

March 2013



In This Issue:

*Missouri Law on Non-Judicial
Foreclosure: A Primer
Measuring Deficiencies Under
Missouri Law ... Page 2*

Fischer & Frichtel ... Page 5

Sunrise Farms ... Page 10

Conclusion ... Page 13

In the News:

Missouri Foreclosures: A Changing Landscape?

Introduction

In 2012, two decisions were published regarding Missouri foreclosure law and how obligors' deficiencies should be measured following foreclosures. The decisions were somewhat surprising given that Missouri law has been long-settled regarding how to measure deficiencies following foreclosures, and given that the long-settled law seemed well-justified by Missouri's statutory scheme governing foreclosure sales.

But troubled times can bring introspection and can trigger critiques anew. The American economy has suffered through recession and

malaise since 2008. Creditors and debtors alike have suffered as a result, but, perhaps understandably, more legislative and judicial empathy has been directed to debtors than to creditors.

And, in this context, long-standing Missouri law on foreclosures and deficiencies has been subject to reexamination.

This article examines and critiques the holdings in the *Fischer & Frichtel* and *Sunrise Farms* cases, and the article analyzes the justification for the approaches set forth in those cases in light of Missouri's statutory scheme.

Missouri Law on Non-Judicial Foreclosure: A Primer

Missouri's statutory scheme regarding foreclosure is straightforward. Missouri is a "deed of trust" state, and lenders holding liens on real estate in Missouri are not required to first sue in a court of law before realizing on their collateral. Instead, so long as it holds a deed of trust containing a "power of sale," a lender in Missouri can issue a notice of default, accelerate its debt, instruct the trustee under the deed of trust to conduct a non-judicial trustee's sale, and advertise the time and place of the sale in accordance with Missouri statute.

The sale is then held at the steps of the local county courthouse. All of this can be accomplished in roughly 27-35 days if there are no complications to the process.

Measuring Deficiencies Under Missouri Law

There is no Missouri statute that requires that any specific price be paid at a foreclosure sale. This is important to remember in analyzing *Fischer & Frichtel* and *Sunrise Farms* below. Thus, Missouri law sets forth a number of procedures that a foreclosing lender must follow in order to ensure that a lawful trustee's sale is conducted. But ensuring that a specific amount be bid at the sale is not one of them.

Although subject to occasional amendment from time to time, Missouri law on foreclosures has largely been in place for more than 100 years. Because it sets out precise details as to what a lender must do in order to have a lawful sale ("provide notice to X, Y, and Z, send notices by this method, ensure proof of notice, publish here for at least X number of days," etc.), both lender and obligor alike should be able to rely on Missouri's statutory scheme in determining whether a sale has in fact been legally conducted. And it is the job of the

courts to ensure predictability to those who follow the statutes and who rely on precedent.

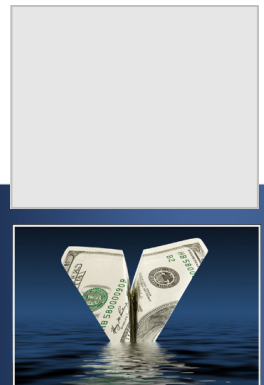
For these very reasons, both lender and obligor alike should be able to rely on the statutory scheme and on long-standing precedent in case law in coming to the determination that Missouri law does not require that a specific amount be bid at a sale in order for the sale to be legal.

These conclusions have formed a bedrock for years in Missouri when it comes to the issue of measuring an obligor's deficiency following a trustee's sale. The rule has been established, virtually without question until 2012, that an allegation of inadequate bid price, after a regularly conducted foreclosure sale, will not be a successful defense for a borrower or guarantor, unless that borrower or guarantor can show that the bid actually "shocks the conscience" of the court such that the sale is tainted by fraud. This is a heavy burden to be sure.

Therefore, in the following hypothetical, the deficiency obligation owed by borrowers and guarantors is measured as set forth below:

Total Indebtedness:	\$1.2 million
Bid at Trustee's Sale:	\$700,000.00
Deficiency Owed:	\$500,000.00

One reason for Missouri precedent on establishing deficiencies is (correctly) that, if the Missouri legislature has not seen fit to establish a statute that



requires a specific bid amount at a trustee's sale, then a Missouri judge surely has no business doing so. And there are other reasons as well:

- recognition of the fact that the sale is part of an enforcement process, therefore is not a sale involving the typical "willing seller" and "willing buyer," and thus the property has not been exposed to the market for a traditional amount of time;
- recognition of the fact that a buyer at a foreclosure sale may not have an opportunity to inspect the property (like an arm's length buyer would) that is the subject of the sale; and
- recognition of the fact that a trustee at a sale cannot (and is not required under Missouri law to) make traditional representations and warranties regarding the property that an arm's length seller would make, thereby exposing the bidder at a foreclosure sale to risk of the unknown.

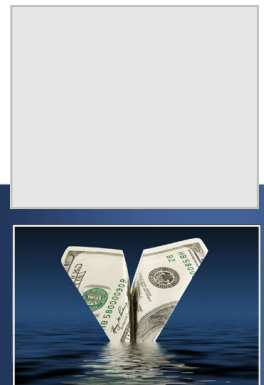
There have been other rationales cited, but these are the primary ones. The following is a summary of legal holdings on the issue through the years:

- ◇ [Betzler v. James](#), 126 S.W. 1007, 1011-12 (Mo. 1910) ["There must be something more than mere inadequacy of price – some fraud or unfair dealing; some deceit practiced upon the mortgagor, or some unfair advantage taken in respect of the transaction"].
- ◇ [Schwarz v. Kellogg](#), 243 S.W. 179, 184 (Mo. 1922) ["At trustee's sale it is well known property does not usually bring its full value. Bidders frequently take their chances both on the value and title of the property. If such sales were set aside because the price was but one-third or one-fourth its full value, bidding at such sales would be unduly discouraged and hampered because, after all, the true value of real estate is a matter about which there is a great difference of opinion even among men having the same opportunity to know its value"].

