REMARKS OF MICHAEL E. BUCKLEY RE S.B. 479

Senate Judiciary Committee
May 30, 1989

My name is Michael Buckley. I am in the private practice of law in Las Vegas with the firm of Jones, Jones, Close & Brown, Chartered. I am also a member of the State Bar of Nevada Business Law Committee, and it is in this capacity that I appear before you today in support of SB 479, which had its beginnings in a bill proposed by our Committee.

SB 479 deals with the "one-action" rule, NRS 40.430, which governs enforcement of real estate loans. The bill has two principal purposes: first, to eliminate certain problems experienced in 1987 amendments to NRS Chapter 40 and 107 (1987 Statutes 1643, Chapter 685 [SB 369]), and, secondly, to identify specifically permitted acts when a loan is secured by real estate.

To my knowledge, Nevada is one of 4 or 5 states which has a "one-action" rule. Originally enacted as a procedural rule in the 1860's, (an identical statute was enacted in California about the same time), the law states that there shall be but "one-action" for the collection of a debt or enforcement of a right secured by a mortgage or lien upon real estate. The courts have held this to mean two things: first, that a borrower can require a lender to foreclose real estate before suing on the note; and, secondly, that if a lender sues on the note before foreclosing, the lender forfeits its real estate security.

Hand in hand with this rule are the "fair value" deficiency statutes, beginning at NRS 40.451. Enacted in 1969, this rule states that following a foreclosure, a lender can only obtain a personal judgment for the difference between the unpaid debt and the greater of (i) the amount bid at foreclosure or (ii) the court determined fair market value of the real estate. SB 479 does not address the liability of a debtor, guarantor or surety for a deficiency.

Since, the definition of an "action" nowhere appears in the statutes, there is only constantly evolving case law to define what a trust deed beneficiary can and cannot do. Originally, "action" meant a law suit. Over the years, however, "action" has been held or believed to include such things as a bank's right of set off, filing a lift stay action in a bankruptcy proceeding, seeking a receiver and seeking attorneys' fees in a receiver proceeding, although there is better authority that these so called "actions" are permissible.

The idea behind SB 479 was to identify acts which members of the Committee believed could be done under existing law, place those identified acts in the statute, and add construction provisions which will provide flexibility and leeway in an area where the penalties for violation are sometimes way out of proportion to the wrong.

Before I address the specific sections of the bill, let me emphasize that the one action rule is a complex law, and that the amendments do not seek to change that law, simply to spell out the exceptions. The Business Law subcommittee which proposed this bill seriously considered recommending the adoption of the Uniform Land Security Interest Act ("ULSIA"). Since adopting the ULSIA would, however, require the repeal of the "one-action" rule together with the 125 years of case law interpreting the law, the subcommittee believed that the proposal you are considering is a more realistic alternative and will go a long way toward correcting many of the ambiguities and uncertainties which presently exist.

With the foregoing in mind let me take you through the specific sections:

1. Section 1 adds three new provisions to Chapter 40, which are set out in Sections 2, 3 and 4 of this bill.

2. Section 2, the first new section, excepts assessment liens, mechanics liens and judgment liens from the one action rule. While these liens clearly fit within the statute, we believe it was intended to apply only to consensual liens.

3. The second new provision, Section 3, is probably the heart of our proposal. Several years ago, in the Component Systems case, 101 Nev. 76 (1985), a lender was placed in the position of filing what it thought was a mandatory counterclaim or losing its rights by not filing. The Supreme Court held that the counterclaim was not mandatory, and that the filing of the counterclaim by the lender violated the one action rule. As a result, the lender forfeited its collateral. This is a trap for the unwary and prevents full and fair litigation of the real issues. Litigation decisions made in error should be rectifiable so long as no final judgment is entered. The Committee believes this is consistent with California case law and modern civil procedure.

4. The third addition to Chapter 40, Section 4, addresses the distribution of proceeds from a foreclosure sale. This section, however, duplicates AB 320 previously passed by the Assembly, and should be deleted.

5. Section 5 amends the one action rule itself in three respects: first, it makes some minor grammatical changes and

clarifications; secondly, it requires the statute to be liberally construed; and, lastly, Subsection 4, beginning on page 3, line 25, adds the "safe harbors". Let me address in detail these last two points:

(a) Liberal Construction. The liberal construction provision is intended to give weight to the idea that, within the limitations of the statute, the intent of the parties at the time the obligation was incurred should govern enforcement of the collateral. If, for example, the parties intended to have more than one source of collateral for loan repayment, and upon default a disagreement arises concerning in what order the collateral should be realized, this amendment provides what is undoubtedly the existing law, namely, that the intention at the time the obligation was incurred must govern, and not as of the time the default occurs.

(b) "Safe Harbors". The "safe harbors" include "actions" expressly permitted by present law as well as actions which are implicitly permitted by law. These actions are as follows:

(1) Actions Presently Permitted by Statute. Actions which are presently permitted by statute are as follows:

° Subsection 4(a), appointment of a receiver or obtaining possession of property. This is presently permitted by NRS 107.100, the receiver statute, and NRS 104.9503 of the Uniform Commercial Code.

° Subsection 4(c), enforcement of a security interest outside the state of Nevada. This exception was passed in 1987 and is presently found in NRS 40.430.

° Subsection 4(d), bringing an action for fraud. NRS 40.545 permits financial institutions to bring such an action. This subsection would expand the exemption to all beneficiaries.

