S213137

IN THE SUPREME COURT
OF THE STATE OF CALIFORNIA

CAROL COKER,
Plaintiff and Appellant,

v.

JP MORGAN CHASE BANK, N.A., et al.,
Defendants and Respondents.

Fourth Appellate District, Division One
(Case No. D061720)

San Diego County Superior Court
(Case No. 37-2001-00087958-CU-MC-CTL)
(Hon. Luis R. Vargas, Presiding)

ANSWER BRIEF ON THE MERITS

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1. Does Civil Code of 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 Civil Code of Procedure section 726?

INTRODUCTION

Defendant-Respondent JP Morgan Chase Bank ("Chase") concedes that Code of Civil Procedure section 580b prohibits lenders from obtaining a deficiency after a foreclosure sale of a home financed by a purchase money loan. Chase nevertheless claims that lenders are freed from the restrictions of section 580b when borrowers, like Plaintiff-Appellant Carol Coker, themselves arrange the sale and remit all of the proceeds to the lender. The text and purpose of the statute make clear that it applies after a short sale as well as a foreclosure.

Code of Civil Procedure section 580b provides that no deficiency judgment shall lie "in any event after a sale" of residential property secured by a deed of trust given to the lender to secure a loan used to pay all or part of the purchase price. (All further statutory references are to the Code of Civil Procedure unless otherwise indicated.) This Court has interpreted section 580b to mean that a lender cannot obtain a deficiency after the security on such a loan is sold or is otherwise exhausted. With a short sale, the property is sold to a third party, the security is exhausted, and the lender receives all of the proceeds. Thus, under the plain text of the statute, section 580b applies to prevent lenders from pursuing borrowers personally after a short sale.

The purposes behind section 580b confirm that the statute applies after a short sale. The Legislature originally enacted section 580b during the Great Depression to protect both individual homeowners and the overall economy in times of economic decline. It did so by placing the risk of inadequate security exclusively on the purchase money lender. If the security is insufficient to satisfy the note, the lender—not the borrower—shoulders that loss, and the economy is protected from the further decline that would result were

borrowers saddled with substantial personal liabilities. At the same time, allocating the risk of inadequate security to lenders discourages banks from overvaluing the property and thus deters unsound land sales.

Construing section 580b to apply after a short sale promotes each of these purposes. It ensures that banks, not borrowers, bear the risk of inadequate security and protects borrowers who lose their property through short sales from burdensome personal liabilities. Interpreting section 580b to limit lenders to the value of their security after a short sale also discourages banks from inflating property values at the time they extend home loans.

The Legislature's most recent antideficiency law (section 580e) confirms that section 580b provides antideficiency protection after a short sale of property secured by a purchase money deed of trust. The legislative history of that later statute shows that the Legislature knew that section 580b already barred deficiencies following short sales involving purchase money obligations.

Ignoring the text of section 580b, Chase argues that the Court should instead discern the Legislature's intent based on the Legislature's purported ratification of *Jack Erickson & Associates v.*

Hesselgesser (1996) 50 Cal.App.4th 182 (*Jack Erickson*), a decision that, according to Chase, held that section 580b does not apply following a short sale. But *Jack Erickson*'s conclusion is premised on a now-overruled understanding of section 580b. It is unsurprising therefore that, in the more than seventeen years since that case was decided, no published California decision has discussed, or even cited, *Jack Erickson*. In addition, the Legislature is deemed to ratify consistent and well-developed judicial interpretations. *Jack Erickson* reflects neither.

Chase's further argument that short sales eliminate the protections of section 580b ignores that the statute applies after a sale and is wrong on its own terms. As an initial matter, Chase's claim that it can collect a deficiency based on a provision in its sale-approval letter requiring borrowers to remain personally liable on the note fails because, as this Court has already held and Chase concedes, the protections of section 580b cannot be waived.

Chase's effort to label its argument as something other than an impermissible waiver is also without merit. Chase is incorrect when it claims that short sales transform secured purchase money obligations covered by section 580b into unsecured notes liberated from the

restrictions of section 580b. This Court has made clear that the protections of section 580b attach at the loan's inception and remain after the exhaustion of the security. It does not matter, therefore, how the security is extinguished—section 580b's protections apply.

Chase also errs in its reliance on this Court's observation in *DeBerard Properties, Ltd. v. Lim* (1999) 20 Cal.4th 659, 669 (*DeBerard*) that parties can destroy the purchase money character of a loan through a deed of reconveyance. That language contemplates a situation in which the lender reconveys a deed of trust in return for substitute security (i.e., refinances a loan)—not when, as in a short sale, the lender realizes the entire value of the security for itself.

Chase's additional claim that Coker waived the "security-first" protections of section 726 is also misplaced. The "security-first" rule requires lenders to resort to their security before reaching into a borrower's personal assets. Here, Chase resorted to its security by approving the short sale and realizing the security's entire value. Chase's claim that Coker waived the protections of section 726, rather than insisted on them, therefore fails.

Because section 580b applies after a short sale, the Court of Appeal's judgment should be affirmed.

STATEMENT OF FACTS

In 2004, Coker purchased a condominium in San Diego, California. (Clerk's Transcript ("CT") at pp. 152-167.) To finance the purchase, she borrowed $452,000 from Chase's predecessor in interest, secured by a deed of trust on the property. (*Id.* at pp. 152-180.)

By 2010, following one of the nation's worst recessions and housing crises, Coker fell behind on her payments. (See CT at p. 181.) In response, Chase recorded a Notice of Default and began the process of foreclosing on the property. (*Ibid.*)

While Chase's foreclosure process was underway, Coker offered Chase an alternative: a short sale by which a buyer whom Coker had identified would pay $400,000 for the property. (CT at pp. 183-198.) Because the sales price was not sufficient to pay off the entire note, Coker requested Chase's permission to proceed with the sale. (See CT at pp. 197-198.)