- ◇ [Carondolet Savings and Loan Assn. v. Boyer](#), 595 S.W.2d 744, 747 (Mo.App. 1980) ["it is a well-established rule in Missouri that mere inadequacy of consideration, without more, will not justify setting aside a foreclosure sale"].
- ◇ [Kurtz v. Ripley County State Bank](#), 785 F.Supp. 116, 118-19 (E.D.Mo. 1992) ["If a sale is fairly and lawfully conducted, without fraud and partiality and with full opportunity for competitive bidding, then an inadequate sale price alone will not justify setting aside a foreclosure sale"].

There are two other fundamental reasons that a low sale price at a trustee's sale is not a defense to collection of a deficiency in Missouri:

- first, it is well recognized in Missouri that a lender is free to ignore its collateral entirely and instead sue on the debt it is owed and collect a judgment for the entire amount of that debt. [Bank of Houston v. Milam](#), 830 S.W.2d 705, 707 (Mo.App. 1992). Thus, a return of zero on a lender's collateral is not a defense to an action on the debt owed by the borrower and guarantor; and
- second, and more important, when a trustee's sale of collateral is conducted, the lender itself is not required to even bid at that sale. [Boatmen's Bank of Pulaski County v. Wilson](#), 833 S.W.2d 879, 882 (Mo.App. 1992). This means that a third-party bidder can be the sole bidder at a foreclosure sale



and be the successful bidder at the sale after issuing a very low bid. After the money is tendered to the trustee, and duly delivered to the lender, the lender is free to seek the balance of the deficiency from the borrower and any guarantors.

Borrowers, guarantors and their lawyers may view this last hypothetical as a true doomsday scenario – a tragic miscarriage of justice. But they need not view it that way at all, nor should they.

The obligors and their lawyers may be right to view this last scenario (as unlikely as it is) as involving absurd behavior by the lender (unless the property is environmentally unsound or otherwise so “toxic” that ownership of it is unjustified). But it also involves equally absurd behavior by the borrower and guarantors – and this is something that is rarely stated in the debate over proper measurement of deficiencies following foreclosure sales. Borrowers, guarantors, and their lawyers should know what Missouri law prescribes in terms of what a lender must do, and what a lender is not required to do, in connection with a foreclosure sale. And they should know enough that anyone attending a sale of their property is not going to be required to bid a specific amount. In turn, that should lead those borrowers, those guarantors, and their lawyers to a commonsense conclusion: they should attend the foreclosure sale of the

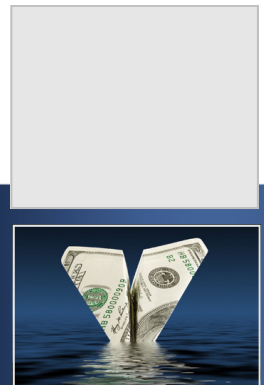
property that secures their debt, and they should themselves prepare to bid at it.

It is true that the obligors may still owe a deficiency afterward. But, at least for their troubles, they will have emerged from the process still in ownership of their property if they place a bid superior to the prevailing bid that they intend later to protest as having been inadequate, “shockingly inadequate,” or a “steal,” allegations that all experienced lenders’ lawyers have seen at one time or another. (Meanwhile, the lender, too clever by half, will have effectively traded his secured claim for an unsecured claim; thus, the borrower’s “doomsday scenario” has been converted to the lender’s, by virtue of the borrower’s vigilance in attending the sale).

In addition, the presence of obligors at the foreclosure sale may benefit those obligors in another way. Their bid may, in turn, lead to competitive bidding – driving up the price, nullifying the effect of the allegedly shockingly low opening bid, and, *voila*, decreasing the deficiency owed by the obligors afterward. By undertaking these efforts, the obligors will have acted to protect themselves more effectively than by retaining (and paying) lawyers after the fact, who will only lead those obligors to the courthouse and plead to a judge to allow them to hide behind the judge’s robe, when Missouri’s statutes allow for no such thing.¹

¹ There are circumstances under which it will not be feasible for borrowers and guarantors to bid competitively at foreclosure sales. There are situations where lenders do not work with their borrowers over prolonged periods of time, during which the borrowers and guarantors may have been provided the opportunity to seek financing in an effort to strike a deal with their lenders, or during which borrowers could, at a minimum, at least have been lining up enough financing to bid at a foreclosure sale should the day of reckoning come. In those cases, where the lender simply declares default and proceeds quickly to foreclosure (as it has the right to do), there may simply not be enough time for a borrower or guarantor to procure financing for the foreclosure sale. There are also other situations where downtrodden borrowers or guarantors, no matter how much time they might have, simply will not qualify for any level of financing and therefore may not be able to bid at a foreclosure. Missouri statutes do not provide any means of relief for such unfortunate obligors; for them, the last resort to reorganize their affairs, maximize property value, and/or minimize their deficiency obligations is Title 11 of the United States Code – which provides them the right to seek the relief, not available to them from Missouri judges, from United States bankruptcy judges.

