

NEVADA FORECLOSURE ISSUES
THE ONE ACTION RULE AND CASH COLLATERAL

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I. THE ONE ACTION RULE

A. NRS 40.430: "One Action Rule"

". . . there may be but one action for the recovery of any debt, or for the enforcement of any right secured by a mortgage or other lien upon real estate"

"The Shield" (Security first): Purpose is to require the creditor to exhaust security. *McMillan v. United Mortgage Co.*, 84 Nev. 99 (1968). Debtor may raise the one action rule as a defense to any "action."

"The Sword" (Sanction): An action in violation of the statute results in a loss of security. *Nevada Wholesale Lumber Co. v. Myers Realty, Inc.*, 92 Nev. 24 (1976)

Basic Rule: If the obligation is secured by a deed of trust the lender must foreclose.

B. "Mortgage or other lien"

Pursuant to **NRS 40.433**, the one action rule does not apply to:

1. Mechanic's liens;
2. Assessment liens under NRS Chapters 116 (common interest communities), 117 (condominiums), 119A (timeshares) or 278 (planned unit developments); or
3. Judgment liens.

C. Ultimate Sanction.

"Chapter 40 of the Nevada Revised Statutes provides a comprehensive scheme of creditor and debtor protection with respect to the foreclosure and sale of real property subject to security interests." *Keever v. Nicholas Beers*, 96 Nev. 509 (1980). Accordingly, where creditor set up a procedure whereby it could obtain the real property collateral by exercising options to purchase rather than foreclosing, the violation of public policy resulted in loss of collateral and underlying secured obligation.

D. Waivers

NRS 40.453 states: "*Except as otherwise provided in NRS 40.495:*

1. *It is hereby declared by the Legislature to be against public policy for any document relating to the sale of real property to contain any provision whereby a mortgagor or the grantor of a deed of trust or a guarantor or surety of the indebtedness secured thereby, waives any right secured to him by the laws of this state.*

2. *A court shall not enforce any such provision."*

1. Borrower/Trustor. One action rule may not be waived in advance. *Paramount Ins. v. Rayson & Smitley*, 86 Nev. 644 (1970); *Keever v. Nicholas Beers*, 96 Nev. 509 (1980).

2. Purchase Money? Although the statute refers to documents "relating to the sale of real property," the Court, in *Nevada Wholesale Lumber*, refers to the non-waiver statute even though the case does not mention the existence of a sale. The *Keever* court, however, emphasizes the improper waivers were contained in a "document relating to the sale of real property."

3. Guarantors and Sureties.

The interrelationship of the foreclosure process with a lender's right to proceed against its unsecured guaranties has long been the subject of consideration by the Nevada Supreme Court, which at first denied guarantors the protection of the fair value deficiency laws¹, then granted those rights to guarantors², based on arguments that it was inconsistent to allow a lender greater recovery rights against a guarantor than against a debtor, and that, without the protection of the deficiency laws, lenders were likely to obtain "double recoveries." The issue of guarantor liability was finally addressed by legislation in 1989, codified as **NRS 40.495**, which provides in part:

2. Except as otherwise provided in subsection 4, a guarantor, surety or other obligor, other than the mortgagor or grantor of a deed of trust, may waive the provisions of NRS 40.430. If a guarantor, surety or other obligor waives the provisions of NRS 40.430, an action for the enforcement of that person's obligation to pay, satisfy or purchase all or part of an indebtedness or obligation secured by a mortgage or lien upon real property may be maintained separately and independently from:

(a) An action on the debt;

¹ See, e.g., *Thomas v. Valley Bank*, 97 Nev. 320, 629 P.2d 1205 (1981)

² *First Interstate Bank v. Shields*, 102 Nev. 616, 730 P.2d 429 (1986)

(b) The exercise of any power of sale;

(c) Any action to foreclose or otherwise enforce a mortgage or lien and the indebtedness or obligations secured thereby; and

(d) Any other proceeding against a mortgagor or grantor of a deed of trust.

3. If the obligee maintains an action to foreclose or otherwise enforce a mortgage or lien and the indebtedness or obligations secured thereby, the guarantor, surety or other obligor may assert any legal or equitable defenses provided pursuant to the provisions of NRS 40.451 to 40.463, inclusive.