Chase conditionally consented to Coker's request. (CT at pp. 197-198.) In a June 2010 letter, Chase notified Coker that it would authorize the sale by releasing its lien on the property in return

for the net sales price. (*Ibid.*) The letter stressed that Chase would receive all of the proceeds from the sale:

> The borrower (seller) must net zero. All proceeds are to be remitted to the lender. All amounts remaining and retained by borrower shall automatically be assigned to lender even if proceeds exceed the approved net amount. **Neither the borrower nor any other party may receive any sales proceeds or any other funds as a result of this transaction.** The borrower must assign to Chase any rights to escrow funds, insurance proceeds, or refunds from prepaid expenses. Chase can apply the proceeds of the sale to the outstanding indebtedness in any manner that Chase should elect.

(CT at p. 198, underline and bold in original.) According to its calculations, Chase would net approximately $375,000 from the sale: the $400,000 sales price less the costs associated with the sale. (CT at p. 197.) The broker's commission, sellers' closing costs, and taxes were attributed to Coker's account, and not absorbed by Chase. (*Ibid.*)

Chase's approval of the short sale also demanded that Coker agree to pay any balance remaining on the loan. (CT at p. 197.) The letter said: "The amount paid to Chase is for the release of Chase's 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." (*Ibid.*)

In July 2010, the short sale transaction closed, and about one month later, Chase reconveyed the deed of trust to facilitate the sale to the new buyer. (CT at pp. 200-203, 205.) Chase received all of the net proceeds of the sale, which totaled $375,062.25. (CT at p. 203.)

At the time Chase approved the short sale of Coker's condominium, short sales were a common alternative to foreclosure. (Chase's Opening Brief on the Merits ("OB" at p. 6.) Many lenders chose short sales over foreclosures, because short sales allowed them to avoid the time and expense of the foreclosure process and of carrying and marketing the property if no third-party buyer purchased the property at the foreclosure sale. (See *Rex v. Chase Home Finance* (C.D.Cal. 2012) 905 F.Supp.2d 1111, 1139 (*Rex*).)

Several months after the short sale in this case, a debt collector acting on Chase's behalf demanded that Coker pay the balance that, according to Chase, was still due on the note. (See CT at p. 207.) The notice claimed that Coker owed Chase $116,686.89 and warned that the sum could continue to grow as interest or other charges accrued. (*Ibid.*)

STATEMENT OF THE CASE

Coker filed a declaratory relief action against Chase alleging that Chase's collection efforts were unlawful. (Slip opn. at p. 4.) Her first amended complaint asserted claims under section 580b, section 580e, and common law antideficiency protections. (*Ibid.*)

The trial court (Hon. Luis R. Vargas) sustained Chase's demurrer without leave to amend. (Mot. to Augment Record on Appeal, Ex. 1 at p. 1; CT at pp. 253-254.) With respect to Coker's cause of action under section 580b, the court agreed with Chase that the statute applied only after a bank foreclosed on a property, not after a short sale. (Mot. to Augment Record on Appeal, Ex. 1 at p. 1.)

The Court of Appeal unanimously reversed. The court held that "section 580b applies to any loan used to purchase residential real property (purchase money loan) regardless of the mode of sale." (Slip opn. at p. 6.) The statute's "plain language," the court explained, does not limit its reach to foreclosure sales, and section 580b's use of the phrase "in any event" reinforces that "the Legislature intended section 580b to apply to all sales." (*Id.* at p. 11.)

The court further observed that, under the statute, lenders bear the risk of inadequate security. (Slip opn. at p. 10.) The Legislature

enacted section 580b to (1) stabilize land sales by preventing lenders from overvaluing property, and (2) protect homebuyers as a class in times of economic decline by limiting their losses to the land used as security. (*Ibid.*) The statute accomplishes these objectives by relieving borrowers of the obligation to pay deficiencies if the security proves inadequate. (*Ibid.*)

The court also rejected Chase's argument that Coker had lost section 580b's antideficiency protections by failing to compel Chase to foreclose on her property as, Chase contended, section 726 requires. (Slip opn. at pp. 15, 18.) The court explained that, because a sale had occurred and Chase had received the proceeds, section 726 posed no impediment to the application of section 580b. (*Id.* at pp. 17-18.)

Finally, the Court of Appeal rejected Chase's claim that Coker's acceptance of Chase's condition that she remain liable on the note authorized Chase to collect a deficiency balance. (Slip opn. at p. 18.) Because parties cannot agree to waive the antideficiency protections of section 580b, the provision of Chase's sale-approval letter imposing such a requirement is invalid. (*Ibid.*) In light of these

conclusions, the court remanded the case to the trial court with instructions to overrule Chase's demurrer. (*Ibid.*)

This Court granted Chase's petition for review.

ARGUMENT

I. Section 580b Bars Deficiency Liabilities After Short Sales.

"In California, as in most states, a creditor's right to enforce a debt secured by a mortgage or deed of trust on real property is restricted by statute." (*Walker v. Community Bank* (1974) 10 Cal.3d 729, 733.) California law protects defaulting homebuyers through a series of interrelated statutes that limit lenders' rights to collect on a note after default. (See generally *ibid.*; *Roseleaf Corp. v. Chierighino* (1963) 59 Cal.2d 35, 38-39 (*Roseleaf*).) Under section 726, for example, a creditor "must rely upon his security before enforcing the debt." (*Roseleaf, supra*, 59 Cal.2d at p. 38.) That means that the creditor must exhaust the value of its security before pursuing the borrower for any deficiency. (See *ibid.*)

Even after the security is exhausted, other provisions of California law bar creditors from collecting a deficiency balance on the note. (*Roseleaf, supra*, 59 Cal.2d at pp. 38-39.) As this Court explained, "[i]n certain situations, . . . the Legislature deemed even

this partial deficiency [permitted under section 726] too oppressive. Accordingly, . . . it enacted section 580b . . . which barred deficiency judgments altogether on purchase money mortgages." (*Cornelison v. Kornbluth* (1975) 15 Cal.3d 590, 601.)

