

Missouri Supreme Court Reaffirms Deficiency Judgment Measure

On April 17, 2012, the Missouri Supreme Court affirmed that Missouri law will continue to calculate a deficiency judgment based on the difference between the debt owed and the price paid at foreclosure, absent modification by statute. In *First Bank v. Fischer & Frichtel Inc.*, the court voted 6-1 to uphold the state's common law approach in lieu of adopting the Restatement (Third) of Property's fair value methodology despite the latter's widespread acceptance in other states. The court left open the possibility that it might reconsider the standard for voiding a foreclosure sale based on an inadequate sales price.

First Bank v. Fischer & Frichtel Inc.

In 2000, First Bank (the "Lender") loaned Fischer & Frichtel (the "Borrower") \$2,576,000 to purchase 21 lots in Franklin County, Missouri. Over the next eight years, the Borrower sold 12 of the 21 lots and made payments toward the principal on its loan, which, after several modifications, was to become due on September 1, 2008. After the Borrower failed to pay the balance due, the Lender conducted a foreclosure sale for the nine remaining lots, which the Lender, as the sole bidder, eventually purchased for \$466,000. The Lender then sued the Borrower to collect the balance due on the note of \$667,875.75.

At trial, the Circuit Court admitted certain evidence regarding the value of the foreclosed property, which reflected an appraised value of approximately \$100,000 per lot – double the amount paid by the Lender at the foreclosure sale. The jury instruction stated: "If you find in favor of [Lender], then you must award [Lender] the balance due [Lender] on the promissory note on the date of maturity, *less the fair market value* of the property at the time of the foreclosure sale, plus interest." The trial court overruled the Lender's objection to this instruction, and the jury awarded the Lender \$215,875 for its deficiency judgment and \$37,500 for interest. The Lender, claiming it was due a deficiency judgment in the amount due on the note less the *price bid at the*

foreclosure sale, filed a motion for a new trial, arguing that the Circuit Court erred in the jury instruction because it misstated Missouri law. After the Circuit Court granted the Lender's motion, the Borrower appealed to the Missouri Court of Appeals for the Eastern District, which subsequently transferred the case to the Missouri Supreme Court.

The Borrower asked the Missouri Supreme Court to overrule Missouri's common law approach to measuring deficiency judgments and adopt the Restatement (Third) of Property fair value calculation method, which limits a lender's deficiency damages to the difference between the fair market value of the property on the date of the sale and the amount due on the note. During oral argument, counsel for the Borrower stated that 35 states have incorporated a fair market value approach. In rejecting the argument, however, the court noted that the states using the fair market value approach have either always done so or have done so in accordance with state statute.

Although lenders may take comfort in the status quo ruling as to the measure of deficiency judgments, they should be aware that the court appears willing to revisit another aspect of the foreclosure process, a challenge to the strict standard for voiding a foreclosure sale based upon an inadequate sales price. Currently, Missouri law requires a borrower to demonstrate that the price paid at the sale is "so gross that it shocks the conscience...and is in itself evidence of fraud." *Cockrell v. Taylor*, 145 S.W.2d 416, 422 (Mo. 1940). Although the Borrower argued that this onerous standard is so strict that it provides an illusory remedy, it did not ask the state Supreme Court to revisit it. The court expressed surprise at the omission, noting that the court has not re-examined the standard for voiding a foreclosure sale in more than 60 years. Even then, the court did not consider whether its standard for setting aside a sale was out of step with that used in other states at the time.

What This Means to You

In light of the court's analysis in this case, we advise all lenders to carefully assess their credit bid at a foreclosure sale and consider consulting with a Husch Blackwell attorney about their bid strategy. This case may prompt disgruntled borrowers to challenge the validity of the price paid at a sale, and the court seems willing to revisit other aspects of its archaic standard.

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