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Tools of Ignorance: An Appraisal of Deficiency Judgments

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Abstract

While achieving success as a major league catcher, Mike Matheny was preparing for a post-baseball career in real estate development. He could not have picked a worse time to pursue his aspiration. Matheny lost his accumulated savings and his family's home after being held personally liable for a $4.2 million deficiency judgment following foreclosure of property he was unable to develop or market during the Great Recession. Matheny's failure to succeed in real estate was the proximate cause of his return to baseball as manager of the St. Louis Cardinals.

Matheny's story provides the backdrop for examining the methods by which deficiency judgments are calculated. The traditional common law approach has been criticized as unjust and overdue for reform. The most widely adopted variation, known as the "fair value" method, is hollow at its core. It provides no meaningful guidance to triers of fact charged with adjudicating value. This Article proposes a re-imagination of the method of calculating deficiency judgments based on experience in transactional practice and alternative dispute resolution. It seeks to accommodate the interests of borrowers and lenders, and the public interest in judicial efficiency and access to affordable credit.

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I. Introduction

The national pastime of baseball, perhaps more than any other sport,[1] has a rich and colorful language.[2] Baseball fans of a certain age will remember when announcers and color commentators used the phrase "tools of ignorance" to describe the catcher's face mask, oversized mitt, chest protector, shin guards, and other padding and bumpering.[3] The thought was that no sensible athlete would choose a

1. *See* Flood v. Kuhn, 309 F. Supp. 793, 797 (S.D.N.Y. 1970) ("Baseball has been the national pastime for over one hundred years and enjoys a unique place in our American heritage.").

2. *See* Sam Phillips, *Corked Bats, Spitballs and Excessive Pine Tar (Ethical Issues in Baseball and the Law),* PRECEDENT, Spring 2014, at 34, 35 (arguing that baseball, "perhaps more than any other sport," has a colorful language). Cases arising out of the baseball context tend to inspire colorful judicial rhetorical flourishes. *See, e.g.*, Flood v. Kuhn, 407 U.S. 258, 266–67 (1972) (painting baseball as a "fine sport and profession, which brings surcease from daily travail and an escape from the ordinary to most inhabitants of this land"); Coomer v. Kan. City Royals Baseball Corp., 437 S.W.3d 184, 188 (Mo. 2014) (en banc) (describing "the joy that comes with being close enough to the Great American Pastime to smell the new-mown grass, to hear the crack of 42 inches of solid ash meeting a 95-mph fastball, or to watch a diving third baseman turn a heart-rending triple into a soul-soaring double-play").

3. As used in the title of this Article, the phrase "tools of ignorance" is intended as a metaphorical critique of existing methods for calculating the size of deficiency judgments. Herold "Muddy" Ruel, a major league catcher for nineteen seasons, is credited with coining the phrase. *See* Chuck Rosciam, *The Evolution of Catchers' Equipment*, BASEBALL RES. J. (2010), http://sabr.org/research/evolution-catchers-equipment (last visited Apr. 2, 2015) (noting that Ruel was "a backstop and a lawyer who caught for greats like Walter Johnson with the Washington Nationals in the 1920s") (on file with the Washington and

position that required wearing an extra ten pounds of equipment and sitting in a crouch for nine innings during the dog days of summer.[4] It was also a reminder that, by the premature end of his playing career, the typical major league catcher had broken most of the bones in both hands at least once and suffered post-concussion syndrome from foul balls, flying bats ricocheting off his mask, and collisions with base runners determined to reach home plate ahead of his tag.[5] When it became apparent that the catcher's position produces a disproportionate number of major league managers,[6] the phrase fell into desuetude.

Lee Law Review); Dan McGrath, *Tough and Smart and Behind the Plate*, N.Y. TIMES (May 8, 2010), http://www.nytimes.com/2010/05/09/sports/09cnccatchers.html?_r=0 (last visited Apr. 2, 2015) (asserting that by calling his catcher's gear by this title, Ruel was "thereby questioning his own sanity for subjecting his body to such pain and suffering") (on file with the Washington and Lee Law Review).

4. *See* Phillips, *supra* note 2, at 36 ("The legal profession tries to avoid ignorance altogether. Veteran lawyers, much like veteran ballplayers expected to perform jumping jacks in spring training, are required to attend MCLE programs.").

5. *See* McGrath, *supra* note 3 ("[C]atching is still the toughest job on a baseball field—think foul tips and balls in the dirt, and having to squat while doing it . . . ."); Rosciam, *supra* note 3 (outlining the sources of pain endured by catchers, which ultimately led to the invention of catchers' gear).

6. *See* Richard Schumann, *Playing Background of Major League Managers*, SABR RES. J. ARCHIVE, http://research.sabr.org/journals/playing-background-of-major-league-managers (last visited Apr. 2, 2015) (surveying the playing background of major league managers from 1901–1981 to show that, among major league managers who were former players, ex-catchers comprise a larger percentage (21.6%) than any other position) (on file with the Washington and Lee Law Review). Of the thirty current managers in Major League Baseball, twelve were former catchers. *See* Doug Miller, *Catchers Manage, All Right*, MLB.COM (May 26, 2005), http://m.mlb.com/news/article/1063444/ (last visited Apr. 2, 2015) ("Catchers are forced to watch a game the way a manager does . . . .") (on file with the Washington and Lee Law Review). Eleven broadcasters, including legendary play-by-play announcer Joe Garagiola and color commentator Tim McCarver, were former catchers. *See* McGrath, *supra* note 3 (arguing that the prevalence of catchers going on to become managers is largely because "[c]atching is . . . the toughest job on a baseball field" and "a catcher has to be the smartest player on the field"). An explanation for this phenomenon is that the catcher functions as an unofficial on-field member of the coaching staff, making decisions on every play. *See* Miller, *supra*, ("In essence, the catcher is running the game out there . . . ."). Although they comprise the largest percentage of managers who were former players, ex-catchers paradoxically have a lower winning percentage (.493) than managers who were former players in any other position. *See* Schumann, *supra*, (coming to this

Mike Matheny, four-time Gold Glove-winning catcher and manager of the St. Louis Cardinals since 2012, is the most recent example of this phenomenon.[7] By the time he succeeded Tony La Russa as the Cardinals' manager, Matheny had lost his personal fortune[8] in the 2008 financial crash.[9] Following a mortgage

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conclusion through examination of the "playing backgrounds of the 338 men who were major league managers between 1901 and 1981").

7. Others include Yogi Berra (Yankees and Mets), Bruce Bochy (Giants), Ralph Houk (Yankees, Tigers, and Red Sox), Mike Scioscia (Angels), Jeff Torberg (multiple teams), and Joe Torre (Cardinals and Yankees).

8. Matheny earned a career salary of more than $18.5 million. *See* Joe Strauss, *Matheny Says Financial Woes Helped Him Grow*, ST. LOUIS POST-DISPATCH (Mar. 28, 2014), http://www.stltoday.com/sports/columns/joe-strauss/strauss-matheny-says-financial-woes-helped-him-grow/article_c7c0635a-a679-5ea3-b0b2-121294d15e28.html (last visited Apr. 2, 2015) [*hereinafter* Strauss, *Matheny Says Financial Woes Help*] (noting that, after the crash, "he and his family eventually were evicted from their West County home, unable even to take along keepsakes from Matheny's playing career") (on file with the Washington and Lee Law Review).

