The State Bar of California Presents A Special Joint Section Publication of the Business And Real Property Law Sections

How The Real Estate Meltdown Has Changed Real Estate & Business Law

THE STATE BAR OF CALIFORNIA • ISSUE 4 2010

BUSINESS LAW NEWS

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California Real Property Journal

The Acquisition of Distressed Real Estate Debt: Lifecycle of a Transaction

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I. OVERVIEW

For the commercial real estate practitioner, the acquisition of distressed debt presents a far more interesting subject than originating a loan or buying real property because it involves components of lending, acquisition, workout, foreclosure, and possibly bankruptcy law. The presence of a default and the fact that either or both the asset and the borrower are having trouble layers in a set of circumstances and issues lawyers must understand to assist their clients. "Loan to own" — or the purchase of distressed debt with the ultimate goal of acquiring the underlying real property security — has become a strategy of many real estate investors in the current economic climate. But, many investors who buy debt also implement a broader strategy that includes not only property acquisition, but also working out a distressed loan to becoming a performing asset.

This Article will highlight material considerations and provide counsel with a framework for advising clients regarding the acquisition of real property secured debt.

To understand the complexity of buying distressed debt, this Article tracks the lifecycle of a distressed debt acquisition. To price and underwrite the deal, a prudent debt buyer will preview the entire transaction from loan acquisition to possible workout and enforcement of remedies. When an investor buys debt with the intent to access the real property security before assuming ownership of the property, it must appreciate that it will first be a lender — perhaps for a day, a month, a year, or longer. This topic will be considered in two sequential parts: first, acquiring the loan, and second, negotiating the workout or, alternatively, undertaking enforcement action.[1]

II. THE LOAN ACQUISTION

Buying debt initially involves two steps: negotiating the loan purchase agreement and executing thorough due diligence to understand the loan, the borrower, and the property.

A. The Loan Purchase Agreement

1. *Negotiating the Loan Purchase Agreement*

The Buyer's ability to negotiate the loan purchase agreement successfully ("Purchase Agreement") depends on several factors, including whether the acquisition will be accomplished through a negotiated transaction or a competitive bid transaction. Typically, the Purchase Agreement is drafted by Seller's counsel as an "as is" sale with very limited representations and warranties from Seller. In negotiating the loan sale agreement for Buyer, we recommend Counsel be as aggressive as possible within reason because the motivations for selling a loan vary from bank to bank. Bear in mind however, that achieving Buyer-favored provisions similar to those identified below is directly proportional to the Seller's financial strength and may be subject to caps and time limitations. The Buyer should be prepared to negotiate important provisions in the Purchase Agreement, including the following:

a. Description of Assets Buyer is Purchasing

The Purchase Agreement should provide that Buyer is purchasing all of Seller's right, title, and interest in the loan, the loan documents, and the loan file. This provision should include, without limitation, the rights to payment, servicing rights with respect to the loan, rights under any pending enforcement actions (such as foreclosures and receivership orders), and claims filed by Seller in any pending bankruptcy case or insolvency proceeding.

b. Representations and Warranties

There are several representations and warranties from Seller that are important to Buyer. Here are a few key ones to consider:

- *Authority and Consents*. Loans may have several participating banks or may have been assigned one or more times to a lender before it comes across Counsel's desk. Seller should represent that it has

the authority to sell the loan and does not require the consent or approval of any other party, including loan participants. Alternatively, if approvals are necessary, Seller should represent that it has obtained the required consents. Buyer should require evidence of such consents at or before the closing of the sale.

- *Loan File Disclosed*. Seller should represent that it has provided all of the documents and materials related to the loan and the collateral in Seller's possession or reasonably obtainable by Seller, including copies of all correspondence between Seller and Borrower. This is a critical representation because Buyer needs to know it has access to the universe of information available to Seller regarding the loan and the real and personal property collateral.[2]

- *Unpaid Principal Balance*. Seller should provide a representation as to the current principal balance of the loan, and the location and amount of all escrowed funds held by Seller, as of the closing date. After the closing date, Buyer will be responsible to Borrower for funds originally held by Seller prior to the sale. In California, the application of escrowed funds to amounts due after a default may trigger the "one action rule"[3] if the lender has no separate security interest in such funds. A personal property security agreement identifying deposit and escrow accounts is an important collateral document.

- *Notices*. In addition to obtaining copies of all notices of default given by Seller to Borrower as part of the loan file, Seller should represent that such notices were delivered in compliance with the loan documents and applicable law.

- *Cross Collateralization*. Borrower may have an extensive relationship with Seller and therefore, Buyer should seek a representation that the loan is not cross-collateralized or cross-defaulted with any other loan with Seller that is not the subject of the Purchase Agreement.

c. Deposit and Due Diligence Period

The deposit and due diligence provisions should state that Buyer has complete discretion to decide whether to proceed with the transaction within the due diligence period. The provisions should also state, without qualification, that if Buyer does not proceed for any reason (or no reason at all), the deposit will be returned. Counsel should be aware that sometimes the deposit language is more complex, allowing Buyer to terminate only for specific reasons or requiring Seller's approval for a return of Buyer's deposit upon termination. The due diligence provisions in the Purchase Agreement do not require the same complexity as an agreement for the acquisition of a fee interest because Buyer is not taking title to real property.

d. Allocation of Risk

The Purchase Agreement should provide that Seller is responsible for the loan before closing, and Buyer is responsible for the loan only after closing. If the Purchase Agreement is not clear on this issue, then Buyer may acquire unanticipated liabilities.

e. Seller Defaults and Indemnity

The Purchase Agreement should address the scope and nature of Buyer's remedies upon Seller's default. For instance, can Buyer terminate immediately and get its deposit back, or is Buyer required to allow Seller time to cure its default? Buyer should seek an indemnity from a financially strong Seller for Seller's acts prior to closing and in the event of Seller's default under the Purchase Agreement. If Seller's default is discovered after closing, then the Purchase Agreement can provide for the repurchase of the loan after the expiration of an acceptable cure period.

B. The Due Diligence Process

At the outset of the due diligence process and before launching an in-depth review of the loan documents, Counsel should help Buyer understand some key elements about the lending relationship between Seller and Borrower, and where applicable, between Seller and other participating lenders. Counsel should understand early in its review whether the distress relative to the loan is the result of a failure of the property to perform, a problem with Borrower as operator, or simply an inability to refinance a maturity default. Guaranty agreements, updated title, correspondence between Seller and Borrower, and intercreditor or participation agreements are key documents to preview at the beginning of the due diligence process. Reviewing these items early may help Counsel discover material issues that may alter Buyer's interest in acquiring the loan.

Notwithstanding the foregoing, Counsel should perform an exhaustive due diligence review of the loan documents, real property documents, title documents, and related materials, as well as prepare a summary outlining material due diligence issues for Buyer's consideration.

