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July 17, 2017

Double Trouble—Is Black Sky Capital Blue Skies for Lenders?

An annoying question for lenders is whether or not a lender can enforce two loans to the same borrower and secured by the same property. The nagging issue is usually raised when a lender makes (1) a first loan and an additional advance to the borrower secured by the same property, (2) a first secured loan followed by a secured credit line or (3) a first secured loan and a new secured second loan to finance other properties.

In California, there can only be "one form of action," either a judicial foreclosure or a non-judicial foreclosure. In a judicial foreclosure, if the real property collateral is sold for less than the amount owed under the secured debt, the lender may sue for a deficiency judgment—the difference between the amount owed and the fair market value of the property. (Cal. Civ. Pro. Code § 726). In a judicial foreclosure, the borrower has a right of redemption. In a non-judicial foreclosure, no deficiency judgment is allowed under a power of sale in a deed of trust. (Cal. Civ. Pro. Code § 580(d)). In a non-judicial foreclosure, the borrower has no right of redemption. When there is a senior deed of trust and a junior deed of trust and the senior lender sells the property by a non-judicial foreclosure and the real property collateral is sold for less than the amount owed under the total secured debt, the junior lender becomes a "sold-out junior," and the junior lender may enforce its promissory note against the borrower in a judicial proceeding, (*Roseleaf Corp. v. Chierighino* (1963) 59 Cal.2nd 35, 43-44).

So what happens when a lender holds both the senior deed of trust and the junior deed of trust? Can it non-judicially foreclose the senior deed of trust and then be a "sold-out junior" and sue on the promissory note?

In *Simon v. Superior Court*, 4 Cal.App.4th 63 (1992), the *Simon* court said no, a senior lender cannot non-judicially foreclose the senior deed of trust and then claim it is a "sold-out junior" and judicially collect on the promissory note. The rationale was "[w]e will not sanction the creation of multiple trust deeds on the same property, security loans represented by successive promissory notes from the same debtor, as a means of circumventing the provisions of section 580d." (Id.) Under the *Simon* rationale, if a lender were to sue on the promissory note secured by the foreclosed-out junior deed of trust, then the judicial action on the second promissory note would "eliminate the debtor's right of redemption thereto; and thereafter effect an excessive recovery by obtaining a deficiency judgment against the debtor on an obligation secured by a junior lien the creditor chose to eliminate." (Id. at 78)

Since 1992, lenders did what *Simon* says.

Then, on June 14, 2017, in *Black Sky Capital, LLC v. Cobb*, 17 C.D.O.S. 5699 (2017), the U.S. Court of Appeals for the Fourth District decided not to do what *Simon* says. The *Black Sky* court reasoned that "Section 580d precludes recover 'for a deficiency on a note secured by a deed of trust . . . 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. By using the singular throughout the statute, the Legislature unambiguously indicated that section 580d applies to a single deed of trust; it does not apply to multiple deeds of trust even if they were secured by the same property.'" (Id. at 8) The *Black Sky* court held "that [section 580d] does not apply to preclude [the holder of a junior deed of trust] from suing for the balance due on the junior note [when the senior lender is also a 'sold-out junior' when the loans were not made concurrently]. It makes no difference whether the junior lienholder is the same entity or a different entity as the senior lienholder." (Id.)

It is important to note that in *Black Sky*, the senior loan secured by the senior deed of trust was made in 2005. Two years later in 2007, the junior loan secured by the junior deed of trust was made. The default and the non-judicial foreclosure on the senior deed of trust occurred later in 2014.

Does it matter that there were two years between the senior loan secured by the senior deed of trust and the junior loan secured by the junior deed of trust? The *Black Sky* case stated that "the second loan was issued two years after the first, and the default did not occur until seven years later. 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." (Id. at 6)

Will the *Black Sky* case apply when the senior deed of trust and the junior deed of trust are recorded simultaneously? Will that appear as a circumvention of section 580d? Under the conclusion of *Black Sky* court, the timing of the recording of the multiple deeds of trust may not matter as the court relied on the plain language of section 580d and the references to a singular deed of trust.

There is a clear conflict between the *Simon* and the *Black Sky* cases. We will need to wait for the Supreme Court of California to resolve the differences. Until that happens, a lender is still vexed with double trouble if it makes two loans to the same borrower secured by the same property.

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This update was republished in the [September issue](#) of the Real Property Law Section e-Bulletin of the *California Bar Journal*.

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