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COMMENTS

GUARANTORS' DEFENSES TO A DEFICIENCY: A LEGISLATIVE SOLUTION*

I. Introduction

A. *Illustrative Guarantor Hypothetical*

Dan Daring (Dan) started his printing business by buying two properties, one containing an office building and the other a press plant. The properties were appraised at $750,000 and $3,000,000, respectively. Luckily, seller, Sal Slick (Sal), agreed to "carry-back"[1] a portion of the purchase price. Dan put $50,000 down on the office building property and $100,000 down on the press plant property. However, since this was Dan's first time purchasing such a large commercial complex, Sal required guarantors.[2] Gail Smith (Gail), Dan's longtime friend, guaranteed the $700,000 note for the parcel with the office building. Additionally, Dan's brother, Gerry Daring (Gerry), guaranteed the $2,900,000 note for the parcel containing the press building. Gerry also gave Sal a second deed of trust on a vacant commercial lot he owned, as security for the guarantee.

Unfortunately, Dan ran into financial problems, was unable to make his loan payments, and defaulted on both loans. Following Dan's default, Sal nonjudicially[3] foreclosed on both

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1. A seller carry-back is explained *infra* note 80.

2. "A surety or guarantor is one who promises to answer for the debt, default, or miscarriage of another, or hypothecates property as security therefor." CAL. CIV. CODE § 2787 (West 1974 & Supp. 1991).

3. "Most states permit some kind of out-of-court foreclosure sale. Some re-

properties.[4] Sal successfully credit bid in the office building for $450,000 and the press plant for $1,500,000. This left a total of $1,650,000 due on the notes.

Luckily for Dan, a section of California's anti-deficiency legislation[5] protects debtors in his situation.[6] As a result, Dan was not liable to either the creditor or the guarantors[7] for the $1,650,000 deficiency.[8] Unfortunately, the guarantors are unprotected by this legislation.[9] Consequently, Sal sought deficiencies against the guarantors by bringing judicial actions for the balance owing on the notes.[10] Hence, Gail became liable for a $250,000 deficiency, and Gerry became liable for a

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quire that the instrument contain a power of sale clause or be a deed of trust rather than a mortgage. A few require subsequent court confirmation of these sales." R. BERNHARDT, CALIFORNIA REAL ESTATE FINANCE 36 (1989).

4. If Sal foreclosed by a court action he would have to include the guarantors as parties in order to recover a deficiency judgment from them. Titus v. Wood, 45 Cal. App. 541, 188 P. 68 (1920). In contrast, Sal's choice of nonjudicial foreclosure eliminated his obligation to include the guarantors. However, as seen in this hypothetical, this can circumvent the intended procedural safeguard of joining the guarantors initially when a deficiency is sought.

5. Anti-deficiency legislation serves the purpose of limiting personal judgments against debtors which arise when the security for their debts does not satisfy the full amount of their obligations. *See* Leipziger, *Deficiency Judgments in California: The Supreme Court Tries Again*, 22 UCLA L. REV. 753 (1975) (illustrating the difficulties California courts experience when trying to apply the anti-deficiency statutes to serve this purpose).

6. *See infra* notes 101-10 and accompanying text discussing California Code of Civil Procedure section 580d which gives Dan deficiency protection from Sal after a nonjudicial sale. Alternatively, even if Sal judicially foreclosed no such deficiency could be had against Dan because of California Code of Civil Procedure section 580b. *See infra* notes 80-100 and accompanying text.

7. Not only is the debtor shielded under California Code of Civil Procedure section 580d from Sal seeking a deficiency but, the debtor in a California Code of Civil Procedure section 580b transaction will not have to indemnify the guarantors in any instance for a deficiency paid on the debtor's behalf. *See infra* notes 154-63 and accompanying text.

8. "[A] deficiency is nothing more than the difference between the security and the debt." Brown v. Jensen, 41 Cal. 2d 193, 198, 259 P.2d 425, 427 (1953). Deficiency is defined as, "[t]hat part of a debt secured by [a] mortgage not realized from sale of mortgaged property." BLACK'S LAW DICTIONARY 421 (6th ed. 1990).

9. "In the absence of legislative relief, the guarantor must understand that his obligation includes protecting himself by bidding the property up to its fair market value." J. HETLAND, CALIFORNIA SECURED REAL ESTATE TRANSACTIONS 314 (1970). This assumes that the guarantor has the cash to bid at the foreclosure sale and protect himself from a large deficiency.

10. This assumes that Gerry waived his California Civil Code section 2845 defense which requires Sal to exhaust the security first. Waiver of this defense is common. *See infra* notes 136-41 and accompanying text.

$1,400,000 deficiency. Gail had no money to pay the judgment. She will either be burdened for years with this obligation or have to file bankruptcy.[11] Meanwhile, by depleting his life savings, Gerry paid $500,000 of the $1,400,000 deficiency. Afterwards, Sal proceeded to nonjudicially foreclose on Gerry's vacant lot appraised at $1,300,000.[12] No other competitive bidders were present, so Sal was able to successfully credit bid in $900,000, just enough to pay off the first deed of trust on the lot. Thus, there was no surplus to reduce Gerry's remaining $900,000 deficiency.

In the end, Dan, the principal debtor, was completely relieved of his liability while the guarantors carried this heavy burden. Yet, should not the same anti-deficiency principles protecting to Dan also protect Gerry and Gail as obligors? There are convincing arguments for extending deficiency protection to guarantors. Further, as illustrated in the conclusion of this comment, if the guarantors, Gerry and Gail, were afforded such protection in this transaction, the result would be much more equitable.

B. *Guarantors and California's Anti-deficiency Statutes*

The depression of the 1930's served as the catalyst for California's anti-deficiency legislation.[13] The Legislature's main objective in adopting such legislation was to ameliorate the bleak economic conditions of the debtor class.[14] The heart of the plan involved protecting debtors against deficiencies.

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11. This illustrates the problem of unequal bargaining power at work in guarantor situations. First, Gail probably did not realize her potential liability as a guarantor. Notably, she did not even begin to have the money to cover the guarantee. It is likely that she anticipated that the security would satisfy the debt and that her sole purpose was to help out if payments were late or missed.

12. One would assume that the foreclosure would be incorporated into the deficiency action on the guarantee. However, nothing in the deficiency statutes mandates that guarantors are entitled to one-action protection, even when there own security is involved. Therefore, guarantors are in the same position as debtors in the pre-section 726 era when the occurrence of two actions instead of one was possible.

13. *See* Poteat, *State Legislative Relief for the Mortgage Debtor During the Depression*, 5 LAW & CONTEMP. PROB. 517 (1938) which provides an in-depth look at the effect of the depression on debtors and the history of debtor-creditor legislation.

14. *See* Riesenfeld, *California Legislation Curbing Deficiency Judgments*, 48 CALIF. L. REV. 705 (1960) for a complete overview of the California legislature's objectives in enacting the anti-deficiency statutes.

To attain their goal, the Legislature codified debtor deficiency protection in California Code of Civil Procedure sections (1) 726, the "one-action" rule; (2) 580a, the fair value provision; (3) 580b, the purchase-money anti-deficiency statute; and later, in 1939, (4) 580d, the nonjudicial foreclosure anti-deficiency statute.[15]

However, the Legislature was silent on the application of these statutes to guarantors. Besides eliminating the surety/guarantor distinction,[16] there has been no attempt by the Legislature to delineate guarantors' deficiency defenses. Unfortunately, within the California courts, this legislative inaction led to the general denial of deficiency protection for guarantors.[17] Only on rare occasions have the California courts sheltered guarantors from deficiency judgments.[18]

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15. For easier reference California Code of Civil Procedure section 726, the "one-action" rule, and sections 580a, 580b, and 580d will be described collectively throughout this comment as the "anti-deficiency statutes."

These particular statutory descriptions were provided in Mertens, *California's Foreclosure Statutes: Some Proposals For Reform*, 26 SANTA CLARA L. REV. 533, 533-34 (1986).

16. California Civil Code section 2787, discussed *infra* notes 117-19 and accompanying text, abolished the distinction between guarantors and sureties. CAL. CIV. CODE § 2787 (West 1974 & Supp 1991). Therefore, a reference to guarantors includes sureties as well. Previously, Lange v. Aver, 241 Cal. App. 2d 793, 50 Cal. Rptr. 847 (1966), involving an endorser, held that the two parties, a surety and endorser, came under the same rules. Therefore, the aforementioned deficiency defenses might also be available to endorsers.

Historically, a guarantor and surety were compared as follows:

> A surety and guarantor have this in common, that they are both bound for another person; . . . . A surety is usually bound with his principal by the same instrument, executed at the same time and on the same consideration . . . . On the other hand, the contract of [a] guarantor is his own separate undertaking, in which the principal does not join.

BLACK'S LAW DICTIONARY 1293 (6th ed. 1991).

17. *See, e.g.*, Commonwealth Mortg. Assurance Co. v. Superior Court, 211 Cal. App. 3d 508, 259 Cal. Rptr. 425 (1989); Coppola v. Superior Court, 211 Cal. App. 3d 848, 259 Cal. Rptr. 811 (1989); Union Bank v. Gradsky, 265 Cal. App. 2d 40, 71 Cal. Rptr. 64 (1968); Heckes v. Sapp, 229 Cal. App. 2d 549, 40 Cal. Rptr. 485 (1964).

18. Presently, there are three exceptions which provide guarantors with deficiency defenses. The first exception applies when the principal debtor is also the guarantor, if not in form, then in substance, discussed *infra* notes 126-33 and accompanying text. The second is a suretyship defense under California Civil Code section 2845, discussed *infra* notes 136-41 and accompanying text. The final exception is the *Gradsky* estoppel effect, discussed *infra* notes 171-77 and accompa-

These judicial precedents create a practical problem for some debtors. Debtors soliciting guarantors may find these individuals unwilling to participate in their transactions for fear of the inequities that may occur. In addition, barring deficiency protection for guarantors does not uphold the spirit of the anti-deficiency statutes, nor does it promote just results.[19] Failing to protect guarantors from deficiencies allows unscrupulous creditors to manipulate transactions at great expense to the obligors.[20] Finally, it is inherently unfair to limit the principal obligor's liability, while at the same time greatly expanding the guarantor's chance of a deficiency for the debtors obligation.

Disparate treatment of guarantors need not necessarily result of following the policies arguments which protect debtors. For example, the state of Nevada, which adopted some of California's anti-deficiency statutes,[21] advocates a more lenient approach to guarantors under its anti-deficiency legislation.[22] Arguably, the Nevada approach is the better scheme.[23] Granting deficiency protection to guarantors serves the purposes of the anti-deficiency statutes, and helps to strike an essential balance between obligors and creditors. Ultimately,

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nying text.

19. For examples of inequitable results, see *infra* note 197.

20. This failure gives lenders an incentive to use guarantors to eliminate all risks involved in extending loans. However, lenders may decrease their risk in other ways. After evaluating both the security's value and the debtor's financial background, lending institutions may choose not to extend a loan. If lenders do extend the loan, they can protect themselves by loaning less than the property's fair market value. This reduction would account for market fluctuations and insure that the debtor had a cash equity incentive to continue payments. *See* Washburn, *The Judicial and Legislative Response to Price Inadequacy in Mortgage Foreclosure Sales,* 53 S. CAL. L. REV. 843, 845 (1980).

21. *See* NEV. REV. STAT. §§ 40.430, 40.451-.459 formally adopting statutory language similar to California Code of Civil Procedure section 726 and section 580a. The Nevada Legislature has not, however, adopted statutes similar to California Code of Civil Procedure sections 580a or 580d.

22. *See, e.g.*, Crowell v. John Hancock Mutual Life Ins. Co., 102 Nev. 640, 731 P.2d 346 (1986); First Interstate Bank v. Shields, 102 Nev. 616, 730 P.2d 429 (1986) (These cases hold that guarantors are entitled to the protection of Nevada's fair value deficiency legislation.).

23. For example, the Nevada Supreme Court in *Shields* stated, "[a]lthough we have previously held that the protection of the deficiency judgment legislation is inapplicable to an action on a guaranty contract, we are now convinced that it is unsound to deny guarantors the benefits of such [anti-deficiency] legislation." 102 Nev. at 437, 730 P.2d at 430-31 (citations omitted).

the questions become: (1) Does the integration of guarantors into anti-deficiency statutes serve the Legislature's intent; and (2) Who should bear the greater risk when the primary debtor defaults? Keep in mind throughout this comment that a legislative solution to guarantor protection requires a delicate allocation of risk between the creditor, the debtor, and the guarantor.

First, the background section of this comment discusses the protections afforded the primary debtor under California's anti-deficiency statutes.[24] Second, it discusses the treatment of guarantors under the same legislation.[25] Then the analysis illustrates how this treatment adversely effects guarantors in deficiency situations.[26] Finally, the proposal section introduces changes to California's anti-deficiency statutes.[27] These modifications integrate guarantors into the anti-deficiency legislation, and strengthen their standing in deficiency actions. The comment concludes that extending deficiency protection to guarantors serves the statutes' purposes.

II. BACKGROUND

A. *The Events Leading to the Enactment of the Anti-Deficiency Statutes*

To understand the legislative purpose behind anti-deficiency statutes,[28] it is necessary to focus on the events which gave rise to their existence. Anti-deficiency statutes were enacted in response to the "Great Depression" of the 1930's.[29] During this period, state legislatures were preoccupied with the peril of the debtor class.[30] Real estate values declined sharply as a result of the depression. Debtors lost not only their residences, but other property which served as their

24. *See infra* notes 40-110 and accompanying text.
25. *See infra* notes 111-90 and accompanying text.
26. *See infra* notes 200-31 and accompanying text.
27. *See infra* notes 232-42 and accompanying text.
28. *See supra* text accompanying note 15 for a list of the relevant statutes.
29. *See generally* Poteat, *supra* note 13.
30. *See* Notes and Comments, *Mortgage Moratoria Legislation – Deficiency Judgments*, 8 WASH. L. REV. 179 (1934) (containing a classification of deficiency legislation formulated by the different states following the 1930 depression). *See also* Feller, *Comparative Study*, 46 HARV. L. REV. 1061 (1933) (containing a history of legislative measures exacted during depressions prior to the 1930's).

livelihood.[31] In contrast, lenders were accumulating large quantities of property for substantially less than the initial estimated value.[32] Moreover, these creditors still held notes for the remainder of the debt. Meanwhile, the debtors faced with large personal judgments had little or no means of paying them.[33]

To counter the great menace that had befallen the debtor class of the "Great Depression," the California Legislature in 1933 enacted California Code of Civil Procedure (1) section 726,[34] which in judicial actions requires foreclosure first, prevents the debtor from having to defend himself in numerous law suits, and provides fair value protection; (2) section 580a,[35] which subjects a nonjudicial sale to a fair value test before a deficiency judgment can be obtained against the debtor; (3) section 580b,[36] which enumerates two purchase-money situations completely prohibiting deficiencies; and later, (4) section 580d,[37] which eliminates deficiencies after nonjudicial trustee's sales, and paralyzed the application of section 580a to

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31. *See* Riesenfeld, *supra* note 14, at 705.

