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Are You Ready for the Next Downturn? A Lender May Be Able to Both Foreclose on a Senior Lien and Seek a Deficiency on a Junior Lien

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Since the 1992 decision in <u>Simon v. Superior Court</u>, California lenders holding senior and junior liens on the same real property were barred from **both** non-judicially foreclosing pursuant to the senior lien **and** seeking a deficiency judgment on the junior lien. The *Simon*court recognized that a true "sold-out junior," whose lien was extinguished because a third party senior lender decided to conduct a non-judicial foreclosure sale, was not barred from seeking a deficiency judgment, but held that if a party controlled both the senior and junior liens and all related foreclosure decisions, they were not a true sold-out junior and that anti-deficiency laws barred them for pursuing a deficiency judgment. The *Simon* court was concerned that if the rule were otherwise, lenders would structure a single loan as two loans to increase potential recoveries against the borrower, thereby circumventing anti-deficiency protections.

In <u>Black Sky Capital</u>, <u>LLC v. Cobb</u>, California's Fourth District Court of Appeal recently rejected the reasoning of *Simon*, and held that a lender was not necessarily barred from enforcing the junior debt under these circumstances. The *Black Sky* court narrowly interpreted the anti-deficiency language of Code of Civil Procedure § 580d and determined that it did not apply to the junior lien in that case because, among other things, the senior and junior debts were separate obligations made years apart and there was no evidence the second loan was made in an attempt to circumvent the anti-deficiency statutes. **Note**, the California Supreme Court has granted review of this case, and may issue an opinion later this year.

Potential Impact

The *Black Sky* decision potentially opens the door for lenders to enforce two liens on the same property in this manner for the first time in more than 25 years. Lenders in the right circumstances would have the option to sue the borrower for collection of the "sold-out" junior lien debt following the foreclosure of the senior lien. However, the court's analysis left open many questions concerning what circumstances might be seen as an attempt to circumvent anti-deficiency laws (e.g. what if the two loans were made simultaneously, not years apart?). The California Supreme Court's decision may provide clarity on this issue one way or another. Stay tuned.

Read Part two here.

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