CURING TITLE DEFECTS DURING FORECLOSURE

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This article will discuss title defects that can come up during foreclosures in the State of Washington, as well as various approaches to cure those defects so that the foreclosure can continue. In the context of foreclosures, title defects tend to have a couple of common and recurring facts:

(1) The event that caused the title defect took place several years before it was discovered.

(2) More often than not, the lender looking to foreclose is often not the same lender that originated the loan with the defective title documents. In some cases, this is because the title defect has carried over from loan to loan in a series of refinances. In other cases, it is because the original lender sold the loan and/or is out of business and the loan is now owned by a successor entity.

(3) The borrower is not available and/or is not cooperating. In some cases involving residential properties, the borrower has simply moved away and has no interest in dealing with the property anymore.

Because of these common facts, it can be difficult to get access to documents and other evidence from the time when the title defect first was created. This will often dictate which of the options discussed below are even available to an attorney looking to cure the defect so that the foreclosure can continue.

1. Paid Prior Liens.

On occasion, a trustee's sale guaranty or litigation guaranty will show a prior mortgage loan that was paid off years ago. If the prior mortgage loan was indeed paid off, the fix can be relatively simple.

Washington law requires lenders to release their mortgages when the loan secured by those instruments has been paid in full:

> Whenever the amount due on any mortgage is paid, the mortgagee or the mortgagee's legal representatives or assigns shall, at the request of any person interested in the property mortgaged, execute an instrument in writing referring to the mortgage by the volume and page of the record or otherwise sufficiently describing it and acknowledging satisfaction in full thereof.[1]

Failure to provide a satisfaction or lien release can expose the lender to a claim for damages and attorney fees:

> If the mortgagee fails to acknowledge satisfaction of the mortgage as provided in RCW 61.16.020 sixty days from the date of such request or demand, the mortgagee shall forfeit and pay to the mortgagor damages and a reasonable attorneys' fee … .[2]

The borrower would also be entitled to an order quieting title:

> … said court, when convinced that said mortgage has been fully satisfied, shall issue an order in writing, directing the auditor to immediately record the order.[3]

The Deed of Trust Act, Chapter 61.24 RCW, has similar language. It requires the trustee to reconvey the deed of trust when the obligation has been paid and the trustee has received a request for reconveyance from the beneficiary:

> The trustee of record shall reconvey all or any part of the property encumbered by the deed of trust to the person entitled thereto on written request of the beneficiary, or upon satisfaction of the obligation secured and written request for reconveyance made by the beneficiary or the person entitled thereto.[4]

However, that does not always happen. In some cases, the request for reconveyance is never submitted as part of a refinance, leaving the deed of trust of record even though the secured obligation was paid off. By the time this is discovered, usually in the context of a subsequent refinance or foreclosure of a later mortgage loan, the prior lender may no longer be available. These days, the typical reason would be that the prior lender went out of business in the Great Recession that started in or about 2008. And it is not always the case that there is a

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[1] RCW 61.16.020.

[2] RCW 61.16.030.

[3] RCW 61.16.030

[4] RCW 61.24.110(1).

clearly identifiable successor-in-interest to the prior lender's interest in the deed of trust that remains of record.

The Deed of Trust Act was amended in 2013 to account for these situations. It now authorizes title insurance companies, title insurance agents and attorneys, subject to certain qualifiers, to submit a request for reconveyance to the trustee if the beneficiary is not available to do it:

> If the beneficiary fails to request reconveyance within the sixty-day period specified under RCW 61.16.030 and has received payment as specified by the beneficiary's demand statement, a title insurance company or title insurance agent as licensed and qualified under chapter 48.29 RCW, a licensed escrow agent as defined in RCW 18.44.011, or an attorney admitted to practice law in this state, who has paid the demand in full from escrow, upon receipt of notice of the beneficiary's failure to request reconveyance, may, as agent for the person entitled to receive reconveyance, in writing, submit proof of satisfaction and request the trustee of record to reconvey the deed of trust.[5]

The Deed of Trust Act also addresses situations where the trustee is unable or unwilling to reconvey the deed of trust. In those cases, the act authorizes title insurance companies, title insurance agents, escrow agents, and attorneys to record a notarized declaration of payment:

