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LAW SUMMARY

Are Non-Judicial Sales Unconstitutional? The Super-Priority Lien and Its Influence on State Foreclosure Statutes

Ryan Prsha*

I. INTRODUCTION

As part of an ongoing balancing act between the interests of mortgage creditors and homeowners' associations, twenty states have implemented a "super-priority" lien that allows homeowners' association dues and assessments to take precedent over the property's mortgage in the event of a foreclosure.¹ Although originally intended to give mortgage creditors an incentive to pay off the association dues themselves, this lien has led to several unintended consequences.² Courts have accepted the concept of non-judicial foreclosure.³ However, due to a federal district court decision interpreting the super-priority lien, the constitutionality of these sales could soon be put into question.⁴

In 2015, the U.S. District Court for the District of Nevada cited a landmark civil rights case from Missouri, *Shelley v. Kraemer*,⁵ and ruled that a private, non-judicial foreclosure sale was a state action.⁶ This, in turn, subjected the sale to the Due Process Clause of the U.S. Constitution⁷ and subse-

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1. R. Wilson Freyermuth & Dale A. Whitman, *Can Associations Have Priority over Fannie or Freddie?*, 29 PROB. & PROP. 26 (Jul./Aug. 2015).

2. JOINT EDITORIAL BD. FOR UNIF. REAL PROP. ACTS, THE SIX-MONTH "LIMITED PRIORITY LIEN" FOR ASSOCIATION FEES UNDER THE UNIFORM COMMON INTEREST OWNERSHIP ACT 1 (2013), http://www.uniformlaws.org/shared/docs/jeburpa/2013jun1_JEBURPA_UCIOA%20Lien%20Priority%20Report.pdf [hereinafter "LIMITED PRIORITY LIEN"].

3. Arthur B. Axelson, Heather C. Hutchings & Alvin C. Harrell, *Update on Mortgage Foreclosure Litigation: Mers, Standing to Sue, and "Show Me the Note" as Defenses*, 67 CONSUMER FIN. L.Q. REP. 155, 156 (2013).

4. *See* U.S. Bank, N.A. v. SFR Invs. Pool 1, LLC, 124 F. Supp. 3d 1063, 1078 (D. Nev. 2015).

5. *Shelley v. Kraemer*, 334 U.S. 1, 1 (1948).

6. *See* U.S. Bank, N.A., 124 F. Supp. 3d at 1077.

7. *See id.* at 1078.

quently put in jeopardy the concept of non-judicial foreclosure.⁸ Although this decision's effect is currently confined to the State of Nevada, there are nineteen other states, including Missouri, that have yet to make a decision on how to handle the super-priority lien.⁹ If Nevada's *Shelley* justification is invoked in the remaining district courts, there could be widespread implications for all non-judicial foreclosure statutes across the country.

Part II of this Note discusses the background necessary to understand the super-priority lien and its constitutional implications in regards to non-judicial foreclosure. Part III reviews the recent developments that have given rise to this issue. Part IV discusses the ramifications of the manner in which the super-priority lien is being handled and how the court's methodology could potentially affect the constitutionality of non-judicial foreclosure.

II. LEGAL BACKGROUND

In order to fully understand the implications that the super-priority lien has created for non-judicial foreclosure, it is necessary to discuss the predicates on which the issue stands. This Part will first examine the foreclosure process and how it relates to the super-priority lien. Next, it will explore the constitutional grounds that the district courts have relied on, including the concepts of state action and non-judicial foreclosure.

A. The Basics: What Is a Lien and How Does It Work?

A lien is a notice attached to a property informing others that the property titleholder owes a creditor money, and the property has been put up as collateral for the debt.¹⁰ If the owner fails to pay back what is owed, the creditor¹¹ may foreclose on the property and use the proceeds of the sale to pay off what is left of the balance.¹² If more than one lien is put on the property, each lien is given a priority order in which the debt will be paid off.¹³ The debt with the higher priority is the senior lien, and those with lower priority are considered its junior.¹⁴ As soon as a senior creditor forecloses, all subordi-

8. *See generally id.*

9. MO. ANN. STAT. § 448.3-116.2(3) (West 2016).

10. *Lien*, BLACK'S LAW DICTIONARY (5th ed. 1979).

11. When a creditor holds the benefit of the lien, he or she may also be referred to as a lienor. *Lienor*, BLACK'S LAW DICTIONARY (5th ed. 1979).

12. *See* Nick Timiraos & Alan Zibel, *Reviews Begin for Borrowers Disputing Foreclosures*, WALL ST. J. (Nov. 2, 2011) <http://www.wsj.com/articles/SB10001424052970203707504577012130274478996>.

13. Amy Loftsgordon, *Foreclosure, Liens, and the First in Time, First in Right Rule*, ALLLAW, <http://www.alllaw.com/articles/nolo/foreclosure/liens-first-time-right-rule.html> (last visited Apr. 21, 2016).

