No. S213137
(Court of Appeal No. D061720)
(San Diego County Super. Ct. No. 37-2011-00087958-CU-MC-CTL)

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

CAROL COKER,

Plaintiff and Appellant,

v.

JPMORGAN CHASE BANK, N.A., for itself and as a successor in interest to CHASE HOME FINANCIAL LLC,

Defendants and Respondents.

Appeal From Judgment And Order Of The Superior Court
For The County of San Diego
(Hon. Luis R. Vargas, Presiding)

JPMORGAN CHASE BANK, N.A.'S OPENING BRIEF ON THE MERITS

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ISSUES PRESENTED

1. Does California Code of Civil Procedure Section 580b apply after a creditor releases its security, at the borrower's request, to facilitate the borrower's short sale?

2. Does a borrower's request and acquiescence in a creditor's destruction of its security in connection with a short sale constitute a waiver of rights and defenses by the borrower under California Code of Civil Procedure Section 726?

INTRODUCTION

This appeal presents the issue of whether the anti-deficiency protections of Code of Civil Procedure Sections 580b and 726 apply following a short sale. The answer is no because a short sale transforms a loan from secured to unsecured. As a result, the "security first" rule of Section 726 can no longer be invoked. Similarly, Section 580b applies only to secured purchase money loans, and therefore cannot apply once the loan becomes unsecured.

A short sale is a contract-based transaction that provides borrowers with an alternative to foreclosure. The lender permits the borrower to sell the property initially used to secure the loan to a third party for less than the amount owed on that loan. *Bank of Am., N.A. v. Roberts*, 217 Cal. App. 4th 1386, 1390 (2013). To effectuate that sale, the lender must agree to release its security interest and reconvey the deed to the property. *Id.* The lender's release of its security interest is necessary to allow the borrower to sell the property to a third party free of the lender's encumbrance on the title. *Id.* at 1398. In many short sales, like the one in this case, the agreement by the lender to release its security interest and reconvey the deed to the borrower is given in exchange for the borrower's agreement to remain personally responsible for any unpaid loan balance after the short sale. *See, e.g.*, Clerk's Transcript ("CT") 46-47.

The borrower's request that the lender release its security in order to allow a short sale to proceed has legal consequences. To begin with, the borrower waives her rights under Section 726. *Roberts*, 217 Cal. App. 4th at 1398. Section 726, often referred to as the "security first" rule, provides borrowers with the right to insist that a lender holding a secured loan proceed with a foreclosure action prior to looking to the borrower for repayment. *Sec. Pac. Nat'l Bank v. Wozab*, 51 Cal. 3d 991, 996-97 (1990). A borrower's rights under Section 726 are waived in connection with a short sale because once the lender releases its security interest, it gives up its right to foreclose. It would therefore make no sense to allow the borrower to invoke the "security first rule" because the borrower has just induced the lender to give up its security interest. *Roberts*, 217 Cal. App. 4th at 1398.

In addition, the borrower's request that the lender release its security in order to allow a short sale to proceed transforms the loan from secured to unsecured. This removes the loan from the ambit of Section 580b, for four reasons:

First, "[i]t is well established that unsecured purchase money notes are not subject to section 580b." *Jack Erickson & Associates v. Hesselgesser* ("*Jack Erickson*"), 50 Cal. App. 4th 182, 189 (1996). In determining whether a purchase money loan is secured or unsecured under Section 580b, courts look to whether the parties have agreed to alter the secured nature of the loan. *DeBerard Props., Ltd. v. Lim*, 20 Cal. 4th 659, 663-64, 668 (1999) (destruction of the security interest removes a loan from the scope of Section 580b); *Spangler v. Memel*, 7 Cal. 3d 603, 610 (1972) (recognizing that applicability of Section 580b is determined by "the particular purchase money situation"). In the context of a short sale, a previously secured loan is transformed into an unsecured loan to allow the borrower to sell the property and avoid foreclosure. *Jack Erickson*, 50 Cal. App. 4th at 189.