Buyer may find it difficult to perform physical inspections of the property because Seller is the lender and not the owner, and Seller may have a strained relationship with Borrower. As a result, a certain amount of Buyer's underwriting and pricing may be based on educated guesswork.

1. Document Request List

Pre-acquisition due diligence is essential on distressed loan assets because more often than not, issues relating to the structure of the loan and the lending relationship with the Borrower can affect the value of the transaction to Buyer. Problems range from the misspelling of Borrower's name on a UCC filing to title being vested in the wrong borrower entity. Other problems include unpaid taxes, mechanics liens, and defective guaranties (guaranties that do not include the requisite real property waivers essential to maintaining a separate claim against the guarantor).

Sellers typically do not provide a complete due diligence package at the outset of the transaction. Therefore, during the letter of intent stage Counsel should develop with Buyer a "Document and Due Diligence Request List" specific to the loan and asset type, which should be sent to Seller prior to the commencement of the due diligence period. Counsel can develop this list by combining a loan origination or workout checklist with an asset class-specific property acquisition due diligence list.[4] The list should require Seller to deliver without limitation all documents and amendments, including all loan documents and the original loan commitments, guaranties, title insurance policies, intercreditor agreements, third-party reports, leases, appraisals, and contracts (franchise agreements, management agreements, co-restrictive easement agreements, etc.), CC&Rs, the servicing file, correspondence with Borrower, loan and payment history, Borrower entity documents, and standard real property due diligence items. The request should also include Seller's origination checklist, showing what documents were created at origination, such as intercreditor agreements. Intercreditor agreements often contain notice provisions and rights of junior lenders that need to be addressed before foreclosure can be initiated.

2. Written Due Diligence Report

Counsel should produce a concise but inclusive memorandum ("Due Diligence Report") summarizing material legal due diligence items and pointing out defects and deficiencies to assist Buyer in developing a strategy — whether that strategy includes proceeding with the transaction, a price adjustment, or a decision to walk away from the deal. Counsel should not merely summarize the loan documents but rather highlight for Buyer the most important issues first.

The Due Diligence Report should be updated continually during the due diligence period, resulting in a final product that can be referred to by Counsel and Buyer as needed. The Due Diligence Report should be used to create follow-up questions and additional document requests to Seller as well as a reference piece for pre-acquisition "roll-up" calls with Buyer's underwriting team. It should also contain a document audit or checklist of items reviewed.

3. Due Diligence Review

The due diligence review can be extensive and should include some or all of the following elements.

a. Overview of the Defaulted Loan

Counsel should identify all of the relevant parties, including Borrower parties, guarantors, sponsors, sureties, and relevant third parties. In addition, Counsel should identify defaults, including payment defaults and nonmonetary or technical defaults. Payment and technical defaults can be cured, whereas typically, maturity defaults are cured only by a full payoff of the loan. However, just because a loan is being sold as a distressed loan, Buyer should not assume there is a clear path to the property.

b. The Loan Commitment

Counsel should review the original loan commitment and Seller's origination checklist, which may provide a roadmap regarding loan documentation that should have been produced and executed by Borrower. Lender liability claims may arise out of differences between the loan commitment and the loan documents. However, most well-drafted loan agreements include a clause that the provisions of the loan agreement supersede all other agreements between the lender and Borrower (oral and written).

c. The Loan Documents

Buyer should never assume that the loan documents are enforceable. Rather, Counsel should review the loan documents to determine whether the rights and obligations of the parties are clear and unambiguous, and whether any of the loan documents are open to attack or re-characterization. Counsel should ensure the loan file contains the ***original*** note (and any endorsements relating to an assignment of the note), copies of the as-recorded deed of trust, and assignment of rents along with an assignable lender's policy of title insurance. When a loan has traded hands several times, the original note may be hard to find. Despite the acceptance of fax signatures today, it is still important to receive the original wet-ink promissory note. Without the original note, the Buyer might encounter trouble foreclosing on the collateral.[5] In addition, Counsel should determine whether the deed of trust and assignment of rents were properly executed and recorded.[6]

d. The Loan Agreement

Loan agreements are typically lender-favorable documents. Nonetheless, Counsel should review the loan agreement for provisions imposing post-closing obligations on the lender. The loan agreement may contain complex provisions such as rebalancing payments, funding obligations for additional improvements (construction and tenant improvement draws), and nonrecourse carve-outs for guarantors. The loan agreement may also contain provisions regarding escrowed funds belonging to the Borrower. Those amounts may be significant in the aggregate, and Buyer will be responsible for them post-closing unless otherwise agreed in the Purchase Agreement.

e. Guaranty

The guaranty agreement may be full-recourse, nonrecourse with carve-outs, or in some cases worthless. A well-drafted guaranty might mean the difference between recovery in full or relegation to the value of the collateral, and is an important tool for a lender to maintain its bargaining position throughout the workout or foreclosure process. A lender's right to sue on a guaranty is enhanced if the guaranty agreement contains specific waivers of the election of remedies and anti-deficiency protections otherwise afforded guarantors.[7] Such protections include the "One Form of Action" rule, which was enacted in California to eliminate multiple actions when a creditor elects to sue a debtor after a default on debt secured by real property. The rule provides: "*There can be but one form of action for the recovery of any debt, or the enforcement of any right secured by mortgage upon real property*."[8] In addition to preventing multiple actions, the One Action Rule compels exhaustion of all security before a deficiency judgment is entered, and it ensures that debtors are credited with the fair market value of the real property collateral before they are subjected to personal liability.[9] Guarantors can waive defenses under the One Action Rule.[10] Without the proper waivers, a lender's election to complete a trustee's sale would prejudice the guarantor and thus exonerate it.[11] The presence or absence of properly drafted waivers affects whether a lender can pursue a deficiency judgment as part of a separate action on the guaranty agreement, and it influences whether the guaranty will be effective in pressuring Borrower to accept a workout or friendly foreclosure.[12]

f. Title Report

The status of title of real property collateral will materially affect foreclosure strategy and perhaps Buyer's decision whether to buy the loan. The title report may show title encumbrances, such as mechanics' liens that relate back to a date prior to the recording of the deed of trust, junior liens, judgment liens, and delinquent taxes. Counsel may also find CC&Rs (covenants, codes, and restrictions), laws affecting condominium developments, and covenants restricting building and modifications in a redevelopment district. The coverage of a standard ALTA lender's policy will benefit the originating lender's successors and assigns; however, the lender's ALTA Policy will not insure the title Buyer receives after foreclosing on a property because it is not an owner's policy.

g. Environmental and Other Property Issues

Environmental issues may pose problems for a lender even before the lender takes title to the property. Counsel should review third-party agreements and reports, such as the Phase 1, other environmental reports including property inspection, soils, and engineering reports. If the Phase 1 report required additional study, then Counsel should recommend that Buyer update the environmental reports if necessary to evaluate the risks of any environmental problems. Pre-foreclosure liability may arise if Seller participated in the financial management or exerted any control over Borrower that may have influenced Borrower's treatment of hazardous wastes.[13] The loan documents may include an environmental indemnity from Borrower

