

SD213137

**IN THE SUPREME COURT
OF THE STATE OF CALIFORNIA**

CAROL COKER,

Plaintiff and Appellant,

v.

J.P. MORGAN CHASE BANK, N.A., *et al*,

Defendant and Respondent.

Fourth Appellate District, Division One
(Case No. D061720)

San Diego County Superior Court
(No. 37-2011-00087958-CU-MC-CTL)
(Honorable Luis R. Vargas, Judge Presiding)

**APPLICATION FOR LEAVE TO FILE *AMICUS CURIAE*
BRIEF IN SUPPORT OF PLAINTIFF/APPELLANT
OF HOUSING AND ECONOMIC RIGHTS ADVOCATES,
NEIGHBORHOOD LEGAL SERVICES OF LOS ANGELES
COUNTY, CALIFORNIA HOMEOWNER BILL OF RIGHTS
COLLABORATIVE, LEGAL SERVICES OF NORTHERN
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CERTIFICATE OF INTERESTED PARTIES

(Cal. Rules of Court, rule 8.208)

To the best knowledge of the undersigned, no entity or individual has either (1) an ownership interest often percent or more in the party or parties filing this certificate (Cal. Rules of Court, rule 8.208(e)(1)), or (2) a financial or other interest in the outcome of the proceeding that the justices should consider in determining whether to disqualify themselves (Cal. Rules of Court, rule 8.208(e)(2)), excluding an interest in the outcome that arises solely because the case might establish precedent as set out in Cal. Rules of Court, Rule 8.208(e)(2)(B), other than those listed by the parties themselves.

DATED: August 22, 2014 /s/Elizabeth S. Letcher, SBN #172986
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COLLABORATIVE, LEGAL SERVICES OF NORTHERN
CALIFORNIA, AND PUBLIC COUNSEL**

Pursuant to Rule 8.520 subd. (f) of the California Rules of Court,
Housing and Economic Rights Advocates, Neighborhood Legal Services
of Los Angeles County, The California Homeowner Bill of Rights

Collaborative, Legal Services of Northern California, and Public Counsel¹ respectfully request permission to file the attached *amicus curiae* brief in support of respondent Carol Coker.

Housing and Economic Rights (“HERA”) is a California statewide, not-for-profit legal service and advocacy organization. HERA’s mission is to ensure that all people are protected from discrimination and economic abuses, especially in the realm of housing. In recent years, its work has focused on asset preservation and preventing foreclosure. HERA counsels 1,500-2000 individuals a year, and offers in-depth advocacy (in some cases including legal representation) to over 500 homeowners or former homeowners a year. That volume of cases allows HERA to discern trends in the foreclosure-related problems homeowners face, and as a result, HERA has also turned its focus to fighting the predatory, abusive, and unlawful practices that have followed in the wake of the foreclosure crisis. As part of that effort, HERA has represented former homeowners in multiple suits against major loan servicers (including Chase, Wells Fargo, and Ocwen) and against debt

¹ *Amici* certify that no person or entity other than *Amici* or their counsel authored or made any monetary contribution intended to fund the preparation or submission of the proposed brief. (See Cal. Rules of Court, Rule 8.520 subd. (f)(4)).

collection companies for their unlawful efforts to collect on non-recourse, purchase money mortgages after the borrowers have lost their homes.

HERA and counsel of record for *Amici* Arthur Levy are plaintiffs' counsel in a pending class action, *Banks v. JPMorgan Chase Bank, N.A.*, Alameda County Superior Court Case No. RG12614875, in which the application of the purchase money anti-deficiency statute is an issue and which this Court's opinion could affect.

Neighborhood Legal Services of Los Angeles County has provided civil legal services to low-income residents of Southern California since 1965, and currently serves more than 80,000 individuals and families each year. Its team of attorneys assists clients with issues including immigration, health care, housing, and family law. Throughout the foreclosure crisis, Neighborhood Legal Services has counseled clients at risk of losing their homes, and has become familiar with the unique issues facing homeowners in crisis. Many of these homeowners are now trying to rebuild their lives after losing their homes in short sale transactions, and would suffer severe, unanticipated hardship if their lenders were able to obtain deficiency judgments against them.

The HBOR Collaborative is a partnership of four housing advocacy organizations led by the National Housing Law Project

(NHLP) and funded by the Office of the California Attorney General under the national Mortgage Settlement. NHLP and its partners, Western Center on Law & Poverty, National Consumer Law Center, and Tenants Together, offer free training, technical assistance, litigation support, and legal resources to California's consumer attorneys and the judiciary on all aspects of the new California Homeowner Bill of Rights and related protections, including the anti-deficiency protections under Code of Civil Procedure section 580b. The goal of the Collaborative is to ensure that California's homeowners receive the intended benefits of rights newly secured for them under HBOR and existing law by providing their legal representatives with a broad array of support services and practice resources.

Legal Services of Northern California (LSNC) is a not-for-profit legal aid agency that has served low and moderate-income people in 23 counties in northern California for more than 50 years. Its mission is to provide quality legal services to empower the poor to identify and defeat the causes and effects of poverty. Currently, LSNC has a foreclosure prevention assistance project in which it assists homeowners facing foreclosure and homeowners attempting to recover from the effects of foreclosure. In this project, LSNC has assisted hundreds of homeowners

and provided a range of legal services from counsel and advice to representation in court.

Established in 1970, **Public Counsel** is the nation's largest pro bono law firm. It delivers justice, hope and opportunity to individuals and families, children, immigrants, consumers, veterans, the homeless, nonprofits, and small businesses through direct legal services, legislative and policy advocacy, and impact litigation. Its services span nine practice areas. Annually, Public Counsel assists approximately 30,000 people with direct legal services and assists hundreds of thousands more through filing impact litigation lawsuits, influencing policy, and sponsoring legislation. The Consumer Law Project at Public Counsel deals primarily with legal issues related to mortgages and foreclosure. Since the collapse of the housing market in 2008, the Consumer Law Project has devoted most of its resources to assisting homeowners who are facing foreclosure.

The proposed brief will assist the Court by providing additional history of anti-deficiency statutes, analysis of anti-deficiency protections and changes in the statutory scheme, factual background about the

mechanics of short sale and the impact of deficiency collection on former homeowners.

Accordingly, *Amici* respectfully request that this Court accept and file the attached *amicus curiae* brief addressing the construction Code of Civil Procedure section 580b.

DATED: August 22, 2014 /s/Elizabeth S. Letcher, SBN #172986
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AND PUBLIC COUNSEL

**AMICUS CURIAE BRIEF IN SUPPORT OF
PLAINTIFF/APPELLANT**

INTRODUCTION

This Court has a 60-year history of construing and applying Code of Civil Procedure section 580b to require lenders to look solely to the security for repayment of residential purchase money mortgages. Once the security is exhausted by whatever means – foreclosure sale, short sale, or otherwise – the statute bars all recourse against the borrower. This Court has expressly and repeatedly held that anti-deficiency protection under section 580b is not triggered by a foreclosure sale; instead, the statute bars deficiencies by declaring residential purchase money mortgages non-recourse *ab initio*.

Short sale exhausts the security by payment of the entire value of the security to lender. Because section 580b renders residential mortgages non-recourse, the lender has no recourse against the borrower after a short sale.

A short sale realizes and exhausts the security; it does not “destroy” it. A lender who approves a short sale does not unilaterally surrender its lien, rendering its loan unsecured. Rather, the lender releases its lien simultaneously with (or after) the close of the short sale

escrow, only in exchange for receiving the entire net sale proceeds. When the short sale closes, the lender has exhausted its security as completely as in a foreclosure sale. A lender who believes that the proposed short sale price is below the fair value of the property can disapprove the short sale and proceed to foreclosure.

Coker's residential mortgage was a "garden variety" mortgage to which the sole, limited exception this Court has recognized to section 580b, in commercial mortgage subordination cases, does not apply. This Court broadly banned post-mortgage waivers of section 580b protection in *DeBerard Properties v. Lim* (1999) 20 Cal. 4th 659. *DeBerard* outlaws the purported waiver Chase wrote into Coker's short sale approval letter. No case law before or since *DeBerard* warrants any departure from the application of that ruling to this case in particular, and to short sales in general.

Lenders have approved massive numbers of short sales during the ongoing foreclosure crisis because short sales are highly beneficial to lenders. Short sales enable lenders to liquidate the value of their security immediately. By contrast, foreclosure sales usually result in lenders buying the property at the foreclosure sales, subjecting them to extended and expensive operations to maintain, repair, and market the properties

for sale before realizing dollar one. In their own financial self-interest, lenders have embraced short sale over foreclosure and systematically approved short sales when the short sale price approximates the lender's determination of the fair market value.

