

Advanced Issues in Foreclosure



All rights reserved. These materials may not be reproduced without written permission from NBI, Inc. To order additional copies or for general information please contact our Customer Service Department at (800) 930-6182 or online at www.NBI-sems.com.

For information on how to become a faculty member for one of our seminars, contact the Planning Department at the address below, by calling **(800) 777-8707**, or emailing us at speakerinfo@nbi-sems.com.

This publication is designed to provide general information prepared by professionals in regard to subject matter covered. It is sold with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional service. Although prepared by professionals, this publication should not be utilized as a substitute for professional service in specific situations. If legal advice or other expert assistance is required, the services of a professional should be sought.

Copyright 2011
NBI, Inc.
PO Box 3067
Eau Claire, WI 54702

56537

**Complex Commercial Foreclosure Issues:
A Review Of California Foreclosure Law Regarding
Possession And Receivership**

Submitted by Terrance J. Evans

Complex Commercial Foreclosure Issues: A Review of California Foreclosure Law Regarding Possession and Receivership

By Terrance J. Evans, Esq.

During the foreclosure process, lenders are often very concerned about the preservation of their real property collateral, and their ability to prevent a defaulting borrower from impairing or depleting the rents and/or profits from the estate. In order to properly strategize regarding how to deal with these complex issues, it is important to understand the pertinent legal issues involved. In this article, we will examine possession and receivership issues under California law.

I. Lenders Have Limited Rights to Possession and Rents

A mortgage or deed of trust provides a lender or creditor with a lien against the debtor's interest in the real property collateral, which can be satisfied through a judicial or nonjudicial foreclosure on that security interest. *See*, Roger Bernhardt, *California Mortgages, Deeds of Trust, and Foreclosure Litigation* §6.1 (4th ed. 2011).

Nevertheless, prior to foreclosure, the lien by itself does not give the lender any independent right to possession of the real property collateral (*see* Bernhardt, *supra* at §6.1; *see also* *People's Sav. Bank v Jones*, (1896) 114 Cal. 422) or to the rents derived from the property (*see* Bernhardt, *supra* at §6.1; *see also* *Lee v Ski Run Apartments Assocs.*, (1967) 249 Cal. App. 2d 293). Cal. Civ. Code §2927; Cal. Code Civ. Proc. §744.

Under California law, if the loan documents do not contain an assignment of rents clause or an analogous provision, a default by the debtor does not deprive the debtor of possession of the property or its rents until after a foreclosure has been completed. *See* Bernhardt, *supra* at §6.1. The result would be completely different had the default

occurred in one of the title theory states, which hold that a mortgage gives the creditor title to the mortgaged property (and therefore to its possession and right to rents from the possession). *Id.* at §6.1.

However, California follows a lien theory regarding rents, even when a deed of trust is involved, which means that absent an assignment of rents provision a lender does not have a right to collect rents from the real property collateral until a foreclosure sale extinguishes the debtor's title. *See* Bernhardt, *supra* at §6.1; *see also* *Kinnison v Guaranty Liquidating Corp.*, (1941) 18 Cal. 2d 256. Additionally, without special language in the security instrument, the creditor has no right to possession before the foreclosure sale. Bernhardt, *supra* at §6.1.¹

A. The Effect Of An Assignment of Rents Clause

Institutional lenders making loans in California typically use standardized loan documents and deed of trust forms that contain an assignment of rents clause. *Id.* at §6.2. Essentially, an assignment of rents clause in a deed of trust gives the beneficiary a right to collect rents immediately upon the trustor's default. *Id.* at §6.2. Assignment of rents provisions are regulated by statute in California, and must be enforced in a court receivership action . *Id.*

The remedies available to a beneficiary upon the default of a debtor will be substantially enhanced or limited depending on whether or not the security instrument contains an assignment of rents provision. Bernhardt, *supra* at §6.2.

