IN THE SUPREME COURT OF THE STATE OF NEVADA

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VILLA PALMS COURT 102 TRUST, Appellant, v. WILLIAM L. RILEY, an individual; DEUTSCHE BANK NATIONAL TRUST COMPANY, an expired Nevada Corporation, in its capacity as indenture trustee for the Noteholders of AAMES MORTGAGE INVESTMENT TRUST 2005-3, a Delaware Statutory Trust; and any and all other persons unknown claiming any right, title, estate, lien or interest in the Property adverse to the Plaintiff's ownership, or any cloud upon Plaintiff's title thereto (DOES 1 through 10, inclusive), Respondents.	}	**CASE NO. 62528**

APPELLANT'S RESPONSE TO STATE BAR OF NEVADA REAL PROPERTY SECTION'S *AMICUS CURIAE* BRIEF REGARDING LIEN PRIORITY ISSUE

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I. INTRODUCTION

The legal questions presented in this appeal are currently the most hotly debated real estate issues in Nevada. The State Bar of Nevada Real Property Section's *Amicus Curiae* Brief is evidence of this fact. The Real Property Section's decision to submit the Joint Editorial Board for Uniform Real Property Acts' (the "Board) June 1, 2013 Report (the "Report") to this Court for consideration is important because the Report is, by its own terms, designed to assist courts in interpreting Section 3-116 in Uniform Common Interest Ownership Act ("UCIOA") ("§ 3-116"). Accordingly, Appellant Villa Palms Court 102 Trust ("Villa Palms") encourages the Court to consider the Report and the Board's determination that the intent of § 3-116(c)—the section upon which NRS 116.3116(2) is based—was to create a limited priority for association assessment liens which, if foreclosed, extinguish first security interests otherwise unprotected by lenders.

Respondent Deutsche Bank National Trust Company's (the "Bank") Reply to the *Amicus Curiae* Brief ("Bank's Reply") largely fails to address the Report. Where it does, the Bank ignores the facts of the instant appeal (and most other appeals), misinterprets its and other lenders' legal duties, and misrepresents the central tenets of the Report.

II. ARGUMENT

A. The Court should consider the Report.

"The Joint Editorial Board for Uniform Real Property Acts (the "Board") provides guidance to the Uniform Law Commission (UCL) and others regarding potential subjects for uniform laws relating to real estate . . . ." (JEB Report cover page, attached as Exhibit A to the State Bar's *Amicus* Brief.) "The Board is responsible for monitoring all uniform real property acts." (http://www.uniformlaws.org/Committee.aspx?title=Joint+Editorial+Board+for+Uniform+Real+Property+Acts) In other words, the Board is the ultimate authority on the Uniform Common Interest Ownership Act ("UCIOA") upon which NRS Chapter 116 is modeled. For this reason, the Board's interpretation of UCIOA is important and worth examining.

The Report is all the more applicable when the Board's purpose in drafting it is considered. Specifically, "the Board has prepared this Report to clarify, ***for the benefit of parties and courts*** faced with these disputes, the intended application of § 3-116(c) in a variety of scenarios in which priority disputes might arise." (Report at 6 (emphasis added).) Needless to say, § 3-116(c) of the UCIOA—the very section upon which NRS 116.3116 is based—is very much in dispute in Nevada at the moment. As such, the Board's interpretation of § 3-116(c) is helpful, and should be considered.

B. The Board agrees with Villa Palms that the foreclosure of an association lien extinguishes first security interests.

i. Assessments are vital to associations and assessment liens, therefore, reflect that importance.