9. The Great Recession began in December 2007 with the bursting of the housing bubble and subsequent mortgage market meltdown. *See* KATALINA M. BIANCO, CCH, THE SUBPRIME LENDING CRISIS: CAUSES AND EFFECTS OF THE MORTGAGE MELTDOWN 2 (2008) ("The subprime mortgage crisis, popularly known as the 'mortgage mess' or 'mortgage meltdown,' came to the public's attention when a steep rise in home foreclosures in 2006 spiraled seemingly out of control in 2007, triggering a national financial crisis that went global within the year."). Securities backed by subprime mortgages (for example, mortgages based upon fraudulent appraisals and approved without documentation of borrowers' income) led to both the housing boom and its collapse. *See id.* at 12 ("As homeowners fell behind in their mortgage payments in ever-growing numbers, foreclosures continued to rise and interest rates rose to their highest level in years. These conditions left subprime lenders unable to finance new loans."). In an effort to minimize their risk to originating lenders, subprime mortgages were packaged and sold to mutual funds, pension plans, and other investors. *See id.* at 8–9 ("Due to securitization, investor appetite for mortgage-backed securities (MBS) and the tendency of rating agencies to assign investment-grade ratings to MBS, loans with a high risk of default could be originated, packaged and the risk readily transferred to others."). When the housing price bubble burst in 2008, mortgage-backed securities plunged in value, triggering a financial crisis that pushed the economy into the worst recession since the 1930s. *See id.* at 2 (noting that the financial crisis "went global within the year"). A worldwide tightening of credit paralyzed the housing and construction markets. *See id.* at 18 ("In late March 2008, it was reported that Standard & Poor's/Case-Shiller index showed that U.S. home prices fell another 11.4 percent in January 2008, the housing market's steepest drop since S&P started collecting data in 1987."). The unemployment rate spiked to ten percent in October 2009, its highest level in thirty years. *Economic Releases*,

foreclosure of commercial property that he was unable to develop or market during the Great Recession,[10] Matheny had been held personally liable for a $4.2 million deficiency judgment.[11] His family

U.S. DEP'T OF LABOR, BUREAU OF LABOR STAT., http://data.bls.gov/timeseries/LNS14000000 (last visited Apr. 3, 2015) (on file with the Washington and Lee Law Review). Venerable financial institutions like Bear Stearns and Lehman Brothers failed. *See* BIANCO, *supra* (listing Goldman Sachs, Merrill Lynch, and Morgan Stanley as other large Wall Street investment banks that received reduced earnings due to the crisis). Municipal and state government budgets dependent on property tax revenues were squeezed. *See generally id.*; *see also* JENNIFER TAUB, OTHER PEOPLE'S HOUSES: HOW DECADES OF BAILOUTS, CAPTIVE REGULATORS, AND TOXIC BANKERS MADE HOME MORTGAGES A THRILLING BUSINESS (2014); Lawrence H. White, *Federal Reserve Policy and the Housing Bubble*, in LESSONS FROM THE FINANCIAL CRISIS: CAUSES, CONSEQUENCES, AND OUR ECONOMIC FUTURE (Robert W. Kolb ed., 2010).

10. *See* Jake Wagman & Jennifer Mann, *Matheny Lost His Home in Legal Fight With Bank Over Business Debt*, ST. LOUIS POST-DISPATCH (Nov. 20, 2011), http://www.stltoday.com/sports/baseball/professional/matheny-lost-his-home-in-legal-fight-with-bank-over/article_5c9087aa-c1e7-5fb9-bc25-9f93f8e313c9.html (last visited Apr. 2, 2015) (outlining Matheny's failed real estate ventures) (on file with the Washington and Lee Law Review).

11. *See id.* ("In May 2010, according to an affidavit from Business Bank, Matheny met with the bank and said the development partnership 'was no longer going to make any further payments' and that Matheny and his wife would not satisfy the $4.2 million they had vouched for."). A deficiency judgment is a judgment rendered in favor of a creditor for the difference between the unpaid balance of a debt secured by a mortgage and, under the traditional common law approach, the amount paid by the high bidder at a public sale of the mortgaged property conducted for the satisfaction of that debt. *See* LAWRENCE R. AHERN, III, 1 THE LAW OF DEBTORS AND CREDITORS § 8:20 (2014) (defining a deficiency judgment as "an imposition of personal liability upon a mortgagor for an unpaid balance of a secured obligation after foreclosure of the mortgage has failed to yield the full amount of the underlying debt"). After obtaining a deficiency judgment, the lender is in a position as an unsecured creditor to levy against its debtor's other assets to satisfy that personal judgment. *See* Robert H. Skilton, *Assessing the Mortgage Debtor's Personal Liability*, 90 U. PA. L. REV. 440, 442 (1942) (noting that the creditor can also levy against mortgaged premises). A deficiency judgment is obtained as part of the original proceeding following judicial foreclosure. *See* AHERN, *supra*, § 8:20, para. 2 ("As an initial principle, the mortgagee can obtain a deficiency judgment after a judicial foreclosure, power-of-sale foreclosure, or even after a strict foreclosure, provided the local prerequisites for obtaining a deficiency judgment have been satisfied."). Where foreclosure is by power-of-sale, the mortgagee obtains a deficiency judgment by filing a separate lawsuit against the mortgagor. *See* RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 8.4 (1997) (delineating the process of an action for a deficiency).

had been evicted from their home and was living with his in-laws.[12] Matheny's failure to succeed in real estate was the proximate cause of his return to major league baseball as a manager.[13]

"Every lawsuit is a potential drama: a story of conflict, often with victims and villains, leading to justice done or denied."[14] Matheny's is a haunting and cautionary tale for those who seek to parlay success in an unrelated field into a second career in real estate development.[15] His experience will be painfully familiar to the

12. *See* Wagman & Mann, *supra* note 10 (adding that when Matheny discontinued payments he had told the lender that he had been making payments "at great expense to myself and my family"). As a player with the Cardinals in the early 2000s, Matheny built a 10,000 square foot, seventeen-room house on eleven acres in the Saint Louis suburb of Wildwood, containing an indoor batting cage, four-car garage, five fireplaces, a home theater, a pool with a water slide, a private lake with a floating island golf green, and a treehouse wired for electricity. *See id.* (stating that the property was called a "mini-resort" in real estate listings). "A scoreboard next to a baseball diamond on the property bears the name 'Field of Dreamers.'" *Id.* By 2010 the Mathenys were sharing his in-laws' 2,500 square foot house in Chesterfield. *See id.* (outlining how the downfall of Matheny's real estate business deal led to his family's loss of everything).

13. *See* David Hunn, *Financial Trials Hurt Matheny, But Also Brought Him Back to Cardinals*, ST. LOUIS POST-DISPATCH (Jan. 21, 2013), http://www.stltoday.com/sports/baseball/professional/financial-trials-hurt-matheny-but-also-brought-him-back-to/article_7b3bd867-93b5-5c3e-99f4-bf18e7e03ce7.html (last visited Apr. 2, 2015) ("He wouldn't be a manager now, he told the Post-Dispatch Friday, if he hadn't lost it all on three lots in the Chesterfield Valley.") (on file with the Washington and Lee Law Review).

14. Paul A. Lombardo, *Legal Archaeology: Recovering the Stories Behind the Cases*, 36 J. L. MED. & ETHICS 589, 589 (2008). Although once a subject of controversy, the value of narrative in legal scholarship and education is no longer a matter of dispute. *See, e.g.*, Richard Delgado, *Storytelling for Oppositionists and Others: A Plea for Narrative,* 87 MICH. L. REV. 2411, 2415 (1989)

> Stories and counterstories, to be effective, must be or must appear to be noncoercive. They invite the reader to suspend judgment, listen for their point or message, and then decide what measure of truth they contain. . . . [T]hey offer a respite from the linear, coercive discourse that characterizes much legal writing.

Jean C. Love, Commentary, *The Value of Narrative in Legal Scholarship and Teaching*, 2 J. GENDER RACE & JUST. 87, 88, 92 (1998) (arguing that students learn from narratives in ways they cannot learn from objective analyses and traditional scholarly presentations).