Applying section 580b in the short sale context promotes the dual policies underlying the statute by deterring speculative overvaluations and protecting borrowers against crushing liabilities in a downturn. The recent real estate recession has worked massive hardship on borrowers, particularly the elderly, as they struggle to recover from the loss of homes and damage to credit standing. The Legislature intended section 580b as a consumer safety net in exactly this economic environment. Allowing lenders to pursue displaced borrowers after short sales would cut a hole in that net, without any legal or policy justification.

In sum, Chase is asking this Court to depart radically from this Court's consistent line of decisions holding that section 580b requires residential mortgage lenders to look solely to the security for repayment. Chase is asking this Court to rule contrary to the historic and recently renewed mandates of the Legislature outlawing residential mortgage deficiency liability in ever-expanding classes of loans. Chase is asking this Court to impose deficiency liability on hard-pressed borrowers after

Chase and other lenders have reaped the benefits of short sales by readily liquidating their security and avoiding the protracted and costly property management and marketing costs and risks they would have had to bear if they had proceeded with foreclosure.

This Court should follow the Court of Appeal in reversing the Judgment of Superior Court.

ARGUMENT

I. A Short Sale Exhausts the Security, and So Triggers the Anti - Deficiency Protections of § 580b Under This Court's Longstanding Jurisprudence

A. This Court Has Consistently Applied Section 580b to Require Only Exhaustion of the Security as the Anti-Deficiency Trigger, Not a Foreclosure Sale

For 60 years, this Court, and the California appellate courts in general, have recognized that Code of Civil Procedure section 580b² regulates the character of the loan from inception, and renders purchase money loans within its coverage non-recourse to the borrower.

Although the Court's guiding decisions did not address short sales as such, they consistently uphold a principle far deeper than foreclosure,

² All further statutory references are to the Code of Civil Procedure, unless otherwise noted.

short sale, or any other particular method of exhausting the security: once the security is exhausted – by whatever means – the borrower has no personal liability for any deficiency.

In *Brown v. Jensen* (1953) 41 Cal. 2d 193, this Court held that under section 580b, purchase money lenders may “look only to the security” and cannot obtain a personal judgment for any deficiency beyond the security. Purchase money lenders are deemed to assume the risk that the security may be insufficient to repay the loan, and are barred from seeking deficiency judgments against borrowers if that risk turns against them.

In *Brown*, a second purchase money mortgage holder sued the borrower to obtain a personal judgment after the holder of the first purchase money mortgage had foreclosed, “selling out the second” — that is, the second received nothing out of the sale because the first exhausted the security. The second mortgage holder argued that section 580b was no bar to a personal judgment against the borrower because the foreclosure sale had been “under” the first mortgage and there had been no foreclosure sale “under” the second. (*Brown, supra*, 41 Cal. 2d at p. 196.)

This Court ruled that that a sale under the second was immaterial: a purchase money lender must “look solely to the security” — that is, a purchase money loan is non-recourse:

The question is, therefore, did plaintiff take a purchase money trust deed on the property when it was purchased? If she did, then section 580b is applicable and *she may look only to the security. That is the clear import of the wording of section 580b. The one taking such a trust deed knows the value of his security and assumes the risk that it may become inadequate.*

(*Id.* at p. 197, emphasis added.)

In *Brown*, this Court, in explicit terms, rejected Chase’s argument that the language of section 580b requires a foreclosure sale. There cannot be a deficiency judgment *in any event*, “whether there is a sale under the power of sale or sale under foreclosure, or no sale because the security has become valueless or is exhausted”:

Indeed the purpose of section 580b is that “... for a purchase money mortgage or deed of trust the security alone can be looked to for recovery of the debt.” (*Mortgage Guarantee Co. v. Sampsell*, 51 Cal.App.2d 180, 185 [124 P.2d 353].) The section states that *in no event shall there be a deficiency judgment, that is, whether there is a sale under the power of sale or sale under foreclosure, or no sale because the security has become valueless or is exhausted.*

(*Brown, supra*, 41 Cal.2d at p. 198, italics in original, underscoring added.)

Brown resolved a split of authority, approving *Mortgage Guarantee Co. v. Sampsell* (1942) 51 Cal. App. 2d 180, and rejecting *Hillen v. Soulee* (1935) 7 Cal. App. 2d 45. (*Brown v. Jensen, supra*, 41 Cal.2d at 198-99.) In *Hillen*, the Court of Appeal had allowed the second lender to sue the borrower based on a similar argument to the one Chase makes here: “This is not an action for a deficiency judgment. The security was exhausted by the sale under the first deed of trust and no sale was had under respondent’s [second] deed of trust.” (*Hillen, supra*, at p. 47.) *Brown* disapproved *Hillen* and approved *Mortgage Guarantee* for the proposition that “the security alone may be looked to for payment of a debt secured by a purchase money trust deed.” (*Brown, supra*, 41 Cal. 2d at p. 198-199.)

Brown rejected the argument that there needed to be any sale at all “under the second” for section 580b to apply: “The purpose of the ‘after sale’ reference in the section is that the security be exhausted and that result follows after a sale under the first trust deed.” (*Brown, supra*, 41 Cal.2d at p. 198.) In other words, once the security was exhausted by whatever means, the second, being purchase money, was barred from recovering the deficiency from the borrower.

Brown also held that the purchase money character of a mortgage, and the resulting anti-deficiency protection, is fixed and becomes absolute at the time of the mortgage transaction:

With purchase money trust deeds, however, the character of the transaction must necessarily be determined at the time the trust deed is executed. *Its nature is then fixed for all time and as so fixed no deficiency judgment may be obtained regardless of whether the security later becomes valueless.*

(*Id.* at p. 197, *emphasis added.*)

A leading commentator, Boalt Hall Professor Stefan Riesenfeld, confirmed that *Brown* stands for the proposition that purchase money loans are non-recourse and rejects Chase's claim that it applies only to "deficiency judgments" after a foreclosure sale:

Rejecting the argument that use of the term "deficiency judgment" or of the words "after the sale" requires that there have been an actual foreclosure sale of the security interest, *the court held that the bar applies to situations in which there was such a sale, as well as those in which a sale would be an idle act because the security is exhausted, as was the case in the controversy at hand.* The contrary construction given the section in *Hillen v. Soulee* was disapproved and reliance was placed upon *Mortgage Guarantee Co. v. Sampsell*, in which the court had stated that the security alone may be looked to for payment of a debt secured by a purchase-money mortgage or deed of trust.

Following the doctrine of *Brown v. Jensen* the courts have clung to the view that section 580b deprives the holder of a purchase-money deed of trust or mortgage of any remedy on the underlying debt against the principal debtor

....

(Riesenfeld, *California Legislation Curbing Deficiency Judgments* (1960) 48 Cal. L. Rev. 705, 711 (*emphasis added; article cited with approval in Bargioni v. Hill* (1963) 59 Cal. 2d 121, 123 (the purposes of section 580b “are served by relieving the purchaser of personal liability to any person who finances the purchase and takes as security a trust deed or mortgage on the property purchased”).)

After *Brown*, in *Roseleaf v. Chierighino*, this Court held that a second mortgage holder *can* pursue a personal judgment against the borrower after a non-judicial foreclosure sale by the first mortgage holder that renders the second mortgage valueless. (*Roseleaf v. Chierighino* (1963) 59 Cal. 2d 35). Section 580d prohibits personal liability following a non-judicial foreclosure sale in virtually all cases. (*Id.* at p. 43.) *Roseleaf* held that section 580d only bars a deficiency judgment by the lender who held the trustee’s sale. The statute does not bar a sold-out junior lender from pursuing the borrower on its note after a foreclosure of the first that wipes out the junior’s lien. (*Id.*)

Nine years later, in *Spangler v. Memel*, this Court considered the argument that *Roseleaf* had overruled *Brown*. (*Spangler v. Memel* (1972) 7 Cal. 3d 603, 609). After all, if section 580d only bars a deficiency to the foreclosing lender and not to a sold-out junior, shouldn't section 580b be similarly limited to the senior lender that held the foreclosure sale? If so, as *Spangler* explicitly argued then and Chase implicitly argues again now, didn't *Brown* err in holding that section 580b applies to a second mortgage when the second lender never foreclosed the second?

This Court answered no to both of these questions and reaffirmed *Brown*. (*Spangler, supra*, 7 Cal.3d at p. 609-611.) The Court quoted *Brown* with approval:

The section [580b] states that *in no event* shall there be a deficiency judgment, that is, whether there is a sale under the power of sale or sale under foreclosure, or no sale because the security has become valueless or is exhausted. (*Brown v. Jensen, supra*, 41 Cal. 2d 193, 198; original italics.)

(*Id.* at p. 609.)

