

Will the Current State of the Economy Change 70 Years of Missouri Law on Foreclosures?

For 70 years, Missouri law has provided lenders the ability to seek recovery of their deficiency remaining after foreclosing on real property securing the debt. There is a chance, however, that the law may be about to change. In an unusual move, a Missouri Court of Appeals has, on its own, sent a foreclosure case to the Missouri Supreme Court for further review because the case "presents issues of general interest and importance and for the purposes of reexamining existing law." The case is *First Bank v. Fischer & Frichtel, Inc.*, decided on August 9, 2011. It upheld a lender's right to pursue a borrower for a deficiency claim after a foreclosure sale, following the 1940 Missouri Supreme Court case of *Drannek Realty Co. v. Nathan Frank, Inc.*, 139 S.W.2d 926 (Mo. 1940), which has been the law in Missouri ever since. By sending the *Fischer and Frichtel* case to the Missouri Supreme Court, the Court of Appeals has opened the door to what could be a drastic change in the landscape for lenders handling foreclosures.

Missouri lenders have relied on the *Drannek* case and others like it for decades when pursuing borrowers for repayment of all amounts due, including a deficiency remaining after a foreclosure of the underlying collateral property. Some other states have different approaches regarding deficiency claims, including several where statutes dictate the foreclosure process and a lender's right to seek a deficiency following foreclosure. Some states prohibit deficiency claims altogether. In several other states, a lender is entitled to a deficiency claim only for the difference between the *fair market value* of the property at the time of the sale and the remaining balance of the loan. For lenders, this makes pursuit of deficiency claims more difficult and expensive, as the burden is placed on the lender to prove the fair market value, rather than being able to rely simply on the bid price as lenders can in Missouri.

Here in Missouri, the Court of Appeals clearly had concerns about the continuing application of the *Drannek* case, perhaps in light of the current state of the general economy, as well as the real estate market in particular. Indeed, the state of the economy played a role in the Depression-era *Drannek* case. There, the lender purchased the subject property at a foreclosure sale in 1933, then sued the borrower for the balance due under the promissory notes after giving credit for the foreclosure sale price. The borrower argued that it was unable to refinance its obligation because of the emergency existing in financial circles growing out of the business depression and that the business depression prevented competitive bidding at the foreclosure sale such that the property was not sold for its fair value. The Missouri Supreme Court, however, rejected these equitable arguments, concluded that to invoke equity, there must be fraud, unfair dealing or mistake in the foreclosure sale, so that if the sale is fairly conducted, the amount bid at the sale must stand. Dire conditions in the general economy could not be used to avoid a deficiency claim.

While acknowledging the result of the *Drannek* case, Fischer & Frichtel made arguments similar to those of the borrower in *Drannek*. So far, those arguments have been rejected. A quick look at the facts: Fischer & Frichtel borrowed about \$2.5 million from First Bank to purchase subdivision lots, on which it planned to build and sell homes. The lots were pledged as collateral. Unable to sell all of the lots, Fischer & Frichtel defaulted on the promissory note, and First Bank filed suit for the amount due. First Bank then foreclosed the remaining unsold lots and submitted the only bid of \$466,000. According to First Bank, this left a balance due of

\$667,875.75. After a trial, the jury ruled in favor of First Bank and awarded a total of \$253,375 (the opinion does not explain why the jury awarded less than the alleged deficiency amount); the trial court added an additional \$75,000 in attorneys' fees. Fischer & Frichtel appealed this award and urged the Court of Appeals to adopt a rule similar to that of some other states, where a borrower gets credit for the fair market value of the property at foreclosure. Fischer & Frichtel argued that such a rule would protect borrowers at foreclosure sales from windfall-seeking lenders and noted that the foreclosure sale of its lots was conducted during a drastic downturn in the home sale market, resulting in a particularly depressed sale price through no fault of its own. The Court of Appeals rejected the argument and upheld the deficiency award. Notably, however, the court first recognized the limited deficiency rights of lenders in other states, as well as the many commentators that have observed that foreclosure sales commonly fail to produce fair market value prices. After further noting that the *Drannek* rule was set forth more than seventy years ago and that the issue is of continuing importance, the court ordered the case be sent to the Missouri Supreme Court for further review, providing at least the possibility that the Missouri Supreme Court could overturn the long-standing *Drannek* rule and create a new standard for deficiency claims after foreclosure.