QUARTERLY PROPHETS
Legal Trends & Developments Affecting the Financial and Business Communities

FRANDZEL ROBINS BLOOM & CSATO, L.C.

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Editors' Introduction

Dear Friends,
2010 has been a very eventful year in the financial services industry. Newly enacted legislation at the federal and state levels — some of which will be discussed in this issue of Quarterly Prophets — promises to affect all of us in the future. As we come to the end of this year, we want to take a moment to wish you and your family a very Happy Holiday Season and a healthy and prosperous 2011.

Dodd-Frank Act: Financial Reform with More Regulations for Bank

By Patricia Y. Trendacosta

Calls for financial reform have echoed throughout the halls of Congress since the beginning of what has been characterized as the worst financial crisis since the Great Depression. On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Act"). An omnibus reform package, the Act creates several new regulatory offices, addresses the "Too Big to Fail" concept, eliminates one of the last vestiges of government regulation of demand deposits, and provides for transparency and accountability for certain financial investment products. The Act is massive, cutting across all sectors of the financial industry, and will take months, if not years, before the full effect of the legislation is truly felt. Clients are urged to consult their lawyers for a brief summary of certain provisions to the Act.

MORE REGULATORS

Commercial banking has historically been considered one of the most heavily regulated industries in the nation, with government dictating the banks' cost of funds and rates of return. A lot of those regulations have been lifted and one of the key remaining vestiges has now been repealed.

However, not to be outdone, the Act adds at least five additional oversight/regulatory bodies, which are discussed below and elsewhere in this article.

Financial Stability Oversight Council and Office of Financial Research

Created to address and respond to systemic risk in the economy and provide additional research capability for the Federal Reserve, Congress established the Financial Stability Oversight Council ("Council")

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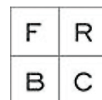

CALIFORNIA CODE OF CIVIL PROCEDURE SECTION 580e – INTRODUCING NEW LIMITATIONS ON DEFICIENCIES AFTER SHORT SALES

By Mercedes O. Martin

On September 30, 2010, Governor Schwarzenegger signed Senate Bill 931 (SB 931) into law which adds Section 580e to the California Code of Civil Procedure. SB 931 aims to protect borrowers by adding yet another layer to California's current anti-deficiency laws. Effective January 1, 2011, Section 580e introduces broad limitations on the ability of lenders to obtain deficiency judgments after consenting to a short sale. Lenders will no longer be able to pursue deficiency judgments against mortgagors or trustors for the difference between the obligation and the amount obtained in a short sale.

Old law vs. New law

A short sale occurs when a mortgagor or trustor sells real property securing a loan for less than the balance owed on the loan. Existing law permits lenders to seek a deficiency judgment for the unpaid balance of a loan after the lender has consented to a short sale. Once Section 580e becomes effective, a lender's written consent to a short sale acts as an automatic waiver of a lender's right to pursue a deficiency judgment against a mortgagor or trustor for the unpaid balance of the obligation.

In relevant part, Section 580e states "No judgment shall be rendered for any deficiency under a note secured by a first deed of trust or first mortgage for a dwelling of not more than four units, in any case in which the trustor or mortgagor sells the dwelling for less than the remaining amount of the indebtedness due at the time of sale ..."

"Once consented to in writing, a lender is obligated to "accept the sale proceeds as full payment and to fully discharge the remaining amount of the indebtedness on the first deed of trust or first mortgage."

Essentially, the effect of Section 580e will be to prohibit recovery of a deficiency after a short sale if: (1) the obligation is a note secured by a first deed of trust, (2) the real property securing the deed of trust is a dwelling of four units or less, and (3) the property is sold with the written consent of the lender.

There are exceptions to this new rule. The reach of Section 580e's anti-deficiency rule is restricted to first position lien holders and has no application to second position or other junior lien holders. Section 580e also states it "shall not apply if the trustor or mortgagor is a corporation or political subdivisions of the state." Neither does Section 580e apply if the note is secured by a first deed of trust or first mortgage for a dwelling of more than four units, therefore excepting commercial projects and the like. Furthermore, if a borrower "commits either fraud with respect to the sale of, or waste with respect to, the real property that secured the first deed of trust or first mortgage," the short sale anti-deficiency protections are lost and the lender may pursue a deficiency plus seek damages for fraud or waste from the trustor or mortgagor or a third party.