15. The legacy project, a capstone to a successful career in an unrelated

transactional practice attorneys who represent clients engaged in one of the riskiest of businesses.[16]

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field, is a related phenomenon. Michael J. Fuchs, founder and former chairman of the board of Home Box Office, invested nearly $100 million of his own money and borrowed an additional $70 million from a syndicate of lenders, including the Bank of Hawaii, to develop sixty-five acres of coastal land in Hawaii for luxury housing, including amenities consisting of a 5.5 acre park with a freshwater pond, swimming pools, hula mound, jogging trail, and courts for basketball, tennis, and sand volleyball. *Judging De Minimis: Does the Judge in Your Foreclosure Case Own Stock in the Bank Foreclosing on You?*, DEADLY CLEAR (June 15, 2012), https://deadlyclear.wordpress.com/2012/06/15/does-the-judge-in-your-foreclosure-case-own-stock-in-the-bank-foreclosing-on-you/ (last visited Apr. 2, 2015) [hereinafter *Judging De Minimis*] (on file with the Washington and Lee Law Review). Fuchs was only able to sell fourteen of the fifty-nine-lot subdivision before the Hawaii real estate market collapsed in 2007. *Id.*; *see also* Agbannaoag v. Honorable Judges of the First Cir. Ct., Civ. No. 13-00205 BMK, 2013 WL 5325053, at *5 (D. Haw. Sep. 20, 2013) (dismissing Plaintiff's complaint with prejudice, without leave to amend, because "amending the Complaint in the manner proposed by Plaintiffs would not cure the deficiencies in the Complaint"). Fuchs defaulted on the loan in 2008. *Judging De Minimis*, *supra*. The lender initiated foreclosure proceedings in October 2009, which resulted in a $21.6 million deficiency for which Fuchs was held personally liable. *Id.* Fuchs subsequently filed a class action lawsuit challenging the constitutionality of the arithmetical method for calculating deficiency judgments as a violation of Due Process. *See Deficiency Judgments—Is Your Court a Collection Agency for Crooks? Class Action Filed in Hawaii*, DEADLY CLEAR (Apr. 29, 2013), https://deadlyclear.wordpress.com/2013/04/29/deficiency-judgments-is-your-court-a-collection-agency-for-crooks-class-action-filed-in-hawaii/ (last visited Apr. 2, 2015) (detailing the complaint for declaratory and injunctive relief brought by Fuchs and others) (on file with the Washington and Lee Law Review). The court granted the lender's motion to dismiss the complaint with prejudice on procedural grounds. *See Agbannaoag*, 2013 WL 5325053, at *1. The case has attracted considerable attention by reason of disclosures that Judge Bert I. Ayabe, who presided over the foreclosure proceedings, owned stock in the Bank of Hawaii through a custodial account controlled by his wife. *See Judging De Minimis*, *supra*, (asserting that the Judge refused to recuse himself although "$29,334 worth of stock invested in the bank is not considered *de minimis* to the average individual"). Penthouse Magazine publisher Robert Guccione is another example of this phenomenon. Guccione lost control of his company as a consequence of his obsessive quest to build a hotel casino on the boardwalk in Atlantic City. *See* Alan M. Weinberger, *The Art of Breaking the Deal: The Case of the Penthouse Casino*, 82 MISS. L. J. 651, 653 (2013) (describing the circumstances and events leading to *Penthouse*, the details of court proceedings, and the reasoning behind the appellate court's reversal to present a "cautionary tale about professional responsibility in transactional practice").

16. Transactional real estate practice deserves more attention than it receives in legal scholarship as it generates a greater proportion of legal malpractice claims than any other field (25%). William H. Gates, *The Newest*

Commercial real estate development is accomplished through the use of other people's money, typically by borrowing from an institutional lender.[17] By entering into a mortgage transaction, a property owner incurs a dual risk—the risk of loss of title to the property through foreclosure and the risk of personal liability for the deficiency in the event that the property sells at foreclosure for less than the remaining balance of the debt.[18]

Deficiency judgments were a frequent consequence of foreclosures in the period following the Great Depression of the 1930s, when fully half of home mortgages went into default.[19] Foreclosing mortgagees made nominal bids at auction sales at which there were few buyers at any price,[20] acquired their borrowers' properties, and claimed deficiency judgments for virtually the full amount of the debt.[21] A rarity in subsequent decades,[22] deficiency judgments

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Data on Lawyers' Malpractice Claims, 70 A.B.A. J. 78, 84 (1984).

17. *See* GEORGE LEFCOE, REAL ESTATE TRANSACTIONS, FINANCE, AND DEVELOPMENT 495–97 (6th ed. 2009) (providing an overview of the real estate development business, including how funding is achieved).

18. *See* Skilton, *supra* note 11, at 441–42 (describing, in detail, the double risk assumed by mortgage debtors). A commercial borrower may be able to protect against this latter risk by negotiating for a nonrecourse mortgage, whereby the borrower is exculpated from personal liability, although this is generally available only for post-construction loans secured by improved property that is already under lease. *See id.* ("Whatever may have been the circumstances, personal liability of an owner of mortgaged premises appears to be the rule and not the exception, and this risk will probably continue even after he has sold the premises to another, for it can only be terminated by novation, cancelation or satisfaction.").

19. *See* David C. Wheelock, *Changing the Rules: State Mortgage Foreclosure Moratoria During the Great Depression*, 90 FED. RES. BANK OF ST. LOUIS REV. 569, 573 (2008), http://research.stlouisfed.org/publications/review/08/11/Wheelock.pdf (noting that, "[d]uring the Depression, several states enacted reforms that limited the rights of lenders to seek deficiency judgments against borrowers").

20. *See* Skilton, *supra* note 11, at 444 (asserting that mortgagees' presence at the auctions discouraged other potential buyers from participating because "[t]hey knew that the mortgagee would not permit his security to be sacrificed to bargain hunters").

21. *See* 2 MICHAEL T. MADISON, JEFFRY R. DWYER & STEVEN W. BENDER, THE LAW OF REAL ESTATE FINANCING § 12:69 (rev. ed. 1995) (noting that this outcome "resulted in a general perception that the foreclosure laws were unfair and in a proliferation of state antideficiency judgment legislation").

22. *See* ANDRA GHENT, RESEARCH INST. HOUS. AM., THE HISTORICAL ORIGINS OF AMERICA'S MORTGAGE LAW 4, 32 (2012), http://www.housingamerica.org/

returned with a vengeance to the dismay of investors like Matheny who borrowed to finance land development during the period before the bubble in property values, inflated by subprime mortgages, burst so spectacularly and unexpectedly in 2008.[23]

Mike Matheny's story provides a backdrop for examining the method of calculating deficiency judgments. Under traditional common law, a deficiency judgment is derived mechanically by subtracting the price for which the property sold at foreclosure, less the expenses of sale, from the outstanding mortgage indebtedness.[24] No consideration is given to evidence of higher property valuations.[25]

RIHA/RIHA/Publications/82406_11922_RIHA_Origins_Report.pdf (explaining restrictions on deficiency judgments that arose during the Great Depression, presumptively leading to a decrease in these judgments in the following decades). Mortgage lenders seldom pursue deficiency judgments because they are unprofitable. *See* MADISON, DWYER & BENDER, *supra* note 21, § 12:2 n.3 ("Unfortunately, the most recent study with respect to deficiency judgments was completed in 1958 . . . reveal[ing] that only a small dollar amount is ever realized in deficiency judgments by lenders."). Most borrowers in foreclosure have few financial resources. According to a recent federal government study, the recovery rate on deficiency judgments was one-fifth of 1%. FHFA OFF. OF INSPECTOR GEN., AUD-2013-001, FHFA'S OVERSIGHT OF THE ENTERPRISES' EFFORTS TO RECOVER LOSSES FROM FORECLOSURE SALES 15 (2012), http://fhfaoig.gov/Content/Files/AUD-2013-001.pdf. Deficiency judgments are "generally pursued only against investors, repeat defaulters, and nonhardship cases." Karen M. Pence, *Foreclosing on Opportunity: State Laws and Mortgage Credit*, 88 REV. ECON. & STAT. 177, 177–78 (2006) (quoting Charles A. Capone, Jr., *Providing Alternatives to Mortgage Foreclosure: A Report to Congress*, U.S. Dep't Hous. & Urban Dev. (1996)). Lenders recently have become more aggressive in pursuing deficiency judgments against so-called "strategic defaulters," for example "someone who had the means but chose to go into default." Kimbriell Kelly, *Lenders Seek Court Actions Against Homeowners Years After Foreclosure*, WASH. POST (June 15, 2013), http://www.washington post.com/investigations/lenders-seek-court-actions-against-homeowners-years-after-foreclosure/2013/06/15/3c6a04ce-96fc-11e2-b68f-dc5c4b47e519_story.html (last visited Apr. 2, 2015) (on file with the Washington and Lee Law Review).

