S243294

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

BLACK SKY CAPITAL, LLC
Plaintiff & Appellant,

vs.

MICHAEL A. COBB, et al.,
Defendants & Respondents.

AFTER A PUBLISHED DECISION BY THE COURT OF APPEAL
FOURTH APPELLATE DISTRICT, DIVISION TWO, APPEAL NO. E064482
ON APPEAL FROM JUDGMENT OF SAN BERNARDINO COUNTY SUPERIOR COURT
CASE NO. CIVDS 1416584, HON. BRYAN F. FOSTER

ANSWER BRIEF ON THE MERITS

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INTRODUCTION

Defendants Michael and Kathleen Cobb (collectively "Cobb") refused to pay two large loans that were issued by the same lender two years apart in two different transactions. When the lender, through its assignee, sued Cobb to recover a personal judgment under the junior loan, Cobb invoked the anti-deficiency statute, arguing that the lender's foreclosure sale under the senior loan eliminated any personal liability under the junior loan. The Court of Appeal correctly rejected Cobb's arguments.

Cobb's position is preempted by the plain text and the language of the anti-deficiency statute at issue here. This action is not for a deficiency after the foreclosure on the senior loan; this action was filed to collect on the separate *junior* loan which was independently issued and recorded two years after the senior loan. Therefore, Cobb's argument is dead on arrival. While the Court does not need to go further beyond the statutory text to dismiss Cobb's distorted view, there are ample other grounds to do so. For example, under the guise of consumer protection, Cobb seeks to prevent lenders that have issued two separate loans secured by the same property from collecting on the junior loan after a non-judicial foreclosure under the separate, senior loan. Adoption of Cobb's view, however, would ironically hurt consumers by eliminating or reducing the number of lenders that would be willing to issue junior loans subsequent to their original loan. In addition, Cobb's view would have a deleterious effect on lenders by jeopardizing or precluding their ability to transfer such mortgages to the secondary market, further exacerbating the impact on consumers.

Cobb's position would also cause lenders to declare non-monetary, technical defaults on the junior loan based on the monetary default of the senior loan, even if the borrower is otherwise fully performing on the junior loan. If adopted, Cobb's view would have this consequence even if the two loans are separate, independent loans issued years apart. This would increase litigation because the lender would need to include both notes in a costly judicial foreclosure action. Otherwise, lenders holding both notes on the same property would be barred by anti-deficiency laws from collecting on the second loan if the lender proceeds with a non-judicial foreclosure under the first loan. For these reasons and others discussed below, the Court should reject Cobb's request for judicial legislation.

Moreover, allowing Cobb to evade his debt under the junior loan in its entirety would be a gross injustice to Black Sky and a corresponding windfall to Cobb. He voluntarily executed the trust deeds to advance his own interests. *He* promised to pay the money *he* borrowed for *his* benefit. *He* induced the bank to rely on his promise by executing the deeds of trust. He received what he sought—cold hard cash in his pocket. He did so not just once but twice. By his own admission, he borrowed an eight-figure loan and another seven-figure loan. (1 CT 88.) He borrowed each loan individually, thereby eliminating the need for a personal guarantee. He now seeks to deprive the bank of *its* benefit of the bargain. He wants to shift the consequence of his defaults to other consumers and borrowers.

He has avoided the debt almost entirely—having paid a tiny portion of his junior $1.5 million loan and leaving an unpaid balance of $1,254,380. (1 CT 86; 23:8.) That's the ultimate form of injustice. While the anti-deficiency laws are designed to protect debtors – primarily consumers purchasing residential properties as their principal place of residence – the

statutes were never intended to be abused as a sword. The Court should reject Cobb's attempt to radically change the law in this manner.

STATEMENT OF THE CASE

A. Factual Summary by the Court of Appeal

The relevant facts were condensed by the Court of Appeal in its published decision. Because Cobb did not file a rehearing petition to dispute any of those facts, they are concisely reiterated here.

