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Case No. S243294

SUPREME COURT OF CALIFORNIA

BLACK SKY CAPITAL, LLC,
Plaintiff and Appellant,

v.

MICHAEL A. COBB and KATHLEEN S. COBB,

Defendants and Petitioners.

After a Decision by the Court of Appeal,
Fourth Appellate District Two
Case No. E064482

From the Superior Court of California, County of San Bernardino
The Hon. Bryan F. Foster, Judge
Case No. CIVDS1416584

AMICUS CURIAE BRIEF OF HOUSING AND ECONOMIC RIGHTS ADVOCATES IN SUPPORT OF DEFENDANTS AND PETITIONERS MICHAEL A. COBB AND KATHLEEN S. COBB

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INTRODUCTION

For most Americans, buying a home is by far the largest and most significant investment of a lifetime. As property values in California, especially in our metropolitan population centers, continue to rise, homebuyers face costs and risks more daunting than ever before. For this Court to have taken the rare step to review an anti-deficiency case is timely.

Downturns in the real estate market have a ripple effect, not only within the housing market itself, but on the overall economy as well. Falling home values trigger increased rates of foreclosure, which in turn accelerate a downward spiral in home values as lenders increase their inventories of homes purchased at foreclosure sales. Homeowners in a depressed market find their homes "under water" and are unable to refinance or sell their way out of unaffordable mortgages. The human toll of lost homes is incalculable. The financial toll on the housing market and on the economy as a whole can be severe, as purchasing power diminishes, expenditures on home improvements and furnishings dissipate, and lending, brokerage, construction, and architectural business contracts.

The California Legislature witnessed this systemic economic syndrome during the Great Depression, and responded 85 years ago by enacting anti-deficiency statutes. These statutes came on the books as the result of "the Great Depression and the corresponding

legislative abhorrence of the all too common foreclosures and forfeitures [which occurred] during that era for reasons beyond the control of the debtors." (*Alliance Mortgage Co. v. Rothwell* (1995) 10 Cal.4th 1226, 1236, quoting Hetland & Hansen, *The "Mixed Collateral" Amendments to California's Commercial Code* (1987) 75 Cal. L.Rev. 185, 187-188, fn. omitted.)

The anti-deficiency statutes continue to serve as a bulwark of protection for borrowers and the economy in general against "bubble markets" like California experienced during the 1920s and the early 2000s. Recent history has again proven that the residential real estate market is prone to booms and busts. In the past decade California experienced the most widespread financial catastrophe since the Great Depression, the era in which the State's anti-deficiency regime was urgently enacted. It is widely documented that this most recent housing meltdown was driven by modern mortgage lending practices that evaded consumer and market protections, at the expense of borrowers and the security of the housing market.

This case presents two significant issues under Code of Civil Procedure section 580d:

First, does the statute bar a deficiency on a second mortgage when the lender forecloses the first mortgage at a non-judicial sale and the same lender also owns the second mortgage at the time of sale? The Courts of Appeal, following *Simon v. Superior Court*

(1992) 4 Cal.App.4th 63, have uniformly and without exception held that it does. This Court should approve those decisions and hold that section 580d bars Blue Sky's action to obtain a personal judgment against the Cobbs based on the second mortgage.

Second, does the statute bar a deficiency on a second mortgage when the first mortgage is foreclosed at a non-judicial sale and, even if there is not common ownership of both loans at the time of the foreclosure sale, a single lender simultaneously originated both loans? This is the second aspect of *Simon*, in which the court presciently foresaw the danger of "piggyback" lending to the anti-deficiency laws. This issue came to be of prime importance to homeowners because of the prevalence of piggyback lending during the recent mortgage bubble—the simultaneous origination of a large first mortgage, together with a smaller piggyback second mortgage in order to achieve a loan-to-value ratio on the first (usually 80%) that would satisfy the requirements to securitize the first.

After *Simon*, the housing market crash of ten years ago compellingly revealed the hazards of piggyback lending. Piggyback seconds threaten homeowners with personal liability on junior loans that lenders structured simply to enable them to sell first mortgages into the market for mortgage-backed securities. This Court should approve this second aspect of *Simon* and hold that section 580d bars a

deficiency not only on a first loan that is non-judicially foreclosed, but also on a simultaneously originated junior mortgage.

ARGUMENT

1. California's Anti-Deficiency Legislation: History, Purposes, and Policy

Since the Great Depression, California's anti-deficiency statutes have protected borrowers against "deficiency judgments" after a mortgage lender has exhausted the loan security, ordinarily through a foreclosure sale or a short sale. "A deficiency judgment is a personal judgment against the debtor-mortgagor for the difference between the fair market value of the property held as security and the outstanding indebtedness." (*Cornelison v. Kornbluth* (1975) 15 Cal.3d 590, 603.)

California's anti-deficiency legislation consists of two "fair value" statutes (Code of Civil Procedure §§ 726 and 580a[1]), the "purchase money" anti-deficiency law (section 580b), and the statute at the heart of this case, section 580d. For reasons that will be explained, section 580d is best classified with the "fair value" statutes. This cluster of anti-deficiency laws, enacted between 1933 and 1940, serves different, but overlapping, purposes.

The "fair value" statutes limit any deficiency judgment to the amount by which the loan balance remaining after the security has

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[1] Unless other stated or indicated by context, all citations are to the Code of Civil Procedure.

been exhausted exceeds the fair market value of the property, regardless of the price actually paid at a foreclosure sale.[2]

> The price at a foreclosure sale is not deemed the equivalent of the property's fair market value. As the United States Supreme Court recently observed, "An appraiser's reconstruction of 'fair market value' could show what similar property would be worth if it did not have to be sold within the time and manner strictures of state-prescribed foreclosure. But property that *must* be sold within those strictures is simply *worth less*. No one would pay as much to own such property as he would pay to own real estate that could be sold at leisure and pursuant to normal marketing techniques."

(*Alliance Mortgage,* 10 Cal.4th at 1236-37, quoting *BFP v.*

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[2] § 580a ("The court may render judgment [after a non-judicial foreclosure sale] for not more than the amount by which the entire amount of the indebtedness due at the time of sale exceeded the fair market value of the real property or interest therein sold at the time of sale with interest thereon from the date of the sale ...."; added by Stats. 1933, ch. 642, § 4); § 726, subd. (b)("the court shall render a money judgment [in a judicial foreclosure action] against the defendant or defendants for the amount by which the amount of the indebtedness with interest and costs of levy and sale and of action exceeds the fair value of the real property or estate for years therein sold as of the date of sale ...."; originally added by Stats. 1937, ch. 353, § 1).

Resolution Trust Corp. (1994) 511 U.S. 531, 539, italics in original.)

In contrast, the purchase money anti-deficiency law entirely eliminates a borrower's personal liability on any mortgage used to purchase a dwelling the borrower intends to occupy.[3]

The last-enacted anti-deficiency statute, section 580d, bars deficiency judgments altogether when the lender conducts a non-judicial foreclosure.[4] By prohibiting deficiencies after a non-judicial foreclosure sale, section 580d provides even stronger anti-deficiency protection than the earlier section 580a, which permitted deficiencies after non-judicial foreclosure sales, but imposed a "fair value"

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[3] § 580b (originally added by Stats. 1933, ch. 642). The original legislation only applied to installment purchases and seller carry-back mortgages. In 1963, the Legislature expanded the coverage of the statute to conventional mortgages used to buy personal residences. (*Id.*, subd. (a)(3)) ("no deficiency shall be owed or collected, and no deficiency judgment shall lie … [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"'; originally added by Stats. 1963, ch. 2158, § 1.)