23. *See* BIANCO, *supra* note 9, at 12 ("By early January 2007, the United States' subprime mortgage industry started to show signs of collapsing from higher-than-expected home foreclosure rates. As homeowners fell behind in their mortgage payments in ever-growing numbers, foreclosures continued to rise and interest rates rose to their highest level in years.").

24. *See* Grant S. Nelson & Dale A. Whitman, *Reforming Foreclosure: The Uniform Nonjudicial Foreclosure Act*, 53 DUKE L.J. 1399, 1404–05 (2004) (comparing this traditional method of calculating deficiency judgments with contemporary "fair value" legislation).

25. *See* RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 8.4 cmt. a (1997) (explaining the traditional method of calculating deficiency judgments, where

Nor does the borrower receive credit for a higher purchase price realized at a subsequent sale by the foreclosing mortgagee or its affiliate.[26] The net foreclosure sale price determines conclusively the extent to which the value of the property is below the outstanding debt.[27]

"the amount realized at the foreclosure sale is automatically applied to the mortgage obligation and . . . the mortgagee is entitled to a judgment for the balance"). Courts in states that follow the traditional common law grant exceptions only in cases when the mortgagor can prove that the foreclosure process was defective, or that the sale price was unconscionable or so inadequate as to raise an inference of fraud or unfair dealing. *See, e.g.*, Resolution Trust Corp. v. Holtzman, 618 N.E.2d 418, 424 (Ill. App. Ct. 1993) (explaining that Illinois law provides exceptions in the following circumstances: "(1) proper notice was not given; (2) the terms of the sale were unconscionable; (3) the sale was conducted fraudulently; or (4) justice was otherwise not done"). Missouri requires a sales price that both raises an inference of fraud and shocks the conscience. *See In re* Russell, No. 12-60190, 2013 WL 1868346, at *4 (Bankr. W.D. Mo. May 3, 2013) (noting that Missouri's "shock the conscious" standard is "among the strictest in the country"). Applying this standard, Missouri courts have refused to set aside sales that resulted in prices that were only 20% to 30% of fair market value. *See* First Bank v. Fischer & Frichtel, Inc., 364 S.W.3d 216, 224 (Mo. 2012) (en banc) (refusing to modify a sales price that was "barely more than 50 percent of the fair market" because the "lender gave cogent reasons for its lower bid due to the depressed real estate market and the bulk nature of the sale").

26. *See* Basil H. Mattingly, *The Shift From Power to Process: A Functional Approach to Foreclosure Law*, 80 MARQ. L. REV. 77, 79 n.9 (1996) (noting counterarguments that propose "[t]here is no reason to distinguish between profits realized on a resale and a surplus produced at a foreclosure sale" (quoting Steven Wechsler, *Through the Looking Glass: Foreclosure by Sale as* De Facto *Strict Foreclosure—An Empirical Study of Mortgage Foreclosure and Subsequent Resale*, 70 CORNELL L. REV. 850, 887 (1985))); Capital One, N. Am. v. Nicoll, 113 So. 3d 1158, 1161–62 (La. Ct. App. 2013) (2013) ("[D]efendant's sole argument is that he is entitled to an extra credit . . . representing the gain realized by plaintiff from the sale of the property to a third party after the sheriff's sale. The law simply does not provide such a remedy for defendant."). *But see* Reg'l Inv. Co. v. Willis, 572 S.W.2d 191, 193 (Mo. Ct. App. 1978) (refusing to award $6,000 deficiency judgment to lender who bid $21,000 after having contracted to immediately resell foreclosed property for $29,000).

27. In theory, through the application of competitive market forces, the property's fair market value will be realized by foreclosure, any equity in the property above the outstanding mortgage debt will be returned to the mortgagor, and, in the event the sale proceeds are insufficient to satisfy the debt, the sale price is used to establish the mortgagor's deficit. *See* 9 GEORGE W. THOMPSON, COMMENTARIES ON THE MODERN LAW OF REAL PROPERTY 693–95 (1958) (outlining the mortgagor's equity). In practice, the dynamics of the open cry auction format penalizes borrowers by discouraging competitive bidding. *See*

This arithmetical method for calculating deficiency judgments has come under attack by judges and commentators as unjust and overdue for reform.[28] Even in a stable market, a forced sale normally

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RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 8.3 cmt. a (1997) ("[B]ecause the mortgage lender can 'credit bid' up to the amount of the mortgage obligation without putting up new cash, it has a distinct bidding advantage over a potential third party bidder."). Real estate does not trade freely in an auction market even under the best of circumstances. Foreclosure sales are not well attended. They are advertised in the classified columns of legal newspapers with limited circulation. The mortgagee is frequently not only the winning bidder but also the only bidder attending the sale. *See id.* § 8.3 cmt. a (explaining the "widely perceived dichotomy between 'foreclosure sale value' and fair market value"). The foreclosing mortgagee enjoys inherent advantages. It bids by way of a credit against the mortgage debt while other bidders are required to pay cash or its equivalent. *See* Roark v. Plaza Sav. Ass'n, 570 S.W.2d 825, 827 (Mo. Ct. App. 1978) (noting that the seller announced at the beginning of the auction that the "sale was for cash, which meant cash, cashier's check or certified funds"). Most real estate buyers are unaccustomed to all-cash purchases. The mortgagee has an informational advantage over third-party purchasers having thoroughly evaluated the property as part of the loan underwriting process. A third-party purchaser must commit resources to due diligence without knowing its chances of being the high bidder. *See* Mashie Rapoport, *New Jersey's Balanced Mortgagor Protection Scheme*, RUTGERS J.L. & PUB. POL'Y (Feb. 24, 2014), http://www.rutgerspolicyjournal.org/new-jersey%E2%80%99s-bal anced-mortgagor-protection-scheme (last visited Apr. 2, 2015) (identifying problems present within the foreclosure process, which is "intended to ensure fairness to the mortgagor" but often lacks competition and "allows the mortgagee to behave opportunistically") (on file with the Washington and Lee Law Review). Potential bidders may find it difficult to inspect the premises prior to sale. Mortgagors who are about to lose their property through foreclosure understandably are reluctant to cooperate. As the party with the most to gain from increasing the purchase price, such behavior is self-destructive. But borrowers facing foreclosure may not be thinking clearly enough to act in their economic best interest. *See* Mattingly, *supra* note 26, at 99 n.100 ("Unfortunately, either hope or despair colors the actions of the borrower who often does not participate in the foreclosure process."). An auction sale is particularly ineffective during the periods of economic depression and collapsed real estate values in which large numbers of foreclosures occur. As a result, the lender will be the high bidder at an artificially low price in the vast majority of foreclosure sales. *See* Jennifer M. West & Daniel A. West, *The New Face of Foreclosure in Missouri: A Look at Statutory Procedure and Both Statewide and National Trends Following the Great Recession*, ST. LOUIS BUS. J., Winter 2014, at 11 (noting, however, that the percentage of third party purchasers at foreclosures has increased recently).