Section 580b's prohibition on deficiency judgments applies after a short sale. The text and purpose of section 580b as well as the legislative history of a subsequently enacted antideficiency statute all make clear that lenders cannot pursue borrowers personally following a short sale.

A. The Text of Section 580b Demonstrates That Its Protections Apply After a Short Sale.

Section 580b specifically prohibits creditors from collecting deficiencies on purchase money loans—loans whose proceeds are used to pay all or part of the purchase price of the property. When the deed of trust and short sale in this case were executed and when the trial court ruled, section 580b said:

> No deficiency judgment shall lie in any event 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, or 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, 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 that dwelling occupied, entirely or in part, by the purchaser.

(Code Civ. Proc., § 580b, as amended by Stats. 1989, ch. 698, § 12.)[1] In interpreting a statute, the Court looks first to the statute's text. (E.g., *Olson v. Auto. Club of S. California* (2008) 42 Cal.4th 1142, 1147 (*Olson*).) The text of section 580b—barring a deficiency "in any event after a sale" of residential property secured by a deed of trust—makes clear that the statute applies after a short sale of the property.

In *Brown v. Jensen* (1953) 41 Cal.2d 193 (*Brown*), this Court held that section 580b bars deficiency actions following any sale of a property secured by a purchase money trust deed, even when the sale is not consummated by the lienholder. In that case, the Court held that a junior lienholder could not obtain a deficiency judgment after the senior lienholder foreclosed and sold the property at a trustee's sale. (*Id.* at pp. 195, 198.) Rejecting the junior lienholder's argument

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[1] Today, section 580b states in relevant part: "no deficiency shall be owed or collected, and no deficiency judgment shall lie, for any of the following: . . . [u]nder 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 that was used to pay all or part of the purchase price of that dwelling, occupied entirely or in part by the purchaser." (Code Civ. Proc., § 580b.) For all of the reasons explained above, the current version of the statute equally bars lenders from pursuing borrowers personally after a short sale of a property involving a purchase money loan.

that she could pursue the borrowers personally because there had been no "sale" under the junior lien, the Court held that the statute's "after a sale" language means either "after an actual sale" or when "a sale would be an idle act, where . . . the security has been exhausted." (*Id.* at pp. 197-198.) The Court explained: "The section states that in *no event* shall there be a deficiency judgment, that is, whether there is a sale under the power of sale or sale under foreclosure, or no sale because the security has become valueless or is exhausted. The purpose of the 'after sale' reference in the section is that the security be exhausted. . . . " (*Id.* at p. 198, italics in original.) Accordingly, even though the junior lienholder had not initiated or consummated the sale, she was barred from reaching the borrowers' personal assets after the security was exhausted. (See *ibid.*)

Under these principles, section 580b applies after the short sale of a property secured by a purchase money deed of trust. With a short sale, there is "an actual sale" of the property. (*Brown, supra,* 41 Cal.2d at pp. 197-198; see CT at pp. 183-203.) Likewise, the security is "exhausted." (*Brown, supra,* 41 Cal.2d at p. 198; see also *Bank of Am., N.A. v. Roberts* (2013) 217 Cal.App.4th 1386, 1398 (*Roberts*) [security is "exhausted" through a short sale].) In this case, as would

have occurred with a nonjudicial foreclosure, Coker's condominium was sold, Chase's lien was released, and Chase received all of the proceeds from the sale. (CT at pp. 183-203.) Indeed, Chase's approval of Coker's short sale was expressly conditioned on the security being exhausted—for Chase's exclusive benefit. Chase's letter consenting to the sale made this point in no uncertain terms:

> The borrower (seller) must net zero. All proceeds are to be remitted to the lender. All amounts remaining and retained by borrower shall automatically be assigned to lender even if proceeds exceed the approved net amount. **Neither the borrower nor any other party may receive any sales proceeds or any other funds as a result of this transaction.** The borrower must assign to Chase any rights to escrow funds, insurance proceeds, or refunds from prepaid expenses. Chase can apply the proceeds of the sale to the outstanding indebtedness in any manner that Chase should elect.

(CT at p. 198, underline and bold in original.) Accordingly, under the plain text of the statute, Chase cannot collect a deficiency after the short sale of Coker's property.

It is irrelevant, moreover, that the sale of Coker's condominium was not conducted pursuant to a judicial or nonjudicial foreclosure. As two federal district courts explained in holding that section 580b bars lenders from collecting deficiencies after a short sale, "[t]he phrase 'in any event' and the lack of adjectives modifying the phrase

'a sale' evinces the intent to have the statute apply broadly to all types of sales," including short sales. (*Rex, supra*, 905 F.Supp.2d at p. 1139; see also *Rahoi v. JPMorgan Chase Bank, N.A.* (N.D. Cal. 2013) 2013 U.S. Dist. LEXIS 83571 at p. *25 (*Rahoi*) [similar].) Outside of the short-sale context, other courts have confirmed that section 580b applies notwithstanding the absence of a foreclosure sale. (See *Ghirardo v. Antonioli* (1996) 14 Cal.4th 39, 49-50 (*Ghirardo*); *Frangipani v. Boecker* (1998) 64 Cal.App.4th 860, 864; *Venable v. Harmon* (1965) 233 Cal.App.2d 297, 302.)

