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Judicial Treatment of California's Anti-Deficiency Legislation Section 580b: Is it Effective?

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JUDICIAL TREATMENT OF CALIFORNIA’S ANTI-DEFICIENCY LEGISLATION SECTION 580b: IS IT EFFECTIVE?

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I. INTRODUCTION

Short sales of real property represent approximately a quarter of all homeowner transactions.¹ Recently, short sales passed foreclosures as the preferred method in home sales due to the ease of sale.² *Coker v. JP Morgan Chase Bank, N.A.*,³ has ruled lenders of a purchase–money mortgage may not pursue a deficiency judgment after the short sale of a home.⁴ Essentially, this means after the sale is completed and the lender has obtained the proceeds from the sale, if there is a deficiency, they may not personally hold the borrower liable for the remaining debt of the mortgage.⁵ The ruling was established under

¹ Alejandro Lazo, *Short Sales in California Surpass Sales of Foreclosed Homes*, L.A. TIMES, Jan. 8, 2013, <http://articles.latimes.com/2013/jan/08/business/la-fi-short-sales-20130109>.

² *Id.*

³ 159 Cal. Rptr. 3d 555 (Cal. Ct. App. 2013).

⁴ *Id.* at 557.

⁵ *Id.* at 565.

section 580b of California's anti-deficiency legislation⁶ after the court interpreted section 580b to include short sales within its purview.⁷ On the surface, the decision affects the large sales transaction section of short sales.⁸ However, the decision has further implications, such as the court's interpretation basis, limiting freedom of contract, and efficacy of anti-deficiency legislation.⁹

Anti-deficiency legislation was enacted during the Great Depression, creating strong implications the legislation was created for the purpose of avoiding similar situations.¹⁰ The following will discuss the historical background of anti-deficiency legislation with focus on the court's treatment of section 580b.¹¹ Additionally, the *Coker* opinion will be analyzed to bring out the court's support for its interpretation of section 580b, which will later be used to discuss the full impact of its decision and if that decision is in line with avoidance of economic downturn.¹²

II. HISTORICAL BACKGROUND

California's anti-deficiency legislation was created in response to the Great Depression of the 1930s.¹³ The legislation involves many basic requirements creditors must comply with to obtain outstanding funds. Some of the basic requirements include: (1) the obligation of a single lawsuit combining the secured debt and unsecured debt;¹⁴ (2) requiring creditors to pursue the secured portion of the mortgage first before a deficiency judgment is attempted;¹⁵ (3) creditors must establish a procedure to follow when obtaining a

⁶ CAL. CIV. PROC. CODE § 580b (West 2014).

⁷ *Id.*

⁸ *See id.*

⁹ *See infra* Part V and accompanying notes 170–229.

¹⁰ *Coker*, 159 Cal. Rptr. 3d at 560.

¹¹ *See infra* Part II and accompanying notes 13–66.

¹² *See infra* Part IV–V and accompanying notes 74–229.

¹³ *Coker*, 159 Cal. Rptr. 3d at 560.

California has an elaborate and interrelated set of foreclosure and anti-deficiency statutes relating to the enforcement of obligations secured by interests in real property. Most of these statutes were enacted as the result of the Great Depression and the corresponding legislative abhorrence of the all too common foreclosures and forfeitures [that occurred] during that era for reasons beyond the control of the debtors.

Alliance Mortg. Co. v. Rothwell, 900 P.2d 601, 606 (Cal. 1995) (internal quotation marks omitted); see Charles B. Sheppard, *California Code of Civil Procedure Section 580b, Anti-Deficiency Protection Regarding Purchase Money Debts: Arguments for the Inclusion of Refinanced Purchase Money Obligations Within the Anti-Deficiency Protection of Section 580b*, 6 S. CAL. INTERDISC. L.J. 245, 249 (1997).

¹⁴ See CAL. CIV. PROC. CODE § 726 (West 2014).

¹⁵ *See id.*

deficiency judgment;¹⁶ (4) purchase–money mortgage deficiency restrictions;¹⁷ (5) limitations on power-of-sale foreclosure deficiencies;¹⁸ and (6) limitations on short sale deficiencies.¹⁹ The remainder of this section will focus on the historical development of section 580b and how courts have applied the statute against short sales.

Section 580b—purchase–money mortgage deficiency restrictions—was enacted in 1933.²⁰ The statute restricts the obtaining of a deficiency judgment tied to a purchase–money mortgage after the sale of real property under a vendor-vendee relationship or secured by a one to four family home.²¹ Many

¹⁶ See *id.* § 580a.

¹⁷ See *id.* § 580b.

¹⁸ See *id.* § 580d.

¹⁹ See *id.* § 580e.

²⁰ Stats. 1933, ch. 642, § 5, p. 1673. As originally enacted, section 580b read as follows: “No deficiency judgment shall lie in any event after any sale under a deed of trust or mortgage given to secure payment of the balance of the purchase price of real property.” *Id.*

²¹ CIV. PROC. § 580b:

(a) No deficiency judgment shall lie in any event for the following: (1) After a sale of real property or an estate for years therein for failure of the purchaser to complete his or her contract of sale. (2) Under a deed of trust or mortgage given to the vendor to secure payment of the balance of the purchase price of that real property or estate for years therein. (3) Under a deed of trust or mortgage on a dwelling for not more than four families given to a lender to secure repayment of a loan which was in fact used to pay all or part of the purchase price of that dwelling, occupied entirely or in part by the purchaser.

(b) For purposes of subdivision (c), a loan described in paragraph (3) of subdivision (a) is a “purchase money loan.”

(c) No deficiency judgment shall lie in any event on any loan, refinance, or other credit transaction (collectively, a “credit transaction”) which is used to refinance a purchase money loan, or subsequent refinances of a purchase money loan, except to the extent that in a credit transaction, the lender or creditor advances new principal (hereafter “new advance”) which is not applied to any obligation owed or to be owed under the purchase money loan, or to fees, costs, or related expenses of the credit transaction. Any new credit transaction shall be deemed to be a purchase money loan except as to the principal amount of any new advance. For purposes of this section, any payment of principal shall be deemed to be applied first to the principal balance of the purchase money loan, and then to the principal balance of any new advance, and interest payments shall be applied to any interest due and owing. The provisions of this subdivision shall only apply to credit transactions that are executed on or after January 1, 2013.

(d) Where both a chattel mortgage and a deed of trust or mortgage have been given to secure payment of the balance of the combined purchase price of both real and personal property, no deficiency judgment shall lie at any time under any one thereof if no deficiency judgment would lie under the deed of trust or mortgage on the real property or estate for years therein.

Id.; *Purchase Money Mortgage*, INVESTOPEDIA, http://www.investopedia.com/terms/p/purchase-money_mortgaged.asp (last visited Sept. 24, 2014) (“[A purchase–money mortgage is a] mortgage

amendments have brought the statute to its current state.²² The last amendment

issued to the borrower by the seller of the home as part of the purchase transaction. This is usually done in situations where the buyer cannot qualify for a mortgage through traditional lending channels. This is also known as seller or owner financing.”).

²² Stats. 1935, ch. 650, § 5, p. 1806 (current version at CAL. CIV. PROC. CODE § 580b (West 2014)); Stats. 1935, ch. 680, § 1, p. 1869 (current version at CAL. CIV. PROC. CODE § 580b (West 2014)) (“No deficiency judgment shall lie in any event after any sale of real property for failure of the purchaser to complete his contract of sale, or under a deed of trust or mortgage given to secure payment of the balance of the purchase price of real property.”); Stats. 1949, ch. 1599, § 1, p. 2846 (current version at CAL. CIV. PROC. CODE § 580b (West 2014)). The 1949 amendment altered section 580b by adding the following:

No deficiency judgment shall lie in any event after any sale of real property for failure of the purchaser to complete his contract of sale, or under a deed of trust or mortgage given to secure payment of the balance of the purchase price of real property.

Where both a chattel mortgage and a deed of trust or mortgage have been given to secure payment of the balance of the combined purchase price of both real and personal property, no deficiency judgment shall lie at any time under any one thereof.

Id.; Stats. 1963, ch. 2158, § 1, p. 4500 (CAL. CIV. PROC. CODE § 580b (West 2014)). The 1963 amendment of section 580b provided as follows:

No deficiency judgment shall lie in any event after any sale of real property for failure of the purchaser to complete his contract of sale, or under a deed of trust, or mortgage, given to [secure payment of the balance of the purchase price of real property] the vendor to secure payment of the balance of the purchase price of real property, or under a deed of trust, or mortgage, on a dwelling for not more than four families given to a lender to secure repayment of a loan which was in fact used to pay all or part of the purchase price of such dwelling occupied, entirely or in part, by the purchaser.

Where both a chattel mortgage and a deed of trust or mortgage have been given to secure payment of the balance of the combined purchase price of both real and personal property, no deficiency judgment shall lie at any time under any one thereof if no deficiency judgment would lie under the deed of trust or mortgage on real property.

Id.; Stats. 1989, ch. 698, §12, p. 2289 (current version at CAL. CIV. PROC. CODE § 580b (West 2014)). The 1989 amendment of section 580b read as follows:

No deficiency judgment shall lie in any event after [any] a sale of real property or an estate for years therein for failure of the purchaser to complete his or her contract of sale, or under a deed of trust or mortgage given to the vendor to secure payment of balance of the purchase price of that real property or estate for years therein, or under a deed of trust or mortgage on a dwelling for not more than four families given to a lender to secure repayment of a loan which was in fact used to pay all or part of the purchase price of [such] that dwelling occupied, entirely or in part, by the purchaser.

Where both a chattel mortgage and a deed of trust or mortgage have been given to secure payment of the balance of the combined purchase price of

transpired in 2012, extending the protection of 580b to include refinanced loans made after January 1, 2013, by incorporating refinanced loans within the definition of purchase–money mortgages.²³

Case law has been heavily active in defining section 580b. The earliest cases used little legislative intent and relied on statutory language in coming to decisions.²⁴ In *Lucky Investments, Inc. v. Adams*,²⁵ further financing was obtained through a reconveyance of the original purchase–money loan.²⁶ The issue was whether the loan would be considered a purchase–money mortgage despite the reconveyance.²⁷ The court ruled a substitution of the form of an obligation did not result in loss of 580b protection because the original character of the loan remained intact.²⁸ This case further defined the meaning of purchase–money mortgage and extended 580b safeguards.²⁹ The *Lucky* opinion stated:

[The court’s] conclusion does not work an undue hardship upon [the lender]. One who takes a purchase-money trust deed knows the value of his security and assumes the risk that it may become inadequate, especially where he takes a second purchase-money trust deed, and he is precluded by this section from bringing an action on the note after the security has become valueless because of the sale under the prior trust deed.³⁰

The statement focused on undue hardship, but by mentioning the lender’s assumption of risk, some insight of the purpose of 580b was provided.³¹ The court in *Lucky* did no further investigation of the purpose of why the purchase–money loan should fall under this statute; it only established the loan fell under the purchase–money mortgage definition as a matter of statutory construction and public policy of inability to waive the statute through change of form.³²

Given the sole basis of statutory language for determining whether a

both real and personal property, no deficiency judgment shall lie at any time under the deed of trust or mortgage on the real property or estate for years therein.

