

The Ninth Circuit Strikes a Major Blow to Nevada HOA Purchasers

Lenders and Servicers have been frustrated with Nevada for the last two years for giving HOA's priority status over secured first liens. This has resulted in substantial losses to the mortgage industry and a windfall to speculators and rent skimmers.

On August 12, 2016, the federal Ninth Circuit Court of Appeals stepped in to correct this injustice and held that the Nevada law was unconstitutional. Bourne Valley Court Trust v. Wells Fargo Bank, N.A., No. 15-15233 (9th Cir. Aug. 12, 2016). Specifically, the Court held that that the provisions of Nevada Revised Statute 116 ("NRS"), as they existed prior to the December 2015 amendments, impermissibly violated lenders' due process rights under the Fourteenth Amendment to the United States Constitution. Decision is attached. NRS Chapter 116 provides that a properly conducted HOA foreclosure sale will extinguish a first deed of trust. This followed the holding by the Nevada Supreme Court in SFR Investments Pool 1 v. U.S. Bank, 334 P.3d 408 (2014). NRS 116.31162 assigns "super-priority" status to the nine months-worth of assessments due just prior to the foreclosure sale. However, before the December 2015 amendments, NRS 116.31163(2) required lenders to "opt-in" to receive notice that their security interest was threatened. HOAs had conducted non-judicial foreclosures on thousands of properties, thereby extinguishing the interests of investors, without any notice of the sale. The resulting loss to investors flew in the face of all common sense and reason.

The Bourne Valley case arose from an HOA foreclosure sale where the borrower failed to pay her HOA dues. Once the dues became delinquent, the HOA recorded the Notice of Delinquent Assessment, the Notice of Default, and the Notice of Sale. The lender originally loaned the borrower \$174,000 to purchase the property. At the HOA foreclosure sale, the purchaser obtained the property free and clear of the deed of trust for \$4,145.00, the amount of the HOA lien. The third party purchaser filed an action to quiet title to the property. The federal district court granted the purchaser's motion for summary judgment. The lender appealed the decision to the federal Ninth Circuit Court of Appeals with a challenge to the constitutionality of NRS 116 under the Fourteenth Amendment to the United States Constitution.

To establish a statute is unconstitutional, a petitioner must show the statute does not meet constitutional minimums, and there was state action that resulted in a deprivation of a constitutionally protected interest. The Ninth Circuit, first looked at whether the provisions of NRS 116 required lenders to "opt-in" to receive notice of the non-judicial foreclosure and held that it did. The Court, citing United States Supreme Court precedent, then held that the statute failed to meet constitutional due process minimums. The Court noted that due process requires notice reasonably calculated to apprise interested parties of the pendency of the action and to provide them an opportunity to present their objections. The Court reasoned that here NRS 116 did not do that because it required lenders to "opt-in" to receive notice. The Court pointed out that the United States Supreme Court has clearly and unequivocally made plain that "opt-in" provisions do not meet due process minimums because they require the deprived party to seek notice rather than requiring the taking party to give notice.

The Court then turned to whether the HOA's conduct qualified as state action. To show state action, a petitioner must show a constitutional deprivation caused by a law created by the state

and that the deprivation was caused by a state actor. A private party becomes a state actor when they act as an agent of the state. The Court first held that there was a deprivation of a constitutionally protected interest by a state law because the lender's property interest was extinguished by the provisions of NRS 116. The Court then held the deprivation was caused by a state actor because the relationship arose between the HOA and the lender only via the provisions of NRS 116, the relationship did not exist prior to the non-judicial foreclosure. The Court noted there was no privity between the parties and therefore by definition, the HOA could not have conducted itself as a private actor.

Bourne Valley does not expressly overrule SFR, but does limit it in fundamental ways. SFR held that a properly conducted non-judicial foreclosure extinguished a first deed of trust, while Bourne Valley held that NRS 116 was unconstitutional, which means the statute did not give HOA trustees the authority to foreclose. SFR also held that a non-judicial foreclosure that extinguished a first deed of trust did not violate due process. However, Bourne Valley held Nevada's non-judicial foreclosure scheme did offend due process because it required lenders to opt-in to receive notice. The implication of the Bourne Valley decision is that even if an HOA non-judicial foreclosure scheme that extinguishes a deed of trust is valid as a general proposition, the Nevada scheme failed to meet due process minimums because it required lenders to opt-in to receive notice. The Bourne Valley decision nullifies SFR's practical significance and stifles its application. Because the Ninth Circuit relied on the Fourteenth Amendment to the United States Constitution when it reached the Bourne Valley decision, theoretically, any subsequent opinion by the Nevada Supreme Court on this issue is of marginal relevance.

This decision has important ramifications for lenders, servicers and investors. It appears that the decision invalidates all NRS 116 non-judicial foreclosures. For that reason, we believe that as a matter of law all pre-2015 NRS 116 foreclosures do not extinguish lenders' first deeds of trust. This is great news for the mortgage industry, which faced billion dollar losses due to the non-judicial foreclosure provisions of NRS 116. We anticipate that purchaser and HOA attorneys will seek to limit the impact of the decision, however on its face, the decision is a major victory.