The Court went on to reject the application of *Roseleaf* to sold out purchase money seconds and expressly reaffirm *Brown*: “Thus, we reaffirm our ruling in *Brown v. Jensen* that section 580b by its language

applies to sold-out junior lienors holding a purchase money mortgage or deed of trust.” (*Spangler, supra*, 7 Cal.3d at 610-611.)

In *DeBerard Properties v. Lim* (1999) 20 Cal. 4th 659, 663-664, the Supreme Court again revisited section 580b and the *Brown-Spangler* doctrine. In *DeBerard*, to avoid foreclosure, the borrower and second mortgage lender agreed to reduce the payment and interest rate on the second; the lender would not foreclose and would resubordinate the second to a modification of the first mortgage. (*Id.* at p. 662.) In exchange, the borrowers agreed to waive their protections under section 580b. The borrowers nevertheless defaulted on both loans, the first foreclosed, and the second sued on the note.

This Court held the suit was barred because section 580b’s protections are unwaivable, even in a post-mortgage transaction for new consideration. (*DeBerard, supra*, 20 Cal.4th at p. 670-671.)

The language of section 580b is plain. A vendor is barred from obtaining a deficiency judgment against a purchaser in a purchase money secured land transaction.... “The explicit language of section 580b brooks no interpretation other than that deficiency judgments are prohibited by the purchase money mortgagee so long as a purchase money mortgage or deed of trust is in effect on the original property. To allow a purchase money creditor to circumvent the absolute rule by enforcing a ... waiver of section 580b in exchange for other concessions would [flout] the very purpose of the rule....”

(*Id.* at p. 663, quoting *Palm v. Schilling* (1988) 199 Cal. App. 3d 63, 76, *emphasis added.*)

This Court again reaffirmed *Brown*'s holding that a purchase money mortgage is non-recourse because a lender is deemed to assume the risk that the security will be inadequate: "The one taking ... a [purchase money] trust deed knows the value of his security and assumes the risk that it may become inadequate. Especially does he know the risk where he takes, as was done here, a second trust deed." (*DeBerard, supra*, 20 Cal.4th at p. 668; quoting *Brown, supra*, 41 Cal.2d at p. 259.)

Brown, Spangler, and DeBerard reflect this Court's consistent, unbroken, and to date unquestioned line of authority that section 580b does not require a foreclosure sale, only that the security be exhausted. Section 580b requires the lender to look solely to the security for repayment. Once the security is exhausted, by whatever means, the statute bars the lender from recovering a deficiency from the borrower.³

B. The Language of Section 580b Does Not Require a Foreclosure Sale

³ Indeed, since the Supreme Court decided *Brown* in 1953, the Legislature has amended section 580b four times without any changes to disapprove of *Brown-Spangler-DeBerard* doctrine, and their rejection of the arguments Chase now makes. (Stats. 1963, c. 2158, p. 4500, § 1; Stats. 1989, c. 698, § 12; Stats. 2012, c. 64 (S.B.1069), § 1; Stats. 2013, c. 65 (S.B.426), § 2.)

Nothing in the plain language of the statute requires a foreclosure sale to trigger section 580b's protection. Chase's brief sidesteps the very issue of statutory construction Chase tenders to the Court. Chase begins with the assumption that in section 580b, "[U]nder a deed of trust' modifies the word 'sale,' such that sales performed under the legal power of sale contained in a deed of trust are the only sales covered by the statute." (Reply Brief at 6.) Chase inserts numbers in its quotation of section 580b "for clarity," placing "[1]" after the clause "after a sale of real property or an estate for years therein ..." (*Id.* at p. 5 & n. 5.) Chase does not provide any analysis or justification for these assertions.

Chase does not consider that an alternative legislative intent would be to place Chase's "[1]" *before* the "sale" clause, making the "sale" clause inapplicable to clauses [2] and [3]. This is exactly how the Legislature read section 580b when it amended it in 2012. (Stats.2012, c. 64 (S.B.1069), § 1.) The Legislature reformatted the statutory language at issue here by breaking the identical language from the previous version into three subparts under subsection (a):

- (a) No deficiency judgment shall lie in any event for the following:

(1) *After a sale* of real property or an estate for years therein for failure of the purchaser to complete his or her contract of sale.

(2) *Under a deed of trust* or mortgage given to the vendor to secure payment of the balance of the purchase price of that real property or estate for years therein.

(3) *Under a deed of trust* or mortgage on a dwelling for not more than four families given to a lender to secure repayment of a loan which was in fact used to pay all or part of the purchase price of that dwelling, occupied entirely or in part by the purchaser.

(Emphasis added.) “[A] mere change in phraseology, incident to a revision of . . . the statute, does not result in a change of meaning unless the intent to make such a change clearly appears.” (*Mosk v. Super. Ct.* (1979) 25 Cal. 3d 474, 493 (*superseded on other grounds by Adams v. Comm. on Jud. Performance* (1994) 8 Cal. 4th 630).)⁴

⁴ The change is, in fact, consistent with the expansion of the statute since the 1930’s. When section 580b was first enacted in 1933, it included only the first category: “No deficiency judgment shall lie in any event after any sale under a deed of trust or mortgage given to secure payment of the balance of the purchase price of real property.” (Stats. 1933, c. 642, § 5). Each subsequent amendment added a separate, disjunctive category. (Stats. 1935, c. 68, § 1)(adding the second category, “or under a deed of trust, or mortgage, given to secure payment of the balance of

The 2012 amendment also added new subsection (b), which broadly bars deficiencies on all refinances of purchase money mortgages covered by subsection (a). Subsection (b) does not require any sale: “No deficiency shall be owed or collected, and no deficiency judgment shall lie, on a loan, refinance, or other credit transaction (collectively, a “credit transaction”) that is used to refinance a purchase money loan, or subsequent refinances of a purchase money loan”

The only reasonable interpretation of new subsection (b) is that it extended the already existing protection for original purchase money mortgages under subsection (a) by putting refinanced loans on an equal footing. Historically, purchase money loans had lost purchase money protection when refinanced. (*Union Bank v. Wendland* (1976) 54 Cal.App.3d 393, 400.) Section 580b subd. (b) changed that.

If, as Chase argues, 580b subd. (a) applies to purchase money mortgages only after a foreclosure sale, by omitting the requirement of a foreclosure sale for refinanced purchase money loans, section 580b subd. (b) would lead to the absurd result of suddenly and inexplicably providing refinanced loans *broader* anti-deficiency protection than original purchase money mortgages. (*Flannery v. Prentice* (2001) 26 _____ (adding third category of purchase money protection).)

Cal.4th 527, 578 (“[W]e avoid any construction that would produce absurd consequences”).)

Nor does the passage of section 580e, condemning short sale deficiencies in section 580e, suggest that the Legislature indirectly, implicitly, and paradoxically validated them in section 580b. In enacting section 580e, the Legislature expanded the antideficiency protection to short sales for all the loans covered by section 580d’s post-foreclosure protection. The Legislature enacted section 580e to put short sales under *non-purchase money mortgages* on anti-deficiency parity with the coverage provided after foreclosure by 580d. (Chase’s Motion for Judicial Notice Ex. 1 at pp. 3-4 (section 580e intended to extend anti-deficiency protection to non-purchase money (refinanced) loans; showing disparate results after short sale and foreclosure for *non-purchase money mortgages*.) Therefore, a more rational reading than Chase’s of section 580e is that the Legislature reaffirmed its longstanding antipathy toward residential mortgage deficiencies by expanding the statutory anti-deficiency prospectively to even more loans and borrowers and signaled

no intent to contract its historic non-recourse protection of purchase money borrowers.⁵

C. Section 580b Precludes Chase from Pursuing a Deficiency from Coker Because the Short Sale Exhausted the Security

There is no principled basis for holding short sales exempt from the *Brown-Spangler-DeBerard* doctrine. Coker’s purchase money second was “a standard purchase money transaction” to which section 580b “automatically” applies. (*Spangler, supra*, 7 Cal. 3d at p. 610.) She did nothing more than buy a home to live in using purchase money financing. She did not buy the property as investment or commercial property, did not develop it, and did not refinance it or obtain

⁵ Chase’s argument that section 580e is unique in addressing short sales because it is more “nuanced” and narrower, (Reply Brief at pp. 14, 16-17), is simply incorrect. Section 580e, which governs short sales for “dwellings,” (§ 580e subd. (a)), does not apply to corporations, LLCs, or partnerships. (§580e subd. (d)(1)). But neither does the purchase money protection of section 580b, as it applies only to loans given to secure repayment of a loan for dwellings “occupied entirely or in part by the purchaser.” (§ 580b subd. (a)(3).) Similarly, Chase argues section 580e is narrower because it does not apply where the borrower engaged in fraud or waste (§ 580e subd. (c)), but a longstanding judicial constructions of section 580b hold the same. (*See, e.g., Glendale Fed. Sav. & Loan Assn. v. Marina View Heights Dev. Co.* (1977) 66 Cal App 3d 101, 139 (anti-deficiency statutes no defense to action for fraud); *Cornelison v. Kornbluth* (1975) 15 Cal.3d 390, 602–604 (580b does not bar actions for bad faith waste).

construction financing to materially increase its value. There is nothing distinctive to remove her purchase money mortgage from the mass mainstream of home purchase transactions.

