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## New CCP §580e: Deficiency Protection for Certain Short Sales

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## **New CCP §580e: Deficiency Protection for Certain Short Sales**

Roger Bernhardt

### **Introduction**

Real estate attorneys need to love distinctions to retain their sanity when dealing with California's antideficiency laws. We have to learn to live with the difference between the affirmative and sanction defense aspects of the CCP §726 one-action rule, between standard and variant transactions under the CCP §580b purchase money rule, and between judicial and nonjudicial foreclosures for the CCP §580d trustee sale rule—to name just a few of the many mysteries that beleaguer decision making. Now, with new §580e in our midst (as of January 2011), we have even more.

### **Analysis**

This section adds a sort of deficiency protection to trustors who sell their property for less than the encumbrances then burdening it. The section provides:

580e. (a) No judgment shall be rendered for any deficiency under a note secured by a first deed of trust or first mortgage for a dwelling of not more than four units, in any case in which the trustor or mortgagor sells the dwelling for less than the remaining amount of the indebtedness due at the time of sale with the written consent of the holder of the first deed of trust or first mortgage. Written consent of the holder of the first deed of trust or first mortgage to that sale shall obligate that holder to accept the sale proceeds as full payment and to fully discharge the remaining amount of the indebtedness on the first deed of trust or first mortgage.

(b) If the trustor or mortgagor commits either fraud with respect to the sale of, or waste with respect to, the real property that secures the first deed of trust or first mortgage, this section shall not limit the ability of the holder of the first deed of trust or first mortgage to seek damages and use existing rights and remedies against the trustor or mortgagor or any third party for fraud or waste.

(c) This section shall not apply if the trustor or mortgagor is a corporation or political subdivision of the state.

This section ought to have been named 580c, since the section currently holding the title has nothing to do with deficiency judgments and this new one borrows enough of its characteristics from its neighboring §§580b and 580d as to fit in between them (while still adding enough new distinctions as to preserve the traditional arbitrary nature of the field).

I will mention the minor features first.

#### ***1. The Kinds of Loans Covered***

Both §§580e and 580d prohibit any judgment for a “deficiency” from being rendered, but depart as to what debts are covered by that prohibition. Whereas §580d applies to any “note secured by a deed of trust upon real property,” new §580e applies only to “a note secured by a first deed of trust or first mortgage for a dwelling of not more than four units.” The scope of this

new section is significantly narrower, meaning that holders of commercial real estate gain no protection under it.

## ***2. The Kinds of Borrowers Protected***

The residential restriction is similar to, but not identical with, that of CCP §580b—the purchase money anti-deficiency statute. That section is also limited (for lender financings) to “a dwelling for not more than four families,” except that it is restricted even further by the additional requirement that the property be “occupied, entirely or in part, by the purchaser,” which is not a condition for new §580e application, thereby covering all 1–4 unit dwellings, whether or not any of those units are owner occupied. (The bill’s author, Senator Denise Ducheny, stated in a letter published in the California Senate Journal on October 8, 2010 (pp 5260–5261), that its purpose was to protect “distressed homeowners,” but that characterization is difficult to square with the absence of any owner-occupancy requirement in the bill itself. Her description may also have little binding effect, her letter having been written only after the bill had already been signed by the Governor.)

Finally, scope issues are further compounded by §580e’s provision that it does not apply “if the trustor is a corporation,” a limitation that exists in neither CCP §580b nor CCP §580d. One wonders what this means for entities like LLCs and partnerships, or for nonqualifying entities that thereafter transfer title to a related qualifying individual just before making the short sale.

## ***3. The Kinds of Lenders Affected***

Section 580d applies to all lenders; §580b applies categorically to all vendors, but conditionally only to third-party lenders who finance acquisition of small residential property. New CCP §580e divides matters up differently, referring to “first deed of trust or first mortgage,” thus including senior lenders and excluding juniors from its prohibition.

All creditors of record must obviously consent to a short sale in order for the new purchaser to obtain clear title, but this section adds that juniors can demand continuing liability from their old debtor as a price for giving such consent, whereas seniors cannot. A middle ground is thus open to the junior creditor—release of the old lien only in return for something—which is not available to the senior, who can either release or refuse to release the old lien, but cannot demand any price for doing so.

## ***4. Exceptions to the Restriction***

New §580e creates exceptions for fraud and waste, which may or may not be new. Acts of waste have been held to disqualify a borrower from the protection of CCP §§580b and 580d only if they were committed in bad faith (*Cornelison v Kornbluth* (1975) 15 C3d 590, 125 CR 557), a qualification that is not mentioned in new §580e. Its absence does not, of course, prevent a court from reading bad faith right back into the new section. On the other hand, if the property has been transferred to a new owner with the old security released, it is hard to see how waste could play any role whatsoever in the transaction.

There is no express exception for fraud in CCP §580b or in CCP §580d, although CCP §726 subsections (f), (g), and (h) do say something on that score. But those sections relate to fraud at the inception of the loan, whereas it is “fraud with respect to the sale” that is unprotected in §580e (such as when the borrower has misinformed the lender of the real short selling price), much like the case in full credit bids that were made in reliance on fraudulent misstatements as to the value of the property. *Alliance Mortgage Co. v Rothwell* (1995) 10 C4th 1226, 44 CR2d 352.

See Bernhardt, *Changing Course: Alliance Mortgage: Partial Answers About Full Credit Bids*, 18 CEB RPLR 323 (Nov. 1995).

### ***5. The Protection Afforded***

New §580e provides that consent to the short sale “shall obligate that holder to accept the sale proceeds as full payment and to fully discharge the remaining amount of the indebtedness”—a provision that significantly differentiates this statute from both CCP §§580b and 580d. Those older sections do not prohibit a lender who has taken additional security or who has had its loan guaranteed by a third party from seeking recourse against those alternative sources. But CCP §580e, on the other hand, treats consent to a short sale as equivalent to a (knowing) full credit bid at a foreclosure sale, with the attendant elimination of all additional relief. The obligation itself is discharged, not merely rendered unenforceable.

“Antideficiency” is a somewhat inappropriate label for this new section, in that foreclosure is avoided entirely by the short sale and release of security. The section says nothing about any consequences to a lender of foreclosing, nor does it impose any restriction on foreclosing (except for foreclosing on any additional security after consenting to a short sale of this security). It deals only with the consequences of releasing the security from its prospect of foreclosure with strings being also attached; its effect is to invalidate only those strings. The release or nonrelease of the security is not affected at all by §580e.

We must now wait to see whether the practical effect of this wiping-out of the middle ground (the strings) will be to induce lenders to lessen their attempts to exact more concessions from their defaulting borrowers, or rather to incline them to merely decline more rapidly to give any consent to their borrowers’ requested short sales.