32. Both foreclosing during the depression and the anti-competitive nature of foreclosure sales contributed to the meager sale prices of debtors' property. *See* Washburn, *supra* note 20, at 843-55. Foreclosure sales continue to be notorious for bringing in low bids. Additionally, recessions are inevitable in any economy. As a result of these two factors, anti-deficiency legislation continues to be a vital protection for obligors even today.

It is not the debtor who assesses the hazards of extending a loan. In fact, it has been noted, "necessity often drives debtors to make ruinous concessions when a loan is needed." Salter v. Ulrich, 22 Cal. 2d 263, 267, 138 P.2d 7, 9 (1943). Rather, it is the creditor with superior bargaining power who allocates the risk by either extending or refusing credit.

Lenders carefully consider the possibility that they will become the owners of the property when they deal so closely with obligors and their property. However, lenders contend that they are not in the real estate business and thus are not responsible for bidding the fair market value on the property. Still it seems unfair to allow lenders to receive real property for less than its fair market value. Lenders should have to assume the risk of bidding a fair price at a foreclosure sale. This is particularly equitable considering the fact that the lender can credit bid at the sale, whereas all others, such as the guarantor, are required to bid cash. *See, e.g.*, R. BERNHARDT, CALIFORNIA MORTGAGE AND DEED OF TRUST PRACTICE 2ND § 8.8 (1990).

33. *See* Chamberlain, *The Legislatures and Relief of Debtors*, 19 A.B.A. J. 474 (1933).

34. *See infra* notes 40-72 and accompanying text.

35. *See infra* notes 73-79 and accompanying text.

36. *See infra* notes 80-100 and accompanying text.

37. *See infra* notes 101-10 and accompanying text.

debtors.[38] These new laws answered the exigencies of many debtors.

However, the Legislature, in the statutory language, did not explicitly provide these safeguards for guarantors. Logically, in order for guarantors to be entitled to these deficiency defenses, this protection must comply with the purposes and policies behind these statutes. Consequently, a history of the statutes' application to the primary debtor[39] must precede a discussion of guarantors' deficiency protection. The following four subsections explain how each of these statutes operate and what purposes they serve.

B. *The Anti-Deficiency Statutes as Applied to the Primary Debtor*

1. *Section 726 - The "One-Action" Rule*

a. *Application*

Simply stated, California Code of Civil Procedure section 726 provides two-tiered protection for a debtor after a judicial foreclosure. The crux of the "one-action" rule is contained in subsection 726(a),[40] which prescribes two avenues of debtor protection. Notably, this first tier contains court imposed remedies not explicitly set forth in the statutes. The first avenue is the "affirmative defense,"[41] and the second is the "sanction effect."[42] Working in conjunction, these two mechanisms reduce the liability of the debtor and eliminate the possibility of multiple actions against him.[43] Furthermore, section 726(b)

38. Section 580d does not apply to guarantors. Therefore, section 580a could be re-activated to supply guarantors with fair value protection discussed *infra* notes 219-21 and accompanying text. *See* CALIFORNIA REAL PROPERTY FINANCING § 7.4 (1988); CALIFORNIA MORTGAGE AND DEED OF TRUST PRACTICE § 4.47 (1979).

39. The terms "primary debtor/obligor" or the "principal debtor/obligor" will be used to refer to the person who actually incurred the original debt by signing the note and deed of trust.

40. CAL. CIV. PROC. CODE § 726 (West 1980 & Supp. 1991). Section 726(a) provides for one-action by stating:

> There can be but *one form of action for the recovery of any debt or the enforcement of any right secured by mortgage upon real property or an estate for years therein,* which action shall be in accordance with the provisions of this chapter.

Id. (emphasis added).

41. *See infra* notes 44-47 and accompanying text.

42. *See infra* notes 48-50 and accompanying text.

43. Security Pac. Nat'l Bank v. Wozab, 51 Cal. 3d 991, 1005, ___ Cal. Rptr. ___, ___ P.2d ___ (1990). "[T]wo fundamental purposes of section 726 [are]: (1)

incorporates a fair value requirement when a deficiency is sought after a judicial foreclosure.

Initially, the section 726(a) affirmative defense permits the debtor to force the creditor to exhaust the security first when the creditor starts a judicial foreclosure action.[44] In this same action, the creditor is required to seek any deficiency needed,[45] for no further deficiency action is allowed.[46] Prior to the adoption of section 726(a), a creditor could have brought two actions against the debtor, one seeking a personal judgment, and another pursuing the security.[47]

If the debtor does not raise the affirmative defense, the section 726(a) sanction effect arises.[48] This "effect" prevents the creditor from later foreclosing on the security that was bypassed in the initial action.[49] The creditor in effect is forced to pursue his remedies, including foreclosure, in one action or forego further recovery.[50]

The second tier of the statute consists of section 726(b),[51] the fair value provision. Following a judicial foreclo-

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preventing a multiplicity of lawsuits against the debtor, and (2) requiring exhaustion of the security before resort to the debtor's unencumbered assets." *Id.*

44. *See* Salter v. Ulrich, 22 Cal. 2d 263, 265-66, 138 P.2d 7, 8 (1943).

45. *Id.* at 268, 138 P.2d at 10.

46. Bank of Am. v. Daily, 152 Cal. App. 3d 767, 771, 199 Cal. Rptr. 557, 559 (1984). The court in *Daily* found the bank's involuntary setoff to be an "action" under California Code of Civil Procedure section 726. *Id.* Therefore, the bank could not later obtain a deficiency judgment. *Id.* at 773, 199 Cal. Rptr. at 560.

The *Daily* decision was disapproved by a case which defined an "action" as "'an ordinary proceeding *in a court of justice.*'" Security Pac. Nat'l Bank v. Wozab, 51 Cal. 3d 991, 998, ___ P.2d ___ , ___ Cal. Rptr. ___ (1990) (citing CAL. CIV. PROC. CODE § 22 (West 1976 & Supp. 1991)). The *Wozab* court objected to the harsh penalty resulting when a setoff of a modest sum is declared to be an action, thus causing the lender under the section 726 sanction effect to lose all other major security, and to forfeit the underlying debt. 51 Cal. 3d at 1005-06, ___ P.2d ___ , ___ Cal. Rptr. ___.

47. *See* Felton v. West, 102 Cal. 266, 269, 36 P. 676, 677 (1894).

48. Walker v. Community Bank, 10 Cal. 3d 729, 737, 518 P.2d 329, 334, 111 Cal. Rptr. 897, 902.

49. *Id.*

50. *Id.*

51. CAL. CIV. PROC. CODE § 726(b) (West 1980 & Supp. 1991). Section 726(b) provides in pertinent part:

> [E]ither party may present evidence as to the fair value of the real property or estate for years therein sold as of the date of sale, *the court shall render a money judgment against the defendant or defendants for the amount by which the amount of indebtedness . . . exceeds the fair value*

sure, the creditor has three months to commence proceedings for a determination of the security's fair value.[52] Section 726(b) calculates the amount of a deficiency as the lesser of (1) the debt minus the fair market value; or (2) the debt minus the price for which the property was sold.[53]

b. *Purpose*

The purpose of section 726(a) was explained in *Felton v. West*:

> Formerly the law allowed an action upon a promissory note, and also a suit in equity to foreclose the mortgage given to secure the note. *The mischief in such a practice lay in the multiplicity of suits, and the harassing of the debtor by two actions, when the creditor could readily enforce his all rights in one.* A remedy for this evil was provided by section 726 of the Code, whereby the creditor was allowed to foreclose his mortgage and have a personal judgment for any defi-

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> *of the real property or estate for years therein sold as of the date of sale.* In no event shall the amount of the judgment, . . . exceed the difference between the amount for which the real property or estate for years therein was sold and the entire amount of indebtedness secured by the mortgage or deed of trust.

Id. (emphasis added).

52. CAL. CIV. PROC. CODE § 726(b) (West 1980 & Supp. 1991). Section 726(b) provides in pertinent part:

> In the event that a deficiency is not waived or prohibited and it is decreed that any defendant is personally liable for the debt, then *upon application of the plaintiff filed at any time within three months of the date of the foreclosure sale* and after a hearing thereon at which the court shall take evidence and at which hearing either party may present evidence as to the fair value of the real property or estate for years therein sold.

Id. (emphasis added).

53. *Id.* The fair value provision operates when the debt is undersecured, meaning that the sale of the property did not satisfy the entire debt. For example, assume that the debtor owes $700,000 on a debt, and is now in default. The debt is secured by the debtor's property which has a fair market value of $400,000. The high bid at the foreclosure sale is $100,000, by the creditor, who takes the property.

Following the precepts of section 726(b), the deficiency cannot exceed $300,000, even though it appears that the creditor is still owed $600,000. The $300,000 figure is arrived at by subtracting the fair market value of the security ($400,000) from the debt ($700,000). This figure is less than subtracting the price bid for the property ($100,000) from the debt ($700,000). The provision prevents the creditor from realizing a double recovery on the debtor's obligation, as occurs in the situation described *infra* note 64.

> ciency in the same action. This court has construed this law so as to suppress the mischief and advance the remedy by compelling the creditor to exhaust his security before proceeding personally against the debtor.[54]

Accordingly, the primary purpose of section 726(a) is to remove the debtor's burden of defending multiple actions against the debtor for the same obligation. Presently, multiple actions are prevented because the creditor must simultaneously foreclose on the security under the deed of trust, and sue on the note for a deficiency.[55] When fully integrated, the affirmative defense and sanction effect serve this purpose.

The affirmative defense, as stated in *Salter v. Ulrich*,[56] ensures "that a mortgagee by his own act alone cannot waive the provisions of section 726 and sue upon the debt."[57] The debtor opts for this defense because he expects foreclosing on the security to reduce, or even eliminate, a deficiency, thus decreasing his potential for liability.[58] As noted in *Walker v. Community Bank*,[59] if the creditor could unilaterally waive the security, there would be no reason for a secured transaction.[60]

Assuming the affirmative defense was waived, a creditor may want to foreclose on the security not included in the first action. Nonetheless, the creditor is barred by the sanction effect from proceeding against the security to collect the remainder of the debt.[61] Once again, the sanction effect forces the creditor to pursue all available security in the first ac-

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54. Felton v. West, 102 Cal. 266, 269, 36 P. 676, 677 (1894) (emphasis added).

55. *Id.* at 268, 36 P. at 677.

56. 22 Cal. Rptr. 263, 138 P.2d 7 (1943).

57. *Id.* at 266, 138 P.2d at 8. The *Salter* court also noted "that the benefits of the section cannot be waived in advance by the mortgagor but there seems to be no clear-cut decision as to the right of the mortgagor or trustor to make a subsequent waiver, although several cases indicate that this may be done." *Id.* at 266, 138 P.2d at 8-9 (citation omitted).

58. *Id.* at 266, 138 P.2d at 8.

Professor Hetland argues that if a creditor does not include all security in the judicial sale, the creditor is automatically precluded from obtaining a deficiency against the debtor. This is because, in these situations, the creditor cannot unilaterally waive the security which was intended by the parties to be applied towards the obligation. Hetland, *Deficiency Judgment Limitations in California – A New Judicial Approach*, 51 CALIF. L. REV. 1 (1963).

59. 10 Cal. 3d 729, 518 P.2d 329, 111 Cal. Rptr. 897, (1974).

60. *Id.* at 735-36, 518 P.2d at 333, 111 Cal. Rptr. at 901.

61. *Id.* at 736, 518 P.2d at 333, 111 Cal. Rptr. at 901.

tion.[62]

Furthermore, judicial foreclosure on the debtor's security activates section 726b, the fair value provision.[63] One purpose of this section is to prevent a "double recovery."[64] Another purpose is to ensure that the debtor receives the full benefit of his property's value.[65]

First, absent a fair value provision, a foreclosing creditor could acquire the security yet, make bids far below the property's fair value.[66] The remaining debt would be offset by the creditor's low bid, and not by the security's full value as expected. As a result, the creditor would realize a double recovery.[67] The double recovery results from the fact that the creditor pays less than the property's true value, and gets a greater deficiency judgment.

Second, the amount of a deficiency should be contingent on the property's true value, and not a temporary decline in the economy.[68] A debtor's deficiency could increase greatly during a short term market flux. So as to properly reduce the debt, the property's fair value, as well as the sale price, must be considered.

In summary, two provisions in section 726 protect debtors in judicial foreclosures. Initially, section 726(a) removes the

62. *Id.*

63. The "plaintiff"/creditor must file an application within three months of the foreclosure sale in order to actuate this provision. *See supra* note 52.

64. To illustrate this double recovery, consider a variation on the hypothetical presented *supra* note 53. The debt was $700,000. If the deficiency is computed by subtracting $100,000, the low bid, instead of $400,000, the fair market value, it amounts to $600,000. Consequently, the creditor holds $400,000 in property and a $600,000 deficiency judgment. This $1,000,000 exceeds the original debt by $300,000.

65. Walker v. Community Bank, 10 Cal. 3d at 736, 518 P.2d at 333, 111 Cal. Rptr. at 901.

66. Roseleaf Corp v. Chierighino, 59 Cal. 2d 35, 40, 378 P.2d 97, 99, 27 Cal. Rptr. 873, 875 (1963). The court, in *Roseleaf*, stated that the "[f]air value provisions are designed to prevent creditors from buying in at their own sales at deflated prices and realizing *double recoveries* by holding debtors for large deficiencies." *Id.* (emphasis added). The *Roseleaf* court discussed section 580a and section 726(b) together. *Id.* Therefore, the same fair value arguments will hold true when section 580a is discussed *infra* notes 73-79 and accompanying text.

67. *Roseleaf*, 59 Cal. 2d at 40, 378 P.2d at 99, 27 Cal. Rptr. at 875.