² *First Bank v. Fischer & Frichtel, Inc.*, 364 S.W.3d 216 (Mo. 2012).



Fischer & Frichtel²

The Facts and the Holding

Fischer & Frichtel, Inc. ("F&F") borrowed more than \$2.5 million from First Bank, and gave First Bank a lien on real estate. Over time the loan was paid down, but in 2005, during a decline in the housing market, F&F struggled to sell lots for sales of homes. This caused F&F to default on the loan debt that it owed to First Bank.

First Bank worked with F&F and extended the maturity date on the loan six times. The final extended maturity date came and went in September 2008. The unpaid maturity at the time was in excess of \$1.1 million. The parties did not agree on a further extension and First Bank foreclosed on the property.

There were no allegations that the sale was improperly conducted in any way. The prevailing bid at the sale was \$466,000, and that bid was made by First Bank.

First Bank sued to collect the debt. When it did, First Bank alleged it was owed the full amount of the debt it was owed (i.e., the debt less a credit for the net proceeds of the \$466,000 that was bid at the sale). The case went to trial. At the trial, F&F presented expert testimony to the effect that the property had a fair market value of \$918,000 at the time of the sale.

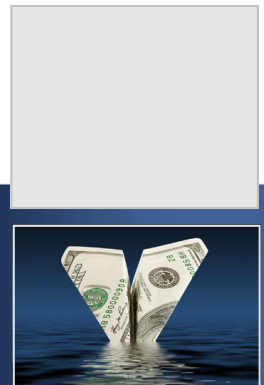
The trial court initially did something extraordinary by the standards of Missouri law. Liability was not an issue; only the amount owed to First Bank was. The trial court instructed the jury not to award First Bank the amount of the debt it was owed. Instead, it instructed the jury to award First Bank the amount of its debt as it existed prior to the foreclosure sale, less the fair market value of the property at the time of foreclosure.

This was obviously an error by the trial court (an error that was, as explained below, duly recognized and

corrected by the trial court). The debt before the foreclosure sale was the \$1.1 million owed to First Bank, together with any other interest and charges owed under the applicable loan documents. Then, a foreclosure sale of the property was held in accordance with Missouri law. That sale resulted in a *payment* on that debt in the amount of the net proceeds realized from the sale (the prevailing bid of \$466,000, less costs). There was no payment made on the loan in any other amount. The lender neither received nor realized any money against the debt it was owed other than the prevailing \$466,000 bid, which the lender credited against the debt. Again, there was no payment received by the lender on account of the sale other than in the amount of the prevailing bid. This was true irrespective of whether the real estate collateral in question had a non-foreclosure "fair market value" of ten dollars or 10 million dollars – or whether it was worth \$466,000 or \$918,000.

Because the jury instruction was clearly in error – directing the jury to award First Bank something other than the amount of debt First Bank was owed – First Bank filed a motion for a new trial. The trial court admitted its mistake and granted the motion. F&F, no doubt realizing the considerable gift it had been given in the form of the improper jury instruction, appealed the order granting the new trial.

The case made its way to the Missouri Supreme Court, which affirmed the order granting the new trial.



The Supreme Court's Analysis – and Strong Hint

The Missouri Supreme Court began with an explanation of how different states set deficiencies owed by obligors following foreclosure sales, stating that some states utilize the amount of the prevailing bid to set the deficiency only if there is no challenge by the obligor with respect to the adequacy of the bid amount. In those states, if there is such a challenge, the courts sometimes reject the bid amount in favor of "fair market value" and thus set the deficiency at a lesser amount. In such cases, the equation for calculating a deficiency (using the above hypothetical) would be altered as follows:

Total Indebtedness:	\$1.2 million
Bid at Trustee's Sale:	\$700,000.00 (Rendered Irrelevant)
Fair Market Value:	\$1 million
Deficiency Owed:	\$200,000.00

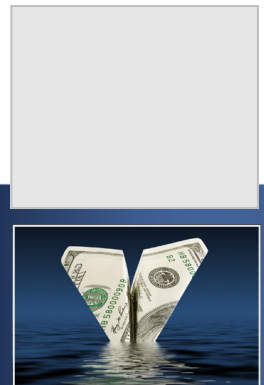
The Court noted that this approach is recommended by the Restatement (Third of Property), which would "always allow debtors to pay only the difference between the debt and the fair market value of the property at the time of the foreclosure sale ..."

The Missouri Supreme Court then explained that Missouri, together with a number of other states, have not followed the recommendation of the Restatement and have, instead, set the deficiency in an amount equal to the debt less the prevailing bid. These states, including Missouri, "do not permit a debtor to attack the sufficiency of the foreclosure sale price ... even if the debtor believes that the foreclosure sale price was inadequate."

The perceived distinction in approaches raises a core issue, however, which is this: are the approaches really different to begin with? The Missouri Supreme

Court's own observation was that the Restatement would call for obligors to pay "only the difference" between debt and "fair market value ... at the time of ... foreclosure ..." (emphasis added). But if a foreclosing lender scrupulously complies with the law of Missouri (or of any state), and forecloses in strict compliance with that law, does not the prevailing bid that is set forth on the day of sale, no matter whether there is a lively concourse of bidders or a lonely secured lender standing at the courthouse steps, affirmatively establish the "fair market value at the time of foreclosure"? It would seem that it does, because the circumstances of the situation dictate precisely in what context the property is being sold. In turn, they dictate who ultimately bids, and who places the greatest bid.

