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Mortgages--Right of a Second Purchase Money Mortgagee When a Foreclosure of the First Mortgage Exhausts the Security

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The *Suchman* case is a particularly hard case because of defendant Suchman's payment in advance when he took possession of the apartment in 1948. It is obvious that the position of Suchman was affected adversely by his failure to enter any defense in the foreclosure action to which he was a party defendant. Technically, therefore, his lease, and all rights thereunder, were cancelled by the foreclosure action. It would appear that the tribunals were swayed by the hardship on Suchman, who was placed in the unhappy position of being called upon to pay rent twice for occupation of the premises.

It is fundamental that one may not be enriched unjustly at the expense of another.[26] Suchman for some unexplained reason chose not to defend himself in the foreclosure action. He continued to occupy the premises without any agreement with the new owner. By his voluntarily continued occupancy, he assumed the obligation to pay rent for the use of the premises. This conclusion is sound, whether the question is treated in the light of the common law or under so-called emergency legislation. Therefore, better reasoning suggests that Suchman should have been designated as a statutory tenant, and as such, the nonpayment summary proceeding against him was justified by law.[27] *Phyllis MacKay*

MORTGAGES. RIGHT OF A SECOND PURCHASE MONEY MORTGAGEE WHEN A FORECLOSURE OF THE FIRST MORTGAGE EXHAUSTS THE SECURITY.

In *Brown v. Jensen*,[1] a recent California case, plaintiff sold her real property to the defendants and took a second deed of trust to secure a note for $7,200 given as part of the purchase price. The first deed of trust went to a loan association to secure a note for $11,300 which was also part of the payment. Defendant defaulted in payment on both notes. The loan association foreclosed, apparently exercising the power of sale in the deed of trust, and bid it in for $11,876.63 and received title from the trustee. Finding her security gone and the note unpaid, plaintiff sued on the note. Held, reversing the judgment of the District Court of Appeal, no recovery. Plaintiff has no action on the note; her action is one for deficiency judgment and there can be no deficiency judgment on a purchase money deed of trust.

In order to understand the reasoning behind this decision, it is necessary to

[26] BLACK, LAW DICTIONARY 1705.

[27] If a tenant holds over without authority under such circumstances as to negative the landlord's consent to the holding, or to rebut the presumption of a renewal of the lease governing the amount of rent, the tenant may be liable for the reasonable value of the use and occupation of the premises. Colyear v. Tobriner, 7 Cal. 735, 62 P.2d 741 (1936). In California the general rule is that, it is the duty of the tenant to surrender possession of the premises on the expiration of his term. Ryland v. Appelbaum, 70 Cal.App. 268, 233 Pac. 356 (1924). The landlord's successor's interest may maintain an action without attornment. Waylan v. Lathan, 89 Cal.App. 55, 264 Pac. 766 (1928), Hewitt v. Justice's Court, 131 Cal.App. 439, 21 P.2d 641 (1933). CALIF. CODE CIV. PROC. § 1161a provides for an action of unlawful detainer: "In either of the following cases, a person who holdsover and continues in possession of real property, after a three-day written notice to quit the same, shall have been served upon him, or if there is a subtenant in actual occupation of the premises, also upon such subtenant, as prescribed in Section 1162 of the Code of Civil Procedure, may be removed therefrom as prescribed in this chapter. 2. Where the property has been duly sold, upon the foreclosure, by proceedings taken as prescribed in this code, of a mortgage, or under an express power of sale contained therein, executed by him, or a person under whom he claims, and the title under the foreclosure has been duly perfected. See also GODDARD, CALIFORNIA LANDLORD-TENANT LAW AND PROCEDURE 50, 51, 55, 186, 189.

[1] Brown v. Jensen, 41 Cal.2d 193, 259 P.2d 425 (1953).

look at the legislative controls placed on the enforcement of financial obligations secured by mortgages and deeds of trust.

