

BUSINESS & FACILITIES UPDATE

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Creditors May Recover a Monetary Judgement on Junior Liens After Foreclosing Property and Extinguishing Rights to Recover Under Senior Lien.

In 2005, Michael and Kathleen Cobb borrowed \$10 million from Citizens Business Bank, executing a promissory note secured by the Cobbs' deed to a piece of commercial property outside Los Angeles. The first note provided if the Cobbs defaulted on the loan, the creditor could force a sale of the property at auction and use the proceeds from that sale to pay down the outstanding loan amount. California law prohibits a creditor who forecloses on a piece of property and forces a sale from then seeking a "deficiency judgment" in court to recover the outstanding amount owed on the loan.

Two years later, in 2007, the Cobbs returned to Citizens Business Bank, this time borrowing \$1.5 million. Again, the Cobbs executed a promissory note on the property, executing a second deed of trust in order to secure the loan. The Cobbs' second note stated that it was secondary and inferior to the obligations established under the first note, meaning that the holder of the second note could not collect until the debt associated with the first note was paid.

In January 2014, Citizens Business Bank packaged and sold both of the Cobbs' loans to Black Sky Capital, LLC. Less than six months later, in June 2014, Black Sky sent the Cobbs notice of default on both loans and informed the Cobbs of Black Sky's decision to sell the property at auction as provided in the first note. In October 2014, Black Sky sold the property at a public auction for \$7.5 million.

In November 2014, Black Sky then sued the Cobbs to recover the amount that the Cobbs still owed to Black Sky under the second note.

In the trial court, the Cobbs argued that Black Sky could not collect any money they owed under the second note because the Black Sky foreclosed and sold the property for less at auction than the total amount they owed. Therefore, the Cobbs contended that any monetary award, including recovery of the balance on the second note, would constitute a "deficiency judgment" against the Cobbs, and the Code of Civil Procedure prohibits such recoveries after a foreclosure. The Cobbs argued that Code of Civil Procedure section 580d precludes monetary judgments for a creditor on a junior note if that creditor also foreclosed the senior note. The trial court agreed that *Simon* applied to the circumstances of the foreclosure sale and attempted recovery and barred Black Sky from recovering anything under the second note. Black Sky appealed.

On appeal, Black Sky argued that the trial court misapplied the law. Black Sky pointed to a Supreme Court case holding the Code of Civil Procedure section 580d does not preclude recovery by a creditor who owns a junior lien if that creditor is not involved in the sale of the property. Black Sky argued that it was immaterial who owned the lien, so long as the different promissory notes established the liens, and the foreclosure did not implicate the more junior of the liens.

The Court of Appeal agreed, observing that while the senior and junior creditor are the same in this case, “[a]ny debt owed on the junior note in this case has no relationship to the debt owed on the senior note,” and the prohibition against deficiency judgments under section 580d only applies where there is one note. The Court of Appeal stated that “[t]he unambiguous language in section 580d . . . indicate[s] that section 580d applies to a *single* deed of trust” and “does not apply to preclude Black Sky from suing for the balance due on the junior note in this case.” (Emphasis added.) The Court of Appeal reversed the trial court’s judgment, and remanded the matter to the trial court for further proceedings. The Cobbs sought review in the California Supreme Court.

The California Supreme Court granted review. After examining the record, the Supreme Court affirmed the Court of Appeals’ analysis, concluding that the plain language of Section 580d bars a deficiency judgment on a note secured by a deed of trust when the creditor sells the property “under power of sale contained in *the*... deed of trust.” (Emphasis in original.) The Supreme Court explained that the definite article in the phrase “*the* ... deed of trust” makes clear that the Code of Civil Procedure prohibits recovery under the foreclosed deed, and not under any other note. Therefore, while the Code of Civil Procedure would prohibit Black Sky from recovering a deficiency judgment on the senior note, its foreclosure of the property did not affect the second note, any obligations the Cobbs owed to Black Sky on the second note, or Black Sky’s attempted recovery through the courts.

Black Sky Capital, LLC v. Cobb (2019) __ Cal.5th __ [2019 WL 1984289].

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