The adoption of SB 931 can be directly attributed to the dramatic increase of short sales in California since 2007. According to the California Association of Realtors, in 2009 there were approximately 90,000 short sales, as opposed to a few thousand in 2008. Given the increasing popularity of short sales, and the ability of lenders to reserve their rights to pursue a deficiency thereafter, some borrowers or obligors have been left in a far worse position than if they had simply let their lender foreclose.

The most common example would be a defaulting borrower whose loan is secured by a first deed of trust on a residence. The borrower favors a short sale over a foreclosure because he or she believes that any difference between the sale price and the amount of the obligation will be discharged. Such borrowers are surprised when months later, a lender pursues them for the deficiency. Borrowers are further surprised when they discover had the lender proceeded with a non-judicial foreclosure instead, the lender would have been precluded from pursuing any deficiency. As stated by the California Senate Committee on Banking, Finance, and Insurance, and the Senate Judiciary Committee, the purpose of SB 931 is to ensure that borrowers who have a non-purchase money recourse loan on residential property are no worse off financially after a short sale than after a foreclosure action.

Applicability in Other Contexts

Although the purpose of SB 931 is clear, eliminating the financial disparity that may occur between foreclosures and short sales, the language of Section 580e leaves its applicability to a variety of alternative lending situations unanswered. The statute specifically references obligations evidenced by a "note", which begs the question: does Section 580e apply to guarantees secured by real property? does it apply to equipment leases secured by real property? The new statute is vague as to its application to lending transactions in which the obligation is evidenced by an instrument other than a promissory note.

Because the statute does not provide answers, courts may look to the legislative history of SB 931 to find the limits of Section 580e's reach. The language of Section 580e states it is applicable to obligations evidenced by a note. However, in its analysis of SB 931, the Senate Judiciary Committee recognized that the purpose of the legislation is to protect distressed homeowners who have non-purchase money recourse loans on residential property when the fair market value of the subject property is less than the amount owed on the first deed of trust. Although this would suggest that SB 931 did not contemplate application of its anti-deficiency limits be-

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Mercedes O. Martin specializes in commercial and real estate loan documentation and real estate transactions.

POTENTIAL PITFALLS FOR LENDERS CONSIDERING MULTIPLE DEEDS OF TRUST ON THE SAME PROPERTY

By Loren R. Gordon

These days it is quite common for a lender to cross-collateralize two or more loans to a single borrower by recording multiple deeds of trust on the same real property collateral. This is especially true when the value of a borrower's real estate portfolio seems to be in an endless freefall, but one property is maintaining equity. Many lenders focus primarily on the upside of having multiple deeds of trust on such a property; if the borrower succeeds in selling the property, the lender hopefully will receive payment in full from the proceeds of the sale. However, many times this is not the result, and the only thing the lender succeeds in doing by cross-collateralizing the debt is complicating enforcement of the obligations. Therefore, a lender must consider certain important issues when evaluating that strategy, including whether the transfer is voidable as a preference, whether the transfer might be considered a fraudulent conveyance, and whether the lender will be limiting its enforcement options. This article will focus on situations where the borrower defaults on a cross-collateralized obligation and what the lender's rights and remedies might be should it need to enforce its security interests.

In California, the enforcement of any debt secured by real property must be by either judicial process in accordance with California Code of Civil Procedure sections 726 et seq.(judicial foreclosure), or by the power of sale contained in the deed of trust pursuant to California Civil Code sections 2924 et seq. (non-judicial foreclosure). In a judicial foreclosure action, the lender may be able to obtain a deficiency after completing the foreclosure, but in a non-judicial foreclosure a deficiency on the obligation is generally not permitted once the sale occurs. A lender must be cognizant of the ramifications of these differences because each of these remedies has benefits and burdens, and those should be considered when a credit is structured and real property collateral is analyzed.

