No. S213137
(Court of Appeal No. D061720)
(San Diego County Super. Ct. No. 37-2011-00087958-CU-MC-CTL)

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

CAROL COKER,

Plaintiff and Appellant,

v.

JPMORGAN CHASE BANK, N.A., for itself and as a successor in interest to CHASE HOME FINANCIAL LLC,

Defendant and Respondent.

Appeal From Judgment And Order Of The Superior Court
For The County of San Diego
(Hon. Luis R. Vargas, Presiding)

JPMORGAN CHASE BANK, N.A.'S REPLY BRIEF

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INTRODUCTION

The version of Code of Civil Procedure Section 580b in effect from its original enactment in 1933 through the date of Coker's short sale seventy-seven years later barred deficiency judgments only after there had been a "sale . . . under a deed of trust." 1933 Cal. Stat. ch. 642, §5, at 1669; 1989 Cal. Stat. ch. 698, §12. A "sale under a deed of trust" is a foreclosure sale where the lender exercises the legal right contained in the deed of trust to sell a borrower's property after default without any further consent. *See Cornelison v. Kornbluth*, 15 Cal. 3d 590, 602 (1975). A short sale, by contrast, is a private, consensual transaction where the borrower agrees to sell the property to a third party for less than the balance the borrower owes, and the lender reconveys the deed of trust. *See Bank of Am. v. Roberts*, 217 Cal. App. 4th 1386, 1390 (2013). Because Coker's property was sold in a voluntary short sale, and was not sold "under a deed of trust," Section 580b does not bar a deficiency judgment by Chase against her.

Since short sales were unknown when Section 580b was passed in 1933, it is not surprising that the statute does not apply to them. Section 580b was responsive to the very different issue then at hand: large numbers of involuntary foreclosure sales pursuant to the lender's security interest embodied in a deed of trust or mortgage. David A. Leipziger, *Deficiency Judgments in California: The Supreme Court Tries Again*, 22 U.C.L.A L. REV. 753, 759-60 (1975). By barring deficiency judgments after a sale "under a deed of trust," the drafters of Section 580b attempted to alleviate the problem of lenders pursuing homeowners for deficiency judgments after their homes had been sold by foreclosure. *Id.*

What the 1933 Legislature would have thought about precluding deficiency judgments following a private sale by the borrower for less than the loan balance—as contrasted with an involuntary sale by a trustee or sheriff—is conjectural.

What *is* known is that the plain language of the 1933 statute applied only where there had been a foreclosure sale—a sale "under a deed of trust." That plain language remained unchanged from 1933 through the time of Coker's short sale.

The distinction between foreclosures under a deed of trust and consensual short sales was recognized nearly twenty years ago in *Jack Erickson & Associates v. Hesselgesser*, 50 Cal. App. 4th 182 (1996). That case squarely held that Section 580b did not apply where the buyer requested and obtained a reconveyance of the deed of trust in order to make a private short sale. *Id.* at 188-89.

The Legislature took no action to overturn *Jack Erickson*'s holding. In the years after that case was decided, and especially in wake of the recent financial crisis, short sales became more prevalent, allowing borrowers to avoid the stigma and negative credit impact of a foreclosure.

During this time, legitimate arguments for *and against* extending Section 580b to short sales could have been (and perhaps were) made. Those in favor could emphasize borrower protection or market stabilization in times of downturn. On the other side of the debate, arguments could stress that if deficiency claims were prohibited after consensual short sales, borrowers would have greater incentive to default for strategic reasons (rather than because of financial hardship), resulting in an increased number of defaults and further declines in real estate values. Consequently, extending Section 580b to short sales would *exacerbate*, not ameliorate, the market-depressing impact of an economic downturn.

The point here is not that one set of arguments necessarily should prevail over the other, much less that this Court should resolve them. Rather, the point is that these opposing arguments are more appropriate for legislative than judicial resolution. But there is no evidence—none—that prior to Coker's short sale, the Legislature grappled with these policy

issues and even considered, much less adopted, an amendment to Section 580b to extend its reach to short sales.

After many decades, the Legislature enacted a new statute in 2010, Section 580e, addressing, for the very first time, deficiency claims after a short sale. Its detailed provisions bar some, but not all, deficiency judgments and collections after short sales. For example, short sales by corporations, limited liability companies ("LLCs") and partnerships are exempted, and actions for fraud or waste are not barred. Moreover, Section 580e is prospective and therefore does not apply to short sales that took place, as Coker's did, before Section 580e was enacted.

Coker now wants this Court to declare that even had Section 580e never been enacted, Section 580b has barred deficiency judgments after a short sale since its adoption in 1933. Her insistence that the Court should read a deficiency bar into Section 580b is precisely what countless cases, and Code of Civil Procedure Section 1858, prohibit. Courts are required to interpret unambiguous statutes according to their language without adding words that the Legislature omitted or disregarding words that the Legislature included. Nor is there any reason to depart from applying the plain language of Section 580b. In effect, Coker asks this Court to ignore Section 580b's plain language, to hold that *Jack Erickson* was incorrectly decided, and to find that Section 580e was unnecessary. The Court should reject that invitation.

In this case, the indicia of legislative intent all point in the same direction. There is no tension between the "plain meaning" of Section 580b and the other indicia discussed in this brief. The consequences of foreclosure sales were the Legislature's immediate concern; indeed, short sales were unknown in 1933. The statute's plain meaning was effectuated in a 1996 decision, *Jack Erickson*, holding that Section 580b did not bar deficiency judgments following a short sale;

that was not questioned by any subsequent ruling or altered by any legislative action prior to the short sale in this case. And even when the Legislature finally addressed short sales, it did so prospectively, and in a nuanced way that would be upended were the Court to hold that Section 580b has barred post-short sale deficiency claims all along.

