problems, and other items).

⁸⁵ Real Estate Funding Solutions, Nothing But the Truth About Foreclosure!, <http://www.angelfire.com/nc3/btal.com/preforeclosure.html> (last visited July 26, 2006) (banks sometimes approve loans to refinance real property in foreclosure, but it is very difficult).

⁸⁶ IGotMyMortgage.Com, Frequently Asked Questions, <http://www.igotmymortgage.com/faqs.html> (last visited July 26, 2006) (most refinance loans can be closed within thirty to sixty days); Nationwide Advantage Mortgage, Frequently Asked Questions, <http://www.nationwideadvantagemortgage.com/faq/faq.shtml> (last visited July 26, 2006) (the loan process can take as little as a few days or more than forty-five days); Quicken Loans, Refinance Questions & Answers, http://www.quickenloans.com/refinance/articles/refinance_questions_answers.html (last visited July 26, 2006) (refinancing normally takes between two and four weeks).

⁸⁷ Real Estate Funding Solutions, Nothing But the Truth About Foreclosure!, <http://www.angelfire.com/nc3/btal.com/preforeclosure.html> (last visited July 26, 2006) (“Some people try to save their home by refinancing. This not only rarely works, but also the process wastes valuable time for the home owner.”).

⁸⁸ This author worked for several years on a case in which the plaintiff asserted such a theory.

property that are not available to tenants.⁸⁹ Thus, there are many reasons that a tenant might wish to force a sale of real property and try to purchase it.

A debtor's ex-spouse, still on title to real property purchased by the couple during the marriage, could promise to sign loan documents to refinance the distressed property and then, at the last minute, spitefully refuse to do so.⁹⁰ While certainly not all ex-spouses are spiteful and vindictive, a number of them prove to be that way.⁹¹

A debtor in a small town may be disliked by someone at the local bank who "misplaces" the loan application or delays the loan approval process for no legitimate reason. Employees of banks and other lenders have been known to act improperly. For example, one African-American businessman states in a newspaper editorial that a local bank told his wife "I wouldn't loan you \$50,000 if you had a \$50,000 CD in my bank."⁹² In another example, the Department of Justice recently announced that a Chicago lender "intentionally avoided serving the credit needs of residents and small businesses located in minority neighborhoods, a practice commonly referred to as redlining."⁹³ In yet another incident, a high-ranking employee of a Japanese consumer credit company was terminated after the company discovered that he had sold information on 7,000 customers for ten million yen.⁹⁴ Thus, it is entirely conceivable that someone at the bank might engage in extrinsic fraud or unfairness with respect to a debtor's efforts to refinance a property in foreclosure.

The possibility of bankers acting improperly is also noted in fiction. For example, in "It's A Wonderful Life," directed by Frank Capra in 1946 and starring Jimmy Stewart, Henry Potter is a "villainous, miserly banker

⁸⁹ SmartMoney.com, To Rent or to Buy?, <http://www.smartmoney.com/home/buying/index.cfm?story=rentown> (last visited July 26, 2006) (a property owner can pay a mortgage to acquire an ownership interest in property and also receive a tax deduction for interest paid on the mortgage).

⁹⁰ "The phenomenon of the spiteful, vengeful ex-spouse is . . . a [serious] problem . . ." Stepfamily Zone, Rebuilding Your Life from the Ashes, <http://www.stepfamily.asn.au/content/view/809/103/> (last visited July 26, 2006); see also Dean Hughson, A Spiteful Ex!, www.divorcesupport.com/columns/archives/dg1-42-98.shtml (last visited July 26, 2006) (offering ideas on how to cope with a "mean, spiteful ex-spouse").

⁹¹ See *supra* note 90.

⁹² Willie Ratcliffe, Reparations for Redlining, SAN FRANCISCO BAY VIEW, www.sfbayview.com/082102/reparationsforredlining082102.shtml (last visited October 26, 2006).

⁹³ Department of Justice, Chicago Bank Charged with Discriminatory "Redlining" Lending, http://www.usdoj.gov/opa/pr/2004/July/04_crt_478.htm (last visited July 26, 2006).

⁹⁴ Japan Privacy Resource, Multiple Arrests in Connection with the Sale of Personal Data to Criminal Gangs, www.privacyexchange.org/japan/nf0407.html#6a (last visited July 26, 2006).

demanding immediate payments and whose consuming goal in life is to destroy the [Bailey Brothers] Building and Loan.”⁹⁵ Potter finds an envelope containing \$8,000 that Bailey Brothers Building and Loan needs to keep its business afloat. Potter keeps the money and “silently watches from his office’s cracked door as Billy [Bailey] frantically searches for the money.”⁹⁶ George Bailey then asks Potter for an \$8,000 loan to replace the misplaced funds, but Potter refuses to help.⁹⁷ Fortunately, George Bailey’s neighbors unite to help him resolve the problem created by Mr. Potter.⁹⁸

In another example, siblings who inherit real property as joint tenants may be unable to refinance a distressed property if there is bad blood between them. One sibling may try to force a sale by refusing unreasonably to provide the documentation necessary for the loan.⁹⁹ There have, of course, been some very famous sibling feuds in both history¹⁰⁰ and literature.¹⁰¹

In all of these hypothetical situations, the debtor could lose the real property at a foreclosure sale due to unfairness or fraud that takes place outside the strict confines of the foreclosure proceeding.¹⁰² Because of the strict timelines associated with nonjudicial foreclosure, the unfair or fraudulent activity would not need to last very long before the debtor were to lose the property at auction. A debtor who could have refinanced the property, but for the extrinsic irregularity, clearly would be harmed in this situation. Assuming that the trustee complied with all of the statutory notice procedures and no

⁹⁵ Tim Dirks, *IT’S A WONDERFUL LIFE*, <http://www.filmsite.org/itsa.html> (last visited July 26, 2006).

⁹⁶ *Id.*

⁹⁷ *Id.*

⁹⁸ *Id.*

⁹⁹ Benny L. Kass, *Can One Co-Owner Mortgage a Property?*, http://realtymtimes.com/rtcpages/20010924_co-owner.htm (last visited Sept. 24, 2001) (extremely unlikely that any legitimate lender would approve a mortgage application for property held in joint tenancy without the signatures of all the joint tenants) (last visited July 26, 2006).

¹⁰⁰ For example, Cleopatra and Ptolemy XIII were rivals for the throne in Egypt. *See, e.g.*, Suite101, *Cleopatra-Egypt’s Last Pharaoh*, http://www.suite101.com/article.cfm/ancient_egypt_for_children/106603, at 1 (last visited July 26, 2006).

¹⁰¹ *See, e.g.*, Genesis 4:2-16; WILLIAM SHAKESPEARE, *RICHARD III* (Janis Lull ed., Cambridge University Press 1999); JOHN STEINBECK, *EAST OF EDEN* (Viking 2003).

¹⁰² Analytically, it makes no difference in these hypothetical situations whether the “bad actor” materially benefits from the bad act. Under the set-aside rule, there must simply be some unfairness, fraud, or irregularity suffered by the debtor. Even under a traditional fraud cause of action, notoriously hard to prove (*see infra* Part X), the defendant’s material gain is not an element. The action merely requires an intentional misrepresentation (or a material omission) upon which the plaintiff reasonably relied and which caused the plaintiff to suffer damages.

collusive bidding occurred at the sale, such a debtor could probably not set aside the foreclosure sale under current law.

V. IN A MAJORITY OF STATES, THE PLAIN LANGUAGE OF THE COMMON-LAW RULE DOES NOT PRECLUDE ITS APPLICATION IN SITUATIONS INVOLVING EXTRINSIC FRAUD

Historically, the common-law set-aside rule articulated by the courts did not include language limiting the rule to situations involving intrinsic fraud.¹⁰³ Indeed, except for California, most courts today do not make any explicit distinction between intrinsic and extrinsic fraud when they state the rule in published opinions.¹⁰⁴ California seems to be the only state that makes such a distinction explicit.¹⁰⁵ In other states, it simply seems to be the case that, as a practical matter, courts have set aside sales only in situations involving intrinsic fraud.¹⁰⁶ Because the set-aside rule articulated by the vast majority of states does not explicitly require the fraud to be intrinsic, the rule itself does not preclude an extension of its application to cases of extrinsic fraud. Thus, it makes sense to conduct further analysis to determine whether the rule should, in fact, extend to extrinsic fraud.