(and from the guarantor) that survived foreclosure. Litigation commenced by a lender to enforce an "environmental provision" (a representation or covenant made by Borrower relating to hazardous substances) does not constitute an action within the meaning of the One Action Rule, nor does it constitute a money judgment for a deficiency.[14]

h. Forbearance Agreements and Enforcement Action Filings

Where the loan is in default, Counsel must determine what actions Seller has taken to enforce the loan. Documents to review include Seller's notices to Borrower, amendments to the loan documents, copies of any recorded notices of default, and any litigation filings, including, for example, a motion seeking the appointment of a receiver. Counsel should caution Buyer that prior to closing on the acquisition of the loan, Buyer should not get involved in Seller's negotiations with Borrower. If Buyer is involved with Seller's management of its loan prior to closing (especially when the original lender is modifying or extending a loan), Buyer may become liable to Borrower for the acts of Seller.[15]

i. Intercreditor and Participation Agreements

Intercreditor and participation agreements usually affect Seller's rights to service the loan and make decisions in the event of Borrower's default. Seller may be required to comply with specific provisions in the intercreditor agreement, such as notice and consent provisions, prior to commencing a foreclosure. Counsel must verify whether Seller has the authority to sell the loan and has received the authority to take enforcement action or enter into workouts prior to the closing date. If the intercreditor agreement is silent, then California Civil Code section 2941.9 provides guidance regarding decision-making procedures among creditors.[16]

Although the subject matter of commercial mortgage backed securities is well beyond the scope of this Article, Counsel should recognize that resolution of securitized loans can be complex. In securitized transactions, the original lender (who negotiated the loan) has likely assigned its interest and is out of the picture. Securitized loans are not based on traditional lender-borrower business relationships and documentation. Rather, they are governed by specific standards set forth in pooling and servicing agreements, which may authorize a special servicer to commence and pursue collection activities. Further, federal tax laws may limit the alternatives available to the parties.[17]

j. Other Third Party Agreements

Some retail and office properties are subject to cross-easement and tenant-in-common agreements, requiring notice and cure rights to a third party. Where the collateral consists of a hotel, Counsel should review tri-party agreements (franchise) and property improvement reports with the franchisor.

k. Servicing File and Lender Liability

Counsel and Buyer should review the history of the loan administration to identify potential enforcement problems and lender liability claims. The increased use of email has resulted in the (unintended) documentation of negligent loan management practices. Counsel should carefully read all of the correspondence between Seller and Borrower, as well as between Seller and any guarantors. The servicing file may include:

- *Notices*. Distressed borrowers may be quick to sue a lender. Therefore, it is critical to confirm that all notices (including default and acceleration notices) have been sent to the Borrower and relevant parties in strict accordance with the loan documents. Although most loan documentation does not require lenders to provide written notice in the event of a default, it is prudent for a lender to provide notice to Borrower with an adequate opportunity to respond and cure. Failure by a lender to provide notice of a default could be viewed as a violation of the covenant of good faith and fair dealing.[18]

- *Promised Advances*. Where Seller and Borrower entered into forbearance and modification agreements, the file may contain correspondence that creates a reasonable expectation on the Borrower's part of more of the same. While it is difficult to determine if any oral representations were made to Borrower, email correspondence between Seller and Borrower may show that advances were promised after the loan was in default.

- *Modifications in Writing*. While servicing the loan, Seller may have inadvertently modified loan terms through its actions. Seller's loan documents may contain covenants for Borrower related to operations and reporting (for example, financial reporting,

operating income, and debt service coverage levels). However, if Seller has not enforced loan covenants, Seller or Buyer (as Seller's assignee) may be precluded from relying on technical defaults to enforce payment of the loan in the absence of the maturity default.[19]

- *Lender's Liability in Tort*. A lender's actions may give rise to a tort claim based on control and interference with the Borrower. When a lender becomes an active participant in the construction enterprise of Borrower, it can be held liable for its negligence in exercising control over Borrower's enterprise. When the lender's conduct goes beyond that of a typical money lender in its involvement with the borrower, the lender may become liable to third parties (e.g., purchasers of defective homes).[20] In addition, Borrower might successfully assert a breach of contract claim. Breach of contract claims by borrowers have included, among other claims, breach of a loan commitment,[21] refusal to advance funds,[22] breach of good faith and fair dealing, failure to provide adequate notice prior to enforecement or a material change in the conduct of lender, and failure to provide new financing or to restructure the terms of an existing loan.[23] Further, defaulted construction loans often give rise to lender liability claims, including negligence claims relating to supervision of construction projects. Finally, a construction lender may be liable to the Borrower and its guarantor for the negligent disbursement of funds in excess of a project's stage of completion.[24]

- *Correspondence with Guarantor*. The correspondence between the lender and the guarantor is often overlooked. Even though the guarantor is familiar with the loan process and the Borrower, adverse material facts about a lending relationship known by the lender should have been disclosed to the guarantor. For example, the lender may owe the guarantor a duty to disclose facts if the lender believes those facts increase the risk to the guarantor beyond which the guarantor intended to assume.[25]

l. Understanding Borrower's Psychological Investment

Finally, Counsel and Buyer should get a sense of Borrower's psychological investment in the property to determine whether Borrower will toss the lender the keys or fight to keep the property (regardless of the logic to do so). Counsel and Buyer should consider whether Borrower brings anything unique to the operation and success of the property. Additionally, they should consider whether a transfer of title to another owner-operator gives the property a better chance at success.

4. Special Considerations for Construction Loans

In today's market, many loan purchasers are encountering distressed construction loans, especially for condominium projects. For construction loans, Buyer must review the lender's existing title policy for relevant title endorsements, including coverage for optional advances. In addition, Buyer must review construction and liability insurance policies. Further, the stage of completion and the cost to complete remaining improvements will be relevant to determining the pricing of the transaction. Counsel should determine if any additional advances are required or whether advances have been made by Seller post-default.

Counsel must also analyze mechanics' liens shown on the title report. A deed of trust recorded before any work is commenced will have priority over subsequent mechanics' liens to the extent of required advances under the loan agreement.[26] However, if construction work on the project commenced before the deed of trust was recorded, properly perfected mechanics' liens will take priority over the deed of trust.[27] Certain mechanics' liens may be vulnerable to attack because they were not properly perfected; or the liens may not relate back to the period prior to the recording of the deed of trust. In the latter case, they can be eliminated through foreclosure.

