WHEN LENDER HAS BOTH SENIOR AND JUNIOR DEED OF TRUST CAN FORECLOSE ON BOTH

Almost two years ago, Money and Dirt covered a Fourth District California Court of Appeal opinion addressing an apparent split of authority regarding how a lender can enforce senior and junior deeds of trust on the same property — see When the Same Lender Has Both a Senior and Junior Deed of Trust….

That Court of Appeal opinion, *Black Sky Capital v. Cobb* — held that Code of Civil Procedure section 580d did **not** bar a lender from pursuing recovery on a note secured by a wiped out junior deed of trust after the same lender foreclosed on a different note secured by a senior deed of trust on the same property. The opinion relied on the text of section 580d (which bars a deficiency only on the foreclosed note), and an earlier California Supreme Court decision *Roseleaf Corp. v. Chierighino*, which broadly held section 580d does not apply to a "sold out" junior lienholder.

The *Black Sky* Court of Appeal opinion also distinguished another case, *Simon v. Superior Court*, in which the First District Court of Appeal reached a different conclusion. The two cases had an important factual distinction: In *Simon*, the lender made the senior and junior loans within ***four days*** of each other, and the court viewed this as an attempt to circumvent section 580d by structuring what was really one loan as two. In *Black Sky*, however, the two loans were made over ***two years*** apart.

The conclusion of Money and Dirt's prior post regarding the Court of Appeal's opinion in *Black Sky* observed:

Splits among the District Courts of Appeal like this can get the attention of the Supreme Court. The Supreme Court might be motivated to grant review of the *Black Sky* decision and settle the law conclusively.

It is also possible that the Supreme Court might not view *Simon* and *Black Sky* as incompatible — after all, the facts in each case were very different, and may have justified the outcomes.

The California Supreme Court granted review of the Court of Appeal's opinion in *Black Sky*, and issued its ruling on May 6, 2019. Here is a recap.

The facts

On August 18, 2005, Michael and Kathleen Cobb borrowed over $10 million from Citizens Business Bank. The note was secured by a deed of trust on a parcel of commercial property in Rancho Cucamonga.

More than two years later, the Cobbs borrowed another $1.5 million from Citizens Business Bank. The note was secured by a second deed of trust on the same property.

Black Sky purchased both notes from Citizens Business Bank.

The Cobbs defaulted on the senior loan, and Black Sky conducted a trustee's sale pursuant to the power of sale provisions in the senior deed of trust, acquiring the property for a credit bid of $7.5 million.

Shortly after, the Cobbs defaulted on the junior loan. Black Sky sued the Cobbs personally to recover the junior debt. The Cobbs moved for summary judgment, arguing that under the *Simon* opinion, the same lender could not seek recovery under a junior lien after foreclosing on the senior lien.

The trial court granted summary judgment for the Cobbs, and Black Sky appealed.

Court of Appeal's opinion

The Court of Appeal reversed the trial court and ruled in favor of Black Sky, finding that nothing in section 580d prohibited recovery on the junior note, which had not been foreclosed. The court distinguished the *Simon* opinion, in which the loans had been entered into only four days apart, which indicated the lender's potential intent to circumvent section 580d.

The Supreme Court's opinion

The Supreme Court affirmed the opinion of the Court of Appeal in favor of Black Sky.

The Court based its decision primarily on on the text of section 580d and the Supreme Court's earlier decision in *Roseleaf*, which held section 580d "does not appear to extend to a junior lienor whose security has been sold out in a senior sale." Section 580d, the Court noted, "makes clear that the statute applies where the sale of the property has occurred under *the deed of trust securing the note sued upon*, and not under some other deed of trust."

Accordingly, section 580d did **not** prevent Black Sky from pursuing recovery on its junior note after the foreclosure of its senior note secured by the same property.

While disapproving *Simon* and other cases "to the extent they are inconsistent with this opinion," the Supreme Court stopped short of *overruling* those cases, apparently recognizing that the holding from *Simon* could still apply depending on the facts. In *Simon*, the same lender made loans only *four days* apart, suggesting an intent to evade section 580d, while in *Black Rock*, the loans were over *two years* apart. The Supreme Court observed:

Where there is evidence of gamesmanship by the holder of the 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

Thus, the Court confirmed that where the facts suggest "gamesmanship scenarios" or "evasive loan splitting," the holding of *Simon* might still apply to bar recovery on the junior obligation. The Court also noted that a lender's conduct under those facts might be subject to challenge under Code of Civil Procedure section 726, but made no rulings on that issue.

Lesson

Based on the Supreme Court's opinion in *Black Sky*, the *general* rule now seems settled: **In most cases where a lender has both a senior and junior lien on the same property, foreclosing on the senior lien will not bar the lender from later pursuing recovery on the junior obligation.**

Under this general rule, borrower challenges to recovery of the junior obligation based on the *Simon* decision are likely to fail.

Unless, that is, there is evidence of "evasive loan splitting" or other "gamesmanship" suggesting that the lender essentially structured one loan as two in order to evade the restrictions on deficiency recovery set forth in section 580d. The closer in time the two loans are made (such as the mere four day gap at issue in *Simon*), the more likely the lender is to fall into the *Simon* exception.