¹⁰³ *Jackson v. Fuller*, 85 F.2d 816, 818 (D.C. Cir. 1936) (sale can be set aside if inadequacy of price “[I]s such ‘as to shock the conscience and of itself suggest fraud or misconduct’”) (quoting *Anderson v. White*, 2 App. D.C. 408, 418 (D.C. Cir. 1894)); *Meador v. Johnson*, 112 P. 1121, 1124 (Okla. 1910) (“Before the sale will be set aside, it must appear that the interests of the debtor have been sacrificed, or that there was some attending fraud or unfair dealing.”); *Lipsev v. Crosser*, 257 N.W. 125, 128 (S.D. 1934) (mere inadequacy of consideration will not invalidate sale without fraud, bad faith, or undue advantage); *Reed v. Bachman*, 78 S.E. 695, 697 (W. Va. 1913) (a party who seeks to have trustee sale set aside for irregularity, want of notice, or fraud, has the burden of proving that contention).

¹⁰⁴ *See, e.g., Griffin v. Roberts*, 364 S.E.2d 698, 699 (N.C. Ct. App. 1988) (to set sale aside, inadequate price must be coupled with some other irregularity in the sale, such as fraud, oppression, or unfairness).

¹⁰⁵ *6 Angels, Inc. v. Stuart-Wright Mortgage, Inc.*, 102 Cal. Rptr. 2d 711, 715 (Cal. Ct. App. 2001) (no set aside because beneficiary’s mistake in setting opening bid occurred de hors sale proceeding); *Nguyen v. Calhoun*, 129 Cal. Rptr. 2d 436, 441, 450 (Cal. Ct. App. 2003) (no set aside because miscommunication regarding postponement did not relate to statutorily required notices or bidding process at sale and thus was de hors the sale; irregularity must arise from foreclosure proceeding itself).

¹⁰⁶ *Dime Sav. Bank of N.Y., FSB v. Zapala*, 680 N.Y.S.2d 665, 666 (N.Y. App. Div. 1998) (“In the exercise of its equitable powers, a court may set aside a foreclosure sale where there is evidence of fraud, collusion, mistake, or misconduct. Absent such conduct, the mere inadequacy of price is an insufficient reason to set aside a sale unless the price is so inadequate as to shock the court’s conscience.”); *Griffin*, 364 S.E.2d at 699 (to set sale aside, inadequate price must be coupled with some other irregularity in the sale, such as fraud, oppression, or unfairness).

VI. EXTENDING THE RULE MAKES SENSE BECAUSE COURTS OF EQUITY DO NOT ALLOW WRONGDOERS TO PROFIT FROM THEIR WRONGS IN OTHER SITUATIONS

A maxim exists in the law that a wrongdoer should not be allowed to profit from his or her wrongdoing.¹⁰⁷ The maxim is widely recognized and has even been codified in California.¹⁰⁸ This principle is closely related to the equitable doctrine of “unclean hands,” which provides that a court of equity may deny relief to a party whose conduct has been inequitable, unfair, and deceitful with regard to the controversy at issue.¹⁰⁹ The maxim has worked its way into several different judicial doctrines.

For example, with regard to probate matters, the courts and legislatures have developed “felonious heir” rules.¹¹⁰ A beneficiary under a will cannot inherit from the decedent if the beneficiary killed the decedent.¹¹¹ Similarly, a

¹⁰⁷ CAL. CIV. CODE § 3517 (West 1997) (“No one can take advantage of his own wrong.”); Clark v. Madeira, 477 S.W.2d 817, 818 (Ark. 1972) (“One cannot profit by his own wrong.”); Wiley v. County of San Diego, 966 P.2d 983, 986 (Cal. 1998) (courts will not assist a participant in an illegal act who seeks to profit from the act’s commission); Hawthorne v. Canavan, 756 A.2d 397, 401 (D.C. 2000) (“A party may not profit from his own wrong.”); Hrynkiw v. Allstate Floridian Ins. Co., 844 So.2d 739, 742 (Fl. Dist. Ct. App. 2003) (insurance company need not defend or indemnify parents of son who shot someone because no person should profit from a wrong); Williams v. State, 404 S.E.2d 296, 298 (Ga. Ct. App. 1991) (“[T]he law will not permit an individual to profit from his own wrong.”); Nelson v. N. Leasing Co., 657 P.2d 482, 484 (Idaho 1983) (“[N]o one should be permitted to profit from his own wrong.”); Walter v. Carriage House Hotels, Ltd., 646 N.E.2d 599, 609 (Ill. 1995) (doctrines of complicity and contributory negligence stem from principle that person should not profit from his own wrong); Cox v. Rolling Acres Golf Course Corp., 532 N.W.2d 761, 764 (Iowa 1995) (“[O]ne cannot profit from his own wrong”); Dalton v. State, 591 A.2d 531, 538 (Md. Ct. Spec. App. 1990) (“[A] defendant cannot profit from his own wrong”); Gregory v. Fed. Land Bank, 515 So.2d 1200, 1203 (Miss. 1987) (“No man should be allowed to profit from his own wrong.”); Howsden v. Rolenc, 360 N.W.2d 680, 682 (Neb. 1985) (“No one should be allowed to profit [from] his own wrong.”) (quoting Whitney v. Lott, 36 A.2d 888, 889 (N.J. Ch. 1944)); Alami v. Volkswagen of Am., Inc., 766 N.E.2d 574, 577 (N.Y. 2002) (“[N]o one shall be permitted to profit by his own fraud, or to take advantage of his own wrong”); State *ex rel.* Raines v. Gilbert, 450 S.E.2d 1, 2 (N.C. 1994) (North Carolina recognizes the principle that no man can profit from his own wrong); Peeler v. Hughes & Luce, 909 S.W.2d 494, 497 (Tex. 1995) (criminal defendant must prove his own innocence in subsequent malpractice action against attorney because person cannot profit from his own wrong); Adkins v. Dixon, 482 S.E.2d 797, 801 (Va. 1997) (“[C]ourts will not assist the participant in an illegal act who seeks to profit from the act’s commission.”) (quoting Zysk v. Zysk, 404 S.E.2d 721, 722 (Va. 1990)).

¹⁰⁸ CAL. CIV. CODE § 3517 (West 1993) (“No one can take advantage of his own wrong.”).

¹⁰⁹ BLACK’S LAW DICTIONARY 268 (6th ed. 2004).

¹¹⁰ Nelson H. Wild, *The Felonious Heir in California*, 49 CAL. ST. B.J. 528 (1974); Claudia G. Catalano, *What Constitutes Contest or Attempt to Defeat Will Within Provision Thereof Forfeiting Share of Contesting Beneficiary*, 3 A.L.R. 5TH 590, 693 (1992).

¹¹¹ Estate of Kramme, 573 P.2d 1369, 1371 (Cal. 1978); WILLIAM BASSETT, ON CALIFORNIA COMMUNITY PROPERTY LAW § 13:62 (2006); *see also* CAL. PROB. CODE § 258 (West 2002) (murderer cannot bring wrongful death action); Bosley v. Hawkins, 24 Ohio Misc. 2d 11, 13–15 (Ohio 1985).

life insurance beneficiary who kills the insured cannot recover under the life insurance policy.¹¹² Due to an overriding public policy that no person be able to profit from his or her own wrongdoing, the courts have found that murderers forfeit rights to any money that they might otherwise have had through the decedent.¹¹³

In another example, courts often use the remedy of a “constructive trust”¹¹⁴ to take property away from a person who acquired it by some improper means.¹¹⁵ Because a constructive trust is an equitable remedy that relates to property rights, the issue arises frequently in the context of bankruptcy proceedings, which are equitable in nature.¹¹⁶ Whether a constructive trust is imposed in the bankruptcy court or in another forum, it always is based on the equitable principle that a person who wrongfully acquires property to which another person is entitled should not be allowed to keep the property.¹¹⁷

In the domestic relations context, courts will often deny relief in a property dispute to a spouse who has committed fraud on a spouse or an ex-spouse.¹¹⁸ Many such cases involve fraudulent transfers by a husband to a third party in

¹¹² *Davis v. Aetna Life Ins. Co.*, 279 F.2d 304, 307–08 (9th Cir. 1960); *N.Y. Life Ins. v. Cawthorne*, 121 Cal. Rptr. 808, 810 (Cal. Ct. App. 1975); *N.Y. Life Ins. Co. v. Henriksen*, 415 N.E.2d 146, 147 (Ind. Ct. App. 1981); *Travelers Ins. Co. v. Thompson*, 163 N.W.2d 289, 294–95 (Minn. 1968); *Baker v. Martin*, 709 S.W.2d 533, 534 (Mo. Ct. App. 1986); *Howsden v. Rolenc*, 360 N.W.2d 680, 681–82 (Neb. 1985); *Turner v. Prudential Ins. Co.*, 158 A.2d 441, 442 (N.J. Ch. 1960).

¹¹³ *Am. Life Ins. Co. v. Anderson*, 21 So.2d 791, 802–03 (Ala. 1945) (beneficiary who murders insured forfeits all rights under life insurance policy due to public policy that no one be able to profit from his own wrong).

¹¹⁴ The constructive trust doctrine is actually the principle that initially gave rise to the felonious heir rule. See *Baker*, 709 S.W.2d at 535; *Howsden*, 360 N.W.2d at 682.