[4] § 580d, subdivision (a) ("no deficiency shall be owed or collected, and no deficiency judgment shall be rendered for a deficiency on a note secured by a deed of trust or mortgage on real property or an estate for years therein executed in any case in which the real property or estate for years therein has been sold by the mortgagee or trustee under power of sale contained in the mortgage or deed of trust"; originally added by Stats. 1940 1st Ex. Sess., ch. 29, § 2.)

limitation on the judgment amount. As will be explained, the Legislature's reason for adding section 580d was to increase protection against "double recovery."

The evil that led to Legislature to add the "fair value" statutes was the potential for a lender to obtain a double recovery from the borrower. "[D]uring the great depression with its dearth of money and declining property values, a mortgagee was able to purchase the subject real property at the 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." (*Cornelison, supra*, 15 Cal.3d at 600, citing *Roseleaf Corp. v. Chierighino* (1963) 59 Cal.2d 35, 40; *see also Alliance Mortgage, supra,* 10 Cal.4th at 1236 ("the antideficiency statutes in part 'serve to prevent creditors in private sales from buying in at deflated prices and realizing double recoveries by holding debtors for large deficiencies.'"))

The enactment of section 580a in 1933 and section 726 in 1937 imposed the "fair value" limitation on any deficiency judgment sought by a foreclosing mortgage lender after either a non-judicial foreclosure sale or a judicial foreclosure sale, respectively. Under the "fair value" statutes, "if, due to the depressed economic conditions, the property serving as security was sold for less than the fair value as determined under section 726 or section 580a, the mortgagee could

not recover the amount of that difference in his action for a deficiency judgment. " (*Cornelison*, *supra*, 15 Cal.3d at 601.)

However, "one significant difference [between non-judicial and judicial sales] remained, namely property sold through judicial foreclosure was subject to the statutory right of redemption (§ 725a [now § 726, subd. (e)]), while property sold by private foreclosure sale was not redeemable." (*Cornelison*, *supra*, 15 Cal.3d at 602.) The effect of the borrower's right to redeem the property at the judicial foreclosure sale price for a year after a judicial foreclosure sale[5] "was to remove any incentive on the part of the mortgagee to enter a low bid at the sale (since the property could be redeemed for that amount) and to encourage the making of a bid approximating the fair market value of the security." (*Id.* at 590, 602 .) Because there is no statutory redemption right after a non-judicial foreclosure sale, after a trustee's sale the lender "could gain irredeemable title to the property by a bid substantially below the fair value and still collect a deficiency judgment for the difference between the fair value of the security and the outstanding indebtedness." (*Ibid.*)

The Legislature added section 580d in 1940 to put non-judicial foreclosure sales on a "parity" with judicial foreclosure sales:

[5] § 726, subd. (e); § 729.030, subd. (b); § 729.060, subd. (b).

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

(*Cornelison*, *supra*, 15 Cal.3d at 602, quoting *Roseleaf, supra*, 59 Cal.2d at 43-44, emphasis added.)

Thus, the Legislature's purpose in enacting section 580d was to "mak[e] the security satisfy a realistic share of the debt" by protecting the borrower against foreclosure sale prices far below fair market value. If the lender wants a personal judgment against the borrower, the lender can elect judicial foreclosure and prove under section 726

that the foreclosure sale price reflects the fair market value of the property.

This Court has emphasized the importance of the anti-deficiency statutes by holding that they represent the public policy of the State and cannot be waived. In *DeBerard Properties v. Lim* (1999) 20 Cal.4th 659, the Court held that, because section 580b reflects a systemic public policy to protect the integrity of the real estate market, a borrower cannot waive the statute, even in a post-mortgage transaction for new consideration:

> The explicit language of section 580b brooks no interpretation other than that deficiency judgments are prohibited by the purchase money mortgagee so long as a purchase money mortgage or deed of trust is in effect on the original property. *To allow a purchase money creditor to circumvent the absolute rule by enforcing a ... waiver of section 580b in exchange for other concessions would [flout] the very purpose of the rule....*

(*Id.* at 663, quoting *Palm v. Schilling,* 199 Cal.App.3d 63, 76 (1988), emphasis added.)

This Court has likewise held that section 580d expresses public policy and is unwaivable. (*Freedland v. Greco* (1955) 45 Cal.2d 462, 467-68; *see also Commonwealth Mortgage Assurance Co. v. Superior Court* (1989) 211 Cal.App.3d 508, 517.)

Because the Legislature enacted the anti-deficiency statutes to protect the public, not simply to reflect a preferred ordering of strictly private concerns, the courts have traditionally "exhibited a very hospitable attitude toward the legislative policy underlying the anti-deficiency legislation and have given it a broad and liberal construction that often goes beyond the narrow bounds of the statutory language. Moreover, the courts have been loath to accept any stratagem calculated to circumvent the social purposes attributed to the legislation by judicial construction." (Riesenfeld, *California Legislation Curbing Deficiency Judgments* (1960) 48 Cal. L.Rev. 705, 709-710, cited with approval in *Prunty v. Bank of America* (1974) 37 Cal.App.3d 430, 436 ("[W]e must also recognize that the 'system' [of anti-deficiency legislation] has been liberally construed to effectuate the specific legislative purpose behind it.").)

2. This Court Should Approve the Heretofore Unquestioned Rule of *Simon*, that Section 580d Applies to a Second Mortgage When the Foreclosing Lender Holds Both First and Second Mortgages at the Time of a Non-Judicial Foreclosure.

    a. Applying Section 580d to Black Sky's Second Mortgage Is Consistent with *Roseleaf* and Necessary to Eliminate the Potential for a Double Recovery from the Cobbs.

Black Sky contends that after non-judicially foreclosing its first mortgage, it is entitled to sue the Cobbs for the unpaid balance of the second mortgage Black Sky also held against the same property. It

bases its argument almost entirely on this Court's opinion in *Roseleaf*, claiming "sold out junior" status.

In *Roseleaf*, this Court held that section 580d does not bar the holder of a second trust deed from seeking a money judgment against the borrower after a non-judicial foreclosure sale under the first trust deed fails to yield any recovery for the second. (*Roseleaf*, *supra*, 59 Cal.2d at 44.) The Court reasoned that section 580d allows the senior lender an election, either to proceed with a judicial foreclosure and obtain a deficiency judgment, with the foreclosure title remaining subject to the borrower's redemption right, or to proceed instead with non-judicial foreclosure and obtain an irredeemable title, while foregoing a deficiency judgment. (*Ibid.*) But a sold out junior has no opportunity for an election, and denying the junior a deficiency judgment would leave it remediless:

> After a senior private sale, the junior has no right to redeem. This disparity of rights would be aggravated were he also denied a right to a deficiency judgment by section 580d. There is no purpose in denying the junior his single remedy after a senior private sale [*i.e.*, a deficiency judgment] while leaving him with two alternative remedies after a senior judicial sale [*i.e.*, either redemption after a senior judicial sale of the property or a deficiency judgment]. *The junior's right to*

> *recover should not be controlled by the whim of the senior, and there is no reason to extend the language of section 580d to reach that result.*

(*Ibid.*, emphasis added.)