° Subsection 4(f), exercising rights and remedies under the Uniform Commercial Code. This exception was added to the one action rule in 1965 (1965 Stats 915). California recently passed extensive legislation amending Section 9-501 of the UCC to address situations in which the collateral is part real estate, governed by the one-action rule, and part personal property, governed by the UCC which has no one action rule. The Committee believes that the exception for acts permitted under the UCC should be sufficient to cover such cases.

° Subsection 4(i), bringing an action against a surety or guarantor 120 days after the trustor files bankruptcy. This is presently set forth in NRS 107.080(6).

° Subsection 4(j), collection of a debt after the property is no longer secured. This exception was passed in 1987 and is presently set forth in NRS 40.4591.

(2) Actions Otherwise Permitted. Those safe harbor provisions which the Business Law Committee believes are presently encompassed within existing interpretations of the one action rule are as follows:

° Subsection 4(b) permits collection of rents. This is permitted by implication in NRS 107.100, the receiver statute.

° Subsections 4(d), 4(k) and 4(l). Subsection 4(d) permits recovery of damages or obtaining declaratory or equitable relief. Since these actions do not involve recovery of the debt or enforcement of the deed of trust, they are not within the plain language of the one action rule. Moreover, statutory protection for obtaining declaratory relief should be available in difficult cases, e.g., multistate foreclosures. Subsection 4(d) would also permit indemnification of a lender who is held liable for a borrower's activities in the rapidly growing area of environmental liability, even though the property has been foreclosed. Subsections 4(k) and 4(l) permit the filing of pleadings and papers in specialized courts, bankruptcy and probate, which are necessary for enforcement of the mortgage.

° Subsection 4(e) excepts holding a trustee's sale. California cases are clear that a creditor may foreclose on collateral by multiple nonjudical sales without bringing into play the one action rule or deficiency statutes.

° Subsections 4(g) and 4(h). The concept behind these sections is that money may be collateral. Subsection 4(g) permits the exercise of a right of set off or pledge in a deposit account which has been given as security for the loan. Simply because the collateral is money should not affect a creditor's right to its benefit. The exception does not give a safe harbor to the exercise of a right of set off pursuant to a general common law right -- the money must be pledged for the loan. Subsection 4(h) permits a drawing under a letter of credit. Letters of credit are often given as additional collateral, and merely constitute another source of repayment.

(3) "Catch All" Provisions. Finally, there are three miscellaneous sections at the end of subsection 4: subsection 4(m) exempts actions which are not for the purpose of collecting the debt or realizing on collateral; subsection 4(n) refers to actions specifically exempted by other statutes; and subsection 4(o) permits the recovery of incidental relief in any permitted action, such as attorneys' fees and costs of suit.

6. Sections 6, 7, 8 and 9 contain minor grammatical corrections to existing law.

Let me direct your attention to the corrections in Section 9 on page 4, line 43, where we have recommended eliminating the

language "surety or other defendant or defendants" and substituted the word "surety". One of the provisions which is troublesome in the 1987 legislation is language referring to "guarantors, sureties or other obligors". The term "other obligors" is not defined and causes confusion. The concept of a "surety" is defined in the Uniform Commercial Code (Section 104.1201(39)) and sufficiently defines someone secondarily liable for an obligation.

7. Section 10 is not new, but merely restates NRS 40.485 and 107.080(6) dealing with the rights of a guarantor or surety. A companion provision, Section 14 of this bill, does, however, eliminate a surety's right to automatic partial subrogation upon partial payment.485. Some counsel for guarantors interpreted the 1987 legislation to permit a guarantor to tender a minor payment (e.g, $100) to a creditor and then claim a right to participate in collateral decisions prior to repayment of the loan, thus reducing a creditor's willingness to enter into a "workout" with the debtor. Workouts should be encouraged, not discouraged, and creditors and debtors should be able to do so without the necessity of obtaining a surety's consent (if the surety has so agreed in its guaranty or suretyship agreement, and such rights may be reserved under Article 3 of the UCC [NRS 104.3606]). NRS 40.485 appeared to place the rights of the surety ahead of the rights of the creditor and the debtor to make arrangements between themselves. While an attempt was made by our Committee to spell out the rights and duties of a creditor to deal with the debtor, since a great deal of freedom to negotiate is important in a workout, we believe that the rights of partial subrogation should be repealed.

8. Section 11 is also not new, but rephrases existing language of Subsection 5 of NRS 107.080, requiring that notices of default be mailed to the surety. This provision should exist separate and apart from the trustee's sale statute. Section 11 also provides a safe harbor to the effect that the surety is not released by reason of failure of the creditor to give notice, if the creditor is willing to provide the surety with the benefit of a reinstatment period. Thus, if a creditor inadvertently fails to notify the surety of a foreclosure sale, the creditor may retain its rights against the surety by providing for an additional reinstatement period or rescinding the notice of sale and starting over. This is in keeping with the Committee's goal of providing that sanctions should not be invoked where there has been no harm.

9. Section 12 amends NRS 107.080 by removing the provisions enacted in 1987 and placing them as set forth above in Section 11 of this bill.

10. Section 13 amends the staute under which a "person with an interest" may request notice of default under a deed of

trust. An almost identical statute has been proposed in A.B. 440, which, however, would also require a trustee to notify junior lienholders. This section would not place any new duties upon the trustee, but simply expand the definition of a "person with an interest" so as to permit someone like a surety, without any interest in the property (but a direct interest in the repayment of the loan), to to take advantage of NRS 107.090 by recording a request for notice of default.

11. Section 14 repeals sections which have been handled elsewhere in SB 479, although of the four repealed sections three are retained in the bill and only the partial subrogation statute is repealed.

Thank you for allowing me the opportunity to address you this morning. I would be pleased to answer any questions you may have.

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