68. As stated in *Roseleaf*, there are times, such as "during the 1930's when it was felt that real property [can]not be sold for its 'true' value." 59 Cal. 2d at 40, 378 P.2d at 99, 27 Cal. Rptr. at 875.

burden of defending numerous actions.[69] The debtor's affirmative defense forces the creditor to exhaust the security first. The effect of this is to reduce any deficiency against the debtor.[70] Additionally, the sanction effect forestalls a second action to foreclose on security excluded from the first action.[71] The second tier, section 726(b), guards against a creditors realizing a double recovery. Section 726(b) also ensures that the debtor receives credit for his property's fair value.[72]

2. *Section 580a - The Fair Value Section*

a. *Application*

California Code of Civil Procedure section 580a applies a fair value requirement to deficiency judgments sought after nonjudicial foreclosures.[73] However, the subsequent enactment of section 580d, prohibiting deficiencies after nonjudicial foreclosures, nullified section 580a's application to debtors.[74] At first glance, the existence of this statute now seems superfluous. However, section 580a is discussed here, because of its potential to serve guarantors.[75]

As mentioned, section 580a establishes a fair market value test for nonjudicial foreclosures.[76] The test in section 580a is

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69. *See supra* notes 54-55 and accompanying text.

70. *See supra* notes 57-60 and accompanying text.

71. *See supra* notes 61-62 and accompanying text.

72. *See supra* notes 63-65 and accompanying text.

73. CAL. CIV. PROC. CODE § 580a (West 1976 & Supp. 1991). Section 580a states that its fair value provision is applicable:

> [w]henever a money judgment is sought for the balance due upon an obligation for the payment of which a *deed of trust or mortgage with power of sale* upon real property or any interest therein was given as security, following the exercise of the power of sale in such deed of trust or mortgage.

Id. (emphasis added).

It is the "power of sale" in the mortgage or deed of trust which gives the creditor the right to foreclose without a judicial proceeding.

74. *See infra* notes 101-02 and accompanying text.

75. The Legislature has amended section 580a three times since section 580d was enacted in 1939. Professor Mertens suggests this proves that the Legislature believes section 580a is still a viable defense. Mertens, *supra* note 15, at 541. Logically, the only recipients of section 580a protection are parties not entitled to a section 580d defense, such as guarantors.

Nevada, which does not employ a staute similar to 580d, permits guarantor 580a protection in secured transactions. *See infra* note 195.

76. CAL. CIV. PROC. CODE § 580a (West 1976 & Supp. 1991). Section 580a

identical to that enunciated in section 726(b).[77] Appositely, section 580a also provides for a three month period in which to determine the property's fair market value.[78] The principle difference between section 726(b) and section 580a is that the latter applies to nonjudicial foreclosures, whereas the former applies to judicial foreclosures.

b. *Purpose*

The purposes of section 580a are also similar to those of section 726(b). Section 580a precludes double recoveries by banks and other creditors.[79] Likewise, section 580a gives obligors the fair market value of their property. However, section 580d seems to frustrate the utility of section 580a. This is because section 580d bars deficiencies after nonjudicial foreclosures, and therefore, eliminates the need for a section 580a fair value hearing.

3. *Section 580b - The Purchase-Money Anti-Deficiency Statute*

a. *Application*

California Code of Civil Procedure section 580b specifies two "purchase-money" transactions which bar a deficiency

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provides in pertinent part:

> Before rendering any judgment the court shall find the fair market value of the real property, or interest therein sold, at the time of sale.

Id.

77. *Id.* Section 580a provides in pertinent part:

> The court may render judgment for not more than the amount by which the entire amount of the indebtedness due at the time of sale exceeded the fair market value of the real property, or interest therein sold at the time of sale . . . ; provided, however, that in no event shall amount of the judgment, . . . exceed the difference between the amount for which the property was sold and the entire amount of indebtedness secured by the deed of trust or mortgage.

Id.

Compare section 726(b)'s test in which the amount of the deficiency is the lesser of the debt minus the fair market value or the debt minus the price for which the property was sold. *See supra* note 52 and accompanying text.

78. CAL. CIV. PROC. CODE § 580a (West 1976 & Supp. 1991). Section 580a provides in pertinent part that:

> Any such action [for a deficiency] must be brought within three months of the time of sale under the deed of trust or mortgage.

Id.

79. *See supra* note 66.

against the debtor.[80] One such transaction occurs when a seller carries back a note from the debtor for part of the purchase price of the property.[81] The second type of transaction involves a lender loaning money to a debtor to purchase a residence.[82] In these two instances, section 580b bans deficiency judgments against the debtors after either type of foreclosure has occurred.[83]

Historically, California courts have struggled to apply section 580b to new variations of these two standard purchase-money transactions.[84] In *Roseleaf Corp. v.*

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80. "Purchase-money" is a term of art in the field of real property secured transactions. The standard section 580b purchase-money transaction, otherwise known as seller carry-back, was described in Roseleaf Corp. v. Chierighino, 59 Cal. 2d 38, 378 P.2d 97, 27 Cal. Rptr. 873 (1963). "Section 580b was apparently drafted in contemplation of the standard purchase money mortgage transaction in which the vendor of real property retains an interest in the land sold to secure payment of part of the purchase price." *Id.* at 41, 378 P.2d at 100, 27 Cal. Rptr. at 876. Thus, came the term "purchase-money."

In 1963, the Legislature amended the statute to include third party lenders securing the purchase of a dwelling for not more than four families, in which the purchaser intended to reside. Presently, this second type of arrangement is also considered a standard purchase-money transaction within the statute. *See* CAL. CIV. PROC. CODE § 580b (West 1976 & Supp. 1991).

For an overview of different states' approaches to purchase-money situations, see Currie & Lieberman, *Purchase-Money Mortgages and State Lines: A Study in Conflict-of-Laws Method,* 1960 DUKE L.J. 1 (1960).

81. CAL. CIV. PROC. CODE § 580b (West 1976 & Supp. 1991). Section 580b providing for this transaction states:

> No deficiency judgment shall lie in any event after a sale of real property or an estate for years therein for failure of the purchaser to complete his or her contract of sale, or under deed of trust, or mortgage, *given to the vendor to secure payment of the balance of the purchase price of that real property or estate for years therein.*

Id. (emphasis added).

82. CAL. CIV. PROC. CODE § 580b (West 1976 & Supp. 1991). Section 580b provides for the lender transaction where a deficiency judgment is expected to be barred:

> No deficiency judgment shall lie in any event after the sale of real property . . . under a deed of trust, or mortgage, on a dwelling for not more than four families given to the lender to secure repayment of a loan which was in fact used to pay all or part of the purchase price of that dwelling occupied, entirely or in part, by the purchaser.

Id.

The prerequisites for a residence as defined in section 580b are: (1) a dwelling, (2) for not more than four families, (3) occupied, entirely or in part by the purchaser. In addition, the language indicates the loan does not have to be for the entire purchase price, only a part of the price of the residence. *Id.*

83. *See supra* notes 81 and 82.

84. For cases illustrating the judiciary's treatment of such variations in light

Chierighino,[85] such a variation occurred. The *Roseleaf* court recommended turning to the policies underlying section 580b when faced with these non-standard purchase-money transactions.[86] Therefore, a deficiency cannot be granted in any transaction where it is found to frustrate the section 580b policies.[87]

b. *Purpose*

Section 580b provided the greatest protection for debtors facing deficiencies. This section went beyond its counterparts and barred deficiencies completely.[88] The court, in *Roseleaf*, determined that the Legislature's intent was to shift the burden of the loss in these transactions to the creditor.[89] This is because the creditor at least has the property to lend him financial support. In *Roseleaf*, the court discussed the previously articulated legislative goals for enacting section 580b.[90] It concluded that two section 580b goals prevail; preventing the aggravation of economic downturn, and deterring overvaluation by the creditor.[91]

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of the purposes of the anti-deficiency statutes, see Brown v. Jensen, 41 Cal. 2d 193, 259 P.2d 425 (1953) (A sold-out junior lienor holding a purchase-money note was barred from getting a deficiency judgment after the senior lienor had foreclosed on the security.); Spangler v. Memel, 7 Cal. 3d 603, 498 P.2d 1055, 102 Cal. Rptr. 807 (1979) (The junior lienor in a purchase-money transaction had subordinated to a construction loan. The court held that a deficiency judgment would be allowed against the debtor.).

85. 59 Cal. 2d 38, 378 P.2d 97, 27 Cal. Rptr. 873 (1963). In *Roseleaf*, the mortgage was secured by a purchase-money deed of trust on a hotel. In the same deal there were also three notes secured by deeds of trust on the debtor's other property. This was considered a variation from the standard purchase-money transaction.

Upon default, both parties agreed that the creditor could foreclose on the hotel. However, the debtor/defendant argued the creditor/plaintiff could not proceed against the other property. The defendant asserted that foreclosing on the three properties was tantamount to a deficiency which is barred in a section 580b transaction. With the purposes of the anti-deficiency statute in mind, the court found that in this section 580b variation the plaintiff was not barred from suing on the three notes which were not secured by the property purchased.

86. *Id.* at 41, 378 P.2d at 100, 27 Cal. Rptr. at 876. The court in *Roseleaf* stated that, "[v]ariations on the standard are subject to section 580b only if they come within the purpose of that section." *Id.*

87. *Id.*

88. *Roseleaf*, 59 Cal. 2d at 42, 378 P.2d at 101, 27 Cal. Rptr. at 877.

89. *Id.*

90. *Id.* at 41-42, 378 P.2d at 100-01, 27 Cal. Rptr. at 876-77.

91. The *Roseleaf* court summed up the purposes for barring a deficiency as

The initial incentive for the anti-deficiency statutes was to protect debtors in periods of economic decline.[92] Section 580b does more than any other statute to serve this purpose. This section shelters debtors from facing large personal judgments after they lose their home, property and possibly their livelihood.[93]

Further, courts have perceived the prevention of "overvaluation"[94] to be a section 580b policy.[95] In the case of overvaluation, "the vendor knows the value of his security and assumes the risk of its inadequacy."[96] Consequently, upon de-

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follows:

> Section 580b places the risk of inadequate security on the purchase money mortgagee. A vendor is thus discouraged from overvaluing the security. Precarious land promotion schemes are discouraged, for the security value of the land gives purchasers a clue as to its true market value . . . . If inadequacy of the security results, not from overvaluing, but from a decline in property values during a general or local depression, section 580b prevents the aggravation of the downturn that would result if defaulting purchasers were burdened with large personal liability. Section 580b thus serves as a stabilizing factor in land sales.

Id. at 42, 378 P.2d at 101, 27 Cal. Rptr. at 877 (citations omitted).

92. *See supra* notes 29-33 and accompanying text.

93. In Bargioni v. Hill, 59 Cal. 2d 121, 378 P.2d 593, 28 Cal. Rptr. 321 (1963), the court stated that the purpose of section 580b was "to prevent the aggravation of a downturn that would result if defaulting purchasers lost the land and were burdened with personal liability." *Id.* at 123, 378 P.2d at 594, 28 Cal. Rptr. at 327.

94. An example of overvaluation is when an unwary buyer is disadvantaged by a seller who sets a property's purchase price at $600,000, when its true worth is $400,000.

95. Preventing overvaluation was legitimized as a purpose of section 580b by the court in *Roseleaf* because it would discourage unsound land sales resulting from overvaluation. *Roseleaf*, 59 Cal. at 42, 378 P.2d at 101, 27 Cal. Rptr. at 877.

However, overvaluation was recently treated as a valid purpose in Nickerman v. Ryan, 93 Cal. App. 3d 564, 155 Cal. Rptr. 830 (1979). At issue in *Nickerman* was whether a former spouse was in a better position to know the value of property in which both spouses previously had held an interest. The court found that the former wife of the plaintiff had no greater knowledge about the property and therefore was not in a position to overvalue the property.

The overvaluation purpose has come under attack. According to Hetland, *supra* note 58, at 4-7, "[p]reventing overvaluation is simply subsidiary to the statute's real purpose." Heckes v. Sapp, 229 Cal. App. 2d 549, 40 Cal. Rptr. 485 (1964), also states, "[p]reventing overvaluation is subsidiary to the depression purpose." This purpose is also questioned in Budget Realty v. Hunter, 157 Cal. App. 3d 511, 204 Cal. Rptr. 48 (1984).

96. *Roseleaf*, 59 Cal. 2d at 43, 378 P.2d at 101, 27 Cal. Rptr. at 877. The premise is that the creditor knows more of the property's true value than the buyer. Therefore the creditor bears the risk of loss because the creditor is in a

fault, the creditor cannot obtain a deficiency, even if there was one. This is because the creditor knew that the sale of the property would not satisfy the debt.[97]

In brief, through section 580b the Legislature has chosen to bar deficiencies where sellers carry back a note and where third parties lend to residential purchasers.[98] One legislative purpose of section 580b is to prevent further hardship in times of economic downturn.[99] In addition, this section prevents creditors from realizing inordinately high recoveries because their asking price was greater than the property's worth. However, the Legislature failed to address the manner in which section 580b effects guarantors.[100]

4. *Section 580d - The Nonjudicial Foreclosure Anti-Deficiency Statute*

a. *Application*

California Code of Civil Procedure section 580d prevents creditors from procuring deficiencies after nonjudicially foreclosing on the debtors' property.[101] In essence, unless creditors foreclose judicially on the debtors' property, they are barred from requesting a deficiency.[102]

Unlike section 726(a), however, section 580d does not require the creditor to simultaneously bring all security into a

better position to manipulate the price. *Id.* at 41, 378 P.2d at 101, 27 Cal. Rptr. at 877.

97. In *Bargioni v. Hull*, 59 Cal. 2d 121, 378 P.2d 593, 28 Cal. Rptr. 321, the court explains that "[t]his section compels a purchase money mortgage to assume the risk that the security is inadequate. The purposes are to discourage land sales that are unsound because the land is overvalued . . . ." *Id.* at 123, 378 P.2d at 594, 28 Cal. Rptr. at 322.

98. *See supra* notes 80 and 82 and accompanying text.

99. *Roseleaf*, 59 Cal. 2d at 42, 378 P.2d at 101, 27 Cal. Rptr. at 877.

100. *Id.*

101. CAL. CIV. PROC. CODE § 580d (West 1976 & Supp. 1991). Section 580d provides in pertinent part:

> No judgment shall be rendered for any deficiency upon a note secured by a deed of trust or mortgage upon real property or an estate for years therein . . . hereafter executed in any case in which the real property or estate for years therein . . . has been sold by the mortgagee or trustee under power of sale contained in such mortgage or deed of trust.