It comes as no surprise that a defaulting debtor in possession of real property collateral is less likely to maintain, secure, and/or insure the property after defaulting on

¹ Please note that following a judicial foreclosure sale, the purchaser is entitled to rents but not possession until expiration of the redemption period. Bernhardt, *supra* at §6.1.

the loan. *Id.* Furthermore, since an uncontested foreclosure in California can take at least four months to complete, and a contested foreclosure involving litigation and bankruptcy can take over a year to complete, there is a serious risk that the defaulting debtor will allow the real property collateral to deteriorate during the lengthy foreclosure process. *Id.* Such a scenario could seriously jeopardize the value of a lender's real property collateral. Additionally, a defaulting debtor may attempt to collect rent and profits from the real property collateral during the foreclosure process without making any attempt to cure the outstanding default on the delinquent loan. *Id.* Assignment of rents and profits clauses are designed to prevent such "waste" and "skimming." *See* Bernhardt, *supra* at §6.2; *see also* *U.S. v Haddon Haciendas Co.*, (9th Cir 1976) 541 F. 2d 777; *see also* *Cornelison v Kornbluth*, (1975) 15 Cal. 3d 590.

B. Using A Receivership In The Workout Of A Defaulted Loan

In light of the ongoing financial crisis in the United States, lenders are increasingly using receiverships to address and resolve issues arising from defaulted commercial loans. *See* Bernhardt, *supra* at §6.2A

The resulting transaction is called a "workout." *Id.* However, this is not a traditional workout between the defaulting borrower and the lender or special servicer but a sale in which a third party purchases the real property collateral subject to the existing deed of trust and assumes the existing loan. *Id.* The principal balance of the loan may be modified to reflect the sales price or some other restructuring of the existing debt may occur. This is especially important for Commercial Mortgage Backed Securities loans ("CMBS loans"), which are held in Real Estate Mortgage Investment Conduits (REMICs). *See* Bernhardt, *supra* at §6.2A. Since the federal tax rules and contracts that govern REMICs typically forbid them from issuing new debt, a receivership sale and an

assumption of the loan allows lenders and special servicers an alternative to foreclosure and resale. *Id.* Additionally, a receivership can provide the following advantages:

- The lender does not have to wait until after the foreclosure process to remove the defaulting borrower as the manager of an income-producing property or a project under construction; *Id.*
- The appointment of a receiver reduces the risk of rent skimming and waste; *Id.*
- A receiver taking over a project under construction will have the authority either to complete the project or to shut it down and secure it if completion is not feasible (lending institutions do not usually have the experience to do this effectively without outside assistance); *Id.* and
- When the court gives the receiver authority to sell the property through a multiple listing service (MLS) by a real estate broker, in most cases the sale will net significantly greater proceeds than a foreclosure sale (this alternative also allows the lender to avoid holding the property in the lender's REO (real estate owned) inventory). *Id.*

Bernhardt, *supra* at §6.2A.

Notwithstanding the above noted advantages that selling a property subject to the loan may provide to CMBS trusts and their servicers, this approach is not entirely without risk. *See* Bernhardt, *supra* at §6.2A. During the negotiating process, the defaulting borrower may stipulate to the appointment of the receiver and consent to the receiver's sale of the property to a new buyer in exchange for a complete or partial waiver from the lender of a deficiency judgment or a complete or partial reduction in the guarantor's liability under the guaranty. *Id.* However, if the defaulting borrower does not consent, California's one-action rule, which is set forth in Cal. Code Civ. Proc. §726(a), and California's antideficiency protections raise the following questions:

- **Is the receiver's sale a judicial foreclosure?** If a judge were to find that a receiver's sale of a distressed property subject to a lien securing a loan in default is not a de facto foreclosure, then the lender risks not qualifying for a deficiency judgment because of not having (1) proceeded by judicial foreclosure, (2) sold the property subject to the post sale statutory right of redemption (an essential antideficiency protection), (3) applied for a timely deficiency under Cal. Code Civ. Proc. §726(b), or (4) satisfied the fair value process. Bernhardt, *supra* at §6.2A.
- **Does the fact of court authorization of the receiver's sale preclude application of the one-action rule?** *See Aplanalp v Forte*, (1990) 225 Cal. App. 3d 609; judicial offset of verdict in favor of borrower against debt owed to lender violated Cal. Code Civ. Proc. §726(a)). Bernhardt, *supra* at §6.2A.
- **Does the exemption from the one-action rule under CCP Cal. Code Civ. Proc. §564(d) apply?** The order appointing the receiver may permit the receiver to sell the property (*see* Cal. Code Civ. Proc. §568.5) if the moving party shows that an imminent financial crisis will occur if the sale is not made. But the power to sell under §568.5 is not expressly mentioned in Cal. Code Civ. Proc. §564(d), which only provides that an action by a secured lender to appoint a receiver under California's receivership law is not an "action" for purposes of CCP Cal. Code Civ. Proc. §726(a). Bernhardt, *supra* at §6.2A.
- **Assuming the receiver's sale is tantamount to a judicial foreclosure allowing a post sale deficiency judgment, how is the deficiency measured?** Bernhardt, *supra* at §6.2A.
- **Even if the borrower consents to the receivership and the sale, is this an invalid waiver of §726(a)?** Bernhardt, *supra* at §6.2A.

Bernhardt, *supra* at §6.2A.

When a receivership action is brought for the above noted purposes, the procedures vary depending on whether there is an assignment of rents clause in the deed

of trust. Bernhardt, *supra* at §6.2A. If no assignment of rents clause exists and the real property collateral is worth less than the amount owed, Cal. Code Civ. Proc. §564(b)(2) enables the lender to obtain appointment of a receiver to take possession pending a judicial foreclosure action by showing the following two things:

1. The mortgaged "property is in danger of being lost, removed, or materially injured, or that the condition of the deed of trust or mortgage has not been performed"; *Id.* and
2. that "the property is probably insufficient" in value to satisfy the secured debt. *Id.*

Bernhardt, *supra* at §6.2A.

II. A Lender's Right to Possession and Rents Before Foreclosure

A. Mortgagee In Possession

One option available to a lender seeking to protect against waste and reach the rents is to take possession of the real property collateral, with the debtor's consent, during the life of the loan. Bernhardt, *supra* at §6.3. A secured creditor who takes such consensual possession of the real property collateral is referred to as a "mortgagee in possession." *Id.* It is important to remember that a lender who becomes a mortgagee in possession acquires both advantages and liabilities. *Id.* This status carries with it consequences beyond those created in a normal deed of trust or mortgage. *See* Bernhardt, *supra* at §6.3.

In light of the legislative overhaul and rationalization of the rents and profits procedures and concepts, few mortgagee-in-possession issues arise. *See* Bernhardt, *supra*

at §§6.3,6.20, 6.25-6.28. Many lenders take steps to avoid mortgagee in possession status because of the liabilities involved. *See* Bernhardt, *supra* at §6.3.

B. Rights Of A Mortgagee In Possession

It is well established under California law that a lender who becomes a true mortgagee in possession may retain possession of the real property collateral until the debt is paid. *See* Bernhardt, *supra* at §6.4; *see also Snyder v Western Loan & Bldg. Co.*, (1934) 1 Cal. 2d 697. Even when an action to collect on the promissory note would be barred by the statute of limitations, a mortgagee in possession may remain in possession as long as the obligation is unsatisfied. *See* Bernhardt, *supra* at §6.4; *see also Spect v Spect*, (1891) 88 Cal. 437. This is typically not important to the beneficiary under a deed of trust because the power of sale remedy is generally not subject to time limitations, however, classification as a mortgagee in possession can be very important to a lender or creditor holding a mortgage or hidden security instrument that is subject to a statute of limitation. *See* Bernhardt, *supra* at §6.4; *see also Aguilar v Bocci*, (1974) 39 Cal. App. 3d 475.

