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Roger Bernhardt

Golden Gate University School of Law, rbernhardt@ggu.edu

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Purchase money antideficiency protection:

Lawler v Jacobs, 2000

Roger Bernhardt

Buyer is not personally liable after defaulting on purchase money note secured by deed of trust on real property, despite agreement to contrary, due to antideficiency protection of CCP §580b.

Lawler v Jacobs (2000) 83 CA4th 723, 100 CR2d 52

After Lawler purchased 128 acres of unimproved ranch land, he sold off 91 acres to two developers for a \$6 million cash down payment and a \$3 million purchase money note secured by the real property. At Lawler's insistence, the developers agreed to remain personally liable for the unpaid debt in the case of default, notwithstanding the antideficiency law (CCP §580b). Lawler agreed to subordinate his note to an acquisition/construction loan so the buyers could subdivide and complete infrastructure improvements.

The developers stopped payments on both loans after the town downzoned the lot size from a 5-acre minimum lot size to 7.5-acre lot size. Lawler sued (1) to foreclose his deed of trust and (2) for fraud and negligent misrepresentation, alleging that the developers never intended to honor their promise to remain personally liable on the note. The jury awarded Lawler \$3 million for his deficiency, plus fees and interest.

The court of appeal reversed. Under CCP §580b, a seller is barred from obtaining a deficiency judgment for the unpaid purchase price secured by a trust deed on the property purchased. This policy, whereby the seller assumes the risk that the value of the security may become inadequate, is intended to discourage sellers from overvaluing the security (thus discouraging precarious land promotion schemes) and to "halt the march of declining property values that would otherwise occur during a depression if defaulting buyers were burdened with great personal liability." 83 CA4th at 732.

Lawler argued that §580b applies only to standard purchase money transactions and that the subordination of his loan placed the transaction outside the intended scope of §580b under *Spangler v Memel* (1972) 7 C3d 603, 102 CR 807, and *DeBerard Props., Ltd. v Lim* (1999) 20 C4th 659, 85 CR2d 292. The court of appeal disagreed, however, holding that the requirements for avoiding §580b were absent. The amount of the loan did not "dwarf" the value of the property at the time of the sale and the use of the property did not change or intensify during the developer's ownership. Moreover, the developers were not in a better position to assess the property's value and evaluate the risks. The risks involved in this venture were well known to Lawler. Accordingly, the court concluded that the parties could not waive the explicit and unambiguous language of the statute and its attendant public policy.

►**THE EDITOR'S TAKE:** It's pretty clear that a seller who agreed to subordinate to an \$8.2 million line of credit to cover both acquisition and development costs does not get the benefit of *Spangler* antideficiency protection when the development costs are never funded by the credit lender. That's *Budget Realty, Inc. v Hunter* (1984) 157 CA3d 511, 204 CR 48, all over again. So the holding in this decision is straightforward; it's all the dicta surrounding it that is so killing.

The *Spangler* exception originally required three conditions: (1) a sale of real property for commercial development, (2) the subordination of the seller’s purchase money loan to (3) a construction loan. The *Spangler* opinion stressed those three considerations several times. Although I was one of many who thought that these distinctions did not make too much sense (the logic seemed to apply equally well to situations not strictly defined by the three conditions), at least the standards were objective and clearly told parties what they could and could not do.

But that was before *DeBerard Props., Ltd. v Lim* rewrote *Spangler*. While *DeBerard* was obviously significant in its own right—holding that CCP §580b could not be waived, even during a post-execution workout—in that opinion, Justice Mosk also mentioned that the seller had urged the court to create another *Spangler*-type exception to §580b. In refusing to do so, Mosk added that *Spangler* was different because there was no construction loan (a point already acknowledged by the seller); he also volunteered some new limiting features of the *Spangler* rule (20 C4th at 666):

[A] *pronounced* intensification of . . . post-sale use. . . . [C]onstruction financing that *dwarfs* the property’s value. . . . [T]he purchaser must be in a *much better* position than the vendor to assess the property’s possible value. . . . [Emphasis added.]

The italicized words show how narrow the *Spangler* standard has become, as gratuitously described in *DeBerard*. And *Lawler v Jacobs* now treats these *DeBerard* glosses as the new rule (83 CA4th at 735):

[T]here was no construction financing that dwarfed the property’s value. . . . [C]onstruction financing did not further a “pronounced intensification”. . . . [A]ppellants were not in a “much better position” than *Lawler* to assess the property’s value. . . .

This, too, of course, is dicta, because there was no actual construction financing to implicate the rule of *Spangler* in the first place, but it tells us that, even when there is subordination to construction financing, *Spangler* may nevertheless not be applied if the new adjectives are not also deemed satisfied.

The original *Spangler* opinion told sellers when they could and could not get around §580b. But the new adjectives are too subjective to offer similar guidance. How large does a construction loan have to be in order to “dwarf” the seller’s carryback? How much development must be contemplated in order for the intensification to be “pronounced”? How much extra knowledge must the purchaser possess in order to occupy that “much better” position than the vendor? With rhetorical qualifications like these, a former safe harbor has turned into a rather unstormworthy anchorage. —*Roger Bernhardt*