If there are mechanics' lien claims and undisbursed loan proceeds, then there are likely to be stop notices (which are independent of lien claims). Stop notices are essentially claims asserted directly against the construction lender to garnish undisbursed construction loan proceeds.[28] Stop notices are not affected by a foreclosure sale and are not insured by the lender's title policy. In addition, construction lenders can be liable to third parties for construction defects if the damage is the result of or is exacerbated by an act of the lender outside the scope of its role as a lender.[29]

5. *Payment or Maturity Default*

Lender should establish whether Borrower is in payment default or maturity default. Where a loan has not matured, Borrower can reinstate a defaulted loan up until five business days before the date of the trustee's sale by bringing the loan current (including default interest and fees), thereby stopping the sale.[30] If the loan has matured by its terms, Borrower will need to pay off the entire loan balance to cure the default.

6. *The Borrowing Entity and Public Record Searches*

Counsel should review all of Borrower's entity documentation to determine who has authority to execute loan related documentation. Consideration should be given to whether the Borrower was formed as a single purpose entity ("SPE") such that the assets are isolated from Borrower's unrelated activities and whether Borrower maintained SPE status. If the borrowing entity acquired additional real property or undertook additional business activities, Borrower may no longer be treated as a "single asset real estate."

Additional public record searches, including bankruptcy, criminal, and money judgments against Borrower or guarantors might be helpful in rounding out the due diligence profile. The road through a bankruptcy may be somewhat more difficult than otherwise planned.[31] Counsel should advise clients to conduct full UCC lien searches, as well as federal and state tax lien and judgment searches to ascertain whether Borrower has further encumbered the real and personal property collateral. There may be a pattern of litigation or other judgments against Borrower or its guarantors, which may predict how Borrower responds to a foreclosure action.

III. POST-CLOSING STRATEGY: FORECLOSURE AND LOAN MODIFICATION

Buyer becomes the lender after it acquires a loan. As a lender holding a distressed loan, Buyer's options include working out the loan to a performing asset, selling the loan, or taking the property. Regardless of the actual next steps for Buyer, developing sound servicing practices and healthy communication with Borrower are important focus points for avoiding liability.

A. Develop Sound Servicing Practices

Prior to entering the market for distressed real estate debt, Buyer should have servicing procedures in place to reduce liability risk. Whether moving to foreclose or entering into workout negotiations, Buyer should service the loan consistent with prudent loan administration practices. Buyer should also engage in conduct with Borrower that is appropriate for a money lender without controlling Borrower's business. A lender may be held liable for damages to a Borrower for exercising control over, or interfering with, a Borrower's business, which includes its corporate governance and management of operations.[32] Buyer should not engage in conduct that usurps Borrower's prerogatives or conduct that takes control of or exercises undue influence over Borrower's governance or operations. As the lender, Buyer must also be careful to avoid inadvertent waivers or modifications of terms under the loan documents.

B. Elements of Sound Servicing Practices

Sound loan servicing practices aimed at striking the right balance between legitimate lender conduct and overreaching may include:

- Bringing experienced servicing personnel in-house or retaining the services of an outside servicing company with a clear understanding of who is responsible for the lending relationship with Borrower(s);
- Maintaining an arm's length relationship with the governance and operations of Borrower;
- Refraining from recommending consultants or contractors for Borrower unless requested to do so;
- Documenting all communication with Borrower ***in writing*** on all matters, whether relating to Borrower activities or material terms and conditions of the loan. Buyer's servicing personnel should not engage in casual communication with Borrower or make any verbal promises;
- Reviewing the loan documents often to confirm both Borrower's and Buyer's compliance;
- Ensuring all notices are given to Borrower under the loan documents, including written notice and a reasonable time for cure in the event of default before steps are taken to enforce terms of the loan documents;[33] and
- Documenting all changes to the loan documents.

C. Avoiding Lender Liability in the Workout Process

To avoid lender liability, Buyer as lender should not tell Borrower that it is willing to engage in a workout if it is not. Additionally, Buyer should not give Borrower advice or exer-

cise any measure of control over Borrower or the collateral. The administration of the loan will require frequent interaction with Borrower. Depending on how Buyer deals with Borrower, that constant interaction may increase the risk of Buyer being considered a fiduciary. Giving business advice as a lender, taking a personal stake in Borrower, conversing with Borrower about its business strategy, and establishing a relationship with Borrower where Borrower relies on business advice from the lender may result in the formation of a fiduciary relationship beyond that of a mere money lender, thereby, increasing the likelihood of lender liability.[34]

D. The Pre-Negotiation Agreement

Before Buyer begins discussions with Borrower, it is highly advisable to enter into a pre-negotiation agreement with Borrower to set the ground rules for any discussions after a default and to secure certain waivers from Borrower. The pre-negotiation agreement should at least secure Borrower's written understanding of the following: (i) the loan is in default; (ii) any conversations are settlement discussions, can be discontinued at any time, are non-binding, and not an amendment or forbearance to the loan documents without a mutual writing evidencing the same; (iii) Buyer has reserved all of its rights under the loan documents; and, if applicable, (iv) forbearance discussions may be held simultaneously with Buyer pursuing foreclosure.

The execution of the pre-negotiation agreement is also an opportunity for Buyer to clean up Seller's mistakes before documenting a workout or modification, that is, correct existing defects in the loan documents. The pre-negotiation agreement is also an opportunity for Buyer to improve its position by seeking assurances in the form of releases from Borrower and guarantors of any existing lender liability claims.

The negotiation of this document can also be an opportunity for Buyer as the new lender to "smoke out" any potential lender liability claims. Liability claims often lie dormant until a lender seeks to enforce the loan through foreclosure and pursuit of guarantors.

To be effective, the pre-negotiation agreement must be executed by the parties prior to any discussion. Pre-negotiation agreements require confidentiality and may also preclude matters discussed during negotiations from being admitted as evidence in any judicial proceeding. While Buyer may not be able to achieve all of the concessions identified above, a discussion with Borrower about a pre-negotiation agreement may provide insight into how cooperative Borrower will be during a workout or foreclosure. Counsel should note that many banks and servicers have adopted a take-it-or-leave-it position with borrowers regarding the pre-negotiation agreement. They consider it "drawing a line in the sand" to determine whether to invest time and resources in a workout with Borrower or proceed immediately to a foreclosure sale without looking back.

E. Forbearance Agreements and Loan Modification Agreements

1. Good Faith Requirement

Buyer should be sure to enter workout negotiations in good faith. If Buyer's sole goal is to get title to the property, any negotiations for forbearance or loan modification may be subject to a fraud claim by Borrower or breach of the covenant of good faith and fair dealing.[35] The concept of negotiating in good faith would not, however, require the Buyer to give in to a one-sided deal favoring the Borrower.[36]

2. Forbearance Agreements

The purpose of a forbearance agreement is to postpone the exercise of lender's remedies while leaving the delinquency status of the loan unchanged. The forbearance period gives Buyer and Borrower time to explore solutions before Buyer commences foreclosure. Solutions may include a sale or refinancing of the property, an infusion of "rescue capital," or modification of the loan.