4. The provisions of NRS 40.430 may not be waived by a guarantor, surety or other obligor if the mortgage or lien:

(a) Secures an indebtedness for which the principal balance of the obligation was never greater than \$500,000;

(b) Secures an indebtedness to a seller of real property for which the obligation was originally extended to the seller for any portion of the purchase price;

(c) Is secured by real property which is used primarily for the production of farm products as of the date the mortgage or lien upon the real property is created; or

(d) Is secured by real property upon which:

(1) The owner maintains his principal residence;

(2) There is not more than one residential structure; and

(3) Not more than four families reside.

E. What Is an "Action?"

Clearly, a personal action against the debtor to collect the note. See *Nevada Wholesale Lumber*, above.

Non judicial actions?

Set off? *Daily v. Bank of America*, 199 Cal. Rptr. 557 (Cal. App., 1984) (unilateral set off violated California one action rule); *United States v. Cail*, 746 F.Supp. 1035 (USDC Nev., 1990) (set off requested by debtor not a violation of Nevada one action rule).

Drawing on letter of credit?

Proceeding against debtor's unpledged personal property or cash, etc.

F. Danger Areas and Safe Harbors

1. Judicial Proceedings. Judicial proceedings in violation of one action rule do not violate the rule unless final judgment is entered. **NRS 40.435** provides:

1. The commencement of or participation in a judicial proceeding in violation of NRS 40.430 does not forfeit any of the rights of a secured creditor in any real or personal collateral, or impair the ability of the creditor to realize upon any real or personal collateral, if the judicial proceeding is:

(a) Stayed or dismissed before entry of a final judgment; or

(b) Converted into an action which does not violate NRS 40.430.

2. If the provisions of NRS 40.430 are timely interposed as an affirmative defense in such a judicial proceeding, upon the motion of any party to the proceeding the court shall:

(a) Dismiss the proceeding without prejudice; or

(b) Grant a continuance and order the amendment of the pleadings to convert the proceeding into an action which does not violate NRS 40.430.

3. The failure to interpose, before the entry of a final judgment, the provisions of NRS 40.430 as an affirmative defense in such a proceeding waives the defense in that proceeding. Such a failure does not affect the validity of the final judgment, but entry of the final judgment releases and discharges the mortgage or other lien.

4. As used in this section, "final judgment" means a judgment which imposes personal liability on the debtor for the payment of money and which may be appealed under the Nevada Rules of Appellate Procedure.

2. Non Judicial Actions by Creditor:

Unlike **NRS 40.435** for judicial proceedings, there is no safe harbor for non-judicial actions in violation of the one action rule.

Example: Cash: What is it? May or may not be collateral, e.g., rents or proceeds under UCC Article 9.

G. What is Not an "Action?"

1. Appointment of Receiver, 40.430(4)(a)
2. Enforcement of Security Interests, 40.430(4)(b), (c), (e), (f), (g)
3. Recovery of Tort Damages, Equitable or Declaratory Relief, NRS 40.430(4)(d)
4. Suits against Guarantors if enforcement of mortgage is stayed for more than 120 days, 40.430(4)(i)
5. Actions by "sold out" mortgagees, 40.430(4)(j) Caution: *Carrillo v. Valley Bank*, 103 Nev. 157 (1987) (Holder of second deed of trust who bid and acquired property at foreclosure of first deed of trust was not "sold out" and was subject to deficiency judgment limitation.)
6. Relating to Bankruptcy Proceedings, 40.430(4)(k)
7. Relating to Probate Proceedings, 40.430(4)(l)
8. Relating to property that is environmentally impaired pursuant to NRS 40.507 and 40.508, 40.430(4)(n)
9. Miscellaneous Actions, which do not involve collection of debt or realization of security, 40.403(4)(m), (o), (p)

See attached "Remarks of Michael E. Buckley re S.B. 479, Senate Judiciary Committee, May 30, 1989" attached hereto.

II. CASH COLLATERAL

A. Uniform Assignment of Rents Act (NRS Chapter 107A [2007])

Rents: "Sums payable for the right to possess or occupy, or for the actual possession or occupation of, real property of another person." **NRS 107A.140(1)**. Typical deed of trust is a "security instrument," NRS 107A.160, containing an "assignment of rents," i.e., "a transfer of an interest in rents in connection with an obligation secured by real property located in this State and from which the rents arise." **NRS 107A.040**.