Consider the following example: a lender has two loans to one borrower — a term loan secured by real property, and an unsecured line of credit. The loans were made at different times and for different purposes. While the borrower has significant assets, the borrower is not liquid, the unsecured line of credit is set to mature soon and the borrower has no ability to repay the loan to the lender. The borrower has requested an extension and modification, and the lender is willing to agree to the request provided that the borrower gives the lender, among other things, a second trust deed lien on the real property collateral that secures the term loan - - ostensibly because there is equity in the real property above and beyond the first deed of trust. By securing the previously unsecured line of credit with the same real property collateral the lender has now, at a minimum, complicated the enforcement of both loans. Following the collateralization of the unsecured line of credit, if there is a default on the line of credit, and the lender wants to obtain a deficiency against the borrower (because the equity in the real property may not be sufficient to cover both loans), the lender will likely need to pursue judicial foreclosure on both loans in order to preserve the right to a deficiency (and the ability to go after borrower's other assets) on the line of credit. This will cost the lender substantially more time and expense than a non-judicial foreclosure, and includes a number of other complications that most lenders prefer to avoid (such as a 1-year redemption period for the borrower after the judicial foreclosure). *See, e.g.,* Cal. Code Civ. Proc. 729.030(b). Had the lender not cross-collateralized the line of credit, it would have been free to pursue the assets of the borrower without regard to the real property collateral.

Consider the following example: a lender has two loans to one borrower — a term loan secured by real property, and an unsecured line of credit.

Most importantly, where there are multiple deeds of trust on the same property and the more senior of the deeds of trust is foreclosed upon, the result is probably the extinguishment or elimination of the junior deed of trust lien. *See Simon v. Superior Court of Contra Costa County*, 4 Cal. App. 4th 63 (1992). The Court in *Simon* held that the lender cannot claim "sold out junior" status and seek a deficiency after it completes a non-judicial foreclosure on the senior deed of trust and extinguishes its own junior trust deed lien. *Simon,* 4 Cal. App. 4th at 66. This result is in contrast to a situation where the deeds of trust were held by separate unrelated parties and the loans secured by such deeds of trust were unrelated and originated at different times. In that case, the junior trust deed holder is considered a "sold out junior" and would have the right to pursue the borrower for a deficiency following the foreclosure by the senior trust deed holder and extinguishment of the junior trust deed holder's lien, subject to and in accordance with applicable law. *See* Cal. Code Civ. Proc. § 580a; *see also, Simon,* 4 Cal. App. 4th at 71 (citing *Roseleaf Corp. v. Chierighino*, 59 Cal. 2d 35, 39 (1963).

The holding in *Simon* effec-

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Loren R. Gordon has been named a "Rising Star" by Southern California Super Lawyers Magazine for two years in a row (2009-2010). His practice emphasizes major debt workout negotiations, restructuring, and documentation of commercial credits, personal property and real estate-secured credits, and construction credits, as well as loan and real property sales.

WHEN DOES YOUR FINANCING STATEMENT REALLY EXPIRE?

By Marshall J. August

On June 30, 2006, the 5-year transition period of revised Article 9 of the Commercial Code took effect. The expiration of the transition period created an ambiguity as to the effectiveness of financing statements filed under the former Article 9. Specifically, some financing statements may cease to be effective at the end of the transition and not the scheduled lapse date. Almost five years after the expiration of the transition period, concerns still remain for any financing statement affected in 2006 that is effective and will be approaching his new lapse date in 2011. Secured parties that plan to continue any of the effective financing statements need to exercise caution due to the uncertainty surrounding the interpretive issue as to the expiration of the financing statement.

When revised Article 9 took effect in 2001, it changed the designation for the filing of the financing statement from the location of where the collateral was located to the location of the debtor (for a corporation, the place would be the state of its incorporation). Although the change simplified the filing process, many financing statements that were filed under the old law would not be in compliance with revised Article 9. To ensure that financing statements filed under former Article 9 would remain effective after revised Article 9 took effect, special transition rules were created. The rules provide a mechanism for a secured party to move existing financing statements to the correct location under revised Article 9, although they imposed a time limit to make the correction up to June 30, 2006. Specifically, Section 9-705(c) provides that a financing statement filed under old Article 9 ceases to be effective under the law of the jurisdiction in which it was filed or June 30, 2006. Simply put, if a financing statement was properly filed under old Article 9, a secured party had until the lapse date or June 30, 2006, whichever came first to file a financing statement in the correct jurisdiction.