Similar to the pre-negotiation agreement, a forbearance agreement can be used to affirm the loan documents, including guaranties, the amount of the debt, the occurrence of default, and provision of waivers of possible claims Borrower may have against Buyer and Seller.[37] A forbearance agreement can also provide for the completion of improvements during the forbearance period. Without violating the covenant of good faith and fair dealing, Buyer can enter into negotiations for a forbearance agreement and simultaneously commence a trustee's sale to start the clock running on the foreclosure process. That step should provide motivation to Borrower. Buyer may also require Borrower to deposit in escrow a deed in lieu of foreclosure to be recorded on a date certain if Borrower's obligations under the forbearance agreement are not met. Counsel should discuss the "deed in a drawer" with the title company before raising it in negotiations because certain title companies may have specific rules for those matters.

Prior to negotiating the forbearance agreement, Counsel should refresh its review of the loan documentation and use the forbearance agreement as an opportunity to eliminate errors and omissions now that its client is the lender. Buyer must take care not to amend the loan documentation without also obtaining the guarantor's written affirmation guarantying payment of the amended loan obligations.

During the forbearance period, Buyer should give Borrower notice in writing of any deviations by Borrower under the forbearance agreement. For example, if Buyer accepts a partial payment but does not clarify to Borrower that the payment is being applied to the debt instead of to a new repayment schedule, Buyer may be prevented from proceeding with its foreclosure.[38] Counsel should be watchful for "mortgagee in possession" issues, which will raise the liability stakes for the lender.

3. Loan Modification

Loan modification agreements can include a simple extension of the maturity date, changes to the economic terms of the loan, or a complete restructuring of the lender-borrower relationship. As with other workout agreements discussed above, Buyer should seek reaffirmation of Borrower's and guarantor's obligations under the loan documents and waivers of potential claims against the lender as conditions to the modification. The consent of a guarantor to any loan modification is imperative because a guarantor may be exonerated if the guaranteed obligation is modified without its consent.[39] Buyer may also seek additional forms of credit and security. In addition, Counsel should at least consider obtaining the consent and subordination of junior lienholders to modifications since material modifications to the loan that are detrimental to non-consenting junior lienholders may result in the modified portion of the senior loan being subordinated to the junior lienholders.[40]

F. Trustee's Sale

In California, a trustee's sale (or non-judicial foreclosure) takes at least four months to complete. Any defect in the foreclosure process can delay the sale, subject the Buyer to claims such as wrongful foreclosure, or both. Borrower may be able to enjoin a trustee's sale if the lender fails to follow statutory procedures. Counsel should advise Buyer to seek the assistance of default services at title companies or reputable third-party foreclosure service companies to ensure compliance with statutory procedures. Challenges to non-judicial foreclosure sales result primarily from (i) claims based on the lack of a material default justifying a foreclosure; and (ii) a defect in the foreclosure process.

In anticipation of the trustee's sale, Buyer must calculate all monetary and nonmonetary defaults for possible inclusion in the Notice of Default ("NOD") recorded under California Civil Code section 2924. The failure properly to describe a claimed default in a recorded NOD precludes the lender from requiring a particular default be cured as a condition to reinstatement of the loan.[41] The NOD must specify amounts due from Borrower as principal or interest to enable Borrower to determine the amount necessary to reinstate the loan. A defective NOD may also excuse Borrower from performance and prevent Buyer from asserting any default by Borrower.[42] If a defect in the NOD or notice of sale is discovered, the sale should be re-noticed. Counsel should also be prepared to advise the Buyer on bidding strategies, including practical reasons for underbidding to protect post-sale damage actions.[43]

G. Deed in Lieu of Foreclosure

While foreclosure is sometimes the only viable path in connection with a defaulted loan, in certain situations, Buyer as the new lender may benefit from taking a deed in lieu of foreclosure. If there are no material lien issues of record against the collateral, the borrower is prepared to give up the asset, or there are complexities regarding the transition of ownership of the property, then a deed-in-lieu of foreclosure may be the best and fastest route to the property. Deed in lieu agreements are similar to purchase agreements and typically contain representations and warranties, as well as other important covenants from Borrower benefitting Buyer, the "purchasing" lender.

Hotels are prime candidates for deeds-in-lieu because of the complexity of the transition to a new owner and manager. A lender may also want the borrower on an unfinished condo development to remain in place as the developer and sell the units to avoid construction defect liability.

Alternatively, when there are junior lien issues or an uncooperative borrower, it is advisable to pursue foreclosure because a deed-in-lieu transaction requires the lender to take title subject to all liens and encumbrances. Title obtained through judicial or non-judicial foreclosure is free from any junior liens and other interests subordinate in priority to the deed of trust. In most instances when a client pursues a deed-in-lieu agreement, Counsel should advise a dual track pursuit with a foreclosure action.

A few cautionary notes: The title policy that is issued upon recording of the grant deed in a deed-in-lieu situation will contain exclusions from coverage relating to creditors' rights issues, which expose the lender to risks arising from "borrower's remorse." For example, Borrower might file a bankruptcy following the deed-in-lieu transaction in an attempt to recover the property. Accordingly, Counsel should request and review all endorsements to the title policy prior to closing. Lender should obtain an owner's policy of title insurance on conveyance of title to lender resulting from either a foreclosure or a deed-in-lieu transaction. The deed-in-lieu agreement should contain a "no merger" clause so that loan documents and the secured obligations remain in full force and effect after the closing of the deed-in-lieu transaction. In this way, after the deed-in-lieu closing, the lender can foreclose on its loan to eliminate any junior liens discovered on title. Finally, the parties to a deed-in-lieu transaction should be aware that the transaction otherwise looks like a sale of real property and might involve transfer taxes and escrow costs.

H. Receiverships and Judicial Foreclosure

A foreclosing lender's strategy may include seeking a court-ordered receiver or judicial foreclosure. In California, a judicial foreclosure typically is used only when the Buyer is seeking recourse against Borrower for an anticipated deficiency, or to resolve particular issues that require litigation.

1. Assignment of Rents

Post-default, the Buyer can enforce an assignment of rents by taking one or more enforcement steps, including: (i) appointment of a receiver; (ii) taking possession of the rents; (iii) delivering a written demand for rents to one or more of the tenants; and (iv) delivering to Borrower a written demand for the rents.[44] Rents received are applied to the debt or otherwise in accordance with the assignment of rents or other loan documents. It is important to note that taking the rents from a property may result in Buyer being deemed a "mortgagee-in-possession" with certain obligations to the property's tenants. Buyer should be mindful that if Buyer receives all of the rents, Borrower may have no other source for operating expenses associated with the property (e.g., utilities, maintenance, etc.).

When foreclosure is initiated on a construction loan project, apartment building, hotel, or other income producing project, the appointment of a receiver is often advisable. Buyer can seek the appointment of a receiver if the deed of trust or other loan documentation contains an "assignment of rents" clause, regardless of the adequacy of the security.[45] To get a receiver appointed, Buyer must file an action against Borrower for specific performance of the assignment of rents clause or as part of a judicial foreclosure.[46] Alternatively, a lender and Borrower may stipulate to the appointment of a receiver. The stipulation must be filed as part of a court action as a court order is required to confirm the receivers' appointment and duties.

