

Navigating Foreclosure in States with “One-Action Rules”

Late last year, the New York Supreme Court decided *172 Madison (NY) LLC v. NMP Grp., LLC*,¹ in which it examined New York’s one-action rule, a complex and often misunderstood rule that can have huge implications for lenders providing or servicing loans secured by real property in jurisdictions that have such rules, such as New York and California. This article provides background on the one-action rule and other anti-deficiency statutes before analyzing the holding in *172 Madison*. It



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Savvy lenders understand the many risks attendant with financing business loans in today’s markets. They use a number of tools and strategies to mitigate their risk of loss on these loans, including personal guaranties and asset collateralization. A personal guaranty is an unsecured

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rule that can have huge implications for lenders providing or servicing loans secured by real property in jurisdictions that have such rules, such as New York and California. This article provides background on the one-action rule and other anti-deficiency statutes before analyzing the holding in *172 Madison*. It then examines the rule’s application in other jurisdictions, and provides some practical tips for lenders that operate in one-action rule States.

I. Background



Asset collateralization is the process by which a borrower pledges some asset as collateral to secure the loan.

promise by an individual (who is typically closely associated with a business seeking a loan) to make loan payments in the event the business is unable to do so.² Generally, if the borrower defaults on its loan, then the lender can file suit against both the borrower and the guarantor to recover the remaining balance of the debt.

Asset collateralization is the process by which a borrower pledges some asset as collateral to secure the loan. This collateral can be of almost any nature, from equipment, inventory, accounts receivable and deposit accounts, along

with many other types.³ Loans that are secured by collateral are called secured loans, and the most common form of collateral for a secured business loan is real property. Thus, in the event of nonpayment or other contractual breach of a secured loan agreement, the lender becomes entitled to seize and sell the collateral and apply the proceeds of the sale against the debt, a process called foreclosure. In most states, a lender of a secured loan may proceed with an action against the borrower on the debt as well as maintain a foreclosure action against the collateral at the same time.

However, even with these safeguards in place, lenders often face a number of procedural hurdles when attempting to collect on a secured debt, especially when the collateral is real property.

This is because, in most cases, a foreclosure sale of the collateral does not generate sufficient proceeds to fully satisfy the underlying debt.⁴ Any remaining balance on the debt after a foreclosure sale is considered a “deficiency.” However, many states restrict (or outright proscribe) a lender’s ability to collect a deficiency judgment after a foreclosure sale through their anti-deficiency statutes. This limits the types of “recourse” available to lenders when attempting to collect a deficiency judgment after a foreclosure sale. When a jurisdiction’s anti-deficiency statute or the terms of a loan agreement prevent a lender from suing on the debt after a foreclosure sale of real property, the jurisdiction or instrument is considered “non-recourse.”

In other words, if a loan is non-recourse, or the terms of the loan agreement are governed by a non-recourse jurisdiction, then a lender will be prohibited from suing the borrower individually on the debt if it has already initiated a foreclosure action against the collateral. Thus, in non-recourse states,⁵ a lender has no recourse against a borrower personally if they have already begun foreclosure proceedings against the collateral securing the loan.

In addition to anti-deficiency statutes, several states have enacted “one-action rules.”⁶ One-action rules have two elements: (1) the lender must pursue foreclosure before taking any other action against the borrower to recover the debt, and (2) all the security must be exhausted before the lender may sue the borrower directly on the debt.⁷ The purpose of one-action rules is to “prevent multiple actions by a lender against a debtor on a single debt; compel

exhaustion of all security before allowing a deficiency judgment; and to ensure that debtors are credited with the fair market value of the secured property before they are subjected to personal liability.”⁸ The only recognized exception to this rule is where the secured lender chooses to judicially foreclose its mortgage or deed of trust.⁹ In such cases, the lender “may assert both a claim for judicial foreclosure and a claim for personal judgment, both in the ‘one-action.’”¹⁰ In this way, one-action rules operate as a type of anti-deficiency statute. Several states have enacted one-action rules, including California, Idaho, Michigan, Montana, Nevada, New York, and Utah.¹¹