1. Short Sale Is the Functional Equivalent of Foreclosure Because It Exhausts the Security

The short sale exhausted Chase's security for the mortgage.

Chase took everything from the sale after sale and closing costs and taxes; Coker received nothing. (CT 197-98.) The "HUD-1 settlement statement" states that \$375,061.86 was for "Payoff 1st Mortgage Ln. [lien] Chase." (CT 201-202 (line 504); *see also* CT 203 ("Total payoff To: Chase".)) The HUD-1 statement clearly establishes that the payment to Chase was to "pay off" the mortgage, and that Chase released its lien only *in exchange for* receiving the entire net proceeds from the sale. If the sale had not closed, Chase would have remained in the position it was before, with its lien in place. (CT 198 ("If the final closing instructions are not followed in their entirety, the lien will not be satisfied and the proceeds check will be returned."))

Under the *Brown-Spangler-DeBerard* doctrines, there is no basis for treating the short sale that liquidated the security, paid Chase the value of the Coker's home, and cleared title of the Chase lien any differently from a foreclosure sale that liquidated the security for Chase.

It simply makes no difference that the sale that exhausted the security is a consensual “private sale.”

2. There Was No “Destruction” of the Security

Evidently recognizing that *DeBerard* precludes finding a “waiver” of section 580b, Chase argues that a short sale is not an “unlawful waiver,” but a “lawful ‘destruction’ of the security that takes the loan outside the scope of section 580b.” (Chase’s Opening Brief at p. 3; *see also* pp. 10, 13-14.) Chase’s argument is clever, but wrong.

DeBerard broadly holds post-mortgage waivers of section 580b illegal, including Chase’s attempt to hold Coker liable for a deficiency after Chase had exhausted the value of its security (CT 198).

“[D]eficiency judgments are prohibited by the purchase money mortgagee *so long as a purchase money mortgage or deed of trust is in effect on the original property*. To allow a purchase money creditor to circumvent the absolute rule by enforcing a ... waiver of section 580b in exchange for other concessions would [flout] the very purpose of the rule. *If the purchase money creditor retains an interest in the original property, the debtor cannot be held for a deficiency.* (*DeBerard, supra*, 20 Cal. 4th at p. 663, *quoting Palm v. Schilling, supra*, 199 Cal.App.3d at p. 76.)

Chase appears to contend that the italicized language means that *DeBerard* does not apply to an agreement such as a short sale where the lender agrees to release its security.⁶ Chase argues that at that point in the short sale, the mortgage becomes unsecured, and therefore beyond section 580b's regulation of only secured purchase money loans.

(Chase's Opening Brief at pp. 10-11; 13-14.)

The flaw in this argument is that the short sale did not destroy Chase's security; it realized and exhausted it. There was never a moment when, as Chase argues, the "*the agreement* to release the security interest transform[ed] [the] secured purchase money loan to an unsecured loan,"

⁶ Chase also suggests that this Court's quotation of *Palm v. Schilling*, *supra*, 199 Cal.App.3d at page 663 of the opinion supports Chase's unduly narrow reading of *DeBerard*. (Chase's Opening Brief at p. 3, 11.) There, the Court quoted *Palm* as saying "If the purchase money creditor does not wish to accept the risk that the property will be lost through foreclosure by another secured creditor, the remedy is to either foreclose himself or destroy the purchase money nature of the transaction..." (Ellipsis in original.) However, the full quotation of *Palm*, which appears on page 668 of the *DeBerard* opinion, contains an important qualification that Chase omits: "the remedy is to either foreclose himself or destroy the purchase money nature of the transaction *by reconveying the deed or mortgage on the original real estate in exchange for the substitution of other security.*" (*Palm v. Schilling*, *supra*, 199 Cal.App.3d at p. 76, 244 Cal.Rptr. 600.)" (Emphasis added.) Here, there was no substitution of the original security for other security; rather, the original security was exhausted.

(Chase Opening Brief at p. 8 (emphasis added)), and Ms. Coker owned the property free of Chase's lien, leaving Chase entirely unsecured. Chase's lien remained in place up to the point the sale closed and Chase received over \$375,000 in satisfaction of its lien.⁷ At that point, the security having been exhausted, Chase had only an unsecured claim for a deficiency. Section 580b barred Chase from seeking to enforce its unsecured deficiency claim against Coker personally. (*E.g.*, *Spangler, supra*, 7 Cal. 3d at p. 609 (unsecured deficiency claim of sold-out junior whose lien was wiped out by senior foreclosure sale held barred by section 580b).)

3. No Exception to 580b Applies

Coker's loan does not fall within any "exception" to 580b. This Court has narrowly construed "exceptions" to 580b and recognized only one relevant here: where a buyer materially increases the value of the property by commercially developing it and subordinating the purchase money debt to a senior construction loan to provide the funding for the new construction and intensified use. (*Spangler, supra*, 7 Cal. 3d at pp. 613-615; *DeBerard, supra*, 20 Cal. 4th at p. 666 ("Spangler's rule is

⁷ The lien was not actually reconveyed until a month after the sale closed. (CT 50-52 (July 22, 2010 closing); CT 54 (August 20, 2010 Substitution of Trustee and Full Reconveyance).

limited to those situations in which a pronounced intensification of the property's anticipated post-sale use both requires and eventually results in construction financing that dwarfs the property's value at the time of sale”); *Jack Erickson and Associates v. Hesselgesser* (1996) 50 Cal. App. 4th 182, pp. 186-187 (applying *Spangler* where the borrower bought the property for investment purposes and subordinated a purchase money second to a \$300,000 construction loan from Union Bank.)

Jack Erickson did not create a “short sale” exception to 580b. *Jack Erickson* was an application of the *Spangler* exception. (50 Cal. App. 4th at pp. 186-189 (distinguishing *Palm v. Schilling* on the ground it did not involve a change in use or a subordination to a construction loan).) The lone sentence in *Jack Erickson* that could remotely be read as beyond the *Spangler* exception is “A second waiver [of section 580b] occurred when he induced respondent to execute a deed of reconveyance and sold the property.” (*Jack Erickson, supra*, 50 Cal. App. 4th at pp. 188-89.) The Court ventured no discussion or analysis to support or justify this statement beyond the application of *Spangler* to the facts before it.

To the extent *Jack Erickson* can be read, as Chase does, to hold that a borrower can waive section 580b merely by “inducing [a lender] to reconvey the deed of trust so that the borrower can sell the property,”

(Chase Reply at 9), this Court disapproved it three years later in *DeBerard*: “*Spangler*, however, creates only a narrow exception to the scope of section 580b, and we decline to create another one here.” (*DeBerard, supra*, 20 Cal. 4th at p. 664.) *DeBerard* reaffirmed *Brown*, outlawed waivers of section 580b beyond the *Spangler* exception, and disapproved *Russell v. Roberts* (1974) 39 Cal.App.3d 390. (*DeBerard*, 20 Cal. 4th at 661-62.)

DeBerard precludes accepting *Jack Erickson* as validating a bald waiver of section 580b in exchange for a lien release by a purchase money lender. Chase’s reading that *Jack Erickson* creates a broad short sale exception to section 580b distorts this Court’s language in *DeBerard*, radically departs from its consistent application of section 580b in *Brown*, *Spangler*, and *DeBerard*, and opens the door to the mischief of virtually any post-mortgage waiver of the statute. Therefore, *Jack Erickson* should be limited to an application of *Spangler* and disapproved to the extent it can be read to validate waivers beyond the *Spangler* exception.

II. Chase’s Theory that Short Sale is a Balanced, Mutually Beneficial Agreement to Release the Lien in Exchange for Deficiency Collection Does Not Match the Reality of Short Sale

A fundamental, if unspoken, premise of Chase's central theory is that short sale is a transaction between two rational actors, making informed decisions to alter their contractual rights and "destroy" the security in exchange for deficiency liability. In practice, this is not the case. Distressed homeowners have little information about their rights and the effect of the transaction they are entering into, and the lender has the upper hand.

