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Right of Deficiency Judgment Where Mortgagee Purchasing at Foreclosure Sale has Later Resold at a Profit

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RIGHT TO DEFICIENCY JUDGMENT WHERE MORTGAGEE PURCHASING AT FORECLOSURE SALE HAS LATER RESOLD AT A PROFIT.

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The purpose of this brief discussion is to consider some aspects of the mortgagee's right to a deficiency judgment, where the mortgagee, upon forclosure, has bought in the property at a sum less than the amount of the mortgage indebtedness, but thereafter sells the property at a price in excess of his bid at the foreclosure sale and sufficient to extinguish the amount of the deficiency judgment sought. It is not intended to include any discussion, other than in passing, of statutes relating to deficiency judgments, or the question of the liability of particular parties, such as indorsers of mortgage notes, for deficiencies.

As a foundation for approaching the situation it is perhaps necessary to restate briefly certain fundamentals which are well known to the reader, and the writer makes due apology therefor.

A mortgage in its usual form is executed by the property owner, of course, as security for a debt owed by him to the mortgagee, the creditor being entitled, in case of nonpayment of the debt, to seek his reimbursement from the sale of the mortgaged property. Where the sum received from the sale is insufficient to reimburse the creditor entirely, he may usually obtain a personal judgment against the debtor for such deficiency.[1]

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[1] See, for example, *In re* White's Estate, 322 Pa. St. 85, 185 A. 589 (1936).

In some states, the right to a deficiency judgment appears to be dependent upon statute, rather than on general equitable principles. See Lewis v. Matteson, 257 Ill. App. 1 (1930); Metz v. Dionne, 250 Ill. App. 369 (1928); City Real Estate Co. v. Realty Construction Corp., 167 Misc. 379, 3 N. Y. S. (2d) 312 (1938); Stellmacher v. Simpson, 195 Wis. 635, 219 N. W. 343 (1928).

In other states, granting the mortgagee a deficiency judgment may rest in the court's discretion, and the light thereto is dependent upon the circumstances of the case. See Atlantic Shores Corp. v. Zetterlund, 103 Fla. 761, 138 So. 50 (1931).

Equity's power in absence of statute to render deficiency judgment, see note, 34 A. L. R. 1015.

As a matter of actual fact, because of lack of bids, or because of insufficiency in the amount of the bids at the foreclosure sale, the creditor frequently is compelled to buy in the property himself. In any event, whether the property is purchased at the foreclosure sale by a stranger or by the mortgagee himself, the purchaser is usually, in the absence of any special agreement, entitled to take the property free from the lien of the mortgage, and the obligor for the payment of the debt is responsible for any deficit.

However, it must be admitted that some argument may be advanced that since the property represents security for the debt, if in any course of dealing at all with the property the creditor ends up by receiving through such property an amount more than equal to the amount of the debt, his debt is satisfied and he should be entitled to recover no additional sums, as for instance through a deficiency judgment against the morgagor. Thus, where the mortgagee has bought in the property at the forclosure sale for an amount less than that of the debt owing to him, but has later sold the property at such considerable profit that his monetary return through the property has equalled or exceeded the amount of the debt, it has been contended that he is entitled to nothing further.

A recent decision in Kentucky[2] offers an interesting example of this argument. It appeared therein that a landowner borrowed some $20,000 from a land bank, executing a first mortgage on his property. Subsequently, he borrowed additional amounts from two state banks, executing to them second mortgages on the property. While he met his payments on the first mortgage, he apparently was unable to do so as to the second mortgages, and eventually he conveyed his title in the property to the state banks on condition of cancellation of his indebtedness to them and upon condition that they assume the mortgage indebtedness to the land bank. The state banks thereafter conveyed the property to individuals who also assumed the mortgage indebtedness to the land bank.