I.

SECTION 580b DOES NOT APPLY TO SHORT SALES.

A. The Plain Language Of Section 580b Applies Only Where There Has Been A Sale "Under A Deed Of Trust."

Although Coker correctly asserts that "[i]n interpreting a statute, the Court looks first to the statute's text" (Answer Brief On The Merits ("AB") 13),[1] her interpretation of Section 580b would read out of the statute the requirement that there first have been a "sale . . . under a deed of trust." Instead, she asserts that Section 580b applies to any sort of sale—non-consensual foreclosure or consensual short sale—so long as property was at one point secured by a deed of trust. AB 13. The plain language of the statute does not bear this meaning.

The relevant portion of Section 580b as it read at the time of Coker's short sale prohibited deficiency claims only after

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[1]When a statute is unambiguous, resorting to other guides to meaning, such as legislative history, is unnecessary. *E.g.*, *Green v. State*, 42 Cal. 4th 254, 260 (2007) ("If the plain language of a statute is unambiguous, no court need, or should, go beyond that pure expression of legislative intent"); *People v. Flores*, 30 Cal. 4th 1059, 1063 (2003). Only if "the terms of a statute provide no definitive answer" may "courts . . . resort to extrinsic sources, including the ostensible objects to be achieved and the legislative history." *Mercy Hosp. & Med. Ctr. v. Farmers Ins. Grp. of Cos.*, 15 Cal. 4th 213, 219 (1997) (citation and internal quotation marks omitted).

there has been a "sale . . . *under a deed of trust*" (emphasis added)—*i.e.*, after a foreclosure sale[2]:

> No deficiency judgment shall lie in any event after a sale of real property or an estate for years therein [1] for failure of the purchaser to complete his or her contract of sale, or [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, or [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. (CODE CIV. PROC. §580b, as amended by 1989 Cal. Stat. ch. 698, §12)[3]

The part of the statute applicable to Coker's case is Clause [3].[4] In language drawn directly from the 1933 legislation, Clause [3] bars a deficiency judgment only where there has been "a sale of real property . . . *under a deed of trust*" encumbering the borrower's residence—*i.e.*, a foreclosure sale.

Attempting to obtain a judicial extension of Section 580b to short sales, which are *not* "sale[s] of real property . . . under a deed of trust," Coker relies on a truncated and misleading quotation of the statute. She quotes *part* of Section 580b as "barring a deficiency 'in any event after a sale' of residential property secured by a deed of trust." AB 13. But unlike Coker's gloss, the actual statute limits the kind of sale at issue to "sales . . . under a deed of trust." CODE CIV. PROC.

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[2]For clarity, Chase has inserted numbers 1, 2 and 3 in brackets to separate the three operative clauses so that the statute can be construed in accordance with the plain text.

[3]As Coker observes, Section 580b has since been amended. AB13.

[4]Clause [1] pertains to contracts of sale. Clause [2] applies to a mortgage or deed of trust given to the vendor. Clause [3] is the relevant clause because it applies to a deed of trust given to a commercial lender. It is that language analyzed in the following text.

§580b. "[U]nder a deed of trust" modifies the word "sale," such that sales performed under the legal power contained in a deed of trust are the only sales covered by the statute. Contrary to Coker's view, Section 580b does not bar deficiency collection efforts following all sales, regardless of type, of residential properties that were at one point "secured by a deed of trust" (AB 13)—a phrase of Coker's making that is absent from the statute.

When read in whole and with no words of the statute omitted or additional words added, the statute's plain meaning is precisely the opposite of what Coker asserts: Section 580b does not apply to a short sale because such transactions are *not* involuntary sales conducted by a trustee or by the sheriff "under a deed of trust."

Indeed, Coker's purpose was to avoid an involuntary foreclosure sale by her lender under its deed of trust. At her request, Chase agreed to release its security lien on the property and reconvey the deed of trust to the borrower in return for Coker's acknowledgement that she would remain liable for the unpaid balance. CT 197. As a result, there never was a trustee's sale. There never was a sheriff's sale. There was only *Coker's* private sale, and that transaction was not "a sale of real property . . . under a deed of trust."

Statutes cannot be interpreted by disregarding language that the Legislature has included, or by adding words not adopted by the Legislature. "In the construction of a statute . . . the office of the Judge is simply to ascertain and declare what is in terms or in substance contained therein, not to insert what has been omitted or to omit what has been inserted." CODE CIV. PROC. §1858; *see, e.g., Vasquez v. State*, 45 Cal. 4th 243, 253 (2008); *Sec. Pac. Nat'l Bank v. Wozab*, 51 Cal. 3d 991, 998 (1990); *People v. Leal*, 33 Cal. 4th 999, 1008 (2004); *Stop Youth Addiction, Inc. v. Lucky Stores, Inc.*, 17 Cal. 4th 553, 573 (1998); *Cal. Fed. Sav. & Loan Ass'n v. City*

of Los Angeles, 11 Cal. 4th 342, 349 (1995); *Wells Fargo Bank v. Superior Court*, 53 Cal. 3d 1082, 1099 (1991).

Coker would have the Court read Section 580b as if the "sale . . . under a deed of trust" language had been omitted and/or instead there had been a Clause 4, containing the language of Section 580e, that would read:

> No deficiency judgment shall lie in any event after a sale of real property . . . *or [4] the trustor sells the property for a sale price less than the remaining amount of the indebtedness outstanding at the time of sale, in accordance with the written consent of the holder of the deed of trust . . . .* (New language taken from Section 580e and not actually in Section 580b is in italics).