> If the trustee of record is unable or unwilling to reconvey the deed of trust within one hundred twenty days following payment to the beneficiary as prescribed in the beneficiary's demand statement, a title insurance company or title insurance agent as licensed and qualified under chapter 48.29 RCW, a licensed escrow agent as defined in RCW 18.44.011, or an attorney admitted to practice law in this state may record with each county auditor where the original deed of trust was recorded a notarized declaration of payment. The notarized declaration must: (i) Identify the deed of trust, including original grantor, beneficiary, trustee, loan number if available, and the auditor's recording number and recording date; (ii) state the amount, date, and name of the beneficiary and means of payment; (iii) include a declaration that the payment tendered was sufficient to meet the beneficiary's demand and that no written objections have been received; and (iv) be titled "declaration of payment."[6]

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[5] RCW 61.24.110(2).

[6] RCW 61.24.110(3)(a).

The beneficiary and trustee of record must be given notice of the declaration of payment, but if they fail to object within 60 days of recording, the lien of the deed of trust is considered released:

> A copy of the recorded declaration of payment must be sent by certified mail to the last known address of the beneficiary and the trustee of record not later than two business days following the date of recording of the notarized declaration. The beneficiary or trustee of record has sixty days from the date of recording of the notarized declaration to record an objection. The objection must: (i) Include reference to the recording number of the declaration and original deed of trust, in the records where the notarized declaration was recorded; and (ii) be titled "objection to declaration of payment." If no objection is recorded within sixty days following recording of the notarized declaration, any lien of the deed of trust against the real property encumbered must cease to exist.[7]

2. Unpaid Prior Liens

2.1. The Wrong Loan Was Paid Off.

The following is a common scenario in cases involving unpaid prior liens:

> Borrower has two mortgage loans from the same lender. Each loan is secured by a different property. The borrower intends to refinance the loan on property no. 1. As part of that refinance, however, the loan on property no. 2 is paid off (or down) by mistake. As a result, the original lender's deed of trust on property no. 1 remains in place and the refinance lender finds itself in a junior lien position.

Usually, this mistake is not discovered until years later, when the borrower defaults on the refinance loan and the lender's foreclosure counsel gets a trustee's sale guaranty or litigation guaranty which shows the prior deed of trust in place.

Most lenders in these situations should have title insurance coverage for these situations. If the intent of the parties to the refinance was to pay off the loan on property no. 1, the prior deed of trust—the one that was supposed to be paid—would not be shown on the lender's loan policy of title insurance. So the first thing for lenders who find themselves in this situation to do is to submit a claim on their title policy.

As far as correcting the situation, lenders now have access to a fairly robust remedy in the form of equitable subrogation. In the early 2000s, there was some doubt as to whether this

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[7] RCW 61.24.110(3)(b).

remedy was available to lenders covered by title insurance due to the unfortunate decision in *Kim v. Lee*.[8] However, the Washington Supreme Court has severely limited and all but overruled *Kim v. Lee* in *Bank of America v. Prestance Corporation*[9] and its progeny, including *Columbia Community Bank v. Newman Park, LLC*.[10] As a result of these decisions, today's lenders who find themselves behind a prior deed of trust they thought they had paid off should have ready access to equitable subrogation, assuming the elements of that doctrine are met of course.

2.2. Home Equity Lines of Credit

Unpaid home equity lines of credit (HELOC) present a different type of problem. To properly close a home equity line of credit, the balance must be paid off and the account closed by the lender. That does not always happen, however. In some cases, the lender and/or escrow pays down the HELOC balance to zero, but neglects to ensure that the account is closed and that the deed of trust securing the HELOC is reconveyed.

Typically, this mistake then goes undiscovered for years, until the borrower defaults on the refinance loan. At that point, the refinance lender is hit with the unpleasant news that the HELOC lien is still there. And more often than not, the borrower has continued to draw on the HELOC (innocently or not), which by the time the refinance lender is about to foreclose has a significant balance owed.

The doctrine of equitable subrogation should be available to refinance lenders who find themselves behind a HELOC they though they paid off. Also, the lender should have a claim under its loan policy of title insurance, and possibly a claim against the escrow agent (which should be insured for errors like this) assuming the error was caused by the escrow company.

