



# AB 273 CREATES NEW CHALLENGES FOR SECURED LENDERS

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During the 2011 Nevada Legislative Session, several amendments were made to the statutory framework for deficiency actions following foreclosure of deeds of trust on real property. This article provides an overview of some of the changes implemented by Assembly Bill 273 (AB 273).

## **NRS § 40.459 – Limitations on Amount of Deficiency Judgments**

NRS § 40.459 provides for the calculation of deficiency amounts for obligations secured by real property. Before AB 273 was enacted, NRS § 40.459 provided two ways to calculate the amount of a deficiency judgment, whichever was the lesser amount:

- (1) the amount by which the indebtedness exceeded the fair market value of the property on the date of the foreclosure sale; or
- (2) the amount by which the indebtedness exceeded the amount of the selling price of the property at the foreclosure sale.

Section 5 of AB 273 created an additional limitation on deficiency amounts and clarified how the “amount of the indebtedness” is to be calculated. The new statute reads as follows:

- 1. After the hearing, the court shall award a money judgment against the debtor, guarantor or surety who is personally liable for the debt. The court shall not render judgment for more than:
  - (a) The amount by which the amount of the indebtedness which was secured exceeds the fair market value of the property sold at the time of the sale, with interest from the date of the sale; or
  - (b) The amount which is the difference between the amount for which the property was actually sold and the amount of the indebtedness which was secured, with interest from the date of sale; or

- (c) If the person seeking the judgment acquired the right to obtain the judgment from a person who previously held that right, the amount by which the amount of the consideration paid for that right exceeds the fair market value of the property sold at the time of sale or the amount for which the property was actually sold, whichever is greater, with interest from the date of sale and reasonable costs, whichever is the lesser amount.
2. For the purposes of this section, the “amount of the indebtedness” does not include any amount received by, or payable to, the judgment creditor or beneficiary of the deed of trust pursuant to an insurance policy to compensate the judgment creditor or beneficiary for any losses incurred with respect to the property or the default on the debt.<sup>1</sup>

### **Limitation of Deficiency Where Right to Deficiency Was Acquired From Another Person who Held That Right**

Part (c) of subsection 1 of NRS § 40.459 limits “the recovery of a creditor who acquired the right to obtain payment for an obligation secured by the real property from another person who owned that

obligation.”<sup>2</sup> An issue that will likely generate litigation is the meaning of subsection 1(c). Although it appears that the intent of this provision was to limit recovery where, post foreclosure, the lender sells the right to pursue a deficiency action,<sup>3</sup> borrowers will undoubtedly assert that the effect of this provision is to limit a deficiency award whenever the underlying debt has been acquired.

According to the legislative minutes, “the bill prevents a person who has purchased the rights to a loan from receiving a judgment for more than what he paid plus interest.” The legislative minutes give the following example:

These provisions say if a bank chooses to pursue someone for a deficiency judgment in a situation where a house was purchased for \$200,000 and the value dropped to \$100,000 – and the bank decided to pursue the homeowner for the \$100,000 and then sold it to a collection agency for \$20,000 – all the collection agency could collect would be the \$20,000 plus interest and fees.<sup>4</sup> (Emphasis added.)

This statute has a tremendous potential to undermine the value of commercial transactions involving Nevada real estate loans. Loans are often acquired for a number of reasons, including pooling

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transactions,<sup>5</sup> bank failures<sup>6</sup> and note sales. Indeed, it is a fundamental aspect of a promissory note that it is a “negotiable instrument” and thus freely transferrable. However, the Nevada Supreme Court has held that a change to the method of calculating deficiency judgments does not violate the contract clauses of the United States or Nevada constitutions, particularly where the amendment applies to trustee’s sales occurring after the effective date of the statute.<sup>7</sup>

## Impact of Insurance Proceeds

New subsection 2 to NRS § 40.459 provides that “the amount of the deficiency judgment must be reduced by the amount of any insurance proceeds received by, or payable to, the creditor.”<sup>8</sup> The legislative minutes indicate the genesis of this change:

The court must reduce the amount of the judgment by the amount of any insurance proceeds received by or payable to the lender. Section 2 covers the junior lenders, and section 5 covers the senior lenders. Because of the complex nature of what we have been through starting around 2007, many banks have failed and were purchased by larger banks. The Federal Deposit Insurance Corporation (FDIC) has insured the new banks. They said that for any loan that the previous bank secured for the purchase of a house, they would insure against loss for the new bank so they would not be

assuming all the risk of the purchase. That insurance is upwards of 80 percent of any loss. A lot of homes were purchased with private mortgage insurance (PMI), which covers the borrower in the case where he cannot make his mortgage payments; if the home is repossessed by the bank, the deficiency between the value of the home and the balance of the loan is covered by the PMI.