Of course, "[d]oing so would violate the cardinal rule of statutory construction that courts must not add provisions to statutes." *Wozab*, 51 Cal. 3d at 998.

Coker argues that Section 580b must encompass more than foreclosures because the Legislature did not use the language found in Section 580a ("'exercise of the power of sale'") or Section 580d ("'sold by the mortgagee or trustee under power of sale'"). AB 16. But the references in Section 580a and 580d to "power of sale" are most naturally read to distinguish a particular variety of foreclosure sale (non-judicial, performed under a power of sale) from the major variety of foreclosure sale (judicial, not performed under a power of sale), and not to distinguish foreclosures from short sales. *Brown v. Jensen*, 41 Cal. 2d 193, 196-97 (1953). Consequently, Section 580a applies "to sales made without court assistance under a power of sale contained in a trust deed," and 580d applies "where the property has been sold under the power of sale (as distinguished from a sale in a foreclosure action) contained in the trust deed." *Id.*

Conversely, Section 580b applies after "any foreclosure sale, private or judicial, of property securing a purchase money mortgage." *Cornelison*, 15 Cal. 3d at 603. The

Legislature's use of different language in Section 580b as compared to Sections 580a and 580d was necessary to allow for Section 580b to cover both ways of pursuing a foreclosure.

For these reasons, Section 580b bars a deficiency judgment after there has been a foreclosure sale. Its words cannot be stretched to apply where there has been no "sale . . . under a deed of trust" at all, but only a private, consensual sale facilitated by the lender's voluntary reconveyance of its deed of trust.

B. As *Jack Erickson* Squarely Held, Section 580b Does Not Apply Where The Parties Agree To Destroy The Secured Nature Of The Purchase Money Loan To Allow the Borrower To Make A Short Sale.

Until the decision in this case, the plain meaning of Section 580b was unquestioned in the only case to consider the issue of whether deficiency judgments were barred following a short sale. In *Jack Erickson*, the property was covered by multiple liens. 50 Cal. App. 4th at 184-85. To avoid foreclosure, the parties agreed that the lender in the third position would reconvey its security interest so that the borrower could sell the property to a third party and pay off the first and second lien holders. *Id.* In return, the lender in the third position allowed the borrower to proceed with the short sale on the condition that the borrower remain personally responsible for the repayment of the purchase money loan. *Id.*

The court held that the borrower was not entitled to antideficiency protection under Section 580b when the borrower "induced [the lender] to execute a deed of reconveyance" so that the borrower could sell the property leaving the lender "without security." 50 Cal. App. 4th at 188-89. The court reasoned that once the lender reconveyed the deed of trust at the borrower's request, the loan became unsecured and Section 580b's provisions governing sales "under a deed of trust" no longer applied: "[i]t is well established that unsecured

purchase money notes are not subject to section 580b"; "[w]e reject the argument that [the borrower] could extinguish the security interest, sell the property to a third party, and invoke section 580b to shift the loss of the ill-fated project to [the lender]. *Id.* at 189.

Jack Erickson rests on the unchallenged proposition that where a loan is *unsecured*, the lender can seek repayment from the borrower. *Id.* The court recognized that events subsequent to origination could remove a transaction from the ambit of Section 580b. *Id.* at 188-89. To that end, *Jack Erickson* cited *Palm v. Schilling*, 199 Cal. App. 3d 63 (1988), for the proposition that a creditor could avoid Section 580b if it agreed to destroy its security interest in the property. 50 Cal. App. 4th at 188.

Coker does not attempt to distinguish this case from *Jack Erickson.* She does not contend that her short sale agreement was materially different from the transaction in *Jack Erickson* with respect to the consensual release of the security. She does not deny that *Jack Erickson* held that when the borrower induces the lender to release its security interest and reconvey the deed of trust to allow the borrower to sell the property, Section 580b does not apply. And she does not challenge *Jack Erikson*'s premise that unsecured purchase money loans do not come within the reach of Section 580b.

Instead, Coker forthrightly urges this Court to overrule *Jack Erickson* on two grounds: (1) the opinion was impliedly disapproved by *DeBerard Properties, Ltd. v. Lim*, 20 Cal. 4th 659 (1999), which prohibits a subsequent waiver of antideficiency protection; and (2) because the nature of the loan is "fixed for all time" *Jack Erickson* rests on the faulty premise that the parties can subsequently alter the secured nature of a purchase money loan. AB 4-5, 24, 31 (citation and internal quotation marks omitted). Coker's arguments are wrong.

Coker first contends that *Jack Erickson* is no longer good law because it cites a sentence in *Russell v. Roberts*, 39 Cal. App. 3d 390 (1974), for the proposition that the protections of Section 580b can subsequently be waived by the borrower. AB 33 (citing *Russell*, 39 Cal. App. 3d at 394-95) ("However, section 580b can be waived by the buyer's subsequent conduct"). To be sure, that single waiver sentence in *Russell* is no longer authoritative (*see DeBerard*, 20 Cal. 4th at 670-71), but its deletion does not undermine the actual holding of *Jack Erickson* that Section 580b does not apply to a sale where the lender releases its security to allow a sale between a borrower and a third party purchaser.

