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Agreements to indemnify & the antideficiency laws:

Trust One v Invest Am., 2005

Roger Bernhardt

Mortgage broker's agreement to indemnify its mortgage banker for any loss following foreclosure sale is unaffected by antideficiency laws.

Trust One Mortgage Corp. v Invest Am. Mortgage Corp. (2005) 134 CA4th 1302, 37 CR3d 83

Invest America, a Georgia corporation, and Trust One, a California corporation, were parties to a 2002 broker agreement (Agreement), entered into in California, by which Trust One funded real estate secured loans brokered by Invest America. The Agreement contained a California choice of law provision and a provision requiring Invest America to indemnify losses or repurchase loans in the event of a borrower's early default or fraud in the loan application. Under the Agreement, loans were made in 2002 and 2004 to a Georgia resident, secured by real property in Georgia. After the borrower's early default, the real property security was foreclosed nonjudicially, leaving a substantial deficiency. Trust One sued Invest America on several grounds, including indemnity. The trial court granted summary judgment in favor of Trust One.

The court of appeal affirmed. That Trust One is a California corporation and has its principal place of business in California constituted a reasonable basis to enforce the California choice of law provision. Accordingly, the indemnification provision was subject to California's antideficiency legislation, which bars a deficiency judgment following nonjudicial foreclosure of real property under CC §580d.

The indemnification provision was not a loan guaranty, the enforcement of which would constitute an action for a deficiency prohibited by California law under *Union Bank v Gradsky* (1968) 265 CA2d 40, 71 CR 64. California law distinguishes between a guaranty (CC §2787)—a direct promise to perform the principal's obligation if the principal fails to perform—and an indemnity (CC §2772)—a promise to reimburse the indemnitee for losses suffered or to hold the indemnitee harmless. The instant provision was not a direct promise by Invest America to perform the borrower's obligations; it did not obligate Invest America to indemnify Trust One for all borrowers' defaults, only from losses resulting from specified conditions, and it could be triggered without a borrower default, *e.g.*, when the loan package contained misrepresentations about the value of the property securing the loan. Thus, the provision was an indemnity, not a guaranty.

The indemnification provision was enforceable under California law because its purpose and effect were not to recover a deficiency from the borrower in violation of the antideficiency laws. If the indemnitor and obligor are substantially identical, the indemnity may be seen as an invalid attempt to have the obligor waive in advance the statutory bar against deficiency judgments. Here, however, the critical factor was that Invest America, a third party unrelated to the borrower, executed the Agreement containing the indemnification provision. Invest America was not the primary obligor or a related entity; it was not a principal obligor in guarantor's guise. The broker's agreement was not executed as part of the loans, but was a separate transaction made

well in advance of the underlying loans and governed all loan packages Invest America presented to Trust One.

THE EDITOR'S TAKE: Many of the complications in this case are due to the court's gratuitous inclusion of what I think are irrelevant rules. The basic issue is whether a mortgage broker's agreement to indemnify its mortgage banker for any loss following a foreclosure sale is affected by our antideficiency laws. Because the mortgage broker was in no sense a debtor, its indemnification agreement is entirely unrelated to California rules protecting debtors against deficiency judgments.

It is true that any underlying antideficiency protections that might apply come from Georgia, where the property was located. But the lender was not trying to hold the mortgage borrowers personally liable for deficiencies; it wanted to enforce the broker's promise to take back bad loans and/or cover the losses that followed from their insufficient foreclosure sales. As so viewed, I suspect that a Georgia court would reach the same conclusion as our California court did in refusing to apply its borrower antideficiency protection rules to brokers who place their loans. See, *e.g.*, *Graham v Casa Invs. Co.* (Ga App 2005) 616 SE2d 833. Since the loan purchase agreement called for California law, with one of the parties residing and suing in California, the choice of law outcome was easy to predict.

All of the discussion about the indemnitor being really the same as the debtor was accurate but not entirely on point. I don't know whether Georgia has an alter ego doctrine similar to California's, but I do know that this has nothing to do with this case, where nobody was contending that the broker was the secret underlying borrower in these deals. There is a distinction between indemnitors and guarantors, but having pointed that out, the court appears to have forgotten about it immediately thereafter. As *Commonwealth Mortgage Assur. Co. v Superior Court* (1989) 211 CA3d 508, 259 CR 425, has held, alter ego is a valid defense whether the surrogate's promise is to indemnify or to guarantee.

That distinction might have been important had Invest America done a better job of collecting evidence for its defenses. If the properties were really worth as little as they were sold for on foreclosure (and if the debtors were real people with any solvency), meaningful deficiency judgments could have been obtained against them in Georgia through proper compliance with that state's foreclosure rules. According to the opinion, the indemnification agreement "permits Trust One to demand that Invest America cure the breach or repurchase the loan." 134 CA4th at 1306. While I assume that the agreement also permits Trust One to conduct the foreclosure itself and then recoup its losses from Invest America, I doubt that Trust One would insist on that remedy and would be more than willing to allow Invest America to buy back the loan at its face value and go after the debtors itself if it thought that that strategy had any chance of success. And—post facto—that might entitle Invest America to say that Trust One's failure to give it the opportunity to do that estopped Trust One from enforcing Invest America's hold harmless promise to it.

That, of course, is nothing but the *Gradsky* defense in a slightly different context. See *Union Bank v Gradsky* (1968) 265 CA2d 40, 71 CR 64. If a lender is estopped from going after the party who agreed to guarantee payment of a loan because it elected to make its

California foreclosure sale nonjudicial rather than judicial, its choice to not get timely court confirmation after its Georgia foreclosure sale should similarly estop it from going after the party who agreed to indemnify it against loss on a loan it made. But just as a California *Gradskey* defense would require the defendant to show that the lender actually did conduct a nonjudicial trustee sale, a Georgia *Gradskey* defense would require evidence of noncompliance with those local procedures—which evidence was not presented here.

Had such evidence been offered, it could have led to an interesting discussion of the effect of any waiver provisions in the lender-broker agreement. *Gradskey* estoppel has been waivable since 1997 (five years before this loan agreement was executed) under CC §2856. If there was such a waiver in this case, the code section's permission to waive just about everything would probably cover the estoppel defense variation raised here.

But then, that would make the indemnitor/guarantor distinction more interesting. The statute says “a guarantor *or other surety*” (emphasis added) may waive its rights. Does that include an indemnitor? This opinion makes much of the fact that an indemnitor does not make the same kind of direct promise to pay someone else's debt as does a guarantor or surety (the pairing of these terms is found in CC §2787). Miller and Starr opine that indemnitors are protected the same as guarantors (4 Miller & Starr, California Real Estate 10:214 (3d ed 2003)), but it might not be that simple, and it is possible that a court will refuse to put an indemnitor's waiver within CC §2856 because an indemnitor is a different creature.

If that turns out to be the case, we can start watching to see whether the lending industry or the legislature will redraft its documents or its statutes faster to clean up the mess.—
Roger Bernhardt