Accordingly, in agreeing to allow Appellant Carol Coker ("Coker") to pursue a short sale to avoid foreclosure, Respondent JPMorgan Chase Bank, N.A. ("Chase") agreed to release its security in exchange for Coker's promise to remain personally responsible for the loan's outstanding balance. CT 46. This agreement altered the nature of the loan, changing it from a secured to unsecured purchase money loan. As a result, Section 580b ceased to apply. *Jack Erickson*, 50 Cal. App. 4th at 189.

Second, finding that Section 580b does not extend to short sales is consistent with the distinction between a lawful "destruction" of the security and an unlawful "waiver" of Section 580b. *See, e.g., DeBerard Props.*, 20 Cal. 4th at 663, 667-668. An unlawful waiver occurs when, in exchange for better terms under an existing loan, the lender forces the borrower to agree to waive Section 580b even though the lender continues to retain its security interest. *See, e.g., id; Lawler v. Jacobs*, 83 Cal. App. 4th 723, 736 (2000). Consequently, cases finding an unlawful waiver of Section 580b turn on the concern that the lender will ultimately recover more than is owed under the loan. *Id.* This concern arises from the risk that the lender will be able to sell the secured property obtained in foreclosure at a profit in addition to recovering the outstanding balance remaining on the loan. *Id.* By contrast, in a short sale the lender gives up the power to recover the secured property through a foreclosure when it agrees to release its security interest. This release of the lender's security interest is a lawful "destruction" of the security that takes the loan outside the scope of Section 580b. *DeBerard Props.*, 20 Cal. 4th at 667-68. A short sale is therefore not a waiver of Section 580b rights but instead a legally enforceable agreement between the parties to destroy the security and alter the nature of the loan. *Id.*; *see also Jack Erickson*, 50 Cal. App. 4th at 189.

Third, expanding the scope of Section 580b to apply to short sales is inconsistent with the legislative history of this statute. Section 580b has been amended twice since *Jack Erickson* held that a short sale removed the loan from the protections of Section 580b. In neither amendment did the Legislature modify the language of the statute to address or abrogate the holding in *Jack Erickson*. In amending Section 580b without legislatively overturning *Jack Erickson*, the Legislature has ratified *Jack Erickson*'s holding that Section 580b does not preclude a lender from obtaining a deficiency judgment following a short sale. *See Marina Point, Ltd. v. Wolfson*, 30 Cal. 3d 721, 734 (1982). Instead, in 2011, the Legislature *prospectively* ended the right of a secured lender to obtain a deficiency judgment after a short sale. Section 580e prospectively prohibits collections or personal judgments following certain short sales. CODE CIV. PROC. §580e; *Roberts*, 217 Cal. App. 4th at 1394-95. The decision below impermissibly alters the *Legislature's* judgment that its new rule should not be applied to secured loans made in the shadow of a clear and theretofore unquestioned judicial determination that Section 580b does not bar deficiency judgments following a short sale.

Fourth, expanding Section 580b to retroactively sweep in short sales does not further the policy objectives underlying the statute. Section 580b has two policy objectives: (1) protecting borrowers from being subject to large personal debts; and (2) preventing the overvaluation of property by lenders. *See, e.g.*, *DeBerard Props.*, 20 Cal. 4th at 663-64; *Spangler*, 7 Cal. 3d at 610. A holding that Section 580b does not apply to short sales does not frustrate the first objective because borrowers can always obtain the protection of the statute by forcing a foreclosure rather than electing to proceed with a short sale. Consequently, the only borrowers who would be faced with a deficiency are those that have

voluntarily chosen a short sale over foreclosure. Nor will refusing to apply Section 580b to short sales provide an incentive to lenders to overvalue property. Because Section 580e already extends anti-deficiency protection prospectively to short sales, refusing to extend Section 580b to *prior* short sales will not modify future lender behavior.