As the Cobbs' briefs emphasize, this case is distinguishable from *Roseleaf.* Unlike Black Sky, Roseleaf Corporation did not hold both the first and second trust deeds at the time of the foreclosure sale. Roseleaf only held the second, the first being owned by the unnamed "strangers to this action" who instituted the non-judicial foreclosure sale. (*Roseleaf, supra*, 59 Cal.2d at 38.) Their foreclosure sale wiped out Roseleaf's second trust deed.

Unlike Roseleaf Corporation, Black Sky was not an innocent third party bystander at the trustee's sale. Unlike Roseleaf, it was Black Sky that elected to conduct a non-judicial foreclosure. Its own sale wiped out its second trust deed. This materially distinguishes this case from *Roseleaf*, and should lead to a different result.

Roseleaf teaches that the Legislature's purpose in eliminating deficiency judgments after non-judicial foreclosure sales was to "mak[e] the security satisfy a realistic share of the debt" by undercutting the incentive of the foreclosing lender to underbid at a non-judicial sale, just as the right of redemption protects the borrower against underbidding at a judicial sale. If the lender is entitled to pursue a deficiency, the lender has a financial incentive to underbid at

a trustee's sale to maximize a deficiency judgment against the borrower. This creates the risk of "double recovery" the Legislature intended section 580d to eliminate.

In contrast with *Roseleaf*, Black Sky instituted the senior foreclosure sale *and* had an incentive to underbid at the sale in order to maximize the Cobbs' deficiency on the second. To the extent the foreclosure sale price was high enough to yield proceeds to pay any of Black Sky's second, Black Sky's deficiency would be correspondingly reduced. If, as Black Sky contends under *Roseleaf*, the anti-deficiency laws do not apply to its second deed of trust,[6] then Black Sky would be able to pursue the Cobbs for a money judgment, not only free of the anti-deficiency bar of section 580d, but also without any limitation under the "fair value" statute, section 580a. (*Roseleaf, supra*, 59 Cal.2d at 39-41 (fair-value limitations of sections 580a and 726 do not apply to a sold out junior who recovers nothing from a senior trustee's sale).) Black Sky would be able to obtain a judgment against the Cobbs for the full balance of its second note, even if Black Sky had already once recovered some of that by taking title to the property at the trustee's sale.

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[6] "This action is not for a deficiency after the foreclosure on the senior loan; this action was filed to collect on the separate *junior* loan which was independently issued and recorded two years after the senior loan." (Answer Brief at 1, italics in original; *see also* pp. 11-12.)

Allowing Black Sky to pursue the Cobbs for a money judgment on the second, therefore, would authorize Black Sky to attempt to accomplish and/or to accomplish the very evil both *Roseleaf* and *Cornelison* teach the Legislature intended 580d to prevent—a double recovery.

b. The Language of Section 580d Allows Applying the Statute to Black Sky's Second.

Black Sky responds that the language of section 580d is "clear and unambiguous" that its deficiency exemption only applies to the mortgage that is foreclosed at the trustee's sale. (Answer Brief at 10-13.) Black Sky cites the statement in *Roseleaf* that "'[Such] mortgage or deed of trust' [in the statute] refers to the instrument securing the note sued upon. Thus section 580d *does not appear to extend* to a junior lienor whose security has been sold out in a senior sale." (*Roseleaf, supra*, 59 Cal.2d 35 at 43, emphasis added; Answer Brief at 11-12.)

Even if this terse and tentative statement, made in passing and without any supporting analysis, were read as a judicial construction of the language of section 580d, *Roseleaf* is clear that the Court based its decision almost entirely on the statutory purpose of forcing a foreclosing lender to an election between judicial and non-judicial foreclosure. Both remedial alternatives contain built-in incentives to ensure that the sale would "mak[e] the security satisfy a realistic share

of the debt." The Court found most persuasive that depriving the junior of any right to collect on a junior loan would create the judicial anomaly of leaving the junior remediless, "at the whim of the senior" and through no fault of its own.

Black Sky reports that after *Roseleaf*, the Legislature amended section 580d to replace "such deed of trust" in section 580d, subdivision (a), with "the deed of trust." (Stats. 1989, ch. 698, § 13; *see* Answer Brief at 12.) *Roseleaf*, therefore, does not address the language of the post-1989 statute. Arguably, the change from "such" to "the" introduces ambiguity. "*Such* deed of trust" more clearly ties the trustee's sale back to the "note secured by a deed of trust"—that is, the senior note. "*The* deed of trust" is less definitive because here, the property *was* "sold by the mortgagee or trustee [Black Sky] under power of sale contained in *the* mortgage or deed of trust." "The" does not conclusively relate back to the mortgage or deed of trust that was foreclosed.

But even if it did, the application of section 580d should not rest on the potentially fortuitous choice of a single word, that the Legislature used "the," instead of "a" or "such." This Court appeared to recognize this in grounding its decision in *Roseleaf* on the statutory purpose, instead of the statutory language. Contrary to Black Sky's textual argument, statutory construction principles do not bind this Court to focus on any single word, or to woodenly adopt a literal

interpretation that conflicts with the statutory purpose as found by this Court in its long-standing decisions in *Roseleaf* and *Cornelison.*

The "plain meaning rule"—that "if the statutory language is clear and unambiguous our inquiry ends"[7]—does not require a court to mechanically apply a "literal meaning" to a single word or phrase if doing so would be contrary to the legislative intent. "Literal" meaning is not "clear and unambiguous" if, when read in context, the literal meaning of words used by the Legislature do not comport with the intent of the legislation.

The intent of the Legislature is paramount. "Literal construction should not prevail if it is contrary to the legislative intent apparent in the statute. The intent prevails over the letter, and the letter will, if possible, be so read as to conform to the spirit of the act." (*Lungren v. Deukmejian* (1988) 45 Cal.3d 727, 735.)

> [T]he 'plain meaning' rule does not prohibit a court from determining whether the literal meaning of a statute comports with its purpose or whether such a construction of one provision is consistent with other provisions of the statute. The meaning of a statute may not be determined from a single word or sentence; the words must be

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[7] Answer Brief at 10, quoting *Kirby v. Immooss Fire Protection, Inc.* (2012) 53 Cal.4th 1244, 1250.

construed in context, and provisions relating to the same subject matter must be harmonized to the extent possible.

(*Ibid.*)

This Court applied these principles in *People v. Pieters* (1991) 52 Cal.3d 894. There, the "double base term limitation" of Penal Code section 1170.1a limited the maximum prison term in cases involving multiple sentences for drug sales to twice the number of years imposed as the base term under section 1170. Section 1170.1a contained express exceptions, none of which applied in *Pieters*. The trial court nevertheless imposed an eight-year sentence on the defendant, more than doubling his three-year base term based on "drug quantity enhancements" under section 11370.4. However, at the time defendant committed the crimes, the double base term limitation statute did not exempt quantity enhancements from its coverage.