In addition, had the Legislature intended to limit section 580b's protections to foreclosure sales, it would have said so, just like it did in other antideficiency provisions. For example, section 580d prohibits deficiencies on notes secured by a deed of trust on real property after the property "has been sold by the mortgagee or trustee under power of sale contained in the mortgage or deed of trust." (Code Civ. Proc., § 580d, subd. (a); see also *id.*, § 580a [limiting deficiency collections "following the exercise of the power of sale in [a] deed of trust or mortgage"].) The absence from section 580b of this kind of "clear and unequivocal limiting language" reinforces that section 580b is not confined to nonjudicial foreclosure sales. (*Rahoi*,

supra, 2013 U.S. Dist. LEXIS 83571 at p. *30; see also *Rex*, *supra*, 905 F.Supp.2d at pp. 1139-1140 [similar].) Likewise, section 580c limits fees and costs in cases "where existing deeds of trust or mortgages are judicially foreclosed." (Code Civ. Proc., § 580c.) No similar language limiting section 580b to judicial foreclosures appears in the statute. Accordingly, a plain-text reading of section 580b establishes that banks may not pursue borrowers personally after a short sale.

B. The Purposes of Section 580b Support This Conclusion.

The purposes of section 580b also demonstrate that lenders cannot collect deficiency balances after short sales. "Statutes should be interpreted to promote rather than defeat the legislative purpose and policy." (*Freedland v. Greco* (1955) 45 Cal.2d 462, 467 (*Freedland*).) The "applicable rule of statutory construction is that the purpose sought to be achieved and evils to be eliminated have an important place in ascertaining the legislative intent." (*Ibid.*) With respect to section 580b in particular, "[t]he purpose of the statute causes it to be applied liberally and broadly." (*Weinstein v. Rocha* (2012) 208 Cal.App.4th 92, 97.) Reading section 580b to apply

following a short sale promotes the statute's purposes. Chase's contrary interpretation of the statute would frustrate them.

Enacted during the Great Depression, section 580b was intended to protect both individual homebuyers and the overall economy in times of economic distress. The statute accomplishes these goals by squarely placing the risk of inadequate security on the purchase money lienholder. (E.g., *Bargioni v. Hill* (1963) 59 Cal.2d 121, 123.) As this Court has explained, when property values drop 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." (*Roseleaf, supra*, 59 Cal.2d at p. 42.) In this way, section 580b serves an important role in stabilizing the economy during an economic recession: after default, "the purchaser's loss is limited to the land that he or she used as security in the transaction, purchasers as a class are harmed less than they might otherwise be during a time of economic decline, and the economy benefits." (*DeBerard, supra*, 20 Cal.4th at p. 663.)

At the same time, allocating the risk of insufficient security to the lienholder serves as an important "transaction-specific stabilization measure." (*DeBerard, supra*, 20 Cal.4th at p. 663.) By

discouraging the overvaluation of the security, section 580b helps ensure that the price of the property accurately captures its true value. (*Ibid.*)

Interpreting section 580b to bar deficiency liability after a short sale promotes each of these purposes. It ensures that banks, like Chase, retain the risk of inadequate security: if the value of the property at the time of the short sale is less than the note, the bank—not the borrower—shoulders that loss. In turn, sparing borrowers from that loss protects the overall economy from the further slide that would result if they were saddled with often substantial personal liabilities. Preventing banks from collecting deficiencies after short sales also deters lenders from overvaluing the price of their collateral at the time of the loan's origination.

Chase's contrary arguments based on the statute's purpose fail. (See OB at pp. 17-19.) Chase first argues that reading section 580b to apply to short sales is not "necessary" to protect defaulting borrowers from personal liability because, according to Chase, property owners could always allow the lender to foreclose. (OB at pp. 17-18.) To begin with, Chase cites no authority for the novel proposition that the statute applies only if the borrower has no alternative to avoiding a

deficiency judgment. In any event, as discussed above, the Legislature relieved borrowers from personal liability not only to protect individual property owners but also to stabilize the economy as a whole. (E.g., *DeBerard*, *supra*, 20 Cal.4th at p. 663.) Denying antideficiency protection to borrowers who choose short sales over foreclosure directly undermines this macro-stabilization objective. Indeed, as one court explained, were section 580b construed not to protect borrowers after a short sale, "banks would have a new tool that would allow them to both collect the proceeds of the sale of the home *and* proceed against the borrower directly," a result that is "undoubtedly barred if a bank accomplishes the sale through a foreclosure sale." (*Rahoi*, *supra*, 2013 U.S. Dist. LEXIS 83571 at p.*36, italics in original.)

Chase's further claim that preventing lenders from collecting deficiency judgments following a short sale will not deter future overvaluation of real property is also misplaced. (OB at pp. 18-19.) Whether section 580e, a 2010 statute barring deficiencies after short sales, applies retroactively is not a question pending before this Court. But even if Chase is correct that that statute applies only to short sales executed after the statute's enactment, that fact does not detract from

the Legislature's goal in section 580b of discouraging property overvaluations at the time Chase extended a loan to Coker in this case.

C. The Legislature's Enactment of Section 580e Confirms that Section 580b Applies After a Short Sale.

The Legislature's enactment of section 580e in 2010 also demonstrates that section 580b's protections apply following a short sale. Although there is "some incongruity in the notion that one Legislature may speak authoritatively on the intent of an earlier Legislature's enactment when a gulf of decades separates the two bodies . . . the Legislature's expressed views on the prior import of its statutes are entitled to due consideration" and will not be disregarded. (*Western Security Bank, N.A. v. Superior Court* (1997) 15 Cal.4th 232, 244.)