14. *Chase Plaza Condo. Ass'n v. JPMorgan Chase Bank, N.A.*, 98 A.3d 166, 173 n.4 (D.C. 2014).

nate junior liens on that property are effectively extinguished.¹⁵ However, when a junior creditor forecloses, all senior liens remain intact.¹⁶ Therefore, while a junior creditor can still foreclose, the new buyer receives the property already burdened by the senior liens.¹⁷ Consequently, any property foreclosed by a junior creditor is worth less than market value because the new buyer must pay off all senior liens to clear title.¹⁸

The priority order of liens is well established under a combination of equitable jurisdiction and statutory law.¹⁹ Real estate taxes owed on the property always take first priority.²⁰ Historically, any mortgage on the property will take first priority after the taxes have been paid off.²¹ Inevitably, all other liens fall somewhere further down the priority pecking order.²² On paper, this system makes a great deal of sense. The mortgage providers typically have much more capital invested in the property than any of the other creditors, so it is logical to prioritize their debt. In practice, however, several issues have developed with junior liens – especially those imposed by homeowners’ and condo associations.

B. *The Role of Association Dues and Assessments*

Homeowners’ and condo associations typically assess periodic dues on each property within their boundaries.²³ Depending on the property, the fees can range from just a few hundred dollars per month, to thousands of dollars over that span.²⁴ These dues are used for a variety of purposes that provide the community with both visual benefits, such as general neighborhood

15. 7912 Limbwood Court Trust v. Wells Fargo Bank, N.A., 979 F. Supp. 2d 1142, 1149–50 (D. Nev. 2013).

16. *How Does Lien Priority Affect Me?*, FORECLOSURE U., http://www.foreclosureuniversity.com/studycenter/freereports/lien_priority.php (last visited Apr. 11, 2016).

17. *Id.*

18. James L. Winokur, *Meaner Lienor Community Associations: The “Super Priority” Lien and Related Reforms Under the Uniform Common Interest Ownership Act*, 27 WAKE FOREST L. REV. 353, 358–59 (1992).

19. *See* Schroeter Bros. Hardware Co. v. Croatian “Sokol” Gymnastic Ass’n, 58 S.W.2d 995, 1001 (Mo. 1932); *see also* Huggins v. Hill, 236 S.W. 1051, 1053 (Mo. 1921) (en banc).

20. *Priority of Mortgage and Tax Liens*, 10 REAL ESTATE CTR. 1110, 1110 (1996) (revised in Oct. 2005), <https://assets.recenter.tamu.edu/documents/articles/1110.pdf>.

21. *Id.*

22. *Id.*

23. “LIMITED PRIORITY LIEN”, *supra* note 2, at 1.

24. *See The Average HOA Dues*, GEEKS ON FIN., http://www.geeksonfinance.com/info_8775420_average-hoa-dues.html (last visited Apr. 12, 2016).

maintenance, and invisible benefits, such as property insurance for common areas.²⁵

Because an association's source of revenue is usually limited to common assessments, the surrounding residents of the community bear the consequences of default by a property owner of his or her assessment obligations.²⁶ In the event of a default, the association must either increase the fees for the remaining property owners or reduce the maintenance and services it provides.²⁷ Neither option is ideal, and as the months pass without payment, it becomes increasingly harder for the surrounding property owners to bear the weight of the cost.²⁸ In an attempt to mitigate this hardship, a unit or parcel within an association's boundary becomes subject to a lien in the amount of unpaid dues.²⁹ This lien, although vital to the continued operation of the association, is typically junior to the property's mortgage.³⁰

Because of the low priority, it is tremendously difficult for an association to foreclose on its lien.³¹ Any rational potential buyer would be frightened by the prospect of paying off the remaining mortgage just to receive clear title.³² Subsequently, the associations must typically wait for the senior mortgage provider to foreclose on the property in order for it to collect its debt.³³ If the mortgage foreclosure takes a long period of time, or if the foreclosure proceeds are inadequate to pay off the mortgage, then the association will once again be forced to bear the cost of the unpaid dues.³⁴

These delayed and inadequate proceedings have become more common in the aftermath of the subprime mortgage crisis.³⁵ In a soft housing market, mortgage creditors have an incentive to delay foreclosure in hopes of getting greater value from the property when the market recovers.³⁶ Additionally,

25. Shannon Ireland, *Why You Shouldn't Hate Your Homeowners Association Dues*, ZILLOW (Oct. 9, 2015), <http://www.zillow.com/blog/dont-hate-hoa-dues-184748/>.

26. Winokur, *supra* note 18, at 359.

27. *Id.* at 359–60.

28. *Id.* at 359.

29. "LIMITED PRIORITY LIEN", *supra* note 2, at 1.

30. *Id.* at 2.

31. Winokur, *supra* note 18, at 358–59.

32. *Id.*

33. "LIMITED PRIORITY LIEN", *supra* note 2, at 2.