"On or about August 18, 2005, the Cobbs borrowed $10,229,250 from Citizens Business Bank." (Typed opn. 1.) [1] "The note was secured by a deed of trust on a parcel of commercial real property in Rancho Cucamonga." (*Ibid.*)

"On or about September 13, 2007, the Cobbs obtained a second loan from Citizens Business Bank, in the amount of $1,500,000, which was secured by a second deed of trust on the same property." (*Ibid.*) "Black Sky purchased both notes from Citizens Business Bank[.]" (*Ibid.*) "After the Cobbs defaulted on the senior loan, Black Sky opted to conduct a trustee's sale under the senior deed of trust." (*Ibid.*)

Black Sky "acquired the property on or about October 28, 2014 for $7,500,000." (*Ibid.*) "On November 4, 2014, after the Cobbs defaulted on

[1] The copy of the opinion attached to the petition for review does not exactly match the copy of the one found on the court's website. The former also reflects different pagination based on the electronic filing of the petition for review. The pages identified in this brief refer to the copy posted on the court's website.

the junior loan, Black Sky filed the suit which is the subject of this appeal, seeking to recover the amount still owed on the junior note." (*Ibid.*)

After noting that "[t]he relevant facts, stated above, are undisputed" (Typed opn. 3), the Court of Appeal further observed that "the second loan was issued two years after the first, and the default did not occur until seven years later." (*Id.* at p. 10.) The court also confirmed that "[a]ny debt owed on the junior note in this case has no relationship to the debt owed on the senior note[.]" (*Id.* at p. 14.)

B. Procedural History

1. The Pertinent Pleadings

After obtaining title to the property based on the senior foreclosure sale (1 CT 144), Black Sky sued Cobb to collect the amount owed on the separate, junior loan. This action, the subject of this appeal, is not for a deficiency on the senior loan after the non-judicial foreclosure.

The complaint included three causes of action: breach of the promissory note and loan agreement, account stated and money lent. (1 CT 13-44.) The complaint alleged that the subject loan "was commercial in nature, it was not a purchase money loan, and the parties to the agreement were sophisticated." (1 CT 19, ¶ 24.) Black Sky also explained its standing to prosecute the action based on the assignment of the loan by Citizens Business Bank, as the original lender, to Black Sky, the assignee. (1 CT 19-20, ¶¶ 26-28.)

Cobb filed an answer, invoking the "anti-deficiency statutes" and Code of Civil Procedure section "580" (among other statutes) while citing *Simon v. Superior Court* (1992) 4 Cal.App.4th 63 and other cases, claiming that this lawsuit is barred by the anti-deficiency laws (1 CT 47, ¶ 12.)

2. The Competing Summary Judgment Motions

a. Cobb's Motion

Cobb sought summary judgment, arguing that by foreclosing on the senior lien which secured the first loan, Black Sky obtained title "at a substantially below-market price." (1 CT 59:10-11.) Cobb, however, did not present any evidence to substantiate this assertion; e.g., an appraisal report. (1 CT 86-89 [Cobb declarations reiterating the loan amounts and attaching, as exhibits, the two deeds of trust, the notice of default and the trustee's deed upon sale].) Invoking a new statute omitted from his answer (section 580d), Cobb argued that the complaint is barred by the anti-deficiency laws. (1 CT 63-73.) [2]

Black Sky opposed Cobb's motion for summary judgment. (2 CT 468-491 [opposition]; 3 CT 492-513 [opposition Separate Statement]; 3 CT 514-517 [judicial notice request]; 3 CT 518-611 [appendix of evidence and declarations].)

Cobb replied (3 CT 638-662), objecting to Black Sky's opposition materials (3 CT 612-628). Cobb filed another Separate Statement (3 CT 629-637) and submitted additional exhibits. (3 CT 663-685.)

b. Black Sky's Motion

Conversely, Black Sky filed its own summary judgment motion.[3]

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[2] (1 CT 50-74 [Cobb's notice of motion and Points & Authorities]; 75-83 [Separate Statement]; 84-90 [two Cobb declarations]; 91-182 [judicial notice request]; 2 CT 330-332 [amended notice of motion].)