Id.

²³ CAL. CIV. PROC. CODE § 580b(c).

²⁴ See *Roseleaf Corp. v. Chierighino*, 378 P.2d 97, 101 (Cal. 1963). The court in *Roseleaf* points to other courts’ lack of explanation why “purchase money mortgages were singled out for special treatment” and conclusions have been made assuming the 580b statute applies. *Id.*

²⁵ 7 Cal. Rptr. 57 (Cal. Ct. App. 1960).

²⁶ *Id.* at 58–61.

²⁷ *Id.* at 59.

²⁸ *Id.* at 61.

²⁹ See *id.*

³⁰ *Id.*

³¹ See *id.*

³² See *id.* “Whatever the intent of the parties, [the parties] could not waive the protection of section 580b in advance.” *Id.*

current case fell under anti-deficiency protection, it became difficult for courts to ascertain sound conclusions.³³ California legislation had given little purpose upon the enactment of its anti-deficiency legislation, and it became clear judiciary interpretation of statutory intent was necessary to guide courts in their decisions.³⁴ It was not until *Roseleaf Corp. v. Chierighino*³⁵ the California Supreme Court rendered a paramount decision defining legislative purpose and intent behind section 580b.³⁶ In *Roseleaf*, Roseleaf Corporation sold a hotel to Chierighino.³⁷ Consideration given for the hotel consisted of a first deed and chattel mortgage from an unrelated party and three notes given to Roseleaf Corporation secured by three properties owned by Chierighino tied to a second deed of trust.³⁸ Subsequently, the first deed of trust for the three parcels of land was foreclosed upon through power-of-sale.³⁹ The foreclosure extracted all value from the second deed of trust, and Roseleaf Corporation filed suit against Chierighino to recover the outstanding balance.⁴⁰ Chierighino asserted a 580b defense, stating the second deed of trust was not subject to a deficiency judgment.⁴¹

The court in *Roseleaf* began its 580b analysis by stating the general application of section 580b:

Section 580b was apparently drafted in contemplation of the standard purchase money mortgage transaction, in which the vendor of real property retains an interest in the land sold to secure payment of part of the purchase price. Variations on the standard are subject

³³ See *Brown v. Jenson*, 259 P.2d 425, 427 (Cal. 1953) (reasoning “no deficiency judgment may be obtained regardless of whether the security later becomes valueless” because the statute provides protection for mortgagors). *But cf.* *Roseleaf Corp. v. Chierighino*, 378 P.2d 97, 99–100 (Cal. 1963) (explaining the defined legislative purpose behind anti-deficiency legislation statute 580a: the fair-market value limitations). “Fair-value provisions are designed to prevent creditors from buying in at their own sales at deflated prices and realizing double recoveries by holding debtors for large deficiencies.” *Id.* The purpose of 580d, the denial of a deficiency judgment after a power-of-sale foreclosure, was to create an equal choice for the creditors. *Id.* at 101–02. Before the denial of deficiency judgments for nonjudicial foreclosures, it was always to the creditors advantage to foreclose nonjudicially because of statutory redemption denial. *Id.* Statutory redemption gives the mortgagor who was foreclosed upon a right to purchase his property back for a certain time period after the sale but only for judicially foreclosed properties. *Id.* Denying the deficiency judgment of a nonjudicial foreclosure creates equality by guaranteeing a title that cannot be bought back. *Id.* (noting there are past cases that decipher the purpose of section 580d).

³⁴ See Sheppard, *supra* note 13, at 262–63; Jamie O. Harris, *California Code of Civil Procedure Section 580b Revisited: Freedom of Contract in Real Estate Purchase Agreements*, 30 SAN DIEGO L. REV. 509, 510 (1993).

³⁵ 378 P.2d 97 (1963).

³⁶ *Id.* at 99–100.

³⁷ *Id.* at 98.

³⁸ *Id.*

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ *Id.*

to section 580b only if they come within the purpose of that section.⁴²

The security transaction in the *Roseleaf* case was not a vendor-vendee type and, therefore, was not within the general application.⁴³ The case made it necessary for the court to determine the purpose of 580b.⁴⁴ In defining the purpose of the statute, the court distinguished other suggested, however, inappropriate reasoning by establishing compatibility between the inappropriate reasoning and other provisions within California's anti-deficiency legislation.⁴⁵ By eliminating past reasoning, the Court narrowed its view on the purpose of section 580b and came to the conclusion the purchase-money mortgage anti-deficiency statute was enacted to "serve[] as a stabilizing factor in land sales" by shifting the risk of inadequate security to the mortgagee.⁴⁶ The risk shift prevents an overvaluation of the property by the vendor and "prevents the aggravation of the downturn that would result if defaulting purchasers were burdened with large personal liability."⁴⁷ Using the contrived purposes, the court went on to determine 580b did not apply to the case because the hotel was not overvalued, and it was unascertainable as to which party had more knowledge to value the property.⁴⁸

As stated above, anti-deficiency legislation is not subject to being waived, and courts have interpreted 580b and its purpose to justify their position of

⁴² *Id.* at 100.

⁴³ *Id.* at 98, 100–02.

⁴⁴ *Id.* at 101.

⁴⁵ *Id.* The court in *Roseleaf* demonstrated why other purposes courts proposed were not the correct purpose for section 580b. *Id.* The first purpose the *Roseleaf* court distinguished was 580b was created to prevent an unjust outcome by allowing the lender to obtain the property at an extremely low value and at the same time allow a deficiency judgment to be held against the debtor. *Id.* The court continued to reason this purpose was not contemplated in section 580b enactment because fair-market value limitations already cover this purpose by ensuring the property be sold at a fair-market value. *Id.* The court also explained 580b singled out purchase-money mortgages for a particular reason and not for the reason of preventing double recovery given that many other mortgage types would be allowed to obtain the property at a low price and obtain a deficiency judgment. *Id.*

The *Roseleaf* court disregarded a second purpose given in *Brown*, which stated, "the purpose of section 580b is to make certain that in the case of 'a purchase money mortgage or deed of trust the security alone can be looked to for recovery of the debt.'" *Id.* (quoting *Brown v. Jensen*, 259 P.2d 425, 427 (Cal. 1953)). The court in *Roseleaf* asserted the purpose given in *Brown* only stated a conclusion of how to apply the statute but gave no guidance on when to apply the statute in a scenario in need of statutory interpretation. *Id.*

The last purpose the court in *Roseleaf* distinguished from the true purpose was the proposal "one taking a purchase money trust deed knows the value of his security and assumes the risk that it may become inadequate." *Id.* The *Roseleaf* court believed this purpose was not a sufficient purpose to bar deficiency judgments for purchase-money mortgages. *Id.*

⁴⁶ *Id.*

⁴⁷ *Id.*

⁴⁸ *Id.* at 101–02.

borrower protection and inability to circumvent legislation.⁴⁹ However, there is an exception to the non-waiving normality, which the court in *Spangler v. Memel*⁵⁰ discovered.⁵¹ In *Spangler*, the court ruled waving of anti-deficiency legislation would be allowable if the two following conditions were satisfied: (1) there must be an ex post subordination agreement;⁵² and (2) the original land use must change.⁵³ The court's reasoning for the first requirement was the increased risk accompanying a subordination agreement.⁵⁴ The second requirement involved change of purpose of the original financing, and, in turn, the loan amount was now based on the change in use, not the market value of the property.⁵⁵ The two elements together virtually altered the characterization of the financing from a purchase-money type, and, because of that change, statutory language and legislative purpose remained intact.⁵⁶ However logically sound the *Spangler* decision may appear, it has attracted some scrutiny in being incongruent with clear statutory language.⁵⁷

Section 580e bars all deficiency judgments from all lienholders "if the holder of said deed of trust consented to [a] short sale and received the proceeds of [that] sale as agreed."⁵⁸ Section 580e was effective as of July 15, 2011,⁵⁹ but

⁴⁹ See *Lucky Invs., Inc. v. Adams*, 7 Cal. Rptr. 57, 61 (Cal. 1960).

⁵⁰ 498 P.2d 1055 (Cal. 1972).

⁵¹ *Id.*

⁵² *Id.* at 1059–61.

⁵³ *Id.* at 1059–60 (noting value is determined by the property's change in use, not fair market value as a purchase-money mortgages use).

⁵⁴ *Id.* at 1061 ("[T]he risk of the failure of the commercial development is thrust upon the vendor.").

⁵⁵ *Id.* The market value of the land depends upon the likelihood of the success of the commercial development. *Id.* The success of the commercial development depends upon the obtaining of loans to construct it. *Id.* The securing of these loans depends upon the ability of the purchaser to give the lender a senior security interest. *Id.*

⁵⁶ See *id.* at 1060–62.

⁵⁷ Harris, *supra* note 34, at 526. "[I]n *Spangler* the Supreme Court adopted and then enlarged upon the unfortunate and unnecessary fictions created in the *Brown* and *Roseleaf* decisions that to create an exception to clear statutory language." *Id.* The *Spangler* standard has also been subject to criticism due to its vague language of "commercial development," "change in use," and others. *Id.* at 532.

⁵⁸ Marianne M. Jennings, *From the Courts*, 42 REAL EST. L.J. 493, 496–97 (2014); see CAL. CIV. PROC. CODE § 580e (West 2014):

(a)(1) No deficiency shall be owed or collected, and no deficiency judgment shall be requested or rendered for any deficiency upon a note secured solely by a deed of trust or mortgage for a dwelling of not more than four units, in any case in which the trustor or mortgagor sells the dwelling for a sale price less than the remaining amount of the indebtedness outstanding at the time of sale, in accordance with the written consent of the holder of the deed of trust or mortgage, provided that both of the following have occurred:
 (A) Title has been voluntarily transferred to a buyer by grant deed or by other document of conveyance that has been recorded in the county where all or part of the real property is located.

the question remained whether the statute would be applied retroactively. *Bank of America, N.A. v. Roberts*⁶⁰ took on the novel issue and found the statute cannot be applied prior to July 15, 2011.⁶¹ The court reasoned statutes are generally applied prospectively, and there must be specific express language directing application otherwise.⁶² There was no express language directing the statute to be applied in any other way than prospectively.⁶³ The court went on to state its “interpretation [was] further confirmed by the legislative history” through the absence of any indication the statute was to be applied retroactively.⁶⁴

The outcome of the *Bank of America* decision resulted in all short sales prior to July 15, 2011, maintaining the ability to hold the borrower personally liable after the sale.⁶⁵ This held true until five days later when *Coker* was decided, rendering attempts to obtain a deficiency judgment after a short sale useless.⁶⁶

(B) The proceeds of the sale have been tendered to the mortgagee, beneficiary, or the agent of the mortgagee or beneficiary, in accordance with the parties’ agreement.