2. Understanding the Borrower

Understanding Borrower is a key element in deciding when to seek the appointment of a receiver. A loan may be distressed not only due to market conditions, but also as a result of Borrower's actions. Borrower may simply not be the best operator of the subject asset. Buyer may also decide Borrower is untrustworthy or that there are potential third-party liabilities, in which case the appointment of a receiver is recommended. The appointment of a receiver provides certain protections because the receiver is an agent of the court and not of the lender. Receivers not only collect rents and manage properties, but can also conduct court-approved sales of assets.

The appointment of a receiver is authorized by certain provisions in a variety of documents. Construction loan agreements and workout agreements sometimes contain provisions authorizing the lender or a receiver to complete improvements in the event of default.[47] So long as the provisions authorize the appointment of a receiver for the purpose of completing improvements and state the completion of improvements pending a foreclosure sale is necessary to preserve and protect the value of the real property security, then the court will likely appoint a receiver to complete improvements upon the lender's request.

Generally, a receiver may do anything with the assets of the receivership estate that the Borrower could have done, subject to the terms of the order of appointment.[48] To complete the work, Buyer (now as the lender) typically advances funds to the receiver authorized through the court. These advances are evidenced by "receiver's certificates" and are the equivalent of a secured advance to the underlying loan.

I. Pursuing the Guarantor

The presence of a well-drafted guaranty throughout the workout process will aid Buyer in obtaining Borrower's coopera-

tion and be helpful in pursuing a deficiency judgment. Buyer may "double-track" by filing both a judicial and non-judicial foreclosure. Each type of foreclosure has its benefits and drawbacks. The majority of foreclosures in California are non-judicial.

Buyer may use the judicial foreclosure to seek appointment of a receiver and add a cause of action to the complaint against the guarantors. Filing a judicial action is expensive and may not be necessary depending on the circumstances and asset class. But, a non-judicial sale may render the guaranty unenforceable unless Buyer has taken certain steps to preserve the guaranty or the guaranty contains proper waivers.[49]

Upon satisfaction of guaranty obligations, a guarantor is subrogated to the rights of the original lender, Seller, against Borrower. Once a guarantor pays the guaranty, it may then seek reimbursement from Borrower. After a non-judicial foreclosure sale, however, a guarantor is precluded from obtaining reimbursement from Borrower because the collateral has been sold.[50]

The suretyship provisions of the California Civil Code effectively require that the lender first seek to recover against the property before pursuing the guarantor. When a guaranty agreement contains express waivers of the relevant suretyship defenses provisions because the guaranty is deemed to be an obligation separate and distinct from the underlying debt, the lender may proceed directly against the guarantor without first exhausting its remedies against the borrower. A state of the art guaranty will contain a so-called "Gradsky waiver," in which the guarantor waives any and all subrogation rights. Such waivers are expressly enforceable and broadly construed. A lender may procure a valid waiver of the guarantor's suretyship defenses, but not of the borrower's anti-deficiency protections. Many guaranty agreements drafted in recent years contain waivers, however it is incumbent on Counsel to review and confirm that the full complement of waivers is included in the guaranty agreement.[51]

If Buyer wishes to continue an action against the guarantor following a foreclosure sale, Buyer should tender the loan to the guarantor for full payment prior to the sale to preserve its deficiency under the guaranty. If the guarantor refuses the tender, that refusal establishes a factual waiver to the defense that the foreclosure destroyed the guarantor's subrogation rights.[52]

J. Taking Ownership

Before Buyer takes title to property of any asset class, Buyer should obtain specific insurance policies that cover construction defects and other general liabilities, particularly when there is pending construction and possible sales of residential condominiums to consumers. Naming Buyer as an additional insured on Borrower's original policy will not be sufficient. Insurance policies covering construction defects should also include the ten-year "tail" component mandated by Code of Civil Procedure section 337.15. Further, even though Seller's title insurance survives a foreclosure, Buyer should purchase an owner's policy insuring title when it takes title on the closing of a deed-in-lieu agreement or foreclosure sale.

IV. BANKRUPTCY ISSUES

A. Effect of Borrower's Bankruptcy on Enforcement of Debt

Distressed debt acquisitions often involve distressed borrowers. Distressed borrowers may resort to filing for bankruptcy. While this article is not meant to be an inclusive piece on bankruptcy law, Counsel and buyers should be mindful of some material issues a Borrower's bankruptcy filing might cause. Counsel should be aware of the major issues and assist Buyer in retaining competent bankruptcy counsel.

Clients often ask lawyers to draft clauses in forbearance or pre-negotiation agreements to procure the Borrower's agreement not to file bankruptcy. However, agreements made in advance to waive the automatic stay under the Bankruptcy Code are generally deemed invalid as a restraint against filing bankruptcy, which is in violation of public policy.[53] Buyer should factor into its underwriting analysis the cost of protracted bankruptcy litigation. Several key facts will affect a lender's ability to obtain relief from the automatic stay to enforce its rights under the loan documents.[54]

B. The Automatic Stay

When a debtor files for bankruptcy protection, an automatic stay under Bankruptcy Code section 362 immediately stops any action by the lender to collect the debt or enforce the lender's rights to foreclose on the real property. The purpose of the stay is to give the debtor time to liquidate or reorganize for the benefit of all its creditors.[55]

The automatic stay under section 362[56] temporarily freezes most lender efforts to recover property or take other legal action. The stay blocks litigation, lien enforcement, and other lender self-help remedies.[57] However, a lender may seek a court order allowing relief from the stay to proceed against specific property in certain circumstances. Lenders should plan on no less than 60

to 120 days to get relief from the automatic stay. The actual period of time may be much longer in instances where there is equity or the debtor can prove the lender is adequately protected.

C. Can the Lender Get Relief from the Automatic Stay?

After the debtor files for bankruptcy and the automatic stay is in effect, the Bankruptcy Code provides four possible grounds for obtaining relief from the automatic stay.[58]

1. Lack of Adequate Protection

Lender can establish lack of adequate protection of its interest in the property by showing erosion in the value of the collateral resulting from declining market values, unpaid real property taxes, waste, deferred maintenance, or failure to maintain adequate insurance.[59] Defenses developed by debtors include the ability to make periodic cash payments or bringing in new cash investment to the extent of the decrease in value of the property.[60]

2. Debtor Holds Insufficient Equity and the Property Is Not Necessary to an Effective Reorganization[61]

Lender bears the burden of establishing whether the debtor has equity in the property. If the debtor has no equity in the property and has little or no chance of successfully reorganizing, there is no reason to delay a secured lender's enforcement of its rights, even if the lender's interest in the property is adequately protected for the moment. On the other hand, if there is significant equity in the property, maintaining the stay gives the debtor an opportunity to maximize the value of the property for its unsecured creditors and interest holders, either through orderly liquidation or retention of the property under a confirmed plan.[62] If the property is necessary for reorganization (that is, it generated significant cash flow to support the asset and provide additional cash to assist debtor's reorganization effort), then a lender needs to be concerned about a "cram-down" — that is, the approval of a plan without the lender's consent — particularly if the asset value is less than the total lien. The fact that the property's market value is less than the total lien does not mean that relief from stay is automatic. Current and future projections of cash flow are equally important from the debtor's and the court's perspective.