[3] (1 CT 183-209 [Black Sky's notice of motion and Points & Authorities]; 1 CT 210-226 [Separate Statement]; 2 CT 227-326 [appendix of declarations and evidence]; 2 CT 230-233 [declaration of original lender's

Cobb opposed Black Sky's cross-motion for summary judgment.[4] Black Sky filed its reply Points and Authorities (3 CT 686-698), in addition to responding to Cobb's evidentiary objections (3 CT 699-704).

3. The Trial Court's Ruling

After entertaining oral argument (RT 1-26) and taking the matter under submission, the trial court ruled on Cobb's evidentiary objections, sustaining the vast majority of them. (3 CT 708.) The court also granted both parties' requests for judicial notice. (*Ibid.*) The court held that Code of Civil Procedure section 580d, as interpreted by *Simon, supra,* 4 Cal.App.4th 63, bars this action. (3 CT 710-711).

After entering a formal order (3 CT 712-718), the court entered judgment for Cobb and awarded Cobb's attorneys' fees. (3 CT 719-722).

4. The Court of Appeal Reverses the Judgment.

Black Sky appealed the judgment. (3 CT 735-736.) Reversing the judgment, the Court of Appeal held that "neither the rule enunciated in *Simon* nor section 580d applies under the circumstances of this case." (Typed opn. 3.) Having examined the record and the relevant case law, the court reasoned that "[t]here is nothing in the record that supports the conclusion that the second loan was in any way an attempt to circumvent the antideficiency statutes in the event of default on the first loan." (*Id.* at p.

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senior vice president]; 2 CT 234-240 [declaration of Black Sky's manager]; 2 CT 327-329 [judicial notice request].)

[4] (2 CT 333-357 [opposition]; 2 CT 358-379 [declaration and attachments]; 2 CT 380-394 [evidentiary objections to Richards Declaration]; 2 CT 395-400 [evidentiary objections to original lender's declaration]; 2 CT 401-467 [opposition Separate Statement].)

10.) The court held that the plain language of section 580d does not support Cobb's arguments and the trial court's judgment. (*Id.* at pp. 11, 15.) The court concluded that the anti-deficiency statute does not preclude Black Sky from suing to collect the balance due on the separate junior loan. (*Id.* at p. 15.) Accordingly, the court deemed it unnecessary to address Black Sky's alternative contention that Cobb waived the anti-deficiency protections by entering into forbearance agreements. (*Id.* at p. 16, fn. 6.)

5. This Court Grants Review.

Cobb sought review based on the Court of Appeal's rejection of *Simon.*[5] This Court granted review without changing the specification of the issue framed by Cobb. (Sept. 27, 2017 Order.)

[5] Cobb framed the issue as follows: "Does Code of Civil Procedure section 580d ("Section 580d") bar a single creditor that owns both the senior and junior liens encumbering the same parcel of real property from seeking a money judgment against the debtor under the sold-out junior lien when that creditor caused its own sold out junior status." (PFR 5.)

LEGAL DISCUSSION

I. By Circumscribing the Scope of the Anti-Deficiency Law at Issue Here, the Legislature Has Precluded Cobb's Arguments.

A. Summary of the Foreclosure Process and Its Statutory Framework

"In California, the financing or refinancing of real property generally is accomplished by the use of a deed of trust." (*Orcilla v. Big Sur, Inc.* (2016) 244 Cal.App.4th 982, 994.) "There are three parties to a deed of trust: (1) the trustor, who owns the property that is conveyed to (2) the trustee as security for the obligation owed to (3) the beneficiary." (*Aviel v. Ng* (2008) 161 Cal.App.4th 809, 816.) "The trustee holds a power of sale. If the debtor defaults on the loan, the beneficiary may demand that the trustee conduct a nonjudicial foreclosure sale." (*Biancalana v. T.D. Service Co.* (2013) 56 Cal.4th 807, 813.) Once the sale is conducted, "[t]he purchaser at a foreclosure sale takes title by a trustee's deed." (*Id.* at p. 814.)