In addition to the foregoing, another reason why a lender or creditor may want to become a mortgagee in possession is that such possession carries with it the right to take the rents and profits generated by the real property collateral. *See* Bernhardt, *supra* at §6.4. A mortgagee in possession may apply the profits from the real property collateral toward payment of the debt even if there is no assignment of rents clause in the security instrument. *See* Bernhardt, *supra* at §6.4; *see also Nelson v Bowen*, (1932) 124 Cal. App. 662; *see also Johns v Moore*, (1959) 168 Cal. App. 2d 709. Rent is consideration for the right to possess property; thus the right to receive rents belongs to the party that has the

right to be in possession, which is the lender or creditor when it is a mortgagee in possession. *See* Bernhardt, *supra* at §6.4.

C. Liability Issues

A mortgagee in possession is accountable to the debtor for management of the real property collateral and is liable for failing to act reasonably and in a businesslike manner in handling the real property and the rents collected. *See* Bernhardt, *supra* at §6.5; *see also* *Davis v Stewart*, (1944) 67 Cal. App. 2d 415. Notwithstanding its obligations, the mortgagee in possession is not entitled to compensation for its management efforts. *See* Bernhardt, *supra* at §6.5; *see also* *Earp v Earp*, (1991) 231 Cal. App. 3d 1008, 1014. A mortgagee in possession does not ensure the profitability of the premises but is responsible for any losses caused by its negligence. *See* Bernhardt, *supra* at §6.5; *see also* *Murdock v Clarke*, (1891) 90 Cal. 427, 438. This liability extends to junior creditors as well as to the debtor. *See* Bernhardt, *supra* at §6.5; *see also* *Anglo-Californian Bank, Ltd. v Field*, (1908) 154 Cal. 513.

By comparison, a creditor with an assignment of rents clause in its security instrument may obtain most of the advantages of possession without the accompanying liabilities through the appointment of a receiver (which does not carry mortgagee-in-possession status). *See* Bernhardt, *supra* at §6.5. Rent assignment clauses are therefore considerably superior to the direct taking of possession by the creditor. *Id.* Mortgagee-in-possession status is particularly dangerous if there is any risk that the real property collateral is contaminated because any owner or operator may be held responsible for clean-up costs (*see* Bernhardt, *supra* at §§6.54-4.57, 5.60).

///

///

D. Debtor's Consent Required

Pursuant to California's Civil Code, a mortgage does not automatically entitle the mortgagee to possession of the mortgaged property (as was true under the title theory of mortgages at common law). *See* Bernhardt, *supra* at §6.6; *see also* Cal. Civ. Code §2927; *see also* Cal. Code Civ. Proc. §744.

A debtor may make an independent agreement with the lender, however, to let the lender take possession of the property, either at the inception of the loan or at a later time; and no additional consideration is required. *See* Bernhardt, *supra* at §6.6; *see also* *Nelson v Bowen* (1932) 124 Cal. App. 662. The mere entry by the lender with the debtor's consent is sufficient. *See* Bernhardt, *supra* at §6.6. A formal agreement is unnecessary; consent is implied, especially when the lender has entered after a default and without the debtor's objection. *See* Bernhardt, *supra* at §6.6; *see also* *Hooper v Young*, (1903) 140 Cal. 274 (deed absolute); *see also* *Spect v Spect*, (1891) 88 Cal. 437 (mortgage).

Some California courts have even found that a peaceable entry may be all that is required for a lender or creditor to become a mortgagee in possession. *See* Bernhardt, *supra* at §6.6; *see also* *Snyder v Western Loan & Bldg. Co.*, (1934) 1 Cal. 2d 697; *see also* *Nelson v Bowen*, *supra*. Nevertheless, *see* *Freeman v Campbell*, (1895) 109 Cal. 360. Bernhardt, *supra* at §6.6. A forcible entry, however, will subject the intruding lender or creditor to liability for forcible entry and trespass rather than creating mortgagee-in-possession status. *See* Bernhardt, *supra* at §6.6; *see also* *McGuire v Lynch*, (1899) 126 Cal. 576 (trespass); *see also* *Calidino Hotel Co. v Bank of America Nat'l Trust & Sav. Ass'n*, (1939) 31 Cal. App. 2d 295, 306, (forcible entry).