Here, the 2010 Legislature that enacted section 580e expressed its view that the earlier-enacted section 580b already applied to short sales involving purchase money notes. For example, the Senate Rules Committee Analysis states that, under existing law, notwithstanding some disagreement among lawyers, "it is generally believed" that section 580b "provide[s] protection to a purchase money note that becomes the subject of a judicial or nonjudicial foreclosure action or a short sale." (Sen. Rules Com., Analysis of Sen. Bill No. 931, as

amended June 1, 2010, p. 2; see also e.g., Assem. Com. on Banking & Finance, Hearing on Sen. Bill No. 931, as amended June 1, 2010, p. 1 [same].) This legislative history material "shows the California legislature *knew* Section 580b applied to short sales." (*Rex, supra*, 905 F.Supp.2d at p. 1144, italics in original.)

Reading section 580b as applying after a short sale, moreover, would not give section 580e retroactive application, as Chase contends. (OB at pp. 16-17.) Section 580e was adopted not to protect purchase money borrowers (who already were protected under section 580b), but rather to extend antideficiency protections to non-purchase money obligations. Section 580e prohibits deficiencies on any note that is secured solely by a deed of trust on residential property following a short sale. (Code Civ. Proc., § 580e.) By contrast, section 580b applies only to purchase money obligations. (See *id.*, § 580b; *Rahoi, supra*, 2013 U.S. Dist. LEXIS 83571 at p. *40 [while section 580b applies only to purchase money loans, section 580e applies "more broadly" to notes secured by a deed of trust on residential property].) Consequently, interpreting section 580b to apply after a short sale does not retrospectively extend section 580e.

Section 580e's legislative history supports this conclusion as well. The sponsor of section 580e explained that "the purpose of this proposed legislation [section 580e] is to protect distressed homeowners who have non-purchase money recourse loans on residential property . . . ." (Sen. Daily J., 2009-2010 Reg. Sess., October 8, 2010, pp. 5260-5261; see also Assem. Com. on Banking & Finance, Hearing on Sen. Bill No. 931, as amended June 1, 2010, p. 3 [similar].) Legislative analyses also noted that "[d]ue to vagueness in current law a borrower with a non-purchase money loan could become liable for debt under a short sale" and that the proposed legislation "seeks to clear up any legal confusion between purchase money and non-purchase money loans in regards to short sales." (Assem. Com. on Banking & Finance, Hearing on Sen. Bill No. 931, as amended June 1, 2010, p. 3.) Thus, as one court explained, "the plain language and legislative history of Section 580e shows that this statute was enacted to expand the *type of mortgages* to which anti-deficiency protections applied, not the *modes of sale*." (*Rex*, *supra*, 905 F.Supp.2d at p. 1145, italics in original.) Accordingly, the enactment of section 580e supports, not undermines, the conclusion that, for purchase money loans, section 580b applies after a short sale.

D. Chase's "Ratification" Argument Is Without Merit.

Omitting any mention of the statute's text, Chase argues that the Court should discern the Legislature's intent based on the Legislature's purported acquiescence in the Court of Appeal's decision in *Jack Erickson*, *supra*, 50 Cal.App.4th 182, which, according to Chase, held that section 580b does not apply following a short sale. (OB at pp. 15-16.) Chase's reliance on *Jack Erickson* and the doctrine of Legislative acquiescence lacks merit.

First, *Jack Erickson*'s purported approval of deficiency judgments following short sales is premised on a now-overruled understanding of section 580b. In the four-sentence passage of the opinion on which Chase's argument rests, *Jack Erickson* stated that a "second waiver [of section 580b] occurred when [the buyer] induced [the seller] to execute a deed of reconveyance and sold the property." (*Jack Erickson*, *supra*, 50 Cal.App.4th at pp. 188-189.) In discussing the rules governing such waivers, the *Jack Erickson* court observed that, while borrowers cannot waive antideficiency protections in advance, "section 580b can be waived by the buyer's subsequent conduct," citing, *inter alia*, *Russell v. Roberts* (1974) 39 Cal.App.3d

390, 394-395 (*Russell*). (*Jack Erickson*, *supra*, 50 Cal.App.4th at p. 185.)

Almost three years after *Jack Erickson* was decided (and as discussed more fully below), this Court in *DeBerard* held the opposite: that subsequent conduct cannot waive section 580b's protections. (*DeBerard*, *supra*, 20 Cal.4th at pp. 670-671.) In so ruling, the Court specifically disapproved the very part of *Russell* on which *Jack Erickson* relied. (*Id.* at p. 671.) Consequently, the validity of *Jack Erickson*'s "second waiver" analysis is, at best, in doubt following *DeBerard*. It is unsurprising therefore that no published California Court of Appeal decision relies on—or even cites—*Jack Erickson*.

Second, the Legislature is deemed to ratify only longstanding and consistent judicial interpretations. As this Court has explained, legislative inaction can signal acquiescence "when there exists both a well-developed body of law interpreting a statutory provision and numerous amendments to a statute without altering the interpreted provision." (*Olson*, *supra*, 42 Cal.4th at p. 1156.) Thus, in *Olson*, the Court rejected a legislative-endorsement argument where the judicial action consisted of a single Court of Appeal decision on which no

other court had relied. (*Ibid.*) That is the situation here: Chase's acquiescence argument rests on a single Court of Appeal decision—indeed, only four sentences in that decision—that no subsequent published California case has even cited.

At the same time, Chase points to nothing in the legislative history of the 2012 and 2013 amendments to section 580b that mentions *Jack Erickson* or its purported rule on short sales. Some of Chase's own authorities (OB at p. 15) make clear that this absence undermines any suggestion that the Legislature implicitly adopted *Jack Erickson*'s interpretation of section 580b. (See, e.g., *Marina Point, Ltd. v. Wolfson* (1982) 30 Cal.3d 721, 735 [principle of legislative acquiescence "particularly applie[d]" because the legislative documents "establish[ed] beyond question that the Legislature was well aware of [this Court's] construction" of the relevant provision]; *County of Tulare v. Nunes* (2013) 215 Cal.App.4th 1188, 1199 [stating that the "legislative history of the amendment confirms the Legislature was mindful of these prior decisions," footnote omitted].)