At the outset, the Report discusses the importance of assessments to associations and the need for associations to enforce their assessment liens. The Board states that, "[a]ssessments constitute the primary source of revenue for the community, and the ability to collect assessments is crucial to the association's ability to provide the maintenance and services expected by community residents." (Report at 1.) "To facilitate the association's ability to collect assessments, assessments unpaid by an owner constitute a lien on the owner's unit/parcel. In theory, the lien provides the association with the leverage needed to assure timely collection of assessments." (*Id.*) This ability to collect assessments is crucial because if an association cannot collect assessments from the owner of a unit/parcel, the association must either reassess the remaining unit/parcel owners in the community or reduce the maintenance and services residents have come to expect. (*See id.*)

Because the ability to collect assessments is critical, an association's lien is prior to almost all other encumbrances on the property. (*See id.*) This priority, however, is not absolute. An assessment lien is subordinate to tax liens and other governmental charges for obvious public policy and regulatory reasons. (*See id.* at

2.) Likewise, complete priority over traditional first mortgage lender liens could discourage common interest community development as many (likely most) lenders would be reluctant to lend from a subordinate position without some sort of cap on the association's lien. (*See id.*)

The interplay between an association's vital need to collect assessments and a lender's desire to secure its loans is at the heart of § 3-116(c) and, therefore, NRS 116.3116. Indeed, the Board accurately notes that the drafters of § 3-116(c) "struck a workable and functional balance between the need to protect the financial integrity of the association and the legitimate expectations of first mortgage lenders." (*Id.* at 3-4.) This balance took into account two assumptions about the market at the time: (1) units/parcels had equity, and (2) the first security interest holder would promptly institute foreclosure proceedings to enforce their mortgages. (*See id.* at 4.) However, the recent economic recession created an environment in which these two assumptions were no longer true. Because of this, we find ourselves in the current legal debate over the interpretation of NRS 116.3116.

There is really not much disagreement about any of the foregoing. In fact, Villa Palms suspects that in a substantial majority of briefs before the Court on this very issue, the lender most likely acknowledges that NRS 116.3116(2) provides assessments liens with "super priority." In fact, in its very first reference to the lien

at issue in this case, the Bank referred to the lien as "the homeowner association's ***super priority lien*** . . . ." (*See* Respondent's Opening Brief at 2.) The real question is whether "super priority"—a term derived from the language of NRS 116.3116(2) stating that assessment liens are "also prior to all security interests described in paragraph (b)"—really means "prior to" as the statute says. *See* NRS 116.3116(2). In other words, if a first security interest holder fails to protect its interest by paying the super priority amount prior to an association's foreclosure, is the first security interest extinguished? As discussed below, the Board answers this question in the affirmative.

ii. The Board affirms the Real Estate Division of the Department of Business and Industry for the state of Nevada's and Villa Palms' position that foreclosure of the super priority lien extinguishes first security interests.

The Board's clarification of § 3-116(2) most applicable to the instant appeal comes by way of Example Two in the Report. Example Two is based in part on the facts found in *Summerhill Village Homeowners Association v. Roughley*, 270 P.3d 693 (Wash. Ct. App. 2012). (*See* Report at 8.) In *Summerhill*, like here, the association foreclosed its assessment lien before the lender took steps to protect its interest. (*See id.* at 8.)[1] The Washington Court of Appeals held that under

[1] Villa Palms will be the first to point out that Washington law differs from Nevada law by expressly requiring that assessment liens be foreclosed by judicial foreclosure. *See* WASH. REV. CODE ANN. §64.34.364(5) (2012) (explicitly stating

Washington's six-month priority lien statute, the association's foreclosure sale extinguished the mortgagee's lien. (*See id.*)

The Board agrees with the Washington Court of Appeals.

> To the extent that *Summerhill Village* held that the association's foreclosure sale extinguished [the lender's] mortgage lien, the decision is consistent with the proper understanding of the six-month limited priority lien reflected in § 3-116. Section 3-116(c) establishes that the association's lien is "prior to" even the lien of a first mortgage to the extent of both "common expense assessments . . . which would have become due in the absence of acceleration during the six months immediately preceding institution of an action to enforce the lien" and "reasonable attorney's fees and costs incurred by the association in foreclosing the association's lien." ***A foreclosure sale of the association's lien (whether judicial or nonjudicial)[2] is governed by the principles generally applicable to lien foreclosure sales, i.e., a foreclosure sale of a lien entitled to priority extinguishes that lien and any subordinate liens, transferring those liens to the sale proceeds. Nothing in the Uniform Laws establishes (or was intended to establish) a contrary result.***

(*Id.* at 9 (emphasis added).)