Section 726 of the California Code of Civil Procedure provides that when an indebtedness is secured by a mortgage on real or personal property, the security must be exhausted before there can be a suit on the note.[2] The original purpose of Section 726 in requiring that the security should be exhausted prior to suit on the note was to prevent the debtor from being subject to more than one suit; not to eliminate a right of the creditor.[3] Therfore when the security has been exhausted through no fault of the mortgagee, as by foreclosure of the first mortgage, he may bring an action on the note, since foreclosure proceedings would be an idle act.[4]

It was arguable whether California Code of Civil Procedure Section 726 applied to deeds of trust, but the question was settled in *Bank of Italy v. Bentley*.[6] The court said:

> ". . . it must be held that, either by reason of implied agreement or by reason of public policy, the holder of a note secured by a deed of trust must first exhaust the security before resorting to the personal liability of the trustor."[7]

Soon after this decision, the California Legislature adopted Section 580a of the Code of Civil Procedure which set forth the procedure by which deeds of trust should be foreclosed.

Sections 726, which applies to mortgages, and 580a, which applies to trust deeds, are comparable in that they both provide for the fair market value rule to limit the amount of a deficiency judgment sought when the foreclosure sale does not yield a sufficient sum to pay the note. This limitation was grouped with the moratorium statutes enacted during the recent depression period to protect the debtor. The rule provides that a deficiency judgment after the sale of the security cannot exceed the difference between the amount of the original indebtedness and the value of the security at the time of foreclosure, as fixed by a court-appointed appraiser, no matter what the property sold for on foreclosure. Before this addition to Section 726 and the enactment of Section 580a, a holder of a note secured by a trust deed or a mortgagee could bid in at a nominal figure at the foreclosure sale, acquire the property and still obtain a large deficiency judgment against the debtor.[8]

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[2] CALIF. CODE CIV. PROC. § 726 provides in part: "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 or personal property which action must be in accordance with the provision of this chapter . . . " The basic requirement of a single action includes a judicial sale of the security and a deficiency judgment for the balance due on the debt, when required.

[3] Ould v. Stoddard, 54 Cal. 613 (1880), Felton v. West, 102 Cal. 266, 36 Pac. 676 (1894), Commercial Bank v. Kershener, 120 Cal. 495, 52 Pac. 848 (1898), Savings Bank of San Diego County v. Central Market, 122 Cal. 28, 54 Pac. 273 (1898), Murphey v. Helman Commercial Trust and Savings Bank, 43 Cal.App. 579, 185 Pac. 485 (1919). For a full treatise see Comment, 31 CALIF. L. REV. 429 (1943).

[4] Merced Security Savings Bank v. Casaccia, 103 Cal. 641, 37 Pac. 648 (1894), Crescent Lumber Co. v. Larson, 166 Cal. 168, 135 Pac. 502 (1913), Ferry v. Fisk, 54 Cal.App. 763, 202 Pac. 964 (1921), Hellman Commercial Trust and Savings Bank v. Maurice, 105 Cal.App. 653, 288 Pac. 683 (1930). As to the application of this rule to the second mortgagee see Savings Bank of San Diego County v. Central Market, 122 Cal. 28, 54 Pac. 273 (1878), Giandeini v. Ramirey, 11 Cal.App.2d 469, 54 P.2d 91 (1936).

[5] CALIF. CODE CIV. PROC. § 726.

[6] 217 Cal. 644, 20 P.2d 940 (1933).

[7] *Id.* at 658, 20 P.2d at 945.

[8] 22 CALIF. L. REV. 180 (1934).

During the depression era, further restrictions were placed on the rights of a holder of a note secured by a trust deed. The first paragraph of Section 5806 of the California Code of Civil Procedure, enacted in 1933 and reenacted in 1935, states:

> "No deficiency judgment shall lie in any event after any sale of real property for failure of the purchaser to complete his contract of sale, or under a deed of trust, or mortgage, given to secure payment of the balance of the purchase price of real property"

Section 580d of the California Code of Civil Procedure, enacted in 1941, provides:

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

These two statutes and the fair market value rule of Sections 726 and 580a virtually eliminate the aforementioned evil of the creditor bidding in cheaply at a foreclosure sale, obtaining the property, and holding the debtor to a large deficiency judgment.

