5-1997

Trading Mortgages for Judgments Against Community Property

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Family Code §1102 (former CC §5127), which requires the signatures of both husband and wife for the leasing, conveying, or encumbering of community real property, is fundamentally incompatible with Fam C §910, which holds a couple’s community property liable for the debts of either spouse, even though not joined in by the other. That incompatibility and absurdity is dramatically demonstrated by the following example. An unsecured lender to one spouse (i.e., the other spouse has not signed the unsecured note) can get a money judgment against the defaulting debtor spouse and record a judgment lien against the community property family home under Fam C §910, whereas a secured lender to that same spouse (i.e., the lender whose note and deed of trust on the house was not signed by the other spouse) gets no security interest whatsoever in the house—not even on half of the community property—because the lack of two signatures renders the deed of trust entirely invalid under Fam C §1102.

**Background: Droeger**

In *Droeger v Friedman, Sloan & Ross* (1991) 54 C3d 26, 283 CR 584, reported at 14 CEB RPLR 260 (Oct. 1991), one spouse had given her law firm a security interest in two properties to secure its fees in her divorce action. The husband challenged the encumbrances under former CC §5127 (Fam C §1102) because he had not consented. The law firm argued that the encumbrances should be valid at least as to the wife’s half interest in the community property. The court, however, held that the absence of the other spouse’s signature voided the instrument entirely, not just halfway. But *Droeger did not* decide what was to happen next: What becomes of the creditor who has just lost its security because of the missing signature? *Lezine v Security Pac. Fin. Servs., Inc.* (1996) 14 C4th 56, 58 CR2d 76, reported at 20 CEB RPLR 41 (Jan. 1997), now answers that question: loss of the security is possibly the best thing that can happen to the creditor.

**Lezine**

In *Lezine*, the husband—who had forged his wife’s signature on a quitclaim deed, which made him appear to be the sole owner of the couple’s residence—executed deeds of trust on the house to two different creditors (one of which was not a party because it abandoned its appeal). After the wife learned of her husband’s dealings, she successfully sued to invalidate the liens under former CC §5127 (Fam C §1102), but in the same action the court gave the creditors money judgments against the husband. Unknown to the wife, the creditors recorded their judgment liens in the county of the couple’s residence, thus creating liens against the house. Three months later, in the wife’s separate dissolution action, the court awarded her the residence as her separate property, and assigned the two lender debts to her husband. When she later tried to refinance the property, she learned about the judgment liens. She then moved for clarification of the prior judgment voiding the deeds of trust, arguing that *Droeger* compelled the conclusion that the judgment liens should not attach to the same property on which the creditors’ deeds of trust had been voided.
The California Supreme Court confirmed that when a creditor’s deed of trust is executed only by the husband, that creditor loses its security because the wife did not sign, but the creditor in Lezine does not lose its claim, and thus is entitled to a money judgment against the husband for the loan. The court further held that, once the judgment was recorded, it became a lien on the very same house because Fam C §910 holds the community liable for the husband’s debts. After the house was awarded to the wife in the dissolution proceedings, she took it subject to the judgment lien, which covered the same loan that had been secured by the deed of trust she had previously successfully challenged! The result may seem weird, but the logic is hard to avoid (and the court’s ruling was unanimous). The legislature could overturn it, but first they would have to come up with an alternative acceptable to most sides, which is unlikely.

**Importance of Timing**

Timing may have had a lot to do with the Lezine outcome. Under Fam C §916 (former CC §5120.160), community property awarded to a spouse in a dissolution action is no longer liable for marital debts assigned to the other spouse, subject, however, to existing liens. Ms. Lezine lost because she filed separate actions for invalidation of the deeds of trust and for dissolution of the marriage, and let the first go to judgment several months before the second. Thus, the deeds of trust had already been vacated and a money judgment entered for the creditors and recorded before the house was awarded to her as her separate property in the dissolution action. The Lezine court speculated that the same result probably would have occurred had she asked for all her relief in one action. Had she been able to file separate actions and have the outcomes occur in reverse order, however, the house should have lost its community character (i.e., she already would have been awarded the residence as her separate property in the dissolution action) before there were money judgments to record resulting from the invalidation action. In that case, the house should not have been liable for the debts of her (former or current) spouse under Fam C §916. Ensuring such a result for the innocent spouse will be a challenge for matrimonial counsel in future litigation.