102. Brown v. Jensen, 41 Cal. 2d 193, 197, 259 P.2d 425, 427 (1953).

nonjudicial foreclosure sale.[103] When multiple security is given the creditor is permitted to separately foreclose on each piece of security.[104] Selling additional security at a trustee's sale is not considered a deficiency,[105] therefore, the fair market value provision of section 580a does not apply.[106] The problem with considering only the sale price is that the actual fair market value of the security could further reduce the debt.[107]

b. *Purpose*

The purpose of section 580d is to place nonjudicial foreclosure sales on an even par with judicial foreclosures.[108] Judicial foreclosures are favored by obligors because such fore-

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103. *Roseleaf,* 59 Cal. 2d at 43-44, 378 P.2d at 101-02, 27 Cal. Rptr. at 877-78.

104. *Id.* For the deal in *Roseleaf,* the creditor had multiple security, the hotel and three other properties, to satisfy the debt. The court permitted the creditor to nonjudicially foreclose on each piece of security separately.

105. *Id.* The *Roseleaf* court stated that nonjudicially foreclosing upon the other security is not a deficiency.

106. However, there are *compelling* arguments in favor of applying the section 580a fair value provisions to these sales. *See generally* Hatch v. Security First Nat'l Bank, 19 Cal. 2d 254, 120 P.2d 869 (1949). Consider the following scenario: For a $400,000 loan the creditor requires the debtor to encumber three properties each worth $250,000 for a total of $750,000 in security. After default the creditor forecloses on property #1. The creditor credit bids $100,000 and receives the property. The remaining debt is $300,000. At the second and third nonjudicial sales the creditor successfully credit bids $100,000 and $150,000 respectively on properties #2 and #3. The debtor is saved from a deficiency, but the creditor has been unjustly enriched by receiving $750,000 in property for a $400,000 debt.

Had section 580a applied, the fair value of properties #1 and #2 would have satisfied the debt. Property #3 would not have been sold. Not to mention the possibility of a $100,000 surplus for the debtor after the first two foreclosures. Further, this hypothetical also justifies the application of section 580a to guarantors, who could be considered additional security. *See* Mertens *supra* note 15, at 543, 561-70 (applying section 580a to multiple security), & 566 (applying section 580a specifically to guarantors). *See also infra* note 221 and accompanying text.

In contrast, section 580a was applied to a junior lienor who successfully bid at the foreclosure sale. Walter E. Heller Western, Inc. v. Bloxham 176 Cal. App. 3d 266, 221 Cal. Rptr. 425 (1985).

107. *See* Hatch v. Security First Nat'l Bank, 19 Cal. 2d 254, 120 P.2d 869 (1949). In *Hatch* the note was secured by two properties. First, the creditor nonjudicially foreclosed on the primary security. The debtor contended that the fair market value of this property should have eliminated the debt. However, only the sale price was considered. The creditor later foreclosed on the second property. If section 580a had applied after the first nonjudicial foreclosure, the property's fair market value would have wiped out the debt.

108. *Roseleaf,* 59 Cal. 2d at 43-44, 378 P.2d at 101-02, 27 Cal. Rptr. at 877-78.

closures provide for the right of statutory redemption.[109] After a judicial foreclosure the debtor is subject to a deficiency, yet he may buy his land back.[110] As a trade-off, the creditor may choose the quicker nonjudicial foreclosure and forego a deficiency. Under such a scenario, the creditor is assured that the debtor cannot reacquire the land by redemption at the bid price.

5. *Debtors' Current Status Under the Anti-Deficiency Statutes*

To summarize, anti-deficiency statutes protect primary obligors by placing them on a more equal footing with creditors, and by sparing them from financial disaster. Section 726(a) prevents a debtor from litigating multiple actions. In addition, section 726(b) assures that the debtor receives the benefit of the fair value of his property. Meanwhile, section 580a requires a fair value test after a nonjudicial foreclosure, but is powerless in the wake of section 580d.

Meanwhile, section 580b shifts the risk of loss to the creditor by barring deficiencies in purchase-money transactions. It also provides special protection to debtors who lose their residence. Furthermore, section 580b prevents aggravation of economic downturn and overvaluation of property. Finally, section 580d bars deficiencies after nonjudicial foreclosure sales, thus placing judicial foreclosure on a more equal level.

These anti-deficiency measures vastly improve the position of defaulting debtors. Unfortunately, the deficiency statutes do not mention guarantors. The Legislature was remiss in not granting guarantors shelter from the problems of unequal bargaining power, lender's double recoveries, economic downturn, overvaluation and unscrupulous practices of creditors.

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> Statutory redemption, . . . is the right of the mortgagor to regain title to property sold at judicial foreclosure for up to one year thereafter by paying the foreclosure sale purchaser (who may be different from the mortgagee) the amount that was bid at the sale (rather than the amount that was owing on the debt).

R. BERNHARDT, CALIFORNIA REAL ESTATE FINANCE 33 (1989).

110. *Id.*

C. *History of the Rights and Protection Afforded Guarantors in Deficiency Situations*

The following section discusses the treatment of guarantors' deficiency liability by the Legislature and the Judiciary. As mentioned, the California Legislature has not specifically clarified guarantors' rights and liabilities under the anti-deficiency statutes. As a solution, the Legislature could present a definitive framework to determine guarantors' status in deficiency situations by: (1) explicitly advocating strict application of surety/guarantor law in these deficiency situations;[111] or (2) incorporating guarantors by reference to the anti-deficiency legislation. Presently, neither has been done.

Moreover, when the courts have considered deficiency defenses for guarantors, they, either implicitly or explicitly, molded their decisions to further the policy of anti-deficiency statutes.[112] Furthermore, they have looked to established suretyship law. However, since suretyship law does not reflect the special purposes of the anti-deficiency statutes, courts have sometimes found it inapplicable in deficiency situations.

1. *Legislative Steps*

Historically, California Civil Code section 2809 was the main statute governing guarantors.[113] Section 2809 provides that, "[t]he obligation of a guarantor must be neither larger in amount nor in other respects more burdensome than that of the principal; and if in its terms it exceeds it, it is reducible in

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111. *See infra* note 120 arguing that strict application of suretyship law would circumvent the purposes of the anti-deficiency statutes.

112. Currently there are two judicial theories to determine guarantors' deficiency liability. One view is that a guarantor is a separate and independent contract from the principal and is required to rely on his own resources to fulfill his obligation. *See, e.g.,* Loeb v. Christie, 6 Cal. 2d 416, 57 P.2d 1303 (1936); Adams v. Wallace, 119 Cal. 67, 51 P. 14 (1897). An alternative view classifies the guarantor as additional security, like all other debtor property. *See* Gottschalk v. Draper Cos., 23 Cal. App. 3d 828, 100 Cal. Rptr. 434 (1972); Union Bank v. Gradsky, 265 Cal. App. 40, 71 Cal. Rptr. 64 (1968); Heckes v. Sapp, 229 Cal. App. 2d 549, 40 Cal. Rptr. 485 (1964). This has been a very crucial distinction in the past. This comment proposes that a guarantor's liability should not pivot on this distinction. Rather, the focal point for determining the guarantor's obligation should be whether or not it would fit within the reasoning and intent of the anti-deficiency statutes.

113. CAL. CIV. CODE § 2809 (West 1974 & Supp. 1991).

proportion to the principal obligation."[114] This statute was enacted in 1872[115] before the advent of the anti-deficiency statutes. Hence, it has minimal effect on guarantors' protection in deficiency situations.[116]

In 1939, the distinction between guarantors and sureties was abolished by an amendment to California Civil Code section 2787.[117] Accordingly, in California, both sureties and guarantors now have the same rights and liabilities.[118] However, this has not been the solution to determining guarantors' standing in deficiency situations.[119]

Arguably, suretyship statutes affect a guarantor's stance with regards to a deficiency.[120] However, from the perspec-

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114. *Id.*

115. *Id.*

116. Loeb v. Christie, 6 Cal. 2d 416, 57 P.2d 1303 (1936) (The guarantor attempted under section 726(a) to force the creditor to exhaust all security. The guarantor wanted to include the security to decrease his liability as the debtor could do. The guarantor argued that under section 2809 his burden could not be made greater than that of the principal obligor. The court, in denying the protection, said the guarantor's burden would not be heavier.).

117. CAL. CIV. CODE § 2787 (West 1974 & Supp. 1991). Section 2787 provides in pertinent part:

> *The distinction between sureties and guarantors is hereby abolished.* The terms and their derivatives, wherever used in this code or in any other statute of law of this State now in force or hereafter enacted, shall have the same meaning, as hereafter in this section defined . . . . Guaranties of collection and continuing guaranties are forms of suretyship obligations, and except in so far as necessary in order to give effect to provisions specially relating thereto, *shall be subject to all provisions of law relating to suretyship in general.*

Id. (emphasis added).

118. American Guar. Corp. of Cal. v. Stoody, 230 Cal. App. 2d 390, 41 Cal. Rptr. 69 (1964).

119. *See, e.g.*, Everts v. Matteson, 21 Cal. 2d 437, 132 P.2d 476 (1942).

120. Some authorities argue extensively that suretyship law governs the rights and liabilities of guarantors and sureties in case of a deficiency. They insist the present one-action rule and anti-deficiency statutes do not control this tripartied transaction. For instance, Professor Rintala suggests applying anti-deficiency statutes to guarantors "is mistaken because it is based upon a statutory scheme designed to apply to two-party, secured creditor-debtor relationships. The approach advocated by [her article], on the other hand, is based upon the statutory provisions governing three-party suretyship relationships . . . ." Rintala, *California's Anti-Deficiency Legislation and Suretyship Law: The Transversion of Protective Statutory Schemes*, 17 UCLA L. REV. 245, 246 (1969). In contrast, Professor Hetland views any strategy outside anti-deficiency statutes as inadequate to deal with guarantors and deficiencies. *Infra* text accompanying notes 167-68.

Actually, suretyship law may eliminate a guarantor's deficiency defenses. Consider California Civil Code section 1210, which provides in pertinent part that tive of the judiciary, these suretyship laws do not solidify guarantors' deficiency rights and obligations.[121] Conceivably, the Legislature did not contemplate employing suretyship law as an avenue to define the bounds of guarantors' protections under the deficiency laws. Thus, another avenue must be found.

2. *The Courts' Response*

Essentially, the California judiciary holds that guarantors are not within the scope of the anti-deficiency statutes.[122] The main justification for such a proposition seems to be that the deficiency statutes only refer to principal debtors, not guarantors.[123] Furthermore, the courts give little deference to suretyship arguments.[124] They apply suretyship/guarantor law only when it does not run counter to the purposes of deficiency legislation.[125] Accordingly, the California courts' approach centers on anti-deficiency statutes, while only tangentially considering suretyship law.

Notably, a guarantor is fully protected by the anti-deficiency statutes when he is in reality the principal debtor. For example, in *Union Bank v. Dorn*,[126] the guarantor of a

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"[a] surety is liable, . . . though the [principal's personal] disability be such as to make the contract void against the principal; but he is not liable if . . . the liability of the principal . . . ceases, unless the surety has assumed liability with knowledge of the existence of the defense." CAL. CIV. CODE § 2810 (West 1974) In other words, under this statute a surety is liable if the principal has a defense that is personal only to himself.

Anti-deficiency statutes are considered personal to the debtor. *See* Gottschalk v. Draper Cos., 23 Cal. App. 3d 828, 100 Cal. Rptr. 434 (1972). Ultimately section 2810 allows anti-deficiency defenses to preempt rights under suretyship law. If this is the case, then modifying the anti-deficiency legislation is the only effective way to accomodate guarantors within these statutes.

121. Apparently, courts prefer to avoid the complex task of integrating suretyship law into deficency situations. Judges consistently apply the purposes of the anti-deficiency legislation to determine if a defense is available to guarantors. *See infra* notes 147-49 and 164-68 and accompanying text.

122. *See infra* notes 134-90 and accompanying text.

123. *See infra* notes 146, 152 & 162 and accompanying text.

124. *See, e.g.*, Gottschalk v. Draper Cos., 23 Cal. App. 3d 828, 100 Cal. Rptr. 434 (1972) (The court noted that California Code of Civil Procedure section 580b, was personal to the buyer and did not extend to the guarantor. Therefore, the court held that California Civil Code section 2810 was not controlling.).

125. *See infra* notes 171-77 and accompanying text discussing the proper application of suretyship law to a guarantor in a deficiency situation.

126. 254 Cal. App. 2d 157, 61 Cal. Rptr. 893 (1967).

partnership note was also a partner.[127] The partnership defaulted on its note.[128] To recover the debt, the creditor first nonjudicially foreclosed on the security.[129] Then, the creditor proceeded against the partner as guarantor for the deficiency.[130] However, the court considered the partner to be a principal obligor.[131] Consequently, the guarantor successfully raised the section 580d defense to protect himself from a deficiency after the creditor nonjudicially foreclosed on the primary security.[132]

This "alter-ego" type theory affords guarantors the maximum deficiency protection. This is not to say that all guarantors have deficiency defenses equal to those of the debtor. Only those guarantors who are found to actually be a debtor are allowed complete deficiency defense.[133]

a. *Section 726 - The "One-Action" Rule*

Currently, section 726 protections do not extend to guarantors.[134] Potentially, guarantors could raise the section 726 defenses to force the creditor (1) to exhaust all the debtor's

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127. *Id.* at 158, 61 Cal. Rptr. at 894.
128. *Id.*
129. *Id.*
130. *Id.* at 159, 61 Cal. Rptr. at 894.
131. *Id.*
132. *Id.*
133. This "alter ego" theory was recently illustrated in Security Pac. Nat'l Bank v. Wozab 51 Cal. 3d 991, ___ P.2d ___ , ___ Cal. Rptr. ___ (1990). Security Pacific National Bank exteded a line of credit to Anco Fire Protection, Inc., (Anco). Mr. Wozab, Anco's president and majority shareholder, and Mrs. Wozab, an Anco director, gave continuing guarantees for the company's debt. Out of concern for Anco's financial status, the bank had the Wozabs execute a deed of trust on their home as security for their continuing guarantee. Later, the bank made a set-off against the Wozab's personal savings account before proceeding against the security.

A section 726 defense was afforded the Wozabs. *Id.* at 1004-05, ___ P.2d at ___ , ___ Cal. Rptr. at ___ . The Wozabs' dual role, as debtors and guarantors, mandated that in either capacity they be afforded anti-deficiency protection. However, the Wozabs were found to have "voluntarily relinquished the protection of the security-first rule." *Id.* at 1005.