Similarly, nothing in NRS 116.3116 establishes (or even suggests) that the general principles of lien foreclosure law do not apply to the foreclosure of an

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that a non-judicially foreclosed super priority lien is not entitled to lien priority under the statute). This, however, is a distinction without a difference. As the Board notes, whether the assessment lien is foreclosed judicially or non-judicially, the result is the same as long as the foreclosure process in the state, be it judicial or non-judicial, is followed. (*See* Report at 9 and n.8.)

[2] At this point in the quotation, the Board footnotes that the UCIOA provides that an "association must foreclose its lien in the manner in which a mortgage is foreclosed. Thus, an association may foreclose its lien by nonjudicial proceedings if the state permits nonjudicial foreclosure." (*Id.* at n.8.)

association's super priority lien in Nevada. Therefore, the foreclosure of an association's lien extinguishes first security interests if holders of first deeds of trust do not adequately protect their interests prior to the foreclosure.

C. The Bank's Reply Brief, which raises new and largely hypothetical issues, fails for three reasons.

i. The Bank's Reply Brief has little to do with the actual Report.

The principal argument asserted in the Bank's reply brief is that Villa Palms' interpretation of NRS 116.3116 somehow contradicts state and federal policies by incentivizing timely foreclosures. (*See* the Bank's Reply Brief at 2-5.) Notably, this argument fails to address the Report in the least bit, and instead advances arguments that should have been made in the Bank's answering brief. Regardless, the argument is without merit.

As set forth above, and noted in the Report, § 3-116 (and NRS 116.3116) is concerned with the rights and responsibilities of associations and lenders. (*See* Report at 3-4.) Despite this emphasis, the UCIOA does not prejudice the rights of homeowners as the Bank would have the Court believe. Indeed, the UCIOA and NRS Chapter 116 go to great lengths to protect homeowners' rights. Assessment liens cannot be foreclosed without multiple notices being sent to the unit/parcel owner. *See* NRS 116.31162 *et seq.* The notice and opportunity for owners to cure their deficiencies, however, must be balanced with an association's right to foreclose its lien and timely collect assessments. Otherwise, as noted extensively in

the Report, those assessments will have to be reassessed to the other owners in the association or the association must reduce the maintenance and services other owners have come to expect. (*See* Report at 1-2.)

Not only does the Bank's meritless argument fail to address the Report, it reads more like a position paper in support of amending NRS 116.3116. The Bank's Reply advocates for a change to the law rather than provides argument for how the law should be interpreted as written. Such an argument should be directed to the Nevada Legislature, not this Court.

ii. The Bank's due process argument is not addressed in the Report or raised by the Bank in its prior briefing.

The Bank's second argument is that under NRS Chapter 116, lenders are not given notice and an opportunity to protect their security interest. Putting aside the fact that the Bank is simply wrong, this contention is not addressed in the Report, nor did the Bank raise this issue in its prior briefing in this appeal.

First, the Bank's argument is highly fact-specific. In this case, however, the Bank has not even argued, much less produced evidence, that it was denied the opportunity to pay the association to protect its interest. (*See generally*, Respondent's Opening Brief.)

Second, as argued in Appellant's Reply Brief, if an association's foreclosing agent fails to cooperate with a lender regarding the super priority portion of a lien, the lender has every right to seek assistance and redress from the courts *before* the

foreclosure sale. Surely a lender can get at least temporary relief from a court stopping a foreclosure sale, and an injunction forcing an association (really the association's foreclosing agent) to cooperate so that a lender can protect its interest. The problem, however, is that lenders, including the Bank here, sit on their rights and only cry foul long after a third party purchases the property at auction. Unfortunately for the lenders, their inaction has compromised their rights.

iii. The Bank's non-judicial foreclosure argument also fails.