Bank of Italy v. Bentley and the subsequent enactment of Section 580a determined that the security of deed of trust, like that of a mortgage, must be exhausted first before there can be any action on the note. But, before *Brown v. Jensen* was adjudicated, there was no decision which limited the creditor's rights where the security was exhausted through no fault of the creditor.

In *Hillen v. Soule*,[9] a 1935 District Court of Appeals case, the court was faced with the same problem as the case under discussion, but since the deed of trust was executed before the enactment of the 580 Series, it was held that those restrictions on foreclosures and deficiency judgments of deeds of trust were inapplicable and a recovery was allowed on the note.

However, in the decision, Justice Spence, who wrote a dissenting opinion in the present case, said by way of dicta that recovery on the note should be allowed. "It is sufficient answer to state that this is not an action for a deficiency judgment. The security was exhausted by the sale under the first deed of trust and no sale was had under respondent's deed of trust. We are therefore of the opinion that the provisions of said Section 580(b) are inapplicable."[10]

The Ohio courts had difficulty in arriving at a solution in the same type of case. In *Carr v. Cleveland Trust Co.*,[11] the Trust Company held a second mortgage on Carr's property The Home Owners Loan Corporation, holder of the first mortgage, foreclosed, naming the Trust Company as party defendant. The Trust Company answered, requesting that their note be satisfied from the proceeds of the foreclosure of the first mortgage, but the sale did not realize a sufficient amount to pay any part of the Trust Company's note. After the statute of limitations had run on a deficiency judgment, the Trust Company sued on the note.

The Ohio Court of Appeals held that there could be no recovery since the

[9] 7 Cal.App.2d 45, 45 P.2d 349 (1935).
[10] *Id.* at 47, 45 P.2d at 349.
[11] 48 O. Law Abs. 179, 74 N.E.2d 124 (1947).

action was for a deficiency judgment and that it was barred by the statute of limitations.

> "But in whatever light we view the proceedings which took place, either by way of foreclosure or by separate personal judgment on the note, one fact stands out in bold relief and that is that a deficiency judgment resulted from the entire proceedings by reason whereof the plaintiffs are entitled to whatever benefits accrue from the provisions of the deficiency judgment act—so-called."[12]

The majority of the court in *Brown v. Jensen* felt this was the correct interpretation of a deficiency judgment, quoting it in the majority opinion.[13]

However, the Supreme Court of Ohio reversed this decision,[14] saying,

> "The very word 'deficiency' denotes a lack, shortage or insufficiency and presupposes that a creditor has already realized some amount of his claim from the security held.[15] . . a deficiency judgment is the balance of personal indebtedness above the amount realized on the sale of the mortgaged property securing such indebtedness.[16] . . According to our understanding a secured obligation is one which, when the time comes to enforce payment of the claim, has at least some existing security to which the creditor may look for his money."[17]

In view of the fact that there are nothing but contrary decisions in other jurisdictions,[18] how did the Supreme Court come to set aside the interpretation set forth in *Hillen v. Soule* and decide that there can be no action on a note secured by a purchase money deed of trust. Let us first look at the reasoning in the decision of *Brown v. Jensen.*

Justice Carter, writing the majority opinion of the court, grants that there can be an action on a note secured by a mortgage when the security has been exhausted through no fault of the mortgagor.[19] But the court says that plaintiff's action is one for a deficiency judgment and since her note was obtained as part of the purchase price for the sale of realty and is secured by a deed of trust on that realty, she has no cause of action because hers is a purchase money trust deed and, according to Section 580(a), there cannot be a deficiency judgment after a foreclosure of a purchase money deed of trust.