34. Winokur, *supra* note 18, at 358–59.

35. "LIMITED PRIORITY LIEN", *supra* note 2, at 5. The FHFA has published foreclosure timelines for all fifty states, showing the "periods within which . . . servicers are expected to complete the foreclosure process for mortgages that did not qualify for loan modification or other loss mitigation alternatives." *Id.* at n.3 (quoting State-Level Guarantee Fee Pricing, 77 Fed. Reg. 58991, 58992 (proposed Sept. 25, 2012)). The average timeline across the nation "is 396 days, ranging from 270 days (a common timetable in nonjudicial foreclosure states such as Georgia, Michigan, Minnesota and Missouri) to 750 days in New Jersey and 820 days in New York." *Id.*

36. *Id.* at 5.

delaying foreclosure allows the lender to avoid the legal obligation to pay off the ever-growing amount of unpaid association dues and assessments that have accrued.³⁷ The consequences of the existing priority system, which incentivize the mortgage provider to delay foreclosure, have proven to be “devastating to the community and the remaining residents.”³⁸ Under this system, the mortgage provider can sit back and watch its collateral continue to be preserved by the various community-enhancing efforts of the surrounding property owners.³⁹ The lender is essentially receiving an unfair value “to the extent that [it] enjoys this benefit by virtue of a conscious decision to delay . . . foreclosure.”⁴⁰

C. *The Creation of the Super-Priority Lien*

Twenty different states have attempted to mitigate this unfair value by creating a super-priority lien status for association dues.⁴¹ In these states, the fees owed to an association take priority over the mortgage, typically for up to six months worth of outstanding payments.⁴² Some states, such as Missouri, have statutes that only apply to condominium associations.⁴³ Others, such as Nevada, have created statutes that apply for up to nine months of unpaid dues for any type of homeowners’ association.⁴⁴ Despite these differences, the underlying motivation behind and subsequent implication of each statute remains fairly consistent from state to state.⁴⁵

For practical reasons, the associations’ whole lien could not take priority over a mortgage.⁴⁶ The principle justification was that “complete priority for association liens could discourage common interest community development . . . [because] [t]raditional first mortgage lenders might be reluctant to lend from a subordinate lien position if there was no ‘cap’ on the potential burden of the an [sic] association’s assessment lien.”⁴⁷ Therefore, the super-priority statute drafters were forced to come up with “an equitable balance between the need to enforce collection of unpaid assessments and the obvious necessity for protecting the priority of the security interests of lenders.”⁴⁸ Drafters have generally struck this balance with a six to nine month period.⁴⁹

37. *Id.*

38. *Id.*

39. *Id.* at 6.

40. *Id.*

41. *Id.* at 3.

42. *Id.*

43. MO. ANN. STAT. § 448.3-116.2(3) (West 2016) (this provision is part of Missouri’s Uniform Condominium Act).

44. NEV. REV. STAT. ANN. § 116.3116(2) (West 2016).

45. See “LIMITED PRIORITY LIEN”, *supra* note 2, at 2–4.

46. *Id.* at 2.

47. *Id.*

48. UNIF. COMMON INTEREST CMTY. § 3-116 cmt. 1, U.L.A. (1994).

49. “LIMITED PRIORITY LIEN”, *supra* note 2, at 3.

The drafters' primary assumption in striking this balance was that "if an association took action to enforce its lien and the unit/parcel owner failed to cure its assessment default, the first mortgage lender would promptly institute foreclosure proceedings and pay the prior six months of unpaid assessments to the association to satisfy the limited priority lien."⁵⁰ This would permit the mortgage lender to maintain its priority lien position and convey clear title in its foreclosure sale.⁵¹ The failure of this theory ultimately leads to the non-judicial foreclosure issue that forms the crux of this Note.

D. The Basics of Non-Judicial Foreclosure

As stated above, when a property owner defaults on a loan in which the property was collateral, the creditor can foreclose on said property in order to recover the debt owed.⁵² In most states, the primary method for creditors to collect their debt involves a process known as non-judicial foreclosure.⁵³ As the name suggests, non-judicial foreclosure does not require court action.⁵⁴ Instead, some minimal level of notice must typically be given to all interested parties before the sale can happen.⁵⁵ Once this notice requirement has been fulfilled, the property is auctioned off to the highest bidder.⁵⁶

Since non-judicial foreclosure is a statutory creation, its notice requirement is handled differently from state to state.⁵⁷ In many states, such as Missouri and Nevada, a creditor that is non-judicially foreclosing on a property must give actual notice to any interested party that has "opted into" the notice requirement.⁵⁸ Regardless of the state, the level of notice required generally does not live up to the procedural due process requirements of the Constitution, which would require the foreclosing party to provide notice that is reasonably calculated to alert concerned parties of the action and to give those

50. *Id.* at 4.

51. *Id.*

52. *Id.*

53. Kylee Gloeckner, *Nevada's Foreclosure Epidemic: Homeowner Associations' Super-Priority Liens Not So "Super" for Some*, 15 NEV. L.J. 326, 327 (2014).

54. *Id.* at 327–28.

55. *See id.*

56. *See id.* at 328.

57. GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW 998–99 (5th ed. 2007); *see Mullane v. Cent. Hanover Bank & Trust Co.*, 339 U.S. 306, 312 (1950).

58. Missouri statute requires that "[a]ny person desiring notice of sale under any deed of trust or mortgage with power of sale upon real property may, at any time subsequent to recordation of such deed of trust or mortgage, cause to be filed for record in the office of the recorder of each county in which any part or parcel of the real property is situated a duly acknowledged request for such notice of sale." MO. REV. STAT. § 443.325 (2000); *see also* NEV. REV. STAT. ANN. § 107.090.3 (West 2016).

parties an opportunity to object.⁵⁹ However, because these non-judicial foreclosures are private, not state, actions, the notice requirements of the Constitution are not implicated.⁶⁰ Because there is no constitutionally guaranteed right to procedural due process in the context of a private action, it is completely up to the states to decide where to set the notice requirement.⁶¹ Although widely accepted, this premise has recently been questioned due to the District Court of Nevada's interpretation of the super-priority lien.⁶²

The specifics of this development will be explained in full detail in Part III, but it is important to first understand the predicate on which this challenge to non-judicial foreclosure's notice requirement is based: the state action doctrine.