We are trying to establish in statute that those insurance instruments must be exercised first, before the amount of the deficiency is determined in a court action, thereby minimizing the potential deficiency for which a borrower can be sued. The insurance instruments have to be collected first.<sup>9</sup>

Thus, any potential loss mitigated by an insurer (such as mortgage, title or SBA insurance) must be taken into account when determining the amount of the indebtedness owed as of the date of the foreclosure. It should be noted that the application of this rule is limited by its terms as being “for purposes of this statute.” Thus, it appears that the legislature has not abrogated the collateral source rule except with regard to real property deficiency actions.

## Application to Commercial Loans

The majority of the legislative discussion regarding the changes to NRS § 40.459 surrounded residential loans, not commercial loans. In Assemblyman Marcus Conklin’s opening remarks, he

stated that the bill “deals with homeowners who purchase and live in their home and never treat it as an investment and then are forced out and lose their good credit. At the end of the day, they are slapped with a deficiency judgment. This bill deals with those judgments.”<sup>10</sup> However, there is nothing in the statute itself that differentiates between commercial and residential loans.

## NRS § 40.495 – Actions Against Guarantors

AB 273 also clarifies how to determine the amount of a deficiency judgment in an action against a guarantor where the creditor is proceeding under a valid one action rule waiver, but the

foreclosure sale has not occurred (Section 5.5). The new provision – subsection 4 of NRS § 40.495, reads:

4. If, before a foreclosure sale of real property, the obligee commences an action against a guarantor, surety or other obligor, other than the mortgagor or grantor of a deed of trust, to enforce an obligation to pay, satisfy or purchase all or part of an indebtedness or obligation secured by a mortgage or lien upon the real property:

- (a) The court must hold a hearing and take evidence presented by either party concerning the fair market value of the property as of the date of the commencement of the action. Notice of such hearing must be served upon all defendants who have appeared in the action and against whom a judgment is sought, or upon their attorneys of record, at least 15 days before the date set for the hearing.
- (b) After the hearing, if the court awards a money judgment against the debtor, guarantor or surety who is personally liable for the debt, the court must not render judgment for more than:
  - (1) The amount by which the amount of the indebtedness exceeds the fair market value of the property as of the date of the commencement of the action; or
  - (2) If a foreclosure sale is concluded before a judgment is entered, the amount that is the difference between the amount for which the property was actually sold and the amount of the indebtedness which was secured,
    - whichever is the lesser amount.

Thus, where there is an action against a guarantor before the foreclosure has occurred, the court must hold a deficiency hearing to determine the fair market value of the property as of the date the lawsuit was commenced. The deficiency amount will then be the difference between the fair market value of the property as of the date the lawsuit was commenced and the indebtedness on the loan. If the foreclosure sale occurs

while the litigation is pending, then the deficiency amount will be determined by the difference between the purchase price of the property and the amount of the indebtedness or the fair

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market value of the property as of the date of the commencement of the action and the indebtedness, whichever is the lesser amount.<sup>11</sup>

It is important to note that the statute fails to reconcile what happens when a creditor receives differing deficiency judgment amounts against the guarantor and maker of the note when the actions are brought at different times. Because of fluctuations in market values, it is likely that the fair market value of a property could change between the commencement of a deficiency action against the guarantors and the actual foreclosure date. Thus, a creditor could obtain deficiency judgments against a guarantor and a maker of the note that have differing amounts.

The purpose of Section 5.5, as stated in the legislative minutes, is to ensure that creditors cannot collect a double recovery against guarantors. Assemblyman Conklin stated:

What is happening from time to time is that if there is a foreclosure, instead of going after the land first and then going

after the guarantor for the difference, banks are choosing to go after the guarantor for the total amount of the loan. If we allow banks to continue to do that, people will not invest in Nevada. No one is going to take that kind of position to guarantee a loan secured by property. It would be different if it was an unsecured loan. What we are trying to do here is force banks to choose one course of action. They can still choose to sue the guarantor, but they have to take the land first.<sup>12</sup>

## AB 273's Effective Date

According to AB 273, the effective date of Sections 5 and 5.5 is the day the bill is passed and approved. Section 6(3) provides that Section 5.5 of AB 273 only applies to an action "commenced on or after the effective date of this act." The governor signed the bill into law on June 10, 2011.