STATEMENT OF FACTS

A. Background.

A short sale is a contract-based transaction that provides borrowers and lenders with an alternative to foreclosure. Under a short sale contract, the lender agrees that the borrower may sell the property directly to a third party for less than the amount remaining on the loan. *Roberts*, 217 Cal. App. 4th at 1390, 1398. To allow the borrower to sell the property unencumbered to a third party purchaser, the lender agrees to release its security interest in the property and reconvey the deed of trust to the borrower. *See, e.g.*, CT 46-47. The agreement by the lender to release its security interest and re-convey the deed is essential to a short sale because, absent the destruction of the lender's security interest, the borrower cannot transfer an unencumbered title to a third party purchaser. *Roberts*, 217 Cal. App. 4th at 1398.

Short sales are a relatively new form of loss mitigation that came into favor starting in 2008 and subsequently proliferated as an alternative to foreclosure. *See* Cal. Senate Banking, Finance and Insurance Comm. Analysis of S.B. 931, at 3 (April 7, 2010). Short sales enable borrowers to avoid the negative consequences of foreclosure, including the long-term negative credit consequences that can limit a borrower's ability to obtain credit and employment. Enrolled Bill Report, Business Transportation and Housing Agency, S.B. 931 (Sept. 1, 2010); Letter from Shanna Welsh to Nadia Leal re S.B. 931 (Dec. 16, 2009). In addition, borrowers preferred

short sales because short sales allow borrowers to feel as though they have taken responsibility for their obligations. Letter from Shanna Welsh to Nadia Leal re S.B. 931 (Dec. 16, 2009). Given the advantages to borrowers of short sales over foreclosures, short sales grew from a few thousand in 2008, to approximately 90,000 in 2009, and then 110,000 in 2010. *See, e.g.*, Cal. Senate Banking, Finance and Insurance Comm. Analysis of S.B. 931, at 3 (April 7, 2010); *see also* CT 82; Letter from Shanna Welsh to Nadia Leal re S.B. 931 (Dec. 16, 2009); Cal. Assembly Committee on Banking and Finance, Analysis of S.B. 931, at 2 (June 21, 2010).

B. Coker's Short Sale Transaction.

In 2004, Coker obtained a $452,000 purchase money loan which she used to purchase residential property in San Diego, California. CT 2-3. After a notice of default and election to sell was recorded, Coker approached Chase about the possibility of proceeding with a short sale instead of foreclosure. CT 30, 43. As part of this request, Coker submitted a proposal to Chase for a third party to purchase the property for $400,000, an amount that would result in Chase receiving approximately $167,000 less from the sale than the outstanding balance owed by Coker. CT 3. Chase agreed to allow Coker to proceed with the short sale subject to Coker's written agreement that "[t]he amount paid to Chase is for the release of its security interest(s) *only*, and the Borrower is still responsible for all deficiency balances remaining on the Loan, per the terms of the original loan documents." CT 197 (emphasis added). Coker agreed to proceed with the short sale subject to the terms and conditions of that agreement. *Id.*

On or about January 25, 2011, approximately eight months after the short sale, a collection agency contacted Coker by mail about the deficiency remaining on the loan.

CT 143-44. In this communication, the collection agency requested that Coker resolve the $116,686.89 balance remaining on the note. CT 207.

C. Trial Court Proceedings.

Coker filed this lawsuit seeking a declaratory judgment that her promise to be responsible for the outstanding balance on her loan in exchange for Chase's consent to allow her to short sale was legally unenforceable. CT 1. The first amended complaint asserted three causes of action for declaratory relief. CT 140-50. Each alleged that Coker was excused from her contractual obligations for the outstanding loan balance: the first cause of action alleged that Section 580b relieved her of the obligation to repay the deficiency (CT 145-46); the second asserted that the newly enacted Section 580e applied retroactively to bar collection of the deficiency (CT 147); and the third asserted that California common law barred Chase from enforcing Coker's contractual obligations to be responsible for the deficiency balance remaining on the loan after the sale (CT 148-49).

The trial court sustained Chase's demurrer to the first amended complaint without leave to amend. Motion to Augment (granted by Court of Appeal July 19, 2012) Ex. 1. The court found that: (1) Section 580b only applied after a property was sold by judicial or non-judicial foreclosure; (2) Section 580e did not apply retroactively to Coker's short sale; and (3) California law did not provide non-statutory anti-deficiency protections. *Id.*; CT 263-64. Coker appealed. CT 257.