E. The State Action Doctrine

A state action is “[a]nything done by [the] government[, such as] . . . an intrusion on a person's rights . . . by a governmental entity.”⁶³ Once something is considered a state action, it is subject to the due process requirements of the Constitution under the Fifth and Fourteenth Amendments.⁶⁴ Therefore, there is a significant notice requirement for any action considered a state action, a requirement not present for actions that are private.⁶⁵ Consequently, classifying a transaction as state action has tremendous implications in regards to how to execute a sale.⁶⁶

59. See *Mullane*, 339 U.S. at 314–15.

60. *Shelley v. Kraemer*, 334 U.S. 1, 13 (1948) (the Fourteenth Amendment's due process protections are not implicated unless state action is involved, as private action is *not* subject to due process restraints). Contrary to popular belief, the Constitution generally applies only to the government. Barring an exception, private activity is not subject to the due process requirements of the Constitution. Without the distinction between private action and state action, the Fourteenth Amendment state action requirement becomes irrelevant. Donald M. Cahen, *The Impact of Shelley v. Kraemer on the State Action Concept*, 44 CAL. L. REV. 718, 720 (1956).

61. Even prior to the super-priority issue, there was a push among legal scholars to reform non-judicial foreclosure on a national level as a Uniform Nonjudicial Foreclosure Act. However, this has gotten very little attention from legislators and the judiciary. NELSON & WHITMAN, *supra* note 57, at 996. This will be discussed further in Part IV.

62. See *U.S. Bank, N.A. v. SFR Invs. Pool 1, LLC*, 124 F. Supp. 3d 1063 (D. Nev. 2015).

63. Gregory K. Laughlin, *Digitization and Democracy: The Conflict Between the Amazon Kindle License Agreement and the Role of Libraries in a Free Society*, 40 U. BALT. L. REV. 3, 50 n.264 (2010) (first alteration in original) (quoting *State Action*, BLACK'S LAW DICTIONARY (9th ed. 2009)).

64. ERWIN CHEMERINSKY, *CONSTITUTIONAL LAW PRINCIPLES AND POLICIES* 530 (Vicki Been et al. eds., 4th ed. 2011).

65. *Shelley*, 334 U.S. at 16.

66. *U.S. Bank, N.A.*, 124 F. Supp. 3d at 1076.

Typically, the Constitution's guarantee of due process under the Fourteenth Amendment applies only to actions of the government and its agents.⁶⁷ However, this "blanket rule" is subject to a few exceptions.⁶⁸ One of these exceptions, known as "entanglement," allows the Due Process Clause to apply as long as the government actively authorizes, encourages, or facilitates private conduct that would otherwise violate the Constitution.⁶⁹ When these situations arise, the government must either stop associating with the private entity, or the private entity must start complying with the Constitution.⁷⁰

As discussed later in this Note, a U.S. district court has recently used the state action doctrine to create a heightened notice standard for homeowners' associations when foreclosing on a super-priority lien.⁷¹ The court was able to do so because of the landmark 1948 civil rights case out of Missouri, *Shelley v. Kraemer*.⁷² In *Shelley*, the Supreme Court of the United States effectively struck down all racially restrictive covenants on real estate.⁷³ The Court held that private parties could not seek judicial enforcement of the covenants because any enforcement by the courts would constitute a state action.⁷⁴ This would have made the enforcement a discriminatory state action via the entanglement exception, and such state action would have violated the Equal Protection Clause of the Fourteenth Amendment of the Constitution.⁷⁵ The Court ultimately concluded that the "action of state courts and of judicial officers in their official capacities is to be regarded as action of the State within the meaning of the Fourteenth Amendment."⁷⁶

The Supreme Court decided *Shelley* in the 1940s, well before the other famous victories of the civil rights movement.⁷⁷ During this period, there was immense pressure on state governments to uphold racially restrictive

67. CHEMERINSKY, *supra* note 64, at 519.

68. *Id.* at 521.

69. *Id.* at 539.

70. *Id.*

71. *See U.S. Bank, N.A.*, 124 F. Supp. 3d at 1081.

72. *Shelley v. Kraemer*, 334 U.S. 1 (1948).

73. *Id.* at 23.

74. *Id.* at 20.

75. *Id.*

76. *Id.* at 14.