In sum, the text and purpose of section 580b as well as the legislative history of section 580e all demonstrate that section 580b applies after a short sale.

II. Short Sales Do Not Divest Borrowers of Section 580b's Protections.

Ignoring that section 580b applies "after a sale," Chase claims that short sales divest borrowers of the protections under section 580b. In particular, Chase asserts that, through a short sale, the parties contract to transform the original secured purchase money note into an unsecured note stripped of section 580b's protections. This argument fails on multiple grounds.

A. Chase's Demand that Coker Remain Personally Liable on the Loan Is Unenforceable.

To begin with, Chase's claim that the parties in this case contracted to take the loan outside the purview of section 580b (OB at pp. 13-14, 18) lacks merit because the protections of section 580b cannot be waived. As Chase concedes, waivers of section 580b, even in exchange for concessions by the lender, are void. (*DeBerard*, *supra*, 20 Cal.4th at pp. 668-669; see OB at p. 14.) Section 580b applies "'in any event,'" and this "strict language . . . runs counter to the possibility of waiver, contemporaneous or subsequent."

(*DeBerard*, *supra*, 20 Cal.4th at p. 670; *Lawler v. Jacobs* (2000) 83 Cal.App.4th 723, 736 (*Lawler*) ["[t]here is no wiggle room in the statute that would permit a vendor to enforce a waiver of its protection in exchange for other concessions"].)

As this Court has explained, section 580b is unwaivable because of the statute's important public purpose—"stabiliz[ing] the state's economy, to the benefit of all." (*DeBerard*, *supra*, 20 Cal.4th at p. 669; see also Civ. Code, § 3513 ["a law established for a public reason cannot be contravened by a private agreement"].) Accordingly, "[t]o allow a purchase money creditor to circumvent the absolute rule" against deficiency liability "'by enforcing a waiver of section 580b in exchange for other concessions would flout the very purpose of the rule.'" (*DeBerard*, *supra*, 20 Cal.4th at p. 663, alterations and ellipses omitted, quoting *Palm v. Schilling* (1988) 199 Cal.App.3d 63, 76 (*Palm*)].)

Here, Chase seeks to enforce such a waiver. According to Chase, it can collect a deficiency on Coker's loan because, among other reasons, its short-sale approval letter stated that "[t]he amount paid to Chase is for the release of Chase's 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 at p. 197; see OB at pp. 14, 18.) That is the definition of waiver. (See *Lawler*, *supra*, 83 Cal.App.4th at p. 737 [promise "of full recourse without restriction of the antideficiency laws is nothing more than an unenforceable waiver of 580b"].) Although Chase seeks to recharacterize its effort to avoid the restrictions of section 580b not as an illegal waiver but rather as a permissible "destruction" of the security interest, Chase's new label does not change the substance of its position. Like "the vendors in *DeBerard*, [Chase] here could have pursued a foreclosure sale due to [Coker's] defaulting on [her] mortgage; [Chase] simply opted for the convenience of a short sale. Thus [Chase] essentially seek[s] to impermissibly 'circumvent' Section 580b by contracting for a short sale in lieu of a foreclosure sale, a result that would 'flout ... the very purpose of the rule.'" (*Rex*, *supra*, 905 F.Supp.2d at p. 1141, footnote omitted, ellipses in original.)

It makes no difference, moreover, that Chase did not retain the same security interest after the short sale. (OB at p. 14.) As Chase notes, without section 580b's protections, a lender retaining its security interest can recover both the property and the outstanding

balance after borrower default. (*Ibid.*) A lender reaps the same windfall in a short sale: without section 580b's protections, a lender reconveying its security interest to facilitate a short sale can recover both the entire value of the property and the outstanding balance.

At the same time, allowing lenders to avoid section 580b through the terms of their short sale agreements would allow banks to take advantage of borrowers during a time of severe financial distress. As this Court has recognized, "ruinous concessions are, if anything, easier to obtain when the debtor is in default." (*DeBerard*, *supra*, 20 Cal.4th at pp. 670-671, alterations and internal quotation marks omitted.) Here, Chase maintained its threat of foreclosure both before and throughout the short-sale process, and it had the unilateral authority to accept or reject any short sale that Coker proposed. Given its power over the disposition of Coker's condominium, Chase was in a position to condition its approval of any short sale on advantageous (and unenforceable) terms. Under established law, Chase's leveraging of that position to divest a borrower of the protections under section 580b is unenforceable.

B. Short Sale Transactions Do Not Remove Purchase Money Loans from the Scope of Section 580b.

Chase's further claim that short sale transactions transform the nature of purchase money loans and thereby remove them from the scope of section 580b is also without merit.