///

///

E. Entry Following Invalid Foreclosure Sale

There appears to be no clear rule regarding entry into possession subsequent to an invalid foreclosure sale. *See* Bernhardt, *supra* at §6.7. For example, the California Supreme Court has held that a purchaser who took possession under a judicial sale that was void for lack of an indispensable party was nevertheless a mortgagee in possession. *See* Bernhardt, *supra* at §6.7; *see also* *Burns v Hiatt*, (1906) 149 Cal. 617. Conversely, the California Supreme Court has also held to the contrary when the entry followed a private sale under a power of sale in a mortgage (as distinct from a deed of trust) that was barred by the statute of limitations. *See* Bernhardt, *supra* at §6.7; *see also* *Faxon v All Persons*, (1913) 166 Cal. 707.

When a lender or creditor takes possession under circumstances that do not entitle it to claim mortgagee-in-possession status, it loses all the advantages of that status. *See* Bernhardt, *supra* at §6.7. The lender cannot retain possession to force payment of a debt that is otherwise barred (*See* Bernhardt, *supra*; *see also* *Faxon v All Persons*, *supra*), and it cannot apply rents collected toward reducing the debt (*See* Bernhardt, *supra*; *see also* *Freeman v Campbell* (1895) 109 Cal. 360). Any money collected must be turned over to the debtor even though the mortgage debt remains unpaid. *See* Bernhardt, *supra* at §6.7; *see also* *Belcher v Aaron*, (1937) 8 Cal. 2d 180. Thus, the lender must return to the debtor any rents, which it will likely not be able to recover thereafter because of California's antideficiency laws. *See* Bernhardt, *supra* at §6.7.

F. Acts That Do Not Trigger Mortgagee In Possession Status

Mortgagee-in-possession status does not result automatically simply by taking a security interest in land. *See* Bernhardt, *supra* at §6.8. Neither a mortgage nor a deed of trust in and of itself gives the lender or creditor a right to possession of the real property.

See Bernhardt, *supra* at §6.8; see also Cal. Civ. Code §2927; *Snyder v Western Loan & Bldg. Co.*, (1934) 1 Cal. 2d 697; *Bank of America v Bank of Amador County*, (1933) 135 Cal. App. 714. Nor does a deed absolute intended as a mortgage authorize the lender or creditor to take possession of the property unless the deed expressly so provides. See Bernhardt, *supra* at §6.8; see also *McGuire v Lynch*, (1899) 126 Cal. 576.

Physical acts of management—not merely rent collection—are required for a creditor to become a mortgagee in possession (see Bernhardt, *supra* at §6.8; see also *Bank of America v Bank of Amador County*, *supra*). The creditor does not become an automatic mortgagee in possession merely because any of the following four circumstances exist:

1. **The security documents contain an assignment of rents clause** (See Bernhardt, *supra* at §6.8; see also *Freeman v Campbell*, (1895) 109 Cal. 360; *Bank of America v Bank of Amador County*, *supra*);
2. **The creditor personally collects rents from the tenants under an assignment of rents clause** (See Bernhardt, *supra* at §6.8; see also Cal. Civ. Code §2938(e)(1); *Strutt v Ontario Sav. & Loan Ass'n.*, (1972) 28 Cal. App. 3d 866, 879; but see *Johns v Moore* (1959) 168 Cal. App. 2d 709, suggesting, in dictum and in pre-Cal. Civ. Code §2938(e)(1) context, that creditor's collection of rents would be enough to impart mortgagee-in-possession status);
3. **The creditor enters the premises to make repairs to preserve the security** (See Bernhardt, *supra* at §6.8; see also *Gudel v Ellis*, (1962) 200 Cal. App. 2d 849; or
4. **The creditor obtains the appointment of a receiver to manage the property** (See Bernhardt, *supra* at §6.8; see also Cal. Civ. Code §2938(e)(1); *Tourny v Bryan*, (1924) 66 Cal. App. 426; *Murdock v Clarke*, (1891) 90 Cal. 427).