77. Although implementation of the *Shelley* rule was clearly the correct and necessary measure to take back in the 1940s, the passing of time has changed its necessity. In the decades since *Shelley*, the federal government implemented the Fair Housing Act of 1968. *See* Fair Housing Act of 1968, §§ 42 U.S.C. 3601–3619 (2012). By striking down racially restrictive covenants, the Fair Housing Act rendered the *Shelley* holding practically irrelevant. The case still stands as good law, though, so the justification used by the court and the subsequent rule created remain intact. Cahen, *supra* note 60, at 718. Many of the inconsistencies that appear in the use of the state action doctrine reflect the changing social realities from 1948 to the present day. CHEMERINSKY, *supra* note 64, at 522.

covenants due to the intolerant racial norms of the time.⁷⁸ Because of this, it was left to the federal courts to render them unconstitutional.⁷⁹ The *Shelley* ruling allowed courts to apply the Fourteenth Amendment to situations that were only state actions under “color of law,” which ultimately helped forge the entanglement exception to the state action requirement.⁸⁰ The idea behind the “color of law” doctrine was to allow the courts to grant protection when state officials were “so clothed with governmental power that they can effectively deprive persons of rights guaranteed under the fourteenth amendment.”⁸¹ However, this doctrine needed to be extended even further to cover *Shelley*, since the landlords in that case were not state officials.⁸² The activities of individuals cannot violate the Fourteenth Amendment by themselves; the *Shelley* ruling therefore took racially restrictive covenants from “non-constitutional grounds” and made their enforcement in court a matter of state action, subject to the strictures of the Fourteenth Amendment.⁸³ Although this rule has not gone forgotten since the time of *Shelley*, it has been applied sparingly and inconsistently.⁸⁴

Recently, this same premise – that a judicial enforcement of an action between two private parties constitutes a “state action” – has been used to justify a notice requirement for the non-judicial foreclosure of a super-priority lien.⁸⁵ This notice requirement has placed non-judicial foreclosure statutes in peril.

III. RECENT DEVELOPMENTS

The super-priority lien drafters’ intention was to create an incentive for mortgage lenders to pay off monthly association dues while they waited to foreclose on a property.⁸⁶ It was the drafters’ belief this would keep the remaining homes within the association from taking on the burden of unpaid dues, with minimum inconvenience to the lender.⁸⁷ However, the mortgage service providers did not always act as expected and often continued to let

78. See Abigail Perkiss, *Shelley v. Kraemer: Legal reform for America’s neighborhoods*, CONST. DAILY (May 9, 2014), <http://blog.constitutioncenter.org/2014/05/shelley-v-kraemer-legal-reform-for-americas-neighborhoods/>.

79. *Id.*

80. Cahen, *supra* note 60, at 719.

81. *Id.*

82. See *Shelley v. Kraemer*, 334 U.S. 1 (1948).

83. Cahen, *supra* note 60, at 723–24.

84. See *Lugar v. Edmonson Oil Co.*, 457 U.S. 922 (1982); *Flagg Bros. v. Brooks*, 436 U.S. 149 (1978).

85. *U.S. Bank, N.A. v. SFR Invs. Pool 1, LLC*, 124 F. Supp. 3d 1063, 1074–75 (D. Nev. 2015).

86. “LIMITED PRIORITY LIEN”, *supra* note 2, at 3–4.

87. *Id.*

dues go unpaid.⁸⁸ This became an issue when the neglected associations decided to actually use their super-priority liens to foreclose on the defaulted property.⁸⁹

A. An Unintended Drawback of the Super-Priority Lien

Although the super-priority lien has existed since 1976,⁹⁰ only recently was its true meaning put into question.⁹¹ In *SFR Investments Pool 1 v. U.S. Bank*, a homeowners' association attempted to foreclose on a property after its dues and assessments had gone unpaid.⁹² This action caught the mortgage provider off guard.⁹³ It was previously assumed that the super-priority lien existed as a quasi-requirement for lenders to pay off the association dues but held no true priority over the mortgage.⁹⁴ However, in this case, the Supreme Court of Nevada ruled that a super-priority lien is, in fact, a true lien that allows an association to sell a property with clear title.⁹⁵

Determining that the super-priority lien allowed an association to sell property clear of the mortgage was just the start. The typical prospective buyer – frightened of purchasing a mortgage-burdened home – no longer posed an obstruction to an association's decision to foreclose.⁹⁶ This ultimately resulted in associations having the practical ability to foreclose on properties without the bank taking any action.⁹⁷ Although the Supreme Court of Nevada had established the true meaning of the super-priority lien, the process in which associations could actually perform super-priority foreclosures was still up in the air.⁹⁸ In states with non-judicial foreclosure statutes, foreclosure sales did not require the associations to go through the court system.⁹⁹ Instead, an association could initiate a sale by recording a notice of default and privately auctioning the home to a third-party bidder.¹⁰⁰ The minimal notice required to execute a sale under a non-judicial foreclosure statute led to the troubling circumstances in *U.S. Bank v. SFR Investments Pool 1* – a second Nevada case between the same parties.¹⁰¹

88. *Id.* at 5.

89. *See SFR Invs. Pool 1, LLC v. U.S. Bank, N.A.*, 334 P.3d 408 (Nev. 2014).

90. "LIMITED PRIORITY LIEN", *supra* note 2, at 2.

91. *See SFR Invs. Pool 1*, 334 P.3d at 412.

92. *Id.* at 409.

93. *Id.*

94. *Id.* at 412.

95. *Id.* at 419.

96. Winokur, *supra* note 18, at 358–59.

97. *See generally SFR Invs. Pool 1*, 334 P.3d at 408.

98. *See id.*

99. *See id.* at 417.

100. Gloeckner, *supra* note 53, at 328.

101. *U.S. Bank, N.A. v. SFR Invs. Pool 1, LLC*, 124 F. Supp. 3d 1063 (D. Nev. 2015).