To substantiate the conclusion that this is an action for a deficiency judgment, the court states that a deficiency "may consist of the whole debt because a deficiency is nothing more than the difference between the security and the debt."[20] The decision then quotes from the Court of Appeals decision in *Carr v. Cleve-*

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[12] *Id.* at 187, 74 N.E.2d at 128, 129.

[13] 41 Cal.2d at 198, 259 P.2d at 427.

[14] Carr v. Home Owners Loan Corporation, 148 Ohio St. 533, 76 N.E.2d 389 (1947).

[15] *Id.* at 539, 76 N.E.2d at 393.

[16] *Ibid.*

[17] *Id.* at 540, 76 N.E.2d at 394.

[18] In U.S.B. and M. Liquidation Corp. v. Hilton, 307 Mass. 114, 116, 29 N.E.2d 684, 685 (1940), the court said, "But the very cases that have held these moratorium laws constitutional have laid stress upon the consideration that they were directed primarily to regulation of the remedy and that they did not substantially impair the obligation of the contract The more recent decisions in New York to which our attention has been called have held these 'Moratorium Laws' inapplicable even in New York to cases where the security has been wholly swept away by a foreclosure of a prior mortgage." Also see Weisel v. Hagdahl Realty Co., 241 App.Div. 314, 271 N.Y. Supp. 629 (1934), Home Building and Loan Association v Blaisdell, 290 U.S. 398 (1933).

[19] Brown v. Jensen, *supra* at 195, 259 P.2d at 426.

[20] *Id.* at 198, 259 P.2d at 427.

land Trust Co. which was later reversed on these grounds by the Supreme Court of Ohio.[21]

It is further stated that the broad protections of 580(b) were for the benefit of the debtor and that the purpose of the after sale reference in the section is that the security be exhausted, and that results after a sale under the first trust deed.

It is obvious that the court had to extend itself to create such an interpretation of Section 580b. The more logical conclusion would be to follow the dicta set forth in *Hillen v. Soule,* based on the rule which is applied when the security is exhausted in a mortgage; namely, to allow suit on the note.

A deficiency judgment in California,[22] and by the weight of authority in other jurisdictions,[23] demands a prior sale under the power of sale of a deed of trust or a foreclosure under the mortgage *by the creditor seeking the deficiency judgment.* There was no such sale or foreclosure in this case. True, there was a foreclosure under the first mortgage, but how should that affect the second, other than to diminish the security It is stretching Section 580b almost to the breaking point, and perhaps beyond, to say that foreclosure of the first mortgage affects the second so as to limit, and, in this case, destroy the creditor's rights.

Glenn On Mortgages, in discussing the rights of the second mortgagee after a foreclosure action by the first, says, "But suppose there is no surplus at all and thus the second mortgagee has no security then he is nothing but a general creditor to the full extent of his debt. Since these deficiency judgment laws do not operate as restriction upon general debts, it follows that they do not govern the second mortgage."[24]

Before the depression, restrictions on deficiency judgments were relatively unknown,[25] but the inequity of large deficiency judgments during this period manifested a necessity for a statutory public policy to protect the debtor from oppressive deficiency judgments on foreclosure.[26] While the original enactments might have been considered as only temporary restrictions, it soon became apparent that these restraints equalized the benefits and detriments of mortgagor and mortgagee without driving investment from this field.

Therefore, it might be argued that the court is merely following the impetus of the legislature in restricting the rights of the creditor under a purchase money deed of trust or mortgage. The recent case of *Mortgage Guarantee Co. v. Sampsell*[27] and the subsequent enactment of the second paragraph of Section 580b substantiates the fact that the legislature is interested in limiting deficiency judgments. While the facts of that case are involved, the district court of appeal in the end result allowed deficiency judgment on a chattel mortgage that was executed to secure a note given as part of the purchase price. But an addition to Section 580b, enacted in 1949, precluded a creditor from obtaining a deficiency

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[21] Carr v. Home Owners Loan Corporation, *supra* note 16.