(2) In circumstances not described in paragraph (1), when a note is not secured solely by a deed of trust or mortgage for a dwelling of not more than four units, no judgment shall be rendered for any deficiency upon a note secured by a deed of trust or mortgage for a dwelling of not more than four units, if the trustor or mortgagor sells the dwelling for a sale price less than the remaining amount of the indebtedness outstanding at the time of sale, in accordance with the written consent of the holder of the deed of trust or mortgage. Following the sale, in accordance with the holder’s written consent, the voluntary transfer of title to a buyer by grant deed or by other document of conveyance recorded in the county where all or part of the real property is located, and the tender to the mortgagee, beneficiary, or the agent of the mortgagee or beneficiary of the sale proceeds, as agreed, the rights, remedies, and obligations of any holder, beneficiary, mortgagee, trustor, mortgagor, obligor, obligee, or guarantor of the note, deed of trust, or mortgage, and with respect to any other property that secures the note, shall be treated and determined as if the dwelling had been sold through foreclosure under a power of sale contained in the deed of trust or mortgage for a price equal to the sale proceeds received by the holder, in the manner contemplated by Section 580d.

Id.

⁵⁹ CIV. PROC. § 580e.

⁶⁰ 159 Cal. Rptr. 3d 345 (Cal. Ct. App. 2013).

⁶¹ *Id.* at 350.

⁶² *Id.* at 352. “[S]tatutes ordinarily are interpreted as operating prospectively in the absence of a clear indication of a contrary legislative intent In construing statutes, there is a presumption against retroactive application unless the [l]egislature plainly has directed otherwise by means of ‘express language of retroactivity’” *Id.*

⁶³ *Id.*

⁶⁴ *Id.*

⁶⁵ *See id.*

⁶⁶ *Coker v. JP Morgan Chase Bank, N.A.*, 159 Cal. Rptr. 3d 555, 565 (Cal. Ct. App. 2013).

III. FACTS

The facts of *Coker* will be laid out to give background and provide context for the following analysis. Carol Coker owned real property located in San Diego, California.⁶⁷ With Chase Home Finance (Chase) as the financing lender, Coker obtained a note that was secured by a deed of trust against the property in San Diego.⁶⁸ Coker eventually went into default and negotiated a sale with a third party for less than the outstanding balance under the loan.⁶⁹ Chase agreed to accept the terms of the third party deal on the condition Coker would stay liable for the excess balance left on the note.⁷⁰

After the sale, Coker was asked to pay the remaining loan balance.⁷¹ Coker refused and responded by filing a declaratory relief action to settle whether she was able to obtain anti-deficiency protection after a short sale was conducted.⁷² The superior court sustained the Chase demurrer, ruling Coker would not receive anti-deficiency protection because the protection was only available for property that was sold through judicial or non-judicial foreclosure.⁷³

IV. ANALYSIS

The main issue before the *Coker* court was whether 580b protection extended to short sales.⁷⁴ Ancillary issues will be discussed in this analysis, as there were more mentioned in *Coker*; however, section 580b and its application to short sales will be the primary focus.⁷⁵

The court began its analysis by describing California's two types of foreclosures: judicial and non-judicial.⁷⁶ Carol Coker believed section 580b applied only to judicial and non-judicial foreclosures.⁷⁷ A non-judicial foreclosure is one in which no judicial determination is necessary.⁷⁸ Given the

⁶⁷ *Id.* at 557.

⁶⁸ *Id.*

⁶⁹ *Id.*

⁷⁰ *Id.* at 557–58.

⁷¹ *Id.* at 558.

⁷² *Id.*

⁷³ *Id.*

⁷⁴ *Id.*

⁷⁵ *Id.* The court in *Coker* first addressed the standard of review that would be used throughout the case. *Id.* It concluded the appropriate review would be one of de novo and all the pleaded facts would be taken as true. *Id.*

⁷⁶ *Id.* at 559.

⁷⁷ *Id.* at 558.

⁷⁸ *See id.* at 559. “[N]either appraisal nor judicial determination of fair value is required, and the debtor has no postsale right of redemption.” *Id.* (quoting *Alliance Mortg. Co. v. Rothwell*, 900 P.2d 601, 607 (1995)) (internal quotation marks omitted).

minor impediments to complete a non-judicial foreclosure, the process is relatively quick and inexpensive.⁷⁹ Under anti-deficiency law, if a non-judicial foreclosure is conducted, a deficiency judgment will be barred from recovery.⁸⁰ This is true even if the loan is not a purchase-money mortgage.⁸¹ The reasoning behind the deficiency denial is to place power-of-sale foreclosures and judicial foreclosures on parity.⁸² Judicial foreclosures allow for a statutory redemption right, and power-of-sale foreclosures do not.⁸³ If a lender chooses to non-judicially foreclose, the title will be free and clear of any past mortgagor right to purchase the property back after foreclosure completion.⁸⁴

A judicial foreclosure requires the foreclosing party to file a lawsuit and establish the loan is in default.⁸⁵ The process takes a longer period of time to complete than the non-judicial foreclosure due to court oversight.⁸⁶ The key difference between non-judicial and judicial foreclosure with regard to anti-deficiency legislation, is the foreclosing party will only be denied a deficiency judgment if the loan was a purchase-money loan.⁸⁷ If the loan is not a purchase-money loan, a deficiency judgment will be available as long as all other anti-deficiency provisions comport.⁸⁸

In *Coker*, it was undisputed whether there was a judicial or non-judicial foreclosure.⁸⁹ In its place, a short sale occurred to fulfill *Coker*'s mortgage obligation after default.⁹⁰ A short sale occurs when the lender agrees to take less

⁷⁹ *Id.* “Nonjudicial foreclosure is less expensive and more quickly concluded than judicial foreclosure, since there is no oversight by a court . . .” *Id.* (quoting *Alliance*, 900 P.2d at 607).

⁸⁰ CAL. CIV. PROC. CODE § 580d (West 2014).

⁸¹ *See id.*

⁸² *See* *Roseleaf Corp. v. Chierighino*, 378 P.2d 97, 101–02 (Cal. 1963):

[S]ection 580d was enacted to put judicial enforcement on a parity with private enforcement. This result could be accomplished by giving the debtor a right to redeem after a sale under the power. The right to redeem, like proscription of a deficiency judgment, has the effect of making the security satisfy a realistic share of the debt. By choosing instead to bar a deficiency judgment after private sale, the [l]egislature achieved its purpose without denying the creditor his election of remedies. If the creditor wishes a deficiency judgment, his sale is subject to statutory redemption rights. If he wishes a sale resulting in nonredeemable title, he must forego the right to a deficiency judgment. In either case the debtor is protected.

Id. at 102.

⁸³ *Id.*

⁸⁴ *See id.*

⁸⁵ *Arabia v. BAC Home Loans Servicing, L.P.*, 145 Cal. Rptr. 3d 678, 685 (Cal. Ct. App. 2012).

⁸⁶ *Coker v. JP Morgan Chase Bank, N.A.*, 159 Cal. Rptr. 3d 555, 559 (Cal. Ct. App. 2013).

⁸⁷ CIV. PROC. § 580b.

⁸⁸ *See id.*; *id.* § 580a (requiring for a foreclosure to be sold close to its fair market value to prevent lenders from a “double recovery”).

⁸⁹ *Coker*, 159 Cal. Rptr. 3d at 559.

⁹⁰ *Id.*

than the mortgage owed in full satisfaction of the outstanding balance.⁹¹ The short sale agreement stated, as many other short sale agreements state, the mortgagor would still be liable after the security had been sold.⁹² Section 580b does not specifically state conducting a short sale will result in a forfeit of deficiency judgments on a purchase–money loan.⁹³ Again, the question remains whether the subsequent agreement between the borrower and lender preventing deficiency judgments will be enforced or precluded under section 580b of California’s anti-deficiency statute.

A. Statutory Interpretation

The court laid the foundation for how the statute would be interpreted by reminding the reader of the context that drove anti-deficiency legislation through creation and passage and by confining the core analysis to the language of the statute.⁹⁴ The context in which the statute was created was during the Great Depression, and the section 580b language used by the court was the following:

No deficiency judgment shall lie in any event after a sale of real property for failure of the purchaser to complete his or her contract of sale under a deed of trust or mortgage on a dwelling given to a lender to secure repayment of a loan which was in fact used to pay all or part of the purchase price of that dwelling.⁹⁵

The statute was amended to only include purchase–money mortgages for one to four family homes, which was the type of property handled in *Coker*.⁹⁶

When looking at the plain meaning of the language, the court referred to *Aozora Bank* to support its view by citing broad language from the opinion stating a purchase–money loan is a non-recourse loan in California and, therefore, the lender’s only recourse option was to obtain and sell the security.⁹⁷ The *Aozora* opinion indicated the loan in the case was non-recourse and, if section 580d applied after a power-of-sale foreclosure, there would likely be no possibility of a deficiency judgment.⁹⁸ The *Aozora* court did not state purchase–

⁹¹ *Id.*

⁹² *Id.* at 558.

⁹³ *See* CIV. PROC. § 580b.

⁹⁴ *See Coker*, 159 Cal. Rptr. 3d at 560. “Words must be construed in context, and statutes must be harmonized, both internally and with each other, to the extent possible.” *Cal. Mfrs. Assn. v. Public Utils. Comm’n*, 598 P.2d 836, 840 (Cal. 1979).

⁹⁵ CIV. PROC. § 580b.

⁹⁶ *Coker*, 159 Cal. Rptr. 3d at 560.

⁹⁷ *Id.* “Section 580b addresses purchase-money loans and establishes that they are non-recourse loans under California law. ‘In a nonrecourse loan..., the borrower has no personal liability and the lender’s sole recourse is against the security for the obligation.’” *Id.* (quoting *Aozora Bank, Ltd. v. 1333 N. Cal. Boulevard*, 15 Cal. Rptr. 3d 340, 342 (Cal. Ct. App. 2004)).