This basic premise—that the parties could by agreement alter the secured nature of the loan, rendering the lender unsecured, and thereby make the deficiency bar of Section 580b inapplicable—has never been disapproved. This Court, relying on the same case cited in *Jack Erickson*, approved that premise in *DeBerard*: "[i]f 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 by reconveying the deed or mortgage on the original real estate . . . .*" 20 Cal. 4th at 669 (emphasis added) (quoting *Palm*, 199 Cal. App. 3d at 76). Nothing in *DeBerard* discusses, much less disapproves, *Jack Erickson*'s application of this principle.[5]

Coker's insistence that parties destroy "'the purchase money nature of the transaction'" only when the reconveyance

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[5]Notably, *DeBerard* disapproved of other cases involving the extent to which parties can waive Section 580b where it would otherwise be applicable. *See DeBerard*, 20 Cal. 4th at 671 (disapproving *Russell*, 39 Cal. App. 3d at 394-95; *Goodyear v. Mack*, 159 Cal. App. 3d 654, 659-60 (1984), and *Shepherd v. Robinson*, 128 Cal. App. 3d 615, 626 (1981)).

of the deed of trust involves an "'exchange for the substitution of other security'" is unsound. *See* AB 34 (quoting *DeBerard*, 20 Cal. 4th at 669). Among other things, Coker overlooks that *DeBerard's* statement of the operative principle that the destruction of the security removes the loan from the ambit of Section 580b omits any reference to an "exchange for the substitution of other security." 20 Cal. 4th at 669 (quoting *Palm*, 199 Cal. App. 3d at 76). Moreover, limiting the destruction rule so that it would come into play only when there is an exchange for new security would make no sense. Under this view, a lender who is left with only the promise to repay would be barred from recovering the deficiency under Section 580b while the lender who extracts an alternative security interest could avoid Section 580b and pursue a deficiency against the borrower. Coker offers no rationale for such an outcome.

Coker's further argument that "the character of the transaction is determined at the time the trust deed is executed" (AB 31) is erroneous. This Court has consistently held that the parties can by agreement subsequently alter the secured nature of the loan and thereby render inapplicable the antideficiency protection of Section 580b. *DeBerard Props., Ltd. v. Lim*, 20 Cal. 4th 659 (1999); *Spangler v. Memel*, 7 Cal. 3d 603 (1972). *DeBerard* declared that if the parties subsequently eliminate the lender's security interest, the protection of Section 580b ceases to apply. 20 Cal. 4th at 669. Similarly, in *Spangler* the purchaser of property pursuant to a purchase money loan lost antideficiency protection under Section 580b when it exercised its right under a subordination clause to obtain a construction loan to which the original purchase money loan would be subordinated. 7 Cal. 3d at 611-12. The Court held that the parties' subsequent subordination agreement resulted in a "non-standard" purchase money loan to which Section 580b no longer applied. *Id.*

DeBerard and *Spangler* are not inconsistent with *Brown v. Jensen*, 41 Cal. 2d 193 (1953). In *Brown*, the lender's security interest remained in place but became valueless after the senior lien holder foreclosed on the property. *Id.* at 195. In that circumstance, the Court held that Section 580b applied to bar sold-out junior lien holders from seeking a personal judgment against the borrower. *Id.* at 195-96, 198-99. Unlike here, *Brown* did not involve a consensual sale that required destroying or otherwise altering the security interest. *Id.* at 195-96. There was no reconveyance of the security and the nature of the loan did not change. *Id.* Therefore *Brown* does not address Section 580b's applicability to short sales.

Ghirardo v. Antonioli, 14 Cal. 4th 39 (1996), also does not support Coker's position. There, the Court considered whether the lender's reconveyance of the security altered the ability of the lender to recover outstanding amounts owed on the previously secured note. *Id.* at 43. The borrower made a payment to the lender intended to be a complete repayment of the obligation. *Id.* at 45. After the lender had released its security interest in the property, it discovered that additional monies were owed. *Id.* The Court concluded that the seller/lender was entitled to recover the outstanding amounts owed on the note:

> After the payoff and reconveyance, any remaining obligation was *no longer secured.* Nor, strictly speaking, did the sums omitted from the payoff demand constitute a "deficiency," i.e., the difference between the value of the large note and the value of the real property in a judicial foreclosure. (*Id.* at 50 (emphasis in original))

Accordingly, *Ghirardo* is consistent with the reasoning in *Jack Erickson* and *DeBerard* that when the borrower requests or agrees to the lender's reconveyance of its security, Section 580b does not bar collection of the outstanding balance of the loan.

C. The Legislature Did Not Overturn *Jack Erickson*, Although It Amended Section 580b In Other Respects.

Coker disputes that the Legislature ratified *Jack Erickson*. AB 24. Specifically, Coker argues that there can be no legislative acquiescence unless at the time the statute was amended there was a well-developed body of law interpreting a statutory provision and numerous amendments to the statute in question. AB 25. On reflection, there is no need to reach the issue of ratification, for at the very least it is indisputable that until 2010, the Legislature took no action to abrogate or overturn *Jack Erickson*. And when the Legislature finally addressed the issue, it enacted Section 580e, a brand-new statute that prohibits deficiency judgments following short sales only in *some* circumstances, and then only for short sales occurring after the effective date of Section 580e.

"The Legislature is deemed to be aware of existing laws and judicial decisions construing the same statute in effect at the time legislation is enacted, and to have enacted and amended statutes in the light of such decisions as have a direct bearing upon them." *Viking Pools, Inc. v. Maloney*, 48 Cal. 3d 602, 609 (1989) (citation and internal quotation marks omitted). Whether the members of the Legislature actually approved of the holding in *Jack Erickson* is unknowable; what we *do* know is that the Legislature took no action to abrogate it until after Coker's short sale was completed.

