

# SERVICING MANAGEMENT

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## Strict Trust Deed Servicing

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**S**ervicers of trust deed loans subject to California law should take note of the strict nature of legislation in the state. Specifically, California requires that prompt and accurate payoff demand statements be provided to persons entitled to receive them, and that the note and deed of trust be properly and promptly reconveyed upon payoff.

The consequences of not following these requirements could result in forfeiture of important rights, damages and even criminal penalties.

California Civil Code (all citations refer to this code, unless stated otherwise) Section 2943(c) states: "A beneficiary or his or her authorized agent shall, on the written demand of an entitled person or his or her authorized agent, prepare and deliver a payoff demand statement to the person demanding it within 21 days of the receipt of the demand."

An "entitled person" means the trustor, a junior trust deed holder, their successors or assigns or an escrow (§2943(a)(4)). "A payoff demand statement" means a written demand statement prepared in response to a written demand made by an entitled person setting forth the amounts required to fully satisfy all obligations secured by the loan that is the subject of the payoff demand statement (§2943(a)(5)).

If a beneficiary intentionally and without good cause fails to deliver a payoff statement to an entitled person within 21 days following

demand, the beneficiary is liable to the entitled person for all damages such person may sustain due to such refusal and the beneficiary must pay \$300 to the entitled person (§2943(e)(4)).

### Consequences

A payoff demand statement that understates the true debt can have dire consequences. This is because a "payoff statement may be relied upon by an entitled person ... in accordance with its terms for the purpose of establishing the amount to pay off the obligation in full" (§2943(d)(1)). "The entitled party ... may rely upon the statement upon the earlier of (i) the close of escrow, (ii) transfer of title, (iii) recordation of a lien" (§2943(d)(3)(a))."

A beneficiary or servicer who realizes the payoff statement erroneously understates the true debt may correct the error by verbally notifying the entitled party and providing an amended written statement within one business day thereafter.

But this must be done before the three dates specified in the code,

after which the beneficiary must reconvey the note and deed of trust upon receipt of the sum specified in the payoff demand. This means the portion of the debt that exceeds the sum in the erroneous payoff statement is converted from a secured to an unsecured obligation.

In such case the beneficiary's only legal remedy is to sue on the unsecured obligation.

Suit on an unsecured obligation is a far less preferable remedy than the opportunity to foreclose on a secured obligation. It is, nevertheless, a valuable remedy. After obtaining judgment, the beneficiary may record an abstract of judgment that will attach to all real property the debtor owns.

This may be a particularly effective remedy with respect to commercial property because deeds of trust on commercial property frequently require the trustor to keep the property free of all liens regardless of their priority.

### Damages

Can an entitled person require a beneficiary to reconvey the deed of trust or hold the beneficiary liable for damages due to an erroneously low payoff statement to an entitled person where the beneficiary recognizes and corrects the error before the three dates specified in §2943?

It is doubtful the entitled person could succeed in such a case. The courts would likely hold that the detailed procedures in §2943, *supra*, "occupy the field" and prescribe the

only available remedies regarding payoff statements. California procedural provisions of the foreclosure statute bar claims based upon common law negligence theories and provisions of the commercial code bar claims based upon equitable theories.

### ***Proper execution***

“A recorded mortgage must be discharged by a certificate signed by the mortgagee, his personal representative or assigns, ... stating that the mortgage has been paid, satisfied or discharged” (§2939). The certificate of discharge, commonly known as a reconveyance, must be recorded in the county where the deed of trust was recorded.

If this is not properly executed, it will not be effective when recorded, since under California law it would not be in the chain of title and does not give constructive notice even though it is recorded.

In consequence, an improperly recorded reconveyance could adversely impact the priority of subsequent lien holders and subject the beneficiary under the deed of trust identified in the improperly

recorded reconveyance to significant damages.

Under present California law, the only remedy for an improperly recorded reconveyance is a quiet title action. Attempts by the California Trustee’s Association to permit trustees to unilaterally rescind defective recorded reconveyances have been rebuffed in the California legislature.

After the note and deed of trust are paid off, the beneficiary must deliver the original note, deed of trust, deed of trust for request for reconveyance and recording fees to the trustee under the deed of trust. Within 21 days after receiving these documents the trustee must record the reconveyance and deliver the original note to the borrower.

If the reconveyance has not been recorded within 60 days after the payoff, upon the trustor’s written request, the beneficiary must substitute himself as trustee and record the reconveyance. If not recorded within 75 days after pay off, any title company may prepare and record a release of the obligation (§2941(b)).

A person who violates any of these provisions is required to pay the person affected by the violation for

all damages, which could include emotional distress, and the sum of \$300.

In addition, a beneficiary may be liable for attorney fees and costs under the attorney fee provisions in the note and deed of trust.

Also, a violator may face a fine of \$400 plus six months’ imprisonment in the county jail (§2941.5).

California laws with regard to payoffs and reconveyances create substantial risks for today’s mortgage industry. Deeds of trust are usually assigned and often repeatedly reassigned, and beneficiaries use servicers, subservicers and reconveyance and document tracking companies.

A failure by anyone in the chain to handle a payoff or reconveyance properly and timely can expose such person and others in the chain to significant adverse consequences.

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