ONE HOUR CLE CREDIT

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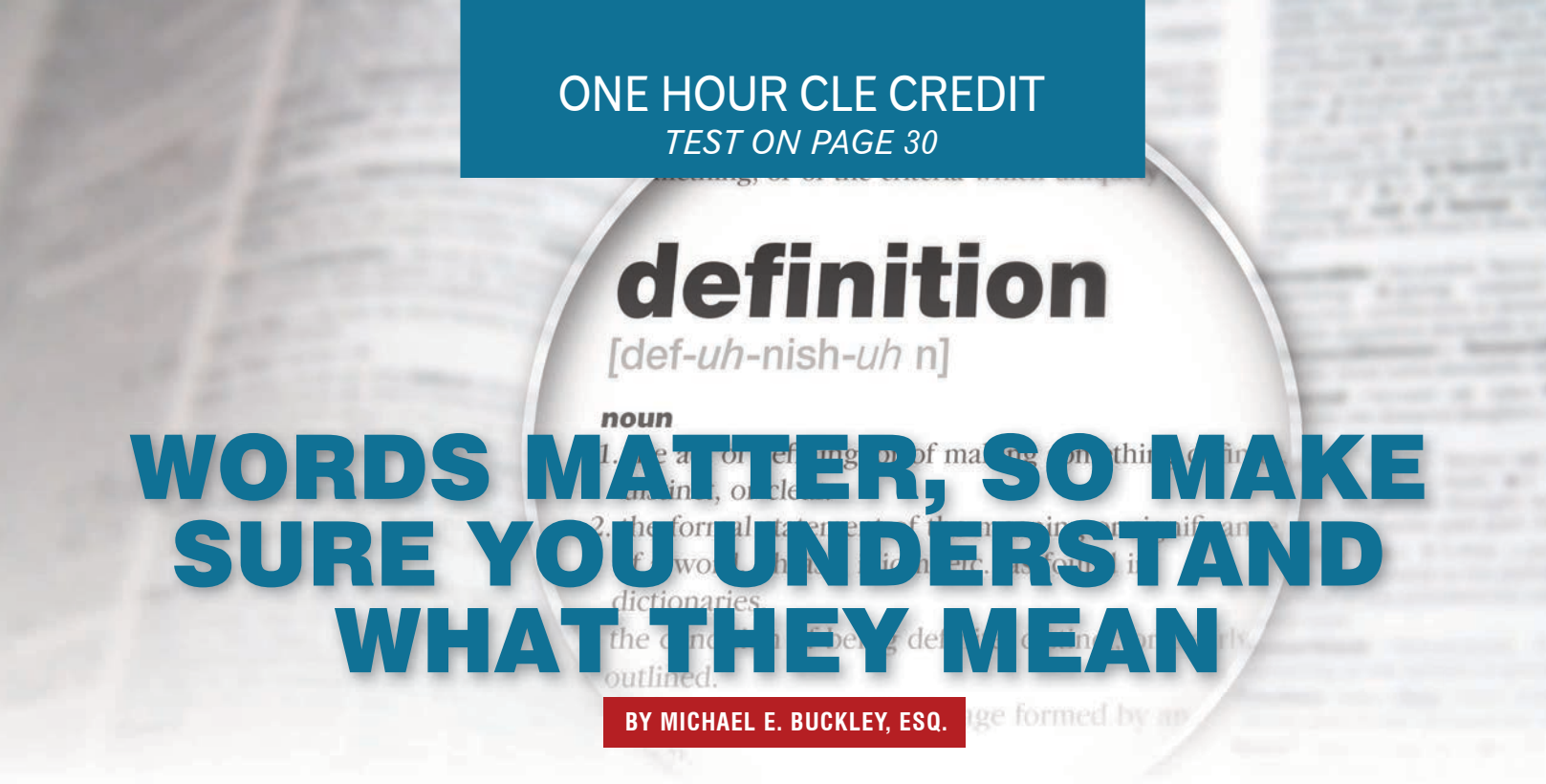

WORDS MATTER, SO MAKE SURE YOU UNDERSTAND WHAT THEY MEAN

BY MICHAEL E. BUCKLEY, ESQ.

"'When I use a word,' Humpty Dumpty said, in rather a scornful tone, 'it means just what I choose it to mean — neither more nor less.'"

