

Prospective Waivers of the Fair Market Value Defense Held Invalid in Arizona Court

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In an opinion issued last week, the **Arizona Court of Appeals** held that commercial borrowers and guarantors cannot prospectively waive their right to limit their damages in a deficiency action on the basis of the fair market value of property sold through a trustee's sale, potentially impacting any loan agreements that provide for such waivers. The holding does not affect most residential loans, for which lenders are generally precluded from recovering deficiencies.

Background

A.R.S. § 33-814(A) provides that borrowers, and by extension guarantors, are entitled to a credit on the underlying debt for the greater of the trustee's sale price or the fair market value of the trust property at the time of the sale, as determined by the court at a priority hearing. The purpose of these provisions is to protect borrowers from inequities that may result if the property is sold below market value. In an effort to avoid litigation, lenders sometimes include language in loan documents stating that borrowers and guarantors waive the ability to seek a determination of market value.

The Arizona Court of Appeals Abolishes Prospective Waivers of the Fair Market Value Defense

A prospective waiver of a fair market value hearing was at issue in *CSA 13-101 Loop, LLC v. Loop 101, LLC*, No. 1 CA-CV 12-0167, 2013 WL 4824461 (Ariz. App. Sept. 10, 2013). In that case, a lender made a \$15.6 million loan, which was secured by a deed of trust. In the note and guaranty, the borrower and guarantors waived "the benefits of any statutory provision limiting the right of [lender] to recover a deficiency," including the benefits of A.R.S. § 33-814. Even more specific, the deed of trust stated that the sales price at the trustee's sale would conclusively establish the fair market value of the property and that the borrower and guarantors waived their ability to seek a fair market value determination.

Following a default, the lender initiated a trustee's sale, at which the lender's assignee purchased the property with a credit bid of \$6.15 million. At the time, about \$11.2 million remained due on the note. The lender's assignee then brought a deficiency action against the borrower and guarantors

for the difference. The borrower and guarantors counterclaimed, asserting that the credit bid was unreasonably low. The court denied a motion to dismiss the counterclaims, holding the borrower and guarantors were entitled to a fair market value hearing notwithstanding the written agreements to the contrary.

The Court of Appeals affirmed, holding that the deed of trust statutes impliedly prohibit prospective waivers of fair market value hearings. The court relied on the purpose of the deed of trust statutes, the comprehensiveness of the protections, and the legislative history, which the court stated was to protect borrowers from the unfairness that results if a property is sold at a trustee's sale below its market value. According to the court, allowing parties to prospectively waive the protection of a fair market value hearing would effectively undo the statutory scheme and undermine an important purpose of the deed of trust statutes.

Conclusion

Arizona's appellate courts have shown increased interest of late in foreclosure-related cases. Earlier this summer, Division One of the Arizona Court of Appeals abolished prospective waivers by borrowers of the residential anti-deficiency protections under A.R.S. § 33-814(G) based on public policy grounds. *Parkway Bank & Trust Co. v. Zivkovic*, 232 Ariz. 286, 304 P.3d 1109 (App. 2013). In another decision out last week, Division Two of the Arizona Court of Appeals, citing *Parkway Bank*, declined to consider whether a guarantor can waive some of the protections of A.R.S. § 33-814. *First Credit Union v. Courtney*, No. 2 CA-CV 2013-0005, slip op. (Ariz. App. Sept. 12, 2013). Lewis Roca Rothgerber continues to monitor the developments in this evolving area.

Lenders, borrowers, and guarantors should consider how these recent decisions affect their existing and prospective lending relationships.

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