¹¹⁵ See, e.g., 13 B.E. WITKIN, SUMMARY OF CALIFORNIA LAW 885–86 (10th ed., 2005 & Supp. 2006); Larry Hultquist, *The Necessity for Unjust Enrichment in a Constructive Trust in California: Elliott v. Elliot*, 19 HASTINGS L.J. 1268 (1968).

¹¹⁶ *B&F Cattle, Inc. v. Bair*, No. 02-10076-7, 2005 Bankr. LEXIS 661, at *30 (Bankr. D. Kan. Apr. 14, 2005) (courts can impose a constructive trust against property obtained through fraudulent or improper means); *Limor v. Buerger*, 322 B.R. 781, 829 (Bankr. M.D. Tenn. 2005) (constructive trust imposed against one who, by fraud, commission of a wrong, or unconscionable conduct obtained an interest in property that he ought not retain); *Miller v. Van Dorn Demag Corp.*, No. 03-11319C-7G, 2005 Bankr. LEXIS 1091, at *29 (Bankr. M.D.N.C. Mar. 1, 2005) (constructive trust imposed by court of equity when holder of title to property obtained title by fraudulent or inequitable conduct); *Kamand Constr., Inc. v. Prop. Mgmt.*, 298 B.R. 251, 255 (Bankr. M.D. Pa. 2003) (courts impose a constructive trust when party acquires property as a result of fraud, undue influence, or other circumstances suggesting unjust enrichment).

¹¹⁷ See *Rankin v. Satir*, 171 P.2d 78, 81 (Cal. Dist. Ct. App. 1946) (constructive trusts are based on the equitable principle that no person should take advantage of his own wrong, which exists in any case where there is a wrongful acquisition of property to which another is entitled).

¹¹⁸ See James L. Buchwalter, Annotation, *Unclean Hands as Bar to Equitable Relief in Domestic Relations Proceeding or Dispute*, 2002 A.L.R. 5TH 17, § 11a, 2002 WL 31002160 (2002).

order to deprive a wife or former wife of her interest in the property.¹¹⁹ For example, the court has denied relief to a husband who placed real property in the name of his first wife to avoid alimony claims by his second wife and then sued the first wife to compel reconveyance of the property.¹²⁰ Other cases involve property settlement agreements marred by fraud.¹²¹ For instance, the court has denied relief to an attorney-husband who defrauded his unrepresented wife in the creation of their marital settlement agreement and later sought to prevent the wife from setting aside that agreement.¹²² In all of these domestic relations cases, courts have acted to prevent someone who has acted unfairly in the family law context from benefiting from the unfair act to the detriment of the ex-spouse.

In all of the situations in which the courts already apply this rule, the courts have been concerned with fairness. It is simply not fair to allow somebody to commit a wrong and to profit from that wrong. Because courts already prevent wrongdoers from profiting from their wrongs in other situations, it makes sense to apply the same rule in the context of nonjudicial foreclosure sales. A person who wrongfully forces a foreclosure sale and then purchases the property (often at a greatly reduced price, as discussed in Part X, *infra*), should not be permitted to profit from the wrongful act. Courts have safely applied the maxim in other contexts, such as family law, bankruptcy, and probate. Courts can also safely apply it in the context of nonjudicial foreclosure sales.

¹¹⁹ *Lucas v. Grant*, 962 S.W.2d 388, 390–91 (Ark. Ct. App. 1998) (court denies relief to husband who transfers real property to second wife to avoid first wife’s enforcement of judgment and later seeks to recover property from second wife); *Potter v. Boisvert*, 256 P.2d 625, 626 (Cal. Dist. Ct. App. 1953) (court denies relief to husband who places real property in paramour’s name to prevent wife from discovering affair and later seeks judicial decree affirming his ownership in the property held in paramour’s name); *Williams v. Williams*, 336 S.E.2d 244, 245–46 (Ga. 1985) (court denies relief to husband who places real property in the name of his first wife to avoid alimony claims by his second wife and later sues to compel reconveyance of the real property); *Calcote v. Calcote*, 583 So. 2d 197, 200 (Miss. 1991) (court denies relief to husband who conveys real property to his brother to prevent wife from reaching the property in potential divorce and later seeks constructive trust in the property); *Levy v. Braverman*, 260 N.Y.S.2d 681, 683 (N.Y. App. Div. 1965) (appellate court denies relief to husband who has stock issued in defendant’s name to prevent ex-wife from collecting on judgment and then seeks judicial determination of beneficial ownership in the stock); *Camp v. Camp*, 163 P.2d 970, 972 (Okla. 1945) (court denies relief to husband who transfers property to partner to deprive wife of her share in divorce and later sues to recover the property from partner).

¹²⁰ *Williams*, 336 S.E.2d at 245–46.

¹²¹ *Chrisomalis v. Chrisomalis*, 615 A.2d 266, 270–71 (N.J. Super. Ct. App. Div. 1992) (court denies relief to wife who signed antenuptial agreement waiving her interest in husband’s estate with knowledge of agreement’s effect but without intent to be bound by agreement and who later seeks to nullify agreement); *Webb v. Webb*, 431 S.E.2d 55, 61–62 (Va. 1993) (court denies relief to husband, an attorney, who defrauded unrepresented wife in creation of the couple’s property settlement agreement and later sought to prevent wife from setting aside the agreement).

¹²² *Webb*, 431 S.E.2d at 61–62.

VII. SETTING ASIDE NONJUDICIAL FORECLOSURE SALES DUE TO EXTRINSIC FRAUD OR UNFAIRNESS MAKES SENSE BECAUSE COURTS OF EQUITY ALREADY SET ASIDE COURT JUDGEMENTS OBTAINED BY EXTRINSIC FRAUD OR MISTAKE

If a plaintiff obtains a judgment (or a default judgment) by fraud or mistake, and the defendant did not act negligently, then the court may grant equitable relief by vacating the judgment.¹²³

In order to set aside a judgment under this rule, the fraud committed upon the defendant must have been *extrinsic* to the proceeding.¹²⁴ Of course, this rule is the direct opposite of the rule for setting aside foreclosures.

Extrinsic fraud is extraneous or collateral to the matters at issue in the litigation.¹²⁵ The essential characteristic of extrinsic fraud is that it has the effect of preventing a fair adversary hearing, the aggrieved party being deliberately kept in ignorance of the action or proceeding, or in some other way fraudulently prevented from presenting his claim or defense.¹²⁶

¹²³ See, e.g., *Chisholm v. House*, 160 F.2d 632, 643 (10th Cir. 1947) (“Equitable relief from a judgment may be obtained on the ground of extrinsic or collateral fraud.”); *Olivera v. Grace*, 122 P.2d 564, 567 (Cal. 1942); *Bernath v. Wilson*, 309 P.2d 87, 89 (Cal. Dist. Ct. App. 1957) (plaintiff’s attorney agrees to extend time to plead, secretly took defendant’s default, and waited until after six month safety period to procure default judgment); *In re David H.*, 39 Cal. Rptr. 2d 313, 322 (Cal. Ct. App. 1995) (court recognizes extrinsic fraud as ground for relief); *In re Marriage of Baltins*, 260 Cal. Rptr. 403, 411 (Cal. Ct. App. 1989) (quoting *Olivera*, 122 P.2d at 567); *Lieberman v. Aetna Ins. Co.*, 57 Cal. Rptr. 453, 462 (Cal. Ct. App. 1967) (insurance company lulled into false sense of security); *Sipe v. McKenna*, 200 P.2d 61, 64 (Cal. Dist. Ct. App. 1948) (failure to make service and filing of false return treated as extrinsic fraud); *Atha v. Glenn*, 174 N.E. 826, 827 (Ind. Ct. App. 1931) (party seeking to set aside judgment based on extrinsic fraud must show that he is free from fault or negligence); *In re Marriage of M.E.*, 622 N.E.2d 578, 581 (Ind. Ct. App. 1993) (court may set judgment aside if judgment was obtained through extrinsic fraud); James, O. Pearson, Jr., Annotation, *Fraud in Obtaining or Maintaining Default Judgment as Ground for Vacating or Setting Aside in State Courts*, 78 A.L.R.3d 150, 159–68, 173–78 (1977 & Supp. 2006).