Upon their failure to meet the payments on the mortgage, the land bank foreclosed, bought in the property itself for some $13,000, and sought a deficiency judgment against the mortgagor

[2] Kentucky Joint Stock Land Bank v. Farmers Exchange Bank, 274 Ky. 525, 119 S. W. (2d) 873 (1938).

and those assuming the mortgage indebtedness. Following rendition of a judgment dismissing that portion of the petition seeking such personal judgment and after the land bank's appeal was prosecuted therefrom, the land bank sold the property to a stranger for a total consideration in excess of its bid at the foreclosure sale, sufficient to extinguish the deficiency judgment that it sought.

At that point the appellees entered the contention (which the court termed "indeed a novel one") that the profit realized by the land bank by such resale satisfied the unpaid balance of the debt, after crediting the net proceeds of its bid thereon, and wiped out the deficiency which is sought to recover from the appellees.

In reversing the judgment of the lower court dismissing that portion of the petition seeking deficiency judgments, the appellate court refused to give serious consideration to the appellees' contention. It pointed out that whether the land bank would ever collect the consideration from its vendee was problematical, since its payment was spread over a long period of years, and whether the vendee's installment promises would be promptly or at all met was uncertain. Moreover, it declared that there was no distinction between a purchase at a foreclosure sale by a stranger and purchase by the mortgagee, and that in each case the mortgagor was still responsible for any deficit. It quoted from a standard text work[3] to the effect that the sum for which mortgaged property is sold must be taken, as between the parties to the sale, as conclusive test of its value, and that the amount of the deficiency is to be ascertained accordingly and not by taking the market value at the time, in case it exceeds the amount received from the sale.

The Kentucky court also distinguished a decision of the Tennessee Court of Appeals[4] which the appellees cited to support their contention. The Tennessee case is somewhat similar so far as concerns the facts that the mortgagee foreclosed, bought in the property, sold at a profit, and sought a deficiency judgment. However, the foreclosure appears to have been unfair to a degree

[3] Jones on Mortgages (8th ed.), § 2206.
See also 42 Corpus Juris 295; Reed v. Inness, (Mo. App.) 102 S. W. (2d) 711 (1937); *In re* White's Estate, 322 Pa. St. 85, 185 A. 589 (1936).

[4] Union Stock Joint Land Bank v. Knox County, 20 Tenn. App. 273, 97 S. W. (2d) 842 (1936).

amounting to fraud, and the court designated the price paid as inadequate. Upon those grounds the court looked with disfavor upon the attempt to obtain a deficiency judgment, characterizing it as a "windfall" sought by the mortgagee after it had, through the resale of the property, obtained an amount sufficient to cover the entire obligation.

In regard to the matter of an inadequate price being paid at the foreclosure sale, it is interesting to note that in the Kentucky case the land was appraised, prior to the foreclosure sale, at $8,475, and the mortgagee bid in the property for a sum slightly in excess of $13,000.[5] Thus, no ground appears to have existed for contending that the price paid was inadequate, and indeed no such contention was advanced. Nor was any attack made upon the fairness of the foreclosure proceedings.

Returning again to momentary consideration of the Tennessee decision, such decision appears to be in line with a number of decisions in foreclosure proceedings brought about due to the period of economic depression.[6] Many appellate courts have evidently considered it unjust to grant a deficiency judgment where the mortgagee has been made whole by means of the mortgaged property itself. Indeed, it is common knowledge that during the piling up of foreclosure proceedings during the depression, many trial courts, even in the face of repeated reversals, consistently refused to grant deficiency judgments at all, continuing the proceedings until the mortgagee was willing to enter into some compromise agreement with the mortgagor, such as agreeing to accept the property itself in full settlement of the indebtedness.

Thus, the principles referred to by the Kentucky court that the amount of the deficiency is to be ascertained by the sum for which the property was sold at the foreclosure sale, and not by taking the market value of the property even though exceeding in amount the sum received at the sale, has been departed from by several courts. Where the mortgagee has purchased the property at the foreclosure sale, they have held that equity

[5] In some states, statutes now require appraisal of the property before foreclosure sale. See, for example, Louisiana and New York statutes.