D. The Court Of Appeal Decision.

The Court of Appeal reversed the judgment. *Coker v. JP Morgan Chase Bank, N.A.*, 159 Cal. Rptr. 3d 555 (2013). The court first held that security first rule under Section 726 did

not apply to short sales. *Id.* at 563-65. However, it concluded Section 580b is not limited to foreclosures but applies to all forms of property sales, including short sales, where the borrower used a purchase money loan to purchase the property. *Id.* at 565. As a result, Coker's contractual obligation to be responsible for the deficiency balance was an unenforceable "waiver" of Section 580b's protections. *Id.*

ARGUMENT

A short sale cannot occur unless, at the borrower's request, the lender agrees to release and destroy its security interest. There are two legal consequences to the lender's release and destruction of its security interest. *First*, the borrower waives her right under Section 726 to insist that the lender foreclose on the security before seeking a personal judgment for the balance of the loan. *Second*, because the agreement to release the security interest transforms a secured purchase money loan to an unsecured loan, it removes the loan from the reach of Section 580b, which applies only to secured loans.

I.

THE "SECURITY FIRST" RULE EMBODIED IN SECTION 726 DOES NOT APPLY TO SHORT SALES WHERE THE LENDER HAS SURRENDERED ITS SECURITY INTEREST TO ENABLE THE SALE TO PROCEED.

Section 726 establishes the "one action" or "security first" rule: "[t]here 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." CODE CIV. PROC. §726(a). That one form of action is a foreclosure action in which the creditor must first exhaust the security before seeking a monetary judgment for the deficiency. *See Sec. Pac. Nat'l Bank*, 51 Cal. 3d at 997; *Shin v. Superior Court*, 26 Cal. App. 4th 542, 545 (1994). "In other words, '[a]

secured creditor can only bring one lawsuit to enforce its security interest and collect its debt.'" *Nat'l Enters., Inc. v. Woods*, 94 Cal. App. 4th 1217, 1232 (2001) (quoting *Sec. Pac. Nat'l Bank*, 51 Cal. 3d at 997).

"[T]he operation of Section 726 is in large part within the control of the debtor." *Sec. Pac. Nat'l Bank*, 51 Cal. 3d at 1004. "If a secured creditor brings an action on the debt before foreclosing the security, the debtor can interpose [S]ection 726 as an affirmative defense," so as to require "the creditor to exhaust the security before [it] may obtain money judgment against the debtor." *Id.* at 1004-05. However, "[i]f the debtor does not raise the statute as an affirmative defense, the creditor's action on the debt is allowed to proceed to judgment." *Id.* at 1005. In that event, the creditor is "precluded from thereafter foreclosing on the security" because it "is deemed to have elected his remedy." *Id.* Moreover, a debtor can also waive the protection of Section 726 by consenting to an arrangement in which the beneficiary of the trust deed relinquishes the security without retiring the note. *Roberts*, 217 Cal. App. 4th at 1398 (citing *Pac. Valley Bank v. Schwenke*, 189 Cal. App. 3d 134, 141-42 (1987)).

In *Roberts*, the Court of Appeal applied these long standing rules to hold that a borrower who requests and acquiesces in a short sale waives her rights under Section 726. The borrower in that case obtained a home equity line of credit, secured by a second deed of trust. *Id.* at 1390. Later, to avoid foreclosure, the borrower requested that the lender release its security to allow for a short sale to proceed. *Id.* Because the proceeds of the sale would have paid only a portion of the outstanding balance, the lender required that the borrower agree to remain responsible for the deficiency. *Id.* at 1391-92. After the lender brought an action for the deficiency the borrower asserted that the lender needed to judicially foreclose in order to sue for the deficiency. *Id.* The court disagreed, holding

that the borrower waived the protections of Section 726 when the lender agreed to release its security at the borrower's request. *Id.* at 1395. The court concluded that Section 726 does not apply where the borrower "asked for and consented to the short sale arrangement." *Id.* at 1398.

