STRIVING FOR FAIRNESS:

THE ONE ACTION RULE AND FAIR VALUE DEFENSES

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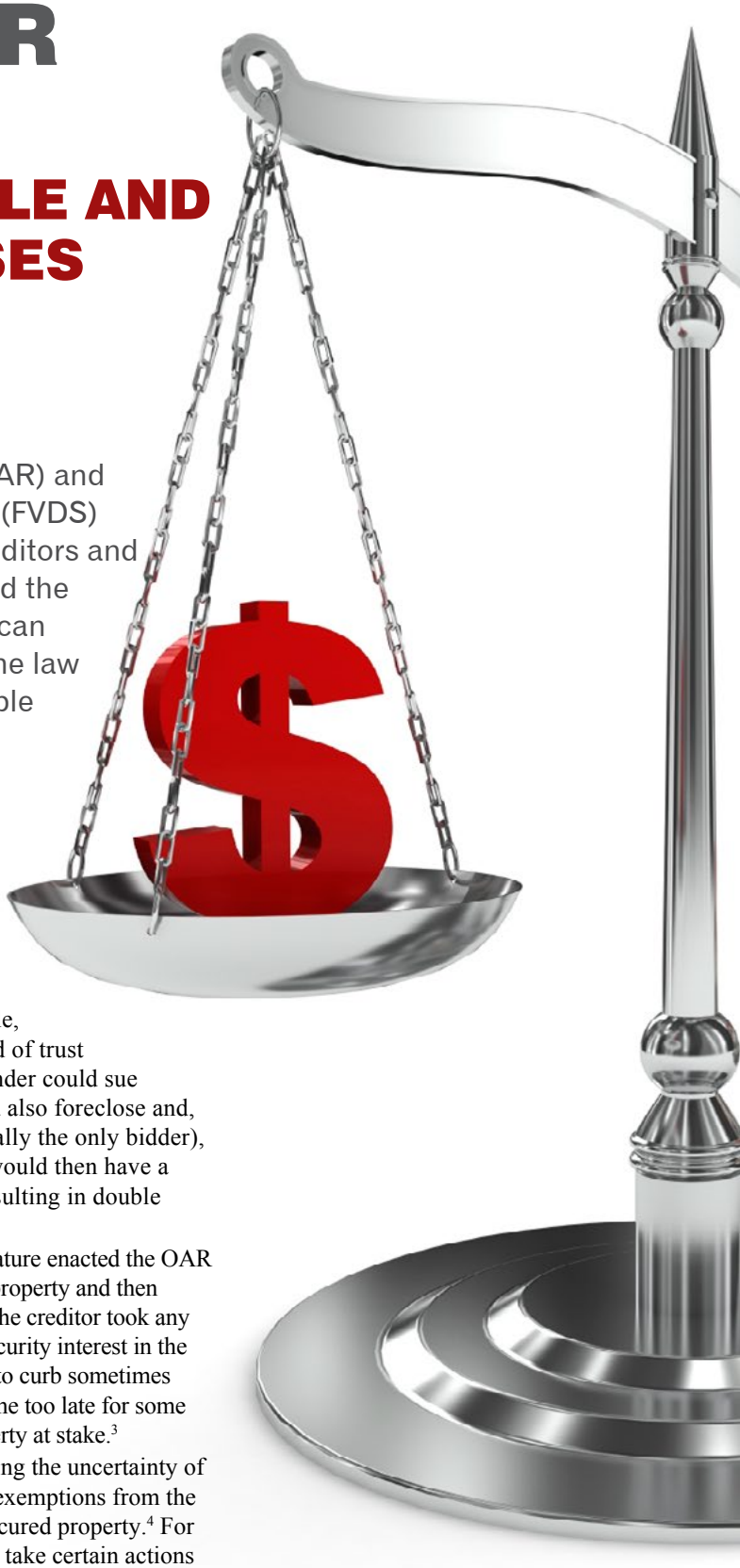


The One Action Rule (NRS 40.430-40.435) (OAR) and the fair value defenses (NRS 40.451-40.4639) (FVDS) are intended to achieve fairness between creditors and borrowers/guarantors. Together, the OAR and the FVDS have evolved to ensure that a creditor can collect its debt but cannot double recover. The law is unsettled, however, regarding certain double recovery issues that arise when a guarantor waives the OAR.