The Bank ends by asserting that the Report ignores the differences between the judicial foreclosure sale in *Summerhill* and the non-judicial foreclosure sales that occur in Nevada. (*See* the Bank's Reply Brief at 9-10.) The Bank is wrong. In fact, the Report goes to great lengths to note that whether an association's foreclosure is judicial or non-judicial, "principles generally applicable to lien foreclosure sales, i.e., a foreclosure sale of a lien entitled to priority extinguishes that lien and any subordinate liens" apply. (Report at 9.) In fact, as noted above, the Report highlights this principle by reiterating that extinguishment occurs in both the judicial and non-judicial setting. (*See id.* at n.8.)

The reason the Bank attempts to make the judicial/non-judicial distinction is because the Bank believes that only in a judicial foreclosure will the Bank receive notice and an opportunity to pay off the super priority lien, thereby satisfying due process concerns. The Bank, however, fails, yet again, to acknowledge that

Nevada's version of the UCIOA allows associations to foreclose their liens non-judicially while at the same time providing ample notice to the lenders. *See* NRS 116.31162 *et seq.* As set forth in detail in Villa Palms' Opening Brief, and re-stated in its Reply Brief, NRS 116.31168(1) requires associations to give first security interest holders notice of the foreclosure sale by reference to NRS 107.090 and the notice requirements therein. (*See* Opening Brief at 18; Reply Brief at 22-23.) Tellingly, the Bank did not dispute (until now) that NRS 116.31168(1) requires associations to give lenders notice. (*See generally*, Respondent's Opening Brief.) Again, Villa Palms objects to the Bank's back-door attempt to offer arguments now that do not relate to the Report, and should have been raised earlier.

III. CONCLUSION

The Report provides important insight into this important debate and should be considered by the Court.

DATED this 12th day of March, 2014.

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ATTORNEY'S CERTIFICATE PURSUANT TO RULE 28.2

1. I hereby certify that this brief complies with the formatting requirements of NRAP 32(a)(4), the typeface requirements of NRAP 32(a)(5) and the type style requirements of NRAP 32(a)(6) because:

☒ This brief has been prepared in a proportionally spaced typeface using Microsoft Word 2010 in Times New Roman 14; or

☐ This brief has been prepared in a monospaced typeface using [*state name and version of word-processing program*] with [*state number of characters per inch and name of type style*].

2. I further certify that this brief complies with the page- or type-volume limitations of NRAP 32(a)(7) or the Court's Order because, excluding the parts of the brief exempted by NRAP 32(a)(7)(C), it is either:

☐ Proportionately spaced, has a typeface of 14 points or more, and contains ____ words (not including disclosure statement, table of contents, table of authorities, required certificate of service and compliance with rules, and any addendum containing statutes, rules, or regulations); or

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3. Finally, I hereby certify that I have read this appellate brief, and to the best of my knowledge, information, and belief, it is not frivolous or interposed for any improper purpose. I further certify that this brief complies with all applicable Nevada Rules of Appellate Procedure, in particular NRAP 28(e)(1), which requires every assertion in the brief regarding matters in the record to be supported by a reference to the page and volume number, if any, of the transcript or appendix where the matter relied on is to be found. I understand that I may be subject to sanctions in the event that the accompanying brief is not in conformity with the requirements of the Nevada Rules of Appellate Procedure.

DATED this 12th day of March, 2014.

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CERTIFICATE OF SERVICE

I certify that on the 12th day of March, 2014, I served a copy of this **APPELLANT'S RESPONSE TO STATE BAR OF NEVADA REAL PROPERTY SECTION'S *AMICUS CURIAE* BRIEF REGARDING LIEN PRIORITY ISSUE** upon all counsel of record:

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