As in *Roberts*, Coker requested that Chase release its security interest so that she could proceed with a short sale. In acquiescing to this request Chase was placed in a position where the option of seeking a foreclosure in lieu of proceeding against Coker for the outstanding debt was no longer a possibility. Having previously requested that Chase forgo its right to foreclose and release its security interest, Coker cannot invoke the "security first" rule of Section 726, force Chase to foreclose on a security interest that no longer exists, and avoid her promise to remain responsible for the deficiency balance remaining on the loan.

II.

SECTION 580b DOES NOT APPLY TO SHORT SALES.

Section 580b's scope is limited to secured purchase money loans. *DeBerard Props.*, 20 Cal. 4th at 665; *Spangler*, 7 Cal. 3d at 610. Because a short sale requires the lender to release its security interest, the loan is transformed from secured to unsecured and is thereby removed from the reach of Section 580b. This result is consistent with both prior case law distinguishing between the concepts of waiver and destruction of a security interest and the legislative history of the anti-deficiency statutes. Further, this result is consistent with the policies underlying Section 580b.

A. A Short Sale Removes Loans From The Scope Of Section 580b By Transforming Them From Secured To Unsecured.

Section 580b prevents a creditor from obtaining a deficiency judgment in connection with a secured purchase money loan. *See generally Spangler v. Memel*, 7 Cal. 3d 603 (1972). As used in this context, a secured purchase money loan is a loan where the proceeds are used to purchase the real property that secures repayment of the loan. *See* BLACK'S LAW DICTIONARY 1101 (9th ed. 2009) (definition of "mortgage"). A defining feature of a secured purchase money loan is that the lender "retains an interest in the land sold to secure payment" on the loan. *Roseleaf Corp. v. Chierighino*, 59 Cal. 2d 35, 41 (1963). Conversely, "it is well established that unsecured purchase money notes are not subject to section 580b." *Jack Erickson*, 50 Cal. App. 4th at 189 (*citing Nevin v. Salk*, 45 Cal. App. 3d 331, 342 (1975)).

Because a secured purchase money loan is not immutable, the parties may contract to alter the secured nature of the loan. *Id.; see also DeBerard Props.*, 20 Cal. 4th at 669 (*citing Palm v. Schilling*, 199 Cal. App. 3d 63, 76 (1988)). As a result, a purchase money loan that was previously secured can be rendered unsecured by events arising after the loan's origination. *See, e.g., Jack Erickson*, 50 Cal. App. 4th at 188-89 (purchase money note transformed from secured to unsecured because the borrower requested that the lender reconvey its security interest). And this Court has stated that a lender who becomes concerned that its security will be lost as a result of a foreclosure by a senior lien holder can remove the loan from the scope of Section 580b by "destroy[ing] the purchase money nature of the transaction by reconveying the deed or mortgage on the original real estate." *DeBerard Props.*, 20 Cal. 4th at 669 (*citing Palm*, 199 Cal. App. 3d at 76).

Applying these principles, the Court of Appeal in *Jack Erickson* considered the impact of a short sale on Section 580b and held that because the agreement transformed the loan from secured to unsecured, the loan was removed from the scope of Section 580b. In that case, a secured purchase money loan was the subordinate loan on a property. 50 Cal. App. 4th at 184-85. When the borrower ran into financial difficulties, the two senior lien holders moved to foreclose on the property. *Id.* In order to avoid the consequences of a foreclosure, the borrower requested, and the holder of the subordinate purchase money loan agreed, to reconvey its security interest so that the borrower could sell the property to a third party, repay the senior lien holders, and avoid the foreclosure. *Id.* Because the property's purchase price was less than the total amount owed on the loans, the holder of the purchase money loan, who stood third in line, did not receive any proceeds from the sale. *Id.* The holder agreed to allow the borrower to proceed with the short sale on the condition that the borrower remain personally responsible for the repayment of the purchase money loan. *Id.* When the holder sought to enforce the borrower's promise to repay the outstanding balance, the borrower claimed that Section 580b barred the action. *Id.*

