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EARLELAW NEWSLETTER

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California Foreclosures and Deficiency Judgments

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A recent decline in the value of certain residential real estate combined with increasingly higher monthly payments on sub-prime loans, occasioned by adjustable interest rates, appears to be driving an increase in the filing of Notices of Default (NODs), the first step in the foreclosure process.

An increase in the filing of NODs has, in turn, resulted in an increase in the number of inquiries EARLE LAW OFFICES has been receiving from homeowners, real estate investors, and real estate professionals, who need legal representation in cases relating to loan defaults.

In order to respond in a general fashion to the most common questions EARLE LAW OFFICES has been receiving of late, this EARLELAW NEWSLETTER will provide a brief overview of California law relating to foreclosures and deficiency judgments.

There are two types of foreclosure actions in California: judicial and non-judicial. The vast majority of California foreclosure actions proceed as non-judicial foreclosures because judicial foreclosures take much longer to complete and to become final than do non-judicial foreclosures and, therefore, are generally more expensive for lenders.

California's anti-deficiency statutes preclude or limit lenders' ability to obtain personal judgments against defaulting borrowers in many situations where proceeds from the sale of a property which has been foreclosed upon fail to extinguish the outstanding debt which was secured by the property. *See*, California Code of Civil Procedure §§ 580a, 580b, 580d, 726(a).

C.C.P. § 580d generally prohibits deficiency judgments following non-judicial foreclosure of real property. Section 580b generally prohibits deficiency judgments after any foreclosure sale, judicial or non-judicial, of property that is securing a third-party purchase money trust deed or mortgage on owner-occupied residential property, or on a seller-held purchase money trust deed or mortgage on any kind of property.

Non-Judicial Foreclosure

By choosing non-judicial foreclosure, the creditor waives the right to a deficiency judgment. Roseleaf Corp. v. Chierighino, 59 Cal.2d 35, 43-44 (1963). When a deficiency judgment is barred following a non-judicial foreclosure under a deed of trust, the trustee has a duty to cancel the underlying note. Kerivan v. Title Ins. & Trust Co., 147 C.A.3d 225, 230-231.

Section 580d does not bar recovery on a debt by a sold-out junior lienholder whose security has been rendered worthless by non-judicial foreclosure of a senior lienholder. Roseleaf Corp. v. Chierighino, 59 Cal.2d at 43. However, no deficiency judgment may be recovered in any event after the sale of property under a trust deed given to the vendor to secure payment of the balance of the purchase price. C.C.P. § 580b. All standard purchase-money transactions are subject to the C.C.P. § 580b bar to deficiency judgments. Spangler v. Memel, 7 Cal.3d 603, 610 (1972).

Judicial Foreclosure

A creditor may generally obtain a deficiency judgment following a judicial foreclosure, except where the purchase-money rule would bar such a judgment. C.C.P. § 580b. When recovery of a

deficiency judgment is allowed, recovery is limited to the amount by which the outstanding debt exceeds either the fair market value of the property at the time of sale or, if less, the sale price. C.C.P. § 580a.

The purchase-money rule does not, however, apply in cases where the property has been refinanced and the purchase-money loan replaced with a different loan which also is secured by the subject property. Union Bank v. Wendland, 54 C.A.3d 393, 399-400 (1976).

Deficiency Judgments Generally

The “One-Form-of-Action” rule provides that foreclosure is the only form of action to recover any debt or enforce any right secured by a deed of trust or mortgage. C.C.P. § 726(a). The rule has two purposes: to compel a secured creditor to resort first to the security and to protect the debtor from multiple suits when a creditor holds multiple security interests. Savings Bank v. Central Market Co., 122 Cal. 28 (1898).

The security-first requirement of the One-Form-of-Action rule does not preclude, as mentioned above, an action on a debt by a creditor whose security has been rendered worthless without any fault on the part of the creditor. Id., at 33-36. The most common example is the sold-out junior lienholder, whose security has been rendered worthless by foreclosure of a senior lien. Roseleaf Corp. v. Chierighino, 59 Cal.2d at 39-44.

Bad-Faith Waste

California’s anti-deficiency statutes also do not bar actions for bad-faith waste, a judicially-created tort action which was first recognized in California in 1975, by the state supreme court. Cornelison v. Kornbluth, 15 Cal.3d 590 (1975).

The traditional definition of “waste” involves conduct by a person in possession of real property that impairs the value of the property, which serves as the lender’s security interest. Evans v. California Trailer Court, Inc., 28 C.A.4th 540 (1994).

Waste includes diminution in value of real property which is caused solely or primarily as a result of economic pressures of a market depression.

Bad-faith waste, on the other hand, involves conduct which is “reckless,” “intentional,” or “malicious” and is distinguished from ordinary waste,

which results from the neglect that occurs due to an owner’s financial inability to properly maintain real property. Cornelison v. Kornbluth, 15 Cal.3d at 604.

Loan Fraud

The One-Form-of-Action rule also does not bar an action for damages for fraud, if the action is brought by a person authorized by California to make or arrange loans, or by any subsidiary, affiliate, or successor in interest that originated the loan or purchased the loan or any interest in the loan, against a borrower for fraudulent conduct that induced the original lender to make a loan secured by a trust deed. Civil Code § 1572. Punitive damages are authorized in an amount equal to fifty percent (50%) of actual damages. C.C.P. § 726(f), (h); Financial Code §§ 779(a), 7460(a), 15102(a). This exception does not, however, apply to loans secured by single-family, owner-occupied residential real property if the property is actually occupied by the borrower as represented to the lender in order to obtain the loan and the loan was for less than \$150,000, adjusted for inflation.

* Anthony F. Earle, Esq. practices in the areas of business law, family law, real estate law, and trusts and estates. He represents individuals, small businesses, and real estate investors and professionals in both litigation and non-litigation matters.

Mr. Earle is licensed to practice law in all California state trial and appellate courts, the United States Supreme Court, the United States Court of Appeals for the Ninth Circuit, and federal trial courts in the Northern District of California. He is also a licensed Real Estate Broker.

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