It is true that, on the very next day, when a lender then takes the property into REO (Real Estate Owned), that lender will look to market the property in a different way than it was marketed for foreclosure (notice to obligors, publication, etc.). And that very different marketing process may then establish a new (and greater) "fair market value" for the property. But that expanded, more diligent sale process in which the lender may engage following foreclosure is not statutorily required of him *when he forecloses*. Thus, consideration of "fair market value," in lieu of a prevailing credit bid placed at a properly conducted trustee's sale, constitutes judicial legislation, and is not proper in calculating the deficiency.



The Missouri Supreme Court noted that Missouri's rule for establishing deficiencies (debt less bid, without regard for "fair market value" of a property subjected to the open market) does contain the very smallest of exceptions: the case where the sale actually "shocks the conscience" of the court. The Court noted that this exception is "among the strictest in the country" because the sale price must be so inadequate under the circumstances that it gives rise to an "inference of fraud."

While the exception may be among the strictest in the country, it is also utterly correct – and Missouri should be proud of the fact that its judiciary has steadfastly set forth such an eminently reasonable standard so consistently for so long. Again, the basis for it goes back to Missouri's statutory scheme governing trustees' sales under powers of sale contained in deeds of trust. If the statutes are followed, the sales that ensue should be unassailable, absent fraud.³ If a different result is wanted, it should be effected by statutory amendment, rather than by judicial substitution of the Restatement in place of Missouri's statutes.

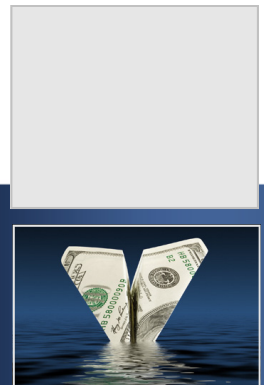
The Missouri Supreme Court rejected F&F's challenge to the order granting First Bank a new trial, noting that Missouri's equation for setting deficiencies is long-established, is subject to *stare decisis*, and should therefore not be lightly overruled. But in the midst of rejecting F&F's challenge, the Missouri Supreme Court managed to load its decision with a significant amount of intrigue. It stated that F&F's public policy arguments – that the court should change the way Missouri calculates deficiency obligations – "have no application to a *sophisticated debtor* such as [F&F]" (emphasis added).

Obviously, this leaves open the question of whether the Court might consider that public policy

would dictate a different result in the case of a "less sophisticated" debtor. While that proclamation may provide hope to the "unsophisticated" and to some debtors' counsel throughout Missouri, it also undoubtedly leaves at least some to wonder whether there is an implication that one rule of law might apply to the unsophisticated, whether another rule of law might apply to the sophisticated, and whether the courts really have a desire to make threshold (and potentially insulting) determinations, in the first place, regarding what parties before them are sophisticated and unsophisticated.

Aside from the issue of "sophistication," it would seem that the greater potential legal effect of the Court's opinion lies in the Court's observation that, while F&F asked that the Court change Missouri law on how deficiencies are calculated, *F&F did not ask that the court consider voiding the foreclosure sale itself*. The opinion, obviously, makes no promises, but it does offer a hint:

... Frischer & Frichtel does not ask this Court to reexamine the strict standard for voiding a foreclosure sale, as one might expect ... This is surprising in one sense, for setting aside an unfair sale, rather than allowing it to stand unchallenged and then considering whether to adjust how to determine the deficiency, would avoid many of the policy concerns raised by both parties ... Moreover, this Court has not reexamined the standard for voiding a foreclosure sale since its decision in Roberts, 232 S.W.2d at 546, decided



³ Missouri's statutes require a lender to follow certain procedures in *foreclosing on real estate*; they do not require that a lender be converted into a real estate broker, undertaking the duty to "shop" the property to obtain fair market value for the benefit of the borrower who breached his contract with the lender.

more than 60 years ago, nor did this Court appear to consider at that time whether its very stringent standard for setting aside a sale was out of step with that used in other states.

Thus, although the Missouri Supreme Court affirmed in Fischer & Frichtel, it made two observations at the close of its opinion that could affect the landscape for Missouri foreclosures in the near future:

- 1) F&F was sophisticated, F&F likely could have arranged financing in order to be a competitive bidder at the foreclosure sale, and F&F nonetheless did not bid at the sale, meaning that the Fischer & Frichtel case was “not a case ... in which to consider a modification of the standard for setting aside a foreclosure sale solely due to inadequacy of price ...” and
- 2) F&F argued for a change in how deficiencies are calculated, and did not argue for a change in when Missouri courts should consider setting aside foreclosure sales outright, something the Missouri Supreme Court found “surprising” given that it had not considered the standard for setting aside foreclosure sales for “more than 60 years” and given that, back when it did last consider the issue, the Court did not consider whether Missouri was “out of step” with other states more kindly disposed to debtors.