3. Single Asset Real Estate Cases[63]

As part of the 2005 amendments to the Bankruptcy Code, Congress made it harder for a single asset real estate borrower to use bankruptcy to protect itself from a foreclosing creditor. In theory, it should not be difficult to assess the business of a single asset real estate venture and propose a plan. As a result, a lender may obtain relief more quickly from the automatic stay than if the debtor has multiple assets. In a single asset real estate case, the debtor must take one of two actions within 90 days after the petition date: (i) file a plan of reorganization that the court believes has a reasonable possibility of being confirmed within a reasonable time; or (ii) make monthly payments to the secured creditor in an amount equal to interest at the non-default contract rate on the portion of the claim secured by the real property.[64] The 90-day period can be extended by the bankruptcy court for cause, otherwise this deadline effectively *fast-tracks* a single asset real estate case.

4. A Scheme to Delay and Defraud Creditors

The bankruptcy filing may be part of a scheme to delay and defraud the lender, involving a transfer of the real estate without lender or court consent, multiple bankruptcy filings affecting the property, or simply the debtor's bad faith.[65] Sometimes debtors become serial bankruptcy filers to prevent foreclosure. When there is only a short period between the dismissal of a prior bankruptcy case and the filing of a new petition, some courts have required debtors to show there has been a change in circumstances justifying the new case.[66] In other instances, Borrower may transfer a percentage interest in title to one or more third parties who, in turn, file petitions for relief under Chapter 7 or 11 of the Bankruptcy Code. Typically in such a case, the "debtor" in bankruptcy is a fictitious person or business entity that files a "bare bones" petition with incomplete schedules and exhibits. The bankruptcy court can issue an "in rem" order for relief that, upon recordation in the real property records, acts as a complete relief from stay with respect to the property, even as to other future bankruptcy filings. It may take two or even three such cases to be filed before the court will enter such an order.

D. Settling the Automatic Stay Litigation

As with any litigation, there is the possibility of settling with the debtor during the automatic stay. The lender can negotiate a stipulation with the debtor or trustee modifying the automatic stay, which might include "drop dead" dates or periodic protection payment agreements. Any such stipulation is, of course, subject to approval by the bankruptcy court after notice to other creditors and the U.S. Trustee's office. With "drop-dead" date agreements, a lender and debtor can

execute an agreement allowing the lender the freedom to foreclose if the debt is not paid in full or reinstated by a stipulated date certain — the "drop-dead date".

A lender and the debtor can also agree on a schedule of periodic adequate protection payments or use of cash collateral through a stipulated order terminating the stay, whereby the lender agrees to refrain from enforcing the loan documents conditioned on receipt of the agreed payments and the debtor's use of cash proceeds according to a specified budget. Cash collateral agreements can be very useful in protecting lender's interest in proceeds from a business or property.

E. The Effect of Lender Involvement in Debtor's Business

Finally when a lender becomes heavily involved in the management of its debtor's affairs, the lender is at risk of being treated as an "insider" if Borrower files bankruptcy.[67] In such a case, payments made to the lender may be attacked as being preferential, and the bankruptcy court may also subordinate the claims of the lender to those of other creditors.[68]

V. CONCLUSION

A buyer must consider many issues in the acquisition of distressed real estate secured debt. A transaction may take many months to complete resulting in significant legal and due diligence costs for Buyer. Nonetheless, the acquisition of distressed real estate debt can be profitable for clients, as well as an enjoyable professional challenge for the real estate practitioner, so long as there is an approach and strategy that anticipates the full lifecycle of the transaction and accounts for the risks inherent therein. ■

ENDNOTES

1 In this Article, the bank or other institution selling the loan is referred to as "Seller," its borrower as "Borrower," the purchaser/client as "Buyer," and Buyer's counsel as "Counsel."

2 *See infra* Part II.B.

3 Cal. Civ. Proc. Code § 726; *Bank of Am. v. Daily*, 152 Cal. 3d 767 (1984) (discussing lender set off).

4 Several good examples can be found in section 10.2 of Roger Bernhardt et al., California Mortgages, Deeds of Trust, and Foreclosure Litigation (CEB 4th ed. 2003); *see also* Joshua Stein, A Guide to Troubled Commercial Real Estate Loans for Lenders and Borrowers (LexisNexis 2010). Stein's guide is written in a more casual format, however, he provides several checklists that may be helpful.

5 *See In re Hwang*, 396 B.R. 757 (Bankr. C.D. Cal. 2008); *In re Vargas*, 396 B.R. 511 (Bankr. C.D. Cal. 2008). In *HSBC Bank USA, N.A. v. Valentin*, 2008 WL 4764816 (Table) (N.Y. Super. 2008), the New York court dismissed a foreclosure action because, even though given an opportunity to, plaintiff had not proved the ownership of debt and mortgage. The complaint was dismissed with prejudice, and the "notice of pendency" against the property was cancelled.

6 Cal. Civ. Code § 2938.

7 *Id.* § 2856(a)-(d); *Union Bank v. Gradsky*, 265 Cal. App. 2d 40 (1968); *see also Mariners Sav. & Loan Ass'n v. Neil*, 22 Cal. App. 3d 990 (1971).

8 Cal. Civ. Proc. Code § 726(a).

9 *In re Prestige Ltd. P'ship-Concord v. East Bay Car Wash Partners,* 234 F.3d 1108, 1115 (9th Cir. 2000).

10 For a set of model waivers, see Michael T. Andrew et al., California Real Estate Finance Practice: Strategies and Forms § 6.58 (CEB 2000).

11 *Gradsky*, 265 Cal App. 2d at 40.

12 For an in-depth discussion of the One Action Rule and anti-deficiency issues, see Charles A. Hansen, *Wielding the Two-Edged Sword: What Every Attorney Needs to Know about Real Property Secured Transactions*, pt. II *Enforcing Trust Deeds*, 22 CEB Real Prop. L. Rep. 159 (July/Aug. 1999). For discussion about the enforcement of Nonrecourse Carve-Out Guaranties, see Gregg Loubier & Joshua del Castillo, *The New Age of Real Estate Loan Defaults*, 31 CEB Real Prop. L. Rep. (Jan. 2008).

13 *United States v. Fleet Factors Corp.*, 901 F.2d 1550, 1557 (11th Cir. 1990). *Fleet Factors* applied the "active participation test," but it was later criticized when the Ninth Circuit Court of Appeals held that there "must be some actual management of the facility" before a lender falls outside of a creditor's exemption. *In re Bergsoe Metals Corp.*, 910 F.2d 668 (9th Cir. 1990).