Violating the one-action rule leaves lenders vulnerable to heavy sanctions, which include the potential loss of their secured status in the lien’s collateral.¹² Importantly, courts have adopted a functional approach to determining whether a lender’s actions are considered “other action” that would run afoul of the rule. While obtaining a judgment in a lawsuit to recover the debt would certainly meet the definition of “other action,”¹³ a “threshold consideration (but not the only one) in determining whether given conduct that is not on its face ‘judicial action’ may violate the one-action rule is whether such conduct attempts to realize upon assets of a borrower that are not part of the collateral securing the debt.”¹⁴ For example, certain behavior, such as exercising a setoff right against a borrower’s unpledged accounts, may violate the one-action rule.¹⁵ A lender must therefore ensure that its enforcement conduct is carefully tailored so as not to violate the one-action rule.

Furthermore, several jurisdictions have determined that the one-action rule is “susceptible of a dual application—it may be interposed by the debtor as an affirmative defense, or it may become

operative as a sanction.”¹⁶ In other words, violating the rule vests in the borrower an affirmative defense against the action, and raising that defense compels the lender to foreclose on the collateral prior to initiating a suit on the debt.¹⁷ Alternatively, if the borrower chooses not to assert the defense, it may still be used as a sanction against the lender on the basis that the lender, in foregoing foreclosure on the collateral in the action brought to enforce the debt, has effectively made an election of remedies and waived its security interest in the collateral.¹⁸

The one-action rule does not generally prevent a secured lender from filing a complaint and obtaining a judgment against a guarantor or other secondary obligor prior to foreclosing on real property collateral securing the guaranteed indebtedness.¹⁹ However, as was the case in *172 Madison (NY) LLC v. NMP Grp., LLC, infra*, if the underlying loan was non-recourse, then lenders in one-action rule jurisdictions may not be able to commence an action against the guarantor unless the loan contains a springing recourse carve out guaranty provision.

II. *172 Madison LLC v. NMP Group, LLC*

In *172 Madison*, UBS Real Estate Securities, Inc. (“UBS”) financed a \$29 million non-recourse loan to defendant NMP-Group, LLC, the (“Borrower”).²⁰ This loan was secured by a mortgage on the property at 172 Madison Avenue in New York City.²¹ The loan also contained a recourse carve-out guaranty provision (the “Guaranty”) that imposed personal liability on Natalia Pirogova, Borrower’s sole member, under certain circumstances. Particularly, Pirogova promised that she would be liable for the full amount of the debt in the event that Borrower filed a voluntary petition for bankruptcy.²²

This case commenced in February 2010, when UBS's predecessor-in-interest, who was the noteholder at the time, claimed that Borrower had defaulted on the loan.²³ As a result, the lender sought to foreclose on the mortgaged property.²⁴ After several months, the court granted summary judgment to UBS's predecessor-in-interest in the foreclosure proceeding, ordering that the property be sold at a public auction.²⁵

However, Borrower filed a voluntary petition for bankruptcy on the scheduled date of sale, which prevented the auction from being held.²⁶ UBS then moved for summary judgment against Pirogova, arguing that Borrower's filing of the bankruptcy petition triggers liability under the springing recourse provision of the Guaranty for the entire amount owed on the loan under the foreclosure judgment.²⁷

The court first considered Pirogova's liability under the Guaranty.²⁸ It noted that recourse carve-out Guaranty provisions are primarily created to deal with this exact situation.²⁹ In these circumstances, the lender agrees to only look to the mortgaged property in the event of default as long as the borrower and/or guarantor promises to pay for the entire debt if they impede foreclosure on the mortgaged property by filing for bankruptcy.³⁰ The court held the loan agreement to be unambiguous, including Pirogova's liability under the Guaranty for the entirety of the debt.³¹