2.3. Construction Liens

Construction liens, traditionally referred to as mechanic's liens or materialmen's liens, are creatures of statute. They have no basis in common law or equity. Washington's construction lien statute is codified at Chapter 60.04 RCW.

Since the construction lien statute is in derogation of common law, it is strictly construed, at least as far determining whether a lien has attached to a particular piece of property. The construction lien statute sets up a number of notice, claim and foreclosure requirements, which

[8] 145 Wn.2d 79, 31 P.3d 665.

[9] 160 Wn.2d 560, 160 P.3d 17 (2007) (adopting portions of Restatement (Third) of Property (Mortgages) § 7.6, under which a refinancing mortgagee's actual or constructive knowledge of intervening liens does not automatically preclude a court from applying equitable subrogation).

[10] 177 Wn.2d 566, 304 P.3d 472 (2013) (explicitly adopting Restatement (Third) of Property (Mortgages) § 7.6 in full and rejecting the "volunteer rule" as a bar to equitable subrogation).

must be strictly complied with in order to sustain a construction lien claim.[11] Once those requirements have been satisfied, however, the statute is broadly construed to protect those that come within its protection.[12]

The priority of a construction lien vs. a mortgage is not determined by the recording date, as usually is the case with recorded interests. Instead, the priority of a construction lien vs. a mortgage is determined by the date the lien claimant started work or first delivered materials to the project vs. the recording date of the mortgage.[13] If the lien claimant started work or first delivered materials to the project before the mortgage was recorded, the construction lien is senior and superior to the mortgage even though the claim of lien was recorded after the mortgage (assuming the lien claimant has met all the requirements to claim a lien).

2.3.1 *Release of Lien Bond*

One option available to lenders who find themselves behind construction liens is to post, or have their borrower post, a release of lien bond.

The construction lien statute allows the owner or any other interested party to post a release of lien bond to release the underlying real property from the lien claim. If the claim of lien is for $10,000 or less, the amount of the lien bond must be the greater of $5,000 or two times the lien amount. If the claim of lien is for more than $10,000, the amount of the lien bond must be one-and-a-half times the lien amount. The statute also allows the parties to work out some other arrangement to provide alternate security or collateral for the lien claim.[14]

Once a release of lien bond is posted, the lien is effectively transferred to the bond, which means it's no longer an impediment to the lender foreclosing on its collateral.[15] This also means that the property owner is not a necessary party in a construction lien foreclosure against the release of lien bond.[16]

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[11] *E.g.*, *Dean v. McFarland*, 81 Wn.2d 215, 219-20, 500 P.2d 1244 (1972) ("A lien of the type involved here is a creature of statute and is in derogation of the common law. As such, it must be strictly construed to determine whether a lien attaches. The statutory operation is not to be extended for the benefit of those who do not clearly come within the terms of the statute.").

[12] RCW 60.04.900; *Kinnebrew v. CM Trucking & Const., Inc*., 102 Wn. App. 226, 231, 6 P.3d 1235 (2000) ("Lien statutes should be liberally construed to protect those within the scope of the statute.")

[13] RCW 60.04.061.

[14] RCW 60.04.161.

[15] *CalPortland Co. v. LevelOne Concrete LLC*, ___ Wn. App. ___, 321 P.3d 1261 (2014).

[16] *Id.*

2.3.2 *Frivolous Lien Action.*

Another option available to lenders whose foreclosures are caught up in a construction lien claim may be to challenge the lien claim head-on.

The construction lien statute provides for a summary procedure to get rid of frivolous liens, or reduce liens that are clearly excessive. The owner or any interested party, which would include a lender, can make a motion in the superior court where the property is located for an order to show cause requiring the lien claimant to show why the lien is not frivolous or clearly excessive.[17] This can be done as part of an ongoing foreclosure lawsuit, or as a separate mini-lawsuit if no action to foreclose has been filed.[18]

If, following a hearing, the court determines that the lien is frivolous, the court will issue an order releasing the frivolous lien. If the court determines that the lien is clearly excessive, the court will issue an order reducing the amount of the lien. In either case, the lien claimant is liable for the moving party's costs and attorney fees. Conversely, if the lien claimant is successful—that is, if the lien is neither frivolous nor excessive—the moving party is liable for the lien claimant's costs and fees.[19]

These proceedings are in the nature of a trial by affidavit.[20] The decision is based on written submissions. There is no live testimony.