A. Short Sales Primarily Benefit the Lender

Since the foreclosure crisis, mortgage servicers' use of short sales as an alternative to foreclosure in California has grown exponentially, and now represents a much larger share of total forfeiture actions.⁸

⁸ In the first quarter of 2008, foreclosures made up 94% of home forfeiture actions for first lien residential mortgages serviced by select national banks and a federal savings association reviewed by the Office of the Comptroller of the Currency. (Off. of Comptroller of the Currency and Office of Thrift Supervision, *OCC and OTS Mortgage Metrics Report for the Third Quarter of 2008* (2008) p. 6 < <http://www.occ.gov/publications/publications-by-type/other-publications-reports/mortgage-metrics-q3-2008/mortgage-metrics-q3-2008-pdf.pdf>> [sic] (as of August 18, 2014)). Short sales and deed-in-lieu-of-foreclosure actions together constituted the remaining 6%. (*Id.*) By the fourth quarter of 2012, the balance had shifted dramatically: foreclosures made up 63% of forfeiture actions and short sales made up 36%. (Off. of Comptroller of the Currency and Office of Thrift Supervision, *Mortgage Metrics Report for the Fourth Quarter of 2012* (2012) p. 8, <<http://www.occ.gov/publications/>

Lenders release their liens in exchange for receiving less than the debt owed them, for good reason: short sales immediately realize the value of “under water” properties for lenders, without the delay, costs, and risks of foreclosure sales.

The statutory foreclosure procedure takes months, and failure to adhere to it can create legal risks. More significantly, foreclosure usually results in the lender buying the property by successfully credit bidding at the sale.⁹ After a bank purchases its security at a foreclosure sale, it takes the property into the lender’s “real estate owned” or “REO” inventory. Once the property becomes REO, the lender bears full responsibility for ongoing property maintenance, repairs, and upkeep, taxes, insurance, and liability, frequently for vacant properties. The

[publications-by-type/other-publications-reports/mortgage-metrics-2012/mortgage-metrics-q4-2012.pdf](#)> (as of August 18, 2014). *See also* Cal. Senate Banking and Financial Institutions Comm. Analysis of S.B. 412 (2011-2012 Reg. Sess.) (March 12, 2011) at 3.

⁹ In 2011-13, sales of bank-owned properties outnumbered private purchase at foreclosure sales by about 10:1. RealtyTrac, *Short Sales and Foreclosure Sales Combined Accounted for 16 Percent of U.S. Residential Sales in 2013* (January 23, 2014), <<http://www.realtytrac.com/content/foreclosure-market-report/december-and-year-end-2013-us-residential-and-foreclosure-sales-report-7967>> (as of August 19, 2014).

property value may slide even further during vacancy.¹⁰ The lender must prepare the property for market, which includes evicting tenants, repairing damage and rendering the property presentable and marketable to the public. Then, the lender must list the property for an REO sale and find a buyer.

The entire REO sales process, which can be lengthy, especially in a depressed market, must occur before the lender realizes any money whatsoever after a foreclosure sale where the lender has credit bid to purchase. In contrast, short sale enables the lender to realize the value of the security immediately; the bank “trades a slow moving or greatly depreciated asset for liquidity.”¹¹ Short sale avoids delay, evictions, repairs, and carrying the property in inventory and marketing the property itself,¹² saving an estimated \$50,000 or more per property.¹³

¹⁰ Miller, *Short Sales Overview with an Emphasis on Broker Issues*, (2010) 26(3) Prac. Real Est. Law 9.

¹¹ *Ibid.*

¹² Chase Motion for Judicial Notice Exh. 1 at p. 6 (short sales “save banks millions in foreclosure costs and costs associated with REO properties).

¹³ Chase Motion for Judicial Notice Exh. 4, at p. 66 of 271.

In comparison, short sales provide few tangible benefits to homeowners over foreclosure, if any. Although real estate agents desperate for business in the post-crash economy frequently touted short sales as a means of preserving borrowers' credit rating, in reality, there is little difference between the effects of short sale and foreclosure on credit score for most borrowers. Fair Isaac Corporation ("FICO"), whose credit scoring system is considered the standard measure of consumer credit risk, compared the impact on credit score for mortgage delinquency, short sale, foreclosure, and bankruptcy in a 2011 report and found that there is "no significant difference in score impact between short sale/deed in lieu/settlement and foreclosure" – particularly where the short sale left a deficiency.¹⁴ A 2010 study by Vantage Score similarly found that little

¹⁴ Gaskin, *Research Looks at How Mortgage Delinquencies Affect Scores*, FICO Banking Analytics Blog, (May 24, 2011) <<http://bankinganalyticsblog.fico.com/2011/03/research-looks-at-how-mortgage-delinquencies-affect-scores.html>> (as of August 20, 2014); see also Elmer, *Speeding Up Short Sales*, N.Y. Times (May 24, 2012), <<http://www.nytimes.com/2012/05/27/realestate/mortgages-speeding-up-short-sales.html>> (as of August 19, 2014) (director of Experian, one of the major credit bureaus, explains the "misperception" that short sales are "easier on credit scores" than foreclosures; real difference in impact is "slight"); California Dept. Real Estate, *Loan Modification Self Help Guide*, (July 2011) (hereafter "*Loan Modification Self Help Guide*") at 5 <www.dre.ca.gov/files/pdf/re21.pdf> (as of August 20, 2014) (warning,

difference in effect: short sale decreased credit score by 120 to 130 points, while foreclosure reduced it by 130 to 140.¹⁵

Short sale can, in fact, have negative effects. As the legislative history of § 580e shows (*see, e.g.*, Chase Motion for Judicial Notice, Exh. 1 at pp. 4-6), before that statute was enacted, borrowers with refinanced (that is, recourse) loans could end up with far more liability after short sale than after foreclosure. The California Department of Real Estate has warned that other negative effects of short sale, such as added tax liability, can also harm sellers.¹⁶

in “homeowner beware” section, that “[a] short sale does not necessarily look better on your credit report than does a foreclosure”). The legislative history Chase cites for its claim that short sales enable borrowers “to avoid long-term negative credit consequences,” (Chase Opening Brief at p. 5), does not support this proposition; instead, it states only that the report of a “settled debt” helps homeowners feel they took responsibility. (Chase Motion for Judicial Notice, Exh. 4, December 16, 2009 Letter by Shanna Welsh.)

¹⁵ VantageScore, *Impact on Consumer VantageScore Credit Scores Due to Various Mortgage Loan Restructuring Options*, (January, 2010) pp. 8, 9, <www.vantagescore.com/docs/loan_restructuring_options.pdf> (as of August 20, 2014).

¹⁶ Bell and Tutera, *Short Sales -- An Overview and Warning to Real Estate Licensees Re: Fraud, and Legal and Ethical Minefields*, (2010) California Department of Real Estate, at 7, <www.dre.ca.gov/files/pdf/Article_ShortSales03_2010.pdf> (as of August 20, 2014) (agent’s fiduciary to seller includes explaining risks of short sale).

Moreover, during the foreclosure crisis, many consumers faced high-pressure tactics to enter into short sales from unscrupulous real estate agents or scammers who did not fully explain the process.¹⁷ Homeowners already in arrears on their mortgage are particularly vulnerable, facing financial hardship and the stress of a looming foreclosure, and lack the financial resources to hire financial, legal, or tax experts to advise them.¹⁸ After their financial condition becomes public record when the lender records a Notice of Default, homeowners are frequently inundated with offers of “help” from not only foreclosure rescue scams, but real estate agents pushing short sale who stand to make a commission. Often, only the “most conscientious real estate

¹⁷ Bell and Tutera, *supra*, at p. 7; California Dept. Real Estate, *Warning Regarding Residential Short Sales* (April 2010), <http://www.dre.ca.gov/files/pdf/ca/2010/ConsumerAlert_ShortSales.pdf> (as of August 20, 2014) (warning companies soliciting distressed homeowners may be scams); *Loan Modification Self Help Guide*, *supra*, at p. 5 (discussing short sales).

¹⁸ California Association of Realtors, *Short Sale Fraud*, Q. 3; <<http://www.car.org/legal/foreclosure-short-sale-folder/short-sale-fraud-and-scams/?view=Print&url=http://www.car.org/legal/foreclosure-short-sale-folder/short-sale-fraud-and-scams/>> (as of August 19, 2014).

professionals” insist that borrowers seek legal advice to assess potential outcomes.¹⁹

Chase’s claim that borrowers “can always escape personal liability by refusing to agree to a short sale and compelling the lender to invoke foreclosure” therefore rings hollow. (Opening Brief at 18). This argument assumes that homeowners facing foreclosure have access to neutral, accurate legal advice. Chase’s fiction that borrowers voluntarily make an “informed choice” when they agree to deficiency collection in exchange for being allowed to sell short, (*id.*), and its suggestion that this is somehow an even trade, ignores the practical reality of most borrowers considering short sale after the foreclosure crisis.