Having established the validity of the loan and Guaranty, the court next considered the application of New York's one-action rule.³² While it noted that the one action rule generally bars an action on the debt once a lender has elected to foreclose a mortgage, "[t]he election of remedies doctrine only operates when there was a choice of remedies available at the time the prior actions were undertaken."³³ In other

words, when the lender first considered foreclosure, the option to recover the balance of the debt from the Guarantor was unavailable because Borrower had not yet filed for bankruptcy, and so the springing recourse provision had not yet been triggered.³⁴ As such, lender did not have an election of remedies available to it prior to initiating foreclosure.

As a result, the court held that, when a lender has contractually agreed to limit its remedies to foreclosure, subject to the borrowing parties' compliance with certain loan covenants, and the borrowing parties breach those covenants only after the commencement of foreclosure proceedings, New York's one action rule will not bar the lender from seeking alternative relief at that point. As additional support for its holding, the court also noted in dicta that, in this case, the Borrower filed for bankruptcy with Pirogova's full knowledge and consent.³⁶

However, despite holding that UBS's actions do not violate the one-action rule, the court stated that a "choice between the two remedies must ultimately be made."³⁷ As a result, UBS now had a choice between foreclosing on the property at 172 Madison Avenue and pursuing the Guarantor for a deficiency judgment or vacating the foreclosure judgment and substituting it with a money judgment against Guarantor.³⁸

This decision affects how lenders attempt to collect on defaulted debts. Lenders should be aware of states' one-action rules and how they can limit their remedies in the event a borrower defaults on its loan. Timing is incredibly important, as the lender in *172 Madison* could have lost its secured interest in the property if it had attempted to collect from the borrower or guarantor prior to the borrower's filing for bankruptcy. New York is not the only state with a

one-action rule; however, and this next section examines the operation of one-action rules in other jurisdictions.

III. One-Action Rules in Other Jurisdictions

Several other jurisdictions have adopted one-action rules, too. Of these, many have modeled their one-action statutes after California's one-action rule,³⁹ which places limits on lenders' ability to enforce and collect debts that are secured by real property located in California.⁴⁰ It specifically provides: "[t]here 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."⁴¹

Like New York's rule, California's one-action rule requires lenders to exhaust the entirety of their real property security before suing on the underlying debt or before taking other judicial action to collect against any of the borrower's unpledged assets.⁴² This has important implications for lenders. For example, California courts generally apply the one-action rule whenever the real property collateral is located in California, even if the parties elected the law of another jurisdiction to govern the terms of the loan. California courts have also held that explicit waivers of the one-action rule are unenforceable, and will void any clause that is construed as an implicit waiver of the rule.⁴³

As a result, an unwary lender may inadvertently implicate a State's one-action rule—for example, if a lender acquired a blanket security interest in all of a borrower's assets, and the borrower owned or leased real property in California, then any attempts to collect on the debt directly prior to foreclosing on the California real property could violate the one-action rule, and the lender could lose its secured status in the California property.⁴⁴

The issue becomes even murkier when the terms of the loan create security interests in collateral across several jurisdictions, one of which has a one-action rule. This is because one-action rule states, like California, have held that a judicial action *in any other state* can violate the one-action rule in California.⁴⁵ Thus, a lender could inadvertently trigger a State's one-action rule simply by bringing an action to recover the debt in a different state.⁴⁶ A lender must therefore foreclose on California real property prior to obtaining a judgment on the debt in another jurisdiction. Failure to do so could result in a lender's loss of its secured position in the California real property.⁴⁷

However, California courts have placed limits on using the one-action rule as a sanction. In *Security Pacific Nat'l Bank v. Wozab*,⁴⁸ the California Supreme Court held that a lender should not be subjected to the double sanction of losing both its security interest in its collateral and the underlying debt.⁴⁹ Such a holding would create a windfall for the borrowers, who would receive all of the benefits of their bargain with their lender while incurring none of the obligations, and would therefore create an inequitable outcome.⁵⁰