The Court of Appeal ruled against the borrower on two independent grounds. The first ground, that Section 580b does not apply after a loan is subordinated to a construction loan, is irrelevant to this case. *Id.* at 188. But the second ground couldn't be more relevant. The court found that in acquiescing to the borrower's request that it release its security interest, the lender had transformed the loan from a secured purchase money loan to an unsecured purchase money loan. *Id.* at 189. As a result, Section 580b no longer applied to the loan. *Id.* In reaching this conclusion, the court rejected "the argument that [the borrower] could extinguish

the security interest, sell the property to a third party, and invoke section 580b to shift the loss of the ill-fated project to the [lender]." *Id.*

This portion of *Jack Erickson* is directly on point. Although the *Jack Erickson* court did not use the phrase "short sale," the sale in that case was functionally identical to the short sale involved in this case. Like the sale at issue here, the sale in *Jack Erickson* was a sale of previously secured property to a third party for less than the full balance owing on the loans secured by the property. *See Coker*, 159 Cal. Rptr. 3d at 559 (a short sale is a sale where "the sale price is less than the balance of the outstanding debt secured by the deed of trust"). Similarly, both the sale in *Jack Erickson* and the sale orchestrated by Coker were undertaken by borrowers seeking to avoid the ramifications of a foreclosure. In both instances, moreover, the lender's consent was conditioned on the borrower's agreement to remain personally liable for the outstanding balance on their respective loans. Consequently, *Jack Erickson*'s holding that the sale transformed the purchase money loan from a secured to an unsecured loan is directly applicable here.

B. Finding That Short Sales Are Outside The Scope Of Section 580b Is Consistent With Prior Case Law.

A holding that Section 580b does not apply to short sales is also consistent with this Court's cases. Specifically, this Court has stated that the parties can avoid Section 580b by destroying the lenders' security interest through a release of the lender's lien and a subsequent reconveyance of the deed to the borrower. *DeBerard Props.*, 20 Cal. 4th at 669. The Court has therefore recognized that the destruction of the security for a secured purchase money loan effectuates a change to the nature of the loan that removes it from Section 580b.

In *DeBerard Properties*, the Court considered whether a borrower may waive the protections of Section 580b in exchange for the lender's consent to the restructuring of a borrower's loan. 20 Cal. 4th at 668. After analyzing the purposes behind Section 580b, the Court held that as long as the lender retained a security interest in the real property, the protections of Section 580b could not be waived. *Id.* at 663, 667-668. Instead, to remove a loan from the scope of Section 580b, it was necessary for the lender to surrender its security interest in the subject property. *Id.*; *see also Palm*, 199 Cal. App. 3d at 76. Requiring the lender to release its security interest before a waiver of Section 580b could occur was necessary to eliminate the risk of the lender achieving a double recovery by obtaining both the property and the outstanding balance on the loan. *DeBerard Props.*, 20 Cal. 4th at 670-71; *Palm*, 199 Cal. App. 3d at 76; *see also Roberts*, 217 Cal. App. 4th at 1396 (*citing Nat'l Enters.*, 94 Cal. App. 4th at 1225).

The short sale at issue in this case was not based on an impermissible "waiver" of rights under Section 580b where the lender retained the security interest. Instead, the transaction destroyed that interest. *See, e.g.*, *DeBerard Props.*, 20 Cal. 4th at 670-71; Order re Motions to Dismiss, *Rahoi v. JPMorgan Bank, N.A.*, No. 12-CV-03756-LHK, Docket No. 42 (N.D. Cal. June 12, 2013) (finding that short sales are not an impermissible waiver but instead involve the destruction of the security). As a result, the "waiver" risk that a lender will receive a windfall by recovering both the property and the outstanding balance does not exist. Accordingly, a determination by the Court that the agreement between Chase and Coker was a valid contract to destroy the security, not a unilateral waiver of rights by the borrower under Section 580b, is fully consistent with the distinction made by the Court in *DeBerard Properties*.

C. The Legislature Has Ratified The Interpretation of Section 580b in *Jack Erickson* And Has Declined To Retroactively Extend Section 580e To Short Sales.