28. *See* Mattingly, *supra* note 26, at 81

> Courts and legislatures have constantly struggled to regulate the proper balance of power between lenders and borrowers . . . [and] have operated on the premise that if they could strike the proper balance, then property sold at a foreclosure sale would generate

will not yield a price that reflects the intrinsic value of property if it were marketed by an owner not under distress.[29] During severe economic downturns, mortgaged property is sold "under the hammer" at substantially depressed prices.[30]

In the wake of the Depression, states enacted remedial legislation to prevent perceived lending abuses and to moderate the economic dislocation caused by declining property values.[31] Statutes circumscribing the ability of lenders to obtain deficiency judgments benefit some defaulting mortgagors but not without a tradeoff: The unintended consequences of Depression-era measures impose costs on a larger pool of borrowers by increasing the expense and reducing the supply of financing for land acquisition and development.[32]

The most common form of debtor protection is the so-called "fair value" limitation on deficiency judgments.[33] Embodied in statutes in many jurisdictions and the common law of others, the fair value approach is recommended by the Restatement of Property.[34] While

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proceeds in the approximate amount of the property's value.

29. *See* Nelson & Whitman, *supra* note 24, at 1489 ("In many cases . . . the foreclosure sale does not result in any surplus. Instead, the proceeds fall short of satisfying the foreclosed obligation . . . ."). The United States Supreme Court has observed the price-suppressing tendency of the forced sale of property at foreclosure: "No one would pay as much to own such property as he would pay to own real estate that could be sold at leisure and pursuant to normal marketing techniques." BFP v. Resolution Trust Corp., 511 U.S. 531, 539 (1994).

30. *See* Resolution Trust Corp. v. Carr, 13 F.3d 425, 430 (1st Cir. 1993) (holding, under the circumstances, that the petitioner failed to meet the burden of proof for bad faith when the sale price was merely inadequate).

31. *See generally* Grant S. Nelson, *Deficiency Judgments After Real Estate Foreclosures in Missouri: Some Modest Proposals*, 47 MO. L. REV. 151 (1982); Robert M. Washburn, *The Judicial and Legislative Response to Price Inadequacy in Mortgage Foreclosure Sales*, 53 S. CAL. L. REV. 843 (1980).

32. *See* Mattingly, *supra* note 26, at 106 ("[A]nti-deficiency legislation inappropriately shifts the risk of market fluctuations from the owner to the lender, who must absorb losses but forgo gains in the value of the property. Efficiency and fairness dictate that the fluctuation of value must remain with the borrower as owner.")

33. *See* Nelson & Whitman, *supra* note 24, at 1491 ("[S]tates utilizing this statutory approach measure a deficiency judgment as the difference between the foreclosure price and the fair market value of the property.").

34. *See* RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 8.4 cmt. a (1997) (stating that this approach protects the "unjust enrichment of the mortgagee" by preventing the "mortgagee purchasing the property at a deflated price, obtaining a deficiency judgment and, by reselling the real estate at a profit,

not prohibiting a lender from seeking a deficiency judgment, fair value limitation offers a more debtor-friendly alternative to the arithmetical method.[35]

This Article argues that the Restatement approach is hollow at its core—the meaning of a fair value is vague, subjective, and unquantifiable.[36] The statutory variation proposed in this Article is informed by experience in transactional practice and alternative dispute resolution.[37] It would more fully involve appraisal professionals in a quasi-judicial capacity.[38] By offering a more structured alternative to the Restatement, the proposal seeks to accommodate the interests of borrowers, lenders, and the public.[39]

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achieving a recovery that exceeds the obligation."). The Restatement states in relevant part:

> § 8.4 Foreclosure: Action For A Deficiency
>
> (a) If the foreclosure price is less than the unpaid balance of the mortgage obligation, an action may be brought to recover a deficiency judgment against any person who is personally liable on the mortgage obligation in accordance with the provisions of this section.
>
> (b) Subject to Subsections (c) and (d) of this section, the deficiency judgment is for the amount by which the mortgage obligation exceeds the foreclosure sale price.
>
> (c) Any person against whom such a recovery is sought may request in the proceeding in which the action for a deficiency is pending a determination of the fair market value of the real estate as of the date of the foreclosure sale.
>
> (d) If it is determined that the fair market value is greater than the foreclosure sale price, the persons against whom recovery of the deficiency is sought are entitled to an offset against the deficiency in the amount by which the fair market value . . . exceeds the sale price.

Id.

35. *See* Nelson & Whitman, *supra* note 24, at 1492–93 (using an example to demonstrate how the fair value approach "can result in a significantly reduced deficiency liability").

36. *Infra* Parts III–IV.

37. *See infra* Part V and accompanying text (proposing a model statute).

38. *Infra* Part V.

39. *Infra* Part V.

II. The Toughest Man Alive

Michael Scott Matheny grew up in Reynoldsburg, a suburb of Columbus, Ohio.[40] He was drafted by the Milwaukee Brewers out of the University of Michigan, where he was co-captain of the baseball team.[41]

Matheny was considered one of baseball's best defensive catchers[42] and a master of the psychology of handling pitchers.[43] Over the course of thirteen seasons behind the plate, he earned the nicknames "Toughest Man Alive" and "Mad Dog Matheny" in recognition of his hard-nosed style of play.[44]

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40. Willie Springer, *Cardinals to Name Matheny as Manager*, CBS ST. LOUIS (Nov. 13, 2011), http://stlouis.cbslocal.com/2011/11/13/cardinals-to-name-matheny-as-manager/ (last visited Apr. 2, 2015) (on file with the Washington and Lee Law Review).

41. *Mike Matheny #22*, MLB.COM, http://stlouis.cardinals.mlb.com/team/coach_staff_bio.jsp?c_id=stl&coachorstaffid=118414 (last visited Apr. 2, 2015) (on file with the Washington and Lee Law Review).

42. He was adept at blocking balls in the dirt and throwing out base-runners attempting to steal. He won the Rawling's Gold Glove, awarded to the best defensive player in each position in 2000, 2003, and 2004 with the Cardinals, and in 2005 with the San Francisco Giants. Rick Hummel, *Molina Wins Golden Glove Award*, ST. LOUIS POST-DISPATCH (Nov. 1, 2011), http://www.stltoday.com/sports/baseball/professional/cardinal-beat/molina-wins-gold-glove-award/article_8e723afe-04de-11e1-8202-001a4bcf6878.html (last visited Apr. 2, 2015) (arguing that catcher Yadier Molina surpassed Matheny as the best defensive catcher in St. Louis Cardinal's history after Molina won his fourth consecutive Gold Glove award in 2011) (on file with the Washington and Lee Law Review). He set major league records for catchers by playing in 252 games without committing an error from August 1, 2002, to August 4, 2004, and by fielding 1,565 consecutive chances without an error in 2004. Matthew Jussim, *Giants vs. Cardinals NLCS: St. Louis Manager Mike Matheny Proves Experience Is Overrated*, SPORTS WORLD REP. (Oct. 17, 2012), http://www.sportsworldreport.com/articles/5820/20121017/giants-vs-cardinals-nlcs-st-louis-manager-mike-matheny-proves-experience-is-overrated-commentary.htm (last visited Apr. 2, 2015) (on file with the Washington and Lee Law Review).

43. *See* Tim McKernan, *Mike Matheny: From InsideSTL to Cardinal Manager*, INSIDESTL.COM (Nov. 14, 2011), http://www.insidestl.com/insideSTLcom/McKernan/tabid/61/articleType/ArticleView/articleId/7784/Mike-Matheny-From-insideSTL-To-Cardinal-Manager.aspx (last visited Apr. 2, 2015) ("He knew some guys needed to be yelled at (like Matt Morris), and he knew that some guys needed to be handled differently (like Garrett Stephenson).") (on file with the Washington and Lee Law Review).