B. The Lender Controls Short Sale

Even Chase’s theory of short sale – that the lender releases and destroys the security interest *at the request of the borrower* so that the borrower can sell the property, (Chase Opening Brief at 8) – is misleading about who controls whether short sale will resolve delinquency, and inconsistent with the true mechanics of short sale.

First, the lender (or its mortgage servicer agent) has complete veto power and therefore ultimately controls the short sale process. A lender

¹⁹ Chase Motion for Judicial Notice, Exh. 4, Letter from Shanna Welsh to Nadia Leal re: S.B. 931 (Dec. 16, 2009) at p. 69 of 271.

has no legal obligation to accept less than full repayment of an outstanding debt, so a lender's agreement to a short sale is strictly voluntary.²⁰

Most lenders require the borrower to demonstrate that they have experienced financial hardship and that default or foreclosure is imminent before they will consider approving a short sale.²¹ The lender

²⁰ Miller, *Short Sales Overview with an Emphasis on Broker Issues, supra*, p. 10; Bernhardt, *1 Mortgages, Deeds of Trust, and Foreclosure Litigation* § 7.21A, p. 536 (4th Ed. 2013). The California Association of Realtors even warns in its "Short Sale Addendum" Form that the lender holds the reins:

NO ASSURANCE OF LENDER APPROVAL. Buyer and Seller understand that Short Sale Lenders...are not obligated to give consent to a short sale... Short sale lenders may require that, in order to obtain their approval for a short sale, some terms of the Agreement such as the Close of Escrow, be amended... Buyer, Seller and Brokers do not have control over whether Short Sale Lenders will consent to a short sale, or control over any act, omission, or decision by any Short Sale Lender in the short sale process.

(CT 40 (Coker Short Sale Addendum)).

²¹ Miller, *Short Sales Overview with an Emphasis on Broker Issues, supra*, at p. 10; Brumfield, *The 'Short Cut' to the Stabilization of the Underwater Housing Market: How the New FHFA Short Sale Guidelines Promote Economic Efficiency* (2012) 41 *Real Est.L.J.* 456, 462 (hereafter "*The Short Cut*") (have to demonstrate financial difficulty). While Chase argues that borrowers have incentive to default

performs an analysis based on the borrower's finances, the market value of the property, and other factors (similar to the Net Present Value or "NPV" analysis in loan modification) to determine whether short sale is more favorable to the lender than foreclosure.²² The lender approves the price of the home, and may even require the seller to counter a purchase offer with a higher price, as it did Ms. Coker.²³ If the lender believes that

"strategically," this financial review allows the lender to deny short sale if it believes the financial hardship is not genuine. If there are other means lender to collect the full value of the loan, for example, if the borrower has significant assets in stock or savings or has a high salary, the lender may well pursue those alternative means of collection rather than approve a short sale, or simply proceed to foreclosure.

²² Guidelines for the federal Making Home Affordable program governing short sales, Home Affordable Foreclosure Alternatives ("HAFA"), for instance, note that some form of "Expected Recovery Analysis" is typical: "Although not a HAFA requirement, it is expected that servicers will, in accordance with investor guidelines, perform a financial analysis to determine if a short sale or DIL is in the best interest of the investor, guarantor and/or mortgage insurer." Fannie Mae, *Making Home Affordable Handbook v. 4.4*, Chapter § 6.1.3, page 170, <https://www.hmpadmin.com/portal/programs/docs/hamp_servicer/mhahandbook_44.pdf> (as of August 20, 2014); Brumfeld, *The Short Cut, supra*, at p. 462 (lenders accept short sale where the outcome is better than foreclosure).

²³ The buyer offered in March, 2010 to purchase the property for \$375,000. (CT 46). Ms. Coker made a counteroffer on May 5, 2010: "Per negotiator, sales price to be \$400,000." (CT 44). The Buyer counteroffered for \$380,000 including the deposit, (CT 42), and the final

the proposed sale price does not fairly reflect the market value of the security, or provide sufficient financial benefit to the lender, the lender can disapprove the short sale. Finally, the lender imposes the requirement that the entire sale proceeds go to the lender: in Chase’s own pithy language, “[t]he borrower (seller) must net zero.” (CT 47).

In practice, short sale is simply not an individually negotiated transaction between parties of equal bargaining power and information.

III. The Court Should Promote the Legislative Intent to Provide Systemic Market Stabilization by Finding 580b Bars Chase from Pursuing Deficiency on Purchase Money Loans After Short Sale

The purposes of section 580b were two-fold: (1) preventing overvaluation of real estate at the time of sale; and (2) providing stabilization in economic downturns by exonerating defaulting purchasers from large personal liabilities. (*DeBerard, supra*, 20 Cal. 4th at 664.) Upholding the this Court’s longstanding principle that section 580b makes purchase money loans non-recourse and bars Chase from pursuing a deficiency, no matter how the security is exhausted, promotes each of these objectives.

counter was “Purchase Price to be \$400,000, including deposit.” (CT41). The sale closed for \$400,000. (CT 50-52).

A. Anti-Deficiency Protection Stabilizes the Market by Discouraging Lender Speculation

California's anti-deficiency protections may be grouped into "fair value" and "purchase money" limitations.

The "fair value" limitations restrict the amount of the deficiency a lender can recover from the borrower to the excess of the debt over the "fair value" of the real property security at the time of the foreclosure sale, regardless of the foreclosure sale price. (Code Civ. Proc., §§ 580a, 726(b).) "Fair value provisions are designed to prevent creditors from buying in at their own sales at deflated prices and realizing double recoveries by holding debtors for large deficiencies." (*Roseleaf, supra*, 59 Cal.2d at p. 40.)

Section 580d, which prohibits the recovery of any deficiency after a non-judicial foreclosure sale, is closely related to the fair value limitations and best fits in that category. Section 580d is a "parity" statute, intended to put non-judicial foreclosure sales on an equal footing with judicial foreclosure sales. (*Roseleaf, supra*, 59 Cal. 2d at 43.) Before section 580d, lenders had no incentive to buy the security at deflated prices at a judicial foreclosure sale because the borrower had a

one-year right to redeem the property at the foreclosure sale price.²⁴

(*Ibid.*) There was no right of redemption after a non-judicial sale. (*Ibid.*)

Section 580d was intended to address this discrepancy, and achieved parity between judicial and non-judicial foreclosure sales by eliminating any right to a deficiency after a non-judicial sale:

By choosing instead to bar a deficiency judgment after private sale, the Legislature achieved its purpose without denying the creditor his election of remedies. If the creditor wishes a deficiency judgment, his sale is subject to statutory redemption rights. If he wishes a sale resulting in nonredeemable title, he must forego the right to a deficiency judgment. In either case the debtor is protected.

(*Roseleaf, supra*, 59 Cal. 2d at pp. 43-44.)

The Legislature had an entirely different purpose in enacting section 580b, the “purchase money” limitation. While the fair value limitations protect the borrower against unfairness during the foreclosure sale process, the purchase money limitation protects *the market* against speculative overvaluation at the time of the loan transaction itself.

Section 580b helps deter real estate “bubbles” by putting the entire risk of

²⁴ The borrower could arrange a sale at market value within a year and simultaneously exercise the right of redemption, thereby depriving the lender of the advantage of its below-market foreclosure purchase price.

the inadequacy of the security to pay the loan on the parties providing financing for real property purchases:²⁵

Section 580b places the risk of inadequate security on the purchase money mortgagee. A vendor is thus discouraged from overvaluing the security. Precarious land promotion schemes are discouraged, for the security value of the land gives purchasers a clue as to its true market value. If inadequacy of the security results, not from overvaluing, but from a decline in property values during a general or local depression, section 580b prevents the aggravation of the downturn that would result if defaulting purchasers were burdened with large personal liability. Section 580b thus serves as a stabilizing factor in land sales.

(Roseleaf, supra, 59 Cal. 2d at 43 (citations omitted).)

Section 580b promotes market stabilization by influencing lender decision-making at the time of loan underwriting. Knowing that it must look only to the security, the lender will exercise greater diligence in valuing the security and limiting the loan amount accordingly, or suffer consequences. If lenders limit credit to avoid anti-deficiency exposure against overvaluation, fewer properties will be sold at speculative values and the market is protected as the Legislature envisioned.

²⁵ Section 580b applies both to seller carrybacks, whether in the form of an installment sale contract or conventional carryback mortgage (§ 580b subd. (a)(1), (2)), and conventional mortgage financing by third parties, *e.g.*, banks like Chase, when providing purchase money financing for owner-occupied residences of four units or less (§580b subd. (a)(3)).

Opening a short sale loophole to this Court’s longstanding principle that the lender must look solely to the security for repayment of a purchase money mortgage would significantly water down the Legislature’s policy of enlisting loan underwriting as a hedge against speculation in the mass residential real estate market. Giving lenders a “short sale out” disserves this policy without any countervailing justification.