Secured parties that plan to continue any of the effective financing statements need to exercise caution due to the uncertainty surrounding the interpretive issue as to the expiration of the financing statement.

An ambiguity exists, however, because Commercial Code section 9-705(d) provides that a secured party could continue the effectiveness of a financing statement that was filed under old Article 9 that was filed in the correct filing office under both former Article 9 and revised Article 9 by simply filing a continuation statement. When Section 9-705(c) and 9-705(d) are read together, an ambiguity arose. One interpretation was that Section 9-705(c) applied only to financing statements filed in a filing office that was correct under the old law, but incorrect under revised Article 9. Another interpretation was that Section 9-705(c) meant that it only applied to all financing statements that were filed under the old Article 9 and would cease to be effective on June 30, 2006, unless brought into compliance under revised Article 9. Given the ambiguity, there is an interpretive issue as to what the lapse date would apply to those financing statement due to lapse between July 1 and December 31, 2001, that were continued under the old Article 9, a portion of the 6 month continuation window. Secured parties could not be certain whether these affected financing statements would cease to be effective on June 30, 2006, or lapse at the end of the full 5 year period provided in Section 9-705(d).

This ambiguity is exemplified as follows: A financing statement originally filed on September 15, 1996 and continued for the effective date of prior Article 9 would have a new lapse date of September 15, 2006. Depending upon how a Court might interpret Section 9-705(c) the financing statement may have ceased to be effective on June 30, 2006, not the September 15, 2006 date. Based upon these ambiguities, a safe harbor provision was created during which a secured party could file its continuation statement for an affected financing statement regardless of how the courts interpreted Section 9-705(c). That safe harbor ran from January 1, 2006 through June 30, 2006.

Questions for 2011 still remain. The multiple interpretations of Commercial Code section 9-705(c) creates uncertainty regarding whether the financing statements will next elapse on June 30, 2011 or the fifth anniversary of the original lapse date. If Section 9-705(c) applies to all financing statements filed under former Article 9, then they lapse on June 30, 2011, instead of the lapse date from the filing of the continuation statement.

For those secured parties concerned about section 9-705(c), steps can be taken to minimize the risk. Those steps are as follows: Identify those financing statements that (1) were originally filed on or before December 31, 1996; (2) were due to lapse between July 1, and December 31, 2001; (3) were continued on or before June 30, 2001; and (4) were continued again on or before June 30, 2006. If any active financing statements meet the above criteria the secured party needs to file its next continuation statement prior to the expiration of the lapse date of the continued financing statement but in no event later than June 30, 2011.

Marshall J. August's practice emphasizes provisional and post-judgment remedies including receiverships, writs of attachment, writs of possession and enforcement of judgments. Mr. August has been a frequent lecturer for the Los Angeles County Bar and client groups on creditor's rights and remedies. He is a member of the Los Angeles County Bar Association (former Chair, Secretary and member of the Executive Committee of the Provisional and Post-Judgment Remedies Section, 1988-2002; Secretary, 1990-91; Treasurer, 1991-92; Vice Chair, 1992-93; Chair, 1993-94; Editorial Board, Provisional and Post-Judgment Remedies Section Newsletter, 1989), the American Bar Association, the Equipment Leasing Association and the State Bar of California.

Financial Reform

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and the Office of Financial Research ("Research Office").

Headed by the Treasury Secretary, the Council is comprised of 10 representatives from the federal financial regulators and one independent member (plus five non-voting members). The Council is intended to facilitate information and data sharing among the financial regulators and, together with the Research Office, to monitor and collect financial information for purposes of, among other things, providing regular reports to Congress on the financial stability of the U.S.