¹²⁴ See Pearson, *supra* note 123 at 157; *Gibble v. Car-Lene Research*, 78 Cal. Rptr. 2d 892, 904–05 (Cal. Ct. App. 1998); *Pour le Bebe, Inc. v. Guess, Inc.*, 5 Cal. Rptr. 3d 442, 457 (Cal. Ct. App. 2003) (“The most common ground for equitable relief [from a judgment] is extrinsic fraud”) (quoting 8 B.E. WITKIN, CALIFORNIA PROCEDURE 727 (4TH ED., 1997)); *Lamb v. Leiter*, 603 So. 2d 632, 635 (Fla. Dist. Ct. App. 1992); *Walker v. Hall*, 166 S.E. 757, 759 (Ga. 1932); *In re Marriage Glover*, 723 N.E.2d at 932; *In re Marriage of M.E.*, 622 N.E.2d at 581 (court may set judgment aside if judgment was obtained through extrinsic fraud); *Dixson v. Carter*, 138 So. 2d 227, 230 (La. Ct. App. 1962); *Fleisher v. Fleisher Co.*, 483 A.2d 1312, 1314–15 (Md. 1984); *Schillerstrom v. Schillerstrom*, 32 N.W.2d 106, 116–17 (N.D. 1948); *Bryan v. Bryan*, 66 S.E.2d 609, 610 (S.C. 1951) (fraud must be extrinsic in order for court to grant equitable relief vacating judgment).

¹²⁵ 37 AM. JUR. 2D *Fraud* § 10 (2001).

¹²⁶ See, e.g., Pearson, *supra* note 123 at 169; *Chisholm*, 160 F.2d at 643 (fraud is extrinsic when “it prevents a party from having a trial or from presenting his cause of action . . . or operates upon matters pertaining not to the judgment itself, but to the manner in which it was procured”); *Caldwell v. Taylor*, 23 P.2d

The U.S. Supreme Court announced the standard for extrinsic fraud in this context long ago.

Where the unsuccessful party has been prevented from exhibiting fully his case, by fraud or deception practiced on him by his opponent, as . . . where an attorney fraudulently or without authority assumes to represent a party and connives at his defeat; or where the attorney regularly employed corruptly sells out his client's interest to the other side,—these, and similar cases which show that there has never been a real contest in the trial or hearing of a case, are reasons for which a new suit may be sustained to set aside and annul the former judgment. . . . In all these cases, and many others which have been examined, relief has been granted, on the ground that, by some fraud practiced directly upon the party seeking relief against the judgment or decree, that party has been prevented from presenting all of his case to the court.¹²⁷

In essence, the courts have set aside fraudulently obtained judgments because the defendants were unfairly prevented from litigating their claims due to acts directed toward the defendants without their knowledge.¹²⁸ The U.S. Supreme Court seemed particularly concerned about situations where attorneys purportedly aligned with their client secretly take steps to secure the client's defeat.¹²⁹

There are many similarities between extrinsic fraud committed in the process of obtaining a judgment and extrinsic fraud committed in the process of completing a nonjudicial foreclosure sale. For example, in both instances, somebody not party to the official proceeding is conniving to defeat the

758, 761 (Cal. 1933) (“The main requirement to establish extrinsic fraud is that the unsuccessful party was prevented by his adversary from presenting *all* of his case to the court.”); *Kuehn v. Kuehn*, 102 Cal. Rptr. 2d 743, 747–48 (Cal. Ct. App. 2000) (wife adequately alleges extrinsic fraud where husband prevented her from fully participating in dissolution by falsely representing to her that his attorney represented both of them); *Pour le Bebe*, 5 Cal. Rptr. 3d at 457 (essential characteristic of extrinsic fraud is that it has the effect of preventing a fair adversary hearing because the aggrieved party is in some way fraudulently prevented from presenting a claim or defense) (quoting *Olivera*, 122 P.2d at 567); *In re Paternity of K.M.* 651 N.E.2d 271, 277 (Ind. Ct. App. 1995) (extrinsic fraud amounts to fraud outside the issues of a case and it prevents the trial of an issue in the case); *Metzger v. Turner*, 158 P.2d 701, 703–05 (Okla. 1945); *Chewing v. Ford Motor Co.*, 579 S.E.2d 605, 610 (S.C. 2003) (“Extrinsic fraud is ‘fraud that induces a person not to present a case or deprives a person of the opportunity to be heard.’”) (quoting *Hilton Head Ctr., Inc. v. Public Serv. Comm’n*, 362 S.E.2d 176, 177 (S.C. 1987)).

¹²⁷ *United States v. Throckmorton*, 98 U.S. 61, 65–66 (1878).

¹²⁸ *See, e.g.*, 8 B.E. WITKIN, CALIFORNIA PROCEDURE 728 (4th ed., Witkin Legal Institute 1997 & Supp. 2006) (the strongest examples of extrinsic fraud include those where the defendant does not have a fair opportunity to litigate his claim or defense).

¹²⁹ *Throckmorton*, 98 U.S. at 66.

wronged party. In the context of a judgment, it may be an attorney secretly working to obtain his client's defeat at trial.¹³⁰ In the context of nonjudicial foreclosure, it may be a tenant secretly working to force the foreclosure sale.¹³¹

In both situations, the wronged party cannot adequately protect himself from the extrinsic fraud because he does not know that the secret attacks exist. In the context of a judgment, a client would not expect to encounter subversive behavior from his attorney and would not be alert to the danger.¹³² Similarly, in the context of a nonjudicial foreclosure sale, a debtor would not likely expect to encounter subversive behavior from his tenant, banker, or other acquaintance and would not be attuned to it.

Moreover, in both situations, the wronged party is losing for reasons beyond his control. In the context of a judgment, the defendant may lose a lawsuit because his attorney is secretly working against his interests.¹³³ The defendant himself, however, may be doing everything within his power to defend against the claim, such as providing his attorney with all relevant information, participating in discovery, and appearing at trial to testify.¹³⁴ In the context of a nonjudicial foreclosure proceeding, the debtor may lose his property because his tenant or banker is secretly working against his interests.¹³⁵ The debtor, himself, however, may be doing everything possible to avert the sale, such as trying to refinance or to cure the default.¹³⁶

Of course, there are differences between the situations too. Most notably, an attorney has a fiduciary duty to the client, whereas a tenant or other third party does not have such a duty to a debtor owning a distressed property. This distinction would be critical in an action for damages resting on a breach of fiduciary duty. However, with respect to an equitable action to set aside a sale, an unsuspecting debtor could be defrauded by the secret actions of a tenant just as easily as a defendant could be defrauded by the secret actions of an attorney. For this purpose, the similarities between the situations outnumber the differences.

¹³⁰ *Id.* at 67 (example of attorney working to secure client's defeat).

¹³¹ *See supra* Part IV.C.

¹³² *See Throckmorton*, 98 U.S. at 65–66.

¹³³ *Id.*

¹³⁴ The client's participation in preparing discovery responses is mandatory. *See, e.g., CAL. CIV. PROC. CODE* § 2025.010 (West Supp. 2006); *see also* Chain, Younger, Cohen & Styles, Sequence of a Case/YourParticipation, http://www.chainyounger.com/pa_personal_injury_1.html (last visited Aug. 2, 2006).

¹³⁵ *See supra* Part IV.C.

¹³⁶ *See* Colorado Housing Counseling Coalition, Foreclosure Prevention Counseling, http://www.housingcounseling.com/search/foreclosure_prevention.html (last visited Aug. 2, 2006).

Because of these similarities, it makes sense to apply the same rule permitting set asides for extrinsic fraud in both situations. The courts have already applied the rule when setting aside judgments for more than one hundred years. It should also be possible to apply the rule in setting aside nonjudicial foreclosure sales.

VIII. EXTENDING THE RULE COMPORTS WITH THE POLICY OF PROTECTING DEBTORS FROM THE WRONGFUL LOSS OF THEIR PROPERTY

As noted in Part III, *supra*, one purpose of the set-aside rule is to protect debtors from wrongful loss of their property.¹³⁷ Courts have noted that a power of sale contained in a deed of trust is a “harsh method” of enforcing lenders’ rights.¹³⁸ Indeed, nonjudicial foreclosure sales are “much liable to abuse” and should be “jealously watched by courts of equity.”¹³⁹ With the possibility of abuse in the system, it makes sense that debtors should be protected from the wrongful loss of their property.

Debtors often have the most to lose from abuses in the nonjudicial foreclosure process. For example, after a debtor loses a property, it is often gone for good.¹⁴⁰ When the property lost at auction is a family home, as it sometimes is, then the debtor’s loss is particularly acute and may affect children or other family members too.¹⁴¹ Even if a property is not “gone for good” after a sale, the debtor cannot recover the property without filing an equitable action to set aside the sale.¹⁴² By its very nature, litigation is a

¹³⁷ See *Moeller v. Lien*, 30 Cal. Rptr. 2d 777, 782 (Cal. Ct. App. 1994); *Cox v. Helenius*, 693 P.2d 683, 686 (Wash. 1985) (“[T]he process should provide an adequate opportunity for interested parties to prevent wrongful foreclosure.”).

¹³⁸ *Sys. Inv. Corp. v. Union Bank*, 98 Cal. Rptr. 735, 745 (Cal. Ct. App. 1971).