Chase offers a various arguments that applying section 580b protection after short sale will not deter overvaluation of property. Each fails. First, Chase argues that in the future, no lenders will be deterred from overvaluing property in the future by section 580b, since any deterrence will already be accomplished by section 580e, so that this Court’s construction of section 580b will affect only loans already originated. (Chase Opening Brief at 18-19). But this Court does not ignore the statutory purpose unless it can literally “effectuate” that purpose in the future with its decision. Instead, the statutory purpose acts as an aid to construction . (See, e.g., *DiCampli-Mintz v. County of Santa Clara* (2012) 55 Cal. 4th 983, 992 (statute “must be given a reasonable and common sense interpretation *consistent with the apparent purpose and intention of the lawmakers*” (emphasis added)). The statutory

purpose of deterring speculation remains crucial to this Court’s analysis of section 580b.

Chase argues twice that anti-deficiency protection promotes “strategic default” in general, so that allowing anti-deficiency protection after short sales would destabilize the economy even further by creating even more “strategic default.” (Reply at 19, 21). However, as set out above, lenders require proof of genuine economic hardship before they approve a short sale, and control the process in its entirety; lenders can simply refuse to approve a sale that appears to be “strategic” or not driven by financial need.²⁶

B. Applying Section 580b to Short Sales Stabilizes the Market by Protecting Borrowers Who Have Lost their Homes from Crushing Debt

The Court’s decision in this case can further the Legislature’s *primary* goal in enacting section 580b: to protect defaulting purchasers from unmanageable debt burdens and so avoid worsening the economic crisis. As this Court has repeated:

The primary purpose of section 580b is ‘in the event of a depression in land values, to prevent the aggravation of the

²⁶ If “strategic default” is a material risk, Chase should take that possibility into account when underwriting purchase money loans, not after-the-fact by asking the Court to exonerate it from a risk Chase should have foreseen when making the loan.

downturn that would result if defaulting purchasers lost the land and were burdened with personal liability.’ (*Bargioni v. Hill*, [(1963)] 59 Cal.2d 121, 123....)

(*Cornelison*, *supra*, 15 Cal.3d at p. 603.)

Borrowers who lost their homes in recent years are singularly ill-equipped to deal with deficiency debt. Borrowers who short sold had already proved to their lenders that they were experiencing financial hardship at the time of sale. But that hardship continues for many. Middle income households were the hardest-hit by the drop in housing prices,²⁷ and overall wealth declined more for middle income families than high income families,²⁸ while middle class debt rose sharply.²⁹ With

²⁷ In general, the recession “hit the already disadvantaged especially hard.” Ellen and Dastrup, *Housing and the Great Recession* (October, 2012) Russell Sage Foundation and Stanford Center on Poverty and Inequality, at 4 <https://www.stanford.edu/group/recessiontrends/cgi-bin/web/sites/all/themes/barron/pdf/Housing_fact_sheet.pdf> (as of Aug. 21, 2014)

²⁸ Data on relative wealth decline across socioeconomic groups demonstrates that wealth declined more in income households than in high income households. Between 2007 and 2009, net wealth declined by 12.8% for the 95th percentile of the population, by 28% for the 50th percentile, and by 60.9% for the 25th percentile. Pfeffer, Danziger, and Schoeni, *Wealth Levels, Wealth Inequality, and the Great Recession* (June 2014) Russell Sage Foundation <http://www.stanford.edu/group/scspi/_media/working_papers/pfeffer-danziger-schoeni_wealth-levels.pdf> (as of August 20, 2014). For the

national unemployment rates still high, many families continue to experience income instability.³⁰

The financial crisis had a devastating effect on the elderly. The rate of foreclosure among homeowners over 65 was nearly ten times higher in 2011 than it was in 2007.³¹ Older workers were also among the hardest hit with job loss, making delayed retirement difficult.³² Many had planned to cash out home equity to finance retirement, but found it

5th percentile of the population, which was already in debt and had no wealth, indebtedness increased by 105.4%. *Ibid*; see also Wolff, *The Asset Price Melt-Down and the Wealth of the Middle Class* (2013) US2010 PROJECT, PP. 5-6 <<http://www.s4.brown.edu/us2010/Data/Report/report05012013.pdf>> (as of August 20, 2014).

²⁹ Wolff, *Asset-Price Melt-Down*, *supra*, at pp. 4, 8-9, 11.

³⁰ Danziger, *Evaluating the Effects of the Great Recession*, (2013) 650 ANNALS OF THE AMERICAN ACADEMY OF POLITICAL AND SOCIAL SCIENCES 6, 13-17, <<http://sagepub.com/content/650/1/6>> (as of August 20, 2014).

³¹ Consumer Finance Protection Bureau, *Snapshot of Older Consumers and Mortgage Debt* (May 2014) (hereafter “*Snapshot of Older Consumers*,”) at 11 <<http://www.consumerfinance.gov/reports/snapshot-of-older-consumers-and-mortgage-debt/>> (as of August 20, 2014).

³² Munnell and Rutledge, *The Effects of the Great Recession on the Retirement Security of Older Workers* (2013) 650 ANNALS OF THE AMERICAN ACADEMY OF POLITICAL AND SOCIAL SCIENCES 124, 134-136.

wiped out. The recession caused six years of negligible returns on retirement investment portfolios.³³ With the simultaneous drops in the stock and housing markets and sharp declines in interest rates on savings, these sources of wealth were wiped out, leaving seniors financially fragile and particularly unable to recover from losing their homes.³⁴

Allowing deficiency judgments against families who have just lost their homes, whether to foreclosure or short sale, would cause both individual hardship and aggravate the economic recession. Anti-deficiency laws were established to protect from a spiral of economic downturn.³⁵ During the great depression of the 1930s, deficiency

³³ *Id.* at p. 128

³⁴ *Snapshot of Older Consumers, supra, at p. 11-12*; Tawinsi, *Nightmare on Main Street: Older Americans and the Mortgage Crisis* (July, 2012) AARP Public Policy Institute <http://www.aarp.org/content/dam/aarp/research/public_policy_institute/cons_prot/2012/nightmare-on-main-street-AARP-ppi-cons-prot.pdf> (as of August 19, 2014)

³⁵ Perlman, *Mortgage Deficiency Judgments during an Economic Depression* (1934) 20 Virginia L. Rev. 771, 771 (hereafter “*Mortgage Deficiency Judgments*”); Poteat, *State Legislative Relief for the Mortgage Debtor During the Depression* (1938) 5 Law and Contemporary Problems 517, 517-544, <<http://scholarship.law.duke.edu/lcp/vol5/iss4/4>> (as of August 21, 2014).

judgments against mortgage debtors were recognized to have a severe economic impact on the surrounding community.³⁶

They do so today as well. Deficiency judgments trigger personal bankruptcies; foreclosure or short sale and bankruptcy have proven to be complements.³⁷ When facing a deficiency judgment, a debtor logically turns to bankruptcy to discharge personal liability and to protect non-real-estate assets.³⁸ A 2014 study of defaulted loans originated between 2005 and 2007 found that personal bankruptcy rates were significantly higher in states that allowed deficiency judgments.³⁹ A second study tracked mortgages originated in 2004 and 2005 found that bankruptcy filings generally occurred *after* mortgage defaults, and concluded that borrowers

³⁶ Perlman, *Mortgage Deficiency Judgments*, *supra*, p. 771; Kwan, *Mortgagor Protection Laws: A Proposal for Mortgage Foreclosure Reform in Hawai'i* (2001) 24 U. Haw. L. Rev. 245, 258, 265-267 (hereafter "*Mortgagor Protection Laws*").

³⁷ Li and White, *Mortgage Default, Foreclosure, and Bankruptcy* (2009) (National Bureau of Economic Research) <<http://www.nber.org/papers/w15472>> (as of August 21, 2014)

³⁸ Kwan, *Mortgagor Protection Laws*, *supra*, 24 U. Haw. L. Rev. pp. 265-267.

³⁹ Demiroglu, Dudley, and James, *State Foreclosure Laws and the Incidence of Mortgage Default* (2014) 57 Journal of Law and Economics 225, 232, 263-64.

file for bankruptcy as a protective measure to shield non-real-estate assets and overall reduce the cost of losing their home.⁴⁰

Forcing former homeowners to file bankruptcy to discharge or ward off deficiency judgments and protect their remaining assets further slows the economy, because such debtors will discharge all other debts in their bankruptcy, hurting all other creditors.⁴¹ “[O]nce the bankruptcy barrier is breached, there is no reason to hold back or work extra hours in order to pay any debt that can be extinguished. The entire local economy and its rebounding potential will suffer from the resulting write-offs.”⁴²

Even if deficiency debt does not force households into bankruptcy, it makes recovery more difficult for both the individual and the economy

⁴⁰ Li and White, *Mortgage Default, Foreclosure, and Bankruptcy supra*, pp. 3-5.