However, the powers of the Council go beyond financial system monitoring and assessment. Under specific circumstances, the Council's reach can impact the regulatory oversight of nonbank financial companies and domestic subsidiaries of foreign banks by putting those entities under the supervision of the Federal Reserve.

The Consumer Financial Protection Bureau

Intended to strengthen the consumer protection role of the federal financial regulatory agencies, the Act creates the Consumer Financial Protection Bureau ("Bureau"). The Bureau is intended to consolidate the roles of the Comptroller of the Currency, Office of Thrift Supervision, Federal Deposit Insurance Corporation ("FDIC"), Federal Reserve, National Credit Union Administration, Department of Housing and Urban Development, and Federal Trade Commission. The Bureau will be headed by an independent director appointed by the President and confirmed by the Senate.

"TOO BIG TO FAIL"

As with prior financial crises, the issue of whether any financial institution was too big to fail was addressed at length by media, industry and Congressional titans. The Act attempts to address the seeming inequity of the concept of "too big to fail" by adopting a policy that no taxpayer will be responsible for saving a failing financial company or cover the cost of such company's liquidation. This would be effected by a procedure whereby the financial regulatory agencies, either jointly or independently, by a two-thirds vote, could vote for the orderly liquidation of an institution and/or the appointment of a receiver.

While many, at first blush, may see little difference from that which is currently employed by the FDIC and other regulators, the Act does require certain oversight by and reporting to Congress. Financing of such orderly liquidations, to the extent any such liquidations are beyond the jurisdiction of the FDIC and the Securities Investors Protection Corporation, will be managed by the FDIC through the use of a new, separate fund that will be funded by covered financial institutions. The federal government's liquidation obligation is limited to 10% of the total consolidated assets of the institution, or 90% of the fair value of the total consolidated assets.

The Act also limits the ability of large financial firms to continue to acquire companies if the acquisition would result in total consolidated liabilities of the acquirer to be in excess of 10% of the aggregate consolidated liabilities of all financial companies.

Perhaps one of the most significant changes is the tinkering with investment and commercial bank regulations to cover financial institutions that serve as banks and commercial firms.

REGULATORY EFFICIENCIES and LESS REGULATION

In the never-ending search to streamline the financial regulatory system, the Act abolishes the Office of Thrift Supervision and delegates regulation of thrifts to appropriate regulatory agencies.

The temporary increase of FDIC insurance coverage for deposits to $250,000 has been made permanent by the Act.

Regulation Q, the prohibition on payment of interest on demand deposits has now been repealed. While effectively repealed earlier for consumers with the establishment by Congress of NOW (i.e., Negotiable Order of Withdrawal) accounts, the repeal of Regulation Q will end the general prohibition against paying interest on commercial DDAs. While it will free up institutions with respect to its commercial depositors, a cottage industry of companies established to effectively provide interest on a business' demand deposit account will be challenged to create new, higher paying products for their bank clients.

MORE REGULATIONS

Perhaps one of the most significant changes is the tinkering with investment and commercial bank regulations to cover financial institutions that serve as banks and commercial firms.

Under the Act,

- The FDIC may not approve, for 3 years, applications for FDIC insurance for entities owned by a commercial firm, nor can a federal regulatory agency approve an application that will result in a commercial firm controlling a credit card bank, trust bank or industrial bank.

- The Federal Reserve is given greater authority as to the types and timing of additional reports from bank holding companies.

- Bank holding company capital requirements are strengthened.

- The Federal Reserve must include, in its evaluation of bank holding company applications to acquire banks or nonbanks, the risk to the stability of

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Financial Reform

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the U.S., banking or financial systems.

- More stringent capitalization criteria are also imposed for interstate acquisitions.

- Lending limits for national banks (and very likely, state banks) are expanded to include direct and indirect advances of funds based on repayment from specific collateral, advances pursuant to a contractual commitment, credit exposure from a derivative transaction, repurchase agreements, reverse, repurchase agreements, and the like.

- Charter conversions for banks will be permitted only for institutions not operating under written enforcement agreements with regulators.

- Banks will not be able to sell assets to insiders or any related interest, except under certain circumstances.