In theory, the burden of proof is supposed to be shifting. First, the moving party must present affidavits or declarations explaining why the lien is frivolous or excessive. Then the burden shifts to the lien claimant to present a *prima facie* case for its lien. The burden then shifts back to the moving party to prove that the lien was frivolous or excessive when filed.[21]

From a practical standpoint, however, the burden of proof rests squarely on the moving party—at least as far as declaring a lien frivolous. Courts are very reluctant to declare liens frivolous. A lien is not frivolous merely because it is invalid; it has to be so invalid as to be "beyond legitimate dispute".[22]

2.3.3 *Equitable Subrogation*

Under the right circumstances, equitable subrogation should be available to lenders who find themselves in a priority dispute with one or more construction lien claimants. This is

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[17] RCW 60.04.081.

[18] RCW 60.04.081(3).

[19] RCW 60.04.081(4).

[20] *Andries v. Covey*, 128 Wn. App. 546, 113 P.3d 483 (2005).

[21] *Williams v. Athletic Field, Inc*., 142 Wn. App. 753, 139 P.3d 426 (2006).

[22] *Intermountain Elec., Inc. v. G-A-T Bros. Constr., Inc*., 115 Wn. App. 384, 62 P.3d 548 (2003).

particularly the case for lenders who financed the construction itself, and as part of that loan refinanced out an earlier acquisition lender. In those cases, construction lien claimants who began work *after* the acquisition loan but *before* the construction loan would get a windfall if they could claim priority over the construction lender. But for the construction loan, the lien claimants would have been junior to the acquisition loan and the only reason the acquisition loan is no longer there is because the construction lender paid it off. Under these facts, it would not be inequitable to give the construction lender the priority position previously held by the acquisition lender.

However, that does not necessarily mean the entire construction loan amount would be senior and superior to the lien claimants. If the construction lender is paying off the acquisition lender in addition to funding construction, the construction loan will obviously be larger than the acquisition loan. Although there is no Washington case law directly on point, most courts would probably "split up" the construction lender's priority, giving the construction lender priority over the lien claimants to the extent of funds used to refinance out the acquisition loan, but leaving the construction lender behind the lien claims for the rest of the construction loan.

3. <u>Scrivener's Errors</u>

A scrivener's error is one where the instrument fails to reflect the parties' true intent.[23] A common scenario in the context of foreclosures is a deed of trust which describes some but not all of the real property offered as collateral. For example, the collateral consists of three parcels, Parcels A, B, and C, but the deed of trust only contains a legal description of Parcel A. Lenders facing this situation have a number of options available to them, depending on what caused the error and the level of cooperation from the borrower.

3.1. <u>Curative Instrument</u>

The most simplest solution is often to prepare and record a curative instrument, such as an amended or new deed of trust with the correct and complete legal description. This obviously requires the cooperation of the borrower, which often isn't available seeing how the borrower is facing foreclosure.

However, Washington law provides two mechanisms to have curative instruments executed without the borrower's cooperation. One is RCW 6.28.010, which gives courts authority to appoint a commissioner to execute the instrument:

[23] *E.g.*, *Glepco, LLC v. Reinstra*, 175 Wn. App. 545, 307 P.3d 744 (2013).

> The several superior courts may, whenever it is necessary, appoint a commissioner to convey real estate:
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> (1) When by a judgment in an action, a party is ordered to convey real property to another, or any interest therein.
>
> (2) When real property, or any interest therein, has been sold under a special order of the court and the purchase money paid therefor.

Another, more modern and perhaps more useful mechanism is CR 70, which seems to provide for essentially the same thing, only it authorizes the court to appoint any person, not just a commissioner, to execute the instrument:

> If a judgment directs a party to execute a conveyance of land or to deliver deeds or other documents or to perform any other specific act and the party fails to comply within the time specified, the court may direct the act to be done at the cost of the disobedient party by some other person appointed by the court and the act when so done has like effect as if done by the party. …

3.2. Reformation

Reformation an equitable remedy that brings a writing that is materially different from the parties' agreement into conformity with that agreement.[24] A party seeking reformation must prove the facts supporting it by clear, cogent, and convincing evidence.[25] Since deeds of trust and mortgages are forms of contract, the parties' intent is determined by " 'by viewing the contract as a whole, the subject matter and objective of the contract, all the circumstances surrounding the making of the contract, the subsequent acts and conduct of the parties to the contract, and the reasonableness of respective interpretations advocated by the parties.' "[26]

Referring back to the scenario laid out above, if the evidence shows that the borrower and lender intended all three parcels (A, B and C) to be the collateral, the lender should be entitled to a decree reforming the deed of trust to describe all three parcels. Once that decree is in place, the foreclosure can proceed.