As an initial matter, this Court has made clear that, with purchase money trust deeds, the character of the transaction is determined at the time the trust deed is executed. (*Brown*, *supra*, 41 Cal.2d at p. 197.) "Its nature is then fixed for all time and as so fixed no deficiency judgment may be obtained regardless of whether the security later becomes valueless." (*Ibid.*) The dispositive question in determining whether section 580b applies, therefore, is whether the seller took a purchase money trust deed on the property at the time the property was originally purchased: if it did, "section 580b is applicable and [the seller] may look only to the security." (*Ibid.*; see also *DeBerard*, *supra*, 20 Cal.4th at p. 663 ["The language of section 580b is plain. A vendor is barred from obtaining a deficiency judgment against a purchaser in a purchase money secured land transaction."].) Put another way, section 580b is "an absolute bar to

deficiency judgments in purchase money secured land sales." (*DeBerard*, *supra*, at p. 664.)[2]

This is true even if the security is reconveyed after the loan's inception. In *Brown*, the Court made clear that the protections of section 580b do not disappear even if, after the loan's origination, the lender's security is extinguished. (See *Brown*, *supra*, 41 Cal.2d at p. 197.) Likewise, in *Ghirardo*, *supra*, 14 Cal.4th 39, the Court held that, under section 580b, a vendor could not collect a deficiency judgment after reconveying the deed to the buyer pursuant to the buyer's payoff of the note. (*Id.* at pp. 49-50.) The Court explained that, because the note was purchase money, it was subject to section 580b. (*Ibid.*) And even though any obligations remaining after the payoff and reconveyance were considered "no longer secured," the vendor still could not collect a deficiency judgment in

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[2] The Court has recognized only one exception to section 580b's broad application. In *Spangler v. Memel* (1972) 7 Cal.3d 603 (*Spangler*), this Court held that section 580b does not apply when a vendor subordinates his purchase money lien to a lien securing a construction loan. (*Id.* at pp. 611-615.) This "narrow" exception applies only to commercial development and when, among other factors, a "pronounced intensification of the property's anticipated post-sale use both requires and eventually results in construction financing that dwarfs the property's value at the time of sale." (*DeBerard*, *supra*, 20 Cal.4th at pp. 665, 666; see also *Spangler*, *supra*, 7 Cal.3d at p. 614 & fn. 9.) These criteria are not present here.

light of section 580b. (*Ibid.*, italics omitted; see also *Rahoi*, *supra*, 2013 U.S. Dist. LEXIS 83571 at p. *51, fn. 22 [section 580b precludes deficiency judgment even after second lienholder is "divested of" its security interest following foreclosure sale by senior lender]; *Birman v. Loeb* (1998) 64 Cal.App.4th 502, 520 ["Following foreclosure, defendants were left with an unsecured, unenforceable claim for the balance due on the promissory note. They had no recourse beyond the security," citing, *inter alia*, section 580b].) Accordingly, Chase's claim that short sales transform secured purchase money loans covered by section 580b into unsecured loans freed from section 580b is without merit.

Furthermore, the "destruction" concept from *DeBerard* on which Chase relies does not apply to short sales. (OB at pp. 11-14.) In *DeBerard*, the Court held that, because parties may not contractually waive section 580b's protections, a junior lienholder exacting such a promise may not collect a deficiency judgment, even after the senior lienholder forecloses on the security and leaves the junior with nothing. (See *DeBerard*, *supra*, 20 Cal.4th at pp. 662, 671.) In dicta, the Court added that, "'[i]f the purchase money creditor [i.e., the junior lienholder] does not wish to accept the risk

that the property will be lost through foreclosure by another secured creditor, the remedy is to either foreclose himself or destroy the purchase money nature of the transaction by reconveying the deed or mortgage on the original real estate in exchange for the substitution of other security.'" (*Id.* at p. 669, first alteration in original, quoting *Palm, supra*, 199 Cal.App.3d at p. 76.)

Although Chase's brief does not mention the last clause of this sentence—"in exchange for the substitution of other security"—it is key to understanding the application of the "destruction" concept. When a lender reconveys the original trust deed and substitutes new security—i.e., when it refinances the loan—courts have observed that the lender can avoid section 580b because the purposes of the statute are not served by applying it in that context. This point is made clear by the origins of *DeBerard*'s "destruction" language. *DeBerard* relied on *Palm v. Schilling, supra*, 199 Cal.App.3d at p. 76, which in turn relied on *Goodyear v. Mack* (1984) 159 Cal.App.3d 654, *disapproved on other grounds in DeBerard, supra*, 20 Cal.4th at p. 671 (*Goodyear*). *Goodyear* held that, when a vendor refinances a loan and accepts substitute security, the vendor is entitled to a deficiency judgment post-default because the buyer does not face the prospect of

losing both the original property purchased and remaining personally liable on the loan. (See *Goodyear*, *supra*, 159 Cal.App.3d at p. 659.) Likewise, when the creditor takes a lien on a different property, it may not have superior knowledge about the value of its new security after the refinance. (*Ibid.*)[3]

By contrast, allowing a lender to pursue a post-short sale deficiency balance would leave the borrower without his property, having incurred all of the costs to exhaust the security, and with potentially substantial personal liability. In addition, when the creditor is the original purchase money lender on the property being sold, it knows the value of its security.

When determining the application of section 580b, "courts look to the substance of the transaction, not its form." (*Enloe v. Kelso* (2013) 217 Cal.App.4th 877, 881.) In a short sale, the lender reconveys the deed not to release its security to the borrower but rather to *realize* the value of its security. Chase's reliance on "destruction" theories that do not involve the lender realizing the value of its security is misplaced.

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[3] In 2012, years after *Goodyear*, the Legislature amended section 580b to preclude deficiency liability with respect to any transaction used to refinance a purchase money loan. (See § 580b, as amended by Stats. 2012, ch. 64 (S.B. 1069), § 1.)

At bottom, Chase's contention that short sales that it approves remove purchase money notes from the purview of section 580b reflects the same kind of effort to avoid state antideficiency protections that this and other California courts have rejected. For example, in *Freedland v. Greco, supra*, 45 Cal.2d 462, this Court observed that a creditor could not circumvent the antideficiency protections of section 580d by creating two different notes for the same total indebtedness, one secured and one unsecured. (See *id.* at p. 467.) "It should be clear that in such a case the [sellers] could not recover a deficiency judgment on the unsecured note after selling the property under the trust deed covered by the other note," because the statute could not "be circumvented by such a manifestly evasive device." (*Ibid.*; see also *Cadle Co. v. Harvey* (2000) 83 Cal.App.4th 927, 932 [protections of antideficiency laws "cannot be subverted through artifice"].)