For fourteen years after *Jack Erickson* was decided, the Legislature made no effort to amend Section 580b. At the time of Coker's short sale, Section 580b contained the 1933 limitation that it applies only after a sale by foreclosure—which means that it does not apply to private, consensual sales in which the lender is required to release its security interest.

D. The Enactment Of Section 580e Does Not Support The Applicability Of Section 580b To Coker's Short Sale.

In 2010, the Legislature finally addressed short sales. But it did so by enacting a new statute, Section 580e. That section contains nuances of the kind only the legislative branch can fashion, and it drew lines defining when deficiency judgments would and would not be barred.

To begin with, Section 580e does not apply to corporations, LLCs or partnerships. CODE CIV. PROC. §580e(d)(1). It also does not apply where the borrower has engaged in fraud or waste. *Id.* §580e(c). And it only applies prospectively. *Roberts*, 217 Cal. App. 4th at 1398; *Espinoza v. Bank of Am., N.A.*, 823 F. Supp. 2d 1053, 1058 (S.D. Cal. 2011). Coker argues that the enactment of Section 580e somehow "confirms that Section 580b applies after a short sale." AB 21. Not so: the enactment of a new, narrower statute that applies only to short sales occurring after its effective date is the antithesis of evidence that Section 580b already applies as to *all* borrowers, including corporations, after a private, consensual short sale.

Coker argues that the Legislature's enactment of Section 580e shows that it knew that Section 580b applied to short sales. AB 21-22 (citing *Rex v. Chase Home Fin.*, 905 F. Supp. 2d 1111, 1144 (C.D. Cal. 2012)). Specifically, Coker contends that statements in the legislative history indicating that its members "generally believed" that Section 580b already applied to short sales shows that Section 580e was not addressed to the short sale issue but was enacted to extend existing antideficiency protection to non-purchase money loans. AB 21-22 (citation and internal quotation marks omitted). But Coker mischaracterizes the legislative history, which actually shows that the Legislature was at the very least uncertain as to whether Section 580b applied to short sales.

According to the Legislative Digest, the purpose of Section 580e was "[t]o ensure that a borrower is no worse off financially after a short sale than after a foreclosure." Motion for Judicial Notice ("MJN"), Ex. 1, at 2. Lawmakers were told that Section 580e "would prohibit a lender from pursuing a deficiency judgment *in any case* of short sale in which the property is sold for less than the amount owed with written consent from the lender." *Id.*, Ex. 2 at Attachment "Short Sale Judgment Deficiency Protection" (emphasis added). And the new statute was necessary because "[e]xisting law prohibits a deficiency judgment in any case in which real property or an estate for years therein has been *sold by the mortgagee or trustee under power of sale contained in the mortgage or deed of trust.*" *Id.*, Ex. 5 (emphasis added). Because "existing law" was limited to sales under a deed of trust, the Legislature enacted Section 580e to ensure that borrowers who make a short sale receive the "same protections" as those whose properties were foreclosed upon. *Id.*, Ex. 1, at 2.

Coker's assertion that the legislative history evidences a "general belief" that Section 580b applied to short sales is misleading. AB 21. The legislative history also contains repeated acknowledgements, not mentioned by Coker, that the application of Section 580b to short sales was unsettled. Indeed, the very paragraph Coker quotes stated that the application of Section 580b to short sales was subject to "some disagreement among legal professionals about the circumstances under which purchase money protection provided by CCP 580b applies." *Id.*, Ex. 1, at 1.[6]

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[6]Even that expression of uncertainty was curious given the definitive holding in *Jack Erickson* that Section 580b did not apply following a short sale. *See* 50 Cal. App. 4th at 189.

The legislative history also acknowledges that as "short sales have become more popular," there was nothing to deter lenders from "now requiring borrowers to agree that the lender may pursue them for the difference between the sales price of their home and their unpaid mortgage balance." MJN, Ex. 1, at 3. For example, the legislative history contains an observation that when a senior lien holder agrees to a short sale, the issue of whether Section 580b bars the senior lien holder from pursuing a deficiency "has not yet been litigated, and is thus unresolved." *Id.*, Ex. 3, at 4. Similarly, because a lender's consent to short sale may be conditioned on an agreement by the borrower to be responsible for any deficiency, "the language could be interpreted by the Court as an executory waiver of *CCP § 580b purchase money protection.*" *Id.*, Ex. 4, at Attachment "Short Sale Judgment Deficiency Protection 2010" (emphasis added). Accordingly, the legislative history shows that the Legislature chose to resolve its uncertainty regarding Section 580b by enacting a new statute, Section 580e, dealing with short sales.

Coker's assertion that Section 580e was enacted to address only non-purchase-money short sales because Section 580b already addressed purchase-money short sales (AB 22) ignores this expressed uncertainty about the reach of Section 580b and does not square with the language of Section 580e. As previously noted, Section 580e does not apply to corporate borrowers, LLCs or partnerships. CODE CIV. PROC. §580e(d)(1). Likewise, it does not limit lender remedies for borrower fraud and waste. CODE CIV. PROC. §580e(c) And it only applies prospectively. *Roberts*, 217 Cal. App. 4th at 1398; *Espinoza*, 823 F. Supp. 2d at 1058. None of that would make sense if the Legislature had believed that Section 580b already prohibited deficiency judgments after a short sale even if the borrower was a corporation, LLC or partnership.