134. "The one-action rule . . . is inapplicable to a suit by a secured creditor against a guarantor, endorser, or other surety." Union Bank v. Gradsky, 265 Cal. App. 2d 40, 43 n.3, 71 Cal. Rptr. 64, 67 n.3 (1968) (citing Everts v. Matteson, 21 Cal. 2d 437, 444-45, 132 P.2d 476, 481 (1942); Loeb v. Christie, 6 Cal. 2d 416, 418-19, 57 P.2d 1303, 1304 (1936)). *See also* Murphy v. Hellman Commercial Trust & Sav. Bank, 43 Cal. App. 579, 185 P. 485 (1919).

security; (2) to exhaust all security given by the guarantor; and (3) to have a fair value determination after the foreclosure. A guarantor's section 726 defenses have been discussed when the transaction includes debtors' security.[135] Notably, the question of whether a guarantor may raise the section 726 defenses when he provides his own property as security has not been directly addressed. Nor have guarantors been given the right to insist on a fair value determination after judicial sale.

Alternatively, guarantors might successfully raise California Civil Code section 2845[136] as a deficiency defense.[137] Civil Code section 2845, which is similar to the debtors' section 726(a) affirmative defense, forces the creditor to exhaust the security first, before going against the guarantor.[138] Essentially, this defense reduces the guarantor's contract liability.

Accordingly, some authorities have argued that, "it should now be clear and accepted by the courts that the guarantor [under section 2845] *can* require the creditor to pursue his [the creditor's] security before seeking any personal recovery against the guarantor."[139] Nevertheless, this type of suretyship defense will not succeed if it undermines the purposes of the anti-deficiency laws.[140] Furthermore, this defense is not entirely effective because guarantors usually waive these suretyship rights.[141]

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135. *See, e.g.*, Everts v. Matteson, 21 Cal. 2d 437, 132 P.2d 476 (1942); Loeb v. Christie, 6 Cal. 2d 416, 57 P.2d 1303 (1936).

136. CAL. CIV. CODE § 2845 (West 1974 & Supp. 1991). Section 2845 provides in pertinent part:

> A surety may require the creditor . . . to proceed against the principal, or to pursue any other remedy in the creditor's power which the surety cannot himself pursue, and which would lighten the surety's burden; and if the creditor neglects to do so, the surety is exonerated to the extent to which the surety is thereby prejudiced.

Id.

137. United Cal. Bank v. Maltzman, 44 Cal. App. 3d 41, 118 Cal. Rptr. 299 (1974); Moffett v. Miller, 119 Cal. App. 2d 712, 260 P.2d 215 (1953).

138. CAL. CIV. CODE § 2845 (West 1974 & Supp. 1991).

139. 1 H. MILLER AND M. STARR, CURRENT LAW OF CALIFORNIA REAL ESTATE § 3.163 (1975) (emphasis added); *See also* Rintala, *supra* note 100. "However, both texts [MILLER AND STARR and Rintala] agree that the courts have not entirely followed this logic." *See* Note, 3 UCLA L. REV. 192 (1955), *noted in* R. BERNHARDT, CALIFORNIA REAL ESTATE FINANCE 134 (1989).

140. In one example, *Heckes v. Sapp*, discussed *infra* notes 164-68 and accompanying text, the guarantor could not use section 2847 because the chain of events to follow would circumvent section 580b.

141. Bloom v. Bender, 48 Cal. 2d 793, 803, 313 P.2d 568, 574 (1957); Engelman v. Bookasta, 264 Cal. App. 2d 915, 71 Cal. Rptr. 120 (1968); American

However, if section 2845 is not available, the guarantor cannot otherwise force the creditor to use the security first. In *Loeb v. Christie*,[142] the creditor had not exercised its power of sale against the mortgagor's property. Rather, it proceeded directly against the guarantor.[143] The guarantor attempted to raise the affirmative defense of section 726, and force the creditor to exhaust the debtor's security before bringing an action against the guarantor.[144]

The court concluded that, "[o]n many occasions it has been declared by this court to be the rule that the guarantor's liability may be enforced without first resorting to the mortgage security."[145] In denying the guarantor section 726 protection, the court did not consider whether section 726's policies extended to guarantors. Instead, the court assumed that since guarantors were not specifically mentioned in the one-action rule, it must not apply to them.[146]

The *Loeb* court also rejected a second argument based on California Civil Code section 2809.[147] The guarantor argued that under section 2809 not foreclosing on the debtor's property increased the guarantor's liability beyond the debtor's liability.[148] For if the debtor used the affirmative defense it would reduce or eliminate the guarantor's contract liability. The court stated that disallowing the guarantor the 726 defense "does not cause the guarantor's obligations to be any heavier or more burdensome than that of the principal or maker of the note."[149] The court, however, neglected to explain why this

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Guar. Corp. of Cal. v. Stoody, 230 Cal. App. 2d 390, 395, 41 Cal. Rptr. 69, 71-72 (1964).

142. 6 Cal. 2d 416, 57 P.2d 1303 (1936).

143. *Id.* at 417, 57 P.2d at 1303. *See also* Everts v. Matteson, 21 Cal. 2d 437, 132 P.2d 476 (1942); Union Bank v. Gradsky, 265 Cal. App 2d. 40, 71 Cal Rptr. 64 (1968).

144. This case was decided before 1939 when suretyship law became applicable to guarantors. Under California Civil Code section 2845 a surety may force the creditor to exhaust all security first before seeking a deficiency. *See supra* notes 136-41 for a discussion of section 2845's possible application to guarantors.

145. *Loeb,* 6 Cal. 2d at 418, 57 P.2d at 1303.

146. *Id.*

147. The crux of section 2809 is that the guarantor's obligation cannot be larger or more burdensome than that of the principal debtor. *See supra* notes 113-16 and accompanying text for a discussion of section 2809.

148. *Loeb,* 6 Cal. 2d at 418-19, 57 P.2d at 1303-04.

149. *Id.* at 419, 57 P.2d at 1304. The court held that the debt was no more burdensome because "[t]he principal debtor remains liable at all times for the full

did not increase the guarantor's burden.

b. *Section 580a - The Fair Value Section*

Ironically, even though section 580a is not now used by principal debtors, the courts still insist section 580a is for their benefit. Absent direction from the Legislature, it appears that the creditor need not comply with section 580a when proceeding on the guaranty. However, Professor Hetland has stated:

> The real difficulty in applying the fair value sections to a guarantor's obligation . . . is not that it does not make sense . . . but, rather the legislature has not done so. The courts should not anticipate the legislature extending the fair value anti-deficiency statutes to the guarantor.[150]

Therefore, as enunciated in *Everts v. Matteson*,[151] "section 580a applies only to an action for the recovery of a deficiency judgment upon the principal obligation after sale under trust deed or mortgage, and has no application to an action based upon the independent obligation of a guarantor."[152]

c. *Section 580b - The Purchase-Money Anti-Deficiency Statute*

Logically, a guarantee, itself, can never be purchase-money in character. However, question arises as to whether guarantors are protected by section 580b when the debtor's note is purchase-money in character. The answer is guarantors are not shielded by deficiency protection when the debtor is involved in a section 580b purchase-money situation.[153]

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amount of the obligation and may be compelled to pay it . . . . The obligation of the guarantor is no heavier or more burdensome, since he is liable for as much as, but no more than, the principal debtor or maker of the note . . . ." *Id.* at 420, 57 P.2d at 1304. The court also stated, "the obligation of the guarantor is separate and independent from that of the principal debtor, and the fund which the latter may have supplied for payment of his own obligation is not necessarily or logically available to the guarantor." *Id.*

150. Hetland, *supra* note 58, at 10 *quoted in* E. HALE AND R. FEINSTEIN, NEVADA DEED OF TRUST FORECLOSURES 116 (1989).

151. 21 Cal. 2d 437, 132 P.2d 476 (1942).

152. *Id.* at 446, 132 P.2d at 483 (citing Bank of Am. Nat'l Trust and Sav. Ass'n v. Hunter, 8 Cal. 2d 592, 67 P.2d 99 (1937)).

153. The following cases held that section 580b was intended to protect only the purchaser and not persons secondarily liable such as guarantors, endorsers or sureties. Stephenson v. Lawn, 155 Cal. App. 2d 669, 318 P.2d 132 (1957); Katz v.

The case of *Heckes v. Sapp*,[154] illustrates a guarantor's lack of section 580b protection when the debtor's note is purchase-money in nature.[155] In *Heckes*, the principal debtor purchased fifty lots from the seller who took back a second mortgage on the property.[156] A guaranty was also given to secure performance of the original obligation.[157] Upon default, the first mortgage holder foreclosed and sold the remaining thirty-five lots.[158] With no additional security on which to foreclose, the seller sought recovery from the guarantors.[159] The guarantors claimed they, like the debtor, were also protected from a deficiency under section 580b.[160]

The *Heckes* court, applying the *Roseleaf* analysis,[161] concluded that "the guarantor's obligation is not within this [section 580b's] delineation . . . . Therefore, the guarantor's obligation is not a variation of the standard purchase money mortgage transaction within the purposes of section 580b, and the guarantor should not be protected against a deficiency judgment."[162] Simply stated, the rationale for denial of guarantor section 580b protection seemed to be that guarantors were not mentioned and the statute's "purposes are served by relieving the purchaser [not the guarantor] of personal liability."[163] However, the court never considered whether the *Roseleaf* purposes might also be served if section 580b were extended to guarantors.

In *Heckes,* the guarantor also unsuccessfully argued that he was protected by California Civil Code section 2847.[164]

Haskell, 196 Cal. App. 2d 144, 16 Cal. Rptr. 453 (1961); Heckes v. Sapp, 229 Cal. App. 2d 549, 40 Cal. Rptr. 485 (1964); Roberts v. Graves, 269 Cal. App. 2d 410, 75 Cal. Rptr. 130 (1969).

154. 229 Cal. App. 2d 549, 40 Cal. Rptr. 485 (1964).

155. *Id.* at 553, 40 Cal. Rptr. at 487-88.

156. *Id.* at 550, 40 Cal. Rptr. at 486.

157. *Id.*

158. *Id.* at 551, 40 Cal. Rptr. at 487.

159. *Id.*

160. *Id.*

161. *See supra* note 86 and accompanying text. The *Roseleaf* analysis governs when the situation varies from the standard purchase-money transaction. The court must apply the purposes of section 580b to to these variations to determine if section 580b protection should be extended.

162. *Heckes,* 229 Cal. App. 2d at 553, 40 Cal. Rptr. at 487-88.

163. *Id.* at 551, 40 Cal. Rptr. at 487.

164. CAL. CIV. CODE § 2847 (West 1974 & Supp. 1991). Section 2847 provides in part:

Under the principles of section 2847, a guarantor liable for the debtor's deficiency could recover that deficiency from the principal debtor.[165] On the contrary, the *Heckes* court held that, in this circumstance, it was impermissible for a guarantor to obtain a deficiency from the debtor. Granting the guarantor a deficiency against the debtor under section 2847 would conflict with section 580b, which gave the debtor purchase-money protection.[166] The court quoted from Professor Hetland to the effect that:

> The argument for guarantors' deficiency protection does not lie in the possibility that the guarantor could enforce the obligation against the principal and thus obviate the anti-deficiency legislation; such a possibility does not exist. The courts consistently strike down schemes that are aimed at avoiding the deficiency legislation by illusory changes in form. A flimsy avoidance device based upon an intermediate surety would have no chance of success.[167]

As expected, when the anti-deficiency purposes are jeopardized, the anti-deficiency statutes override surety/guarantor law.[168]

d. *Section 580d - The Nonjudicial Foreclosure Anti-Deficiency Statute*

The section 580d issues are: (1) whether a guarantor may raise this defense after a nonjudicial foreclosure on the debtor's property; and (2) whether it is allowed after a nonjudicial foreclosure on his own property. The landmark case of

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> [i]f a surety satisfies the principal obligation, or any part thereof, whether with or without legal proceedings, the principal is bound to reimburse what he has disbursed, including necessary costs and expenses.

Id.

165. *Id.*

166. *Heckes,* 229 Cal. App. 2d at 552, 40 Cal. Rptr. at 487. *Compare* Union Bank v. Gradsky 265 Cal. App. 2d 40, 71 Cal. Rptr. 64 (1968) (The debtor was not involved in a purchase-money transaction. However, the creditor's choice of nonjudicial foreclosure which precluded the guarantor from getting a deficiency against the debtor. In this instance, the creditor was estopped from getting a deficiency from the guarantor.).

167. *Heckes,* 229 Cal. App. 2d at 555, 40 Cal. Rptr. at 489, *quoting from,* Hetland, *supra* note 58, at 25-26.

168. *Id.*

Union Bank v. Gradsky,[169] partly answered the first section 580d issue.[170] Unfortunately, the availability of guarantors' deficiency protection in the second instance is undecided.

In *Gradsky*, the lending bank nonjudicially foreclosed on the principal debtor.[171] Since section 580d barred the creditor from seeking a deficiency against the debtor, the bank proceeded against the guarantor for the deficiency.[172] The *Gradsky* court held that the bank was estopped from collecting a deficiency from the guarantor because the bank nonjudicially foreclosed.[173] This choice destroyed the guarantor's method of recovery from the debtor, otherwise known as the guarantor's subrogation rights.[174]

This is one instance where the guarantor's relief emanated from a combination of anti-deficiency legislation and suretyship law.[175] The court intermingled California Civil Code sections 2810 and 2819 with the purposes of section 580d in order to reach its decision.[176] As the court stated, "[s]ection 580d itself does not supply the answer, but it is an integral part of the answer which must be given."[177]

In *Gradsky,* it was the creditor's election of remedies which precluded the guarantor from seeking recovery from the principal obligor.[178] Alternatively, it may be the character of the note which bars the guarantor from getting a deficiency from the debtor.[179] This was the case in *Bauman v. Castle,*[180]

169. 265 Cal. App. 2d 40, 71 Cal. Rptr. 64 (1968).

170. "Section 580d itself does not supply the answer, but it is an integral part of the answer which must be given." *Id.* at 46, 71 Cal. Rptr. at 69.

171. *Gradsky,* 265 Cal. App. 2d at 44, 71 Cal. Rptr. at 67.

172. *Id.*

173. *Id.* at 45, 71 Cal. Rptr. at 68-69.