14 Cal. Civ. Proc. Code § 736.

15 *River Colony Estates Gen. P'ship v. Bayview Fin. Trading Group*, 287 F. Supp. 2d 1231 (S.D. Cal. 2003). A cause of action for aiding and abetting breach of fiduciary duty was supported by loan purchaser's knowledge that original lender failed to disclose materials differences in interest rate and other loan terms coupled with substantial assistance given by purchaser in lending process.

16 Cal. Civ. Code § 2941.9 provides in part that "All holders of notes secured by the same real property…may agree in writing to be governed by the desires of the holders of more than 50 percent of the record beneficial interest…."

17 I.R.C. §§ 860D-860G; Treas. Reg. § 1.860G-2 (2009).

18 *K.M.C. Co. v. Irving Trust Co.*, 757 F.2d 752 (6th Cir. 1985). Although the lender was not required to give notice under the loan documents, the jury was instructed that the obligation of good faith and fair dealing may

require the lender to do so upon advancing funds due under the loan documents.

19 *Lopez v. Bell*, 207 Cal. App. 2d 394 (1962).

20 *Conner v. Great W. Sav. & Loan Ass'n*, 69 Cal. 2d 850 (1968). Lender held liable for defective tract homes for failing to properly supervise construction of a project it had financed.

21 *Fischer v. First Int'l Bank*, 109 Cal. App. 4th 1433 (2003).

22 *K.M.C. Co. v. Irving Trust Co.*, 757 F.2d 752 (6th Cir 1985).

23 *Price v. Wells Fargo Bank*, 213 Cal. App. 3d 465 (1989).

24 *Commercial Standard Ins. Co. v. Bank of Am.*, 57 Cal. App. 3d 241 (1976).

25 *Sumitomo Bank v. Iwasaki*, 70 Cal. 2d 81(1968).

26 Cal. Civ. Code § 3136.

27 *Id.* § 3134.

28 *Id.* §§ 3156-3176.5.

29 *Id.* § 3434.

30 *Id.* § 2924c(a)(1). The right of reinstatement applies only to a failure to pay, which may in turn mean that this right is not afforded to non-monetary defaults.

31 *See infra* Part IV.

32 *Connor v. Great W. Sav. & Loan Ass'n*, 69 Cal. 2d 850 (1968).

33 *K.M.C. Co. v. Irving Trust Co.*, 757 F.2d 752 (6th Cir. 1985).

34 *Barrett v. Bank of Am.*, 183 Cal. 3d 1362 (1986).

35 *Auerbach v. Great W. Bank*, 74 Cal. App. 4th 1172 (1999).

36 *Phoenix Mut. Life Ins. Co. v. Shady Grove Plaza Ltd.*, 734 F. Supp. 1181, 1190 (D. Md. 1990), *aff'd* 937 F.2d 603 (4th Cir. 1991).

37 Cal. Civ. Code §1542.

38 *Tully v. World Sav. & Loan Ass'n*, 56 Cal. App. 4th 654, 659 (1997).

39 Cal. Civ. Code § 2819; *V.I.P. Agency v. Duffy Elec. Inc.*, 92 Cal. App. 3d 849 (1979). The change of timing of required payments exonerated the guarantor.

40 *Lennar Ne. Partners v. Buice*, 49 Cal. App. 4th 1576 (1996); *Gluskin v. Atl. Sav. & Loan Ass'n*, 32 Cal. App 3d 307, 314 (1973).

41 *Sys. Inv. Corp. v. Union Bank*, 21 Cal. App. 3d 137 (1971).

42 *Id.* at 153.

43 The topic of bidding strategies is beyond the scope of this Article, but practical advice can be found in Hansen, *supra* note 12.

44 Cal. Civ. Code § 2938(c).

45 Cal. Civ. Proc. Code § 564(b)(11)-(12) permits the appointment of a receiver if loan documentation contains an assignment of rents clause stating that on default the lender may take possession of the rents, issues, or profits of the mortgaged property without regard to the adequacy of the security.

46 *Id.*

47 *Id.* § 2927.

48 *Pacific Ry. v. Wade*, 91 Cal. 449 (1891).

49 *See infra* Part II.D.5.

50 *Union Bank v. Gradsky*, 265 Cal. App. 2d 40 (1968).

51 For a set of model waivers, see *Andrew*, *supra* note 10, § 6.58 *et seq.*

52 *Mariners Sav. & Loan Ass'n v. Neil*, 22 Cal. App. 3d 232 (1971). This article has only provided a brief discussion on this topic of deficiency judgments against a guarantor. The topic could consume an entire publication and often does. For an in-depth discussion of the One Action Rule and anti-deficiency issues, see Hansen, *supra* note 12, at pt. II *Enforcing Trusts Deeds*. For more discussion about the enforcement of Nonrecourse Carve-Out Guaranties, see Loubier & del Castillo, *supra* note 12.

53 *See In re Pease*, 195 B.R. 431, 433 (Bankr. D. Neb. 1996); *In re Jenkins Court Assocs. Ltd. P'ship*, 181 B.R. 33 (Bankr. E.D. Pa. 1995) .

54 The following sections refer to Borrower as the "debtor" and the Buyer as "lender."

55 H.R. Rep. No. 95-595, at 340 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6296-97.

56 11 U.S.C. § 362(a). *Compare* 11 U.S.C. § 362(a) *with* 11 U.S.C. § 303(h) (providing for an involuntary bankruptcy case, where the order for relief is not entered until after the petitioners have proved their case at trial).

57 11 U.S.C. § 362(a); *see also Far Out Prod., Inc. v. Oskar*, 247 F.3d 986 (9th Cir. 2001); *Contractors' State License Bd. v. Dunbar (In re Dunbar)*, 245 F.3d 1058 (9th Cir. 2001).

58 11 U.S.C. § 362(d).

59 *Id.* § 362(d)(1).

60 *Id.* § 361.

61 *Id.* § 362(d)(2).

62 *In re Avila*, 311 B.R. 81 (Bankr. N.D. Cal. 2004).

63 Defined in 11 U.S.C. § 101(51B) as "real property constituting a single property or project, other than residential real property with fewer than 4 residential units, which generates substantially all of the gross income of a debtor who is not a family farmer and on which no substantial business is being conducted by a debtor other than the business of operating the real property and activities incidental [thereto]."

64 11 U.S.C. § 362(d)(3).

65 *Id.* § 362(d)(4).

66 *Id.* § 362(c)(3)-(4); *see also In re Fuhrman*, 118 B.R. 72 (Bankr. E.D. Mich. 1990); *In re Garsal Realty, Inc.*, 98 B.R. 140 (Bankr. N.D.N.Y. 1989).

67 11 U.S.C. § 101(31).

68 *Id.* § 510(c).