If a lender convinces a debtor—following the debtor’s default—to allow the lender to collect rents without assuming responsibility for property management, this should not have the effect of making the lender a mortgagee in possession. *See* Bernhardt, *supra* at §6.8. In the examples described above, the lender still must account for rents actually collected but is not subject to the prudent business standard that courts apply to a true mortgagee in possession (*see* Bernhardt, *supra* at §§6.8, 6.5).

III. Obtaining a Receivership When There Is No Assignment of Rents Clause

A. Cal. Code Civ. Proc. §564(b)(2): Waste or Default; Insufficient Security

When the deed of trust does not contain an assignment of rents clause, the beneficiary nevertheless may have a receiver appointed to protect the property as part of a judicial foreclosure action under Cal. Code Civ. Proc. §564(b)(2). *See* Bernhardt, *supra* at §6.15; *see also Neider v Dardi*, (1955) 130 Cal. App. 2d 646. In order for a creditor to obtain an order appointing a receiver as part of a foreclosure action, grounds must exist for foreclosing. *See* Bernhardt, *supra* at §6.15. It is unclear whether mere neglect of the property or the trustor's waste is a ground for foreclosure, even if the security instrument contains a covenant against waste, unless it also provides that waste is an event of default. *Id.* Most trust deed forms contain such a covenant. Nothing in Cal. Civ. Code §2929 or Cal. Code Civ. Proc. §745 (*see* §§6.10, 6.14) authorizes a foreclosure on the basis of waste alone. *See* Bernhardt, *supra* at §6.15; *see also Leipziger, The Mortgagee's Remedies for Waste*, 64 Cal L Rev 1086 (1976).

It is important to keep in mind that the criteria for appointment of a receiver under Cal. Code Civ. Proc. §564(b)(2) are more stringent than those applicable to a receiver appointed under an assignment of rents clause in a specific performance action. *See*

Bernhardt, *supra* at §6.15. To obtain a receiver in a judicial foreclosure action when there is no assignment of rents, the beneficiary must show either of the following (*See* Bernhardt, *supra* at §6.15; *see also* Cal. Code Civ. Proc. §564(b)(2)):

- The property is in danger of being lost, removed, or materially injured; or
- The trustor has failed to perform a condition of the deed of trust.

See Bernhardt, *supra* at §6.15.

Since the purpose of §564(b)(2) is to preserve the sufficiency of the security to discharge the debt (*see* Bernhardt, *supra* at §6.15; *see also* *Title Ins. & Trust Co. v California Dev. Co.*, (1912) 164 Cal. 58, 61), under either scenario, the beneficiary must also prove that the property would be or is probably insufficient to satisfy the debt. *See* Bernhardt, *supra* at §6.15. Notably, the first clause in §564(b)(2) supports the appointment of a receiver when the property is threatened by loss, removal, or material injury and the relative value of the property after the infliction of injury would be insufficient to satisfy the debt. *Id.* If the threatened injury is considerable but would "leave enough of the property remaining intact to be ample security for the debt, the court should not interfere." 164 Cal at 61; Bernhardt, *supra* at §6.15. Thus, when applying for a receiver under this clause, the plaintiff must show not only that the property is in danger of material injury but also that such injury would so depreciate its value that it would not afford adequate security for the debt. 164 C at 62; Bernhardt, *supra* at §6.15.