44. *See* Joshua Cooley, *Matheny's Mission*, FELLOWSHIP OF CHRISTIAN

Suffering from the effects of post-concussion syndrome,[45] Matheny retired from baseball in 2007 with one year remaining on his contract.[46]

As the Cardinals' choice to succeed Hall of Fame manager Tony La Russa in 2012,[47] Matheny was initially greeted with skepticism.[48]

ATHLETES (May 1, 2014), http://www.fca.org/themagazine/mathenys-mission/#.VNLVHdLF_JA (last visited Apr. 2, 2015) (telling the story of how Matheny received the nickname "Mad Dog") (on file with the Washington and Lee Law Review); Daniel Wasserman, *Trading in Blue for Gold: Mike Matheny's Path to and from Michigan*, MICH. DAILY (June 5, 2011), http://www.michigandaily.com/sports/trading-blue-gold-mike-mathenys-path-and-michigan (last visited Apr. 2, 2015) (noting Matheny's nickname "Toughest Man Alive") (on file with the Washington and Lee Law Review). After being struck squarely in the face by a ninety-five mile-per-hour fastball during an at-bat in 1998, Matheny caught an entire ten-inning game the next day with a puffy face and a couple of missing teeth. *See* Dom Cosentino, *That Time Mike Matheny Took a Fastball To The Face And Barely Flinched*, DEADSPIN (Oct. 23, 2013), http://deadspin.com/that-time-mike-matheny-took-a-fastball-to-the-face-and-1451042467 (last visited Apr. 2, 2015) (stating that after Matheny was struck in the face, "[h]e did nothing but lean on his bat and put his hand on his hip") (on file with the Washington and Lee Law Review).

45. *See Concussion Symptoms Force Matheny to Retire*, ESPN (Feb. 1, 2007), http://sports.espn.go.com/mlb/news/story?id=2751419 (last visited Apr. 2, 2015) (stating that, after Matheny underwent multiple tests as part of a sports concussion program, "he experienced the same troublesome symptoms for a day and a half, such as fatigue, memory problems, and a tough time focusing and seeing straight") (on file with the Washington and Lee Law Review). Matheny says he has no lingering symptoms from the twenty-five to thirty concussions he suffered in his life. Cooley, *supra* note 44.

46. *See id.* ("Mike Matheny's decision to retire was made for him. His doctor refused to clear the longtime catcher to play in 2007 after a concussion sidelined him for the final four months of last season.").

47. *See* Joe Strauss, *Cards Retiring La Russa's No. 10*, ST. LOUIS POST-DISPATCH (May 2, 1012), http://www.stltoday.com/sports/baseball/professional/cards-retiring-la-russa-s-no/article_26116bcf-ebef-5224-ba8f-ae3ff3b30064.html (last visited Apr. 2, 2015) (quoting Chairman Bill DeWitt Jr., "Tony's managerial tenure with the Cardinals will always stand out as one of the greatest eras in Cardinal history") (on file with the Washington and Lee Law Review).

48. *See* Strauss, *Matheny Says Financial Woes Help*, *supra* note 8 ("During an autograph-signing . . . a woman approached to tell [Matheny], 'I thought they were crazy for hiring you, but I guess it's going OK.'"). Matheny himself described his hiring as a "parting-of-the-Red-Sea, walking-on-water type of miracle." Cooley, *supra* note 44. At the time of his selection, Matheny was the youngest manager in major league baseball. *Id.* He had no prior full-time professional coaching experience in any capacity. *See* Jena McGregor, *The Leadership Smarts of Cardinals Manager Mike Matheny*, WASH. POST (Oct. 25,

Now considered among the top echelon of active major league managers,[49] Matheny is one of only five managers in baseball history to lead a major league team to the postseason in each of his first three seasons as manager.[50]

Matheny prepared for his new role by reading books about leadership and consulting with captains of industry.[51] His study of the subject led Matheny to adopt the so-called "servant leadership" model, a nonhierarchical organizational structure where the pyramid is flipped upside down.[52] Characterized by humility and loyalty, servant-leadership is a concept that suits Matheny's personality,[53]

2013), http://www.washingtonpost.com/blogs/on-leadership/ wp/2013/10/25/the-leadership-smarts-of-cardinals-manager-mike-matheny/ (last visited Apr. 2, 2015) (asserting that Matheny had, however, previously served as an adviser for the Cardinals) (on file with the Washington and Lee Law Review).

49. *See The Best Current MLB Managers*, RANKER, http://www.ranker.com/list/best-current-mlb-managers/ranker-baseball (last visited Apr. 2, 2015) (ranking Matheny as the fifth best MLB manager) (on file with the Washington and Lee Law Review). "He's a rock star in the heartland and revered around the game for his humble leadership qualities." Cooley, *supra* note 44.

50. *See* THE ESPN BASEBALL ENCYCLOPEDIA 1672, 1673, 1675 (Gary Gillette & Pete Palmer eds., 4th ed. 2007) (listing the other managers: Larry Dierker, Astros, 1997–1999; Ron Gardenhire, Twins, 2002–2004; Ralph Houk, Yankees, 1961–1963; and Hughie Jennings, Tigers, 1907–1909).

51. *See* Eric Nusbaum, *Mike Matheny, Little League, and Baseball Fundamentalism*, VICE SPORTS (July 24, 2014), https://sports.vice.com/article/mike-matheny-little-league-and-baseball-fundamentalism (last visited Apr. 2, 2015) (describing Matheny's fundamentalist approach to baseball) (on file with the Washington and Lee Law Review).

52. *See* Jenifer Langosch, *Matheny's Selfless Approach A Perfect Fit For Cardinals*, MLB.COM (Sept. 29, 2013), http://mlb.mlb.com/news/article/mlb/st-louis-manager-mike-matheny-has-made-a-point-to-put-his-players-ahead-of-himself-and-theyveresponded?ymd=20130929&content_id=62025156&vkey=news_mlb (last visited Apr. 3, 2015) ("[H]e consumed himself in learning more about a servant-leadership model that had long intrigued him.") (on file with the Washington and Lee Law Review).

53. *See* Cooley, *supra* note 44 (noting that Matheny is active in the Fellowship of Christian Athletes); Daniel Wasserman, *supra* note 44 (quoting a fellow teammate as saying, "Off the field, he taught me to be a man and a respectful person"). Matheny credits his religious faith with influencing his business and coaching philosophy. *See* Cooley, *supra* note 44 ("I always felt I had the responsibility to be an example of how Christians ought to compete."). A year after retiring as a player, Matheny agreed to coach his son's little league team, the TPX Warriors. *See id.* (describing Matheny's transition to Little League coaching). During a flight from New York to St. Louis in 2009, Matheny

and one that he finds familiar.[54]

Matheny was already preparing for life after baseball while still an active player, including real estate correspondence course work during road trips.[55] He has acknowledged being thrilled by the

took out his laptop and wrote from scratch a five-page letter to parents of team members describing his coaching philosophy and expectations. *See id.* ("Mike was asked to coach a youth baseball team and wrote a series of conditions he demanded before agreeing to be with the team."). It went viral after being posted online and has become known as "The Matheny Manifesto." *See id.* (describing how the document was "quickly shared virally across the country"); *see also* Mike Matheny, *The Matheny Manifesto* (2009) [hereinafter *The Matheny Manifesto*], www.mikematheny.com/sites/default/files/docs/MathenyManifesto.pdf (describing his coaching philosophy and directing parents to remain interested but civil). It describes Matheny's vision of a team without parental intrusion and a distinctly faith-based emphasis on character development. *See id.* (explaining that Matheny's vision of a baseball experience with these unique characteristics "is a great opportunity for these boys to grow together and learn some lessons that will go beyond their baseball experience"). It instructs parents to watch games silently, limiting themselves to clapping, because even shouting encouragement puts too much pressure on their children. *See The Matheny Manifesto*, *supra*, at 1 (directing parents to "be a silent source of encouragement" for their player). Players are instructed never to question authority figures, either coaches or umpires. *See id.* at 2 (forbidding the boys from showing any emotion against the umpire). Parents were required to read and sign the letter. *See id.* at 5 ("Let me know as soon as possible whether or not this is a commitment that you and your son want to make."). It concluded by noting that it "may not be the right fit" for everyone, and some parents declined to sign after reading it. *Id.* at 5. Matheny makes no apology for the Christian influence, and players of all denominations are welcome on the Warriors, although "potential coaches must make a testimony of faith." *See id.* at 1 (admitting that his Christian faith serves as a guide for his life); Derrick Goold, *Matheny's "Manifesto" Changes Tone of Youth Baseball*, ST. LOUIS POST-DISPATCH (Sept. 24, 2012, 1:00 AM), http://www.stltoday.com/sports/baseball/professional/matheny-s-manifesto-changes-tone-of-youth-baseball/article_c80de770-9e5f-55c2-888c-f6f4a9b85baa.html (last visited Apr. 3, 2015) (describing how players had to perform a "character study" at each practice) (on file with the Washington and Lee Law Review).