Family Code §1102(d) requires a nonconsenting spouse to file her action within one year after the deed of trust has been recorded, which may abridge the luxury of waiting until the divorce is final before cleaning up the title. (Also, when one spouse conveys community property by deed rather than by a deed of trust, the nonconsenting spouse will have to invalidate the deed before the divorce award in order to get the asset characterized as community property at all.) Matrimonial counsel will have to devise ways to slow the invalidation action enough that it always lags behind the dissolution action, lest they be accused of malpractice for permitting property to be dissipated to creditors rather than preserved for the innocent spouse.

**Creditor Strategies**

Can the creditor—who wants the reverse result—initiate and accelerate its own action in order to convert its defective instrument (deed or mortgage) into a recordable money judgment while the property is still in the community? The creditors in Lezine could not have been expected to act first because they believed that the property belonged solely to the husband based on the forged quitclaim deed; but the law firm in Droeger certainly had to know that the security for their deed of trust was community property—they were, after all, handling the divorce. Before Droeger, the law firm could hope that the deed of trust was valid at least as to the consenting spouse’s one-half community property interest, as some courts had held (Mitchell v American Reserve Ins. Co. (1980) 110 CA3d 220, 167 CR 760), which made taking the security worth the gamble; after Droeger, the firm would know that the deed of trust was bad, and therefore they would not necessarily be motivated to pursue it. After Lezine, however, a creditor ought to appreciate that a bad deed of trust can be converted into a good judgment by appropriate action.
One-Action Rule Considerations

The surest way to get a recordable money judgment is to sue for money. The one-action rule (CCP §726) says you cannot do that if your debt is secured. However, the one-action rule does not apply if the creditor’s security is legally “worthless” (see California Mortgage and Deed of Trust Practice §§4.6–4.8 (2d ed Cal CEB 1990)), and Droeger seems to have made deeds of trust signed by only one spouse entirely worthless. The fact that the security is worthless should give a creditor both a way around the one-action hurdle and a justification for suing even if note payments are not in arrears. So even if the nonconsenting spouse does not sue to invalidate the lien, maybe the creditor can treat it as invalid anyway under Droeger and Lezine.

(I don’t know how this plays out if a year has already passed since the document was recorded. Under Fam C §1102, the nonconsenting spouse has only one year to sue to invalidate the instrument. If the spouse does not file a timely invalidation action, maybe the creditor can no longer rely on the worthless security exception. But then, the creditor with valid security hardly needs to rely on the exception.)

Denial of Relief to Creditor at Fault?

Lezine involved two secured lenders, one of whom may have known of the husband’s forgery. This factor may have led the Lezine court to emphasize that it was not determining the rights of a creditor who knew of the marriage or the Fam C §1102 violation. 14 C4th at 71 n8. Does that mean the Droeger law firm might not be able to get a judgment lien because it must have known that its deed of trust was on community property? Both lenders in Lezine, however—the one with knowledge as well as the one without—got recordable money judgments replacing their mortgages.

Which takes us back to the one-action rule. The rule traditionally is stated as prohibiting a secured lender from suing on its note for a personal judgment except when its security has been rendered valueless without “fault.” If a creditor knows that another signature is necessary, is that creditor “at fault” for purposes of the one-action rule, as Lezine’s footnote hints? If so, will it lose both its security and—as suggested by Security Pac. Nat'l Bank v Wozab (1990) 51 C3d 991, 275 CR 201 (reported at 14 CEB RPLR 22 (Jan. 1991))—its underlying debt as well? In the rarefied atmosphere of one-action land, anything is possible.

Conclusion

Independent of these speculations, a creditor should rarely want to have its security invalidated in order to get a judgment lien instead. The judgment lien may provide an escape from some of the antideficiency rules (e.g., purchase money limitations under CCP §580b and fair value requirements under CCP §580a), but its priority vis-à-vis other liens will start from the date the creditor recorded its judgment rather than the date the former (voided) deed of trust was executed. Also, the creditor would totally lose the right to foreclose under a power of sale clause in the mortgage.