¹³⁹ *Pugh v. Richmond*, 425 S.W.2d 789, 796 (Tenn. Ct. App. 1967) (quoting *Mitchell v. Sherrell*, 11 Tenn. App. 210, 221 (Tenn. Ct. App. 1929)).

¹⁴⁰ See, e.g., ALASKA STAT. § 34.20.090(a) (2004) (sale transfers all of guarantor’s interest in the property); ARIZ. REV. STAT. ANN. § 33-811(E) (2000 & Supp. 2005) (trustee’s deed conveys interest of trustor); N.Y. RE AL PROP. ACTS. § 1411(1) (McKinney 1979 & Supp. 2006) (sale is equivalent to judgment in foreclosure action and bars any claim of redemption); OR. REV. STAT. § 86.755(5) (2005) (highest bidder at auction obtains possession in ten days); OR. REV. STAT. § 86.770(1) (2005) (sale terminates all of debtor’s interest in property); R.I. GEN. LAWS § 34-11-22 (1995 & Supp. 2005) (sale effects a perpetual bar against mortgagor and assigns).

¹⁴¹ Although New York and Washington limit foreclosures to commercial and nonagricultural properties, respectively, such limitations are the exception and not the rule. N.Y. RE AL PROP. ACTS. § 1401 (McKinney 1979 & Supp. 2006); WASH. REV. CODE ANN. § 61.24.030 (West 2004).

¹⁴² See *supra* note 70.

prohibitively expensive and lengthy process.¹⁴³ This expense and delay would likely prevent some debtors from pursuing legitimate claims.

On the other hand, a creditor who is forced to cancel a sale due to some impropriety in the process can simply try again to hold a proper sale in compliance with the rules. The foreclosure acts do not prohibit creditors from serving multiple notices of default or sale.¹⁴⁴ In fact, in practice, creditors must often reinitiate the foreclosure process after a debtor has cured one default and then defaults again.¹⁴⁵ In forcing a creditor to hold a sale without abuses, the most a creditor would lose is (1) the use of its money between the canceled sale and the new sale; and (2) some additional personal effort or, alternatively, attorneys' fees if the creditor uses an attorney to fulfill the prerequisites to foreclosure. While these consequences are real, they seem much less severe than a family's potential wrongful, irretrievable loss of its home.

Moreover, as between debtors and creditors, debtors often need more protection because they may lack the same resources as creditors. Certainly, there are debtors who have tremendous resources and who borrow money for strategic reasons, especially debtors who own high value commercial properties. For example, debtors who could afford otherwise to purchase a property may want the tax deductions associated with mortgage interest and property taxes,¹⁴⁶ they may want to resolve minor cash flow issues,¹⁴⁷ or they may prefer not to sell illiquid assets to generate cash for the sale.¹⁴⁸

¹⁴³ Lord Justice Carnwath, *Judicial Protection of the Environment: At Home and Abroad*, 16 J. ENVTL. L. 315, 321 (2004) ("Litigation through the courts is prohibitively expensive for most people unless they are either poor enough to qualify for legal aid or rich enough to be able to undertake an open-ended commitment to expenditure running into tens or hundreds of thousands of pounds.").

¹⁴⁴ See *supra* note 8 for list of statutes.

¹⁴⁵ See, e.g., *O'Malley v. Chevy Chase Bank, F.S.B.*, 766 A.2d 964, 966 (D.C. 2001) ("Since 1988, O'Malley has defaulted on the loan payments on eleven different occasions. The trustee scheduled foreclosure sales for the property on each occasion. Until the foreclosure sale scheduled for June 20, 1995, O'Malley cured his default on each occasion as allowed under the deed, and reinstated his loan, terminating the foreclosure proceedings.").

¹⁴⁶ See I.R.C. §§ 163(h)(2)(D), (3), 461(c), (g) (2000).

¹⁴⁷ Nineteen percent of small businesses state that they have cash flow problems. *The Cash Flow Problem*, NFIB NAT'L SMALL BUS. POLL (Nat'l Fed'n of Indep. Bus., Washington, D.C.), 2001 at 2, <http://www.nfib.com/object/sbPolls?fedStartPos=31&fedEndPos=40&stateStartPos=1&stateEndPos=10> follow "The Cash Flow Problem" hyperlink). The "most likely source of loans (borrowing) to finance cash flow problems is commercial banks. Seventy (70) percent who borrow for cash flow purposes indicate that they take out a loan or draw down a line from one of them." *Id.* at 4.

¹⁴⁸ *Id.* at 2. ("[P]eople often confuse cash with other business assets . . . [w]hile cash is an asset, it is only one kind of asset. Buildings, land, vehicles, machinery, furniture and fixtures are examples of others. But

However, many debtors, especially residential homeowners, borrow money because they do not have it and they need it to purchase the real property. These debtors would not necessarily have the money to hire lawyers to file lawsuits to protect their interests.

Creditors, on the other hand, often lend money to make a living and are more likely to have attorneys, access to money, and a certain familiarity with the lending process. Secured parties are “notorious for their superior ability to gain access to lawyers compared to debtors”¹⁴⁹ Creditors are more likely than debtors to have the ability to pay attorneys the high fees required to protect their interests.¹⁵⁰ Also, “creditors know that debtors will not have ready access to lawyers”¹⁵¹ Creditors’ advantages in resources indicate that creditors do not generally need the same statutory protections as debtors.

Furthermore, in the relationship between debtor and creditor, the debtor is usually the weaker of the parties in terms of bargaining power.¹⁵² This common sense notion derives from the fact that the creditor is providing something of value that the debtor wants and, thus, has the ability to define the terms upon which the loan will be made.

To that end, creditors normally require debtors to sign promissory notes and deeds of trust with provisions favorable to the creditor. For example,

cash is a very special asset because only cash can be used to make payroll, cover bills, and pay taxes.”). Similarly, most of the time, only cash can be used to purchase real property.

¹⁴⁹ C. Kaufman, *The Scientific Method in Legal Thought: Legal Realism and Fourteen Principles of Justice*, 12 ST. MARY’S L.J. 77, 105 (1980); see also Jean Braucher, *The Repo Code: A Study of Adjustment to Uncertainty in Commercial Law*, 75 WASH. U. L.Q. 549, 560 (1997).

¹⁵⁰ As just one example of creditors being able to pay attorneys’ fees to protect their interests, Allen Matkins, a fairly large firm in California, has a “Bankruptcy and Creditor’s Rights” practice group. According to its website, the firm represents “banks, REITS, finance companies, pension funds and insurance companies; manufacturers and retailers; shopping center owners,” among other clients. The firm specializes in the “[N]egotiation and preparation of transactional and financing documents, workout agreements, deed-in-lieu agreements and forbearance agreements. [They] are also regularly involved in the filing and prosecution of judicial and non judicial foreclosure proceedings, state and federal receivership proceedings, guaranty actions, adversary litigation (e.g., preferences, equitable subordination and fraudulent-transfer litigation), debtor in possession financing motions, automatic stay relief motions and confirmation and cramdown trials.” By its own description, this practice group clearly protects creditors’ interests. Traditionally, big firms charge substantial fees for their services, often hundreds of dollars per hour. Allen Matkins Practice Group, Bankruptcy & Creditor’s Rights, <http://www.allenmatkins.com/practice/bankruptcy.asp> (last visited Aug. 4, 2006).

¹⁵¹ Braucher, *supra* note 149, at 560 (“[C]reditors know that debtors will not have ready access to lawyers”).

¹⁵² Letter from Michael Colodner, Counsel, Hon. James M. McGuire, Counsel to the N.Y. Governor (July 1, 1998) available at <http://www.westlaw.com> (enter search term NY Bill Jacket, 1998 S.B. 588, Ch. 231) (commenting on proposed changes to foreclosure statutes).

common provisions include the creditor's right to recover penalties for late mortgage payments; the creditor's right to accelerate the entire debt upon the debtor's default; the creditor's right to recover reasonable attorneys' fees incurred to enforce payment of the debt; and, of course, the creditor's right to sell the property under a private power of sale.¹⁵³

Although debtors can sometimes negotiate to give themselves more power in their written loan agreements, it rarely occurs in practice when the creditor is a large institution. Even when it does, such negotiation normally takes place only in a commercial context where the debtor is also a large institution. As a matter of practice, large institutional lenders rarely change the preprinted terms of their promissory notes or deeds of trust for individual borrowers or small businesses.¹⁵⁴ The economic reality is that borrowers often need the money more than the lenders need to make the loan. Therefore, the borrowers may not have much bargaining position and may not want to walk away from the deal.

