By Bruce J. Bergman

The Mistaken Foreclosure Sale—Can It Be Undone?

A surprisingly common inquiry from mortgage servicers to their counsel is: There was a mistake in the foreclosure sale just conducted [fill in the date]. Can it just be set aside? The answer to the question varies, but too often the response is "no," suggesting the need for particular servicer vigilance at this stage.

In assessing whether a foreclosure sale can be undone, there are three primary questions to be answered:

- What was the nature of the mistake (that is, did the error hurt the lender or the borrower)?
- Who bid in at the sale—the lender or a third party?
- Is the foreclosure in a judicial or non-judicial foreclosure state? (Of course, there are still variations among the jurisdictions within each category.)

Having outlined the inquiries that illuminate what can be a genuine dilemma, it helps to pinpoint the circumstances that led to the necessity for questions. There are, in turn, two general areas of focus: unilateral mistakes that usually damage the lender, and mutual errors that have perhaps a greater effect upon the borrower. In the realm of lender miscues (specific examples to follow) are blunders in determining the correct bid price or in communicating that to the sale representative—or the failure of that representative to properly perceive or execute the instructions.

If on the eve of sale the loss-mitigation staff works out some arrangement with the borrower but does not convey that result to the servicing department, a gaffe is in the offing.

Regarding the joint errors, a common reason they arise can be attributable to lack of proper interplay between the servicing department and the loss-mitigation group. If on the eve of sale the loss-mitigation staff works out some arrangement with the borrower but does not convey that result to the servicing department, a gaffe is in the offing. Of course, even if the servicing department is properly alerted, it needs to effectively respond.

Here, then, are some scenarios that more vividly expose the problem.

- The lender bids on the property at the sale, but then learns it is worthless.
- The lender's agent at the sale bids $43,000, but a third party tops the bid at $55,000 and it is struck down. Only later does the agent realize the authorization was to bid up to $200,000.
- The lender correctly bid full debt, but mistakenly failed to include $20,000 for advances and taxes.
- Eve-of-sale settlement discussions with the borrower ensue. Forbearance in principle is reached, but before it can be memorialized in a written agreement, the sale is held.
- The lender required a good-faith check to begin settlement negotiations. That check arrived before the sale, which was nevertheless inadvertently conducted.
- An agreed-upon reinstatement check arrives, but the loss-mitigation department doesn't advise the servicing department (or servicing neglects to advise local counsel; or counsel is alerted but misplaces the instructions; or all is well but the representative does not arrive at the sale) and so the sale proceeds.
- A full redemption check is submitted to the servicer's lockbox late on Friday but not reported to staff, and the sale is conducted Monday morning.

Variations on these fact patterns are obvious, and so we return to the basic question: Can the sale be undone in the presence of such errors?

If the lender was the bidder, there should be little problem, although some steps need to be taken. It is not just a matter of making believe the sale never occurred. First, even where the misstep was in the price bid, because the lender now owns the property and can sell it at market value, the lapse becomes irrelevant.

Where the intention had been to allow the borrower to reinstate or settle in some other fashion and the lender was the purchaser, then certain formalities will be pursued. In judicial foreclosure states, a referee is unlikely to simply ignore the event of the sale. Instead, the referee will typically invite a court order cancelling the sale. Because both lender and borrower will join in the application (there is no third-party bidder to object), it can generally be assumed that courts would look favorably upon the cancellation.

Although this can vary in the jurisdictions, in non-judicial states—if prior to recording the deed of conveyance—the goal can be accomplished simply by refraining from recording the deed. Should the deed have already been recorded, however, filing a notice of rescission of the deed (in California, for example) would serve the purpose.

In the instance of a third party as successful bidder, the situation becomes far more tenuous. That third party has rights and may be dedicated to preserving his or her bargain. Therefore, in judicial foreclosure states, opposition to the motion to vacate the sale can be expected. Assuming the error at the sale hurt only the lender, courts may be reluctant to provide rescue.

There may be more sympathy if it was the borrower who

suffered from the oversight, but the bidder's rights still need to be protected. This leads to a host of legal issues (with variations among those in different states) beyond the scope of this review. But the point is obvious: Unwinding the sale may not happen.

It may be somewhat less onerous in non-judicial states, because a sale can often be cancelled if there was no right to conduct the sale in the first instance. In the settlement-with-the-borrower scenario, such a posture might be valid. That becomes a legal issue, though, and a chagrined third party might still protest, leading to a court date with an uncertain result.

As a practical matter, third-party bidders may be amenable to some payment to concede cancellation of the sale. How much that costs might become a business decision to weigh, although this is often the path to a practical solution.

To the extent that some in the servicing community might believe unintended foreclosure sales can readily be corrected, the notion is often false.

To the extent that some in the servicing community might believe unintended foreclosure sales can readily be corrected, the notion is often false. Even where sale cancellation is readily available, some formalities must be adhered to, although in the presence of a third-party purchaser the outcome may be disappointing.

The ultimate message, then, is that meticulous attention to the foreclosure bidding and sale process is even more important than might have been imagined.

Bruce J. Bergman is a partner with Berkman, Henoch, Peterson & Peddy PC, Garden City, New York. He is the author of a three-volume text, *Bergman on New York Mortgage Foreclosures* (Matthew Bender & Co. Inc. [rev. 2006]), and a member of the USFN. He can be reached at b.bergman@bhpp.com.