⁹⁸ *Aozora*, 15 Cal. Rptr. 3d at 341–42.

money loans under section 580b were non-recourse after all types of property sales.⁹⁹ Nevertheless, the court in *Coker* drew its starting point, maintaining purchase–money mortgages are considered non-recourse loans and recovery would be limited to the security proceeds.¹⁰⁰ The language analysis was tapered when the *Budget Realty* court’s application of section 580b in a vendor–vendee setting was cited, which also resulted in a non-recourse loan.¹⁰¹

The court went on to state liberal construction of the statute and broad interpretation has historically been the trend for anti-deficiency legislation.¹⁰² It stated deficiency circumvention of any type would undermine the purpose of the 580b statute.¹⁰³ The court used *Prunty v. Bank of America*,¹⁰⁴ to support its view of broad interpretation, barring circumvention of 580b.¹⁰⁵ In *Prunty*, a construction loan used to build a dwelling was ruled to fall under 580b protection.¹⁰⁶ The loan was not technically a purchase–money loan because the loan was not used to purchase the property; instead, it was used for construction.¹⁰⁷ However, the court in *Prunty* went against the strict language of the statute and concluded the loan was synonymous with a purchase–money mortgage because it fit within the purpose of anti-deficiency legislation.¹⁰⁸

⁹⁹ *See id.* at 344 n.3. “[I]t is unnecessary to decide whether the fee award after the nonjudicial foreclosure was a deficiency judgment prohibited by Code of Civil Procedure section 580d.” *Id.* (showing the court never made a binding conclusion on whether there would be a bar on deficiency judgments following the triggering of an anti-deficiency event).

¹⁰⁰ *Coker*, 159 Cal. Rptr. 3d at 560.

¹⁰¹ *Id.* (citing *Budget Realty, Inc. v. Hunter*, 204 Cal. Rptr. 48, 49 (Cal. Ct. App. 1984) (stating the protection covered a vendor–vendee relationship as one of two purchase–money mortgage situations included in the statute)).

¹⁰² *Coker*, 159 Cal. Rptr. 3d at 560.

¹⁰³ *Id.* at 561.

¹⁰⁴ 112 Cal. Rptr. 370 (Cal. Ct. App. 1974).

¹⁰⁵ *Coker*, 159 Cal. Rptr. 3d at 561.

¹⁰⁶ *Prunty*, 112 Cal. Rptr. at 378–79.

¹⁰⁷ *Id.* at 372.

¹⁰⁸ *Id.* at 376–77:

The final question in the present case is whether the broader language should be interpreted to bar a deficiency judgment after a sale ‘under a deed of trust (plaintiffs’) given to a lender (defendant bank) to secure repayment of a loan which was in fact used to pay all or part’ of the [c]ost of constructing plaintiffs’ ‘dwelling occupied by the borrower(s) (plaintiffs).

The common—and various—definitions of the words ‘purchase’ and ‘purchaser’ are sufficiently flexible to include the suggested alternative meanings; the owner of real property who finances and builds a ‘dwelling’ on it ‘acquires’ or ‘obtains’ the dwelling for a ‘price,’ in no less a sense than the ‘purchaser’ of real property ‘acquires’ or ‘obtains’ the land itself. The flexibility of both definitions has been recognized in pertinent decisions.

In the present case, it seems particularly appropriate that the ‘risk,’ and the ensuing loss in consequence, be borne by defendant bank because of the opportunities it had—and utilized—to protect its security interest against the landslide loss, which actually occurred. These opportunities included the

Prunty has been described as arguable, but the *Coker* court adhered to its reasoning and assessed its case through a broad lens of interpretation.¹⁰⁹

The court stated the legislation was passed to accomplish two purposes.¹¹⁰ The first was to prevent overvaluation of property.¹¹¹ Lenders will be less likely to overvalue the property with 580b in place because the larger the gamble they take on a higher loan amount, the less likely they are to receive that full amount if a default were to occur.¹¹² Protecting borrowers in unfortunate economic times was the second purpose the court put forth.¹¹³ “[I]f inadequacy of the security results, not from overvaluing, but from a decline in property values during a general or local depression, section 580b prevents the aggravation of the downturn that would result if defaulting purchasers were burdened with large personal liability.”¹¹⁴ In turn, 580b functions as a stabilizing device in land sales.¹¹⁵ The court described these public policy goals are achieved by means of section 580b shifting the risk to the lender.¹¹⁶

Using both the language and purpose interpretation, the court in *Coker* concluded section 580b was not limited to foreclosures as the lender

control exercised by the bank over the plans, specifications[,] and construction of plaintiffs’ residence in contemplation of landslide and other physical risks, and the requirement in plaintiffs’ trust deed that they furnish insurance whose coverage protected the bank against loss and which was ‘satisfactory’ to it. We may reasonably assume that such protective measures are readily available to lenders who finance residential construction, that the [l]egislature was aware of this when it amended section 580b in 1963, and that its protection of residential construction borrowers, against deficiency judgments, was continued (under the 1963 amendment) in recognition of the fact that the lenders involved are able to protect themselves against loss of devaluation of their security which might be caused by physical catastrophe. Under these and all the circumstances previously discussed, we hold that section 580d bars a deficiency judgment in the present case.

Id. at 376–78.

¹⁰⁹ *Union Bank v. Anderson*, 283 Cal. Rptr. 823, 827 (Cal. Ct. App. 1991):

Prunty arguably fell within section 580b following a 1963 amendment adding the protection afforded a “dwelling,” and was likely aimed at eliminating the inequitable situation where the purchaser of real property with an existing house was protected by section 580b and the purchaser of real property who later built a house on the lot was not.

Id.

¹¹⁰ *Coker*, 159 Cal. Rptr. 3d at 561.

¹¹¹ *Id.*

¹¹² *See id.*

¹¹³ *Id.*

¹¹⁴ *Roseleaf Corp. v. Chierighino*, 378 P.2d 97, 101 (Cal. 1963).

¹¹⁵ *Coker*, 159 Cal. Rptr. 3d at 561.

¹¹⁶ *Id.*

proposed.¹¹⁷ The court reasoned, because the statute did not include specific language concerning the mode of sale, nor modification of the term “sale,” it was not limited to foreclosure sales.¹¹⁸ Further, the phrase “in any event” in section 580b provided intention of application toward any type of sale.¹¹⁹ *Coker* referred to other courts that have similarly held “foreclosure[s] [are] not a prerequisite trigger to section 580b’s protections.”¹²⁰ The interpretation was far-reaching and of liberal construction, as promised.¹²¹

Section 580e applies to property sales in which the “sale price [is] less than the . . . amount of indebtedness outstanding at the time of the sale, in accordance with the written consent of the holder of the deed of trust or mortgage,” also known as a short sale.¹²² The *Coker* court claimed its view was reinforced through the enactment of section 580e for a number of reasons.¹²³ First, and most evident, is for the reason of 580e being a part of the anti-deficiency legislation group and its instruction to bar deficiency judgments of short sales.¹²⁴ Secondly, the legislative history of section 580e referred to 580b application of short sales and how protection is provided by 580b for purchase–money mortgages that result in short sales.¹²⁵ Section 580e differed mainly in its expansion in not limiting the application to purchase–money mortgages and provided protection for all mortgages subject to short sales.¹²⁶ According to the court, 580e was primarily passed for reasons of expanding protection of all loans arising from a certain mode of sale; however, it was not found 580e was passed to ensure 580b applied to purchase–money loans arising from short sales.¹²⁷ A

¹¹⁷ *Id.*

¹¹⁸ *Id.*

¹¹⁹ *Id.*

¹²⁰ *Id.*; see *Frangipani v. Boecker*, 75 Cal. Rptr. 2d 407, 407–10 (Cal. Ct. App. 1998) (holding 580b protection was available despite the fact the sale may not be subject to the deed of trust; in other words, may not be a foreclosure); see also *Venable v. Harmon*, 43 Cal. Rptr. 490, 493 (Cal. Ct. App. 1965) (holding 580b applied preventing a deficiency judgment and the fact there had not been a sale did not preclude that protection).

¹²¹ See *Coker*, 159 Cal. Rptr. 3d at 561.

¹²² *Id.* at 562 (quoting CAL. CIV. PROC. CODE § 580e (a)(1) (West 2014)).

¹²³ See *infra* note 123 and accompanying text.

¹²⁴ See *Coker*, 159 Cal. Rptr. 3d at 562. This first reason alone is weak because section 580e was passed long after section 580b was in place. There is no way to know section 580e related in any way to cover portions 580b was meant to protect at the time 580b was passed. The court’s second reason suggesting 580b was mentioned in the passage of section 580e provides some evidence to support its interpretation of 580b applying to short sales but is not conclusive the passage of 580e alone should be construed to mean Congress intended section 580b apply to short sales. *Id.*

¹²⁵ *Id.*

¹²⁶ *Id.*

¹²⁷ See *id.* “[T]he purpose of this proposed legislation is primarily to protect distressed homeowners who have non-purchase money recourse loans on residential property.” *Id.* (combining the aforementioned language with the 580e language, which clearly indicated the application to short sales only, the purpose is evident).

deeper dive into legislative history revealed further support, which highlighted the reasoning of 580e limiting its application to short sales through the preexisting assumption 580b applied to all purchase-money mortgages, no matter the mode of sale.¹²⁸

Chase purported, because 580d pertains to only foreclosures, 580b must also be limited to foreclosures.¹²⁹ The court disagreed with that claim while again mentioning the stark difference in the language used between sections 580d and 580b.¹³⁰ “In summary, we conclude the plain language of section 580b, its purpose (as consistently determined by California courts), and the language of other anti-deficiency statutes makes clear that section 580b applies to the short sale here.”¹³¹

B. The Security-First Rule

The next issue the court addressed was if section 580b was not applicable as a result of the “security-first” rule being waived.¹³² Section 726, also known as the “security-first” or “one-action” rule, applies when the debtor asserts its right for the creditor to pursue the security first, before enforcing the amount necessary to fill any unpaid debt.¹³³ In the current case, Chase took the position,

¹²⁸ *See id.*

¹²⁹ *Id.*

¹³⁰ *Id.* “The phrase ‘in any event after a sale’ in section 580b stands in stark contrast to section 580d, which applies only where the real property ‘has been sold by the mortgagee or trustee under power of sale contained in the mortgage or deed of trust.’” *Id.*

¹³¹ *Id.* at 562–63

¹³² *Id.* at 563.