Civil Code sections 2924 through 2924k "provide a comprehensive framework for the regulation of a nonjudicial foreclosure sale pursuant to a power of sale contained in a deed of trust." (*Melendrez v. D & I Investment, Inc.* (2005) 127 Cal.App.4th 1238, 1249.) "These provisions cover every aspect of exercise of the power of sale contained in a deed of trust." (*I.E. Associates v. Safeco Title Ins. Co.* (1985) 39 Cal.3d 281, 285.) "Because of the exhaustive nature of this scheme, California appellate courts have refused to read any additional requirements into the non-judicial foreclosure statute." (*Gomes v. Countrywide Home Loans, Inc.* (2011) 192 Cal.App.4th 1149, 1154.)

"The nonjudicial foreclosure system is designed to provide the lender-beneficiary with an inexpensive and efficient remedy against a defaulting borrower, while protecting the borrower from wrongful loss of the property and ensuring that a properly conducted sale is final between the parties and conclusive as to a bona fide purchaser." (*Yvanova v. New Century Mortgage Corp.* (2016) 62 Cal.4th 919, 926.)

B. Enforcement of Multiple Obligations on the Same Security

A property may be used as collateral to secure different obligations, whether owed to different lenders or in favor of the same lender. When a property is encumbered by liens placed by different lien holders and the holder of the senior lien forecloses, the purchaser at the foreclosure sale takes title to the property free of the junior lien. "A senior foreclosure sale conveys the property free of all junior liens. Thus, the junior no longer has a lien on the property, and the security has been entirely destroyed." (*Bank of America v. Graves* (1996) 51 Cal.App.4th 607, 611–612 (*Graves*).) While the junior lien is extinguished, the debt secured by the lien is not terminated. The sold-out junior lienor can pursue a judgment on the junior loan without implicating or violating the anti-deficiency laws. (See *Roseleaf Corp. v. Chierighino* (1963) 59 Cal.2d 35, 39-44.) [6]

[6] "The term 'sold-out junior lienor' refers to the situation in which a senior lienholder forecloses its lien, eliminating the junior lienor's security interest." (*Graves, supra,* 51 Cal.App.4th at p. 611.) "A 'deficiency judgment' is a personal judgment against a debtor for a recovery of the secured debt measured by the difference between the debt and the net proceeds received from the foreclosure sale." (*Dreyfuss v. Union Bank of Calif.* (2000) 24 Cal.4th 400, 407.)

In articulating the "sold-out junior" exception to the general ban against deficiency judgments, this Court explained in *Roseleaf* that the rationale behind the anti-deficiency statutes and the one-action rule – e.g., to force the lender to go after the property – does not apply to sold-out juniors. "There is no reason to compel a junior lienor to go through foreclosure and sale when there is nothing left to sell." (*Roseleaf,* at p. 39.) Although *Roseleaf* involved liens held by different lenders, as discussed below, its holding and rationale apply equally where the same lender holds the senior and junior liens.

C. Because the Text of the Anti-Deficiency Law Does Not Encompass the Scenario Presented Here, There Is No Statutory Basis for Its Application.

The statutory defense invoked by Cobb on appeal is found in Code of Civil Procedure section 580d.[7] To determine the intended scope of this statute, the Court looks first to its language. (See *Kirby v. Immoos Fire Protection, Inc.* (2012) 53 Cal.4th 1244, 1250 ["If the statutory language is clear and unambiguous our inquiry ends"].) The text of the statutory language at issue here currently provides as follows:

> [N]o deficiency shall be owed or collected, and no deficiency judgment shall be rendered for a deficiency on a note secured by a deed of trust or mortgage on real property or an estate for years therein executed in any case in which the real property or estate for years therein has been sold by the mortgagee or

[7] Unless noted otherwise, all statutory references below refer to the Code of Civil Procedure.

trustee under power of sale contained in the mortgage or deed of trust.