With respect to the first hint provided by the Court (and it is just that, a hint, and not a promise of things to come), the problems that would arise if such an approach were taken have already been addressed above. Courts would find themselves in the business of determining between sophisticated and unsophisticated obligors; they would become engaged in fact-finding missions as to whether obligors really had a meaningful

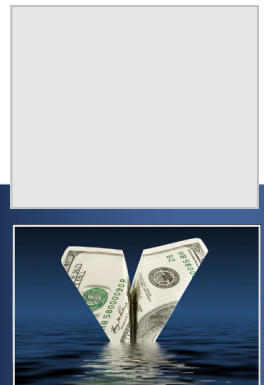
opportunity to competitively bid at foreclosure sales of their properties; and they would do these things in conjunction with an effort to determine whether they should “adjust” deficiency obligations when Missouri statutes provide for no such thing and bankruptcy statutes do.⁴

As to the Court’s second hint – that perhaps a foreclosure sale could be set aside as a means of addressing a perceived unfairness in the obligor’s deficiency obligation – that approach too is fraught with danger in the case where the foreclosing lender has scrupulously complied with Missouri law in conducting the sale. Chapter 443 of the Missouri Revised Statutes governs judicial and non-judicial foreclosures. Any suggestion that a sale might be set aside by judicial caveat when the statutes have been complied with needs to take into account the provisions of Sections 443.280 (applicable to a sale in judicial foreclosure) and 443.290 (applicable to a sale pursuant to a power of sale). Section 443.280 provides:

A purchaser under a sale by virtue of an execution on a judgment rendered in pursuance of the provisions of sections 443.010 to 443.440 *shall take a title as against the parties to the suit, but he shall not be permitted to set it up against the subsisting equities of those who are not parties thereto.*

(emphasis added). And Section 443.290 provides:

⁴ Technically speaking, bankruptcy statutes do not provide for adjustments of deficiency obligations; they provide for discharge of such obligations, meaning that the creditor is enjoined from pursuing them.



All mortgages of real property ... *with powers of sale* in the mortgagee or secured party, and *all sales made by such mortgagee, secured party or his personal representatives*, in pursuance of the provisions of the mortgages ... *shall be valid and binding* by the laws of this state *upon the mortgagors and debtors*, and all persons claiming under them, *and shall forever foreclose all right and equity of redemption of the property so sold.*

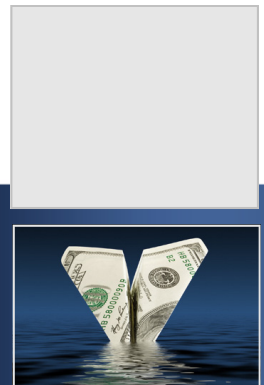
(emphasis added). The language of the statute is clear: when a power of sale in a deed of trust is exercised (and assuming it is exercised in accordance with Missouri's statutes governing foreclosure), the resulting sale is binding on the mortgagors and debtors, and the sale forecloses all of their right in the property. The only exception to this is the mortgagor's statutory redemption right, set out elsewhere in Section 443.

Sections 443.280 and 443.290 were not addressed in [Fischer & Frichtel](#). It is possible that, when the issue of setting aside a Missouri foreclosure sale is next addressed by the Missouri Supreme Court, they will be.

The specific language of Section 443.290 is important to note when recognizing that "fair market value" in a re-sale context (*after* the foreclosing lender has received title to the property and taken it into REO) should not be relevant in properly determining an obligor's deficiency to a lender. The re-sale of the property, after it has been taken into REO, is a subsequent transaction that is completely separate from the loan transaction that was earlier entered into between lender and borrower. In Transaction 1 (in the hypothetical above), Lender loaned Borrower \$1.2 million, and Borrower failed to repay that debt. Lender enforced its remedies in accordance with Missouri statute, and a sale was conducted. At the sale, the prevailing bid was \$700,000.00. That amount was paid to the Lender in accordance with Missouri law, who duly applied it against the debt owed by the Borrower. The sum of \$500,000.00 remained due and owing.

Under Missouri law, anyone could have been the prevailing bidder at the foreclosure sale. It did not need to be the Lender. Title to the property could have been conveyed to Mr. Green or to Ms. White; the identity of the assignee had nothing to do with how much debt was still owed to Lender by Borrower at the end of the day. And there would be no logical corollary between (a) the amount of that debt (the end of Transaction 1) and (b) what Mr. Green or Ms. White did with the property after either of them bought it (the beginning of Transaction 2). They could market it for 10 dollars or 10 million; they could sell it for either of those amounts, or some amount in between. The outcome of their Transaction 2 has no bearing, and should have no bearing, on the amount of debt left to be paid under Transaction 1.

This is not just logic; it is Missouri law. It is Section 443.290, which states that, once the foreclosure sale occurred, the sale foreclosed all of Borrower's right in the property. Thus, what happens to that property afterward is none of his concern and cannot legally impact his rights. He has no more interest in the property, he is not a party to Transaction 2, and he is not any type of third-party beneficiary of its results. Likewise, if Transaction 2 has not yet occurred – if it is still owned by Mr. Green, by Ms. White, or by the Lender, with the property lounging in REO – Borrower has no right to peer into the future, speculate what the property might fetch at a subsequent sale, and hope to gain from it. Nor should he have the right to ask a court to do it for him.



The fact that Transaction 2 is a transaction completely separate from Transaction 1 should (with the greatest respect to the dissenting opinion in Fischer & Frichtel) nullify any argument that the lender might obtain a “windfall” by bidding one amount at foreclosure and re-selling the property at a different amount. A windfall is by definition an unexpected and undeserved *gain* on a specific transaction, but, with respect to Transaction 1, the loan transaction on which the Borrower defaulted, the Lender has incurred a *loss*. Further, real estate lenders in Missouri are not regularly reaping “windfalls” by foreclosing properties at one amount, re-selling them at another, and then “over-collecting” deficiencies from distressed obligors, as experienced real estate lenders throughout Missouri would readily attest. And, as such lenders would further attest, defaulted real estate loans can hardly be characterized as profitable ventures for banks.