¹³³ CAL. CIV. PROC. CODE § 726 (West 2014):

(a) There can be but one form of action for the recovery of any debt or the enforcement of any right secured by mortgage upon real property or an estate for years therein, which action shall be in accordance with the provisions of this chapter. In the action the court may, by its judgment, direct the sale of the encumbered real property or estate for years therein (or so much of the real property or estate for years as may be necessary), and the application of the proceeds of the sale to the payment of the costs of court, the expenses of levy and sale, and the amount due plaintiff, including, where the mortgage provides for the payment of attorney’s fees, the sum for attorney’s fees as the court shall find reasonable, not exceeding the amount named in the mortgage.

(b) The decree for the foreclosure of a mortgage or deed of trust secured by real property or estate for years therein shall declare the amount of the indebtedness or right so secured and, unless judgment for any deficiency there may be between the sale price and the amount due with costs is waived by the judgment creditor or a deficiency judgment is prohibited by Section 580b, shall determine the personal liability of any defendant for the payment of the debt secured by the mortgage or deed of trust and shall name the defendants against whom a deficiency judgment may be ordered following the proceedings prescribed in this section. In the event of waiver, or if the

because Carol Coker never asserted her section 726 right, a deficiency judgment shall be payable from Coker.¹³⁴ Chase heavily relied on the reasoning in *Scalese v. Wong*,¹³⁵ which the *Coker* court distinguished from its case.¹³⁶

In *Scalese*, appellants purchased a five-unit apartment building by securing a purchase-money loan through assumption.¹³⁷ Instead of staying on track with the payment schedule, the appellants wanted to pay the full mortgage at an earlier time than originally agreed upon.¹³⁸ Appellee reacted by not allowing the payment, and appellants responded by refusal to make scheduled payments.¹³⁹ In turn, appellee filed suit requesting specific performance and

prohibition of Section 580b is applicable, the decree shall so declare and there shall be no judgment for a deficiency. In the event that a deficiency is not waived or prohibited and it is decreed that any defendant is personally liable for the debt, then upon application of the plaintiff filed at any time within three months of the date of the foreclosure sale and after a hearing thereon at which the court shall take evidence and at which hearing either party may present evidence as to the fair value of the real property or estate for years therein sold as of the date of sale, the court shall render a money judgment against the defendant or defendants for the amount by which the amount of the indebtedness with interest and costs of levy and sale and of action exceeds the fair value of the real property or estate for years therein sold as of the date of sale. In no event shall the amount of the judgment, exclusive of interest from the date of sale and of costs exceed the difference between the amount for which the real property or estate for years therein was sold and the entire amount of the indebtedness secured by the mortgage or deed of trust. Notice of the hearing shall be served upon all defendants who have appeared in the action and against whom a deficiency judgment is sought, or upon their attorneys of record, at least 15 days before the date set for the hearing. Upon application of any party made at least 10 days before the date set for the hearing the court shall, and upon its own motion the court at any time may, appoint one of the probate referees provided for by law to appraise the real property or estate for years therein sold as of the time of sale. The probate referee shall file the appraisal with the clerk[,] and the appraisal is admissible in evidence. The probate referee shall take and subscribe an oath to be attached to the appraisal that the referee has truly, honestly[,] and impartially appraised the real property or estate for years therein to the best of the referee's knowledge and ability. Any probate referee so appointed may be called and examined as a witness by any party or by the court itself. The court shall fix the compensation, in an amount as determined by the court to be reasonable, but the fees shall not exceed similar fees for similar services in the community where the services are rendered, which may be taxed and allowed in like manner as other costs.

Id.

¹³⁴ See *Coker*, 159 Cal. Rptr. 3d at 563 (arguing because section 726 was not raised, a deficiency judgment was then available as an election, which the court found incorrect).

¹³⁵ 101 Cal. Rptr. 2d 40 (Cal. Ct. App. 2000).

¹³⁶ *Coker*, 159 Cal. Rptr. 3d at 563–64.

¹³⁷ *Scalese*, 101 Cal. Rptr. 2d at 41.

¹³⁸ *Id.*

¹³⁹ *Id.*

judicial foreclosure.¹⁴⁰ At no point during the initial filings or at trial did the appellants assert the one-action rule.¹⁴¹

The trial court found the purchase-money mortgage indicated a prepayment would not be an available option allowed by the agreement.¹⁴² Accordingly, appellee was successful and received an election of remedies.¹⁴³ The election of remedies was either to enforce the specific performance of monthly payments owed or commence a judicial foreclosure.¹⁴⁴ When the appellee elected the specific performance remedy, appellants did not assert their section 726 right to have the security exhausted first.¹⁴⁵

On appeal, appellants argued the damage award was incorrect because appellee may have only pursued the remedy offered under section 580b.¹⁴⁶ The appellate court ruled against the appellants' argument because the following sequence was met: First, appellants never brought up the security-first rule, and, in turn, waived that right;¹⁴⁷ and, second, appellee elected to waive the security interest to receive the specific performance granted.¹⁴⁸ Technically, section 580b "never [came] into play" because there was no sale of security.¹⁴⁹

The *Coker* court distinguished *Scalese* on many grounds.¹⁵⁰ In *Scalese*, the court dealt with the possibility of a judicial foreclosure, which never came to realization. Additionally, a completed short sale did not transpire, as in *Coker*.¹⁵¹ The issue in *Scalese* was a breach of contract issue on whether prepayment would be permitted stemming from the appellants' refusal to make payments on time and appellee's refusal to accept a full prepayment.¹⁵² After

¹⁴⁰ *Id.*

¹⁴¹ *Id.* at 42:

[A]ppellants did not assert section 726 as a defense to the complaint. Further, at the time respondent made the election at the conclusion of trial, appellants voiced no objection and did not demand that the security be exhausted. The record shows that after respondent made the election, the court asked counsel for appellants if he wished to be heard. Counsel replied "I [do not] know if [there is] anything I can say. I mean, that's the remedy [the respondent] wants."

Id. at 43-43.

¹⁴² *Id.* at 42.

¹⁴³ *Id.*

¹⁴⁴ *Id.*

¹⁴⁵ *Id.*

¹⁴⁶ *Id.* at 44.

¹⁴⁷ *Id.* at 43-44.

¹⁴⁸ *Id.* at 44.

¹⁴⁹ *Id.*

¹⁵⁰ See *infra* notes 151-57 and accompanying texts.

¹⁵¹ *Coker v. JP Morgan Chase Bank, N.A.*, 159 Cal. Rptr. 3d 555, 557-58 (Cal. Ct. App. 2013); *Scalese*, 101 Cal. Rptr. 2d at 41.

¹⁵² *Scalese*, 101 Cal. Rptr. 2d at 44.

the court decided appellee's argument was correct and appellants failed to answer with a one-action rule, the appellee proceeded by electing to receive the back payments.¹⁵³ Dissimilarly, the issue in *Coker* was whether a deficiency judgment was available after a short sale occurred.¹⁵⁴ There was a possibility of a power-of-sale foreclosure, but the short sale took its place and was completed.¹⁵⁵ The resulting deficiency was nonexistent in *Scalese*.¹⁵⁶

In addition, the appellants retained ownership of the apartment in *Scalese*. Thus, if the court of appeals determined section 580b applied, the appellants would have received a windfall. They would have owned the apartment free and clear without any liability on the note. In holding section 580b was not applicable, the court sought an equitable result where the appellants owned the apartment but were personally liable for the missed payments on the note, and the appellee had given up its security interest in the apartment. However, *Coker* no longer owned her residence, having sold the property to a third party. Chase received the proceeds of that sale.¹⁵⁷

The connection Chase drew between section 726 and section 580b was incorrect.¹⁵⁸ It would be incorrect to state failure to invoke the one-action rule will result in loss of 580b protection.¹⁵⁹ Instead, it would be precise to posture failure to complete a sale will result in no effect on section 580b because the statute has not yet been triggered; there must first be a sale for section 580b to be triggered.¹⁶⁰ There was only a possibility of judicial foreclosure in *Scalese*; the actual sale did not occur due to the appellant's failure to invoke section 726 and the decision of the appellee to not conduct the sale.¹⁶¹ The facts are clear in *Coker* a short sale occurred.¹⁶² The *Coker* court decided the cases were distinguishable, and, in turn, section 580b applied.¹⁶³

¹⁵³ *Id.*

¹⁵⁴ *Coker*, 159 Cal. Rptr. 3d at 558–59.

¹⁵⁵ *See id.* at 557.

¹⁵⁶ *See Scalese*, 101 Cal. Rptr. 2d at 43.

¹⁵⁷ *Coker*, 159 Cal. Rptr. 3d at 564.

¹⁵⁸ *See infra* notes 159–63 and accompanying texts.

¹⁵⁹ *See* CAL. CIV. PROC. CODE § 726 (West 2014); *see also id.* § 580b (West 2014):

Failure to invoke the one-action rule creates an election of remedies available to the lender. In order for 580b to come in contact with the failure to invoke the one-action rule the lender must also elect to receive the security through a sale and that sale must be completed. If that sequence is satisfied the lender is subsequently barred from a deficiency judgment due to the fact that the security was the chosen remedy.

Id.

¹⁶⁰ *See* CIV. PROC. § 580b (West 2014).

¹⁶¹ *Scalese*, 101 Cal. Rptr. 2d at 41.

¹⁶² *Coker*, 159 Cal. Rptr. 3d at 558.

¹⁶³ *Id.* at 565.

C. Waiver

The court also ruled, consistent with other cases, a waiver of section 580b would be unavailable as a matter of public policy.¹⁶⁴ The cornerstone case, considered the only situation that allows a waiving of section 580b, is *Spangler v. Mermel*.¹⁶⁵ The *Spangler* case can be classified not as a waiver but a change of loan character.¹⁶⁶ The loan was no longer a purchase–money mortgage; instead, it was classified as a subordinate construction loan.¹⁶⁷ The *Coker* court found the loan character in its case was far from the *Spangler* loan, because the loan in *Coker* was never changed from a purchase–money mortgage.¹⁶⁸ The finding there was no loan character change from a purchase–money mortgage leads to the conclusion there may not be a waving of section 580b as a matter of public policy.¹⁶⁹

V. JUDICIAL, LEGISLATIVE, AND SOCIAL IMPACT

The central impact of the *Coker* decision may seem fairly limited because it renders all unpaid debt in direct connection with a purchase–money mortgage following a short sale valueless.¹⁷⁰ Further, the decision only immediately affects short sales completed before July 15, 2011, because after that date, under section 580e, a lender may not collect unpaid debt following a short sale on any type of mortgage.¹⁷¹ However, when the decision is teased out, there are more legal and social ramifications that exist.¹⁷² The following section will discuss the impact the *Coker* decision places on the legal and social world.