[22] Hatch v. Security First National Bank, 19 Cal.2d 254, 120 P.2d 869 (1942), Bank of America v. Gillett, 36 Cal.App.2d 453, 97 P.2d 875 (1940).

[23] Carr v. Home Owners Loan Corporation, *supra* at 541, 76 N.E.2d at 393, Stretch v. Murphy, 166 Ore. 439, 446, 112 P.2d 1018, 1020; Phillips v Union Central Life Ins. Co., 88 F.2d 188, 189 (8th Cir. 1942).

[24] 2 GLENN ON MORTGAGES 878.

[25] Before the 1930 depression period, Oregon was the only state to prohibit deficiency judgments, and then it was only in cases of purchase money mortgages.

[26] Bank of America v. United States, 84 F Supp. 387, 388 (1949).

[27] 51 Cal.App.2d 180, 124 P.2d 353 (1942).

judgment on a purchase money chattel mortgage or trust deed on personal property [28]

The denial of a deficiency judgment after sale or foreclosure of a purchase money trust deed or mortgage is further justified by the fact that the creditor can assure himself of a first lien on the property [29] Also he is in a position to demand a sufficiently large down payment so that if the property diminishes in value and the purchaser defaults on the note, there won't be any necessity for a deficiency judgment since a foreclosure action should bring a sufficient sum to pay the indebtedness.

Brown v. Jensen strengthens this line of reasoning. The loan association valued the property at only $11,300 and the plaintiff took a note for $7,200 so it is easy to conclude that either the purchase price was too high, or the down payment was too small; or both. Also the plaintiff could have bid in at the foreclosure sale, returning what she received via the loan company and recovered the property without suffering any serious loss.

However, this whole line of reasoning does more than equalize the positions of mortgagor and mortgagee; it places the risk of property value deterioration on the vendor without affording him the benefits of an increasing market—an unconscionable result.

The court in *Weisel v. Hagdahl Realty Co.*[30] had something to say in this regard:

> "However, if we consider these statutes [Moratorium Laws] from the position of the mortgagor, a somewhat different view is presented. Assuming for the moment that the property was equal in value to the sum of the mortgages, if the property is bought by the first mortgagee and the mortgagor is compelled to pay a deficiency judgment in favor of the second and third mortgages, he is obligated to pay something in addition when in fact the property was worth the aggregate amounts of the mortgages. If there had been one mortgage for the total amount instead of three, there could have been no deficiency judgment. *The answer is that three mortgages were made as a matter of choice by the mortgagor who knew at the time that they differed in respect to the priority of lien.* It may be argued that the second and third mortgagees should have attended the sale and bid a sufficient sum to protect their respective interest. A like privilege was open to the mortgagor. As a practical question, ordinarily neither would be in position to take such action, and neither was legally bound to do so."[31] (Emphasis added.)

History bears out the fact that deficiency judgments can be oppressive and a debtor should be protected by legislative and judicial action. But the controls should not be enforced where the facts are not applicable to the protective statutes and decisions and an unnecessary extension of the rule leaves the creditor without a remedy. When there is a default on the secured obligation, public policy demands the security be exhausted before there is any action on the note but it should be remembered that the note, not the mortgage, is the primary obligation and the creditor's rights stemming from the note should not be adversely affected by deterioration of the security Whether it be a purchase money deed of trust or any other type of secured obligation, the creditor should not be denied a remedy when the security is exhausted through no fault of the creditor. *Charles H. Clifford*

[28] CALIF. CODE CIV. PROC. §5806: "Where both a chattel mortgage and a deed of trust or mortgage have been given to secure payment of the balance of the combined purchase price of both real and personal property, no deficiency judgment shall be at any time undeer any one thereof."

[29] CALIF. CIV. CODE § 2898: "A mortgage or deed of trust given for the price of real property at the time of its conveyance has priority over all other liens created against the purchaser, subject to operation of the recording laws."

[30] 241 App.Div. 314, 271 N.Y. Supp. 629 (1934).

[31] *Id.* at 319, 271 N.Y. Supp. at 635.