- Investment bank holding companies will no longer be able to elect (or withdraw from) regulation by the SEC.

- A regulatory scheme for securities holding companies is created which shall be under the jurisdiction of the Federal Reserve. The Federal Reserve is charged with the responsibility of promulgating capital adequacy and risk management standards for these securities holding companies.

Moving away from the long-held belief that the insurance business was to be the purview of the states, the insurance industry will also be affected by the Act. It establishes the Federal Insurance Office ("Insurance Office") which will be headed by a director appointed by the Treasury Secretary. The Insurance Office is charged with the responsibility to monitor all aspects of the insurance industry, consult with the states regarding insurance matters of national importance and coordinate federal efforts to develop policy on international insurance matters.

CONSUMER REGULATION

The Act establishes a new "independent" federal agency, the Bureau of Consumer Financial Protection ("Consumer Protection Bureau") charged with oversight for industry compliance with consumer financial regulations. The Consumer Protection Bureau will be headed by a director appointed by the President and confirmed by the Senate and consolidates the consumer protection responsibilities currently held by the OCC, Office of Thrift Supervision, FDIC, National Credit Union Administration, the Department of Housing and Urban Development and Federal Trade Commission. Although the Consumer Protection Bureau is required to coordinate with the Federal Reserve on compliance with federal consumer financial laws, the Federal Reserve cannot intervene in any matter before the Consumer Protection Bureau's director or appoint or remove any officer or employee of the Consumer Protection Bureau.

Further, the Consumer Protection Bureau is authorized to promulgate rules covering bank and non-bank institutions covering consumer protection and implement federal consumer financial protection laws through rules, order, guidance, interpretations, statements of policy, examination and enforcement actions.

MORTGAGE REFORM

Addressing the flood of residential foreclosures caused by the economic downturn, Congress passed legislation aimed at (1) stemming abuses by residential mortgage originators, (2) establishing national minimum underwriting standards, (3) regulating certain high-cost mortgages, (4) creating an Office of Housing Counsel. This part of the Act also amends the Real Estate Settlement Procedures Act covering the activities of a mortgage servicers.

An as yet unanswered question is whether a lender may offer loans with balloon payments or prepayment penalties.

Potential Pitfalls

(continued from page 3)

tively exonerates the borrower from further liability for the junior loan, leaving the lender with the property as its sole source of recovery for both loans. *Simon,* though, dealt with a lender who non-judicially foreclosed upon its senior deed of trust, thereby extinguishing its junior trust deed lien. *Id.* However, in certain circumstances, lenders, for one reason or another, wish to do the opposite (i.e., foreclose on the junior trust deed lien and leave the senior trust deed lien in place). The law in this area is not at all settled in California, and there are a number of cases and concepts that have yet to be homogenized in a way that would provide meaningful guidance to lawyers and lenders. *See Enforcement Issues for a Creditor Holding Multiple Deeds of Trust on the Same Property,* Michael T. Andrew, 27 California Real Property Journal No. 1, at p. 39 (2009). However, under the existing case law, it is sufficient to say that a lender which forecloses on its second trust deed lien with the intention of keeping in place the first trust deed lien, *and* the loan secured thereby, runs the risk of having both the senior lien and the senior obligation deem merged into the lender's fee interest in the property. *See, e.g., Romo v. Stewart Title of California,* 35 Cal. App. 4th 1609, 1617 (1995); *see also*, *Kolodge v. Boyd*, 88 Cal. App. 4th 349, 361-62 (2001). Based on these cases, the question of whether the doctrine of merger would apply (either merger of lien or merger of obligation) would appear to turn on the specific facts of each case (including, but not limited to, whether the lender made a full credit bid at the trustee's sale, whether merger "...prevents injustice and serves the interests of the person holding the two estates...", and the intent of the parties). *Kolodge*, 88 Cal. App. 4th at 362.

Given the complexities (and at times, the uncertainty) of California law in this area, we recommend that lenders do a detailed, fact-based analysis before structuring, restructuring or collateralizing loans with multiple deeds of trust on the same property. In this way, a strategy can be developed to maximize recovery on a defaulted debt before the default occurs.