¹⁶⁴ *Id.* The language of 580b is:

[E]xplicit and unambiguous . . . [:] A vendor cannot obtain a [deficiency] judgment against a purchaser in a purchase money secured land transaction. [There is no wiggle room] in the statute that would permit a vendor to enforce a waiver of its protection in exchange for other concessions. To do so would circumvent the absolute rule and flout its very purpose.

Lawler v. Jacobs, 100 Cal. Rptr. 2d 52, 61 (Cal. Ct. App. 2000). The Supreme Court has held “provisions of section 580b . . . may not be contractually waived by the debtor in advance of or at the time a purchase money obligation is incurred.” *Palm v. Schilling*, 244 Cal. Rptr. 600, 602–04 (Cal. Ct. App. 1988).

¹⁶⁵ 498 P 2d. 1055, 1060–1062 (Cal. 1972).

¹⁶⁶ *Id.*

¹⁶⁷ *Id.*

¹⁶⁸ *See id.* at 1061; *Coker*, 159 Cal. Rptr. 3d. at 558.

¹⁶⁹ *Coker*, 159 Cal. Rptr. 3d at 565.

¹⁷⁰ *Id.*

¹⁷¹ *Id.*; CAL. CIV. PROC. CODE § 580e (West 2014).

¹⁷² *See infra* Part V.A–B and accompanying notes 173–229.

A. Liberal Statute Construction & Broad Interpretation

The *Coker* court stated liberal statute construction and broad interpretation accompany California's anti-deficiency legislation.¹⁷³ Although the court's view can provide equitable results, it also provides opportunity for judicial activism.¹⁷⁴

¹⁷³ See *Coker*, 159 Cal. Rptr. 3d. at 1061; see also *Prunty v. Bank of Am.*, 112 Cal. Rptr. 370, 373 (Cal. Ct. App. 1974). The *Prunty* court cited a few sources explaining how the court should interpret the statute: "The fundamental rule of statutory construction is that the court should ascertain the intent of the [l]egislature so as to effectuate the purpose of the law. . . . Statutes should be construed so as to be given a reasonable result consistent with the legislative purpose." *Id.* (quoting *People v. Superior Court*, 449 P.2d 230, 237 (Cal. 1969)). "Moreover, . . . a statute should be construed with reference to the entire statutory system of which it forms a part in such a way that harmony may be achieved among the parts" *Id.* (quoting *Merrill v. DMV*, 458 P.2d 33, 40 (Cal. 1969)). We are to construe the express language of a statute "according to the usual, ordinary import of the words employed, but in context, keeping in mind the nature and obvious purpose of the statute." *Id.* (quoting *People v. Superior Court*, 449 P.2d at 237). The *Prunty* court followed its interpretation preface with the following statement:

Applying these rules in the interpretation of section 580b in particular (or of any of the other components of the "entire statutory system" of anti-deficiency legislation which includes it), we must also recognize that the "system" has been liberally construed to effectuate the specific legislative purpose behind it. As one writer has stated, ". . . the courts have exhibited a very hospitable attitude toward the legislative policy underlying the anti-deficiency legislation and have given it a broad and liberal construction that often goes beyond the narrow bounds of the statutory language."

Prunty, 112 Cal. Rptr. at 373–374 (quoting Stefan A. Riesenfeld, California Legislation Curbing Deficiency Judgments, 48 CALIF. L. REV. 705, 709 (1960)). It should be noted the *Prunty* court cited court cases in its anti-deficiency interpretation preface but cited to a law review article when expanding the scope of interpretation to liberal construction and broad interpretation. *Id.*

¹⁷⁴ See *Coker*, 159 Cal. Rptr. 3d at 565; see also *Prunty*, 37 Cal. Rptr. at 443; cf. Thomas L. Murphy, *The Dangers of Overreacting to "Judicial Activism"*, UTAH B.J., 38, 39 (2006). The Murphy article defined "judicial activism" as the court either reading the text of law in a "rigid" manner or a liberal manner to get the result it ultimately wants, while having little case law, history, or other established legal references to support its conclusions. See *id.* Reinert defined "judicial activism" as the point when the "[c]ourt ha[s] overstepped its role as interpreter of the law and instead engage[s] in legislating." Joseph A. Reinert, *The Myth of Judicial Activism*, VT. B.J., 35, 35 (2004). The term "judicial activism" refers to a family of views concerning the nature of constitutional interpretation and the institutional role of the court. William Marshall divides the term into seven categories:

(1) Counter-Majoritarian Activism: the reluctance of the courts to defer to the decisions of the democratically elected branches; (2) Non-Originalist Activism: the failure of the courts to defer to some notion of originalism in deciding cases, whether that originalism is grounded in a strict fealty to text or in reference to the original intent of the framers; (3) Precedential Activism: the failure of the courts to defer to judicial precedent; (4) Jurisdictional Activism: the failure of the courts to adhere to jurisdictional limits on their own power; (5) Judicial Creativity: the creation of new theories and rights in constitutional doctrine; (6) Remedial Activism: the use of judicial power to

Prunty, for example, came to an “equitable” result.¹⁷⁵ The court decided although the loan was technically a construction loan, it was intrinsically used as a home purchase and, therefore, fell within section 580b protection.¹⁷⁶ *Prunty* is a prime example of judicial activism used to come to the most equitable result in the court’s opinion.¹⁷⁷ To some, the result is equitable because, although the loan did not fit the exact definition of the statute, the result was aligned with the situation the statute was intended to protect.¹⁷⁸

On the other hand, the result in *Prunty* can be viewed as inequitable. The inequitable view stems from the thought the law should be predictable in its application.¹⁷⁹ In other words, court decisions should stick to the plain meaning of the contested anti-deficiency legislation to keep the law reasonably foreseeable in its true function.¹⁸⁰ Another resolution available to increase predictability of application would be to allow the waiver of section 580b.¹⁸¹ A waiver would produce expected results, but California courts have continuously struck these attempts down as a matter of public policy.¹⁸²

The *Coker* court affirmed the use of liberal construction and broad interpretation, meaning the court’s decision leaves room for judicial activism.¹⁸³ Those against laws being interpreted outside the plain language can find some

impose ongoing affirmative obligations on the other branches of government or to take governmental institutions under ongoing judicial supervision as a part of a judicially imposed remedy; and (7) Partisan Activism: the use of judicial power to accomplish plainly partisan objectives.

William P. Marshall, *Conservatives and the Seven Sins of Judicial Activism*, 73 U. COLO. L. REV. 1217, 1220 (2002). The definitions are all related to a similar core, but in the context of this article the definition Murphy uses is closer to the meaning portrayed in the text for the reason the court in *Coker* is leaving itself an option to read the anti-deficiency legislation in a manner it sees fit. Murphy, *supra* at 39; cf. *Coker*, 159 Cal. Rptr. 3d at 560–61.

¹⁷⁵ See *Prunty*, 112 Cal. Rptr. at 383; see also *Union Bank v. Anderson*, 283 Cal. Rptr. 823, 827 (Cal. Ct. App. 1991) (referring to the *Prunty* decision as avoiding an inequitable result).

¹⁷⁶ *Prunty*, 112 Cal. Rptr. at 378–79.

¹⁷⁷ See *id.*

¹⁷⁸ See *id.*; see also *Anderson*, 283 Cal. Rptr. at 827. The court in *Prunty* cited a law review article to reach its ideal interpretation. The citation could be considered outside the traditional court interpretation scope. *Prunty*, 112 Cal. Rptr. at 373–74.

¹⁷⁹ Robert Justin Lipkin, *We Are All Judicial Activists Now*, 77 U. CIN. L. REV. 181, 182 (2008). “Judicial activism [is] considered by many to be the scourge of American constitutionalism” *Id.*

¹⁸⁰ *Id.*

¹⁸¹ Harris, *supra* note 34, at 510. “More principled and predictable decisions would be based on the negotiated agreements of the parties, including contractual waivers of section 580b protection when they are agreed to.” *Id.*

¹⁸² See *Coker v. JP Morgan Chase Bank, N.A.*, 159 Cal. Rptr. 3d 555, 565 (Cal. Ct. App. 2013); *Lawler v. Jacobs*, 100 Cal. Rptr. 2d 52, 61 (Cal. Ct. App. 2000); *Palm v. Schilling*, 244 Cal. Rptr. 600, 608 (Cal. Ct. App. 1988).

¹⁸³ See *Coker*, 159 Cal. Rptr. 3d at 560–61.

consistency in the court's historical defense of borrowers.¹⁸⁴ The anti-deficiency trend has historically run in favor of mortgagors, which can provide some predictability in application.¹⁸⁵

B. Purpose Establishment & Freedom to Contract

The court in *Coker* reaffirmed the longstanding purpose of 580b that was defined in *Roseleaf*.¹⁸⁶ The main purposes were defined as: (1) discouraging the overvaluation of property by shifting the risk to the seller; and (2) a stabilization factor to prevent aggravation during an economic downturn.¹⁸⁷ In *Roseleaf*, these purposes were backed with limited legislative authority, and, further, no empirical evidence was used to support the outcome.¹⁸⁸ Despite these facts, the court found two purposes.¹⁸⁹

The first of the two purposes contemplates mortgagees will not overvalue their property by keeping the loan-to-value ratio low and, in turn, maintain a lower default possibility.¹⁹⁰ The first purpose the court manufactured is one factor to consider when discouraging overvaluation; however, there are many other factors that could be considered:

While the loan to value ratio of total debt secured by the property is certainly one factor affecting that risk, it is not the only one, and may be less significant than other factors such as cash flow of the property, the buyer/borrower's income and other assets, the relative size of the loans in comparison to each other, and perceived trends in real estate values. Thus, is unlikely to discourage overvaluation, and may in fact promote overvaluation in an otherwise hot market because buyers can increase their offers on paper without fear of personal liability.¹⁹¹

¹⁸⁴ *Id.* Because the court has been moving in this direction since inception of anti-deficiency legislation, it can be seen the court is not a "precedential activist" as defined in William Marshall's article. See Marshall, *supra* note 174.

¹⁸⁵ See *Coker*, 159 Cal. Rptr. 3d at 561; Prunty v. Bank of Am., 112 Cal. Rptr. 370, 373-74 (Cal. Ct. App. 1974).

¹⁸⁶ *Coker*, 159 Cal. Rptr. 3d at 561.