— Lewis Carroll, "Through the Looking Glass"

Obviously Humpty Dumpty was not a lawyer. As lawyers, we know that we often don't know what a word actually means until after the court has spoken. Unfortunately, Nevada practitioners also know that lack of case law frequently leads to statutory interpretation problems, especially when statutes (many of which were enacted at different times), use different, conflicting or undefined terms.[1]

Supreme Court decisions provide welcome clarifications when there is uncertainty. Four recent cases examine the meaning or effect of statutory language, and one explains the meaning of "subordination." Each case reminds us of a very important lesson: words matter. These cases also remind us that sometimes basic principles of law and equity trump silence or a lack of clarity in the statutes.

The Meaning of Words: Foreclosure Sale

The outcome of two 2015 cases depended on whether or not an involuntary sale of mortgaged property was a "foreclosure sale," which would permit the lender to seek a deficiency under NRS 40.451 *et seq*. *U.S. Bank Nat'l Ass'n v. Palmilla Development*, 131 Nev. Adv. Op. 9, 343 P.3d 603 (March 2015) involved a court appointed receiver's sale of mortgaged property; *Branch Banking & Trust Co. v. Windhaven & Tollway, LLC,* 131 Nev. Adv. Op. 20, 347 P.3d 1038 (April 2015) concerned a nonjudicial Texas foreclosure. In both cases, the obligors argued that the sale in question was not a foreclosure sale according to the way the term is used in NRS 40.455, the statute that lets a lender seek a deficiency judgment. This argument was possible because NRS 40.455 does not actually define foreclosure sale.

Relying on dictionary definitions and the user-friendly definition of "foreclosure sale" in a part of NRS 40.462 that deals with foreclosure sale proceeds, the court found that a foreclosure sale, as it was meant in NRS 40.455, had occurred in both cases. In retrospect, this seems like a common sense decision. Yet the time and expense of both trial court adjudication and the appeal process illustrate that the decision was not as straightforward as it may seem in hindsight. While it is hoped that the enactment of SB 453 in 2015 will reduce uncertainties, questions will undoubtedly remain.

Windhaven refers to another principle that practioners may sometimes forget. In the absence of statutory clarity, the common law may supply an answer. As the court noted, citing *Key Bank of Alaska v. Donnels*, 106 Nev. 49, 787 P.2d 382 (1990), statutes that derogate from the common law are to be narrowly construed. Because the common law permits deficiencies, deficiency protection statutes must be so construed. Definitions are important, but don't forget the common law—or the punctuation.[2]

The Meaning of Words: Equal Priority

Sometimes we hear, read or even use words without giving much thought to their actual meanings. This was the case in *Southern Highlands Community Association v. San Florentine Avenue Trust et al.*, 132 Nev. Adv. Op. 3 (January 2016). While the case involved a dispute between homeowner associations' respective assessment liens under NRS Chapter 116, the court's decision should apply to shared priority liens in any setting.

Southern Highlands involved a home subject to assessment liens by both Southern Highlands Community Association (Southern Highlands) and The Foothills at Southern Highlands Homeowners Association (Foothills). Foothills foreclosed its assessment lien, resulting in the sale of the home to a third party and approximately $35,000 in excess proceeds. Following the Foothills foreclosure, Southern Highlands sought to enforce its assessment lien. The statute in question, NRS 116.3116(4), provides, "Unless the declaration otherwise provides, if two or more associations have liens for assessments created at any time on the same property, those liens have equal priority." Finding the term equal

priority ambiguous, the court framed the question as follows: "if two liens are equal in priority, the foreclosure of one lien cannot eliminate the other, else the foreclosed lien would be superior. However, neither can the non-foreclosed lien remain, else it would be superior."[3]

The court rejected the parties' reliance on language within Chapter 116 to resolve the problem, noting that the legislative history of Chapter 116 and the uniform laws upon which it is based do not explain how equal priority liens interact with each other (i.e., the core principle must be defined before parsing words that might seem relevant). Instead, the court relied on the general principles of the law provision of Chapter 116 to look outside the chapter, determining that California's approach to equal priority mechanics' liens, which would probably hold true in Nevada, made the most sense.

The court concluded that, "When one equal priority lienholder forecloses, all other equal priority liens are extinguished. However, all equal priority lien holders share in the foreclosure sale proceeds…." If the sales proceeds are sufficient, the equal priority liens are paid in full; if not, "all equal priority lien holders receive a pro-rata share of the proceeds," although the court does not define pro-rata (e.g., equal percentage shares or based on the proportion of the respective lien amounts). The important takeaway from the case is not just how to apply equal priority to the facts on the ground, but also the more general caution that contracts and statutes (and lawyers) often use words or terms without fully understanding what they mean.