⁴¹ Mixon and Shepard, *Antideficiency Relief for foreclosed homeowners: ULSIA Section 511(b)* (1992) 27 Wake Forest L.Rev. 455, 474.

⁴² *Ibid*; Mixon, *Deficiency Judgments following Mortgage Foreclosures: An Anachronism that Increases Personal Tragedy, Impedes Economic Recovery, and Means Little To Lenders* (1991) 22 Texas Tech. L. Rev. 1, 8.

as a whole.⁴³ Deficiencies, whether reduced to judgment or not, impair access to credit that can help families recover from financial distress. In many instances, prospective creditors make decisions about the availability and cost of credit based solely on credit score.⁴⁴ The total amount a person owes makes up thirty percent of his or her credit score,⁴⁵ and credit score is directly affected by whether a deficiency is reported. Research by FICO, which sets the credit scoring standard, shows that report of a deficiency balance has a measurable negative effect on an

⁴³ Summers, *Lawrence Summers on 'House of Debt*, Financial Times, (June 6, 2014) p. 2 (over-indebted households slow the growth of the economy).

⁴⁴ Consumer Finance Protection Bureau, *Key Dimensions and Processes in the U.S. Credit Reporting System* (December 2012) p. 10, <http://www.consumerfinance.gov/f/201212_cfpb_credit-reporting-white-paper.pdf> (as of August 21, 2014);

⁴⁵ Fair Isaac Corporation, *What's In My Score*, <<http://www.myfico.com/CreditEducation/WhatsInYourScore.aspx>> (as of August 21, 2014); Federal Reserve Board, *Report to the Congress on Credit Scoring and Its Effects on the Availability and Affordability of Credit* (August 2007) p. 25 <<http://www.federalreserve.gov/boarddocs/rptcongress/creditscore/>> (as of August 21,2014) ((same)).

individual's credit score, with a deficiency balance making the score after a short sale up to 35 points lower.⁴⁶

This Court should promote the Legislature's intent to soften the impact on individuals of losing a home, particularly where the loss reflects widespread recession or unfettered and unreasoned expansion by the lending industry.

The recent history of the housing market is an object lesson in the importance of reigning in lenders and discourage them from feeding speculation. The years immediately preceding the 2008 economic crisis saw a spectacular inflation of property values, fueled by the expansion of credit available for both purchase and refinancing.⁴⁷ As investors

⁴⁶ Gaskin, *Research Looks at How Mortgage Delinquencies Affect Scores*, *supra*; Zillow, *Effects of Foreclosure on Your Credit Rating* <<http://www.zillow.com/foreclosures/owner/how-foreclosure-affects-your-credit-rating/>> (as of August 21, 2014) ("The impact of a foreclosure, short sale or deed in lieu could be less severe if your current mortgage lender does not report a deficiency balance on your loan to credit reporting agencies. (A deficiency is the difference between your unpaid mortgage balance and the proceeds from a foreclosure, short sale or deed in lieu.)") In general, lingering defaulted debt slows the recovery of credit scores, while reduction in overall debt helps. VantageScore, *Impact on Consumer VantageScore Credit Scores*, *supra*, pp. 8,9.

⁴⁷ See generally National Comm. on the Causes of the Financial and Economic Crisis in the United States, *The Financial Crisis Inquiry*

searched for high-yield assets, including exotic mortgage-backed securities,⁴⁸ lenders relaxed underwriting standards, drastically expanding subprime lending,⁴⁹ issuing loans with little or even no income documentation,⁵⁰ using inflated appraisals,⁵¹ and requiring less and less money down, even allowing “piggyback” first and second loans that covered the entire value of the home, leaving the homeowner with no

Report (hereafter “*Financial Crisis Inquiry Report*”)(Jan. 2011), pp. 3-5, 17, 83-84, 102–03, 156-157, <<http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf>> (as of August 21, 2014); Wolff, *The Asset-Price Meltdown*, *supra*, p. 3.

⁴⁸ *Financial Crisis Inquiry Report*, *supra*, pp. 102-103.

⁴⁹ Between 2001 and 2006, subprime mortgages jumped from 8.6% to 20.1% of all mortgages originated. Joint Center for Housing Studies of Harvard Univ., *The State of the Nation’s Housing* (hereafter “*State of the Nation’s Housing*”)(Jun. 11, 2007), pp. 3, 17, <<http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/son2007.pdf>> (as of August 21, 2014).

⁵⁰ *Financial Crisis Inquiry Report*, *supra*, pp. 110-11.

⁵¹ *See, e.g.*, Senate Judiciary Comm., Analysis of S.B. 223 (2007-2008 Reg. Sess.) May 8, 2007 pp. 2, 5-7 (analyzing need for legislation prohibiting undue influence on appraisers, noting the prevalence of inflated appraisals, and noting that inflated appraisals lead to more loan defaults).

equity.⁵² This ready lending spurred increased demand for homeownership, which in turn pushed home prices ever upward.⁵³

These lending practices exacerbated the effects of the recession on the housing market.⁵⁴ When the bubble burst in 2007, housing prices plunged approximately 33% nationwide following their 2006 peak, a drop not seen since the Great Depression.⁵⁵ Millions lost their homes, and the damage caused by the foreclosure crisis persists to this day. Nearly 20% of homeowners nationwide were still underwater in 2013, although that figure persists above 25% in low-income areas and minority neighborhoods.⁵⁶ These borrowers remain at risk, since without

⁵² *Financial Crisis Inquiry Report, supra*, pp. 110-11.

⁵³ *Financial Crisis Inquiry Report, supra*, p. 83.

⁵⁴ Gerardi, Ross, and Willen, *Understanding the Foreclosure Crisis* (2011) 30(2) *Journal of Policy Analysis and Management* 382, 385; Ellen and Dastrup, *Housing and the Great Recession, supra*, p. 1

⁵⁵ Federal Reserve Board, *The U.S. Housing Market: Current Conditions and Policy Considerations* (2012) (hereafter “*The U.S. Housing Market*”) p. 3 <<http://www.federalreserve.gov/publications/other-reports/files/housing-white-paper-20120104.pdf>> (as of Aug. 14, 2014).

⁵⁶ *State of the Nation’s Housing, supra p.* 32.

an equity cushion, they may be unable to avoid foreclosure in the event of an economic shock like a job loss or other decrease in income.⁵⁷

Section 580b's allocation of risk to lenders was clearly not enough to prevent the historic bubble and collapse. But section 580b is meant to act as a constraint or moderating influence, not a panacea. The anti-deficiency protections in place during the boom years discouraged even more widespread or extreme speculation. The Legislature's considered response to the bubble, the crash, and the subsequent painful recovery that burdens Californians to this day was to extend anti-deficiency legislation even further.

CONCLUSION

There is no legal or policy reason for this Court, contrary to the *Brown-Spangler-DeBerard* doctrine and the Legislature's consistent and ever-expanding condemnation of residential mortgage deficiency liability, to retrench on 60 years of consistent jurisprudence and legislative action. Rarely is this Court provided with so much guidance about what interpretation would serve the commonly understood legislative purposes of section 580b. Recognizing the non-recourse

⁵⁷ Gerardi *et al.*, *Understanding the Foreclosure Crisis*, *supra*, p. 385; *The U.S. Housing Market*, *supra*, p. 5.

character of purchase money mortgages following short sales not only respects the statute's long judicial and legislative history, but promotes its purposes as well.

DATED: August 22, 2014 /s/Elizabeth S. Letcher, SBN #172986
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**CERTIFICATE OF WORD COUNT
(California Rule of Court 8.204(c)(1))**

This brief, including footnotes but excluding those portions of the brief excludable under California Rule of Court 8.204(c)(3), contains 11,616 words as counted by the Microsoft Word word processing program.

Dated: August 21, 2014

/s/Elizabeth S. Letcher
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PROOF OF SERVICE

I am employed in the County of Alameda, State of California. I am over the age of 18 and not a party to the within action. My business address is 1814 Franklin Street, Suite 1040, Oakland, CA 94612.

On August 22, 2014, I served the foregoing document described as:

APPLICATION FOR LEAVE TO FILE AMICUS CURIAE BRIEF OF HOUSING AND ECONOMIC RIGHTS ADVOCATES, NEIGHBORHOOD LEGAL SERVICES OF LOS ANGELES COUNTY, CALIFORNIA HOMEOWNER BILL OF RIGHTS COLLABORATIVE, LEGAL SERVICES OF NORTHERN CALIFORNIA, AND PUBLIC COUNSEL and AMICUS CURIAE BRIEF

on the parties in this action by serving:

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Executed on August 22, 2014, at Oakland, California.

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