NRS 107A.230(2): "An assignment of rents creates a presently effective security interest in all accrued and unaccrued rents arising from the real property described in the document creating the assignment, regardless of whether the document is in the form of an absolute assignment, an absolute assignment conditioned upon default, an assignment as additional security or any other form. The security interest in rents is

separate and distinct from any security interest held by the assignee in the real property."

NRS 107A.300: *"The enforcement of an assignment of rents by one or more of the methods identified in NRS 107A.260, 107A.270 and 107A.280, the application of proceeds by the assignee under NRS 107A.310 after enforcement, the payment of expenses under NRS 107A.320 or an action under subsection 3 of NRS 107A.330 does not:*

- 1. Make the assignee a mortgagee in possession of the real property;*
- 2. Make the assignee an agent of the assignor;*
- 3. Constitute an election of remedies that precludes a later action to enforce the secured obligation;*
- 4. Make the secured obligation unenforceable;*
- 5. Limit any right available to the assignee with respect to the secured obligation; or*
- 6. Violate the provisions of NRS 40.430 [the "one action rule"]."*

B. Other Personal Property: Proceeds.

Personal property collateral. Sample language from security agreement in deed of trust:

All goods . . . ; together with all rents (to the extent, if any, they are not subject to Article 3); all inventory, accounts, cash receipts, deposit accounts, accounts receivable, . . . insurance and condemnation awards and proceeds, any other rights to the payment of money, . . . arising from or related to the ownership, management, leasing or operation of the Subject Property or any business now or hereafter conducted thereon by Trustor; . . . ; together with all replacements and proceeds of . . . any of the foregoing

NRS 104.9102(1)(kkk) states: *"Proceeds' means, except as used in subsection 2 of NRS 104.9609, the following property:*

- (1) Whatever is acquired upon the sale, lease, license, exchange or other disposition of collateral;*
- (2) Whatever is collected on, or distributed on account of, collateral;*
- (3) Rights arising out of collateral"*

C. Specific Examples: Golf Courses and Hotels

Hotels and Golf Courses: Comment 12 to Section 2 of the Uniform Assignment of Rents Act, relating to the definition of "rents":

Illustration 2. ABC Life Insurance Company holds an assignment of rents on the Friendly **Hotel**. Heinsz is a guest of Friendly Hotel for three nights. Although Heinsz has no possessory interest in a particular hotel room vis-a-vis the owner of Friendly Hotel, Heinsz does "occupy" the room in a fashion that essentially excludes third persons. Sums payable for the room occupancy charges that Heinsz incurs for his stay are "rents." *Sums payable for charges that Heinsz incurs for additional hotel-related services (such as room service meals, dry cleaning or laundry services, or the like) would not constitute "rents," as they are not incurred in exchange for the right to occupy the room.* [Emphasis added.] . . .

Illustration 6. First Bank holds an assignment of rents on Friendly **Golf Course**. Smith pays greens fees to play at Friendly Golf Course. *Sums payable on account of Smith's greens fees are not right [sic]"rents," as Smith does not "occupy" the real property but is merely using it in a temporary and essentially nonexclusive fashion.* [Emphasis added.]

NRS 104.9607(1)(b): After the debtor's default (or if agreed to by the parties before default), the secured party may take the proceeds it is entitled to under NRS 104.9315 and, pursuant to NRS 104.9608(1)(a), apply the cash proceeds collected under NRS 104.9607 to, among other things, "(1) *The reasonable expenses of collection and enforcement and, to the extent provided for by agreement and not prohibited by law, reasonable attorney's fees and legal expenses incurred by the secured party;* (2) *The satisfaction of obligations secured by the security interest or agricultural lien under which the collection or enforcement is made*"

Restaurant Revenues. Proceeds from disposition of inventory or something else?

Cash obtained from operation of a restaurant are not proceeds from the sale or disposition of inventory (e.g., food products), but rather proceeds from the provision of services. See, e.g., *In re GGVXX, Ltd.*, 130 B. R. 322 (Bankr. D. Colo., 1991) and *In re McCann*, 140 B. R. 926 (Bankr. D. Mass., 1992).