174. The court in *Gradsky*, 265 Cal. App. 2d at 44, 71 Cal. Rptr. at 68, stated the principal of subrogation as follows: "One who is neither an intermeddler nor a volunteer and who pays the obligation of another, for which the other is primarily liable, is equitably subrogated to all of the rights and to the security formerly held by the obligee against the principal obligor." *See, e.g.*, CAL. CIV. CODE §§ 2848-2849 (West 1974 & Supp. 1991); Sanders v. Magill, 9 Cal. 2d 145, 70 P.2d 159 (1937); *cf.* Offer v. Superior Court, 194 Cal. 114, 118, 228 P. 11, 13 (1945).

175. *Gradsky,* 265 Cal. App. 2d at 46, 71 Cal. Rptr. at 69.

176. *Id.*

177. *Id.*

178. *See supra* notes 173-74 and accompanying text.

179. *See, e.g.,* Bauman v. Castle, 15 Cal. App. 3d 990, 93 Cal. Rptr. 565 (1971); Heckes v. Sapp 229 Cal. App. 2d 549, 40 Cal. Rptr. 485 (1964).

180. 15 Cal. App. 3d 990, 93 Cal. Rptr. 565 (1971).

which specifically established that the *Gradsky* estoppel effect is inoperative in section 580b transactions.

In *Bauman*, the debtor's note was purchase-money in nature.[181] The debtor defaulted on the note.[182] Thereafter, the creditor nonjudicially foreclosed on the debtor's apartment building.[183] Here section 580b protected the debtor from a deficiency.[184] The only other source of recovery for the creditor was the guarantors.

The guarantors argued that the creditor was estopped from getting a deficiency from the guarantor in this situation.[185] The trial court, after reconsidering its original decision, determined that *Gradsky* did protect the guarantors from a deficiency.[186] However the appellate court judges did not agree with the trial court's decision.[187]

The *Bauman* court concluded that regardless of whether the creditor judicially or nonjudicially foreclosed, no deficiency could be had against the debtor.[188] This was because from the inception of the section 580b transaction, the guarantor was never entitled to a deficiency from the debtor.[189] Therefore, the creditor was not estopped under *Gradsky* from proceeding against the guarantor for a deficiency.[190]

3. *Guarantors' Current Status Under California's Anti-Deficiency Statutes*

The Legislature has failed to integrate guarantors into the anti-deficiency legislation.[191] Further, deficiency defenses based on suretyship law have been inadequate to protect guarantors from deficiencies.[192] Evidently, in California,

181. *Id.* at 993-94, 93 Cal. Rptr. at 567. The transaction fell under section 580b because the seller carried back part of the purchase price on an apartment complex.

182. *Id.* at 992, 93 Cal. Rptr. at 567.

183. *Id.*

184. *Id.* at 994, 93 Cal. Rptr. at 569.

185. *Id.*

186. *Id.* at 992, 93 Cal. Rptr. at 568.

187. *Id.* at 994, 93 Cal. Rptr. at 569.

188. *Id.*

189. *Id.* at 994, 93 Cal. Rptr. at 568.

190. *Id.*

191. *See supra* notes 16-17.

192. *See Loeb v. Christie*, discussed *supra* notes 147-49 and accompanying text. In *Loeb* the guarantor argued that absent application of California Civil Code sec-

suretyship statutes bow to the will of anti-deficiency legislation in cases where there is conflict. The courts deny guarantors deficiency protection because the Legislature failed to address these protections. Nevertheless, there are some safeguards for the guarantor.

Foremost, the most effective defense is the assertion that the guarantor and the principal obligor are "alter-egos."[193] Also, section 2845 forces the creditor to exhaust the security first before taking action against the guarantor for a deficiency. Further, the *Gradsky* estoppel effect can be used by guarantors as a complete bar to a deficiency. However, these last two defenses are often nullified by waiver.

Recently, the Nevada Supreme Court, in *First Interstate Bank of Nevada v. Shields*,[194] advocated a new approach to anti-deficiency statutes similar to those of California. In *Shields*, the court overruled past Nevada decisions which denied guarantors protection.[195] The significance of this case to the state of California is the court's realization that, "[i]t is irrefutably clear that the salutary purposes of the legislative scheme for recovering legitimate deficiencies would be attenuated, if not entirely circumvented in specific instances, by denying guarantors, or any other form of obligor, the protection provided by

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tion 2809, his burden would be heavier than that of the principal's. This argument did not convince the court to grant the guarantor relief from a deficiency. Another example is *Heckes, supra* notes 164-68 and accompanying text, where the court said the guarantor could not use the existing protection of section 2847 of California Civil Code because it would run counter to the anti-deficiency statutes.

193. *See, e.g.*, Union Bank v. Dorn, 254 Cal. App. 2d 157, 61 Cal. Rptr. 893 (1967); Valinda Builders, Inc. v. Bissner, 230 Cal. App. 2d 106, 40 Cal. Rptr. 735 (1964) (The guarantor and the purchaser of the land were alter egos. The guarantor was given the same protection under the section 580b purchase-money note as the purchaser.); Riddle v. Lushing, 203 Cal. App. 2d 831, 21 Cal. Rptr. 902 (1962) (The partners had signed as individual guarantors on a partnership note. Therefore, the partners were given the same standing as the principal obligors.); Everts v. Matteson, 21 Cal. 2d 437, 132 P.2d 476 (1942) (The guarantors were also liable as principal obligors, so the guarantee did not change their liability. The court allowed a section 580a fair value defense to decrease the guarantors' liability.).

194. 102 Nev. 435, 730 P.2d 429 (1986).

195. In two opinions, Crowell v. John Hancock Mutual Life Ins. Co. (1986), 102 Nev. 640, 731 P.2d 346, and First Interstate Bank v. Shields, 102 Nev. 616, 730 P.2d 429 (1986), the Nevada Supreme Court held that guarantors are entitled to the protection of Nevada's fair value deficiency legislation. This fair value provision was similar to section 580a. The *Sheilds* case broke ground by overruling past precedents which held that guarantors were not entitled to fair value deficiency protection.

the deficiency statutes."[196]

Should the Legislature subscribe to the *Shields* view, there may be hope for guarantors in California. There are persuasive arguments to prompt the Legislature to amend the deficiency laws to include guarantor deficiency protection. The California Legislature need only re-examine the purposes of the anti-deficiency statutes to reach this decision.

III. THE RESULTING PROBLEMS

A. *Problems for the Obligor Community*

Ordinarily, guarantors expect a deficiency to be satisfied either by the security, or by indemnification from the debtor. If indemnity recovery is barred guarantors may refuse to risk liability for the deficiency. They may be reluctant to relieve the debtor of his obligation, while in turn bearing all responsibility for that obligation. Alternatively, guarantors might extract much higher prices from the debtor to compensate for the significant risks in guaranteeing a note.

Additionally, inequitable results also occur if guarantors cannot defend themselves against unscrupulous creditors.[197]

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196. *Shields*, 102 Nev. at 618-19, 730 P.2d at 431. The court stated that:

> Nevada's deficiency legislation is designed to achieve fairness to all parties to a transaction secured in whole or in part by realty. To the creditor-obligee, fairness is provided by a recovery methodology that will make the creditor whole if the components for debt satisfaction exist under the panoply of assets peculiar to a given transaction. Conversely fairness is accorded obligors by permitting creditors who have sought to satisfy an indebtedness through sale of a trustor's or mortgagor's realty, to secure a deficiency judgment only to the extent any alleged deficiency exceeds the fair market value of the sold realty.

Id. at 618, 730 P.2d at 431.

197. *See, e.g.*, Crowell v. John Hancock Mut. Life Ins. Co., which "serves to highlight the incongruity and injustice that derives from denying guarantors the benefit of [the] deficiency judgment policies." 102 Nev. 640, 643, 731 P.2d 346, 347 (1986). In *Crowell*, a jury determined that the fair market value of property exceeded the amount of the debt. Therefore, the debtor "lost property of value greater than the debt, but the debt was thereby satified in full." *Id.* at 643, 731 P.2d at 346-47.

In contrast, the trial court relied on the creditor's lower fair market value assessment which was less than the debt to determine the guarantor's liability the same transaction. The trial court ignored both the jury's earlier determination and statutory fair value findings. As a result, a deficiency was entered against the guarantors. Ironically, the creditor had received complete satisfaction of the debtor's obligation from the security. *Id.* at 641-43, 731 P.2d at 347-48.

In First Interstate Bank of Nev. v. Shields, 102 Nev. 616, 617, n.1, 730

Anti-deficiency legislation establishes the ground rules for debtor/creditor interaction. Yet, it is also vital to have such an equilibrium in the guarantor/creditor setting.[198] To obtain this latter balance, guarantors must be integrated into the anti-deficiency statutes.

Until such integration occurs, guarantors will continue to seek judicial relief from the harsh effects of overreaching creditors and the lack of deficiency protection. Therefore, the focal point of the analysis integrates guarantors into the anti-deficiency statues. As illustrated, these protections further the policies and purposes behind the anti-deficiency statutes.

IV. ANALYSIS OF GUARANTORS' PROTECTION

First, the analysis discusses how each anti-deficiency statute currently effects guarantors. This analysis section does not exhaustively analyze the endless variations in which these protections are needed. Rather, it illustrates only some common inequities experienced by guarantors under the current law. Second, the analysis demonstrates how this legislation should operate for guarantors.

Various factors are considered in this second stage. First, the bargaining power of the parties (*i.e.*, the dollar amount involved in the transaction and knowledge of the creditor and guarantor) should weigh heavily in determining guarantors' deficiency protections. Also, whether the property is commercial or residential should effect guarantor's deficiency liability. In addition, guarantors giving security should be given special treatment.[199]

P.2d 429, 430 n.1 (1986), the realty was undisputably worth more than the lender's $70,000 credit bid. In fact, the lender was willing to bid up to $95,000 for the property. This would have eliminated the $87,712.71 debt. However, after the initial $70,000 bid the debtor was left with approximately a $17,000 deficiency. Had the property been sold for its fair value or even the $95,000 credit bid, there would have been no guarantor liability.

198. The *Shields* court asserted that if "a guarantor is denied the protection afforded by the deficiency legislation, we would thereby detach lenders from the deficiency standard imposed by the legislature and subject the guarantors to the vagaries of lender's scruples in any given transaction." 102 Nev. at 619, 730 P.2d at 431.

199. The need to raise deficiency defenses heightens when the guarantors themselves promise security for the debtor's obligation. The arguments are even more compelling because they are situated similarly to the original debtor.

A. *Analysis of Section 726 - The "One-Action" Rule*

Presently, section 726(a)'s affirmative defense[200] and sanction effect[201] are unavailable to guarantors.[202] Additionally, the fair value provision of section 726(b) does not apply to them.[203] Therefore, the guarantors' only chance of having the security exhausted first is California Civil Code section 2845. Unfortunately, waiver of this last defense is usually required by the lender.[204]

In short, dismissing a guarantor's affirmative defenses permits the creditor to waive the security given for the debt, and sue the guarantor directly on the guarantee. This is exactly what section 726(a) seeks to avoid. Further, it is contrary to the party's expectations. A guarantor's lack of a sanction effect, comparable to the debtor's, is inherently unfair, and may lead to multiple actions against the guarantor. In addition, the present approach of not providing guarantors with fair value[205] rights might reward unscrupulous creditors for their cunning measures.[206]

Assuming the guarantor waives California Civil Code sec-

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200. The affirmative defense is discussed *supra* notes 54-55 and accompanying text.

201. The sanction effect is discussed *supra* notes 61-62 and accompanying text.

202. *See supra* notes 134-49 and accompanying text.

203. *See supra* notes 134-49 and accompanying text.

204. The surety's section 2845 defense discussed *supra* notes 136-41 is similar to the debtor's section 726(a) affirmative defense. Both statutes require that the security be exhausted first before the creditor procures a deficiency. The present law denying guarantors protection under section 2845 is derived from *Loeb*, discussed *supra* notes 142-44 and accompanying text, which was decided before the 1939 guarantor/suretyship distinction was eradicated. Section 2845 has not recently been tested but, in one post-1939 case, the court implied that if the guarantor had not waived his section 2845 defense this outcome would likely differ. *Gradsky*, 265 Cal. App. 2d 40, 43 n.3, 71 Cal. Rptr. 64, 67 n.3. (1968).

205. Section 726(b), the fair value provision, is discussed *supra* in notes 63-68 and accompanying text.

206. At worst, the incentive for the creditor to underbid is increased in a section 580b transaction when guarantor is liable for a deficiency. A lender could submit a bid far below fair value knowing that this price cannot be questioned by the guarantor because the section 726(b) fair value provision does not apply to him. Nor might this price ever be questioned by the debtor, especially in a section 580b transaction where the debtor is not liable for a deficiency. Lenders could implicitly institute this procedure into their foreclosure practices, thus realizing a substantial double recovery from reselling the property and collecting a higher deficiency from the guarantor. All this without any penalty to the lender.

tion 2845, the present law allows the creditor to unilaterally foreclose on the security when a guarantor is involved. Does this not violate the principles of *Salter v. Ulrich* by allowing the creditor to act alone? Arguably yes; the act of the parties hypothecating security is now nullified for the guarantor because he cannot force the creditor to foreclose on it.

Unshielded by section 726's affirmative defense, the personal liability of guarantors is greatly increased.[207] The debt if discharged in whole or in part by the debtor's security could have eliminated or at least reduced the guarantor's involvement in an action. Just as with debtors, guarantors have an interest in seeing their personal liability reduced by the fair market value of the security.

This application runs contrary not only to the debtor's expectations but also those of the guarantor. Both assume the security will be exhausted before the guarantor is held liable. Without the affirmative defense a guarantor may find he is no longer participating in a secured transaction, as he anticipated.

The result is even worse when the creditor can ignore the guarantor's own security. Logically, the guarantor, like the debtor mentioned in *Walker v. Community Bank*, gave security in the first place to reduce his contract liability. In order for a secured transaction to have any meaning a guarantor must have the affirmative defense.

Moreover, a guarantor's lack of a sanction effect presents another offensive situation. For instance, what happens if a creditor judicially forecloses on some, not all, of the debtor's security,[208] receives a deficiency judgment, and is subsequently paid for the deficiency by the guarantor?[209] As stated previously, the guarantor could not have forced the creditor to

207. Consider a situation where the debtor defaults on a two million dollar debt. Then, the creditor proceeds against the debtor without foreclosing on the security, a one million dollar building. The sanction effect precludes both the creditor and the guarantor from reaching the property in a latter action. The creditor then recovers the deficiency in the amount of two million dollars from the guarantor. Bypassing the debtor's security has unjustly increased the guarantor's personal liability by one million dollars.