B. Longstanding Precedent Applied in a Novel Context

In *U.S. Bank v. SFR Investments Pool 1*, defendant SFR bought a \$236,000 house at a non-judicial foreclosure sale for a mere \$9000 after the property's homeowners' association foreclosed using Nevada's super-priority statute.¹⁰² This sale effectively wiped out hundreds of thousands of dollars in mortgage debt owed to the plaintiff, U.S. Bank,¹⁰³ which allowed SFR to become the burden-free owner of the home.¹⁰⁴ The foreclosure was proper under Nevada's non-judicial foreclosure statute and notice requirements.¹⁰⁵ U.S. Bank nonetheless attempted to challenge the validity of the sale.¹⁰⁶

U.S. Bank brought an action to invalidate the homeowners' association's sale due to a lack of notice.¹⁰⁷ It was the bank's position "that because the [non-judicial foreclosure] statutes do not require junior lienors to be given notice of an impending HOA foreclosure sale that might extinguish their liens, junior lienors in such circumstances are deprived of the fundamental right to notice protected by the . . . Fourteenth Amendment."¹⁰⁸

102. *Id.* at 1068.

103. *Id.* U.S. Bank is the service provider of the mortgage for the property in question. The recent developments with the super-priority lien specifically deal with mortgages handled by the Federal Housing Finance Agency ("FHFA") and its service providers. The FHFA is an independent regulatory agency responsible for the oversight and conservatorship of the government sponsored enterprises, Fannie Mae and Freddie Mac. See *Fannie Mae & Freddie Mac*, FED. FIN. HOUSING AGENCY, <http://www.fhfa.gov/SupervisionRegulation/FannieMaeandFreddieMac> (last visited Aug. 28, 2016). The goal of these enterprises is to magnify the secondary mortgage market by securitizing mortgages in the form of mortgage backed securities so that the lenders can then reinvest their assets into more lending. Julia Patterson Forrester, *Fannie Mae/Freddie Mac Uniform Mortgage Instruments: The Forgotten Benefit to Homeowners*, 72 MO. L. REV. 1077, 1082–83 (2007). This subsequently increases the amount of lenders in the mortgage market and boosts the economy. *Id.* at 1106–07. Essentially, Fannie Mae (or Freddie Mac) will buy up a number of mortgages and pool them all together and then sell parts of that pool to investors who get paid based on those homeowners paying their mortgage statements. *Id.* at 1081. However, some of the larger financial institutions, such as U.S. Bank, will often act as the service provider for these mortgage pools. *Id.* at 1080. It is the service provider's job to manage and administer each of the numerous mortgages in the pool. *Id.* at 1082–83. This responsibility includes foreclosing on any defaulted mortgages and keeping track of any and all obstacles between the mortgage pool and its profits. *Id.* at 1086. Depending on the size of the pool, this can be a fairly burdensome and problematic task. *Id.* at 1086–87. In return for performing these responsibilities, the service provider receives a percentage of the profits made from the mortgage pool. *Id.* at 1104.

104. *U.S. Bank, N.A.*, 124 F. Supp. 3d at 1068.

105. *Id.*

106. *Id.*

107. *Id.*

108. *Id.* at 1075.

In response, SFR filed a counterclaim for a declaration that the association's foreclosure sale of the property was valid and therefore extinguished U.S. Bank's deed of trust under Nevada's super-priority lien statute.¹⁰⁹ Because it was a private sale, SFR believed that Nevada's non-judicial foreclosure statute rendered the super-priority sale lawful regardless of notice.¹¹⁰ The facts of the case are interesting, but it is the method the district court used to strike down the sale that ultimately threatens the constitutionality of non-judicial foreclosure statutes as they are currently composed.

The court held SFR's claim should be dismissed because court enforcement of the non-judicial foreclosure sale constituted a state action, which subsequently subjected the participants to the full due process protection of the U.S. Constitution.¹¹¹ U.S. Bank's claims, meanwhile, were not subject to this same scrutiny and therefore were allowed to proceed.¹¹²

The court justified the difference in the way it handled each party's claim using the state action rule created in *Shelley v. Kraemer*.¹¹³ The *U.S. Bank* court summarized the essence of *Shelley* in the following way: "When a state permits a private actor to use the machinery of government to deprive another private actor of his constitutional rights, the first actor may in some cases be treated as a state actor for the purposes of the Fourteenth Amendment."¹¹⁴

In regard to SFR's attempt to validate the association's foreclosure sale, this court decided that U.S. Bank may use the *Shelley* rule to "invoke the Fifth Amendment against this Court's potential declaration that SFR owns the Property free and clear of U.S. Bank's interest based on SFR's compliance with certain state statutes governing the notice process if those statutes do not comport with due process."¹¹⁵ The court compared SFR's use of the judicial system to enforce potentially unconstitutional state statutes against U.S. Bank to the way the "neighboring homeowners in *Shelley* sought to invoke the power of the state courts to enforce the constitutionally problematic covenants against the Shelleys."¹¹⁶

In regards to U.S. Bank's attempt to invalidate the sale, the court held that "it [was] U.S. Bank itself, not SFR, who ask[ed] the Court to adjudicate the validity of the potentially constitutionally problematic statutes."¹¹⁷ Therefore, it decided that *Shelley* could not apply because "U.S. Bank cannot complain of the threat of impending judicial action that it has itself demanded."¹¹⁸ Otherwise, the court noted that "the rule of *Shelley* could be combined with a

109. *Id.* at 1068.