Another scenario is one where the deed of trust describes the wrong property, the borrower does not own or have any interest in at all. In that case, establishing the mistake and

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[24] *Denaxas v. Sandstone Court of Bellevue, L.L.C.*, 148 Wn.2d 654, 63 P.3d 125 (2003).

[25] *Akers v. Sinclair*, 37 Wn.2d 693, 226 P.2d 225 (1950).

[26] *Berg v. Hudesman*, 115 Wn.2d 657, 801 P.2d 222 (1990) (quoting *Stender v. Twin City Foods, Inc.*, 82 Wn.2d 250, 510 P.2d 221 (1973)).

scrivener's error is relatively straightforward, and the lender should have access to a reformation action to correct its deed of trust.

Sometimes, the mistake is not discovered until after the foreclosure has already taken place. In those cases, the reformation action should be aimed at the deed from the foreclosure (trustee's deed or sheriff's deed depending on whether the foreclosure was nonjudicial or judicial). In other words, there is no need to undo the foreclosure, have the court reform the erroneous deed of trust/mortgage, and then redo the foreclosure with the correct legal description. Assuming the evidence supports a reformation action to begin with, the court can simply reform the trustee's deed or sheriff's deed itself.[27]

A scenario that can be more difficult is one where the error is more of a surveying error than an error in the legal description. The following scenario illustrates the problem:

> Borrower owns two adjacent parcels, A and B. Borrower applies for a mortgage loan and offers his or her home as collateral, which both the borrower and lender believe is on parcel A. Unbeknownst to the parties, however, the single-family home is actually on parcel B, which the parties believe is vacant.

These facts should support a claim for reformation by the lender. If the lender and borrower intended the single-family home lot to be the collateral, then a court should have little difficulty reforming the deed of trust to describe parcel B instead of parcel A.

However, what if parcel B contains additional improvements by the time the mistake is discovered? What if the borrower improved parcel B after the loan was taken out, thinking it was free and clear from the mortgage loan the borrower thought was secured by parcel A? For example, what if the borrower started and built up a business on parcel B that has no relation to the mortgage loan?

Under those facts, the lender's reformation action is probably less certain. Reformation is after all an equitable remedy.

4. <u>Unrecorded or Improperly Attested Mortgages and Deeds of Trust</u>

As a general rule, an unrecorded or improperly attested mortgage or deed of trust is still valid as between the borrower and the lender. If there are no intervening liens, the fix may be as simple as recording the instrument.

A recorded but improperly attested mortgage or deed of trust will still give notice to the world of the lender's claim of lien against the property described in the instrument:

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[27] *Glepco, LLC v. Reinstra*, 175 Wn. App. 545, 307 P.3d 744 (2013).

> An instrument in writing purporting to convey or encumber real estate or any interest therein, which has been recorded in the auditor's office of the county in which the real estate is situated, although the instrument may not have been executed and acknowledged in accordance with the law in force at the time of its execution, shall impart the same notice to third persons, from the date of recording, as if the instrument had been executed, acknowledged, and recorded, in accordance with the laws regulating the execution, acknowledgment, and recording of the instrument then in force.[28]

It has been suggested that subsequent parties are at least on inquiry notice if they come across a recorded but improperly attested document.[29]

The "missed spouse" is a one example of an improperly attested mortgage or deed of trust. As a general rule, both spouses must sign the instrument if the collateral is community property.[30] If the collateral is the separate property of one of the spouses, the other spouse should ideally sign a quit claim deed at the time of recording the mortgage or deed of trust to make sure the mortgage loan is senior and superior to any community lien acquired by the community after the loan is made.

However, the non-signing spouse can be held to have ratified the mortgage transaction if he or she knew about it (or at least had ready access to information about it) yet failed to repudiate it.[31] In those cases, the lender could seek a declaratory judgment declaring the mortgage loan to be a community obligation even though both spouses did not sign the instrument.