Notably, in California, the one-action rule and other anti-deficiency statutes in the State generally do not apply to entities with a secondary obligation on the debt, such as guarantors, unless the secondary obligation is also secured by California real property.⁵¹ As such, lenders typically foreclose on real property located in California by nonjudicial foreclosure while preserving the right thereafter to pursue a guaranty claim in a separate jurisdiction. In fact, subject to restrictions in other jurisdictions, a lender may initiate foreclosures in those other jurisdictions prior to or concurrent with the

California nonjudicial foreclosure, provided that the lender does not obtain a *judgment* in these other jurisdictions prior to the completion of the trustee sale in California.⁵² This can be a risky strategy; however, as obtaining a judgment prior to the execution of the trustee sale in California can cause a lender to lose its secured status with respect to the California property for violating the one-action rule.

IV. The One-Action Rule and Nonjudicial Foreclosure

A lender could react to the election of remedies restrictions imposed by New York and other jurisdictions' one-action rules and conclude that it could potentially sidestep the rule by strictly adhering to a state's nonjudicial foreclosure requirements, as this would not be considered an "other action" for purposes of the rule in most jurisdictions. Not so fast. This approach should also be pursued with caution because several jurisdictions have held that, where the indebtedness of a mortgage note includes "guaranties," the one-action rule can apply to prevent a lender from nonjudicially foreclosing on the collateral while concurrently suing the guarantors on the debt.⁵³

For example, in *Greenville Lafayette, LLC v. Elgin State Bank*,⁵⁴ the lender attempted to nonjudicially foreclose on collateral that secured a \$1.8 million dollar commercial loan that was also secured by two separate commercial guaranties.⁵⁵ However, prior to initiating the foreclosure sale, Elgin had instituted an action to recover the balance from the guarantors. In response, the borrower asserted that the foreclosure violated Michigan's one-action rule and requested an injunction to stay the sale.⁵⁶

The court in *Greenville* noted precedent from the Sixth Circuit case of *U.S. v. Leslie*,⁵⁷ which stated that under Michigan law, "a lender generally

may simultaneously proceed against a guarantor and foreclose on a mortgaged property because the guaranty is an obligation separate from the mortgage note."⁵⁸ However, the court distinguished the mortgage at issue in *Greenville* from the mortgage in *Leslie* because the former provided that it was "given to secure" payment of the "indebtedness," which was defined to include all guaranties.⁵⁹ As a result, the court reasoned that an action against the guaranties in this case was an action to recover the debt, and so initiating a foreclosure sale while suing to "recover the debt" against the guarantors effectively violated Michigan's one-action rule.⁶⁰

The upshot of *Greenville* is that lenders who wish to retain the ability to file suit against the personal guarantors and simultaneously nonjudicially foreclose on real property securing the debt should make certain that the relevant mortgage documents do not define "indebtedness" or "debt" to include "guaranties."⁶¹

V. Conclusion

The one-action rule is widely misunderstood by lenders and borrowers alike. Because real property frequently serves as security for commercial loans, lenders should be aware of how their attempts to foreclose on collateral or collect on a debt could risk inadvertently violating the rule. Recent court decisions, including *172 Madison*, have sought to strike a balance between the competing interests of lenders and borrowers under the rule. Lenders in one-action jurisdictions now have further assurance that their springing recourse carve-out guaranties will be enforceable if the borrower attempts to stall the foreclosure process by filing for bankruptcy. However, lenders may still only pursue a single recovery strategy in one-action states,

either foreclosure on the collateral or suit on the debt. Because failure to do so could result in a loss of secured status, lenders should review their loan agreements to ensure statutory compliance in states with the one-action rule.

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Footnotes for *Navigating Foreclosure in States with "One Action Rules"*

¹⁴⁴ Misc. 3d 1208(A), 977 N.Y.S.2d 668 (Sup. Ct. 2013).