110. *Id.* at 1077.

111. *Id.* at 1081.

112. *Id.* at 1082.

113. *Id.* at 1076–77.

114. *Id.* at 1076.

115. *Id.* at 1078.

116. *Id.*

117. *Id.* at 1077.

118. *Id.*

declaratory judgment action by any plaintiff to avoid the state-action requirement under the Fifth or Fourteenth Amendments” and therefore “convert any private action into state action simply by asking a court to declare that the private action would be unconstitutional if it had been a state action.”¹¹⁹ As will be discussed in detail in Part IV, the implications of these developments could potentially extend far beyond the minutiae of super-priority lien foreclosures and into the constitutionality of non-judicial lien foreclosures in general.¹²⁰ If this is the case, the Uniform Nonjudicial Foreclosure Act (“UNFA”) will be of fundamental importance.

C. *The Uniform Nonjudicial Foreclosure Act*

In recent years, there has been a strong push by legal scholars to implement the UNFA in order to promote efficiency and fairness in the foreclosure process.¹²¹ The UNFA would require actual notice to all persons whose property rights are put at risk by foreclosure.¹²² It would additionally provide an opportunity for any other interested person to request notice of foreclosure as he or she wished.¹²³ It was the drafters’ belief that these notice provisions would appeal to lenders, while affording borrowers a variety of special safeguards if they act responsibly.¹²⁴

Although the UNFA has received a great deal of praise from legal scholars, the act has struggled to take hold with legislators at all levels.¹²⁵ Conveniently, recent concerns with the super-priority lien could change the minds of many legislators as they consider the act.

119. *Id.* at 1077–78.

120. This is not the first time that the state action doctrine has created cause for concern. Past cases dealing with the entanglement exception have been considered a “conceptual disaster area,” and the Supreme Court itself has admitted that the “cases deciding when private action might be deemed that of the state have not been a model of consistency.” CHEMERINSKY, *supra* note 64, at 521 (quoting Charles L. Black, Jr., *Foreword: “State Action,” Equal Protection, and California’s Proposition 14*, 81 HARV. L. REV. 69, 95 (1967)). Part of this problem arises from the fact that the government is involved in almost all private conduct to some degree and in some capacity. *Id.* at 522. Because of this, a state action requirement necessitates somewhat arbitrary lines to be drawn to establish its existence. *Id.* The civil rights cases from the 1940s utilized and relied on the rule to attack the unnervingly abundant discrimination of the day. *Id.* at 530. However, most of the cases since the civil rights movement have failed to acknowledge the *Shelley* rule’s existence. *Id.* The civil rights cases that relied on the *Shelley* rule are still good law, but they have rarely been followed since. *Id.* Therefore, there is a strain amongst the decisions that allow the arbitrary application of the rule in *U.S. Bank v. SFR Investments*. *Id.*

121. NELSON & WHITMAN, *supra* note 57, at 996.

122. *Id.* at 999.

123. *Id.*

124. *Id.* at 1002.

125. *Id.*

IV. DISCUSSION

The recent developments with the super-priority lien suggest that invocation of the Due Process Clause is required any time a party seeks judicial validation of a non-judicial foreclosure on a lien.¹²⁶ If this holds true, it raises questions about the constitutionality of any state non-judicial foreclosure statute in which the notice requirement does not satisfy constitutional due process requirements. Although the implication of the *Shelley* rule in the context of non-judicial foreclosure is currently confined to the state of Nevada,¹²⁷ there are nineteen other states, including Missouri, that have yet to make a determination on how to handle the super-priority lien.¹²⁸ If Nevada's *Shelley* justification is invoked in the remaining district courts, there could be serious consequences for non-judicial foreclosure statutes across the country. State non-judicial foreclosure statutes have needed reform for some time now, and the unusual circumstances created by the super-priority lien may be the catalyst necessary for change.

Foreclosure statutes that require an interested party to “opt in” before he or she is required to be given notice¹²⁹ of the proceedings are, at the very least, constitutionally suspect. These statutes essentially allow a senior creditor to foreclose on a property in which multiple entities have an interest without notice to those parties solely because those parties failed to fill out the request. The constitutionally guaranteed right to due process should not be taken away solely because the person or entity failed to take an affirmative action. Although these fairness issues are inherent in the statutes themselves, it was not until the courts were forced to confront super-priority lien foreclosures that they were able to find a legal justification for striking down the unfair sales.¹³⁰ The *Shelley* holding essentially gives the courts a backdoor route to striking down private sales that were constitutionally unfair but still valid as a private action sale due to the relaxed statutory notice requirements.

While the end result of classifying non-judicial foreclosure as state action is positive – raising the notice requirement makes the system exponentially fairer – the *U.S. Bank* court's decision to invoke *Shelley* and the state action rule is not the ideal way to bring about this change. Giving private, non-judicial sales full constitutional protection could have several unintended drawbacks. The *Shelley* rule, as interpreted in light of the super-priority lien, establishes a principle so broad that it could, in theory, turn anything into a

126. See *U.S. Bank, N.A. v. SFR Invs. Pool 1, LLC*, 124 F. Supp. 3d 1063, 1072 (D. Nev. 2015).

127. *Id.* at 1067–78.

