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Can the Buyer Of A Property At A HOA Foreclosure Sale Destroy Diversity Jurisdiction By Joining The Former Homeowner?

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In this HOA lien foreclosure case, the Homeowner took out a loan from Wells Fargo to purchase the property. Homeowner fell behind on her HOA dues, and the HOA recorded an assessment lien under NRS 116.3116 (the "Statute"). According to the Nevada Supreme Court in the seminal *SFR* case, the Statute provided that HOA liens take priority over all other liens, including previously recorded Deeds of Trust, for up to the nine months of unpaid HOA dues. The HOA foreclosed, with a third party Buyer purchasing the property. Shortly, thereafter, the Buyer sued Wells Fargo and the former Homeowner to Quiet Title. The Weeping Hollow suit was one of the earlier complaints by buyers to quiet title in a field which would grow over the next few years to several thousand similar cases in Nevada state and federal courts.

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For context, the complaint was filed less than two months after the Nevada Real Estate Division which issued an Advisory Opinion 13-01, on December 12, 2012, suggesting that the HOA would always want to enforce its lien for assessments by starting the *nonjudicial* foreclosure process to trigger the super priority lien and force the first security interest holder to pay that amount. Up to that point, most players in the industry – HOAs, their collection agents, buyers, lenders, title companies and servicers – as well as legislators and courts, believed that the super priority lien constituted a payment priority only over the first deed of trust, which, if non-judicially foreclosed upon would not extinguish a first deed of trust. The NRED Advisory Opinion helped lead to a flood of quiet title actions by buyers seeking title free and clear of all liens, including the first deed of trust.

The Weeping Hollow complaint was over a year and a half before the Nevada Supreme Court turned the industry on its head in *SFR Investments Pool I, LLC v. U.S. Bank*, 334 P.3d 408 (Nev. September 18, 2014), holding that NRS 116.3116(2) gives an HOA a true superpriority lien, proper foreclosure of which – whether by judicial or nonjudicial means –will extinguish a first deed of trust.

Shortly after the Weeping Willow complaint was filed, Wells Fargo removed the case to federal court based on Diversity Jurisdiction. The case was removed for many reasons including because, at that time, many state court judges were refusing to decide the issue and federal courts had a shortened period for discovery so the matters could be heard sooner, and, at that time, "Every federal court in this district to decide this issue has held that an HOA's super-priority lien does not extinguish a first position deed of trust."[1]

Federal statutes permit removal of certain actions from state courts if the amount in controversy exceeds $75,000 and there is "complete diversity" between the plaintiff and all defendants – that is, the plaintiff must be a "citizen" of a different state than every defendant. If there is not complete diversity, and there is no other basis for federal jurisdiction, such as the case involves the U.S. Constitution or federal statute or other federal question, the federal court cannot hear the case. The Plaintiff Buyer and the Defendant Homeowner are both citizens of Nevada, thus appearing to have foreclosed the federal district court from exercising diversity jurisdiction, but Wells Fargo argued that the joinder of the former Homeowner in the lawsuit was a "fraudulent joinder," with the sole purpose of interfering with possible removal. Consequently, her citizenship could be ignored. The

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district court agreed the Homeowner was fraudulently joined. It later dismissed the Buyer's case, concluding that the 2012 HOA foreclosure sale did not extinguish Wells Fargo's 2008 deed of trust because NRS 116.3116(2)(c) (2012) created only a payment priority for the super-priority lien, the foreclosure of which could not extinguish an earlier recorded security interest.

After the district court issued its ruling, the Nevada Supreme Court issued the *SFR* opinion that expressly rejected the district court's interpretation of the Statute. Buyer appealed to Ninth Circuit arguing that *SFR* required reversal in the Weeping Willow case. The Ninth Circuit first had to assure itself that it had jurisdiction. But for the fraudulent-joinder doctrine, the court could have easily concluded the district court lacked jurisdiction because Weeping Hollow and Spencer are not diverse: both are citizens of Nevada.

Under the fraudulent-joinder doctrine, the joinder of a non-diverse defendant is deemed fraudulent, and that defendant's presence in the lawsuit is ignored for purposes of determining diversity, if the plaintiff fails to state a cause of action against the resident defendant, and the failure is obvious according to the settled rules of the state. Wells Fargo had a heavy burden to show that the Plaintiff Buyer obviously failed to state a quiet title cause of action against the former Homeowner. Given that, for the purposes of its quiet title claim, the Buyer needed to show it had superior claim to *all* others, the Ninth Circuit found it was reasonable to join the former Homeowner because Nevada law could permit the former Homeowner to bring claims to the Property by challenging the completed HOA sale on equitable grounds[2] as late as five years after the sale. Thus, absent a fraudulent joinder, and absent complete diversity, the district court lacked jurisdiction to hear the case. The Ninth Circuit reversed the dismissal, and remanded with instructions to send the case back to state court. Wells Fargo sought to substantively challenge the Nevada HOA statute on constitutional and state-law grounds, but the Ninth Circuit did not reach the merits of those challenges"[s]ince this case should never have made it into federal court."

Going forward, the decision may not have much impact on new suits filed originally in federal court or filed originally in state court and removed to federal court as the lender, servicer or beneficiary of record could allege other grounds for federal jurisdiction like federal question jurisdiction based on the apparent violation of the Due Process Clause because the Statute does not expressly require notice of the HOA sale to be given to the first secured interest holder.[3] But it could have far-reaching consequences to existing suits where the only reason the claims are in federal court is potentially defective diversity jurisdiction.

1 *Premier One Holdings, Inc. v. BAC Home Loans Servicing LP*, 2013 U.S. Dist. LEXIS 112590*8. By the end of 2013 that had changed as at least two federal judges held in favor of the buyers, most notably in *7912 Limbwood Court Trust v. Wells Fargo Bank, N.A.*, 2013 WL 5780793 (D. Nev. Oct. 28, 2013).

2 Homeowner could have challenged the HOA sale from which Weeping Hollow gained title on the grounds that the sale was fraudulent, unfair or oppressive, even if the Homeowner was no longer in possession of the property. *Long v. Towne*, 639 P.2d 528, 530 (Nev. 1982); and *Shadow Wood HOA v. N.Y. Cmty. Bancorp.*, 366 P.3d 1105, 1107 (Nev. 2016).

3 The Ninth Circuit recently determined that the Statute does in fact violate the Due Process Clause in *Bourne Valley Court Trust v. Wells Fargo Bank, N.A.*, 832 F.3d 1154, 2016 U.S. App. LEXIS 14857 (August 12, 2016). The Nevada Supreme Court has not decided the issue but it currently has the issue before it on several cases, including *Saticoy Bay LLC Series 350 Durango 104 v. Wells Fargo Home Mortgage, N.A.*, NSC Case No. 68630, argued September 8, 2016.

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