208. The situation becomes even more egregious considering the debtor could use section 726 to force the creditor to foreclose on his security, yet does not do so in hopes of reducing his liability at the guarantor's expense.

209. While this scenario is somewhat unlikely, it illustrates how the anti-deficiency statute purposes can be usurped in certain situations.

exhaust all the debtor's security under section 726(a). The guarantor is now subrogated to the creditor's rights.[210] However, these rights have been limited by the creditor's failure to foreclose on all the security.[211] For if the guarantor now attempts to reach the additional security, the debtor will raise the sanction effect.

Unjustly, the guarantor is precluded from recovery while the debtor is able to retain what may be very valuable security. This presents a strong argument to extend the affirmative defense to guarantors and shift the burden to the creditor to foreclose on all security. Otherwise, the creditor's actions may bar one of the guarantor's avenues to recover the deficiency from the debtor, namely foreclosing on the security.

Similarly, if neither the affirmative defense nor the sanction effect apply to guarantors, the guarantor may be subject to multiple actions. Consider the following scenario (as rarely as it may occur): The creditor judicially forecloses on the debtor's property and receives a deficiency judgment against both the debtor and the guarantor. However, the creditor does not foreclose on the security given by the guarantor, and the affirmative defense is not available to the guarantor to force this foreclosure. Later, in order to satisfy the deficiency, the creditor decides to proceed against the security of the guarantor, who does not have the benefit of the sanction effect.

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210. In California, the *Gradsky* estoppel defense illustrates this principle. *Gradsky*, discussed *supra* notes 171-77 and accompanying text, prevents the creditor from nonjudicially foreclosing in a nonpurchase-money transaction, then proceeding against the guarantor. The courts refused to let the creditors' actions in this situation dictate the guarantors liabilities.

Nonetheless, California's current position, subrogating guarantors to creditors' rights, rather than allowing guarantors their own rights under the guarantee contract, allows the creditor stance to dictate how the guarantor can proceed against the debtor. In these undetermined situations, as succinctly stated in *Gradsky*, the "question remains: As between the Bank and the guarantor, upon whom does the ultimate loss fall?" *Gradsky*, 265 Cal. App. 2d at 46, 71 Cal. Rptr. at 69.

211. The creditor's actions rightfully effect his posture against the debtor, but it is unfair for those actions to dictate the guarantor's rights under his contract with the debtor. In other words:

> Although the maker of the note would likely assert the deficiency statute as a defense against the guarantor, if successful the result would be to subject the guarantor to a defense which he never contemplated, and which does not result from his own actions, but from the creditors neglect [or imposition].

Shields, 102 Nev. at 620, 730 P.2d at 431.

In the above scenario, the obligor/guarantor is subject to two separate actions. Harassing obligors with these two actions is precisely the result, as explained in *Felton v. West*, that section 726 seeks to avoid.[212] The creditor here could have readily enforced all his rights against the guarantor in one action.

Ideally, an extension of the affirmative defense of section 726 would ensure that the guarantor does not shoulder the responsibility for the principal obligor who incurred the debt, while the principal is spared in all, or in part, from his own liability. This would also further the policy that the creditor cannot unilaterally bypass the security, whether it be that of the principal obligor or the guarantor. Finally, this defense would acknowledge the expectations of the parties that the creditor look to the security first, before proceeding personally against the guarantor.[213]

A key benefit of permitting the guarantor to raise the affirmative defense is that all remedies will truly be exercised at once. If the lender's action may result in a deficiency, the entire security,[214] both the debtor's and the guarantor's, should be included in one action. In this one action, all the rights and remedies of the parties can be determined and enforced, which in effect will foreclose any possibility of future action.

Furthermore, the guarantor should be permitted to raise the sanction effect to force the creditor to bring in the guarantor and all other security when there might be a balance left owing on the debt. Arguably, the creditor contemplates a de-

212. This argument was presented in Felton v. West, 102 Cal. 266, 36 P. 676 (1894); *see also supra* note 54 and accompanying text.

213. From a guarantor's standpoint raising the affirmative defense could eliminate his involvement in the action altogether. After a guarantor raises the affirmative defense, a creditor might find that foreclosing on the debtors' property satisfies the entire debt. This would eliminate the need for a deficiency judgment, the guarantor's subrogation to the creditor's rights and, finally, the guarantor's recovery from the debtor for the deficiency (given a deficiency is possible in the particular transaction).

From a creditor's perspective, it would behoove him to bring in all security, both that given by the guarantor and the debtor. There is a chance that the security in its totality would satisfy the debt. In any event, the creditor would be relieved, either wholly or in part, from personally pursuing obligors, who might not have the resources to pay.

214. For a discussion of whether a guarantor is additional security or a separate contract, see *supra* note 112.

ficiency when he judicially forecloses, otherwise he would save his time and money by nonjudicially foreclosing. Therefore, two actions are unnecessary when the creditor could easily proceed with one that includes the guarantor and any security for the transaction.[215]

Moreover, the prevailing practice of confining the fair value provision of section 726(b) to debtors runs contrary to the purpose of limiting double recoveries for the creditor. There are numerous ways in which a guarantor without fair value protection could be unfairly treated. Applying section 726(b)'s fair value provision becomes even more compelling when it is the guarantor's property that is the security sold. Fairness dictates that the guarantor should receive the benefit of the value of his property, just as the debtor receives full value for his property. Without this protection, creditors would be able to manipulate the security so as to deprive both obligors of the value of the property.[216]

The fair value provision of section 726(b) should apply to all liable parties, not just to the principal debtors. As set forth in *Freedland v. Greco*,[217] the provisions of the anti-deficiency legislation "are not solely for the debtor's benefit but are also for the protection of the public."[218] There is no justification for allowing the guarantor to be exploited by creditors while the debtor remains protected. This approach would ensure that creditors do not receive undeserved double recoveries in any instance.

B. *Analysis of Section 580a - The Fair Value Section*

The *Gradsky*[219] estoppel defense prevents deficiencies from being sought against guarantors after nonjudicial sales.

215. The major purpose of section 726, the "one-action" rule, is to limit multiple court actions and reduce the debtor's personal liability. *See supra* notes 54-55 and accompanying text.

216. This was the focus of the guarantor's argument in FBW Enterprises v. Victorio Co., 821 F.2d 1393 (9th Cir. 1987), where the creditor proceeded against the guarantor for the remainder of the debt. The creditor had only credited the debt with the amount of the bid ($750,000), not with the fair market value of the property ($1,771,752.95). Thus, the guarantor, if not protected by the fair value provision, has a substantially higher liability.

217. 45 Cal. 2d 462, 289 P.2d 463 (1955).

218. *Id.* at 467, 289 P.2d at 468.

219. *See supra* notes 171-77 and accompanying text.

Therefore, in that situation, it is unnecessary to apply section 580a. However, as stated in *Bauman*,[220] this is not the case with purchase-money transactions, where a guarantor can be subject to a deficiency after a nonjudicial sale. In addition, a waiver of the *Gradsky* defense can also result in a deficiency against the guarantor after a nonjudicial sale.

In a purchase-money situation, or when *Gradsky* has been waived, section 580a should be revitalized to provide the guarantor fair value protection. The reason for providing such protection follows from the principal propositions advanced in the section 726 fair value discussion: Creditors should not be able to realize double recoveries, obligors should benefit from the value of their land, and to allow any other result would be unfair and against public policy.[221] However, this discussion of section 580a would be moot if the guarantor were allowed a section 580d defense that could not be waived.

C. *Analysis of Section 580b - The Purchase-Money Anti-Deficiency Statute*

At first glance, section 580b[222] seems to fairly allocate the risks between the creditor and guarantor. After all, the creditor seeks a guarantor in these situations because he is aware of the fact that the principal obligor is not liable for a deficiency.[223] However, there are various arguments, attenuated as they may seem, for extending section 580b to guarantors. How many times is the guarantor really aware that a deficiency cannot be had against the principal but, only against

220. *See supra* notes 180-90 and accompanying text.

221. Assume the creditor nonjudicially forecloses on the debtor's purchase-money property, worth $300,000. The debt also amounts to $300,000. If the high bid comes in at $225,000, there will be a $75,000 deficiency. The creditor cannot recover a deficiency from the debtor and the debtor most likely will not raise a fair value argument.

Consequently, ruling out a fair value argument for the guarantor would reward a creditor who violated the principles of section 580a. If the creditor was the high bidder at the sale he has realized a double recovery. Even if a double recovery is not involved, the obligor/guarantor, if not the debtor, would not receive the full benefit of the property's value, or $300,000.

222. Section 580b is discussed *supra* at notes 153-68 and accompanying text.

223. "A guaranty of a purchase money mortgage would be rendered nugatory at the outset if it were so protected because of an effective guaranty would become an illegal impossibility." Consolidated Capital Income Trust v. Khaloghli, 183 Cal App. 3d 107, 113, 227 Cal. Rptr. 979, 986 (1986).

himself? Further, if the guarantor is aware that a deficiency cannot be sought against the debtor,[224] the debtor must increase the monetary incentive for the guarantor to guarantee the note.

Arguably, if the guarantor is going to guarantee a debtor's section 580b transaction, there is a special relationship or fiduciary tie between the two parties. This gives the guarantor two reasons to service the debt should it go into default. First, making payments will ensure that the debtor does not lose the property through foreclosure. Second, the guarantor will continue making payments to save his own credit rating. Therefore, a guarantor with section 580b protection still provides the creditor with some security.

Also, not providing a guarantor with section 580b protection in a seller carry-back situation encourages overvaluation. The prevention of overvaluation is precisely what this section is designed to prevent.[225] The seller may request an inflated price for the property with the thought of recovering from the guarantor.[226] Allotting guarantors a section 580b defense shifts the burden back onto the creditor who knows the value of the property and chose to extend credit in the first place.

Additionally, section 580b takes on new meaning when the principal's obligation is secured by the guarantor's home.

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224. The Joint Committee of the California State Bar Association has proposed the following warning for guarantors:

> *Warning*: Part of the security for the obligation being guaranteed is the personal residence of the borrower. The liability of the borrower cannot exceed the value of his or her residence, and you may have to pay the balance. You will have no right to be repaid by the borrower whose personal residence is part of the security.

On file with the *Santa Clara Law Review*, Santa Clara, California.

225. Recently, overvaluation has been criticized as a valid purpose for section 580b. Budget Realty v. Hunter, 151 Cal. App. 3d 511, 515-16, 204 Cal. Rptr. 48, 50-51 (1984). This view recognizes that the seller will ask and receive only as much as the market will bear.

226.

> By demanding a guarantor (or by tailoring the transaction so that the deeper pocket guarantees rather than incurs the debt), the creditor escapes application of CCP § 580b. The essential principle behind § 580b (that the seller must look only to the security, in accordance with the policy of *Brown v. Jenson* is thus frustrated . . . . When there is no personal obligation to assume there is no personal obligation to guarantee. Guarantor purchase-money protection should be an essential corollary to the rule of Brown v. Jensen, ...

See BERNHARDT, *supra* note 32, § 8.14, at 409.

Whether some section 580b protection should be afforded guarantors who use their own residence as security needs to be considered. It would be unfair if both the debtor and the guarantor lost their home in a foreclosure when the primary debtor was shielded from a deficiency, while the guarantor was still liable for his principal's debt. As with the primary debtor, the legislation should express a preference for those who have lost their homes. Consequently, if a guarantor uses his house as security, he should not face a deficiency if he loses it.[227] If a creditor is concerned about a deficiency, he should seek other security instead of the guarantor's home.

D. *Analysis of Section 580d - The Nonjudicial Foreclosure Anti-Deficiency Statute*

Currently, the guarantor is properly protected by the *Gradsky* estoppel defense.[228] This defense operates as if section 580d itself was preventing the deficiency. It provides maximum protection for the guarantor after a nonjudicial sale of the debtor's property, and exempts him from any further liability.

An exception to applying *Gradsky* is a section 580b purchase-money transaction situation where a deficiency after a nonjudicial foreclosure is barred against the debtor, while still allowed against the guarantor.[229] This deviation from the estoppel effect is because the guarantor in a purchase-money situation arguably knows in advance that he must pay any possible deficiency with no hope of recovery from the debtor.

While this argument is persuasive, it fails to address the purpose of section 580d. The purpose of section 580d is to put

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227. Society values and protects the residence. After all, "a man's home is his castle." E. WARREN & J.L. WESTBROOK, THE LAW OF DEBTORS AND CREDITORS 48 (1986), sums up the usual scenario that occurs with homeowners:

> But when the item sold is a home, the desires of the parties to resist the sale or secure the property purchased are particularly accentuated. A debtor often has substantial amount of equity in a home that could be realized in a private sale, but the value will be lost in a low priced judicial sale . . . . [T]here is the ever-present possibility that a judicial sale of a home will be followed by a complaint or a lawsuit alleging that the home was sold for too low a price.

Id.

228. *See supra* notes 171-77 and accompanying text.

229. *See supra* notes 180-88 and accompanying text.

nonjudicial foreclosure on an even par with judicial foreclosure.[230] "[B]arring a deficiency judgment after a private sale encourages realistic credit bids in the same way that allowing redemption from judicial sales does."[231]

Applying section 580d to guarantors would further this purpose. Logically, higher credit bids will not be encouraged when the creditor can simply rely on the guarantor for a deficiency. In this event, the creditor's incentive to obtain a high bid is diminished. In fact, disallowing this guarantor defense actually usurps the intended purpose of section 580d.

An even more persuasive argument for section 580d protection is presented when the creditor nonjudicially forecloses on a secured guarantor. A nonjudicial foreclosure, in this instance, bars any possible right of redemption in the guarantors. The same section 580d principles should apply to the guarantor as apply to the original debtor.

The creditor chooses his remedy. Should the creditor wish to get a deficiency from the guarantor, he would merely have to foreclose judicially. Again, when guarantor liability is at issue, barring a deficiency after a nonjudicial foreclosure would specifically serve the purpose of the anti-deficiency statutes.