Coker's attempt to read a broader, it's-always-been-that-way, prohibition into the existing version of Section 580b would be unfair to lenders who consented to short sales and the reconveyance of their security in return for the borrower's commitment to be responsible for any deficiency. When Chase and Coker entered into their agreement for reconveyance and a short sale, Section 580e had not been enacted, and the only published appellate opinion (*Jack Erickson*) held that Section 580b did not to apply to short sales. If the Court were now to announce that Section 580b applied following a short sale, all of the nuances of Section 580e, including its prospective application, would be nullified. It would extend antideficiency protection to short sales despite the Legislature's intent that such protections apply only to short sales that occurred after Section 580e was enacted into law. *See Roberts*, 217 Cal. App. 4th at 1393-95 (Section 580e was intended to operate prospectively only). And it would also allow corporate borrowers and others who would otherwise be ineligible for protection under Section 580e to obtain the identical protection under Section 580b.

E. Prior Cases Do Not Support Coker's Contention That Section 580b Applies Even Though There Has Been No Prior Foreclosure Sale.

Coker asserts "other courts have confirmed that section 580b applies notwithstanding the absence of a foreclosure sale." AB 16. Not so. In *Ghirardo v. Antonioli*, 14 Cal. 4th 39 (1998), the Court did not address whether Section 580b applies to cases in which there had been no prior foreclosure sale under a deed of trust. That case cannot be relied upon for a proposition that the opinion did not consider. *See, e.g., Isbell v. Cnty. of Sonoma*, 21 Cal. 3d 61, 73 (1978).

And in *Frangipani v. Boecker*, 64 Cal. App. 4th 860, 864 (1998), and *Venable v. Harmon*, 233 Cal. App. 2d 297 (1965), the creditor disregarded the real property security and sought a deficiency judgment instead. Those cases turned on the

borrowers' continued ownership of the property, with the lender continuing to have a security interest: "The cases holding that a prior sale is not required under §580b rely in their reasoning on the policy that a creditor holding a purchase money note must look to the security; the assumption, therefore, is that the creditor still holds the security and that a later sale to satisfy some or all of the debt is still a possibility." *In re Prestige Ltd. P'ship-Concord v. East Bay Car Wash Partners*, 234 F.3d 1108, 1117 n.5 (9th Cir. 2000). In contrast, here Chase released its security at Coker's request in order to facilitate her short sale.

F. Extending Section 580b To Short Sales Is Not Necessary To Further The Economic Stabilization Purposes Of That Statute.

Because the Legislature enacted Section 580e in 2010, the decision in this case will only affect transactions made prior to 2011, and will not affect future lending decisions of lenders or future property acquisition decisions of purchasers. Nonetheless, Coker makes policy arguments in an attempt to justify the extension of Section 580b to short sales. AB 17-19. Those arguments require the Court to consider whether the reasons that impelled the enactment of Section 580b in the first place apply to short sales with such equal logic and force that, had Section 580e never been adopted, this Court should declare that Section 580b itself bars deficiency judgments after a short sale even though the Legislature could not have had short sales in mind, and did not use language applicable to short sales, when Section 580b was enacted.

Coker makes no effort to provide a balanced evaluation of the policy arguments both for and *against* extending Section 580b's deficiency bar to short sales. Indeed, she provides no economic rationale or empirical evidence to support her assertion that extending Section 580b to short sales by "placing the risk of inadequate security on the lender" necessarily "protect[s] individual homebuyers and the overall economy in

times of economic distress." AB 18. Instead, she argues only that because Section 580b protects borrowers at the expense of lenders, "[t]he statute accomplishes these goals by squarely placing the risk of inadequate security on the purchase money lien holder." *Id.*; *see also id.* at 20. This is not a policy argument, but a "conclusion [that] states the effect of the statute after assuming that it applies," while offering "no rationale for deciding whether or not it applies." *Roseleaf Corp. v. Chierighino*, 59 Cal. 2d 35, 42 (1963).

In any event, there are strong arguments against extending Section 580b's deficiency bar to short sales. There are two main policy objectives underlying Section 580b: (1) stabilization of land sale prices by deterring lenders from overvaluing property; and (2) macroeconomic stabilization achieved through protecting borrowers against "large personal liability." *DeBerard*, 20 Cal. 4th at 663-64. The extension of Section 580b to short sales would not necessarily further either purpose.

Indeed, the evidence shows the opposite. A central feature of the 2008 crash was residential real estate speculation that resulted in overvaluation followed by an onslaught of "strategic defaults," in which borrowers who were otherwise capable of paying their loans defaulted to shed their negative equity positions. TODD J. ZYWICKI & GABRIEL OKLOSKI, MERCATUS CENTER, GEORGE MASON UNIVERSITY, WORKING PAPER NO. 09-35: THE HOUSING MARKET CRASH (Sept. 2009) ("THE HOUSING MARKET CRASH"); Grant S. Nelson & Gabriel D. Serbulea, *Strategic Defaulters Versus the Federal Taxpayer: A Brief for the Preemption of State Anti-Deficiency Law for Residential Mortgages*, 66 ARK. L. REV. 65, 66-67, 76-77, 91 (2013) ("*Strategic Defaulters*"). These market-depressing factors were exacerbated in one-action states (like California) by strong antideficiency protections. *Strategic Defaulters* at 66-67, 76-77, 90.