¹⁸⁷ *Id.*; see *Roseleaf Corp. v. Chierighino*, 378 P.2d 97, 100-01 (Cal. 1963).

¹⁸⁸ See *Coker*, 159 Cal. Rptr. 3d at 561; Harris, *supra* note 34, at 515.

¹⁸⁹ *Roseleaf*, 378 P.2d at 101.

¹⁹⁰ *Id.*; see Harris, *supra* note 34, at 515.

¹⁹¹ Harris, *supra* note 34, at 516-17:

In a dynamic real estate market many factors influence the willingness of a buyer and seller to agree on price and terms and hence affect fair market value. Such factors include existing and potential future uses of the property, perceived direction of changes in the market, availability and cost of financing, governmental restrictions, zoning laws, environmental conditions,

The purposes may not have the most substantial support, but the courts do not seem to be moving away from the *Roseleaf* interpretation, and California legislation has not amended section 580b to reflect a different purpose than the court proposed.¹⁹² Though “legislative acquiescence in prior judicial decisions is not conclusive in determining legislative intent,”¹⁹³ the court in *Coker* made no reference to challenge the purpose given in *Roseleaf*, which further established that purpose as the baseline for section 580b’s interpretation on issues varying from the text.¹⁹⁴

The patent impact of the *Coker* decision is stated in its holding:

“The explicit language of section 580b brooks no interpretation other than that deficiency judgments are prohibited by a purchase money mortgagee so long as a purchase money mortgage or deed of trust is in effect on the original real property.” There is no dispute that the loan in place at the time of the short sale was a purchase money loan. Section 580b applies after a sale of the property, and

tax impacts, terms and conditions for payment, and general economic conditions.

Id.

There simply is no empirical basis for the notion, espoused in *Brown* and adopted in *Spangler*, that sellers as a group necessarily have more knowledge of the value of their properties than do buyers, or for the idea that any construct of law is needed to prevent sellers from “overvaluing” their properties. Sellers naturally want the highest price they can get and buyers naturally want the lowest, but who has the most knowledge about value in a given transaction is a function of individual market sophistication, not a function of status as a buyer or a seller.

Id. at 524.

¹⁹² *Coker*, 159 Cal. Rptr. 3d. at 561. There were two amendments to section 580b after the *Roseleaf* decision, one of which did solve some related confusion. See *supra* notes 17–18; cf. Harris, *supra* note 34, at 538:

[D]o away with the unpredictability of a rule based on an ill-defined notion of “standard” transactions, speculative statutory “purposes,” confusion about the meaning of value, and vague ideas of equity between buyers and sellers as potentially victimized classes, clarity in the law and predictability in the market place should be established by adherence to two basic propositions in 580b subordination cases: [(1)] As *Brown v. Jensen* determined, “in no event” does 580b permit a deficiency judgment on a note secured by a purchase-money deed of trust on the property sold. As interpreted in *Brown v. Jensen*, the words “in no event” preclude a deficiency judgment in the event of a sold-out junior lien, unless the parties otherwise agree. [(2)] The parties to real estate transactions involving purchase-money deeds of trust should be free to bargain about waiver of 580b protection.

Harris, *supra* note 23, at 538–39.

¹⁹³ *DeBerard Properties, Ltd. v. Lim*, 976 P.2d 843, 848 (Cal. 1999) (quoting *Stop Youth Addiction, Inc. v. Lucky Stores, Inc.*, 950 P.2d 1086, 1092 (Cal. 1998)).

¹⁹⁴ *Coker*, 159 Cal. Rptr. 3d. at 561.

there is no requirement in the statute that a foreclosure must occur to trigger its protections. Further, those protections cannot be waived.¹⁹⁵

The court has decided 580b does apply to short sales and is not limited to foreclosures.¹⁹⁶ Taking a narrow view of the holding, the case is limited to extending protection to short sales, which means there may be other types of property sales that are, in form or substance, altered from one of the protected sale types and may not fall under the purview of section 580b.¹⁹⁷ If a broad or expanded view of the holding is taken, it could be interpreted to bar all purchase-money mortgage sales from a deficiency judgment, regardless of the sale type.¹⁹⁸ Additionally, the court emphasized if protection under section 580b is obtained, it cannot be waived.¹⁹⁹

The broad view of the holding leaves little room for freedom of contract around section 580b due to the public policy argument.²⁰⁰ Given the difficulty of section 580b circumvention, lenders will have to adapt and become more creative in avoiding, circumventing, or controlling financial damage of the section 580b statute. One of the most common methods used to ensure a lender obtains the full value of the loan is to procure a guaranty.²⁰¹ A guaranty is a promise given to a lender by a guarantor to ensure full payment of the loan if the debtor becomes unable to fulfill his or her obligations.²⁰² If section 580b applies to a sale, the debtor is essentially unable to personally pay for the excess deficiency the security could not satisfy.²⁰³ If the lender obtains a guaranty, the guarantor would not be liable, and section 580b would allow circumvention of this type.²⁰⁴ Section 580b specifically states:

The fact that no deficiency shall be owed or collected under the circumstances set forth in subdivisions (a) and (b) does not affect the liability that a guarantor, pledgor[,] or other surety might otherwise

¹⁹⁵ *Id.* at 565 (quoting *Palm v. Schilling*, 244 Cal. Rptr. 600, 609 (Cal. Ct. App. 1988)).

¹⁹⁶ *Id.*

¹⁹⁷ *See id.*

¹⁹⁸ *See id.* The broad interpretation is likely the interpretation the court has adopted given the analysis focused more on if a sale was completed, not on the fact it was a short sale. *Id.*

¹⁹⁹ *Id.* The court gives only public policy as its reasoning for the inability to waive. *Id.* Aside from public policy, the only other reasoning the court and other courts allude to is stare decisis. Harris, *supra* note 34, at 546. Further, at one point in time it was held 580b could be waived by subsequent actions of the borrower. *Cf. Russell v. Roberts*, 114 Cal. Rptr. 305 (Cal. Ct. App. 1974).

²⁰⁰ *See Coker*, 159 Cal. Rptr. 3d. at 565.

²⁰¹ Carl D. Ciochon, *Guarantor Liability – A Litigation Perspective*, WENDEL ROSEN (Sept. 1, 2008), <http://www.wendel.com/index.cfm?fuseaction=content.contentDetail&ID=9018>.

²⁰² *Financial Guarantee*, INVESTOPEDIA, <http://www.investopedia.com/terms/f/financial-guarantee.asp>.

²⁰³ *See* CAL. CIV. PROC. CODE § 580b (West 2014).

²⁰⁴ *Id.*

have with respect to the deficiency, or that might otherwise be satisfied in whole or in part from other collateral pledged to secure the obligation that is the subject of the deficiency.²⁰⁵

A guaranty is now a more important consideration when lending; however, securing a guaranty is not as rock-solid as it sounds.²⁰⁶ First, the lender must find a willing guarantor, which in itself may not be an easy task.²⁰⁷ Next, even if the guarantor is obligated and they are called upon to fulfill their obligation, there are a number of defenses a guarantor may assert.²⁰⁸ Some of these defenses include suretyship, “sham” guaranty, contract defenses, and others.²⁰⁹ In these situations, 580b does keep its efficacy in protecting the

²⁰⁵ *Id.*

²⁰⁶ *See* Ciochon, *supra* note 201.

²⁰⁷ *Id.*

²⁰⁸ *Id.*

²⁰⁹ *Id.*:

California law nominally provides strong protections for guarantors as well. Known as “suretyship defenses,” these protections severely restrict the lender’s ability to recover from the guarantor (who is sometimes described as a “surety”). Significantly, these suretyship defenses may be waived by the guarantor. Accordingly, most common forms of guaranty, particularly those used by institutional lenders, contain broad waivers of all potentially applicable suretyship defenses.

Id.

California’s powerful anti-deficiency protections are deemed nonwaivable as a matter of public policy. The sham guaranty rule effectuates this policy by voiding guaranties that attempt to circumvent these protections. The classic application of the sham guaranty rule arises in the context of a general partnership. Because the partners of a general partnership are jointly and severally liable for the partnership’s obligations, the law views the partners and the partnership as essentially one and the same. Accordingly, a partner’s guaranty of the partnership’s real estate secured obligations will be deemed an invalid sham guaranty. Whether the sham guaranty defense is applicable in other situations, such as a guaranty of a limited partnership’s obligations by a limited partner, an LLC’s obligations by a member, or a corporation’s obligations by an officer or shareholder, will depend on the facts presented. Although courts frequently uphold guaranties in these circumstances, if the guarantor can present evidence that the “purpose and effect” of the guaranty was to “subvert” California’s anti-deficiency protections, the sham guaranty defense may apply.

Id.

A guaranty is subject to the full panoply of traditional contract defenses, such as incapacity, unconscionability, illegality, duress, fraud, and mistake, as well as equitable defenses such as waiver and estoppel. The applicability of these defenses will depend upon the facts presented. In general, the closer the transaction appears to the ideal of an arms length transaction negotiated by sophisticated parties represented by counsel, the less likely these defenses are to succeed. By the same token, the farther the facts stray from this ideal, the greater the possibility a court may find one or more of these defenses applicable, particularly if there is evidence of lender misconduct.

borrower but does not place the burden on lenders when estimating property value, and there is no evidence supporting the fact securing a guarantor will assist with possible economic downturn.

Perhaps the most common method of obtaining a guaranty arises in the context of Veteran Affairs (VA) or Federal Housing Administration (FHA) loans.²¹⁰ These mortgages are issued through federally qualified lenders and insured by the FHA or VA.²¹¹ Therefore, in the case of a mortgagor default, the federal government will pay the lender, and the government could pursue a deficiency judgment as a guarantor.²¹² In *Carter*, veterans brought an action under Idaho law to enjoin VA insured loans from their recourse attempt on an outstanding deficiency.²¹³ The Idaho law essentially prevented lenders from obtaining deficiency judgments after nonjudicial foreclosures.²¹⁴ The court described the applicable federal law as follows:

When a veteran takes advantage of the VA guarantee program, two legal relationships are established, both of which are governed by federal law. First, the VA promises to reimburse the lender if the veteran defaults, up to the face value of the guarantee. Second, the veteran promises to reimburse the VA for any amount the VA pays the lender. This is an obligation owed directly to the VA, which it may recover by subrogating itself to any remaining rights of the lender or by pursuing an independent right of indemnity against the veteran.²¹⁵

The court went on to state the issue was not one of preemption because the state and federal statutes did not conflict.²¹⁶ Instead, the state statute simply did not apply to the federal government; federal law governs the VA.²¹⁷ Along the

Id.