The double base term statute was clear that "[t]he term of imprisonment shall not exceed twice the number of years imposed by the trial court as the base term pursuant to subdivision (b) of [Penal Code] Section 1170," subject to listed exceptions. (*Pieters*, *supra*, 52 Cal.3d 894, 897, fn.2.) However, the quantity enhancement statute was not added as an exception to the double base term statute until January 1, 1988, after defendant had sold cocaine to an undercover officer in July 1987. (*Id.*)

This Court nevertheless held that the double base term statute did not apply:

> In order to determine this intent, we begin by examining the language of the statute. But '[i]t is a settled principle of statutory interpretation that language of a statute should not be given a literal meaning if doing so would result in absurd consequences which the Legislature did not intend.' Thus, '[t]he intent prevails over the letter, and the letter will, if possible, be so read as to conform to the spirit of the act.' Finally, we do not construe statutes in isolation, but rather read every statute 'with reference to the entire scheme of law of which it is part so that the whole may be harmonized and retain effectiveness.'

(*Id.* at 898-99, citations omitted.)

Following these principles, this Court relied on the legislative purpose of the quantity enhancement statute to uphold the eight-year sentence, even though it was more than twice the base term, the literal language of the double base term statute did not exempt quantity enhancements, and the Legislature only later amended the double base term statute to exempt quantity enhancements:

> In light of the broadly stated statutory objective of punishing more severely 'those persons [dealing] in large quantities of narcotics,' we do not believe the Legislature

> intended full application of section 11370.4 [the quantity enhancement statute] to depend on the fortuitous availability of some unrelated exception [to the double base term statute]. Any other interpretation would draw a distinction, for instance, between large quantities of drugs possessed by an escaped felon and similar amounts in the hands of a convicted narcotics dealer. Such a distinction would be at odds with the Legislature's desire to punish dealers qua dealers.

(*Pieters*, *supra*, 52 Cal.3d at 901.)

This case presents considerations that *Roseleaf* had no occasion to analyze or decide.[8] The Legislature's objective in enacting section 580d to "mak[e] the security satisfy a realistic share of the debt" and to prevent a foreclosing lender from realizing a double recovery can only be fulfilled if the statute is interpreted as applying to a second mortgage when a foreclosing lender holds both first and second mortgages at the time of the trustee's sale. By electing non-judicial foreclosure, the lender obtains a title free of any borrower redemption rights in exchange for foregoing any deficiency judgment. But the

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[8] Further, this Court "reconsiders its own decisions in shaping the law." (Answer Brief at 3, fn.5.)

lender might still underbid at the trustee's sale in order to achieve a double recovery—namely, obtaining the property at below fair market value *and* a money judgment on the second that does not credit the borrower for the property's fair market value.

This construction of section 580d accords with this Court's tradition of taking a functional, not literal, approach to interpreting the anti-deficiency statutes. *Roseleaf* reflects this approach, largely bypassing textual analysis in favor of "equitable considerations" favoring a junior lienor "who, unlike the selling senior, might otherwise end up with nothing." (*Roseleaf, supra*, 59 Cal.2d at 41.)

This Court recently applied the functional approach to interpreting the purchase money anti-deficiency statute (§ 580b) in *Coker v. JPMorgan Chase Bank, N.A* (2016) 62 Cal.4th 667:

> From this review of the case law, it is evident that in determining the reach of section 580b, *we have focused on the substance rather than form of the loan transaction in question*, and our decisions have concluded that the statute limits a lender's recovery on any standard purchase money loan, regardless of how the security has been exhausted and regardless of whether a sale has occurred under the deed of trust securing the unpaid loan.

(*Id.* at 681, emphasis added.)

Coker relied heavily on this Court's decision in *Brown v. Jensen* (1953) 41 Cal.2d 193, a seminal anti-deficiency opinion that signaled this Court's functional approach. Although at that time section 580b provided that "No deficiency judgment shall lie in any event *after any sale of real property ...* ",[9] *Brown* held, and *Coker* reaffirmed, that no "sale" was required as long as the security had by some means been exhausted:

> ["]It is true that [section 580b] speaks of a deficiency judgment after sale of the security but that means after an actual sale or a situation *where a sale would be an idle act, where, as here, the security has been exhausted.* The deficiency judgment which cannot be obtained is still a deficiency judgment even though it may consist of the whole debt because a deficiency is nothing more than the difference between the security and the debt ...." (*Brown, supra*, 41 Cal.2d at pp. 197–198, italics added.) Section 580b "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

[9] *Brown, supra*, 41 Cal.2d at 196, fn. 1, emphasis added.

> purpose of the 'after sale' reference in the section is that the security be exhausted ...." (*Brown*, at p. 198, second italics added.)

(*Coker*, *supra*, 62 Cal.4th at 677, underscoring added, italics in original.)

Applying the "exhaustion of the security" test adopted in *Brown*, this Court held in *Coker* that section 580b applies after a short sale (as opposed to a foreclosure sale), not because a short sale was a "sale," but because "[t]he short sale, like a foreclosure sale, allowed Chase to realize and "exhaust[]" its security." (*Coker*, *supra*, 62 Cal.4th 667, quoting *Brown*, *supra*, 41 Cal.2d at 198.)

This Court should adhere to the functional approach adopted in these cases, vindicate the purpose of section 580d, and reject Black Sky's request that the Court woodenly assign a literal meaning to the word "the," when doing so runs directly contrary to the Legislature's intent.

c. The Appellate Case Law Unanimously Supports this Construction of Section 580d.

Simon v. Superior Court was therefore correctly decided on the point that section 580d applies to a junior mortgage when the foreclosing senior lienholder also owns the junior. The court properly distinguished *Roseleaf* on these grounds.

(*Simon*, *supra*, 4 Cal.App.4th at 72.) Its reasoning is sound and should be approved.

Cadlerock Joint Venture, L.P. v. Lobel (2012) 206 Cal.App.4th 1531, 1544, is not to the contrary on this point and supports the Cobbs' position, not Black Sky's, on the common ownership rule. The court agreed that "[a] single creditor that, at the time of foreclosure, has both a senior and junior lien on the same real property cannot conduct a nonjudicial foreclosure on the senior lien, then pursue a deficiency judgment as a sold-out junior lienor." (*Id.* at 1544.) The court cited several cases in support of this proposition, which it did not dispute.[10] *Cadlerock* and the cases it cites join *Simon* as *support* for dismissing Black Sky's collection action based on the junior note as barred under section 580d.[11]

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[10] Citing *Bank of America, N.A. v. Mitchell* (2012) 204 Cal.App.4th 1199, 1206-1208; *Ostayan v. Serrano Reconveyance Co.* (2000) 77 Cal.App.4th 1411, 1422; *Evans v. California Trailer Court, Inc.* (1994) 28 Cal.App.4th 540, 551–552; *Simon*, 4 Cal.App.4th at 74–78; *Union Bank v. Wendland* (1976) 54 Cal.App.3d 393, 409 (conc. opn. of Elkington, J.). *See also* Answer Brief at 16-17 (discussing these cases and attempting to distinguish them on simultaneous origination ("piggyback") grounds).

[11] Because ownership of the first and second mortgages in *Cadlerock* had been split by the time the first was foreclosed, *Cadlerock* is likely dicta on this point. However, *Mitchell*, *Ostayan*, and *Evans* and Justice Elkington's concurrence in *Wendland* are on point.