Despite the enactment of Section 580e, there is good reason to believe that extending Section 580b to short sales would have fueled—not diminished—borrower speculation and incentivized strategic defaults. Justice Kennard predicted more than a decade before Coker's short sale that, from the borrowers' perspective, the expansion of Section 580b fuels borrower speculation in a manner that *undermines* the overvaluation and stabilization goals of the statute. *DeBerard*, 20 Cal. 4th at 672 (Kennard, J., concurring). As Justice Kennard recognized, buyers will always be incentivized to offer "more than the market value of the property because they know that in the case of default they will not be personally liable for any deficiency." *Id.* To reach that conclusion, Justice Kennard relied upon both case law and scholars who explained the fundamental "lack of economic logic to the argument that . . . section 580b reduces overvaluation of properties" under modern market conditions. *Id.* (citing *Budget Realty Inc. v. Hunter*, 157 Cal. App. 3d 511, 515-16 (1984); Harris, *California Code of Civil Procedure Section 580b Revisited: Freedom of Contract in Real Estate Purchase Agreements*, SAN DIEGO L. REV. 509, 516-17 (1993); BERHARDT, CALIFORNIA MORTGAGE AND DEED OF TRUST PRACTICE, *One-Action and Antideficiency Rules* §4.27, at 207-08 (2d ed. 1990); HETLAND, CALIFORNIA REAL ESTATE SECURED TRANSACTIONS 270 (1970)); *see also Strategic Defaulters* at 66-67, 90-91.

There is also good reason to believe that extending Section 580b to short sales would not provide additional deterrence to lender overvaluation of real property. Borrowers wanting relief from their loan obligations could always accept foreclosure, following which Section 580b would preclude any deficiency judgment. Alternatively, borrowers concerned about the impact of a foreclosure on their credit rating could request their lender to facilitate a short sale in exchange for

agreeing to remain liable for any deficiency. Because lenders cannot compel a borrower to proceed by way of short sale, lenders considering new loan applications would be bound to know that even though Section 580b does not apply after a short sale, a prospective borrower would always have the ability to prevent a deficiency judgment in the event of default by insisting that the lender proceed by foreclosure. That very real risk provides ample deterrence to overvaluation.

Coker's contention that extending Section 580b's deficiency bar to short sales would help "prevent[] the aggravation of the downturn that would result if defaulting purchasers were burdened with large personal liabilities" (AB 18 (citation and internal quotation marks omitted)) is highly debatable and far from certain. Analysis based on empirical economic data shows that antideficiency laws incentivize borrowers otherwise capable of maintaining their debt payments to strategically default in numbers that saturate the market. THE HOUSING MARKET CRASH (attributing negative equity, antideficiency protections to strategic default); Todd J. Zywicki, Stephanie Haeffele-Balch, *Loans Are Not Toasters: The Problem with a Consumer Financial Protection Agency*, MERCATUS ON POLICY; No. 60 at 1 (Oct. 2009); *Strategic Defaulters* at 66-67, 76-77, 91. These strategic defaults create additional downward pressures on residential housing values.

Consequently, there is considerable support for the view that extending Section 580b to short sales would put all homeowners in a more unstable position, especially distressed homeowners who want to retain their homes in the hope that they will once again appreciate in value. THE HOUSING MARKET CRASH (attributing housing crash to, *inter alia*, negative equity positions resulting in increased strategic defaults).

Coker argues that because the Legislature enacted Section 580e, it has resolved the policy arguments about the

desirability of applying antideficiency protection to short sales in her favor. AB 20-21. But that impermissibly uses hindsight to interpret the statute that governed Coker's short sale at the time it occurred. Without hindsight, the issue is what a knowledgeable reader of Section 580b—a statute enacted in 1933 and not altered since then in any way relevant to the issue at hand—could have known as of the time of Coker's short sale. The Legislature's *subsequent* decision to prospectively prohibit certain deficiency claims does not support the contention that Section 580b applied to such sales before Section 580e came into existence.

In discussing these countervailing arguments, we do not ask the Court to resolve the debate as to the wisdom of extending antideficiency protections to short sales; that is a legislative task. Rather, we mean only to show that there are legitimate arguments on both sides of the question. The Legislature ended the debate in 2010 (at least for the time being) when it enacted Section 580e. But when Coker and Chase agreed to a short sale upon the condition that Coker would remain liable for the unpaid balance of her loan, those conflicting arguments of policy had yet to be addressed and resolved by the Legislature. Indeed, the only case squarely on point (*Jack Erickson*, 50 Cal. App. 4th 182) had held that Section 580b did not apply following a consensual short sale and this Court had stated that Section 580b would not apply if the lender agrees to release its security interest and reconvey the deed of trust. *DeBerard*, 20 Cal. 4th at 663. Furthermore, at the time of her short sale, the Legislature had taken no action to overturn or modify the result in *Jack Erickson*.

In short, whatever one may think of the countervailing policy arguments, the reasons underlying those arguments were not so one-sided, obvious or compelling that this Court should attribute an intent to the Legislature that does not appear anywhere in the statutory language of Section 580b.

Coker provides no persuasive reason why this Court should disapprove *Jack Erickson*. And she provides no reason for why a provision limiting antideficiency protections to sales "under a deed of trust" should apply to a sale transaction in which the lender destroys its security interest by releasing its deed of trust.

II.

COKER WAIVED ANY RIGHT TO OBJECT UNDER SECTION 726 TO CHASE'S DEFICIENCY CLAIM.

Section 726 consists of both the "security-first" rule, requiring a creditor to proceed first against the security before looking to the borrower for a satisfaction of a debt, and the "one-action" rule which limits a creditor to a single action to collect upon its debt. *Sec. Pac. Nat'l Bank v. Wozab*, 51 Cal. 3d 991, 996-98 (1990). Coker concedes that this case does not raise the "security-first" principle embodied in Section 726. AB 37 ("[T]he short sale of her condominium satisfied that rule."); *see also id.* at 38 ("[t]he short sale in this case satisfied the security-first principle"). But that sale did not yield proceeds sufficient to repay the entire debt. Consequently, the issue that remains is whether Chase is barred by the "one-action" principle also embodied in Section 726 from seeking to recover a deficiency.