There is one final point to be made regarding the separateness of Transaction 1 and Transaction 2. It is an obvious one, but its consequence is striking. In the hypothetical used in this article, the Lender was owed \$1.2 million, bid \$700,000.00 at foreclosure, and is owed a deficiency of \$500,000.00. It goes without saying that, if Lender re-sold the property for, say, \$300,000.00 after taking it into REO, there would not be an *upward* adjustment, to \$900,000.00, in the deficiency owed by the Borrower and Guarantors. Nor should there be. Nothing in the Missouri statutes contemplates that the post-foreclosure real estate market has any effect on the proper measure of a deficiency, and such re-sale market should not be allowed to be used by either a creditor or a debtor in an effort to recalculate the debt that is owed as part of a loan transaction.

The soundness or fallacy of these positions may be tested in the future by people whose opinions matter

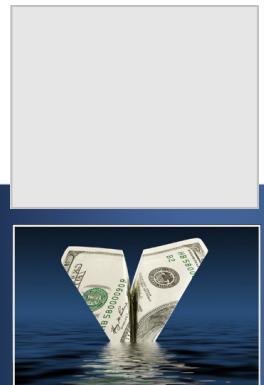
more than the author’s; for now, Fischer & Frichtel is the most recent published decision of the Missouri Supreme Court regarding how to properly measure deficiency obligations following foreclosure. The decision was published in April 2012, and, as noted above, it closed with some degree of intrigue.

It took only two months for another court to opine on just what the Missouri Supreme Court meant when it dropped its hints at the close of Fischer & Frichtel. On June 28, 2012, The Honorable Scott Wright, United States District Court Senior Judge, Western District of Missouri, published his opinion in the Sunrise Farms case. When he did, he opined that the Missouri Supreme Court was not dropping hints at all. Instead, he concluded that they had undertaken a shift that would result in an “inevitable” change in Missouri law.

*Sunrise Farms*⁵

The Facts and the Holding

M&I Marshall & Ilsely Bank (“M&I”) was the holder of four promissory notes under which Sunrise Farms Development, LLC (“Sunrise Farms”) was the maker. Through the years, the debts evidenced by the notes were extended and modified from time to time and were also the subject of a forbearance agreement. In 2010, with the debts in default and with no further deals to be made between the parties, M&I scheduled a foreclosure of the property that secured the debt.



⁵ M&I Marshall & Ilsley Bank v. Sunrise Farms Development, LLC, 2012 WL 2522671 (W.D.Mo. 2012).

The Bank was the only bidder at the sale and placed the prevailing bid of a little more than \$3.72 million. M&I then sued Sunrise Farms and the guarantors for the deficiency, an amount in excess of \$2.5 million. The obligors defended, including on the basis that the property foreclosed had a fair market value of \$6,050,000 at the time of the foreclosure.

The Court determined that the deficiency obligation owed to M&I should not be the amount of the debt (the pre-foreclosure debt less the amount received at foreclosure) but instead should be an amount equal to the pre-foreclosure debt less the fair market value of the property. Thus, on the issue of the amount due and owing, the Court denied the Bank's motion for summary judgment.

In so ruling, the Court delved heavily into the Fischer & Frichtel decision. The reader will remember that the Missouri Supreme Court in Fischer & Frichtel noted the possibility that the Missouri rule on measuring deficiencies might change, but that the facts of Fischer & Frichtel, and the specific plight of F&F in that case, did not offer the case for any such change. F&F was sophisticated, F&F did not bid at the foreclosure sale, etc.

Likewise, Sunrise Farms appeared to be a sophisticated commercial lender. Also, Sunrise Farms, like F&F, had been the beneficiary of a number of extensions and a forbearance agreement, meaning that Sunrise Farms could have, through the years, sought financing to at least bid some specific amount at a foreclosure sale in the event such a sale occurred. There is no mention in the opinion that, when the sale was conducted, either Sunrise Farms or any guarantor placed a bid in excess of the Bank's bid of \$3.72 million, notwithstanding the fact that Sunrise Farms and the guarantors would later allege that the property was worth more than \$6 million.

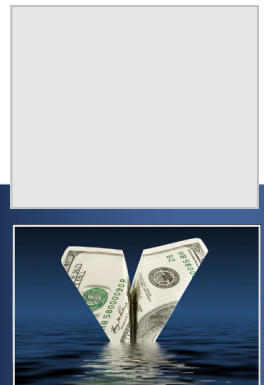
The District Court in Sunrise Farms did not analyze whether the case in front of it was an appropriate one in which to change long-standing Missouri law on the

measurement of deficiency obligations. In other words, it did not, at least in its written opinion, consider whether to reject Sunrise Farms' arguments on the same basis that the Missouri Supreme Court rejected the arguments of H&H. In failing to set forth that analysis, the Court in Sunrise Farms ignored a critical part of the holding in Fischer & Frichtel ["F&F has not argued it could not have purchased the property at the foreclosure sale ... This is not a case, therefore, in which to consider a modification of the standard for setting aside a foreclosure sale ... or whether a change should be made in the manner of determining a deficiency where the foreclosure price is less than the fair market value"].

Instead, the District Court concluded that the Missouri Supreme Court is ready to overhaul long-standing Missouri law on the measure of deficiency obligations when the Missouri Supreme Court is presented with the "right case." Further, the District Court *de facto* concluded that Sunrise Farms *did* in fact present the "right case" for the District Court to embark on a new measure of the deficiency obligation – the District Court ruled that the deficiency should be measured by subtracting from the pre-foreclosure debt the fair market value of the property.

