

WHAT IS THE LIMITATIONS PERIOD FOR A DEFICIENCY ACTION AFTER SHORT SALE?

by

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The limitations period for *junior lien deficiency actions* after short sale, like the limitations period for junior lien deficiency actions after foreclosure, was limited by the 2011 Nevada Legislature pursuant to NRS 40.4639, to six months. In the case of a short sale, the six month period begins to run upon completion of the short sale. But what limitations period applies to *first lien deficiency actions* after short sale?

One somewhat startling answer might be that there is no limitations period, because there is no right for a first lienholder to pursue a deficiency after short sale. An argument can be made that by agreeing to a short sale, the senior lienholder has taken an intentional action to impair its security and cannot thereafter bring suit on the underlying obligation. This argument's origin is the Nevada Supreme Court case of Keever v. Nicolas Beers Co., 96 Nev. 509, 513, 611 P.2d 1079, 1082 (1980). In Keever, the Court stated that a lender which waived its lien "[could not] recover on its promissory note because the loss of the security for the obligation was due to its own action." Id. Similarly, in a short sale, the lienholder voluntarily releases its lien in exchange for less than full payment. However, while the cited language may sound promising to a short selling homeowner, it must be noted that Keever was decided on unique facts which bear no real resemblance to a short sale.

Keever addressed a unique two stage commercial real estate transaction. In the first stage of the transaction, a developer, Beers, financed the purchase of an option to acquire land to be subdivided into residential parcels, by borrowing \$680,000 from First Security Bank. 96 Nev. 509, 511. Unfortunately the facts of the case are vague, but it appears that all Beers acquired (and all the Bank financed acquisition of) was an option to acquire the commercial property. The loan was secured by a first deed of trust, but the parties also agreed to a unique put option whereby a third party, Mason-McDuffie Co., agreed to purchase Beers' option rights at a specified price (just sufficient to cover the loan from the Bank) in the event of a default by Beers. Id. Beers also appointed the Bank as Beers' agent for the sale to Mason-McDuffie. Id. Thus, presumably (based on very vague facts), in the event of a default on the first loan, the Bank would not need to foreclose, but rather would be made whole from the proceeds of the sale of the option to Mason-McDuffie.

In the second stage of the transaction, Beers sold its interest to two successor developers, Keever and Moore. Id. Keever and Moore gave Beers a promissory

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note, which was secured by a second deed of trust on the option. Id. Keever and Moore also agreed to assume Beers' obligations to the Bank under the first loan, and further consented to the appointment of the Bank as Beers' agent in the event of a sale to Mason-McDuffie. Id. The Bank was apparently concerned that in the event of a default on the first loan, that the Bank would be unable to transfer the property to Mason-McDuffie free of liens. Id. To facilitate the transaction in light of the Bank's concern, Beers agreed to waive its second deed of trust if Keever and Moore defaulted on performance of the first loan to the Bank, and Keever and Moore consented to the waiver. Id. Keever and Moore did default. Id. at 512. Beers confirmed to the Bank Beers' waiver of its rights under the second deed of trust, and sought recovery from Keever and Moore on the second note. Id.

The Supreme Court reasoned that the arrangement required Keever and Moore to waive a right "secured ... by the laws of this state," NRS 40.453(1) in a document related to the sale of real property, and the waiver of the second lien was thus barred by the one action rule. Id. at 513. The Supreme Court's primary objection was that despite the second deed of trust, the property itself could not serve as security for the Keever and Moore obligation to Beers, because of the unique put option that Beers, Mason-McDuffie and the Bank had created. The sales price on a default upon the first note was predetermined by the put, and the second lien was waived beforehand. Stated another way, Keever and Moore could never receive the benefit of any appreciation in the value of the property.

The Supreme Court's specific holding in the case, however, was relatively narrow.

We hold that when a trustor agrees, in a 'document relating to the sale of real property,' NRS 40.453(1), to an arrangement on default which ensures that the security will be insufficient to satisfy the debts which encumber it, and the creditor agrees to release the encumbrance instead of allowing its lien to be removed through [foreclosure or trustee's sale], recovery upon the underlying obligation is impermissible if the debtor raises the one action rule as a defense.

96 Nev. At 515-16 (internal citations omitted).

Applying Keever to a deficiency action after short sale is problematic for several reasons. First, the facts of Keever are quite peculiar, and certainly distinguishable from a typical short sale. In Keever, Beers agreed to waive its lien when the property was sold to Keever and Moore, unlike a typical short sale, where the waiver of the lien comes long after the original loan transaction. Second, the waiver of the lien in a short sale is at the request of the borrower, unlike Keever, where the waiver was at the request of a senior lienholder. This argument finds some support in Keever's lengthy dicta: "[t]he right to waive the security is the debtor's, not the creditor's." Finally, if Keever could be logically extended to short sales, why did the Legislature call out second lien deficiency actions after short sale

in NRS 40.4639? After all, Beers' lien, like the liens addressed in 40.4639, was a junior lien. Why would the legislature specifically address the limitations period for a cause of action that does not exist?

Though intriguing, Kever likely does not stand for the proposition that a first lienholder may not seek a deficiency after a short sale. If Kever does not bar a deficiency action after short sale, going back to the question at the outset of this piece, what limitations period applies to a first lien holder? Because the senior lienholder's lien is waived by agreement of the parties, Kever's impairment-of-collateral argument is inapplicable, and it would seem that the now unsecured note should be assessed under the six year statute of limitations for enforcement of contracts, as set forth in NRS 11.190(1)(b) and NRS 11.200. This interpretation would also give effect to NRS 40.4639's short sale provisions, because, at least in the instance of junior lienholders, the deficiency window has been shortened to six months.

In sum, if Kever is inapplicable to deficiency actions by lien holders after short sale, the following limitations periods apply in Nevada:

LIMITATIONS ON DEFICIENCY ACTIONS

	FORECLOSURE	SHORT SALE
FIRST LIEN	6 months after foreclosure sale (NRS 40.455)	<i>NO CHANGE -- 6 YEARS AFTER LAST PAYMENT TO LENDER</i> (NRS 11.200)
JUNIOR LIENS	6 months after foreclosure sale occurring on or after July 1, 2011 (NRS 40.4639)	6 months after short sale occurring on or after July 1, 2011 (NRS 40.4639)