5. <u>Break in the Chain of Title</u>

On occasion, a foreclosure will bring to light a break in the borrower's chain of title. That is, the borrower does not have record title to some of the property offered as collateral, even though the borrower has acted as the owner, and been taxed as the owner, of that portion for many years. For example, a portion of the borrower's property may be "stuck" in the heirs or estate of a prior owner due to an erroneous legal description.

In those cases where the heirs can be located, the fix may be as simple as a curative instrument. In other cases, it may require a quiet title lawsuit, perhaps combined with a claim for declaratory relief to correct an erroneous legal description. If not all heirs can be identified and

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[28] RCW 65.08.030.

[29] 18 WASH. PRAC., REAL ESTATE § 14.8, *Effect of recording* (2014 2d ed.)

[30] RCW 26.16.030(3).

[31] E.g., *Klaas v. Haueter*, 49 Wn. App. 697, 745 P.2d 870 (1987).

located, Washington law allows for lawsuits against unknown heirs[32] as well as lawsuits against unknown claimants.[33]

However, in a relatively recent unpublished decision, the Washington Court of Appeals suggested that lenders do not have standing to bring quiet title actions involving properties they do not own or have the right to possess. In *GMAC Mortgage, LLC v. City of Spokane*,[34] the lender (GMAC) brought a quiet title action against another lender (the city) claiming that the city's deed of trust, which was recorded before GMAC's deed of trust, was no longer enforceable. The court of appeals dismissed the case because the lender could not prove that it had a right to possession of its collateral—the lender had not foreclosed by the time it started its quiet title action. The court also rejected several other arguments by the lender, and ultimately entered a decision confirming that the city's deed of trust was in the first lien position, ahead of GMAC.

6. Tax Liens

6.1. Property Tax Liens

In Washington State, all real and personal property is subject to tax unless specifically exempted by law.[35] (This article will only address property tax applied to real property.)

According to the Department of Revenue, property tax accounts for 30% of total state and local taxes.[36] It is the most important source of revenue for public schools, fire protection, libraries, and parks and recreation districts. The various taxing districts determine the amount needed, after which the county assessor calculates the tax rate necessary to raise that money. The amount of property tax due on a particular piece of property is based on the combination of tax rates and the assessed value of the property.[37]

Taxes assessed on real property automatically become a lien against that property when levied.[38] The lien attaches on January 1 of the year in question, and continues until paid. (By its silence, the statute suggests that nothing more is needed to perfect the lien.)

Tax liens have priority over just about every other interest in the property. That includes mortgages, deeds of trust, and liens that were recorded before the tax lien arose. Lenders may

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[32] RCW 4.28.140.

[33] RCW 4.28.150.

[34] 2013 WL 3148224 (Wn. App. June 18, 2013).

[35] Wash. Const. art. VII, § 1.

[36] http://dor.wa.gov/content/FindTaxesAndRates/PropertyTax. *See also* Homeowner's Guide to Property Taxes available at http://dor.wa.gov/docs/Pubs/Prop_Tax/HomeOwn.pdf.

[37] http://dor.wa.gov/content/FindTaxesAndRates/PropertyTax.

[38] RCW 84.60.010, .020.

protect against this by requiring a reserve or escrow account be set up to pay taxes, having the tax statements send to themselves, and/or by paying the taxes directly and adding that amount to the amount owed.

After three years' of delinquency, the county prosecutor files a Certificate of Delinquency for all taxes owed plus interest and costs.[39] This has the same effect as a lis pendens.[40]

The foreclosure is carried out by the county treasurer by filing the Certificate of Delinquency in the superior court, with the legal assistance of the prosecuting attorney.[41] Notice and summons is given to the owner and any person claiming an interest in the property.[42]

The foreclosure proceedings are summary in nature. The court examines the treasurer's application for judgment and any defenses offered, and issues a decision without further pleadings—although, the court has discretion to continue the matter in the interest of "substantial justice".[43]

Assuming defenses are either non-existent or insufficient, the court will issue an order authorizing the treasurer to sell the property.[44] The treasurer then sells the property at auction to the highest bidder.[45] Notice of the sale must be posted in three public places in the county, one of which is the treasurer's office, for ten consecutive days.[46] The acceptable minimum bid is the total amount of taxes, interest, and costs set out in the judgment.[47] Any excess funds are refunded to the record owner, less payment of all recorded water-sewer district liens.[48]