The One Action Rule

Before the OAR, a lender could foreclose on a mortgage/deed of trust and sue on the note simultaneously, allowing double recovery when the lender obtained the property and a judgment against the borrower/guarantor for the full amount owed.[1] As an example, assume Lender loaned Borrower $100,000 secured by a deed of trust against property worth $150,000. If Borrower defaulted, Lender could sue Borrower and obtain a judgment for $100,000. Lender could also foreclose and, if Lender was the highest bidder at the foreclosure sale (usually the only bidder), Lender would obtain the property worth $150,000. Lender would then have a judgment for $100,000 and the property worth $150,000, resulting in double recovery ($250,000 on a $100,000 debt).

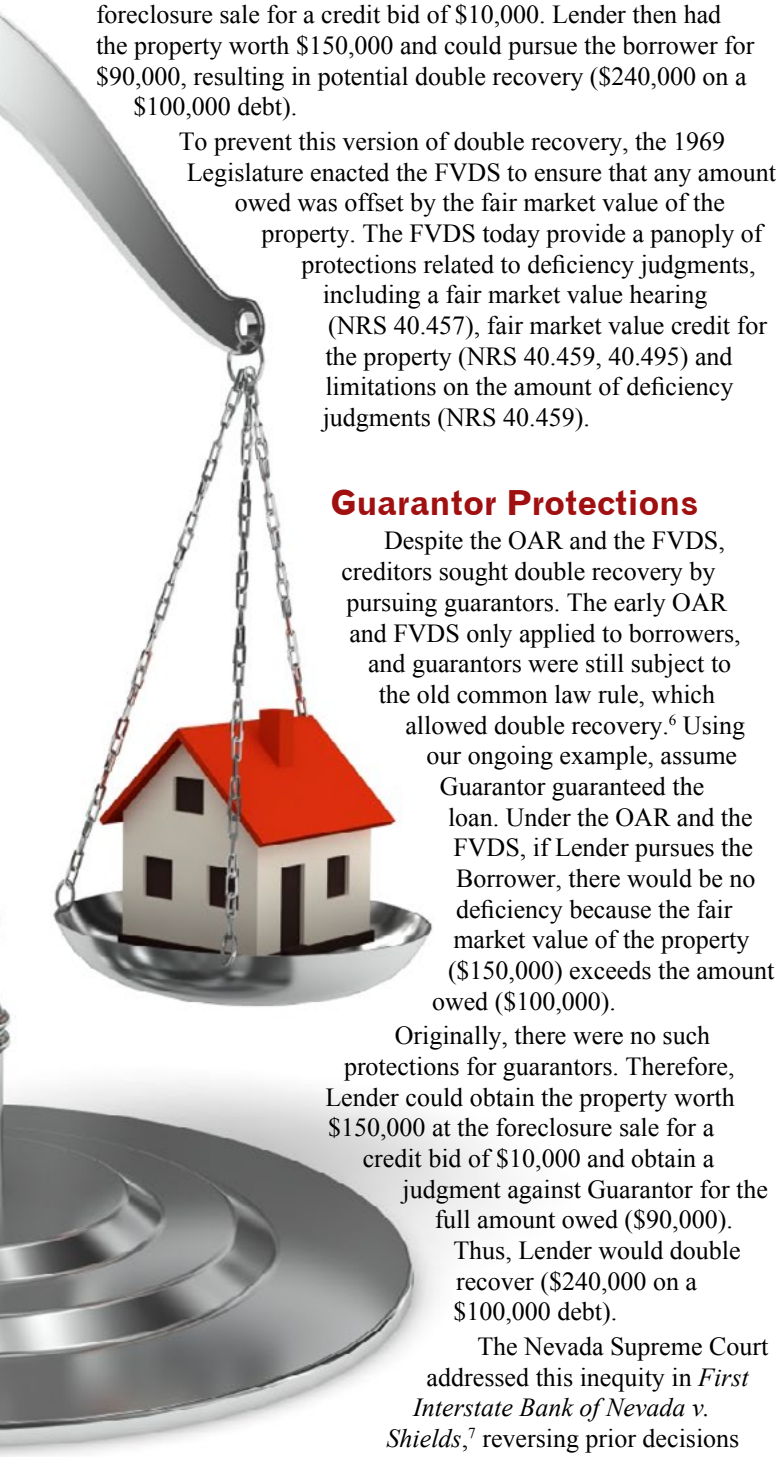
To address such double recovery, the Nevada State Legislature enacted the OAR in 1911, under which a creditor could either foreclose the real property and then seek a deficiency judgment or sue the borrower on the note. If the creditor took any action against the borrower, the creditor immediately lost its security interest in the property.[2] Over time, courts developed exceptions to the OAR to curb sometimes harsh results. These judicially created exceptions, however, came too late for some creditors and created a high-risk gamble with the secured property at stake.[3]