²David Hague, *What Every Guarantor Should Know about the One-Action Rule and Deficiency Actions*, 41 THE ENTERPRISE 37, at 1 (April 2012).

³ See *id.*

⁴ See *id.*; see also Mark S. Pécheck and Kelsey M Lestor, *The ABCs of California Foreclosure Law*, LOS ANGELES LAWYER, at 13 (Jan. 2012).

⁵ Alaska, Arizona, California, Connecticut, Hawaii Idaho, Minnesota, North Carolina, North Dakota, Texas, Utah, and Washington are considered non-recourse states. See Ralph Thompson, *Non-Recourse and Recourse States List*, FORECLOSED DREAMS, (last visited Feb. 17 2014), http://www.forecloseddreams.com/recourse_states.

⁶ These are interchangeably called "single-action rules."

⁷ Pécheck and Lestor, *supra* note 4, at 13.

⁸ John H. Kenney et al., *Beware Calif.'s 'One-Action Rule'*, LAW 360, at *1 (2011).

⁹ Matthew M. Boley, *Utah's "One-Action" Rule*, at 1 (March 2013).

¹⁰ See *id.* However, as was the case in *172 Madison*, if the terms of the loan are non-recourse, then a lender may only foreclose on the collateral. See Part II, *infra*.

¹¹ E.g., *Non-Recourse States – One Action Rule*, REAL INVESTOR TIPS, (Mar. 26 2010), <http://www.realinvestortips.com/blog/short-sale/non-recourse-states-one-action-rule/>.

¹² See Kenney et al., *supra* note 8, at *1.

¹³ E.g., *Kirkpatrick v. Westamerica Bank*, 65 Cal.App.4th 982 (1998).

¹⁴ See Kenney et al., *supra* note 8, at *2.

¹⁵ *Id.*

¹⁶ *Walker v. Community Bank*, 518 P.2d 329, 332 (Cal. 1974).

¹⁷ See Matthew Watson, *Foreclosure in Nevada: One Action Rule*, NEVADA LAWYER, at *1 (Apr. 2010) available at: <http://www.nvbar.org/publications/NevadaLawyer/2009/april/oneaction.htm>.

¹⁸ See Boley, *supra* note 9, at *2 (citing *Walker*, at 332).

¹⁹ See Hague, *supra* note 2 (detailing how one-action rules usually do not protect guarantors from lender's attempts to collect on a debt).

²⁰ See *172 Madison (NY) LLC v. NMP Grp., LLC*, 44 Misc. 3d 1208(A), 977 N.Y.S.2d 668 at *1 (Sup. Ct. 2013).

²¹ See *id.*

²² See *id.*

²³ See *id.*

²⁴ See *id.*

²⁵ See *id.*

²⁶ See *id.*

²⁷ See *id.*

²⁸ While some jurisdictions' one-action rules protect secondary obligors, many one-action jurisdictions do not extend this protection to secondary obligors, such as guarantors or sureties. See *Machock v. Fink*, 137 P.3d 779, 783 (2006), (holding that the one action rule does not apply to suits against guarantors).

²⁹ See *172 Madison* at *2. ("It can be said without exaggeration that the Guaranty was intended to apply to the exact circumstance currently confronting Lender.")

³⁰ See *id.*

³¹ See *id.* (holding that "[t]he agreement, therefore, will be enforced as written").

³² See *id.*

³³ *Id.* (emphasis added).

³⁴ See *id.* ("Here, when the election to foreclose was made, Borrower had not yet filed for bankruptcy, and Lender, thus, had no right to sue for the whole debt or to seek a deficiency judgment at that time.")

³⁶ See *id.* at *3.

³⁷ *Id.*

³⁸ See *id.*

³⁹ See, e.g., *APS v. Briggs*, 927 P.2d 670, 674 (Utah App. 1996) ("California decisions are especially helpful to us in interpreting Utah's one-action statute, because Utah's statute is patterned after California's one-action statute, and because Utah and California have interpreted their one-action statutes almost uniformly.")