Likewise, here, when Chase approves a short sale, it makes the choice to extract the entire value of its security through a sale that the borrower arranges. Chase's argument that, in so doing, it liberates itself from the restrictions of section 580b—when it is undisputed that no deficiency could be obtained if Chase extracted the value of its

security through foreclosure—reflects the kind of evasive device that the antideficiency laws prohibit.

In sum, section 580b applies after a short sale and prohibits banks from pursuing borrowers personally on the balance of their loans.

III. Coker Did Not Waive Her Rights Under Section 726.

Although Coker's complaint did not assert a cause of action under section 726, Chase seeks a ruling from this Court that Coker waived the "security-first" protection that that statute provides. (See OB at pp. 8-10.) Coker did not waive the security-first rule, because the short sale of her condominium satisfied that rule.

Section 726 states in relevant part, "[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 provision of this chapter." (Code Civ. Proc., § 726, subd. (a).) As this Court has explained, section 726 encompasses both "one-action" and "security-first" principles. (*Security Pacific Nat. Bank v. Wozab* (1990) 51 Cal.3d 991, 996-998 (*Wozab*).) The "one-action" rule provides that a secured creditor can bring only one lawsuit to enforce its security

interest and enforce its debt. (*Id.* at p. 997.) The "security-first" principle requires a secured creditor to resort to its security before seeking to enforce the underlying obligation. (*Id.* at p. 999.) Section 726's protections are procedural in nature and are typically invoked in the context of a judicial action as an affirmative defense by the borrower or as sanction against the creditor. (See *id.* at p. 997.)

The short sale in this case satisfied the security-first principle. Just as would have occurred if Chase had completed the nonjudicial foreclosure that it initiated, Chase exhausted its security through the short sale and realized the entire value of its secured interest.

Chase errs in claiming that the short sale waived the security-first rule. (OB at pp. 8-10.) In *Wozab*, the Court explained that a borrower can waive the protections of section 726 "by failing to insist that the creditor first proceed against the security." (*Wozab*, *supra*, 51 Cal.3d at p. 1005.) In that case, after the bank unilaterally took a set-off against the borrowers' personal assets, the borrowers demanded that the bank reconvey the deed of trust to them as a sanction for the bank's violation of the security-first rule. (*Id.* at pp. 996, 1005.) The bank did so, giving the borrowers unencumbered ownership of their property. (*Ibid.*) The Court held that, by reclaiming the deed of trust,

the borrowers precluded the bank from resorting to the security, thereby relinquishing the protection of the security-first rule. (*Id.* at p. 1005.)

Here, by contrast, the reconveyance of the deed of trust did not preclude Chase's resort to its security—it facilitated it. Unlike in *Wozab*, where the borrowers reclaimed the trust deed for their own benefit (*id.* at pp. 996, 1005), here Chase reconveyed the deed as part of a transaction that allowed it to realize the entire value of the security. Likewise, whereas in *Wozab*, the borrowers' actions—"demanding reconveyance of the security and then demanding that the creditor resort to the security"—were "mutually inconsistent" (*id.* at p. 1005), here the reconveyance and the resort to the security were wholly consistent. *Wozab*'s waiver analysis therefore does not apply in this case.

Bank of America v. Roberts, *supra*, 217 Cal.App.4th 1386, on which Chase relies, is also inapposite. (OB at pp. 9-10.) Relying in large part on *Wozab*, the Court of Appeal in *Roberts* held that a borrower of a home equity line of credit (which was not a purchase money loan) waived her rights under section 726 by asking the junior lienholder to reconvey its trust deed to allow a short sale. (*Roberts*,

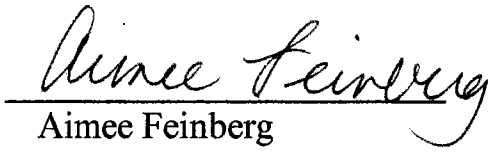
supra, 217 Cal.App.4th at pp. 354-355.) But as just explained, *Wozab*'s waiver analysis does not apply when the lender realizes the entire value of the security. Likewise, the fact that the borrower in *Roberts* requested the bank's approval of a short sale that required the bank to release its lien is of no moment. (*Ibid.*) The borrower in this Court's decision in *Ghirardo*, *supra*, 14 Cal.4th 39, also asked the creditor to approve a transaction and release a lien, yet no waiver was found. (*Id.* at p. 45.) Finally, unlike in Coker's case, had the lender in *Roberts* refused to permit the short sale and the property had been foreclosed on, the creditor would have been entitled to sue for the balance due on the home equity loan. (*Roberts*, *supra*, 217 Cal.App.4th at p. 354.) The same is not true here: had Chase declined to approve the short sale and proceeded with foreclosure, Chase would not be entitled to sue for the balance due. Chase's argument that Coker waived the protections of section 726 should be rejected.

CONCLUSION

For all of the reasons stated above, Coker respectfully requests that the Court of Appeal's judgment be affirmed.

Dated: May 20, 2014

Respectfully submitted,

By: 
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Andrew R. Stilwell

CERTIFICATE OF WORD COUNT
(California Rule of Court 8.204(c)(1))

This brief, including footnotes but excluding those portions of the brief excludable under California Rule of Court 8.204(c)(3), contains 8,249 words as counted by the Microsoft Word word processing program.

Dated: May 20, 2014

Aimee Feinberg

PROOF OF SERVICE

I am employed in the County of Yolo, State of California. I am over the age of 18 and not a party to the within action. My business address is UC Davis School of Law, 400 Mrak Hall Drive, Davis, CA 95616.

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