Perhaps for these reasons, legislatures have incorporated many debtor protections into the nonjudicial foreclosure schemes. For example, as noted, the statutes require the creditor to give the debtor notice of the proceeding with a Notice of Default or Notice of Sale.¹⁵⁵ The notice must be served in a fashion designed to secure the debtor's receipt of the notice.¹⁵⁶ Some states prohibit the creditor from pursuing a deficiency judgment after the nonjudicial

¹⁵³ See, e.g., Note Secured by Mortgage, 4 Bus. Transactions Cal. Transactions Forms § 25:63 (BancroftWhitney 2005); Acceleration on Default, Transactions Cal. Transactions Forms § 25:79 (BancroftWhitney 2005); Default Interest, Transactions Cal. Transactions Forms § 25:80 (BancroftWhitney 2005); Late Charge, Transactions Cal. Transactions Forms § 25:81 (BancroftWhitney 2005); Attorney Fees, Transactions Cal. Transactions Forms § 25:85 (BancroftWhitney 2005); Banker's System Inc., Multistate Manual for Home Loan Note for Credit Unions, at 6-7 (2004) available at www.bankerssystems.com/assets/applets/ProcManuals/HLCU_Jetform.pdf (last visited Aug. 6, 2006).

¹⁵⁴ David Newton, *Negotiating Private Lender Credit Terms*, ENTREPRENEUR.COM, July 19, 2004, <http://www.entrepreneur.com/money/financing/financingcolumnistdavidnewton/article71888.html> (last visited Aug. 6, 2006) ("Working with commercial banks for loans is essentially a one-way settlement process. . . . Entrepreneurs are put in a position where much of the interaction with the banker is not so much negotiations, but the lending institution requesting various types of documentation. . . . In the end, the final loan package generally represents the lender's terms more so than the borrower's unique requests regarding the funding structure.").

¹⁵⁵ ALASKA STAT. § 34.20.070(b) (2004); ARIZ. REV. STAT. ANN. § 33-808(C), (D), (E) (2000 & Supp. 2005); NEB. REV. STAT. §§ 76-1006 - 76-1007 (2003); N.H. REV. STAT. ANN. § 479:25(I) (LexisNexis 2003). N.Y. REAL PROP. ACTS. § 1404 (McKinney 1979 & Supp. 2006).

¹⁵⁶ ALASKA STAT. § 34.20.070(c); ARIZ. REV. STAT. ANN. § 33-808(A); NEV. REV. STAT. ANN. § 107.080(4); N.H. REV. STAT. ANN. § 479:25(II); N.Y. REAL PROP. ACTS. §§ 1405-1406.

foreclosure sale.¹⁵⁷ The debtor normally has a right to redeem the property by curing the default, sometimes until the bidding begins.¹⁵⁸ The debtor normally has a right to postpone the sale.¹⁵⁹ The mortgagor can sometimes convert a nonjudicial foreclosure proceeding into a judicial foreclosure with more court oversight.¹⁶⁰

Similarly, the existence of the common-law set-aside rules shows a judicial desire to protect the debtor by providing a remedy. Extending the existing rules to include extrinsic fraud or unfairness would certainly be consistent with these other debtor protections. An extension would give some debtors an additional opportunity to protect themselves.

IX. EXTENDING THE RULE TO INCLUDE EXTRINSIC FRAUD WOULD NOT DIMINISH THE PROTECTIONS AFFORDED TO BONA FIDE PURCHASERS TO PROVIDE FINALITY IN SALES

As noted in Part IV, *supra*, a second important function of the foreclosure statutes and the set-aside rule is to protect bona fide purchasers, thereby ensuring that sales are final between the parties and conclusive as to bona fide purchasers.¹⁶¹ A bona fide purchaser is generally considered to be a third-party purchaser who acquires the property in good faith, for value, without notice of purported defects in the sale process.¹⁶²

As a general matter of fairness, it makes sense to protect these innocent third-party purchasers of real property who do not know of any problems with the sale. This is especially true because buying properties in this fashion is

¹⁵⁷ ALASKA STAT. § 34.20.100; OKLA. STAT. ANN. tit. 46, § 43(A)(2)(c) (West 1996); OR. REV. STAT. § 86.770(2) (2005).

¹⁵⁸ ARK. CODE ANN. § 18-50-114(a)(1) (2003) (any time before sale); NEB. REV. STAT. § 76-1012 (2003); N.Y. REAL PROP. ACTS. § 1410(1) (any time before bidding); OR. REV. STAT. § 86.753(1) (up to five days before sale).

¹⁵⁹ ALASKA STAT. § 34.20.080(e); ARIZ. REV. STAT. ANN. § 33-810(B), (D); NEB. REV. STAT. § 76-1009; NEV. REV. STAT. ANN. § 107.030(6) (LexisNexis 2001 & Supp. 2005); N.Y. REAL PROP. ACTS. § 1407; R.I. GEN. LAWS § 34-11-22 (1995 & Supp. 2006); UTAH CODE ANN. § 57-1-27(2) (2000 & Supp. 2005); WYO. STAT. ANN. § 34-4-109 (2005).

¹⁶⁰ S.D. CODIFIED LAWS § 21-48-9 (LexisNexis 1987 & Supp. 2003).

¹⁶¹ See, e.g., *Moeller v. Lien*, 30 Cal. Rptr. 2d 777, 782 (Cal. Ct. App. 1994) (the statutory framework governing nonjudicial foreclosure sales ensures that properly conducted sales are conclusive as to bona fide purchasers); *Cox v. Helenius*, 693 P.2d 683, 686 (Wash. 1985).

¹⁶² See, e.g., *Melendrez v. D & I Inv. Inc.*, 26 Cal. Rptr. 3d 413, 424 (Cal. Ct. App. 2005).

notoriously risky.¹⁶³ For example, the purchaser must normally pay in cash and cannot obtain financing;¹⁶⁴ purchasers probably will not know much about the condition of the property's interior;¹⁶⁵ and purchasers will probably not be permitted to inspect the property prior to the sale.¹⁶⁶

Protections exist for bona fide purchasers who buy property at nonjudicial foreclosure sales. For example, in most states, the auctioneer provides a "trustee's deed," as opposed to a grant deed, to the purchaser at a foreclosure sale and conveys title in this manner.¹⁶⁷ A trustee's deed normally contains (1) a description of the property being conveyed; (2) a recital of facts describing the default, the mailing and publication of the notice of sale, the conduct of the sale, and receipt of money from the purchaser; and (3) the name of the purchaser.¹⁶⁸ In many states, if the trustee's deed contains a recital that all of the statutory foreclosure requirements have been fulfilled, a common clause, then the recital is conclusive with respect to a bona fide purchaser and cannot be rebutted in an action to set aside the sale.¹⁶⁹ In this way, bona fide purchasers have strong protection,¹⁷⁰ though it is still a question of fact whether the purchaser is actually a "bona fide" purchaser.¹⁷¹ If the purchaser is not, in fact, a bona fide purchaser (e.g., the purchaser had notice of the purported defects in the sale), then the individual should not deserve the same protections because the purchaser could have decided not to purchase the property and/or factored the known risk into the amount bid for the property.

Bona fide purchasers also receive the benefit of other protections in a minority of states. For instance, New Hampshire imposes a deadline of one year and one day from the date of sale for an aggrieved debtor to challenge the nonjudicial foreclosure.¹⁷² Oregon and Tennessee have attempted to make

¹⁶³ See, e.g., Homes.com, Investment Properties: Foreclosures and Fixer-Uppers, http://www.homes.com/Content/Articles/ArticleBody.cfm?ID=1_3_27 (last visited Aug. 3, 2006).

¹⁶⁴ *Id.*

¹⁶⁵ *Id.*

¹⁶⁶ *Id.*

¹⁶⁷ See, e.g., ALASKA STAT. § 34.20.090 (2004); ARIZ. REV. STAT. ANN. § 33-811(B), (E) (2000 & Supp. 2005); NEB. REV. STAT. § 76-1001(3) (2003); OKLA. STAT. ANN. tit. 46, § 47(B) (West 1996); OR. REV. STAT. § 86.780 (2005); UTAH CODE ANN. § 57-1-28(2) (2000 & Supp. 2005).

¹⁶⁸ See, e.g., IDAHO CODE ANN. § 45-1509 (2003) (Trustee's Deed – Form and Contents).

¹⁶⁹ See, e.g., *Melendrez v. D & I Inv. Inc.*, 26 Cal. Rptr. 3d 413, 424 (Cal. Ct. App. 2005).

¹⁷⁰ *Id.* at 427.

¹⁷¹ NEV. REV. STAT. ANN. § 107.080(5) (LexisNexis 2001 & Supp. 2005) (purchaser at nonjudicial foreclosure auction is not a bona fide purchaser).

¹⁷² N.H. REV. STAT. ANN. § 479:25(II-a) (LexisNexis 2003).

damages the sole method of recovery in actions brought by aggrieved debtors based on allegedly improper foreclosure sales.¹⁷³

In addition to the statutory protections, bona fide purchasers also benefit from protections inherent in litigation to set aside foreclosure sales. For example, it is often difficult for aggrieved debtors to make the legal showing required to set aside foreclosure sales. A party who seeks to set the sale aside has the burden of proving fraud or irregularity.¹⁷⁴ In some states, an aggrieved debtor must show both a defect in the foreclosure process and prejudice that results directly from that defect.¹⁷⁵ In Oregon, an aggrieved debtor who did not receive notice of the sale must show by clear and convincing evidence that he could have cured the default at the time the sale was held.¹⁷⁶ Neither of these standards is easy to meet.

