

11-1997

Death Knell for the “Other Security” Deficiency Exception?

Roger Bernhardt

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

Follow this and additional works at: <http://digitalcommons.law.ggu.edu/pubs>

 Part of the [Property Law and Real Estate Commons](#)

Recommended Citation

Bernhardt, Roger, "Death Knell for the “Other Security” Deficiency Exception?" (1997). *Publications*. Paper 274.
<http://digitalcommons.law.ggu.edu/pubs/274>

This Article is brought to you for free and open access by the Faculty Scholarship at GGU Law Digital Commons. It has been accepted for inclusion in Publications by an authorized administrator of GGU Law Digital Commons. For more information, please contact jfischer@ggu.edu.

November 1997

Death Knell for the “Other Security” Deficiency Exception?

ROGER BERNHARDT

Irrational distinctions tend to be unreliable. That is nowhere more true than in the field of deficiency judgments, where almost every statement made in one decision gets repudiated in another. It has just happened again, with regard to the “other security” variant of the purchase money antideficiency defense, with the result that one device that everyone thought was safe is again in jeopardy.

The Purchase Money Prohibition (CCP §580b)

California law creates a series of obstacles to a lienholder seeking a deficiency judgment (*i.e.*, a personal judgment against the defaulting trustor (borrower) of a secured real property loan for the difference between the amount owed and the amount produced by a foreclosure sale of the security for the debt). See California Mortgage and Deed of Trust Practice, chap 4 (2d ed Cal CEB 1990). One of the antideficiency rules, CCP §580b, explicitly prohibits a deficiency judgment against a borrower after the foreclosure sale of real property that secures a purchase money loan. Code of Civil Procedure §580b defines purchase money as (1) a loan by a third party lender used to pay all or part of the purchase price of a one-to-four unit residential dwelling occupied in whole or in part by the buyer, or (2) a loan by the seller for the balance of the purchase price of property sold to the buyer. Thus, the statute denies a deficiency judgment to specified *residential* lenders, and to *all* sellers, whether they sold the buyer residential or commercial property or raw land.

Like most statutes, CCP §580b gives no reasons for its results, but our courts seem to have an overpowering urge to fill in missing reasons.

“Purposes” of CCP §580b

Brown v Jensen (1953) 41 C2d 193, 259 P2d 425, was the first opinion to ascribe purposes to CCP §580b. *Brown* involved a senior lienholder who foreclosed, thus wiping out a seller’s junior purchase money lien. Because the junior’s security was entirely destroyed and it no longer had a lien on the property, it was a “sold-out” junior. The junior then tried to sue the trustor on the note. *Brown* held that the junior’s action, although technically not an action for a deficiency because the junior had not previously foreclosed, was the functional equivalent of an attempt to obtain a deficiency judgment, and thus was barred by CCP §580b. *Brown* said the purposes of CCP §580b were (1) to make the seller look only to the security for recovery of a purchase money debt, and (2) to put the risk that the property’s value would become inadequate on the seller because of its superior knowledge of the value of the security. The dissent, however, contended that the statute’s purpose was to stop underbidding. Ten years later, in *Roseleaf v Chierighino* (1963) 59 C2d 35, 27 CR 873, Justice Traynor maintained that all three of those purposes were wrong: (1) The statement that the beneficiary must look only to the security was a conclusion, not an explanation; (2) the legislature did not likely intend to base the buyer’s protection on the seller’s superior knowledge; and (3) underbidding is deterred by fair value rules (CCP §580a), not purchase money rules.

Roseleaf’s repudiation of *Brown*’s reasons might have been expected to lead to a contrary result (*i.e.*, *not* applying CCP §580b to a sold-out junior), but Justice Traynor decided to change the reasons rather than the rule. The new purposes of CCP §580b, in his view, were to discourage overvaluation and to prevent the aggravation of economic downturns resulting from deficiency

liability. Were it not for Justice Traynor's great stature, these reasons would have been laughed off long ago. As far as overvaluation is concerned, no seller reduces its price because it might be barred from recovering a deficiency judgment; rather, it *raises* the price to compensate for that risk. Additionally, the buyer is *more* inclined, rather than less, to accept an inflated price because it has antideficiency protection. Regarding the antidepression theory, protecting the buyer at the expense of the seller after a senior foreclosure merely shifts the loss from one to the other, equally worsening any economic downturn (as the supreme court was itself to acknowledge later in *Spangler v Memel* (1972) 7 C3d 603, 102 CR 807).