Cadlerock's criticism of *Simon* was only directed against the other aspect of *Simon*—that a "piggyback" junior is subject to the deficiency bar of section 580d, even when ownership of the two mortgages has been split by the time of the non-judicial foreclosure sale. (*Cadlerock, supra*, 206 Cal.App.4th at 1547-49.) *Cadlerock* endorsed the controlling principle that common ownership at the time of foreclosure triggers the application of section 580d to bar a personal judgment against the borrower under a junior loan.

In sum, Black Sky is unable to cite a single case supporting its position, except arguably *Roseleaf*, which the Courts of Appeal have uniformly held does not apply when, as here, there is common ownership of the foreclosing mortgage and a junior mortgage at the time of foreclosure.

d. Black Sky's Other Arguments Are Without Merit.

Black Sky argues that the Cobbs came out better off because of the non-judicial foreclosure sale because of "a windfall of $1.3 million," representing the deficiency bar of section 580d as applied to the senior mortgage. (Answer Brief at 21-22.) Black Sky's calculations substitute an irrelevant, after-the-fact comparison of the Cobbs' supposed losses for an

analysis of the consequences of Black Sky's election of non-judicial foreclosure for the foreclosure sale process.

By electing non-judicial foreclosure, Black Sky chose to obtain an irredeemable title in exchange for foregoing a deficiency. This election gave Black Sky title free and clear by eliminating the Cobbs' redemption rights, under which they would have had a year to arrange a profitable resale of the property. Black Sky's election avoided expensive, time-consuming, and cumbersome judicial foreclosure litigation, in favor of a quick and easy trustee's sale. (*Coker*, *supra*, 62 Cal.4th at 673.) To obtain a deficiency judgment against the Cobbs, Black Sky would have had to litigate the value of the property in the judicial foreclosure action under section 726, subdivision (b), a lengthy, expensive, complex, and potentially unpredictable issue for commercial property.

Black Sky does not account for these benefits, which almost certainly informed its decision to elect non-judicial foreclosure. Black Sky's accountings are best viewed with skepticism. They are a distraction from the trade-off *Roseleaf* and *Cornelison* hold underlies section 580d.

Whether Black Sky credit bid $7.5 million (as it did) or the entire loan balance of $9.7 million, Black Sky would have taken the property as the high bidder. The deficiency prohibition rendered the $2.2 million difference between Black Sky's actual credit bid and the

first loan balance of no financial consequence as far as the first loan was concerned. In either case, Black Sky would have been the successful bidder and the deficiency on the first would have been barred.

A foreclosure sale price bears little or no relationship to fair market value: "market value, as it is commonly understood, has no applicability in the forced-sale context; indeed, it is the very *antithesis* of forced-sale value." (*BFP v. Resolution Trust Corp.*, *supra*, 511 U.S. at 537, italics in original, cited with approval in *Alliance Mortgage*, *supra*, 10 Cal.4th at 1237.)

If the fair market value of the Cobbs' property had been $10 million, Black Sky would have reaped a windfall of $300,000—the excess of the property value over the $9.7 million balance on the first loan. But because Black Sky obtained irredeemable title, and "there is no oversight by a court" and "[n]either appraisal nor judicial determination of fair value is required,"[12] the anti-deficiency laws provide no recourse for restoring that $300,000 to the Cobbs.

Even though section 580d's deficiency bar on the first limited Black Sky's incentive to underbid, the $1.2 million loan balance on Black Sky's second loan created just that incentive. Black Sky had a financial interest in keeping the bidding down to avoid the outcome of

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[12] *Alliance Mortgage*, *supra*, 10 Cal.4th at 1236.

both taking the property as high bidder *and* having the foreclosure proceeds reduce the Cobbs' exposure on the $1.2 million second. If the property was worth $10 million, Black Sky's incentive was to steer the bidding well below the $9.7 million first loan balance to take title to property worth $10 million while preventing the Cobbs from reaping any credit against the $1.2 million second loan from a foreclosure sale price that went over $9.7 million.

The presence of the second created the risks of underbidding and double recovery the Legislature intended to eliminate by enacting section 580d. Black Sky protests that there is no "actual evidence" that Black Sky underbid at the trustee's sale. (Answering Brief at 5, 20.) Black Sky also points to an appraisal of $8.4 million, arguing that because the property was worth less than the loan balance, there was no potential for double recovery. (*Id.* at 21-22.) While no single appraisal is conclusive in establishing value[13]—especially of commercial property, where the assumptions and conditions framing the appraisal can dramatically affect the result—a more fundamental error undercuts Black Sky's attempt to place the burden on the Cobbs to prove the absence of a double recovery.

[13] *See, e.g.,* § 726, subd. (b) (court must hear evidence of and determine fair value); § 580a (same, with optional report from a probate referee).)

Lenders almost universally use the non-judicial foreclosure process, to avoid the costs and delays of judicial foreclosure litigation. (*Coker*, *supra*, 62 Cal.4th at 673.) Judicial intervention in the non-judicial foreclosure and sale process is rare. "[T]here is no oversight by a court, '[n]either appraisal nor judicial determination of fair value is required,' and the debtor has no postsale right of redemption." (*Alliance Mortgage, supra*, 10 Cal.4th at 1236, quoting Sheneman, Cal. Foreclosure: Law and Practice (1994) pages 6-3.)

The Legislature framed the anti-deficiency laws to be self-executing by providing broad exemptions from deficiency liability that do not require judicial intervention or fact-finding. In enacting section 580d, the Legislature traded off judicial oversight, including fine-grained determinations about the fairness of the sale price, the value of the property, and the allowable amount of a deficiency judgment, to gain the speed, efficiency, and finality of a trustee's sale. The deficiency bar of section 580d does not depend on whether underbidding or double recovery actually occurred. Otherwise, the bar would depend on proof of underbidding in all cases, litigation would abound, and the advantages of the non-judicial remedy would be undermined.

Whether Black Sky underbid, whether property was worth $8.4 million or $10 million or $12.5 million, and whether Black Sky reaped a double recovery, are irrelevant to application of the

deficiency bar. By barring deficiency judgments outright, section 580d obviates all valuation and deficiency litigation. It instead adopts a policy of "no questions asked" about the successful bid at the trustee's sale, the value of the property, and the amount of any deficiency.

Black Sky's "no actual evidence" arguments would, contrary to the blunt language of the statute, mire the courts in price and value determinations the Legislature intended to avoid by simply barring deficiency judgments. Section 580d did its work when Black Sky conducted its trustee's sale. No amount of after-the-fact ad hoc financial justification can now reverse its deficiency bar.

3. Section 580d Applies When a Single Lender Simultaneously Originates Both First and Second Mortgages Secured by the Same Property, and the First is Later Non-Judicially Foreclosed.

The remainder of the brief addresses the other aspect of *Simon*, the effect of a lender's simultaneous origination of two mortgages on the application of section 580d, regardless of whether common ownership of the mortgages continues at the time of foreclosure. In *Simon*, the lender had simultaneously originated both the first and second mortgages, while retaining ownership of them during its non-judicial foreclosure of the first. The court held that either common ownership at foreclosure or simultaneous origination was sufficient to trigger the deficiency bar. (*Simon*, *supra*, 4 Cal.4th at 77-78.)