When applying for a receiver under the default provision of §564(b)(2), it is not enough that the beneficiary show nonpayment of the debt (or other default) and a decline in the value of the security; the property value must have fallen below the unpaid balance of the loan. *See* Bernhardt, *supra* at §6.15. This situation necessitates an evidentiary

showing of the property's present value. *See* Bernhardt, *supra* at §6.15; *see also* *Hibernia Sav. & Loan Soc'y v Ellis Estate Co.*, (1933) 132 Cal. App. 408. Because the appointment of a receiver is viewed as a harsh and drastic remedy, a clear showing that less onerous remedies are inadequate may be required. *See* Bernhardt, *supra* at §6.15; *see also* *Cohen v Herbert* (1960) 186 Cal. App. 2d 488.

The language of §564(b)(2) may be interpreted not to require a showing of insufficiency of security when the property is threatened by loss, removal, or material injury. *See* Bernhardt, *supra* at §6.15. Notwithstanding the decision in *Title Ins. & Trust Co. v California Dev. Co.*, *supra*, beneficiaries may argue that requiring a showing of potential inadequacy of value in cases of threat to the security denies them the right to maintain an adequate margin of security. *See* Bernhardt, *supra* at §6.15. For further discussion of margin of security, *see* Bernhardt, *supra* at §§6.15, 4.51, 5.18, 8.70-8.71; *see also* *People ex rel Dep't of Transp. v Redwood Baseline, Ltd.*, (1978) 84 Cal. App. 3d 662.

B. A Lender Has Limited Ability To Collect Rents Without An Assignment Of Rents

A difficulty confronting a beneficiary whose deed of trust lacks an assignment of rents clause is that a receiver appointed under Cal. Code Civ. Proc. §564(b)(2) may be limited to preserving the real property collateral from waste and may not be entitled to claim rents except as needed to avoid waste. *See* Bernhardt, *supra* at §6.16. It is important to keep in mind that rents and title are different interests, and one may have title to property without having the right to receive rents from it. *See* Bernhardt, *supra* at §6.16; *see also* *Walmsley v Holcomb*, (1943) 61 Cal. App. 2d 578. Therefore, mortgaging the title does not itself convey a present right to the rents from it. *See*

Bernhardt, *supra* at §6.16; *see also Locke v Klunker*, (1898) 123 Cal. 231; *Turner v Superior Court*, (1977) 72 Cal. App. 3d 804, 812. Even if the rents are treated as directly connected to the title, title still remains in the trustor until the foreclosure sale is completed. *See* Bernhardt, *supra* at §6.16. Consequently, without an assignment of rents clause, the rents from the property may be a separate and unencumbered asset. *See* Bernhardt, *supra* at §6.16; *see also Snyder v Western Loan & Bldg. Co.*, (1934) 1 Cal. 2d 697.

It is well established that appointing a receiver cannot increase the scope of the lien against the property. *See* Bernhardt, *supra* at §6.16. If the deed of trust does not cover rents, the receivership may not either. *See* Bernhardt, *supra* at §6.16; *see also Turner v Superior Court*, (1977) 72 Cal. App. 3d 804, 812. Although Cal. Code Civ. Proc. §568 empowers a court to authorize a receiver to collect rents, that power is limited to circumstances where there is an independent ground for placing the rents under the court's control, i.e., when the mortgage has an assignment of rents clause or when the rents must be used to preserve the property. *See* Bernhardt, *supra* at §6.16; *see also Gudel v Ellis*, (1962) 200 Cal. App. 2d 849.

In the past, beneficiaries tried to avoid these difficulties by requiring the trustor to stipulate in the deed of trust that a receiver would be appointed whenever the trustor defaulted. But this stipulation is of little help because the courts have held that jurisdiction to appoint a receiver cannot be conferred merely by consent. *See* Bernhardt, *supra* at §6.16; *see also Baker v Varney*, (1900) 129 Cal. 564. *See also Barclays Bank v Superior Court*, (1977) 69 Cal. App. 3d 593. Notwithstanding such a stipulation, the beneficiary must still prove probable insufficiency of the security to obtain the

appointment. *See* Bernhardt, *supra* at §6.16; *see also* *Bank of Woodland v Stephens* (1904) 144 Cal. 659. When weighing the facts to determine if they support the statutory bases for a receivership, however, the court may consider the stipulation. *See* Bernhardt, *supra* at §6.16; *see also* *Barclays Bank v Superior Court, supra*.