²¹⁰ *Federal Takeover of Fannie Mae and Freddie Mac*, WIKIPEDIA, http://en.wikipedia.org/wiki/Federal_takeover_of_Fannie_Mae_and_Freddie_Mac#Ongoing_status_of_Fannie_and_Freddie_servatorship (last updated Sept. 11, 2014) [hereinafter *Federal Takeover*].

²¹¹ *FHA Loan*, INVESTOPEDIA, <http://www.investopedia.com/terms/f/fhaloan.asp> (last updated 2014).

²¹² See *Carter v. Derwinski*, 987 F.2d 611, 612 (9th Cir. 1993).

²¹³ *Id.*

²¹⁴ *Id.* at 612–13. “*Whitehead v. Derwinski* involved the Washington foreclosure scheme, which is similar to Idaho’s. Like Idaho, Washington allows both judicial and nonjudicial foreclosures. Washington permits deficiency judgments after a judicial foreclosure, but prohibits them altogether after a nonjudicial foreclosure.” *Id.* at 612.

²¹⁵ *Id.* at 612; 38 U.S.C. § 3703 (2012) (describing the authority to bind lenders to terms and conditions of the insurance); 38 U.S.C. § 3720 (2012) (giving authority to pursue veterans in the event of deficiency); 38 C.F.R. § 36.4321 (2010) (stating the promise to reimburse the lender).

²¹⁶ *Carter*, 987 F.2d at 616.

²¹⁷ *Id.*:

We need not decide whether the Idaho foreclosure scheme is preempted. Whether and under what circumstances the state deficiency procedures might

court's line of reasoning, federal subrogation and indemnity remained intact, and pursuit against the veteran for the outstanding balance was valid.²¹⁸

FHA and VA loans have saturated the market, consuming over half of all the single-family mortgages in the United States.²¹⁹ Lenders have taken advantage of this market by becoming federally qualified and receiving their insurance.²²⁰ A federal guaranty of this type may become more common in California and other states with anti-deficiency provisions to provide lenders with the necessary protection they need in the event of a deficiency, essentially eliminating anti-deficiency legislation.²²¹

Another method lenders may use to overcome the deficiency bar of section 580b is to attempt to convert the loan to a subordinated loan under a construction loan and, therefore, fall within the *Spangler* exception.²²² For a lender to purposefully accomplish the *Spangler* exception, it must have the opportunity to do so by attaching the loan to an upcoming or anticipated construction project.²²³ A lender could conceivably finance a home purchase that borrowers intend to substantially modify or are convinced to build upon, subordinate their loan, change the land use to construction, and waive section 580b with consent of the borrower.²²⁴ It is the only waiver exception that has been allowed by the courts and many variables must fall in place for the waiver to be honored, making it difficult for lenders to attain.²²⁵ A mortgagee would likely attempt a waiver of this kind if he had knowledge there were plenty of

produce a lesser recovery than an action on the federal indemnity right [is not] pertinent. Such analysis incorrectly assumes that the VA must comply with the state scheme in order to recover from the veterans. Regardless of the method by which a lender proceeds against a defaulting veteran—even when it does so at the VA's direction—the VA always possesses a right of indemnity against the veteran for the amount of guarantee paid to the lender. This is an independent right of indemnity, created by federal law, which state courts must honor.

Id.

²¹⁸ *Id.*

²¹⁹ *Federal Takeover*, *supra* note 210.

²²⁰ *FHA Requirements: Debt Ratios*, FHA.COM, http://www.fha.com/fha_requirements_debt (last visited Sept. 22, 2014). The requirements promulgated by the FHA are in place to increase the likelihood the potential mortgagor will stay solvent throughout the mortgage. There are essentially two requirements that must be satisfied by the potential mortgagor to qualify: (1) the mortgage payment to effective income ratio must be a maximum of thirty-one percent and (2) the total fixed debt to effective income must be a maximum of forty-three percent. *Id.*

²²¹ *All Praise to the New Subprime – 1 out of 6 FHA Insured Loans Is Now Delinquent. Offering 30x Leverage with FHA Loans.*, DR.HOUSINGBUBBLE (Aug. 22, 2012), <http://www.doctorhousingbubble.com/fha-new-subprime-30x-leverage-fha-insured-loans-bailout/>.

²²² See *Spangler v. Memel*, 498 P.2d 1055, 1062 (Cal. 1972).

²²³ *Id.*

²²⁴ *Id.*

²²⁵ *Id.*

other assets the mortgagor possessed or strongly believed the construction project would be lucrative, to maintain full recovery of any deficiency that may occur.²²⁶

Out-of-state lenders in states that do not have anti-deficiency legislation have an advantage in recovering deficiencies, even if the mortgage is tied to real property situated in California.²²⁷ Generally the governing law of the debt for which the mortgage was obtained will be used to decide the case on that particular issue, but there have been some conflicting decisions.²²⁸ If it is

²²⁶ See *id.* at 1056–57. In *Spanger*, the newly constructed building was not commercially successful due to lack of tenants. *Id.* This lack of occupancy caused the mortgagor to fall behind on payments and, in turn, triggered a cause of action to obtain the deficiency. *Id.* Preferably, a lender would like to have both a commercially successful project, as well as plenty of personal assets to insure the possible loss. *Id.*

²²⁷ See John H. Shadduck, Application of California's Antideficiency Statutes in Conflict of Laws Contexts, 73 CALIF. L. REV. 1332, 1347–48 (1985).

²²⁸ RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 229 (1971):

Issues which do not affect any interest in the land, although they do relate to the foreclosure, are determined, on the other hand, by the law which governs the debt for which the mortgage was given. Examples of such latter issues are the mortgagee's right to hold the mortgagor liable for any deficiency remaining after foreclosure or to bring suit upon the underlying debt without having first proceeded against the mortgaged land.

Id. The choice of law issue that arises in many of these diversity cases is demonstrated in the following quotation:

Section 580b bars a deficiency judgment on a purchase-money mortgage. The leading conflict of laws case involving section 580b is *Yunker v. Reseda Manor*, decided in 1967. In *Yunker*, a California corporation operating in Nevada bought land in Nevada financed in part by the Nevada domiciliary seller. The indebtedness was secured by a purchase-money mortgage, apparently governed by Nevada law. After foreclosure, the seller brought an action for the deficiency in California against the California corporation which had defaulted. The California debtor claimed the action was barred by section 580b, but the Nevada creditor argued that the court should apply Nevada law—which provided no purchase-money deficiency bar—since Reseda Manor was doing business in Nevada and all transactional contacts had occurred there. The *Yunker* court barred the deficiency judgment but obscured the doctrinal basis for its holding. The opinion offered no evaluation of whether the policies underlying section 580b supported the application of the deficiency bar.

By contrast, the court in *Kish v. Bay Counties Title Guaranty Co.* declared that in purchase-money financing of a Nevada property sale, the section 580b antideficiency rights were integrated into the contract, which was to be performed in California and was governed by California law.⁸⁷ Neither the *Kish* nor the *Yunker* holding is supported by an analysis of the policies underlying section 580b. Because they apply section 580b inconsistently, and more importantly, because they lack policy analysis, *Yunker* and *Kish* offer little guidance for evaluating section 580b in accordance with interest analysis.

decided a state's law without anti-deficiency regulation is the governing law for the deficiency issue, an out-of-state lender could conceivably contract with a borrower, acquiring real estate in California, and avoid section 580b.²²⁹ It is a trend that could develop if recovery of debt becomes a pressing issue.

VI. CONCLUSION

The 1930s brought the United States the longest sustained economic downturn of all time.²³⁰ In response, California took action to provide borrowers with protection, shift default risk to lenders, and prevent aggravation during times of economic downturn by enacting anti-deficiency legislation.²³¹ Courts relate to the historical background and some legislative history as the core when fabricating purposes of enactment of anti-deficiency legislation they believe will produce positive economic effects.²³² As suggested above, the court in *Roseleaf* had little support in its use of liberal construction and broad interpretation of section 580b, and, in turn, diminutive reasoning when deciding the purpose of section 580b.²³³

The *Coker* decision was based on the assumption *Roseleaf's* view of anti-deficiency purpose was unquestionably correct.²³⁴ *Roseleaf's* standards made it comfortable for the *Coker* court to conclude the language in section 580b extended to protect borrowers after the completion of a short sale.²³⁵ The further support used by the court citing the passage of section 580e provided little, if anything, in drawing the conclusion 580e was a symbol of what Congress intended section 580b to protect.²³⁶ There was little legislative history to assist its conclusion in this aspect.²³⁷ On top of the fragile interpretation, the court reinforced the non-waivable anti-deficiency legislation precedent as a matter of public policy.²³⁸

The immediate impact of short sale deficiency denial is apparent, but the court's affirmation of anti-deficiency interpretation style, as well as purpose establishment, holds a long-term effect.²³⁹ The long-term effect forces lenders

Shaddock, *supra* note 227.

²²⁹ Shaddock, *supra* note 227.

²³⁰ The Great Depression, HISTORY.COM (2009), <http://www.history.com/topics/great-depression>.

²³¹ See *supra* Part II and accompanying notes 13–66.

²³² See *supra* Part IV–V and accompanying notes 74–229.

²³³ *Id.*

²³⁴ *Coker v. JP Morgan Chase Bank, N.A.*, 159 Cal. Rptr. 3d 555, 560–61 (Cal. Ct. App. 2013).

²³⁵ *Id.* at 565.

²³⁶ See *supra* note 124 and accompanying text.

²³⁷ *Id.*

²³⁸ *Coker*, 159 Cal. Rptr. 3d at 565.

²³⁹ See *supra* Part V and accompanying notes 170–229.

to stray away from using circumvention or waiver contracts with the borrower and find more creative ways to ensure they will receive the full loan amount in the event of a deficiency.²⁴⁰

The overarching principal to take from the case is California courts will use expansive means to limit the freedom to contract when applying anti-deficiency legislation.²⁴¹ There have been limited exceptions allowed, but, for the most part, as a matter of public policy and stare decisis, waivers are not available.²⁴² The court's holding can be considered against the purposes given or counter-productive toward public policy, as many of the loans will be insured by the federal government or supplied with a guarantor, and, therefore, not subject to state law or push forward the purposes expressed.²⁴³ In turn, state law will have a small effect on the public, losing the economic effect of the purpose entirely.

²⁴⁰ *Id.*

²⁴¹ *See supra* Part IV–V and accompanying notes 74–229.

²⁴² *See supra* Part IV.C and accompanying notes 164–169.

²⁴³ *See supra* Part V.A and accompanying notes 173–185.