⁴⁰ See Kenney et al., *supra* note 8, at *1. Other states that have modeled their one-action statutes after California include: Nevada, see N.R.S. § 40.430 (2013) ("[T]here 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."), and Utah, see Utah Code § 78B-6-901 ("[T]here is only one action for the recovery of any debt or the enforcement of any right secured solely by mortgage upon real estate . . .").

⁴¹ C.C.P. § 726 (2013) (detailing California's one-action rule).

⁴² See *id.*; see also *Prestige Ltd. Pshp. v. East Bay Car Wash Partners (In re Prestige Partnership)*, 234 F.3d 1108 (9th Cir. 2000).

⁴³ See Kenney et al., *supra* note 8, at *2.

⁴⁴ See Kenney et al., *supra* note 8, at *1.

⁴⁵ *Ould v. Stoddard*, 54 Cal. 613 (1880).

⁴⁶ This hold true even if the terms of the loan contain a choice of law provision stating that the laws of a state without a one-action rule govern the instrument. See text accompanying notes 43-46.

⁴⁷ Robert O. Barton, *Foreclosures: California's One Action Rule*, CALIFORNIA LAWYER, at 38 (Dec. 2006).

⁴⁸ 51 Cal. 3d 991 (1990).

⁴⁹ *Security Pacific Nat'l Bank v. Wozab*, 51 Cal.3d, 991, 997 (1990).

⁵⁰ See *id.*

⁵¹ See C.C.P. § 726 (2013); C.C.P. § 580d (2013).

⁵² See Kenney et al., *supra* note 8, at *4.

⁵³ *Greenville Lafayette, LLC v. Elgin State Bank*, 296 Mich. App. 284, 818 N.W.2d 460 (2012); see also Boley, *supra* note 9, at 6 ("Likewise, the 'one-action' rule may apply to and protect a guarantor if, according to the plain language of the deed of trust or mortgage, the obligations secured include the obligation of the guarantor. This is because, by its plain language, the one-action rule applies to 'the recovery of any debt or the enforcement of any right secured solely by mortgage upon real estate . . . ' Utah Code Ann. § 78B-6-901.")

⁵⁴ 296 Mich. App. 284, 818 N.W.2d 460 (2012).

⁵⁵ *Greenville*, at 286, 818 N.W.2d at 461.

⁵⁶ See *id.* at 286, 818 N.W.2d at 462; see also M.C.L. § 600.3204(1)(b) (providing that a foreclosure by advertisement in Michigan can only be instituted if "[a]n action or proceeding has not been instituted, at law, to recover the debt secured by the mortgage or any part of the mortgage; or, if an action or proceeding has been instituted, the action or proceeding has been discontinued; or an execution on a judgment rendered in an action or proceeding has been returned unsatisfied, in whole or in part.")

⁵⁷ 421 F.2d 763 (6th Cir. 1970).

⁵⁸ *Greenville*, at 288, 818 N.W.2d at 463.

⁵⁹ *Id.* at 291, 818 N.W.2d at 464.

⁶⁰ *Id.* at 292, 818 N.W.2d at 465. But see *Canvasser Heritage, L.L.C. v. Fifth Third Bank*, 2012 WL 5853896 (Mich. Ct. App. Nov. 15, 2012) (distinguishing from *Greenville* in allowing concurrent foreclosure against collateral and suit against guarantors because the mortgage documents at issue did not include "guaranties" in its definition of "debt" or "indebtedness").

⁶¹ Jeshua Lauka, *One Action Rule Invalidates Lender's Foreclosure*, JESHUA LAUKA'S BUSINESS AND REAL ESTATE LAW BLOG, (April 27, 2012), <http://jeshualaukalegalnews.wordpress.com/2012/04/27/one-action-rule-invalidates-lenders-foreclosure/>.