Simultaneous origination has become an important consumer protection issue because of the rapid growth of mortgage securitization—pooling and selling mortgages to investors through asset-backed securities. The rise of funding mortgages through the securities markets is detailed in the "Financial Crisis Inquiry Report," which Congress commissioned "to provide a historical accounting of what brought our financial system and economy to a precipice and to help policy makers and the public better understand how this calamity came to be." (National Comm. on the Causes of the Financial and Economic Crisis in the United States, The Financial Crisis Inquiry Report (2011) (hereafter the "Report") at xi, <https://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf> (as of March 26, 2018).)

Black Sky takes the position that the simultaneous origination aspect of *Simon* does not apply to this case because the two loans were not simultaneously originated. (Answer Brief at 14, 18-19.) However, because of the public policy importance of applying section 580d to piggyback mortgages, and because Black Sky is requesting that *Simon* be disapproved,[14] HERA believes it is appropriate to provide the Court a full briefing on the second aspect of *Simon*.

[14] Black Sky directly attacks *Simon*'s common ownership rule. Despite its factual distinction of *Simon*, Black Sky's brief appears

Historically, home mortgages were funded through bank and savings and loan capital. That radically changed over the past 20 years with the securitization of the home mortgage market. (Report, *supra*, at 42-45; *see also Yvanova v. New Century Mortg. Corp.* (2016) 62 Cal.4th 919, 930 (addressing the standing of borrowers to challenge mortgage assignments under the mortgage securitization system).) Loans are now originated on an "originate-to-distribute" instead of the traditional "originate-to-hold" basis. (Report at 89.) Virtually immediately upon loan origination, home mortgages are bundled into mortgage-backed securities that are sold to investors. The proceeds from the security sales repay banks and other loan originators, who then step out of the picture, except to the extent they reserve or are allowed the right to service the loans for the investors. The loans become part of a pool of securitized mortgages that are serviced as a group. Investors fund the pool and fare according to its overall performance:

> [A]n investment bank, such as Lehman Brothers or Morgan Stanley (or a securities affiliate of a bank), bundled loans from a bank or other lender into securities and sold them to investors, who received investment

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alternately to approve the simultaneous origination aspect of *Simon* (Answer Brief at 13-14, 30) and also to criticize it (*id.* 15-16, 26-28).

returns funded by the principal and interest payments from the loans. Investors held or traded these securities, which were often more complicated than the GSEs' basic mortgage-backed securities; the assets were not just mortgages but equipment leases, credit card debt, auto loans, and manufactured housing loans.

(Report, *supra*, at 42.)

The Commission found that the years immediately preceding the 2008 financial crisis saw a spectacular inflation of property values, fueled by the expansion of credit that securitization provided for both purchase and refinancing. (Report, *supra*, at 4-6.) Lenders used the stratagem of "piggyback" loans to boost the supply of securitized loans by evading the traditional underwriting requirement that a mortgage borrower provide a significant downpayment, or otherwise have significant equity. (*Id.* at 102-103.) Although *Simon* was decided before the securitization of the market, the 2006 refinancing in *Cadlerock* exemplifies a low- or no-equity loan scenario using dual mortgages at the height of the bubble. (*Cadlerock*, *supra*, 206 Cal.App.4th at 1537-38.)

In 1999, federal regulators acted to limit risk in the mortgage market by placing limits on banks' ability to make loans in excess of 90% of a home's value (the loan-to-value ratio, or "LTV")—unless they contained protections, such as mortgage insurance, that would

protect borrowers and investors against deficiencies in the event of default. (Report, *supra*, at 109.) In addition, the Government-Sponsored Enterprises ("GSEs")—Fannie Mae and Freddie Mac, which fueled the home mortgage market by purchasing and guaranteeing mortgages meeting defined criteria—refused to accept loans with an LTV above 80% unless they contained mortgage insurance. (*Ibid.*)

Traditionally, purchase money mortgage lenders had required a 20% downpayment, ensuring that loans were not made in excess of an 80% LTV ratio. (Report, *supra*, at 109.) However, in the mortgage lenders' drive to saturate the securities markets with new loans to profit from the "originate-to-distribute" model that securitization made possible, responsible lending practices, including compliance with sound LTV requirements, were ignored.

To generate more first mortgages that satisfied the requirements of the GSEs and private mortgage-backed security programs, lenders increasingly made first mortgages without requiring any downpayment or equity from the borrower. Lenders would issue a first mortgage meeting the LTV standard required by a GSE, or for admission to a securitized pool (usually 80%). But to avoid any need for a borrower to provide a downpayment or have equity, lenders would simultaneously issue a second "piggyback" mortgage to cover the remaining property value (usually 20%).

> High LTV lending soon became even more common, thanks to the so-called piggyback mortgage. The lender offered a first mortgage for perhaps 80% of the home's value and a second mortgage for another 10% or even 20%. Borrowers liked these because their monthly payments were often cheaper than a traditional mortgage plus the required mortgage insurance, and the interest payments were tax deductible. Lenders liked them because the smaller first mortgage—even without mortgage insurance—could potentially be sold to the GSEs.

(Report, *supra*, at 109-110.)

Piggyback lending enabled lenders to expand lending rapidly to a new, untapped segment—borrowers without downpayments or equity. (Report, *supra*, at 110.) But these loans were risky. By September 2005, borrowers with piggyback loans were four times as likely as other mortgage holders to be 60 or more days delinquent. (*Ibid.*) Further, piggyback lending presented a substantial risk to borrowers and the housing market at large because it "guaranteed that many borrowers would end up with negative equity if house prices fell, especially if the appraisal had overstated the initial value." (*Ibid.*)

> A home buyer got a first mortgage for 80 percent of the purchase price, then a second, subordinate mortgage from

> the same or a different lender to count as a 20 percent down payment.... After the housing bubble burst, and values plummeted, many piggyback borrowers found themselves with negative equity.

(Prevost, *'Piggyback' Loans Revisited*, N.Y. Times (Dec. 19, 2014), <https://www.nytimes.com/2014/12/21/realestate/piggyback-loans-revisited.html?_r=0> (as of April 10, 2018).)

"80/20s" accelerated as the mortgage boom progressed, and in the final years (2005-2008) became a primary driver that sustained the bubble as property values softened and the soundness of mortgage-backed securities was increasingly called into question.

> Back in 2006 and 2007, you could *easily* obtain 100 percent financing from nearly any bank or lender in town, with the most common the 80/20 combo loan, which is a first mortgage for 80 percent of the purchase price and a second mortgage for the remaining 20 percent. [¶] These high-risk financing deals were rampant, and most homeowners took the bait and chose not to put any money down, assuming their home would appreciate endlessly. This explains why millions of American homeowners are now underwater on their mortgages and/or facing foreclosure.

(Robertson, *Mortgages with No Money Down* <http://www.thetruthaboutmortgage.com/mortgages-with-no-money-down/> [as of April 10, 2018], emphasis in original.)

The percentage of home purchases with 97% or higher combined loan to value increased from about 10% in 2000 to 40% in 2007. (Report, *supra*, at 494 (Figure 4).) The foreclosure start rate (foreclosures commenced) increased from about 1% to 5% during the same period. (*Id.* at 494 (Figure 5).)

Splitting a single transaction into two separate loans allowed the largest mortgage originators, New Century and Countrywide, to churn out more mortgages to sell to investors and the GSEs. Even when faced with compelling evidence that piggyback lending placed both borrowers and the market at risk, New Century increased piggybacks from 9% to 35% of its loan production between 2003 and 2005. (Report, *supra,* at 110.)