Other protections inherent in litigation exist as well. For example, as noted, fraud in the foreclosure process is one basis for setting aside a sale. Fraud is notoriously difficult to prove at trial.¹⁷⁷ The likelihood that an aggrieved debtor could set aside a sale based on fraud, even if allowed to proceed against the purchaser, is fairly slim. Moreover, even if the court determines that the purchaser is not bona fide, the debtor still has the burden of proof in rebutting recitals of compliance in the trustee's deed.¹⁷⁸ All of these "litigation protections" benefit the purchaser by making it difficult for an aggrieved debtor to set the sale aside in a subsequent action.

Extending the set-aside rule to include both intrinsic and extrinsic fraud would not diminish any of the protections afforded to bona fide purchasers. Recitals in a trustee's deed would still be conclusive as to bona fide purchasers in the states that afford such protection. The limitations period for challenging

¹⁷³ OR. REV. STAT. § 86.742(2) (2005) (person who does not receive notice of sale can sue for damages); TENN. CODE ANN. § 35-5-106 (2001) (sale not void or voidable for failing to follow statutory requirements).

¹⁷⁴ See, e.g., *Reed v. Bachman*, 78 S.E. 695, 697 (W. Va. 1913).

¹⁷⁵ See, e.g., *FDIC v. Dye*, 642 F.2d 837, 842 (5th Cir. 1981) (applying Georgia law); *Gilroy v. Ryberg*, 667 N.W. 2d 544, 558–559 (Neb. 2003) (a debtor can show prejudice if a defect has a tendency to result in a reduced sale price and the sale price was inadequate); *Pugh v. Richmond*, 425 S.W.2d 789, 796 (Tenn. App. 1967); *Powell v. Stacy*, 117 S.W.3d 70, 75 (Tex. App. 2003); *Concepts, Inc. v. First Sec. Realty Servs., Inc.*, 743 P.2d 1158, 1159 (Utah 1987).

¹⁷⁶ OR. REV. STAT. § 86.742(2)(c), (3).

¹⁷⁷ James P. Nehf, *Recognizing the Societal Value in Information Privacy*, 78 WASH. L. REV. 1, 31, (2003) ("Fraud is difficult to prove because of the requirement that the tortfeasor act with intent to defraud . . ."); Olga Sirodoeva-Paxson, *Judicial Removal of Directors: Denial of Directors' License to Steal or Shareholders' Freedom to Vote?*, 50 HASTINGS L.J. 97, 141, (1998–1999) ("It is generally recognized that the elements of fraud are difficult to prove . . .").

¹⁷⁸ *Meador v. Johnson*, 112 P. 1121, 1124 (Okla. 1910).

sales would still exist in states that provide for such a period. Damages would still exist as the sole statutory means of recovery in the few states that attempt to limit the debtor's recovery in this way. The elements of fraud would still be difficult to prove because the elements would be the same regardless of whether the fraud is "intrinsic" or "extrinsic" to the sale.

From the bona fide purchaser's perspective, then, an extension of the rule would have little effect. The only difference would be that aggrieved debtors would have an opportunity to recover their property when a third party committed the fraud dehors the sale and the purchaser of the property was not a bona fide purchaser.

X. ALTHOUGH AN EXTENSION OF THE RULE MAY AFFECT THE CREDITOR'S ABILITY TO HAVE A QUICK AND INEXPENSIVE REMEDY, AT LEAST TO SOME DEGREE, THE COURTS SHOULD ALLOCATE THIS RISK TO THE CREDITOR

Extending the set-aside rule may affect the creditors' ability to have a quick and inexpensive remedy, the last of the three policies promoted by the recognition of nonjudicial foreclosure sales.¹⁷⁹ An extension of the rule would likely mean that at least some additional nonjudicial foreclosure sales would be challenged in court. Some of these challenges may result in a set aside of the foreclosure, while others may not. To the extent that the foreclosures are litigated, regardless of the outcome, the creditor has lost the ability to have a quick and inexpensive remedy. As discussed in Parts IV and IX, *supra*, litigation is lengthy and expensive, quite different from the nonjudicial foreclosure process.¹⁸⁰

Banks have argued that a lengthy, litigious foreclosure process adversely affects creditors and the availability of credit, at least to some extent, for several reasons.¹⁸¹ First, when lenders become involved in extensive litigation, they become more cautious.¹⁸² This caution results in less credit

¹⁷⁹ Moeller v. Lien, 30 Cal. Rptr. 2d 777, 782 (Cal. Ct. App. 1994).

¹⁸⁰ See also S. 588, 221st Leg., Reg. Sess. (N.Y. 1998), available at <http://www.westlaw.com> (enter search term NY Bill Jacket, 1998 S.B. 588, Ch. 231) (last visited Aug. 6, 2006) ("Substantial caseloads carried by New York State judges can drag foreclosure [litigation] proceedings out for several years.").

¹⁸¹ The banking industry advanced these arguments when lobbying the State of New York to adopt its nonjudicial foreclosure scheme.

¹⁸² See also Letter from William F. Terry, Secretary, Trustco Bank to, the Hon. James M. McGuire, Counsel to the Governor (July 1, 1998) in N.Y. S. 588, available at <http://www.westlaw.com> (last visited Aug. 6, 2006) (enter search term NY Bill Jacket, 1998 S.B. 588, Ch. 231).

availability.¹⁸³ The lender's ability to foreclose on its collateral without undue delay is an essential condition for its willingness to make the loan.¹⁸⁴ Second, from the banks' perspective, creditworthy borrowers bear the burden of excessive litigation costs because the banks pass those costs on to the consumers.¹⁸⁵ Higher costs may preclude some borrowers from obtaining credit. Third, creditors cannot lend the same funds for two purposes, so money that is tied up in foreclosure litigation is money that is not available for a productive loan.¹⁸⁶ Fourth, banks have choices as to where they extend credit and for what purpose.¹⁸⁷ If banks fear protracted litigation, then they may have a disincentive to make mortgage loans and they may prefer to make other types of loans instead.¹⁸⁸

However, these fears would likely not be realized if the set-aside rule were extended to include extrinsic fraud. Each of the lenders' fears, while arguably distinct, rests on the premise that banks would be involved in excessive litigation.

As noted in detail in Part I, *supra*, borrowers often lack the financial resources, familiarity with the system, and access to attorneys necessary to engage in litigation over a wrongful foreclosure. Without money to pay a lawyer, debtors understandably would have difficulty obtaining legal services. Many debtors cannot afford to pay an hourly rate. Attorneys who represent clients on a contingency fee basis normally choose cases with the prospect of providing an acceptable monetary return.¹⁸⁹ A debtor seeking to set aside a nonjudicial foreclosure would be seeking injunctive relief to recover the property, not necessarily damages. It seems unlikely that a contingency fee attorney would be interested in such a case. Indeed, one study shows that

¹⁸³ *Id.*

¹⁸⁴ Letter from Michael P. Smith, President, New York Bankers Association to the Hon. James M. McGuire, Counsel to the Governor (June 29, 1998) in N.Y. S. 588, *available at* <http://www.westlaw.com> (last visited Aug. 6, 2006) (enter search term NY Bill Jacket, 1998 S.B. 588, Ch. 231).

¹⁸⁵ Letter from William F. Terry, Secretary, Trustco Bank to, the Hon. James M. McGuire, Counsel to the Governor (July 1, 1998) *available at* <http://www.westlaw.com> (last visited Aug. 6, 2006) (enter search term NY Bill Jacket, 1998 S.B. 588, Ch. 231).

¹⁸⁶ Letter from Michael P. Smith, President, New York Bankers Association to the Hon. James M. McGuire, Counsel to the Governor (June 29, 1998) *available at* <http://www.westlaw.com> (last visited Aug. 6, 2006) (enter search term NY Bill Jacket, 1998 S.B. 588, Ch. 231).

¹⁸⁷ Letter from Sanford A. Belden, President and Chief Executive Officer, Community Bank System, Inc. to the Hon. James M. McGuire, Counsel to the Governor (July 1, 1998) (on file with the author), *available at* <http://www.westlaw.com> (enter search term NY Bill Jacket, 1998 S.B. 588, Ch. 231).