128. The basis of which will come down to Missouri courts' interpretations of section 443.327. MO. REV. STAT. § 443.327 (2000).

129. *Id.*

130. See *U.S. Bank, N.A.*, 124 F. Supp. 3d at 1063.

state action with a simple lawsuit.¹³¹ Any court that does not find a state action has impliedly sustained the violation of whatever right is being challenged.¹³² Without limitations on the *Shelley* rule, an incredibly wide range of private conduct could become actionable under the Constitution.¹³³

Without the distinction between private action and state action, the Fourteenth Amendment state action doctrine becomes irrelevant. Both the initial drafters of the Fourteenth Amendment and the subsequent historical context of the U.S. legal system stress a separation between the two.¹³⁴ If private actions become subject to the stringent Fourteenth Amendment requirements, then the rights of private citizens to conduct their own business at arm's length is put in jeopardy simply due to the ever-present possibility of a lawsuit premised off a flimsy procedural defect.

The court handled the super-priority issue in the best way it could within its power. Allowing actual foreclosure after the default of a super-priority lien was necessary to save the interests of the homeowners' associations, and ultimately striking down the unfair *U.S. Bank* sale was necessary to protect the lenders. However, affirming the concept of private-turned-state action simply because a court enforced the sale is problematic. There needs to be a limit on the court's interpretation of *Shelley* in order to keep the intended and necessary distinction between private and state action. Otherwise, private actions will be subject to the heightened standards required by the Fourteenth Amendment's Due Process Clause, ultimately distorting the underlying premise and intended scope of the amendment.

A better approach would be for legislators to simply raise the level of notice required for non-judicial foreclosure up to the point where it satisfies the Due Process Clause. With this approach, the courts would not have to worry about rendering unfair non-judicial foreclosures invalid for reasons of procedural due process under the Constitution. They would simply point to the requirement of the statute and render the sale invalid for not living up to the stated requirements. Had the legislators written a non-judicial foreclosure statute that lived up to the Constitution, the only thing the courts would have to do is decide if a particular sale followed the statutes. Because the legislators have failed to enact a satisfactory law, the courts were forced to invoke *Shelley* so that they could strike down a grossly unfair sale as unconstitutional.

Regardless of whether the law actually does require constitutional protections of due process for private non-judicial foreclosures, basic notions of fairness demand that any person whose rights may be destroyed by a foreclo-

131. CHEMERINSKY, *supra* note 64, at 540 ("*Shelley* remains controversial because ultimately everything can be made state action under it.>").

132. *Id.* at 540–41 (noting that "[a]ll private violations of rights exist because state law allows them").

133. *Id.* at 542.

134. *See generally* Cahen, *supra* note 60, at 732–36.

sure should have a certain level of notice in advance of the proceeding.¹³⁵ The integrity of the non-judicial foreclosure process requires acknowledgement of necessary analogous protections – even if those are not judicial.

If Missouri and other super-priority lien states were to change their statutes to conform to the Due Process Clause, the new statute could potentially look a lot like the UNFA. Implementing the UNFA would not only create a uniform standard of foreclosure, but it would also take the constitutionally suspect non-judicial foreclosure process and bring it within the bounds of constitutional due process.¹³⁶

Non-judicial foreclosure is not covered in the Constitution – it is a creation of statute.¹³⁷ The only reason the courts need to resort to the state action doctrine is to prevent foreclosure sales like the one in *U.S. Bank*. If the statutes were written in a way that complies with the Constitution in the first place, courts would strike down these outlandish sales as a violation of the statute rather than needing to invoke *Shelley*.

Regardless of whether or not these non-judicial foreclosure sales should truly be classified as state actions, it is in everyone's best interests for the statutes to create a procedure that is as fair as possible. Implementing non-judicial foreclosure statutes that comply with the Due Process Clause would encourage fairness and uniformity within the system without requiring the courts to fall further down the slippery slope of the *Shelley* doctrine.

V. CONCLUSION

The courts here deal with a difficult situation. They must enforce the super-priority statutes as true senior liens with foreclosure power in order to protect the homeowners' associations. However, enforcing these foreclosures under most states' non-judicial foreclosure statutes encourages exceedingly unfair *U.S. Bank*-type sales for creditors. In order to try and find an equitable balance, the *U.S. Bank* court used the state action rule from *Shelley v. Kraemer* to classify the unfair sale as unconstitutional. Although this adequately addresses the issue with super-priority liens, these recent developments have taken the *Shelley* rule in a dangerous direction, where its over-application seems inevitable.

This entire issue could easily be avoided by enacting non-judicial foreclosure statutes that comply with the Due Process Clause of the Fourteenth Amendment. If this happened, a court dealing with an unfair super-priority sale could simply strike the sale for not complying with the statute, rather than making a dangerous constitutional argument. Nineteen states have yet to encounter this issue, but it is only a matter of time before the validity of non-judicial foreclosure is put to the test in these venues.

135. *Id.*

136. *Id.*

137. *Id.*