(§ 580d, subd. (a).) Judging by this language, the statute bars deficiency judgments only when real property secured by a deed of trust "has been *sold* by the mortgagee or trustee under power of sale *contained in the ... deed of trust.*" (*Id.* [italics added].) The statute bars a deficiency judgment on the same note secured by the deed of trust which was foreclosed. It does not bar an action on a separate note secured by another deed of trust which was not the basis of the foreclosure.

In this case, after the property was "sold" by foreclosing on the senior lien (*id.*), Black Sky never tried to obtain a deficiency judgment on the senior note secured by the senior lien which was foreclosed. Because this action is for the balance due on the separate junior note, the statutory bar against a deficiency judgment under the senior lien – the lien by which the property was "sold" – has no application. (See *Roseleaf, supra*, 59 Cal.2d at p. 40 [applying this textual analysis in interpreting analogous language under the one-action rule's statutory language in section 726].)

Cobb's entire argument on appeal is directly preempted by *Roseleaf.* Interpreting section 580d in particular, this Court adopted Black Sky's reasoning in *Roseleaf* by focusing on the language of the former version of this statute. Quoting section 580d, the Court explained that it refers to a deficiency "upon a note secured by a deed of trust or mortgage upon real property hereafter executed in any case in which the real property has been sold by the mortgagee or trustee under power of sale contained in such mortgage or deed of trust." (*Roseleaf,* at p. 43). The Court held that the language of section 580d only bars a deficiency judgment on the note

secured by the same deed of trust which was foreclosed. It does not bar a separate action on a separate note which is secured by a junior deed of trust on the same property.

Similarly, the current version of section 580d precludes "a deficiency on a note secured by a deed of trust or mortgage ... in any case in which the real property ... has been sold by the mortgagee or trustee under power of sale contained in *the* mortgage or deed of trust." (§ 580d, subd. (a), italics added.) This makes it arguably more clear that the ban applies only to the loan that was the subject of the foreclosure sale—here, the senior loan. (See *Tiffin Motorhomes, Inc. v. Superior Court* (2011) 202 Cal.App.4th 24, 29 [statutory reference to "co-obligor on a contract debt" means "the parties must be co-obligors on '*a*' single contract"]; italics added.) Because Black Sky is seeking a judgment under the separate junior note, rather than the senior note which was secured by the senior lien that was the subject of the foreclosure sale, section 580d is not triggered.

Consistent with *Roseleaf*'s textual approach, lower courts have rejected other arguments raised by debtors by applying the text of the anti-deficiency statutes. (See, e.g., *Cadlerock Joint Venture, L.P. v. Lobel* (2012) 206 Cal.App.4th 1531, 1549 [holding that section 580d "simply does not apply on its face to a junior lien"]; *id.* at pp. 1542-1543 [explaining that under *Roseleaf*'s textual interpretation, "section 580d refers to a singular note, a singular deed of trust, and a singular trustee"]; see also *MDFC Loan Corp. v. Greenbrier Plaza Partners* (1994) 21 Cal.App.4th 1045, 1053, fn. 2 [examining the text of section 580b in concluding that it does not apply to third party purchase money loan used to acquire commercial property].)

The liberal construction rule invoked by Cobb throughout his brief does not cure the statutory gap discussed above. (OBOM 1, 5-7, 16-17, 20.) "Liberal construction may not be utilized to include within a statute that which the Legislature did not intend." (*Canal-Randolph Anaheim, Inc. v. J. E. Wilkoski* (1980) 103 Cal.App.3d 282, 293.) Because the text of section 580d, on its face, does not apply here, Cobb's entire argument on appeal is preempted on this basis alone.

II. The Discredited Case Authority Invoked by Cobb Provides No Basis to Automatically Apply Section 580d Against Dual-Lienholders.

A. Because the *Simon* decision is analytically flawed, this Court should overrule it.

The primary basis for Cobb's entire brief on appeal is *Simon, supra,* 4 Cal.App.4th 63—the leading case in which an intermediate appellate court refused to apply *Roseleaf* where a single lender, holding both liens, foreclosed on the senior one. In that case, involving a classic attempt to bypass the anti-deficiency statutes, the lender split a single loan into two loans, secured by separate deeds of trust on the same property. (*Simon,* at p. 66.) Both loans were recorded on the same day. (*Ibid.*) After the lender's non-judicial foreclosure of the senior lien eliminated the junior lien, the lender filed an action to recover a judgment under the junior loan.