The Legislature addressed the creditors' concerns regarding the uncertainty of the OAR by enacting NRS 40.430(6), which created specific exemptions from the OAR, so creditors knew which actions would not risk their secured property.[4] For example, creditors could sue for a receiver, sue a guarantor or take certain actions in a bankruptcy proceeding without violating the OAR. Today, even if a creditor violates the OAR, it does not lose its security interest unless it obtains a judgment, in which case the deed of trust is void.[5]

The Fair Value Defenses

After the enactment of the OAR, lenders began to double recover another way – by making very low credit bids at the foreclosure sale. Initially, a deficiency judgment was the amount owed, less the credit bid at the foreclosure sale. Continuing the above example, assume Lender obtained the property at the foreclosure sale for a credit bid of $10,000. Lender then had the property worth $150,000 and could pursue the borrower for $90,000, resulting in potential double recovery ($240,000 on a $100,000 debt).

To prevent this version of double recovery, the 1969 Legislature enacted the FVDS to ensure that any amount owed was offset by the fair market value of the property. The FVDS today provide a panoply of protections related to deficiency judgments, including a fair market value hearing (NRS 40.457), fair market value credit for the property (NRS 40.459, 40.495) and limitations on the amount of deficiency judgments (NRS 40.459).



Guarantor Protections

Despite the OAR and the FVDS, creditors sought double recovery by pursuing guarantors. The early OAR and FVDS only applied to borrowers, and guarantors were still subject to the old common law rule, which allowed double recovery.[6] Using our ongoing example, assume Guarantor guaranteed the loan. Under the OAR and the FVDS, if Lender pursues the Borrower, there would be no deficiency because the fair market value of the property ($150,000) exceeds the amount owed ($100,000).

Originally, there were no such protections for guarantors. Therefore, Lender could obtain the property worth $150,000 at the foreclosure sale for a credit bid of $10,000 and obtain a judgment against Guarantor for the full amount owed ($90,000). Thus, Lender would double recover ($240,000 on a $100,000 debt).

The Nevada Supreme Court addressed this inequity in *First Interstate Bank of Nevada v. Shields*,[7] reversing prior decisions and holding that guarantors, like borrowers, are entitled to the protection of the OAR and the FVDS. The 1989 Legislature, however, modified the rule by allowing guarantors' waiver of the OAR under NRS 40.495(2).

Guarantor Waiver of the One Action Rule

The law remains unsettled regarding several issues that arise when a guarantor waives the OAR, including applying the FVDS, calculating the amount of the deficiency judgment and interpreting the OAR exemptions.

