

DIRT Periodic Development for Thursday, September 12, 2013
Eastern Sav. Bank, FSB v. CACH, LLC

Guest Editor: Dale Whitman
Professor of Law Emeritus
University of Missouri School of Law

Eastern Sav. Bank, FSB v. CACH, LLC, 55 A.3d 344 (Del. Supreme Ct. 2012)

SYNOPSIS: The holder of a judgment lien is entitled to have its judgment satisfied out of the proceeds of a foreclosure sale of a subordinate mortgage on the property.

All of us are familiar with the fundamental idea that a foreclosure of a mortgage or other lien wipes out all subordinate liens and other subordinate interests, provided that their holders are made parties to the foreclosure proceeding. On the other hand, liens and other interests superior in priority to the mortgage being foreclosed are unaffected; they remain on the property, and their holders have no claim on the foreclosure proceeds.

Maybe. But there are exceptions, and this case illustrates one. It holds that when a mortgage is foreclosed in Delaware, all senior liens other than mortgages are wiped out, and their holders can claim the foreclosure proceeds in the order of their priority.

FACTS: Aaron Johnson defaulted on a car loan from CACH. CACH obtained a judgment against Johnson on December 7, 2006 in the Court of Common Pleas. CACH transferred the judgment to Superior Court and got a judgment lien on Johnson's house on December 21, 2006. Meanwhile, Johnson re-titled his property in himself and his wife as tenants by the entirety on December 19, 2006. They obtained a \$168,000 mortgage from Eastern Savings, which was recorded on December 29, 2006. After they defaulted on their mortgage payments, Eastern Savings filed a foreclosure action on August 26, 2008. CACH notified Eastern Savings of their senior judgment lien in the amount of \$16,000. The house was sold at foreclosure in April 2009 for \$133,000; all of the proceeds went to Eastern, despite requests for payment by CACH. CACH filed a complaint in the Court of Common Pleas for misappropriation of funds and unjust enrichment. Eastern Savings won a motion to dismiss for failure to state a claim. CACH appealed to the Superior Court and won. Eastern Savings appealed to the Supreme Court.

10 Del.C. § 4985 provides "Real estate sold by virtue of execution process [a sheriff's sale, including a mortgage foreclosure] shall be discharged from all liens thereon against the defendant ... except such liens as have been created by mortgage or mortgages prior to any general liens." The court held that "all" meant "all," including liens *senior* to the lien being foreclosed. This was consistent with old Delaware

precedent. An 1841 case, Farmers' Bank v. Wallace, held that foreclosure of a junior judgment lien discharged a senior judgment lien. An 1880 case, Sharpe v. Tatnall, held that foreclosure of a junior mortgage discharged a senior mechanic's lien.

COMMENTS: The traditional common law rule does not allow a foreclosing junior lienholder to force a senior lienholder into foreclosure. This is ordinarily a beneficial rule for the senior; its holder can determine the timing of its foreclosure, and not be forced into foreclosure at a time selected by another party and judged inopportune by the senior holder. In other words, the senior holder remains in control of the timing of its foreclosure.

There is a downside to the traditional rule. Bidders at the foreclosure of a junior lien are subject to a potential trap. They must discount or reduce the amounts of their bids by the amount owing on the senior lien, for as a practical matter the successful bidder at the junior foreclosure sale will have to pay off the senior lien later. But sometimes inexperienced bidders do not realize this, or do not recognize that the foreclosure sale at which they are bidding is a sale based on a junior lien. They may bid the full value of the property, without discounting their bids to take the amount of the senior lien into account. In effect, they have paid too much, and the courts usually won't order their money refunded or set the sale aside. (This is one of the reasons that people who watch late-night infomercials on TV should not go to foreclosure sales.) See *Ostayan v. Serrano Reconveyance Co.*, 92 Cal.Rptr.2d 577 (Cal. Ct.App. 2000) (neither the lender nor the trustee conducting the foreclosure sale were liable for failing to warn a bidder that the lien of the deed of trust being foreclosed was subordinate to another deed of trust); *Mann v. Household Finance Corp.*, III, 35 P.3d 1186 (Wash. App. 2001) (same).

The Delaware approach does a couple of things. (1) It eliminates (in part) the trap for bidders just described. (I say "in part" because the Delaware statute only applies to non-mortgage senior liens; senior mortgages are not wiped out.) (2) It also eliminates the senior lien-holder's discretion as to the timing of its foreclosure. It can be forced into foreclosure by the actions of a junior lien-holder.

I think this is a poor idea. It seems to me that one of the good things about having a senior position is that you're in control of your timing, and I see no reason to allow a junior lienholder to take that discretion away from you.

There seems to be no important policy to be served by Delaware's rule. It is true that it results in reducing the number of liens on property (since the senior lien in a case like this is eliminated), but it's not apparent to me why this is a particularly desirable effect. It provides a modest bit of protection to naïve foreclosure sale purchasers, but such people have no business at foreclosure sales anyway; there are too many other ways that they can be burned.