Rejecting the lender's approach, the *Simon* court refused to "sanction the creation of multiple trust deeds on the same property, securing loans represented by successive promissory notes from the same debtor, as a means of circumventing the provisions of section 580d." (*Id.* at

p. 77.) The court reasoned that "[t]he elevation of the form of such a contrived procedure over its easily perceived substance would deal a mortal blow to the antideficiency legislation of this state." (*Id.* at pp. 77-78.) Adopting a categorical ban on deficiency judgments in dual lien-holder cases, the court held that "if legitimate reasons do exist to divide a loan to a debtor into multiple notes thus secured, section 580d must nonetheless be viewed as controlling where, as here, the senior and junior lenders and lienors are identical and those liens are placed on the same real property." (*Id.* at p. 78.) Otherwise, the court held, "creditors would be free to structure their loans to a single debtor, and the security therefor, so as to obtain on default the secured property on a trustee's sale under a senior deed of trust; thereby eliminate the debtor's right of redemption thereto; and thereafter effect an excessive recovery by obtaining a deficiency judgment against that debtor on an obligation secured by a junior lien the creditor chose to eliminate." (*Ibid.* [citing *Freedland v. Greco* (1955) 45 Cal.2d 462, 467].)

While *Simon*'s concerns in cases involving questionable lenders intentionally bypassing the anti-deficiency laws are legitimate, the categorical ban adopted by that court is flawed and inapplicable here. "There is nothing in the record that supports the conclusion that the second loan was in any way an attempt to circumvent the antideficiency statutes in the event of default on the first loan." (Typed opn. 10.) In fact, "the second loan was issued two years after the first, and the default did not occur until seven years later." (*Ibid.*)

Simon also relied on this Court's decision in *Freedland*, "but *Freedland* in fact provides little support. In *Freedland*[,] the creditor had obtained two $7000 promissory notes for the very same $7000 debt,

together with a deed of trust purporting to secure only one of the two notes." (Andrew, *Enforcement Issues for a Creditor Holding Multiple Deeds of Trust on the Same Property* (2009) 27 Cal. Real Prop. J. 33, 34.) In that case, this Court "readily concluded that § 580d barred a deficiency recovery on both notes after foreclosure of the deed of trust." (*Ibid.*) Because redundant notes for the same debt have no economic substance, this Court found them to be a "manifestly evasive device." (*Freedland,* at p. 467.) In this case, however, the second loan obtained by Cobb provided $1.5 million in additional funds in a brand new loan transaction, thereby making it literally impossible for the junior loan to function as an evasive device to bypass the anti-deficiency laws. Because *Simon* erroneously relied on the *Freedland* fact pattern, *Simon* is flawed by applying a categorical ban, irrespective of the legitimacy of the second/separate loan.

Contrary to *Simon*'s approach, this Court "has approved the separate treatment of truly separate, non-overlapping notes" in other cases. (Andrew, *supra,* at p. 34.) For example, in rejecting the application of the one-action rule, this Court has interpreted *Roseleaf* to mean that if there are "separate debts with separate security, even though arising from *one transaction*, then section 726 has no application." (*Walker v. Community Bank* (1974) 10 Cal.3d 729, 740, fn. 5 [italics added].) [8]

Disregarding this critical point, "[t]he *Simon* court's indifference to legitimate reasons for separate notes evidencing separate amounts seems hard to justify. For example, lenders often make a purchase-money first-

[8] Codifying the one-action rule, section 726 "prevents a secured creditor from ignoring its security and suing on the underlying note or debt." (1 Bernhardt, Cal. Mortgages, Deeds of Trust, and Foreclosure Litigation (Cont.Ed.Bar 4th ed. 2009) § 4:6, p. 4-6.) As discussed below, this statute is not implicated here.