In its decision, the District Court stated:

As the Court interprets this case [the Fischer & Frichtel case], the Missouri Supreme Court seems more than willing to reexamine the strict standard for voiding a



foreclosure sale based upon inadequate sale price. The Missouri Supreme Court also seems willing to adopt some form of the Restatement approach in measuring deficiencies.

Fischer & Frichtel is indeed evidence that the Missouri Supreme Court is willing to reexamine the proper method for calculating deficiency obligations following foreclosures of real estate by lenders. It is also evidence that the Missouri Supreme Court is willing to reexamine a change in Missouri law regarding the standards for setting aside foreclosure sales on the basis of inadequate bid price. But Fischer & Frichtel does not mean that either change will occur, and it certainly does not mean that either change has occurred.

The District Court went with the new standard anyway and stated:

Ordinarily, if the state's highest court has announced a rule, this Court is bound to follow it. But if the Court finds *clear evidence* that the state's highest court would not uphold the prior decision, the Court is not required to follow it in this case ... This Court concludes that, if the Missouri Supreme Court were to address the issue today *with the right case*, it would follow the Restatement approach for valuing the deficiency amount.

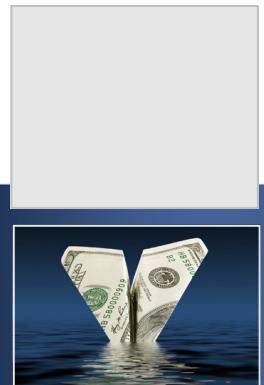
(emphasis added). For the reasons set forth above, the author respectfully disagrees that Fischer & Frichtel offers "clear evidence" that the long-standing Missouri rule on the measure of deficiency obligations either has changed or is about to change. Further, even if it does, it will be, as the District Court noted, "with the right case." There is nothing in the Sunrise Farms opinion that sets out why Sunrise Farms was the "right case" to make the change.

Instead of setting out an analysis of why the obligors were entitled to benefit from a radical departure from long-established Missouri law, Sunrise Farms simply

concluded there was no reason not to immediately move on to the new approach that was only considered as a possibility under Fischer & Frichtel:

As Justice Teitelman saw no reason to wait for the legislature to institute this change in measuring deficiencies, this Court, too, can think of no rationale for prolonging the inevitable. Indeed, the fact that so many states have chosen to adopt some form of the Restatement approach is evidence in and of itself that Missouri will soon make some form of change to the existing law and move toward the fair market valuation.

But Fischer & Frichtel never stated that a change was inevitable, and Justice Teitelman's position, that Missouri law on measuring deficiencies should change immediately, was set forth in a *dissenting* opinion, and not in the majority. This makes it difficult to justify the District Court's determination that there is "clear evidence" that Missouri law on the issue will change. Further, it goes without saying that the Restatement is not Missouri law; its authors are not elected officials of the State of Missouri. Section 443 of the Missouri Revised Statutes are, to this day, and long have been, Missouri's applicable law on foreclosure sales. And they do not require resort to any type of "fair market value" determination.



Conclusion

The Missouri Supreme Court examined in Fischer & Frichtel an issue of Missouri law that had not received much critical attention in recent years. In the end, the Court did not change the prevailing rule, but it left open the possibility that it might be subject to even further scrutiny and, with the right facts and circumstances, perhaps even to change.

Sunrise Farms then boldly went where Fischer & Frichtel did not. It proclaimed that potential change as “inevitable,” and determined that there is “clear evidence” that the Missouri Supreme Court would now no longer follow a Missouri rule of law that has been in force for decades. Whether the Court in Sunrise Farms will be proven correct, that a change in Missouri law is inevitable, is a matter for time to tell. Whether that

change should be forthcoming at all is a matter of opinion.

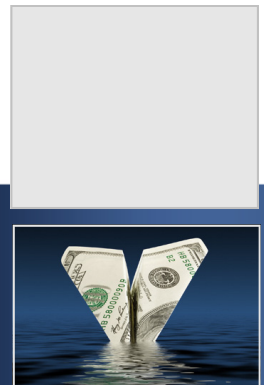
In the meantime, lenders in Missouri need to be aware of the potential of a change in the landscape and be better prepared to justify their bids at foreclosure sales. At the same time, borrowers and guarantors now have an additional argument at their disposal as they seek to minimize their deficiency obligations after their properties are foreclosed. They may not be required to seek to protect themselves by bidding competitively at foreclosures, and they may not be required to seek bankruptcy protection in order to alter their payment obligations to their lenders. They might – just might – be able to procure those adjustments from Missouri courts, depending exactly on how their specific judge views the impact of the Fischer & Frichtel and Sunrise Farms decisions on Missouri law that has been in place for more than 100 years. ■



For More Information

For more information, or if you have any questions regarding creditors rights, loan enforcement or creditor bankruptcy representation, please contact:

- Brett D. Anders | 816.360.4267 | banders@polsinelli.com
- Michael A. Campbell | 314.552.6805 | mcampbell@polsinelli.com



About Polsinelli Shughart's

Creditors Rights, Loan Enforcement and Creditor Bankruptcy Representation

PRACTICE GROUP

Brett D. Anders
Practice Area Chair
Kansas City
816.360.4267
banders@polsinelli.com

Michael A. Campbell
Practice Area Chair
St. Louis
314.552.6805
mcampbell@polsinelli.com