Finding that Section 580b does not extend to the short sale in this case is also consistent with the legislative history of the statute. Specifically, the Legislature ratified the holding in *Jack Erickson* by opting not to modify Section 580b to abrogate that ruling. Instead, the Legislature extended deficiency protections to borrowers who opted for short sales only prospectively when it enacted Section 580e.

"[T]he Legislature is deemed to be aware of existing laws and judicial decisions in effect at the time legislation is enacted and to have enacted and amended statutes in the light of such decisions as have a direct bearing upon them." *People v. Overstreet*, 42 Cal. 3d 891, 897 (1986) (internal quotation marks omitted); *accord*, *In re W.B.*, 55 Cal. 4th 30, 57 (2012) (Legislature "did not signal an intent to supersede" a prior appellate decision when it enacted statute); *Busse v. United Panam Fin. Corp.*, 222 Cal. App. 4th 1028 (2014) (Legislature is "presumed to know about existing case law when it enacts or amends a statute"). Further "[i]t is a well-established principle of statutory construction that when the Legislature amends a statute without altering portions of the provision that have previously been judicially construed, the Legislature is presumed to have been aware of and to have acquiesced in the previous judicial construction." *Marina Point, Ltd. v. Wolfson*, 30 Cal. 3d 721, 734 (1982) (citations omitted); *see also County of Tulare v. Nunes*, 215 Cal. App. 4th 1188, 1199 (2013) (Legislature is deemed to have ratified earlier judicial interpretation of a statute when the Legislature did not modify the language of the statute in subsequent amendments).

Section 580b has been amended twice since *Jack Erickson* was decided. In 2012, the Legislature added a provision to Section 580b defining a "purchase money loan" and also

expanded Section 580b to apply to refinanced purchased money loans. *See* 2012 Cal. Stat. ch. 64, §1 (S.B. 1069). In 2013, Section 580b was amended to prohibit lenders from collecting on outstanding deficiencies, expanding Section 580b's protections beyond the prohibition on personal judgments. 2013 Cal. Stat. ch. 65, §2 (S.B. 426). In addition, in 2010 the Legislature enacted Section 580e. 2010 Cal. Stat. ch. 701, §1 (S.B. 931). While leaving Section 580b undisturbed, Section 580e prospectively prohibits collections or personal judgments in connection with the outstanding balances owed on formerly secured loans following a short sale. CODE CIV. PROC. §580e; *see Roberts*, 217 Cal. App. 4th at 1394-95 (Section 580e applies prospectively based on the strong presumption against retroactivity and unfairness of changing contractual terms); *Espinoza v. Bank of America, N.A.*, 823 F. Supp. 2d 1053, 1058 (S.D. Cal. 2011) (same). By choosing to enact Section 580e, instead of modifying Section 580b, the legislature chose to address anti-deficiency protections for short sales on a prospective basis only. As a consequence, the Legislature ratified *Jack Erickson's* interpretation of Section 580b.

The Legislature's decision to make Section 580e prospective, not retrospective, was based on the sound rational "that past contractual transaction[s] [were] agreed to under the law in effect at the time" and these contracts should not be disrupted. *Roberts*, 217 Cal. App. 4th at 1395; *see also Espinoza*, 823 F. Supp. 2d at 1058. Prior to the enactment of Section 580e, while *Jack Erickson* alone governed the application of anti-deficiency laws to short sales, thousands of short sales occurred California. Cal. Senate Banking, Finance and Insurance Comm. Analysis of S.B. 931, at 3 (April 7, 2010). Many of these short sales mirror the short sale here with respect to lenders' conditioning their agreement to release their security on borrowers' promises to remain personally

responsible for the outstanding balance of the loan. *See, e.g.*, CT 197-98. In enacting Section 580e, the Legislature chose not to disrupt these contracts by retroactively modifying the legal status of short sales under California's anti-deficiency laws. *Roberts*, 217 Cal. App. 4th at 1395; *Espinoza*, 823 F. Supp. 2d at 1058. To now extend Section 580b to cover Coker's short sale would disturb the Legislature's judgment with respect to retroactivity.

D. Construing Section 580b As Not Providing Retroactive Protection To Short Sales Is Consistent With The Policy Objectives Of That Law.