Although AB 273 provides some clarity as to how the effective date works in relation to actions proceeding under Section 5.5, it is not entirely clear how the effective date operates as it relates to Section 5. Under Section 5, it is not clear if it applies only to those loans purchased after the effective date or only to deficiency actions commenced after the effective date. According to the legislative minutes, when asked if the bill would apply retroactively, Assemblyman Conklin stated:

No, it is not. You would be reaching back into contracts that were made under certain circumstances. If that were done, who would ever want to sign a contract or do business in a state that would nullify contracts? ... To retroactively pass laws would set a remarkably dangerous precedent for individuals and businesses that enter into contracts because you will wonder how it can be enforced or how it can change.<sup>13</sup>

In a subsequent hearing on the bill, Assemblyman Conklin reiterated:

There is no retroactivity in this bill. It is simply all future action. We could debate this, but the retroactivity issue is a matter of contract. If Ms. Bustamante Adams and I enter into a contract, we do so under the environment of laws that we have at that time. Those laws are part of the contract because they dictate how we draft the contract. Business does not want to operate in an environment in which laws are changed to favor one or the other party after

they enter into a contract. While on one hand it may be nice to retroactivate a law, the precedent it sets is enormous and probably highly detrimental to the business environment of Nevada.<sup>14</sup>

Although one can assume the statute will only apply prospectively, the language of the statute itself does not specify that this is the case. It is likely that this issue will be a source of contention in the courts, providing yet another source of further litigation and the need for judicial interpretation.

## Conclusion

The new legislation relating to NRS § 40.451 et seq. presents additional challenges to lenders seeking to recover deficiency judgments. Although AB 273 does provide much needed guidance as to how deficiency amounts should be calculated against guarantors in instances where a foreclosure has not been completed prior to the time of final judgment, AB 273 may severely limit deficiency recoveries where the loan is acquired from another person or when the note holder will (or may) receive insurance proceeds. ■

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1 Similar laws apply to junior lien holders as well. See Section 2 of AB 273.  
2 See Legislative Counsel's Digest, § 40.459.  
3 The statute references the acquisition of the right to obtain judgment from a person who previously held that right, rather than the acquisition of the debt from the original payee or deed of trust beneficiary, which, together with the legislative history, indicates that the statute's intent is to limit a deficiency judgment where the cause of action is acquired post-foreclosure.

4 Minutes of the Meeting of the Assembly Committee on Commerce and Labor (76th Session) (March 23, 2011).  
5 It is very common for a number of loans to be grouped together and sold, often to a Real Estate Investment Trust or other investor group.  
6 It is likely that the statute would not apply to loans acquired from the Federal Deposit Insurance Corporation (FDIC), since the FDIC does not appear to fall within the definition of a "person" pursuant to NRS 0.039, and subsection (1)(c) applies to loans acquired "from a person...." The term "person" is not defined in the statute or in the legislative minutes. However, the term "person" is defined in the general definitions that apply to the Nevada Revised Statutes as a whole. It defines "person" as follows:  
Except as otherwise expressly provided in a particular statute or required by the context, "person" means a natural person, any form of business or social organization and any other nongovernmental legal entity including, but not limited to, a corporation, partnership, association, trust or unincorporated organization. The term does not include a government, governmental agency or political subdivision of a government. NRS § 0.039.  
7 *Holloway v. Barrett*, 87 Nev. 385, 390-91, 487 P.2d 501, 504-05 (Nev. 1971), citing *Gelfert v. National City Bank*, 313 U.S. 221(1941).  
8 See Legislative Counsel's Digest, § 40.459.  
9 Minutes of the Meeting of the Assembly Committee on Commerce and Labor (76th Session) (March 23, 2011).  
10 *Id.*  
11 It is important to note that NRS § 40.495(4) does not include the additional limitation on deficiency judgments as set forth in new subsection (c) to NRS § 40.459.  
12 Minutes of Senate Committee on Judiciary (76th Session) (May 3, 2011).  
13 Minutes of the Meeting of the Assembly Committee on Commerce and Labor (76th Session) (March 23, 2011).  
14 Minutes of the Meeting of the Assembly Committee on Commerce and Labor (76th Session) (March 28, 2011).