Applying the FVDS

If a guarantor waives the OAR under NRS 40.495(2), the creditor can sue the guarantor on the guaranty without first foreclosing the property. The FVDS, however, cannot be waived by borrowers or guarantors under NRS 40.453 and 40.495(3). If the creditor "maintains an action to foreclose or otherwise enforce a mortgage," the guarantor is entitled to the FVDS.[8] And the creditor is only entitled to pursue a deficiency judgment after a foreclosure sale, as limited by NRS 40.459. Otherwise a creditor could foreclose the property and obtain a judgment against the guarantor for the entire amount owed, resulting in the exact double recovery the OAR, FVDS and *Shields* prevent.

Before 2011, the statutes did not address the scenario where the guarantor waived the OAR and the creditor did not maintain an action against the property. Perceiving a loophole, creditors began to double recover by taking no action against the property and obtaining judgments against guarantors for the full amount owed. Since the guarantor waived the OAR, the judgment did not void the deed of trust, and creditors could later foreclose the property and hold the judgment – double recovery.

The Legislature addressed this latest iteration of double recovery by enacting NRS 40.495(4), which ensures that the guarantor receives credit for the fair market value of the property, even if the creditor is not maintaining an action against the property.[9]

Calculating the deficiency judgment

Two statutes are implicated in calculating a deficiency judgment against a guarantor when the guarantor waives the OAR: NRS 40.459 and 40.495(4)(b). Read separately, these statutes seem to hinge on the date the creditor files its complaint. If the creditor maintains an action to foreclose or otherwise enforce its mortgage, then the guarantor is entitled to all the FVDS, including the limitations on the amount of the deficiency judgment under NRS 40.459. On the other hand, if the creditor files its complaint against the guarantor and then forecloses, then seemingly both NRS 40.495(3) and 40.495(4) apply. Read together, the court must make all the calculations under NRS 40.459 and 40.495, and enter a deficiency judgment for the least amount.

OAR exemptions and the FVDS

Some creditors challenge how the OAR exemptions contained in NRS 40.430(6) interact with the FVDS when a guarantor waives the OAR. The OAR exemptions were created so that creditors would know definitively which actions would neither violate the OAR nor forfeit the security property. Some of the exemptions include holding a trustee's sale and taking certain actions in a bankruptcy. These exemptions make sense: a creditor

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should be free to foreclose the property or protect its interests in a bankruptcy sale without violating the OAR.

Some creditors attempt to use the exemptions from the OAR to deprive guarantors of their FVDS. The exemptions are not "actions" for purposes of "actions" that would violate the OAR and forfeit the security property. Creditors, however, argue that they also are not an "action to foreclose or otherwise enforce a mortgage" under NRS 40.495(3). Therefore, according to the argument, holding a trustee's sale is not an action to foreclose or otherwise enforce the deed of trust; NRS 40.495(3) is not triggered and guarantors are not entitled to any of the FVDS invoked by NRS 40.495(3). Such an argument is illogical, particularly given that a trustee's sale is undisputedly an "action to foreclose or otherwise enforce a mortgage."

Creditors make similar arguments when the borrower files for bankruptcy.[10] Presume the borrower defaults, the lender files a notice of default, the lender sues the borrower seeking to appoint a receiver and enforce its deed of trust, the borrower files for Chapter 11 bankruptcy and the lender sues the guarantors for breach of guaranty. Because the creditor maintains an action to enforce its deed of trust, the guarantors' FVDS under NRS 40.495(3) are triggered. Therefore, the property must be sold to determine if there is any deficiency under NRS 40.459, and because there may be no deficiency (no damages), judgment must await the foreclosure. Such a result does not conflict with the OAR because the guarantor is not enforcing a OAR; it is the creditor's action to foreclose that triggered the FVDS under 40.495(3).

Conclusion

Given the stakes for all involved: creditors, borrowers and guarantors, the law is fertile ground for creative lawyering. Employing the plain language of the statutes, manipulation for double recovery can be avoided – consistent with decades of precedent and public policy. ■

1 *Paramount Ins., Inc. v. Rayson & Smitley*, 86 Nev. 644, 472 P.2d 530, 533 (1970); *McMillan v. United Mortgage Co.*, 82 Nev. 117, 119, 412 P.2d 604, 605 (1966); *McDonald v. D.P. Alexander & Las Vegas Boulevard, LLC*, 121 Nev. 812, 816, 123 P.3d 748, 751 (2005). The statutes apply equally to mortgages and deeds of trust. NRS 40.433.