Chase's opening brief explained that, under *Roberts*, Coker's request that Chase agree to reconvey its deed of trust in return for her promise to remain liable for any deficiency was a waiver of any defense under Section 726 to the lender's deficiency claim. JPMorgan Chase. N.A.'s Opening Brief On The Merits 9-10. *Roberts* held that where a borrower requests and acquiesces in a short sale, and agrees to be responsible for the deficiency, the borrower waives her rights under Section 726. 217 Cal. App. 4th at 1398 (Section 726 is waived where the borrower "asked for and consented to the

short sale arrangement"). Moreover, the court held, "a short sale is not itself an 'action.'" *Id.*; *accord Wozab*, 51 Cal. 3d at 998 ("action" is defined in Section 22 as "'an ordinary proceeding in a court of justice'"; a private transaction—in that case as setoff—was not an "action").

Coker does not contend that *Roberts* was incorrectly decided. Instead, she argues that *Roberts* is "inapposite" because the lender in that case held a second deed of trust and, after the borrower repaid the holder of the first from the proceeds of the short sale, the lender received only $27,090, while in this case Chase received the entire proceeds of the short sale. AB 39. There is no waiver, she contends, "when the lender realizes the entire value of the security." *Id.* at 40.[7] Coker's attempted ground of distinction is an *ipse dixit* because *Roberts* says nothing about limiting waivers under Section 726 to cases in which the lender receives all of the proceeds from the sale of the property. Whether Chase received 100%, a fraction, or none of the sale proceeds is irrelevant to whether the borrower's request that the lender release its security interest in exchange for a promise to remain liable for the unpaid balance of the debt is a waiver of any defense under the "one-action" rule. *Roberts* squarely addressed that issue and held that it was. 217 Cal. App. 4th at 1398. Nothing in that opinion—or common sense—supports Coker's attempt to distinguish it.

Moreover, *Wozab* makes clear that although a lender cannot avoid Section 726 by unilaterally waiving the security, the borrower's acquiescence in or agreement to the lender's

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[7]We assume that Coker means that Chase received 100% of the proceeds of the short sale. If she means that the short sale price recovered 100% of the fair market value of the property, that statement is unsupported by any finding of the trial court or any evidence in the record. And under either interpretation, those facts have no bearing on the validity of Coker's voluntary waiver.

reconveyance waives the protections of Section 726. 51 Cal. 3d at 1000. In *Wozab*, the lender unilaterally exercised its setoff rights; although the borrower *could have* insisted that the lender restore the funds, it instead acquiesced in the set-off and correctly asserted that as a result the lender's security interest in the property was lost. *Id.* at 1004 n.9, 1005. With the borrower's acquiescence the lender reconveyed the deed of trust. *Id.* at 1005-06. The Court held that the lender was not barred by Section 726 from suing the borrower for the balance of the debt.[8] *Id.*

Both *Roberts* and *Wozab* hold that the agreement of the parties to a reconveyance of the deed of trust waives the borrower's Section 726 defense to an action to collect the unpaid balance of the debt. *Roberts*, 217 Cal. App. 4th at 1398; *Wozab*, 51 Cal. 3d at 1005-06. Here, Coker agreed to—indeed, she requested—a reconveyance of the deed of trust and agreed to be liable for any deficiency. That was a valid waiver of any Section 726 "one-action" defense.

CONCLUSION

Since its effective date in 2011, Section 580e has barred deficiency judgments after some short sales. Time will test the wisdom of that legislation. But at the time of Coker's short sale, the Legislature had not addressed the issue of whether deficiency claims should be barred following a consensual short sale. At that time, under the plain terms of

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[8]If Coker meant to argue that her case can be distinguished from *Roberts* because Chase allegedly recovered the full fair market value of the house, that argument would run afoul of *Wozab's* holding that the borrower can waive the protections of Section 726 for any reason, whether "personal, economic, or otherwise." *See* 51 Cal. 3d at 1005-06. *Wozab* leaves no room for an assertion that the economics of the transaction on the lender affect the validity of the borrower's waiver of Section 726 defenses.

Section 580b, that statute's deficiency bar applied only where the lender had foreclosed on its security. The only relevant case on point—*Jack Erickson*—had squarely held that Section 580b did not apply after a consensual private sale. In the fourteen years following that decision, the Legislature took no action to overturn it. Lenders and borrowers reading the case law and the text of the statute were entitled to conclude, as Coker and Chase did, that under the then-existing law they could lawfully agree to a short sale subject to the lender's right to assert a deficiency claim.

DATED: July 24, 2014.

Respectfully,

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CERTIFICATE OF COMPLIANCE PURSUANT TO CAL. R. CT. 8.520(c)

Pursuant to California Rule of Court 8.520(c)(1), and in reliance upon the word count feature of the software used to prepare this document, I certify that the foregoing Reply Brief of JPMorgan Chase Bank, N.A. contains 8,098 words, exclusive of those materials not required to be counted under Rule 8.520(c)(3).

DATED: July 24, 2014.

GINAMARIE CAYA

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PROOF OF SERVICE
Case No. S213137

I am over the age of eighteen years and not a party to this action. I am employed in the County of San Francisco, State of California. My business address is Three Embarcadero Center, Tenth Floor, San Francisco, California 94111-4024.

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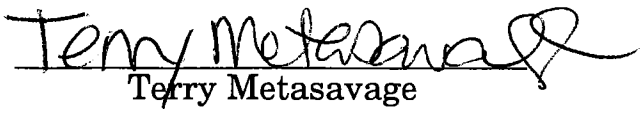
I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Executed at San Francisco, California on July 24, 2014.



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