Countrywide, which securitized 87% of the $1.5 trillion in mortgages it originated between 2002 and 2005 (*id.* at 105), did the same:

> [Countrywide] was issuing subprime loans not with about twenty per cent down, as it had in the nineties, but with zero down; subprime borrowers would often take out what were known as "80/20" loans—a first lien loan for eighty per cent of the purchase price, and a second for

twenty. "We had reached a point where the question was, What will we do next—pay borrowers to take loans?" the former senior Countrywide executive said.

(C. Bruck, *Angelo's Ashes: The Man Who Became the Face of the Financial Crisis*, The New Yorker (March 20, 2018) <https://www.newyorker.com/magazine/2009/06/29/angelos-ashes> (as of April 10, 2018).)

Approximately 15% of all purchase money mortgages originated in California during 2001-2005 had "piggyback" seconds, and the percentage was still over 10% annually from 2007-2012. (Federal Housing Finance Agency Office of Policy Analysis and Research, Working Paper 14-3, *The Relationship between Second Liens, First Mortgage Outcomes, and Borrower Credit: 1996-2010* (2014), p. 31, <https://www.fhfa.gov/PolicyProgramsResearch/Research/PaperDocuments/WP_14-3_Second_Liens.pdf> (as of April 10, 2018).)

Nor was piggyback lending limited to purchase money transactions. Piggyback second liens were also used as a way to extract home equity and avoid LTV and mortgage insurance protections in refinancings. (Federal Housing Finance Agency Office of Policy Analysis and Research, *supra*, at 1). 10%-16% of *all* first lien mortgages originated in California during the years 2001-2007 had "piggyback" seconds. (*Id.* at Table 1b).

Piggyback lending both contributed to the recession and exacerbated its effects. When the bubble burst, housing values plunged approximately 33% nationwide following their 2006 peak, a drop not seen since the Great Depression. U.S. households lost about $7 trillion in wealth as a result. (Federal Reserve Board, *The U.S. Housing Market: Current Conditions and Policy Considerations* (2012) p. 3, <http://www.federalreserve.gov/publications/other-reports/files/housing-white-paper-20120104.pdf> (as of Mar. 26, 2018).)

HERA continues to receive requests from former homeowners who, years after foreclosure on their first loans, continue to receive collection letters and calls from debt buyers on long forgotten seconds. In many cases, and particularly with piggyback refinancing, the former homeowner is not even aware that their loan had been structured as two, the documents having been buried in a single imposing stack of ineffectual disclosures.

When the market finally crashed and the foreclosure crisis began in earnest, whether section 580d applies to piggyback second mortgages after non-judicial foreclosures of the firsts became a pressing issue. Even though *Simon* predated the onslaught of 80/20 mortgages, in 1992 Justice Peterson had already perceived that splitting mortgages into first and second loans threatened the integrity of section 580d:

> We will not sanction the creation of multiple trust deeds on the same property, securing loans represented by successive promissory notes from the same debtor, as a means of circumventing the provisions of section 580d. The elevation of the form of such a contrived procedure over its easily perceived substance would deal a mortal blow to the antideficiency legislation of this state. Assuming, arguendo, legitimate reasons do exist to divide a loan to a debtor into multiple notes thus secured, section 580d must nonetheless be viewed as controlling where, as here, the senior and junior lenders and lienors are identical and those liens are placed on the same real property.

(*Simon*, *supra*, 4 Cal.App.4th at 77-78.)

Cadlerock rejected the simultaneous origination aspect of *Simon*, reasoning that the lender had made two loans, and they could not be judicially treated as a single loan for purposes of section 580d:

> There is no principled distinction to be made between (1) this case (a piggyback transaction with a single lender in which the junior lien is immediately assigned to a third party) and (2) a two-lender piggyback transaction in which two loans are made contemporaneously by two separate lenders, each maintaining ownership of their

respective loans until the senior lien is nonjudicially foreclosed (a hypothetical scenario that clearly would fall under *Roseleaf, supra*, 59 Cal.2d 35). *Applying different rules of law to junior liens originated under these two scenarios would elevate form over substance by, in cases like the one here, treating two separate loans as a single loan based on the happenstance of the two loans having been originated by the same lender. Ironically, this result would be predicated on judicial attempts to prevent lenders from avoiding the substance of the antideficiency statutes by artificially dividing a single loan into the form of two loans.*

(*Cadlerock*, *supra*, 206 Cal.App.4th at 1547, emphasis added.) The court based its holding principally on the text of section 580d, which in the court's view "simply does not apply on its face to a junior lien." (*Id.* at 1549.)

Cadlerock failed to apply the functional construction principles this Court has historically applied to the anti-deficiency statutes. (*See* pp. _____, above.) The court applied literal construction, reasoning that "the mortgage or deed of trust" as used in the statute necessarily refers to only the foreclosed loan, even when a single lender has split its loan between a first and second mortgage. The court did not inquire whether its literal reading of the word "the," detached from

context, comported with the Legislature's purpose of protecting borrowers against deficiencies after non-judicial foreclosure sales, as *Lundgren* and *Pieters* require. (*See* pp. _____, above.)

Cadlerock would permit lenders to split what is in substance a single mortgage into two mortgages and allow the second to be exempt from section 580d. The practice of using "80/20s" to generate securitizable firsts exemplifies splitting. The lenders knew at the time of origination that the borrowers had no downpayment or equity. Splitting the loans was an artifice to meet LTV requirements for securitization. From a functional underwriting standpoint, the lenders were making single "no equity" loans. Splitting was only to provide the lenders immediate compensation by enabling them facially to meet program LTV requirements and then to offload 80% of the loan to investors. *Cadlerock* would sanction a deficiency judgment based on the second based on this purely formalistic loan splitting.

Cadlerock would allow form to control substance in the application of the anti-deficiency laws, which express public policy. It would make state public policy depend on a single word ("the") in a single statute. It would open a wide loophole allowing lenders to evade the legislative intent of section 580d as found by *Roseleaf* and *Cornelison*.

The *Cadlerock* rule would encourage lenders to manipulate mortgages in order to sell "deficiency free" seconds to investors. A

$500,000 first could be artificially split into a $400,000 first and a $100,000 second. If there had been a single loan, section 580d would bar a deficiency on the entire $500,000 first. If the loan were split, *Cadlerock* would exempt the $100,000 second from the deficiency bar. It could be advertised to investors as collectible from the borrower in a down market, presumably commanding a higher price than a $100,000 loan burdened by the deficiency bar. Homeowners would be exposed to deficiency liability simply based on a bald stratagem to evade the statute. The public would rightly hold section 580d in contempt.

There is a well-established judicial tradition of guarding protective legislation against clever devices calculated to evade or thwart it, even though the Legislature did not contemplate the exact stratagems at the time of enactment. The Legislature is not required to be prescient in wording statutes, or to agonize over every contingency before passing a law. The Legislature is entitled to use reasonably plain English with the justified expectation that the courts will vindicate its intent:

> "That construction of a statute should be avoided which affords an opportunity to evade the act, and that construction is favored which would defeat subterfuges, expediencies, or evasions employed to continue the mischief sought to be remedied by the statute, or to

> defeat compliance with its terms, or any attempt to accomplish by indirection what the statute forbids." (50 Am.Jur., Statutes, § 361; see *In re Reineger*, 184 Cal. 97 [193 P. 81].)