What Words Don't Mean: Conclusive Recitals

Shadow Wood Homeowners Association, Inc. et al. v. New York Community Bancorp, Inc, 132 Nev. Adv. Op. 5 (January 2016), also involved the foreclosure of an assessment lien under NRS Chapter 116. While the court determined that significant issues of fact relating to the conduct of the parties precluded summary judgment, it addressed a number of questions of law that have broad implications for practitioners. *Shadow Wood* concerned competing foreclosures by a first mortgage lender and a homeowners association, with the bank seeking to set aside the prior HOA foreclosure through a quiet title action under NRS 40.010. Again, the principles apply equally to non-association liens.

The association and the purchaser of the property at the association foreclosure argued that the recitals, in a deed made pursuant to NRS 116.31164, of the owner's default and compliance with the statutory notice requirements precluded "any post-sale challenge regardless of basis." The court rejected the claim. To begin with, "as a textual matter, the deed recitals to which NRS 116.31166 accords conclusive effect do not relate to the deficiencies NYCB alleges." (In other words, sometimes the words do not mean exactly what we think they mean.)

More importantly, the court, citing *Low v. Staples*, 2 Nev. 209 (1866), for the longstanding proposition that an action to quiet title is a suit in equity, held that "courts retain the power, in an appropriate case, to set aside a defective foreclosure sale on equitable grounds," citing *Golden v. Tomiyasu*, 79 Nev. 503, 387 P. 2d 989 (1963), for the proposition that a foreclosure sale may be set aside where gross inadequacy of price is accompanied by "some element of fraud, unfairness, or oppression."[4] The court also noted that "the legislature is not presumed to overturn long-established principles of law when enacting a statute" and that, as stated in *Windhaven*, the court will strictly construe statutes in derogation of the common law.

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We Know What You Meant: Subordination

The mortgage lender in *Apco Construction et al. v. District Court (In re: Manhattan West Mechanic's Lien Litigation)*, 131 Nev. Adv. Op. 70, 359 P.3d 125 (September 2015), prevailed against the holders of mechanic's liens who argued the lender's subordination of its earlier first mortgages to its later mortgage resulted in the loss of the priority of the first mortgages. The first mortgages predated the commencement of construction and therefore had priority over the mechanic's liens. When construction financing was obtained, after commencement of construction, the lender and owner entered into a subordination agreement, subordinating the first deeds of trust to the later construction deed of trust, with the lender indicating that its intent was to determine "in what order [its] debts would be satisfied."

The mechanic's lien claimants argued, without success, that the subordination agreement was a "complete subordination," resulting in the loss of the original priority of the first deeds of trust. The court instead found the agreement to be a "partial subordination" and adopted the majority position enunciated by the Seventh Circuit.[5] Under this analysis, nonparties are unaffected by the subordination agreement, which simply swaps the priorities of the parties to the subordination agreement. This notably practical result recognizes that a lender has no reason to agree to a complete subordination, and declines to find a complete subordination in the absence of a "clear intent."

Undoubtedly the proliferation of words, in both loan documents and statutes, leads to greater chances for ambiguity. These cases illustrate the importance of using the right words, using them consistently and understanding what they mean, especially in cases where misunderstanding is possible. Practitioners must understand not just what words mean, but how they work. **NL**

1. For example, NRS 40.430, the one action rule, dates back to Nevada's earliest civil practice code, but was amended to clarify its exceptions beginning in 1987. The deficiency statutes, NRS 40.451 to 40.463, were enacted in 1969. Rights to subrogation and exceptions to guarantor protection under the deficiency statutes, NRS 40.465-40.495, were enacted in 1987 and 1989. In 2015, the Real Property Section of the state bar supported changes designed to eliminate some of the inconsistencies in NRS Chapter 40. The bill includes chapter-wide definitions, including "foreclosure sale." The changes were enacted as SB 453, effective October 1, 2015.
2. In *Key Bank*, the location of two commas played a key role in the court's decision that the Alaska statutory deficiency protections applied to an Alaska nonjudicial foreclosure, not to a Nevada trustee's sale.
3. The court quotes from Guy Lamoyne Black, Comment, *Tax Titles in Utah: Caveats for Potential Purchasers and Proposals for Change*, 1991 BYU L. Rev. 1573, 1605 (1991).
4. While the court does not expressly address the fair market value of the property involved, it calculates a bid equal to 23 percent of value and determines that 23 percent "is … not obviously inadequate," referring to *Restatement (Third) of Prop.: Mortgages* §8.3 cmt. b (1997), which suggests a price of less than 20 percent of fair market value would be grossly inadequate.
5. *Caterpillar Fin. Servs. Corp. v. Peoples Nat'l Bank, N.A.,* 710 F.3d 691 (7th Cir., 2013).

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