James A. Billingsley
Dallas
214.661.5541
jbillingsley@polsinelli.com

DeMario Carswell
St. Louis
314.552.6866
dcarswell@polsinelli.com

Michelle L. Clardy
St. Louis
314.552.6830
mclardy@polsinelli.com

Daniel S. Dooley
Kansas City
816.360.4358
ddooley@polsinelli.com

Sherry K. Dreisewerd
St. Louis
314.552.6806
sdreisewerd@polsinelli.com

Robert J. Edwards
Kansas City
816.360.4164
redwards@polsinelli.com

David D. Ferguson
Kansas City
816.360.4311
dfferguson@polsinelli.com

Daniel J. Flanigan
Kansas City | New York
816.360.4260
212.644.2090
dflanigan@polsinelli.com

Tiffany R. Harper
Chicago
312.873.3688
tharper@polsinelli.com

Amy E. Hatch
Kansas City
816.360.4178
ahatch@polsinelli.com

Aaron C. Jackson
Kansas City
816.360.4277
ajackson@polsinelli.com

G. Edgar James
Kansas City
816.395.0661
ejames@polsinelli.com

Shanti M. Katona
Wilmington
302.252.0924
skatona@polsinelli.com

Matthew S. Layfield
St. Louis
314.552.6834
mlayfield@polsinelli.com

Matthew R. Moriarity
Kansas City
816.360.4184
mmoriarity@polsinelli.com

Jason A. Nagi
New York
212.644.2092
jnagi@polsinelli.com

Thomas J. O'Neal
Springfield
417.829.3801
toneal@polsinelli.com

Anthony C. Porcelli
Chicago
312.873.3629
aporcelli@polsinelli.com

Peter J. Schmidt
Chicago
312.873.3627
pschmidt@polsinelli.com

Scot J. Seabaugh
St. Louis
314.552.6845
sseabaugh@polsinelli.com

Cristel D. Shepherd
Denver
720.931.1179
cshepherd@polsinelli.com

Shannon Y. Shin
Chicago
312.463.6358
sshin@polsinelli.com

Jean Soh
Chicago
312.873.3628
jsoh@polsinelli.com

Randy B. Soref
Los Angeles
310.203.5367
bsoref@polsinelli.com

Terrance M. Summers
Kansas City
816.360.4212
tsummers@polsinelli.com

Jerry L. Switzer, Jr.
Chicago
312.873.3626
jswitzer@polsinelli.com

Michael M. Tamburini
Kansas City
816.360.4185
mtamburini@polsinelli.com

Angela S. Taylor
Kansas City
816.360.4143
ataylor@polsinelli.com

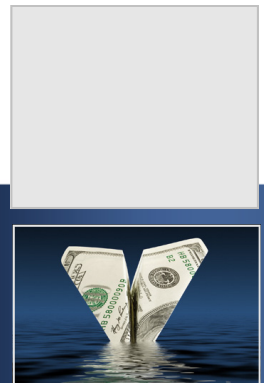
John M. Tyner
Springfield
417.829.3811
jtyner@polsinelli.com

David P. Vallas
Chicago
312.873.3620
dvallas@polsinelli.com

Christopher A. Ward
Wilmington
302.252.0922
cward@polsinelli.com

Llynn K. White
St. Louis
314.552.6804
lwhite@polsinelli.com

Jennifer L Worstell
Chicago
312.873.3619
jworstell@polsinelli.com



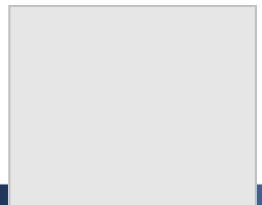
About

Creditors Rights, Loan Enforcement and Creditor Bankruptcy Representation

Lenders in today's market are under severe stress from rising defaults, distressed portfolios and problem credits of all types. Attorneys in the Creditor's Rights, Loan Enforcement and Creditor Bankruptcy Representation Law group have assisted numerous lenders with creative remedies that help lenders maximize their recoveries.

As one of the largest and most experienced creditors rights group in the Midwest, we offer our clients the highest level of knowledge and most comprehensive set of creative solutions for their troubled loans. In addition, we communicate with our clients in an efficient and effective way through AMS extranets, which allow us to provide them with reports and the ability to upload documents and information in a safe and secure environment.

To learn more, visit us online at www.polsinelli.com.



About

Polsinelli Shughart

Serving corporations, institutions, entrepreneurs, and individuals, our attorneys build enduring relationships by providing legal counsel informed by business insight to help clients achieve their objectives. This commitment to our clients' businesses has helped us become the fastest-growing, full-service law firm in America*. With more than 630 attorneys in 16 cities, our national law firm is a recognized leader in the industries driving our growth, including health care, financial services, real estate, life sciences and technology, energy and business litigation. The firm can be found online at www.polsinelli.com. Polsinelli Shughart PC. In California, Polsinelli Shughart LLP.

* *Inc. Magazine*, September 2012

About

This Publication

If you know of anyone who you believe would like to receive our e-mail updates, or if you would like to be removed from our e-distribution list, please contact Interaction@polsinelli.com.

Polsinelli Shughart provides this material for informational purposes only. The material provided herein is general and is not intended to be legal advice. Nothing herein should be relied upon or used without consulting a lawyer to consider your specific circumstances, possible changes to applicable laws, rules and regulations and other legal issues. Receipt of this material does not establish an attorney-client relationship.

Polsinelli Shughart is very proud of the results we obtain for our clients, but you should know that past results do not guarantee future results; that every case is different and must be judged on its own merits; and that the choice of a lawyer is an important decision and should not be based solely upon advertisements.

Polsinelli Shughart PC. In California, Polsinelli Shughart LLP.

Polsinelli Shughart® is a registered trademark of Polsinelli Shughart PC.