V. PROPOSALS FOR GUARANTORS' PROTECTION

Each of the present statutes should be changed to improve the guarantor's situation.[232] Foremost, the proposed statutory changes will aid courts presented with complex guarantor situations in executing the legislative intent of anti-deficiency statutes. In some of the following proposals, the guarantor is allowed to waive his defenses. However, these instances should be limited. If the right to waive is absolute, it would take the law back to square one, where the guarantor is essentially an unprotected party. The result of these proposals

230. United States v. Haddon Haciendas Co., 541 F.2d 777 (1976).

231. *Id.* at 779 (*citing* Roseleaf Corp v. Chierghino, 59 Cal. 2d 35, 43-44, 378 P.2d 97, 102 (1963)).

232. Currently, the California Bar Association's Joint Committee is in the process of revising the anti-deficiency statutes to incorporate guarantors.

will not absolve the guarantor of his obligation to pay. Rather, the suggested procedures contemplate a fairer approach to guarantors in light of the creditor's excessive leverage in most transactions.

A. *Proposal for Section 726 - The "One-Action" Rule*

Section 726 should be amended to give the guarantor the benefit of the judicially created affirmative defense and sanction effect. The statute should also state that the guarantor has these defenses not only when the debtor's property is sold, but also when his own property is involved. To ensure these results, the following italicized sentence should be added to the present section 726(a):

> There can be but one form of action for the recovery of any debt or the enforcement of any right secured by mortgage upon real property or an estate for years therein, *or the recovery on any guarantee or the enforcement under a guarantee of any right secured by mortgage upon real property or an estate for years therein,* which action shall be in accordance with the provisions of this chapter.[233]

In addition, the guarantor should benefit from the section 726 fair value provision. Accordingly, section 726(b) should include the following changes:

> [A]s to the fair value of *either the debtor's or guarantor's* real property or estate for years therein sold as of the date of sale, the court shall render a monetary judgment against the defendant or defendants, *including the guarantor,* for the amount by which the amount of indebtedness . . . exceeds the fair value of the real property or estate for years therein sold as of the date of sale. In no event shall the amount of the judgment, . . . exceed the difference between the amount for which the property or estate for years therein was sold and the entire amount of indebtedness secured by the mortgage or deed of trust.[234]

The guarantor should not be allowed to waive the affirmative defense and the sanction effect of section 726(a). Alternatively, if waiver is permitted it should only occur after the debtor defaults, and then only in specific instances. Section

233. *See supra* note 40 setting forth the original language of section 726(a).
234. *See supra* notes 51-52 setting forth the original language of section 726(b).

726(a) should not be waivable by a guarantor when the debtor's original obligation is $750,000 or less,[235] when it is a purchase-money transaction,[236] or in any instance where the security is a residence.[237] The section 726(b) fair value provision should not be waivable on the grounds that to do so would be contrary to public policy.[238]

B. *Proposal for Section 580a - The Fair Value Section*

If section 580d were not applied to guarantors, the revival of section 580a[239] would be mandated. This section should be made applicable to guarantors in any situation where a deficiency is sought after a nonjudicial foreclosure. This could be done by amending section 580a in the following manner:

> Following the exercise of the power of sale in such deed of trust or mortgage . . . . Before rendering any judgment *against the debtor or guarantor* the court shall find the fair market value of real property, or interest therein sold, at the time of the sale.[240]

The section 580a fair value provision should not be waivable on the grounds that it is contrary to public policy. However, should the legislature determine that section 580d protects guarantors from deficiencies after nonjudicial foreclosures, the need for section 580a guarantor protection would be

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235. This follows NEV. REV. STAT. § 40.495(4)(a) (1989) which in certain instances bars waiver of NEV. REV. STAT. § 40.430 (1989), Nevada's answer to section 726. In Nevada, a guarantor securing a debtor's indebtedness which was never greater than $500,000 cannot waive section 40.495(4)(a). The amount here is increased to $750,000 to reflect the fact that California's property prices are inflated above Nevada's. Keeping in mind the leverage of a creditor, section 40.495 reflects the wisdom in small transactions of protecting guarantors who are arguably less sophisticated than the creditor.

236. This originates from NEV. REV. STAT. § 40.495(4)(b) (1989).

237. This originates from NEV. REV. STAT. § 40.495(4)(c) (1989).

238. *Freedland v. Greco* discusses how public policy necessitates the use of fair value provision in secured transactions. *See supra* note 45 and accompanying text. This approach is analogous to that taken by the U.C.C. where it is clearly established that the debtor or the pledgor may not waive or vary the right to have a "commercially reasonable" sale. Savings Bank of New Britain v. Booze, 34 Conn. Supp. 632, 382 A.2d 226 (1977) (construing U.C.C. § 9-501(3)(b) (1977)). Not being able to waive a commercially reasonable sale or not being able to waive the right to have a sale conducted fairly would reach a similar result.

239. *See* text accompanying notes 219-21 discussing the reactivation of section 580a for guarantors.

240. *See supra* notes 76-77, referring to original language of section 580a.

eliminated.

C. *Proposal for Section 580b - The Purchase-Money Anti-Deficiency Statute*

Due to the special policies and circumstances surrounding section 580b transactions, this statute should also bar deficiencies against guarantors of purchase-money transactions. At the very least, this statute should address one instance where guarantor 580b protection is mandatory. Namely, a specific addition should be made to section 580b which prohibits deficiencies against guarantors who have hypothecated their own residence as security. Section 580b should be amended to read as follows:

> No deficiency judgment shall lie *against a debtor or guarantor* in any event after the sale of real property or an estate for years therein . . . given to the vendor to secure payment of the balance of the purchase price of that real property or under a deed of trust, or mortgage, *or a guarantee of a note secured by a mortgage,* on a dwelling for not more than four families given to the lender to secure repayment of a loan which was in fact used to pay all or part of the purchase price of such dwelling occupied, entirely or in part by the purchaser. *This section shall apply to a guarantor who gives a lender a deed of trust or mortgage to secure the guarantee which deed of trust of mortgage is secured by a dwelling for not more than four families and such dwelling is occupied entirely or in part by the guarantor.*[241]

Ideally, the guarantor would not be able to waive this defense. Alternatively, waiver would be permitted to balance out the risk allocation between the guarantor and the creditor in these transactions. This, of course, with the exception that waiver is not permitted when the guarantor's own home is used as security.

D. *Proposal for Section 580d - The Nonjudicial Foreclosure Anti-Deficiency Statute*

It is essential that the *Gradsky* estoppel effect be codified, so section 580d itself bars a deficiency against the guarantor

241. *See supra* notes 81-82, referring to original language of section 580b.

after a nonjudicial foreclosure sale of any security. Going one step further, the amendment to the present section 580d should also bar deficiencies against guarantors when the creditor elects to foreclose nonjudicially. This would also include nonjudicial foreclosure on the guarantor's property. The section 580d modification would provide:

> No judgment shall be rendered for any deficiency upon a note *or guarantee* secured by a deed of trust or mortgage upon real property or an estate for years therein hereafter executed in any case in which the real property or estate for years therein has been sold by the mortgagee or trustee under power of sale contained in the mortgage or deed of trust *or under a guarantee. This section shall apply to property which secures a guarantee and which is sold by the mortgagee or trustee under the power of sale contained in the mortgage or deed of trust securing the guarantee.*[242]

The guarantor should not be able to waive section 580d in *Gradsky* transactions. A possible waiver exception may apply to section 580b purchase-money transactions where the creditor has nonjudicially foreclosed on the debtor's property. However, when there is a nonjudicial foreclosure on the guarantor's property no waiver would be allowed.

VI. CONCLUSION

In conclusion, endowing guarantors, such as Gerry and Gail, with defenses to deficiencies directly serves the purposes of the anti-deficiency statutes. Deficiency defenses shelter guarantors from a creditor's unequal bargaining power, lender's double recoveries, multiple actions, economic downturn, overvaluation and possible unscrupulous practices of creditors. Incorporating guarantor protection into the anti-deficiency statutes is long overdue.

As shown in the opening hypothetical, the current law denying guarantors deficiency protection has a devastating effect on these obligors. In contrast, the original debtor's liability may be minimal. If Gerry and Gail had been afforded the protection of the anti-deficiency statutes, the result of Dan's default would not have been so inequitable. The following discussion demonstrates how the proposed additions to the

242. *See supra* note 101, referring to original language of section 580d.

anti-deficiency statutes would have worked toward producing more equitable results for the guarantors. Again, this discussion does not attempt to exhaust every possible situation where a guarantor will raise this defense.

A. *Integration of Guarantors into Section 580d*

Beginning with Sal's nonjudicial foreclosure on Dan's warehouse buildings, section 580d would have barred a deficiency against the guarantors.[243] Thus, a nonjudicial foreclosure would have precluded Sal from seeking a deficiency against the guarantors. If Sal intended to seek a deficiency he simply should have elected to foreclose judicially. In the event that section 580d was not extended to guarantors, section 580a and the remaining anti-deficiency statutes would still act as a buffer against the guarantors' liability.

B. *Integration of Guarantors into Section 580a*

Alternatively, if the section 580d proposal were not adopted, the guarantors would have received section 580a fair value protection. Were the original debts totaling $3,600,000 ($3,750,000 purchase price minus $150,000 down) reduced by the fair value of the properties, rather than $450,000 for the office building property and $1,500,000 for the press plant property, the deficiency would have been less than $1,650,000. Conservatively, the properties' fair value might have been $600,000 for the office building and $2,000,000 for the press plant. Combined, these amounts would have reduced the total remaining deficiency to $1,000,000. Most importantly, this avoids a double recovery by Sal.

As a result of allowing the guarantors to raise a section 580a defense to the foreclosure on Dan's property, Gail is liable for $100,000, instead of $250,000, and Gerry is liable for $900,000, not $1,400,000. Providing fair value protection after foreclosure on the debtor's security has reduced the guarantors' combined deficiency burden by $650,000.

Further, if Gerry were able to raise the fair value defense after the nonjudicial foreclosure on his vacant lot, appraised at

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243. Previously a guarantor could not rely on the *Gradsky* estoppel effect to bar a deficiency after a nonjudicial foreclosure because a section 580b transaction was involved.

$1,300,000, his deficiency would have been further reduced. This foreclosure would have resulted in a $400,000 surplus after the $900,000 first deed of trust was paid. Thus, Gerry's deficiency would have been $500,000. Depending on the market, the true fair market value of the security could have equalled the amount of the principal obligor's debt. Consequently, the guarantors' responsibility might have ceased entirely.[244]

C. *Integration of Guarantors into Section 726*

According to the statutory additions, had Sal judicially foreclosed on Dan's property, Gerry would be able to raise a section 726 defense. In the hypothetical, Gerry would have had the option of raising the affirmative defense to force Sal to foreclose on the vacant lot before suing him personally under the guarantee. Foreclosing first on the vacant lot would have reduced Gerry's deficiency. This also may have effectively preserved some of Gerry's $500,000 life savings.

Alternatively, Gerry could waive his affirmative defense and rely on the sanction effect. He could have allowed the creditor his judicial action which did not rely on the vacant lot as security. In this action, the creditor could have reached the $500,000 savings account. Nevertheless, once there was an action, the section 726(a) sanction effect would bar any attempt to foreclose on the vacant lot. Consequently, Gerry loses his savings and still must pay the deficiency. However, his other valuable asset, the vacant lot, would be spared. Notably, even with the section 726 defense, guarantor deficiency protection would not shift the entire risk onto the creditor.

D. *Integration of Guarantors into Section 580b*

Under the arguments presented, section 580b may also

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244. In some instances, as in Crowell v. John Hancock Mut. Life Ins. Co., 102 Nev. 640, 642., 731 P.2d 346, 347-48 (1986), the fair market value of the debtor's property could exceed the debt and therefore extinguish it. In which case, the guarantor should be entirely free from liability. Further, the legitimate expectation of the creditor, complete satisfaction of the debt, has been realized. *Id.*

In the hypothetical, the fair value of both warehouse buildings could have appreciated to $4,000,000. If the section 580a fair value provisions applied after the nonjudicial foreclosure, Gail and Gerry would be relieved of any obligation under the guarantee.

rescue the guarantors from a deficiency in this situation. Gerry and Gail are precisely the type of guarantors that a section 580b defense should protect. The guarantees arose mostly because of a special relation between the debtor and the guarantor. The guarantors were relatively inexperienced. Their real function, or so they thought, was to help Dan avoid default by helping with the payments, making them similar to an original debtor. With section 580b protection, the creditor would not have been able to pursue Gerry and Gail for a deficiency, if they did not waive their 580b protection. In contrast to the original scenario, the guarantors are not held wholly liable for Dan's debt, while Dan is left debt free.

In addition, consider under the proposals what would occur if Gerry had used his home as security, then Sal foreclosed. When Sal foreclosed on the Gerry's home, section 580b would have barred any deficiency, just as it would have protected Dan if he had secured the debt with his residence. After losing his home, Gerry would not be subjected to a further deficiency.

In conclusion, these proposals would serve the intended purpose of the anti-deficiency statutes. Multiple actions against the guarantor would be prevented by applying section 726(a) which would force the creditor to join all parties and their security or lose their remedies. Logically, the same section 726 defenses should be provided to the guarantor, who like the debtor expects the security to be exhausted first. This avoids the harsh result reached when the debtor still owning additional security promised for the original debt raises the section 726 sanction effect against the guarantor after the creditor neglected to bring in all the security in the first action.

In addition, a fair value defense under section 726(b) or section 580a ensures that the debtor and the guarantor receive the benefit of the fair value of the security. This would effectively reduce the amount of the guarantor's deficiency and, consequently, any reimbursement obligation of the debtor. Guarantors raising the fair value defense in both the section 726(b) and section 580a contexts would also prevent double recoveries by creditors.

Furthermore, aggravation of economic downturn and overvaluation would be prevented if section 580b was applied to guarantors. Guarantors who have hypothecated their homes as security would not risk being placed in the same position as the principal debtor of the depression era. Meanwhile, creditors in 580b transactions would no longer be tempted to overvalue the property thinking they could collect the excess funds from the guarantor.

Finally, extending a section 580d defense to guarantors, gives them maximum deficiency protection. This would effectively put nonjudicial foreclosure on a parity with judicial foreclosure. Additionally, this would not bar a deficiency altogether. Rather, it would merely require the creditor to nonjudicially foreclose when he seeks a deficiency.

The Legislature has played a passive role in granting guarantors shelter from unequal bargaining power, lender's double recoveries, economic downturn, overvaluation, or possible unscrupulous practices of creditors. These proposals would uphold the goals of the anti-deficiency statutes, placing the creditor and guarantor on a more equal footing by granting to the guarantor these defenses. Extending these fundamental deficiency protections to guarantors will ensure equitable results in the most basic to the most complex transactions.

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