¹⁸⁸ *Id.*

¹⁸⁹ Herbert M. Kritzer, *Seven Dogged Myths Concerning Contingency Fees*, 80 WASH. U. L.Q. 739, 754 (2002).

contingency fee attorneys took only thirty-four percent of the cases presented to them.¹⁹⁰ A debtor seeking to set aside a foreclosure would likely fall in the other sixty-six percent

Furthermore, because the debtors often lack sophistication, it is unlikely the debtors would attempt to litigate in propria persona. If the debtors were to do so, the lenders' attorneys would likely obtain a quick defense judgment. Not surprisingly, in litigation between a pro se litigant and a represented party, particularly a well-funded represented party such as a commercial lender, the represented party normally wins.¹⁹¹

Even where a debtor can afford an attorney, the borrower may not want to litigate because of the difficulties associated with litigation. As noted in Part IX, *supra*, it is generally hard to prove the type of fraud that would justify the set aside of a foreclosure sale.¹⁹² Thus, a debtor contemplating litigation to set aside a sale is not guaranteed success from the outset and some debtors may not want to take the risk. Moreover, litigation wreaks havoc on a litigant's life. The process provokes anxiety and often leads to a feeling of invasion of privacy.¹⁹³ With multiple discovery obligations, uncertain trial dates, and the prospect of a trial itself, litigation generally creates many hassles for litigants.¹⁹⁴ Debtors with weak claims very well may choose to avoid litigation altogether, even if courts expand the set-aside rule. However, debtors with stronger claims should have the opportunity to litigate if they so desire.

The notion that an expansion of the set-aside rule would not result in undue, excessive litigation finds support in Arkansas. In 1995, the Arkansas Supreme Court found invalid a nonjudicial foreclosure sale that took place without strict compliance with the relevant statutes.¹⁹⁵ The court was not troubled that the irregularities apparently did not prejudice the debtors a great

¹⁹⁰ *Id.* at 755 (focusing on attorneys in the State of Wisconsin).

¹⁹¹ Jona Goldschmidt, *The Pro Se Litigant's Struggle for Access to Justice: Meeting the Challenge of Bench and Bar Resistance*, 40 FAM. CT. REV. 36, 37 (2002).

¹⁹² It is even harder to prove the requisite fraud in jurisdictions that require the alleged irregularity to contribute to the inadequate price obtained at the foreclosure sale. *See, e.g.*, FDIC v. Dye, 642 F.2d 837, 842 (5th Cir. 1981) (applying Georgia law); Pugh v. Richmond, 425 S.W.2d 789, 796 (Tenn. Ct. App. 1967); Powell v. Stacy, 117 S.W.3d 70, 75 (Tex. App. 2003); Concepts, Inc. v. First Sec. Realty Servs., Inc., 743 P.2d 1158, 1159 (Utah 1987).

¹⁹³ Stephen N. Subrin, *A Traditionalist Looks at Mediation: It's Here to Stay and Much Better than I Thought*, 3 NEV. L. J. 196, 206 (2002/2003).

¹⁹⁴ *Id.* at 206.

¹⁹⁵ Henson v. Fleet Mortgage Co., 892 S.W.2d 250, 253 (Ark. 1995) (relying on Craig v. Meriwether, 105 S.W. 585, 587 (Ark. 1907); Raines v. Graham, 69 S.W. 551, 552 (Ark. 1902)).

deal.¹⁹⁶ Instead, the court focused on the need to strictly construe the applicable foreclosure statutes.¹⁹⁷ The decision was very helpful to debtors. The court's holding would seem to invite litigation in Arkansas to set aside any nonjudicial foreclosure sales with alleged irregularities. However, since that time, there is no evidence that lenders have stopped making mortgage loans in Arkansas. Neither is there evidence that a flood of litigation has resulted from the ruling. Indeed, since 1995, it appears that *Henson* has been cited in only fourteen cases.¹⁹⁸

Lenders might also argue that an extension of the set-aside rule would deter potential bidders from attending sales and would force creditors to lose the remedy of nonjudicial foreclosure.¹⁹⁹ If bidders knew that a sale could be set aside due to fraud that occurred outside the context of the sale, which the bidder could not discover despite the performance of reasonable due diligence, the debtors might hesitate to purchase the distressed property at the sale. Indeed, debtors might arguably try to discourage a sale altogether by appearing at the auction to announce that fraud or irregularity had occurred and that the debtor plans to file a lawsuit against anyone who purchases the property. Nobody would want to “purchase a lawsuit,” as the saying goes.

However, while there may be instances where such events occur, they would likely be isolated and would not likely create a widescale abandonment of nonjudicial foreclosure sales. Most importantly, foreclosure sales will always attract bidders in a free market economy because of the deeply discounted “auction price” that bidders normally pay for the distressed properties. By conservative estimates, buyers can often reasonably purchase a property at foreclosure auctions for twenty percent below full market value.²⁰⁰ Some investors believe that they can obtain properties at auction for thirty to forty percent below full market value.²⁰¹ With discounts like these, there will always be eager bidders seeking deals at foreclosure auctions, especially in tight real estate markets like New York and California.

¹⁹⁶ *Henson*, 892 S.W.2d at 253.

¹⁹⁷ *Id.*

¹⁹⁸ Westlaw KeyCite, *Henson v. Fleet Mortgage Co.*, 892 S.W.2d 250 (Ark. 1995).

¹⁹⁹ At least one court has noted that the judiciary must limit set asides because the resulting uncertainty and increase in litigation would deter bidders and force lenders to choose judicial foreclosure. *Gilroy v. Ryberg*, 667 N.W.2d 544, 553 (Neb. 2003).

²⁰⁰ RealtyTrac, *Buying at Auction: Determine Your Bid Amount*, <http://www.realtytrac.com/education/noframes/documentation/HowToBuyForeclosures2.asp?answer=a4#answer> (last visited Aug. 6, 2006).

²⁰¹ Stephanie Rosenbloom, *Foreclosure Auctions: Bidder Beware*, N.Y. TIMES, April 9, 2006, § 11, at 1, available at 2006 WLNR 5966114.

There are also other reasons that an extension of the rule would not likely create a widespread abandonment of nonjudicial foreclosure sales or cause lenders to lose their remedy. First, debtors are often not very sophisticated and are often intimidated by the legal process surrounding foreclosure.²⁰² They may not necessarily have the forethought or the audacity to appear at a sale and attempt to dissuade bidders by threatening a lawsuit against a successful purchaser.

Second, even if a debtor threatened a lawsuit at the foreclosure sale, many auctions are attended by individuals who make a living buying and reselling distressed properties.²⁰³ People who regularly attend auctions “tend to be investors who pool their money and have ties to the construction business. They know the market, they do their research, and they have the capital and the ability to renovate properties sold ‘as is.’”²⁰⁴ Such “professional bidders” may be less likely than casual bidders to succumb to attempted intimidation since they know how the system works. Professional bidders also would be more likely (1) to be able to determine whether the property was worth purchasing even with a threatened lawsuit; (2) to be able to factor the price of a threatened lawsuit into the amount bid at sale; and (3) to have the economic wherewithal to defend such a lawsuit if it arose.

Finally, if a debtor were to file a lawsuit to set aside a nonjudicial foreclosure sale without having announced those plans at the sale, the purchaser would still have all of the protections normally afforded to bona fide purchasers.²⁰⁵ Although a casual bidder at sale may not know that these protections exist, the “professional bidders” who normally attend such sales would be more likely to know about them.

For all of these reasons, in reality, it appears that an extension of the set-aside rule would not negatively affect creditors a great deal. To the extent that an extension might have some effect on the creditors’ ability to have a quick and inexpensive remedy, creditors may perceive the extension as unfair. However, there are three different interests that need to be balanced in all matters relating to nonjudicial foreclosure sales: the debtor, the bona fide

²⁰² See *supra* Part I.

²⁰³ There are many websites that promise to help interested individuals learn how to make a living at foreclosure sales. See, e.g., Foreclosure Deals, Information on Investing Foreclosed Properties, <http://www.foreclosuredeals.com/Miscellaneous-Foreclosures-Articles.php> (last visited Aug. 6, 2006); Important Notice, <http://www.zick.com/SpecialOffer1005.html> (last visited Aug. 6, 2006).

²⁰⁴ Rosenbloom, *supra* note 201.

²⁰⁵ See *supra* Part X.

purchaser, and the creditor. It is virtually impossible to spread burdens and benefits equally among three different interests. As in all balancing tests, some parties will receive a disproportionate share of the burden. Because creditors are in the best position to protect themselves, debtors need the most protection, and bona fide purchasers are normally “innocent” third parties, it is fairest to allocate any perceived unfairness to the creditors.

CONCLUSION

The problem confronting debtors who suffer unfairness or fraud dehors the sale proceeding can be remedied by extending the set-aside rule to cover such cases. An extension of the rule is justified as a matter of fairness to debtors, even if it may cause some slight detriment to creditors. An extension of the rule is also justified in order to prevent wrongdoers from benefiting from their misconduct. Courts apply similar rules in several other legal contexts and should be able to do so here without any dramatic repercussions.