2 1911 CPA § 559. The OAR also eliminated multiple lawsuits: foreclosure in court of equity and money judgment in court of law. *Nevada Land & Mtg. Co. v. Hidden Wells Ranch, Inc.*, 83 Nev. 501, 435 P. 2d 198 (1967); *Bonicamp v. Vazquez*, 120 Nev. 377, 380, 91 P.3d 584, 586 (2004); *Component Systems Corp. v. Dist. Ct.*, 101 Nev. 76, 82, 692 P.2d 1296, 1301 (1985); *McMillan*, 82 Nev. at 121-22, 412 P.2d at 606.

3 *Component Systems*, 101 Nev. at 82, 692 P.2d at 1301; Bonicamp, 120 Nev. at 380, 91 P.3d at 586; *Carrillo v. Valley Bank of Nevada*, 103 Nev. 157, 158-59, 734 P.2d 724, 725 (1987); *McMillan v. United Mortgage Co.*, 84 Nev. 99, 101, 437 P.2d 878, 879 (1968); *McMillan*, 82 Nev. at 121, 412 P.2d at 606.

4 *See* Legislative History of SB 479, Minutes, Senate Committee on Judiciary, May 30, 1989, p. 13 (Remarks of Michael E. Buckley).

5 NRS 40.435; *Bonicamp*, 120 Nev. at 380, 91 P.3d at 586.

6 *Thomas v. Valley Bank of Nevada*, 97 Nev. 320, 322, 629 P.2d 1205, 1207 (1981); *Mfr. and Traders Trust Co. v. Dist. Ct.*, 94 Nev. 551, 553-54, 583 P.2d 444, 445-46 (1978); *see also, Crowell v. John Hancock Mut. Life Ins. Co.*, 102 Nev. 640, 731 P.2d 346, 348 (1986).

7 102 Nev. 616, 730 P.2d 429 (1986) (overruling *Mfr. and Traders Trust*, 94 Nev. at 555, 583 P.2d at 447 and *Thomas v. Valley Bank of Nevada,* 97 Nev. 320, 629 P.2d 1205 (1981) using Justice Gunderson's dissent analysis from these two cases).

8 NRS 40.495(3); *see Lavi v. Dist. Ct. (Branch Banking and Trust Co.)*, Case No. 58968 (Nev. May 24, 2013) (unpublished order), 2013 WL 3278563 (holding that where guarantor waives the OAR, creditor must still file an application for a deficiency judgment within six months of the foreclosure sale pursuant to NRS 40.455, one of the FVDS).

9 2011 Nev. Stat. Ch. 311, 1744; see Legislative History of AB 273, Minutes, Assembly Committee on Commerce and Labor, March 23, 2011, p. 5; Senate Committee on Judiciary, May 3, 2011, pp. 4, 7. In fact, such double recovery was discussed throughout the hearings on AB 557, which amended NRS 40.495 in 1989. 1989 Nev. Stat. Ch. 470, 1001; *see* Legislative History of AB 557, available at http://www.leg.state.nv.us/ Division/Research/ Library/ LegHistory/ LHs/ 1989/ AB557,1989.pdf.

10 *The Ken L. Templeton Family Trust v. Dist. Ct. (AG/ICC Willows)*, Case No. 59586 (Nev. February 5, 2013) (unpublished order), 2013 WL 476026; *see Forouzan, Inc. v. Bank of George*, Case No. 56337 (Nev. February 27, 2012) (unpublished order), 2012 WL 642548 (holding that when the guarantor waives the OAR, the FVDS apply when the creditor elects to foreclose).

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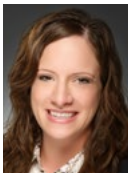

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