

Financial Institutions Law Update

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Washington Court of Appeals Confirms Lenders' Right to Obtain Deficiency Judgments Against Guarantors Following Nonjudicial Foreclosure of Commonly Used Form of Deed of Trust

The Deed of Trust Act generally bars a lender from seeking a deficiency judgment against a borrower following nonjudicial foreclosure of a deed of trust securing the borrower's loan. The Act contains some exceptions in the case of a commercial loan and it expressly permits a lender to seek a deficiency judgment against a guarantor of a foreclosed loan, subject to the guarantor's right to challenge the fair value paid for the property at the trustee's sale. RCW 61.24.100(3)(c), (5). In *Washington Federal v. Gentry*, --- P.3d ---, 2014 WL 627817 (Wash. App. Feb. 18, 2014), a case argued by Lane Powell, Division One of the Washington State Court of Appeals held that the lender's right to seek a deficiency judgment against a guarantor exists even where the foreclosed deed of trust secures both the borrower's loan and the guarantor's guaranty.

The case arose from the borrower LLC's default on a multi-million dollar real estate development loan. The loan was secured by a form deed of trust on the borrower's property (sometimes called a "LaserPro" deed of trust) and personally guaranteed by one of the borrower's principals. The bank nonjudicially foreclosed on the property and then filed a lawsuit against the guarantor for the deficiency. The trial court dismissed the suit. The court ruled that the deed of trust secured both the loan and the guaranty because, among other reasons, the deed defined the term "indebtedness" to include the word "guaranties." The court also ruled that the Deed of Trust Act prohibited a deficiency action against the guarantor because the foreclosed deed of trust secured the guarantor's obligation.

In its published opinion, the Court of Appeals reversed and found for the bank on both issues. Taking the statutory issue first, the court held that the Deed of Trust Act allowed deficiency actions against guarantors of commercial loans and contained no exception for cases where the guaranty is secured by the borrower's foreclosed deed of trust. The court rejected the guarantor's argument that RCW 61.24.100(10) should be construed to imply a prohibition in such cases. On the contractual issue, the court held that, even if it accepted the guarantor's construction of the statute, the bank still would be entitled to a deficiency judgment against the guarantor because the deed of trust did not secure the guaranty. The court concluded that other language in the deed of trust showed that the parties intended the deed to secure only the debts and obligations of the borrower, not a guarantor.

The *Gentry* court noted its disagreement with *First Citizens Bank & Trust Co. v. Cornerstone Homes & Development, LLC*, 314 P.3d 420 (2013), an earlier published opinion issued by Division Two of the Court of Appeals. On similar facts, the *First Citizens* court held that the Deed of Trust Act prohibited the bank from obtaining a deficiency judgment against the guarantor. It is likely that the Washington State Supreme Court will be asked to resolve the apparent conflict between the two opinions.

For more information regarding this matter or loan enforcement strategies in light of the *Gentry* and *First Citizens* decisions, please contact Greg Fox at 206.223.7129, or by email at foxg@lanepowell.com; or Ryan McBride at 206.223.7962, or by email at mcbriider@lanepowell.com.

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