54. *See* Langosch, *supra* note 52 ("'It struck me that I had done some of this as a leader in a catching role,' Matheny said . . . 'My whole point of being in that uniform was to make my pitchers' job easier and to make them better.'").

55. *See* David Hunn & Derrick Goold, *Cardinals Manager Mike Matheny Owes Millions After Losing Legal Fight*, ST. LOUIS POST-DISPATCH (Jan. 19, 2013, 12:05 AM), http://www.stltoday.com/news/local/metro/cardinals-manager-mike-matheny-owes-millions-after-losing-legal-fight/article_0acb85ad-508c-5007-a4c4-b014a052a404.html (last visited Apr. 3, 2015) (describing Matheny's venture into real estate while he still played as an attempt to expand his career beyond baseball) (on file with the Washington and Lee Law Review).

challenge of chasing real estate deals, in which he experienced early success.[56] In September 2005, Matheny formed MPD Investments, L.L.C. (MPD) with former St. Louis indoor soccer players Brett Phillips and Daryl Doran, a neighbor of Matheny's.[57] The entity bought and quickly resold a block in the WingHaven development in St. Charles, Missouri, realizing a $2.4 million profit in six months.[58] As Matheny described the market before 2008, "You could throw a dart at any kind of real estate and you were going to do well."[59]

Matheny could not have picked a worse time to begin a second career in real estate. The greatest financial downturn since the Great Depression suddenly appeared, seemingly out of nowhere,[60] in mid-September 2008 when Lehman Brothers filed for Chapter 11 bankruptcy protection.[61] Real property of all kinds experienced dramatic declines in value.[62] A wave of foreclosures disrupted the lives of millions of borrowers, including Mike Matheny's.[63] Following an historical digression in Part III of this Article,[64] Part IV discusses

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56. *See id.* (describing Matheny's various real estate ventures, including acquiring large plots of land in central Illinois, Missouri, West Virginia, Ohio, and an interest in a Long Island real estate project).

57. *See id.* (describing the formation of MPD).

58. *See* Wagman & Mann, *supra* note 12 ("The trio bought a block at the WingHaven development in St. Charles and flipped it in six months, Doran said in an interview.").

59. Strauss, *Matheny Says Financial Woes Help*, *supra* note 8.

60. *See* Gary Becker, *The Subprime Housing Crisis*, THE BECKER-POSNER BLOG (Dec. 23, 2007, 3:24 PM), http://www.becker-posner-blog.com/archives/2007/12 (last visited Apr. 3, 2015) ("The vast majority of economists, including me, were surprised by the extent of the subprime mortgage crisis.") (on file with the Washington and Lee Law Review).

61. *See* TAUB, *supra* note 9, at 247 (describing how "Lehman, one of the oldest investment houses in the country" was the largest bankruptcy filing in American history).

62. *See id.* at 257 (pointing to the irony of Senator Richard Durbin speaking on the Helping Families Save Their Homes Act while homeowners' houses' worth continued to decline).

63. *See* Strauss, *Matheny Says Financial Woes Help*, *supra* note 8 ("The last six years have taken turns with Matheny, threatening to bankrupt him, evicting him, challenging him, and ultimately providing an opportunity he would have rejected if not for the tribulations preceding it."); TAUB, *supra* note 9, at 282 (noting that, since the "burst of the bubble," about five million homes have experienced foreclosure with millions more underway).

64. *See infra* Part III (discussing the history of foreclosure and deficiency judgments).

Matheny's brief career in real estate and how it led to his return to baseball as a manager.[65]

III. An Historical Digression

The introduction of foreclosure in seventeenth century England was a remarkable innovation in the history of jurisprudence, and the most significant reform in the evolution of land finance law.[66] It is ironic that the modern cause of action for a deficiency judgment, unknown to early English common law,[67] was an unintended consequence of that reform.

The Anglo-American mortgage originated as a device to circumvent the biblical prohibitions against usury.[68] Landowners could not borrow money and pay interest in a straightforward mortgage transaction.[69] This presented a challenge for lenders seeking to earn a profit from lending money in a form that would not be deemed interest.[70] Christian

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65. *See infra* Part IV (documenting Matheny's brief real estate venture career and his return to the Cardinals as manager).

66. *See* 4 JAMES KENT, COMMENTARIES ON AMERICAN COMMON LAW 159 (Oliver Wendell Holmes Jr. ed., 12th ed. 1896) (identifying the court of equity's creation of foreclosure as "one of the most splendid instances in the history of our jurisprudence").

67. *See* John L. Tierney, *"Fair" Value and the Deficiency Judgment*, 16 J. LAND & PUB. UTIL. ECON. 181, 181 (1940) ("The deficiency judgment problem resulting from the foreclosure sale of property for less than the balance due on the mortgage was a perplexing phenomenon of the drastic decline in realty prices during the period from 1929 to 1934.").

68. *See Leviticus* 25:36 to 25:37 (New International Version) ("Do not take interest or any profit from them, but fear your God, so that they may continue to live among you. You must not lend them money at interest or sell them food at a profit."); *Deuteronomy* 23:20 to 23:21 (forbidding charging fellow Israelites interest); *Luke* 6:35 (instructing to lend to your enemies without expecting to get anything back).

69. *See* 18 TIMOTHY J. TRYNIECKI, MISSOURI PRACTICE, REAL ESTATE LAW—TRANSACTIONS AND DISPUTES § 13:1 (3d ed. 2006) (describing how modern mortgages still grant an absolute right in real property subject to the mortgage lien, a practice similar to the ancient one forbidding usurious transactions).

70. *See* ANDRA GHENT, THE HISTORICAL ORIGINS OF AMERICA'S MORTGAGE LAWS 11 (2012) (pointing out how, in medieval England, the most common form of mortgage consisted of the lender receiving the rents and profits from the land to satisfy the debt to avoid the appearance of a usurious transaction). Usury was

lenders believed it was necessary to take possession of the land to collect income from rents and profits.[71] A loan transaction thus necessarily involved not only the transfer of title to the property from the borrower to the lender but also the transfer of possession.[72]

Jewish law did not require creditors to possess the land.[73] Accordingly, for hundreds of years until the thirteenth century, borrowers found it comparatively more advantageous to transact with Jewish lenders.[74] Their superior product became unavailable when Edward I banished the Jews from England in 1290.[75]

By the fifteenth century, the common law of estates and future interests had sufficiently evolved to create the "modern" mortgage in the form of a fee simple subject to condition subsequent.[76] The property owner conveyed defeasible title to the

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punishable by excommunication or other censure by the ecclesiastical courts during the medieval period. *In re* Mich. Ave. Nat'l Bank, 2 B.R. 171, 174 (Bankr. N.D. Ill. 1980) ("[D]uring the medieval period fear of excommunication or other censure by the ecclesiastical courts was a greater deterrent than was the civil penalty of confiscation of all of the property of the usurer . . . .").

71. *See* 9 JOHN S. GRIMES, COMMENTARIES ON THE MODERN LAW OF REAL PROPERTY 693 (1958) ("The pious Christian lender was forced to take possession of the property so that he could reap the rents and issues as recompense for his money lent.").

72. *See* TRYNIECKI, *supra* note 69, § 13:1 (highlighting the similarities between how modern mortgages grant an absolute right in real property subject to the mortgage lien and the similar ancient practice).