Deficiencies After Short Sales

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yond the residential non-purchase money recourse loan realm, this hardly confines the applicability of Section 580e to a whole host of lending scenarios. Section 580e intends to protect "homeowners," which could also include guarantors and equipment lessees so long as the obligation is secured by a first deed of trust on property. This implies that Section 580e would apply to any obligation secured by a first deed of trust, regardless of whether the obligation is evidenced by a note or otherwise.

Along similar lines, it remains to be seen whether the protections of Section 580e can be waived. If a lender keeps language asserting its rights to seek a deficiency in an approval letter or short sale agreement, is this considered a waiver of the protections afforded by Section 580e? Can a lender avoid the limitations of Section 580e by asking a borrower or obligor to sign a new promissory note as a condition to approval of the short sale? Given the public policy considerations behind the enactment of SB 931, waiver of the protections afforded by Section 580e is questionable.

MEASURING THE EFFECT

The inability of first position deed of trust holders to sue trustors or mortgagors after a short sale for the unpaid balance of an obligation will most certainly affect a lender's determination of whether or not to approve a short sale. It is not hard to imagine how this consumer protection legislation could have the opposite effect than the one intended. Once lenders are precluded from exercising the option to pursue any deficiencies after foreclosures and short sales, a lender might not have an incentive to consent to a short sale rather than to proceed with foreclosure, although the lender does avoid the potential of taking ownership of the property. As a result of Section 580e, California may see in increase in judicial foreclosures. Whether Section 580e will have a chilling effect on short sales as a whole is dependent on a multitude of factors, such as Section 580e's applicability to alternative lending scenarios, and whether the short sale anti-deficiency protections can be waived. It remains to be seen how courts will interpret this new Section but as discussed above, the reach of Section 580e could very well be broad and its protections may not be waived. At best, we can look to legislative intent and extrapolate from existing case law interpreting other anti-deficiency rules to form educated estimations as to how broad or narrow Section 580e's reach will be. Until then, lenders should remain aware of the potential application of Section 580e to short sales occurring after December 31, 2009, whether the property involved secures an obligation evidenced by a note or otherwise.

NAMES IN THE NEWS

Bernard R. Given, II, will be serving a second term on the Los Angeles County Bar Association Bankruptcy Sub-Committee.

Thomas M. Robins, III, received in June 2010 a jury verdict in favor of a banking client and against two guarantors on their cross-complaint to rescind their respective guaranties on the grounds that they were "sham guaranties." The bank had made a $7.3 million loan to the borrower secured by a deed of trust on raw land the borrower was developing into "paper lots", guarantied by an affiliated corporation and its owner. When the loan matured and the borrower did not pay it off, a subsequent buyer of the loan sued on the guaranties.

In response, the guarantors raised the "sham guaranty" in a cross-complaint against the loan buyer and the bank, claiming that the bank never intended to look to the borrower or the property but structured the transaction to avoid California's anti-deficiency and one-action rule legislation. The guarantors pointed to facts that (1) the bank had demanded the guaranties, (2) beyond obtaining an appraisal of the property, the bank never looked to the financial wherewithal of the borrower but only the guarantors, (3) all of the relevant pre- and post-loan funding internal memos of the bank relating to the loan referred to the borrower and guarantors collectively as "borrower" or "sponsor", and (4) to testimony of a former officer that he had supposedly been trained by his superiors at the bank about the one action rule and how to avoid it.

The court ruled that in the absence of a situation where the guarantor would be subject to liability for the loan without the guaranty, e.g., where the guarantor was a general partner of the borrower or a co-obligor on the loan, the "sham guaranty" doctrine would only apply if the guarantor had originally approached the lender for the loan but the lender restructured the transaction so that another person or entity was made the borrower and the person originally applying for the loan was made the guarantor and that, absent such a restructuring, the lender's alleged "secret" intention to look first to the guarantor if there was a default, or its underwriting of the loan relying principally on the financial strength of the guarantor was irrelevant. After being instructed in this regard the jury returned a verdict for the bank and against the guarantors, finding that no such restructuring had occurred in this transaction.

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