(*Freedland*, *supra*, 45 Cal.2d at 468.[15])

In *Freedland*, the seller of a liquor store took two notes from the buyer, one secured by a chattel mortgage secured by the equipment sold and the other secured by real property the buyer owned. Each of the notes was for $7,000, the entire unpaid balance of the purchase price. After the buyer defaulted, the seller foreclosed non-judicially on the real estate and then sought to foreclose the chattel mortgage and a deficiency judgment. The Court held that since both notes were given in payment for the store, section 580d barred a deficiency judgment against the buyer:

> It should be clear that in such a case [two notes, one secured by the real estate and the other entirely unsecured] the plaintiffs could not recover a deficiency judgment on the unsecured note after selling the property

15 "A narrow or restricted meaning should not be given to a word, if it would result in an evasion of the evident purpose of the act, when a permissible, but broader, meaning would prevent the evasion and carry out that purpose." (*In re Application of Reineger* (1920) 184 Cal. 97, 103.)

> under the trust deed covered by the other note. It is unreasonable to say the Legislature intended that section 580d could be circumvented by such a manifestly evasive device. In such a situation *the legislative intent must have been that the two notes are, in legal contemplation and under section 580d, one, secured by a trust deed.*

(*Freedland*, *supra*, at 467, emphasis added.)

Likewise here, the courts should not allow the formalistic splitting of a single loan into two at the instant of origination to defeat section 580d. The Legislature must have intended the two loans to be treated as one under the statute. The alternative is to assume that the Legislature intentionally allowed lenders to use the simple device of loan splitting to evade the deficiency bar.

The *Freedland* principle has been applied. In *People v. Hacker Emporium, Inc.* (1971) 15 Cal.App.3d 474, 479, the Court applied *Freedland* to hold that "person" as used in the a section of the False Advertising Law (Bus. & Prof. Code, § 17536) includes a corporation, even though the Legislature had clearly used "person" in several other provisions of the law to mean a natural person and not a corporation. "It is inconceivable that the Legislature would prescribe civil penalties only against individuals as natural persons and not against entities such as corporations for the fraudulent acts proscribed by the code." (*Id.* at 479.) Here, it is inconceivable that the Legislature would

proscribe deficiencies and yet allow loan splitting to circumvent the statute.

In *Cerra v. Blackstone* (1985) 172 Cal.App.3d 604, 608, the court was confronted by the anomaly that the only remedy the Rees-Levering Act specified for violating its reinstatement notice requirements was to bar a deficiency judgment after repossession and sale of the vehicle. Invoking *Freedland*, the court held that the borrower could sue for conversion even though the statute did not mention that remedy:

> If depriving the seller of a deficiency were the consumer's only remedy, the statutory purpose above stated would be frustrated as the dealer would have no incentive to comply. "[Subterfuges], expediencies or evasions employed to continue the mischief sought to be remedied by the statute, . . ." (*Freedland* v. *Greco, supra*, 45 Cal.2d at p. 468) would be encouraged.

(*Id.* at 608-609.)

Likewise, where the Rees-Levering Act did not specify what information a reinstatement notice had to provide, the court in *Juarez v. Arcadia Financial, Ltd.* (2007) 152 Cal. App.4th 889 held that the notice needed to provide sufficient financial detail to enable the buyer to reinstate:

> Thus, under Arcadia's interpretation of the Act, the defaulting buyer's ability to reinstate is left to the discretion of the creditor, who will be in the position of deciding whether to provide a buyer the specific information necessary to allow him or her to reinstate.... Since section 2983.2, subdivision (a)(2) is the only provision that requires creditors to provide information to the buyer, the most reasonable interpretation of that provision is that it requires creditors to provide notice sufficient to allow the buyer to exercise the right to reinstate. (See *Freedland v. Greco, supra*, 45 Cal.2d at p. 468 ["'That construction of a statute should be avoided which affords an opportunity to evade the act, and that construction is favored which would defeat subterfuges, expediencies, or evasions employed to continue the mischief sought to be remedied by the statute, or to defeat compliance with its terms, or any attempt to accomplish by indirection what the statute forbids'"].)

(*Id.* at 907.)

The same principle guides this Court's interpretation of section 580d. The Court should not condone subterfuges, expediencies, or evasions of section 580d, or devices that defeat compliance with its terms, or that accomplish by indirection what the statute forbids.

Where a single lender simultaneously originates two mortgages, the two mortgages should be treated as one for purposes of section 580d.

To protect the integrity of section 580d and avoid immersing borrowers in litigation over the lender's intention in making two loans, this Court should follow Justice Peterson's teaching in *Simon*, that justifications for loan splitting are irrelevant. It is enough that section 580d bars deficiencies:

> Assuming, arguendo, legitimate reasons do exist to divide a loan to a debtor into multiple notes thus secured, section 580d must nonetheless be viewed as controlling where, as here, the senior and junior lenders and lienors are identical and those liens are placed on the same real property. Otherwise, *creditors would be free to structure their loans to a single debtor, and the security therefor, so as to obtain on default the secured property on a trustee's sale under a senior deed of trust; thereby eliminate the debtor's right of redemption thereto; and thereafter effect an excessive recovery by obtaining a deficiency judgment against that debtor on an obligation secured by a junior lien the creditor chose to eliminate.*

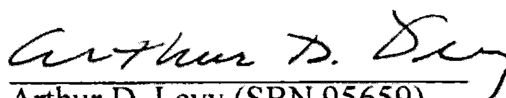
(*Simon, supra*, 4 Cal. App.4th at 78, emphasis added.)

CONCLUSION

HERA respectfully requests that the Court approve the common ownership rule of *Simon v. Superior Court* and apply it to hold that section 580d prevents Black Sky from seeking a personal judgment against the Cobbs on the second mortgage. HERA also requests that the Court either approve the simultaneous origination aspect of *Simon*, or at least make clear that the Court is not signaling any disapproval of that aspect of *Simon* and that it remains good law.

Respectfully submitted,

DATED: April 18, 2018



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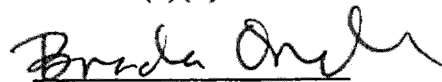
CERTIFICATE OF COMPLIANCE

Pursuant to rule 8.204(c) of the California Rules of Court and in reliance on the word county of the computer program used to prepare this brief, I, Brenda Orellana, as an unrepresented party certify that this brief was produced using a 14-point font and contains 10,414 words, excluding those exempted under rule 8.204(c)(3).

April 17, 2018



Brenda Orellana

PROOF OF SERVICE

At the time of service, I was at least 18 years of age and not a party to this legal action. My business address is 1814 Franklin Street, Suite 1040, Oakland, California 94612.

On the date entered below, I served the attached **AMICUS CURIAE BRIEF OF HOUSING AND ECONOMIC RIGHTS ADVOCATES IN SUPPORT OF DEFENDANTS AND PETITIONERS MICHAEL A. COBB AND KATHLEEN S. COBB** by placing a true copy thereof in an envelope with delivery fees provided and addressed to the persons named on the service list at the addressed shown, sealing and depositing that envelope and sending it in the manner described.

I declare under penalty of perjury under the laws of the state of California that the forgoing is true and correct on this 17 day of April, 2018 in Oakland, California.

Brenda Orellana

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