C. Additional Grounds For Receivership

The beneficiary has additional remedies for obtaining possession before or during foreclosure absent a rents and profits clause. *See* Bernhardt, *supra* at §6.17. In particular, Cal. Civ. Code §2929.5 and Cal. Code. Civ. Proc. §564(c) permit the appointment of a receiver for the limited purpose of inspecting for hazardous substances. *See* Bernhardt, *supra* at §6.17. This particular receivership provision, however, is very narrow, infrequently invoked, and by no means a satisfactory alternative to a broadly worded assignment of rents clause. *See* Bernhardt, *supra* at §6.17.

D. Liability For Receiver's Conduct

Provided that there is no conspiracy or inappropriate control over the receiver, the beneficiary is not liable for the receiver's behavior and is not charged with mortgagee-in-possession status by virtue of the receivership. *See* Bernhardt, *supra* at §§ 6.8; 6.18; *see also* *Tourny v Bryan* (1924) 66 Cal. App. 426. The beneficiary, however, may be responsible for any shortfall in administrative expenses. *See* Bernhardt, *supra* at §§ 6.8; 6.18; *see also* *Ephraim v Pacific Bank*, (1900) 129 Cal. 589, 592, cited with approval by the United States Supreme Court in *Atlantic Trust Co. v Chapman*, (1908) 208 US 360, 373, 52 L Ed 528, 534, 28 S Ct 406.

IV. Conclusion

In conclusion, a lender or creditor's rights to possession and rents are strongest where there is an assignment of rents provision included in the loan documents. To the

extent that a lender or creditor finds itself in a position where its loan documents do not contain an assignment of rents provision, this article provides some helpful alternative approaches for consideration.

ABOUT THE AUTHOR

Terrance J. Evans is a partner in the Trial Practice Group of Duane Morris in San Francisco. He concentrates his practice in representing the financial services industry, which includes international, national and community banks; loan service companies; and insurance companies. During his career, Mr. Evans has both recovered and saved clients of the firm tens of millions of dollars in settlements, judgments and extrajudicial procedures.

Mr. Evans has represented international, national and community banks and loan service companies in complex commercial litigation and various secured transactions, including commercial and residential nonjudicial foreclosures; unified foreclosures; judicial foreclosures; creditor's rights issues, which includes obtaining relief from stay in various bankruptcy courts; mechanics' lien lawsuits; stop notice claims; abatement issues; priority contests; RESPA claims; forbearance agreements; municipality disputes; transfer tax disputes; property tax disputes; short sales; loan purchase and sale agreements; predatory lending claims; discriminatory lending claims; Fair Debt Collection Practices Act claims; and many other issues.

Mr. Evans has been recognized both locally and nationally for his professional accomplishments. In 2010 and 2008, Mr. Evans was honored by the American Business Trial Lawyers of Northern California for his dedication and professionalism. In addition, he was named one of the top 100 minority associates in the United States for 2007 by the Stakeholder Organization. Mr. Evans has also received special honors from the NAACP, the Congressional Black Caucus, the 100 Black Men of Los Angeles, the Young Black Scholars Program, the Black Women Lawyers Association of Los Angeles, the American Legion and many other organizations.

Mr. Evans' contact information is provided below:

Terrance J. Evans, Esq.

Duane Morris LLP
One Market Plaza, Spear Tower Suite 2200
San Francisco, CA 94105-1127
Phone: 415-957-3000
Email: tjevans@duanemorris.com

THANK YOU

for choosing NBI for your
continuing education needs.

Please visit our website at
www.nbi-sems.com
for a complete list of
upcoming learning opportunities.

NBI | NATIONAL
BUSINESS
INSTITUTE™