Section 580b was enacted in 1933 during the Great Depression to deal with specific economic issues created by that crisis. Because of the "dearth of money and declining property values, a mortgagee was able to purchase the subject real property at [a] foreclosure sale at a depressed price far below its normal fair market value and thereafter to obtain a double recovery by holding the debtor for a large deficiency." *Roberts*, 217 Cal. App. 4th at 1396 (*citing Nat'l Enters.*, 94 Cal. App. 4th at 1225). In light of these concerns, the Legislature enacted Section 580b which addresses two main policy objectives: (1) protecting defaulting borrowers against "large personal liability"; and (2) stabilization of land sale prices by deterring lenders from overvaluing property. *DeBerard Props.*, 20 Cal. 4th at 663-64. Neither of these policy goals would be furthered by extending Section 580b to short sales.

1. Extending Section 580b To Short Sales Is Not Necessary To Protect Defaulting Borrowers.

Extending Section 580b's protections to short sales is not necessary to protect defaulting borrowers from personal liability. A borrower always has a choice: accept the adverse consequences of foreclosure and retain the protection of

Section 580b, or avoid foreclosure by agreeing to a short sale that will leave her responsible for the outstanding balance on the loan following that sale. Accordingly, a borrower can always escape personal liability by refusing to agree to a short sale and compelling the lender to invoke foreclosure.

In this case, the borrower made the opposite decision. Coker opted to have Chase release its security interest and reconvey the deed so that she could sell the property to a third party. In return, Coker promised to remain "responsible for all deficiency balances remaining on the Loan, per the terms of the original loan documents." CT 197. Having made an informed choice, memorialized in a written contract, Coker cannot now claim that an extension of Section 580b is somehow necessary to protect her from liability for a deficiency to which she agreed in return for the lender's consent. Allowing a borrower to avoid foreclosure and then invoke Section 580b to avoid the consideration given to induce the lender to agree to the short sale, is inconsistent with and does not further the policy behind Section 580b.

2. Retroactively Extending Section 580b To Short Sales Will Not Deter Future Overvaluation Of Real Property.

Retroactively extending Section 580b to bar deficiency judgments after a short sale will not further the goal of deterring overvaluing of real property by lenders. Section 580b has functioned as a deterrent to the overvaluing of real property security (*see, e.g.*, *DeBerard Props.*, 20 Cal. 4th at 663-64) because lenders cannot recover the difference between the value of the property and the amount of the loan. However, this policy objective addresses the lender's behavior at the time of origination.

A holding that Section 580b applies to short sales will have no effect on future loan decisions. That is because Section 580e will apply to all future loans. Consequently, the only

issue in this case is whether Section 580b applies to short sale transactions made *prior* to adoption of Section 580e. How that issue is resolved can have no impact on the overvaluation of real property in the future.

CONCLUSION

For the reasons set forth above, the Court of Appeal's decision should be reversed.

DATED: February 19, 2014.

Respectfully,

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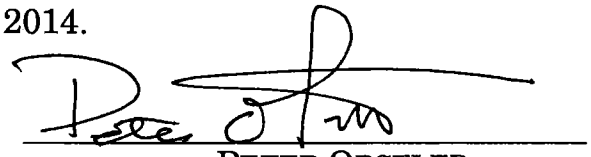
CERTIFICATE OF COMPLIANCE PURSUANT TO CAL. R. CT. 8.520(c)

Pursuant to California Rule of Court 8.520(c)(1), and in reliance upon the word count feature of the software used to prepare this document, I certify that the foregoing Opening Brief on the Merits of JPMorgan Chase Bank, N.A. contains 5,649 words, exclusive of those materials not required to be counted under Rule 8.520(c)(3).

DATED: February 19, 2014.



PETER OBSTLER

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PROOF OF SERVICE

I am over eighteen years of age and not a party to this action. I am employed in the County of San Francisco, State of California. My business address is Three Embarcadero Center, 10th Floor, San Francisco, CA 94111-4024.

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Dated: February 19, 2014

Gigi Francisco-Ferrer