[6] For comprehensive annotations upon the financial depression as justification for moratorium or other relief to mortgagor (including decisions under statutes in that regard), see 104 A. L. R. 375; 97 A. L. R. 1123; 96 A. L. R. 853; 94 A. L. R. 1352; 90 A. L. R. 1330.

demands, in view of the times, that the market value of the land be considered, and where it equals or exceeds the amount of the debt, deficiency judgments have been denied.[7] Of course, in some states, by statute, it may be shown as a defense to a deficiency judgment that the property was worth the amount of the debt or that the price bid was less than the real value of the property.[8]

While such decisions, referred to above, did not actually involve a situation where the mortgagee later resold the property at a profit, it will be seen that the situation therein is closely analagous, for if the appraised market value is greater than the price paid at the foreclosure sale it may naturally be assumed that the mortgagee who obtains the property at the foreclosure can, if he wishes, sell at the market price at a considerable profit.

However, even in cases similar to the Tennessee case wherein profits on resale are considered in their effect on the right to deficiency judgments, it will be found (as in the Tennessee case) that fraud or unfairness in the foreclosure sale, or inadequacy in the price bid therein, is the turning point upon which the decision is made. In this regard, consider a New York case[9] in which property subject to a mortgage of $9,000 was bought in at the foreclosure sale by the mortgagee for $500, and a judgment was also obtained by the mortgagee against the mortgagor for a deficiency in excess of $10,000. Thereafter, the mortgagee sold to a bona fide purchaser for $13,000, all cash. In view of that fact the court refused to allow enforcement of the deficiency judgment and relieved the mortgagor from such judgment.

The New York case is distinguishable from the Kentucky case upon at least two points. First, the price paid at the foreclosure sale was obviously inadequate, a fact not appearing in the Kentucky case; second, the prize received on the resale was

[7] See Cooper v. Knight, 117 Fla. 32, 157 So. 27 (1934); Better Plan Bldg. & Loan Assn. v. Holden, 114 N. J. Eq. 537, 169 A. 289 (1933); Monaghan v. May, 242 App. Div. 64, 273 N. Y. S. 475 (1934).

On the other hand, it has been said that the mortgagee has the right to buy in if he can for an amount wholly inadequate in relation to the value of the property, and misfortune or hard times do not affect the matter. Reed v. Inness, (Mo. App.) 102 S. W. (2d) 711 (1937), and cases cited therein.

[8] See Richmond Mortgage & Loan Corp. v. Wachovia Bank & Trust Co., 210 N. C. 29, 185 S. E. 482 (1936); Tarboro Bldg. & Loan Assn. v. Bell, 210 N. C. 35, 185 S. E. 486 (1936).

[9] Chemical Bank & Trust Co. v. Adam Schumann Associates, 150 Misc. 221, 268 N. Y. S. 674 (1934).

all in cash, while in the Kentucky case the consideration was to be paid in installments over a long period of time, with a natural doubt as to whether it would in fact be received.

While the Kentucky case applies the rule existing prior to the conditions resulting from the depression, it must be noted that in that case as well as in older cases, the sales were fairly conducted and adequate prices were bid. Thus, in 1912, the United States Circuit Court of Appeals for the 8th Circuit[10] refused to credit against a deficiency judgment the amount received on resale which was in excess of the price at which the mortgagee bid in the property on the foreclosure sale, the sale on foreclosure having been fairly conducted, although the price bid was less than the amount of the debt.

Accordingly, it is believed that upon analysis of later cases appearing to vary from the former rule, it will be found that in fact the price bid at the foreclosure sale was inadequate or inequitably low due to economic conditions.

[10] Ramsden v. Keene Five Cents Sav. Bank, 198 Fed. 807, 117 C. C. A. 449 (C. C. A. 8th, 1912).

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