At the conclusion of the sale, the treasurer issues a tax deed to the successful bidder.[49] The tax deed is prima facie evidence that the tax foreclosure was proper.[50] It also acts as judicial estoppel, preventing a challenge based on defenses that existed before judgment was entered—

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[39] RCW 84.64.050. For a detailed discussion of tax foreclosures in Washington, see Randall Thomsen, *Washington State Property Tax Foreclosures: Quoerere Dat Sapere Quoe Sunt Legitima Vere*, 32 GONZ. L. REV. 123 (1996-97).

[40] RCW 84.64.050(4).

[41] RCW 84.64.050.

[42] RCW 84.64.050.

[43] RCW 84.64.080.

[44] RCW 84.64.080.

[45] RCW 84.64.080.

[46] RCW 84.64.080.

[47] RCW 84.64.080.

[48] RCW 84.64.080. No excess is refunded when the county obtains title at the sale and then resells the property. *King County v. Odman*, 8 Wn.2d 32, 37-38, 111 P.2d 228, 230 (1941).

[49] RCW 84.64.080.

[50] RCW 84.64.180.

with two notable exceptions: that the tax has been paid, or that the property was not liable for the tax.[51]

6.2. Federal Tax Liens

Federal tax liens are governed by the Internal Revenue Code, which supersedes state law in this area. Unpaid taxes automatically become a lien on all the taxpayer's property.[52] The lien attaches when taxes are assessed and continues until taxes are paid.[53]

As against mortgages (and deeds of trust), mechanic's liens, or judgment liens, the priority of a federal tax lien is determined by when a notice of the lien was filed with the recorder's office.[54] This is a difference between federal tax liens and state tax liens.

7. Bankruptcy Notice Predating Sale but Received After

The filing of a bankruptcy creates a bankruptcy estate consisting of the debtor's property.[55] As a general rule, all creditors are automatically stayed from taking any actions outside of the bankruptcy court against property of that estate and/or the debtor.[56]

In some cases, bankruptcy is filed at the very last minute, such that the foreclosing lender is not made aware of the bankruptcy until after the foreclosure sale has taken place. Those sales may be set aside by the bankruptcy trustee such that the foreclosed property becomes part of the bankruptcy estate.[57] However, the bankruptcy trustee generally cannot set aside a foreclosure sale made to a good faith purchaser who perfects the transfer (i.e., records the deed) before receiving notice of the bankruptcy.[58]

Under the Deed of Trust Act, the foreclosing trustee can rescind the sale up to 11 days after the sale date.[59] One of the bases for rescission is that an error was committed in the sale process, which arguably should include a sale conducted in violation of the automatic bankruptcy stay. If the foreclosure sale is subject to be set aside the trustee anyway, lenders will probably be better off having the trustee rescind the sale pursuant to the Deed of Trust Act and then work within the bankruptcy case to pursue recovery. If the borrower has no equity in the collateral,

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[51] RCW 84.64.180.

[52] 26 U.S.C. § 6321.

[53] 26 U.S.C. § 6322.

[54] 26 U.S.C. § 6323(a), (f); RCW 60.68.015(2).

[55] 11 U.S.C. § 541(a).

[56] 11 U.S.C. §§ 362(a) & 541(a).

[57] 11 U.S.C. § 549(a).

[58] 11 U.S.C. § 549(c).

[59] RCW 61.24.050(2)(a).

more often than not the lender will be given relief from the automatic bankruptcy stay and allowed to continue its foreclosure outside of the bankruptcy court.[60] The end result may be a delay of some weeks or months, but ultimately this outcome will be preferable to defending an avoidance action by a bankruptcy trustee.

CONCLUSION

Foreclosures can bring to light title problems that have gone unnoticed for years or decades. As such, they can be an opportunity to "set the record straight" and create a clean slate going forward. By and large, most of the situations discussed in this article should be covered by the lender's title insurance policy. So before pursuing any of the options and approached discussed in this article, lenders would be well advised to considering making a claim under their title insurance policies.

[60] 11. U.S.C. § 362(d).