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**California Supreme Court Clarifies Application of Anti-Deficiency Statute Where Lienholder Foreclosing on Senior Lien Seeks a Deficiency Under Its Junior Lien.**

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On May 6, 2019, the California Supreme Court issued its opinion in Black Sky Capital, LLC v. Cobb, holding that where there is no allegation of evasive loan splitting, California Code of Civil Procedure section 580d does not bar a deficiency judgment on a junior lien held by a senior lienholder that foreclosed on the property comprising the security for both liens. In other words, due to the holding in Black Sky Capital, California lenders who are both the senior and junior lienholder on the same real property can now obtain a deficiency judgment against the borrower under a junior lien after conducting a non-judicial foreclosure sale of the property under the senior deed of trust. However, the Court indicated that where there is evidence of “intentional loan splitting” with the apparent purpose of circumventing the anti-deficiency statutes, a question would arise as to whether the two liens held by the same creditor should be treated as a single lien within the meaning of section 580d.

The California Supreme Court in Black Sky Capital rejected the reasoning in Simon v. Superior Court, which held that “where a creditor makes two successive loans secured by separate deeds of trust on the same real property and forecloses under its senior deed of trust’s power of sale, thereby eliminating the security for its junior deed of trust, section 580d . . . bars recovery of any deficiency balance due on the obligation of the junior deed of trust.” As such, for the first time in over 25 years, lenders in California can take the benefit of the entirety of their collateral by foreclosing on a senior lien and seeking additional recovery on a “sold-out” junior lien by pursuing the borrower for the deficiency.

**The Simon Decision**

In Simon v. Superior Court (1992) 4 Cal. App. 4<sup>th</sup> 63, the bank made two loans secured by separate deeds of trust encumbering the same real property and recorded on the same day. Id. at 66. After the borrower defaulted on the senior note, the bank proceeded with a non-judicial foreclosure under the power of sale conferred by the senior lien. The junior lien was extinguished by the bank’s non-judicial foreclosure of its senior lien. The bank then sued the borrower seeking recovery of a deficiency due on the junior note, together with accrued penalties, interest, and attorney fees. In defense, the borrower raised various provisions of the anti-deficiency statutes of the Code of Civil Procedure as affirmative defenses. The issue confronted by the Court was whether a creditor who makes two successive loans to a debtor, both secured by the same real property, can recover *any* deficiency under the junior lien after it eliminated the security for its junior lien by non-judicially foreclosing on the senior lien. Id. at

67. The Court found that where the bank holds both the senior and junior liens and elects to foreclose non-judicially on the senior lien, the bank is not a “sold-out” junior lienholder because no third party’s foreclosure or purchase affected the security of the junior lien. Therefore, the Court held that section 580d barred a foreclosing senior lienholder from pursuing a deficiency judgment under its junior note. Id. at 76-77.

Several cases considered by the California Courts of Appeal have cited Simon’s reasoning with approval. See, e.g., Bank of America, N.A. v. Mitchell (2012) 204 Cal. App. 4th 1199, 1207; Ostayan v. Serrano Reconveyance Co. (2000) 77 Cal. App. 4th 1411; and Evans v. Cal. Trailer Court, Inc. (1994) 28 Cal. App. 4th 540.

### **Facts and Procedural History of Black Sky Capital Case**

In Black Sky Capital, LLC v. Cobb (2019) 2019 Cal. Lexis 3043,\* the bank made two successive loans to the borrowers, one loan in August of 2005 and a second loan in September of 2007. Id. at 3. The loans were sold to plaintiff, Black Sky Capital, who elected to pursue a non-judicial foreclosure under the senior lien on the property. Id. Black Sky Capital acquired the property at a public auction and one week later filed a lawsuit to recover the deficiency owed under its junior deed of trust, which was extinguished by the foreclosure sale. Id.

Relying on Simon, the trial court granted summary judgment, ruling that section 580d bars the monetary judgment sought by Black Sky Capital because the statute precludes a deficiency judgment in favor of a junior lienholder who was also the foreclosing senior lienholder. Id. The Court of Appeal reversed, declining to follow Simon and instead relied on Roseleaf Corp v. Chierighino (1963) 59 Cal. 32d 35, 43, which held that section 580d does not preclude a deficiency judgment for a non-selling junior lienholder. Id. The Appellate Court held that “the unambiguous language in section 580d . . . indicate[s] that [the statute] 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” Id. at 4. The California Supreme Court granted the borrowers’ petition for review to revisit the application of Section 580d.

### **Black Sky Capital Decision and The Supreme Court’s Criticism of Simon**

The California Supreme Court rejected the reasoning in Simon and instead relied on a more narrow interpretation of the anti-deficiency statutes. Black Sky Capital, LLC, 2019 Cal. Lexis 3043\* at 13-14. The Court found that Simon, and the cases that followed, did not properly examine the text of section 580d, and instead primarily relied on the legislative intent rather than the plain language of the statute. The Court held that the plain language of section 580d, subdivision (a), “makes clear that the statute only applies where a sale of the property has

occurred under the deed of trust securing the note sued upon, and not under some other deed of trust.” *Id.* at 13. Therefore, the Court concluded that the statute did not preclude Black Sky Capital from obtaining a deficiency judgment under the junior note because no foreclosure sale had occurred under the junior deed of trust.

Nonetheless, in dicta, the Court noted that, “[w]here there is evidence of gamesmanship by the holder of senior and junior liens on the same property, a substantial question would arise whether the two liens held by the same creditor should – in substance, if not in form – be treated as a single lien within the meaning of section 580d.” *Id.* at 15. In other words, where there is evidence to suggest that two notes arose from evasive loan splitting, with the effect of circumventing the anti-deficiency statutes, the court may treat the two loans as one under section 580d, thereby prohibiting the junior lienholder from seeking a deficiency judgment. *Id.* at 15. However, where there is no allegation of evasive loan splitting or recovery in excess of that which any junior lienholder would be able to recover, the junior lienholder may seek a deficiency judgment under the junior note. *Id.* at 17.

#### **Recommendations Based on Analysis of Black Sky Capital**

By overruling *Simon*, the *Black Sky Capital* decision makes clear that California lenders may pursue a deficiency judgment against a borrower for the balance due under a junior lien after foreclosing on the senior deed of trust. Therefore, lenders with a senior and junior lien on the same property no longer need, for example, to first foreclose under the junior lien and preserve their remedies under the senior lien. This is particularly true where the value of the property does not support a decision to foreclose under the junior lien. Instead, pursuant to the Court’s decision in *Black Sky Capital*, lenders may elect to foreclose under the senior lien, without fear of extinguishing the debt represented by the junior lien, and initiate a civil action for a deficiency judgment against the borrower under the second note that had been secured by the junior deed of trust. Nonetheless, if it appears that a lender is attempting to thwart section 580d by engaging in intentional loan splitting, courts may treat two separate loans as one for purposes of applying the anti-deficiency statutes and preclude a deficiency judgment.