Variants and Purposes

Roseleaf accepted the *Brown* logic that CCP §580b barred a deficiency judgment for a sold-out junior whose lien secured a purchase money loan. However, *Roseleaf* limited the logic to the "standard" purchase money mortgage transaction (*e.g.*, in which a seller takes back from the buyer a note secured by the property that was sold). Because the sold-out junior (seller) in *Roseleaf* decided to take back a note secured by *other* properties owned by the buyer instead of the property sold, *Roseleaf* held that the transaction was a "variant" of the standard transaction. The court reasoned that in variant transactions the purposes of CCP §580b are to be examined to determine whether the statute should apply in that particular case. The *Roseleaf* court concluded that CCP §580b did not bar the junior's (seller's) action on the note in this particular variant of the standard transaction. This holding became known as the "other security" exception to CCP §580b.

Justice Traynor's economic notions as expressed in *Roseleaf* are able to survive because in standard transactions CCP §580b is applied "automatically," *i.e.*, no one gets to argue that the logic would not pass a high school economics course. In variant transactions, however, as noted above, the *purposes* of CCP §580b are to be considered in finding the correct result. This is where irrationality leads to instability.

Roseleaf was a variant in that the seller took back a deed of trust on other property, rather than that which it sold to the buyer. Ordinary lay people might think that a seller who insists on different property as security for the price of what was sold is more likely than not to be overvaluing it, and that the effect on a depression is the same whether the buyer owes a deficiency judgment after losing either parcel *A* (the sold property) *or* parcel *B* (other property). However, in holding that the *Roseleaf* seller could recover on a purchase money note as a sold-out junior, Justice Traynor held that the purposes went the other way for this variant.

If a variant can attain the same impregnable status as a standard transaction, we lawyers can nonetheless work with it, despite its total absurdity: If deficiency protection is desired, the deed of trust is put on the property sold; if deficiency exposure is wanted, then it should cover other security instead. Indeed, such a strategy seemed almost recommended in another Traynor opinion, *Kistler v Vasi* (1969) 71 C2d 261, 78 CR 170. (In *Kistler*, the buyer paid the seller's broker with a deed of trust from buyer directly to the broker, rather than give paper to the seller to be assigned to the broker. The court allowed the broker to sue the buyer for a deficiency judgment and rejected the buyer's argument that, because the seller's commission obligation was discharged by giving the broker the buyer's deed of trust, the transaction was in effect a purchase money loan by the seller.)

The recent case of *Conley v Matthes* (1997) 56 CA4th 1453, 66 CR2d 518 (reported at 20 CEB RPLR 244 (Oct. 1997)), however, has shattered the supposedly settled "other security" variant, and held that a variant may have feet of clay. In this case, Conley sold two properties to Matthes, taking back a second deed of trust on one parcel to secure part of the price of the other parcel. When a senior lien foreclosure wiped out Conley's second, he sued as a sold-out junior, claiming protection under the "other security variant." He lost because, according to the Second

District Court of Appeal, the two sales were so closely related that “the ‘other’ property is not really ‘other.’” 56 CA4th at 1463. *Roseleaf* was distinguished on the ground that the other property in that case was “completely foreign to the transaction,” whereas the properties in *Conley* were a package deal. 56 CA4th at 1464. Thus, the CCP §580b policies were held to lead to protection rather than exposure for the buyer.

If other security must be “really other” to fit the *Roseleaf* variant, can deals be structured to fit it? *Conley*’s analysis of “really other” security is too filled with moralisms and other extraneous considerations to give the bar much help. The transaction was an integrated package at the beginning, but by the time of closing it had broken down into two separate sales, the second sale being entirely optional and independent of the first. We may surmise that any arrangement with more integration than this (*i.e.*, any extensive cross-referencing) may be called “not really other.” I doubt, however, that we can predict how much *less* interrelation between the parcels is sufficient to make it really “other security.” If the other security is, for instance, found to be “necessary to the consummation of the sale” (56 CA4th at 1461) because the deal won’t close otherwise, how likely is it that a court will regard it as “unrelated” and deny the buyer deficiency protection?

As yet, there is no legal risk in taking other security to secure a seller’s note, even if that security is later deemed related to the sold property. The arrangement may not help the seller, but it should not hurt. (Who among us, however, is willing to wager against the possibility of a decision coming down to the effect that a seller who takes other security rather than its own gets no security interest whatsoever, or, worse, becomes a debtor rather than a creditor of the buyer? That would surely deter overvaluation in some parallel universe.)