73. *See* GEORGE E. OSBORNE, MORTGAGES § 3, at 6 (2d ed. 1970) (delineating Jewish law from other ancient laws in that, when dealing with a Jewish lender, "the creditor did not take possession").

74. *See id.* (noting that, because of the favorable Jewish practices, "there developed in the twelfth and thirteenth centuries a gage of lands and tenements confined exclusively to Jewish creditors").

75. *See id.* (reporting that the benefits of Jewish lenders became "obsolete" with the expulsion of the Jews from England in 1290).

76. *See* THOMAS LITTLETON, LITTLETON ON MORTGAGES § 332, *quoted in* THEODORE F.T. PLUCKNETT, A CONCISE HISTORY OF THE COMMON LAW 606 (5th ed. 1956) (describing the origin of the word "mortgage" as an amalgam of the French word for "dead" and an Anglo–Saxon term, "gage," that roughly translates as "pledge"). According to a leading authority on the history of the law of property, the device was called a "mortgage" because "it is doubtful whether the [borrower] will pay . . . ; and if he doth not pay, then the land which is put in pledge upon condition for the payment of the money is taken from him

lender, subject to the condition subsequent that would revest title in the borrower on repayment of the debt.[77]

Creditors would lend no more than they thought the land was worth or would be worth at the end of the term of the loan.[78] Because the length of a typical mortgage loan was only six months,[79] the risk that the property might decline in value was minimal. There was no personal liability on the part of the borrower if the value of the land happened to be less than the amount of the debt, nor was there any surplus payable to the borrower if the value of the land exceeded the debt.[80]

Time was of the essence for mortgages prior to the seventeenth century.[81] Payment was required to be made on one day, and one day only, known as "Law Day."[82] There was no right to prepay.[83] A mortgagor who failed to repay the indebtedness during regular business hours on the appointed day for any reason forfeited all interest in the mortgaged premises to the mortgagee, a process that came to be known as strict foreclosure.[84] Regardless of how much of the debt had been

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forever, and so dead to him . . . . And if he doth pay the money, then the pledge is dead as to the [lender]." *Id.*

77. *See* Lawrence G. Preble & David W. Cartwright, *Convertible and Shared Appreciation Loans: Unclogging the Equity of Redemption*, 20 REAL PROP. & TR. J. 821, 823 (1985) ("The borrower conveyed seisin and a deed to the lender, subject to a condition subsequent which would revest seisin in the borrower upon repayment of the debt.").

78. *See In re* Mich. Ave. Nat'l Bank, 2 B.R. 171, 176 (Bankr. N.D. Ill. 1980) ("It would appear that in the early gages the value of the land was roughly the equivalent of the amount of the debt.").

79. *See* Mendes Hershman, *Introduction* to 2 MICHAEL T. MADISON, JEFFRY R. DWYER & STEVEN W. BENDER, THE LAW OF REAL ESTATE FINANCING, at xxviii (rev. ed. 1995) (describing the historical length of a typical mortgage loan).

80. *See In re Mich. Ave. Nat'l Bank*, 2 B.R. at 176 (noting the lack of personal liability on the part of the borrower).

81. *See* GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW § 1.2, at 8 (5th ed. 2007) (emphasizing the importance of timeliness in 17th century mortgage practices).

82. *See* KENT, *supra* note 66, at 188 (identifying Law Day as payment day).

83. *See* Alan M. Weinberger, *Neither an Early Nor a Late Payor Be—Presuming to Question the Presumption Against Mortgage Prepayment*, 35 WAYNE L. REV. 1, 6 (1988) (reaffirming the traditional view that, unless expressly granted in an agreement, borrowers do not have the right to prepay).

84. *See* Wechsler, *supra* note 26, at 857 n.43 (describing how the term

repaid, a borrower who failed to discharge the obligation in full on Law Day lost title to the entire property.[85] These rules were strictly enforced by the courts of law.[86]

The deficiency judgment was unknown to early foreclosure practice.[87] Strict foreclosure meant that the mortgagee took title to the property in full satisfaction of the debt.[88] Not until the eighteenth century would it become the rule that, if the value of the land was insufficient to fully compensate the lender, it might maintain an action at law for the balance as a personal obligation of the mortgagor after foreclosure.[89]

Forfeiture of title was repugnant to the notion of equity. By the seventeenth century the English Courts of Chancery began to intervene to protect borrowers against forfeiture resulting from harsh common law rules.[90] Chancellors created exceptions in

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"strict foreclosure" originated in the United States in the early eighteenth century).

85. *See* Preble & Cartwright, *supra* note 77, at 823 (recognizing that default by the borrower on Law Day destroyed the borrower's right to the property entirely, giving title to the lender).

86. *See id.* (noting that the courts of law strictly enforced property laws).

87. *See* Harold C. Vaughan, *Reform of Mortgage Foreclosure Procedure—Possibilities Suggested by* Honeyman v. Jacobs, 88 U. PA. L. REV. 957, 958 (1940) (pointing out the noted absence of the deficiency judgment from the early law of mortgages and describing its development in later foreclosure practice).

88. *See* KENT, *supra* note 66, at 181 (noting that, when strict foreclosure is practiced, the creditor takes the estate for himself).

89. *See* Amory v. Fairbanks, 3 Mass. 562, 562–63 (1793) ("A mortgagee, who has entered for condition broken, may afterwards have an action upon the bond, and he will recover the difference between the value of the bond, and the amount of principal and interest on the bond."). The size of the deficiency was ascertained by estimate based on proof of the value of the property. *See id.* at 563 (describing the calculation of the deficiency); *see also* Vaughan, *supra* note 87, at 965 (calculating the deficiency based on reports from appraisers of the value of the property at issue); Tierney, *supra* note 67, at 182 n.11 (noting that the practice of a mortgagee suing for the deficiency after a foreclosure sale became a rule of law early on); *In re* Mich. Ave. Nat'l Bank, 2 B.R. 171, 176 (Bankr. N.D. Ill. 1980) ("At the outset a creditor would lend no more than he thought that the land was worth, or would be worth at the end of the agreed term.").

90. *See* JESSE DUKEMINIER, ET AL., PROPERTY 619 (7th ed. 2010) (describing how "the courts stepped in to protect borrowers from overreaching lenders"). Use of the term "equity" to describe the extent to which the fair market value of the property exceeds the amount of indebtedness secured by the property and, therefore, the net value of a borrower's ownership interest, "pays linguistic

cases of accident, mistake, and special hardship.[91] Soon courts were routinely granting equitable relief, compelling mortgagees to reconvey property to mortgagors upon repayment of the principal, with interest and costs, even if Law Day had long since passed.[92]

As a consequence of the creation of the borrower's equity of redemption, a lender's title was clouded (or rendered unmarketable) for an indefinite period of time by the possibility that a defaulting borrower might seek and obtain relief in equity notwithstanding the terms of the mortgage.[93] It was impossible for a lender to know with any degree of certainty when or whether it would be free to use or sell the land.[94] Accordingly, lenders were given the right to petition for a decree of foreclosure, meaning that the chancery court would set a certain date for when their borrowers' equity of redemption would finally terminate if the default persisted.[95] Cutting off the equity of redemption granted indefeasible title to the mortgaged property to the mortgagee, regardless of the value of the property in

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homage to the generations of chancellors who have been moved to protect debtors from overreaching moneylenders." *Id.* at 618.

91. *See* 1 JOSEPH STORY, COMMENTARIES ON EQUITY JURISPRUDENCE, AS ADMINISTERED IN ENGLAND AND AMERICA § 29, at 28–29 (1836) (noting the ability of Courts of Chancery to create exceptions to forfeiture of title and generally describing the role of the courts of equity in mortgage law).

92. *See* CHARLES HARPUM, ET AL., MEGGARY & WADE: THE LAW OF REAL PROPERTY 1172 (6th ed. 2000) (describing the intervention of the courts of equity in regulating mortgages and foreclosures).

93. *See id.* at 1173 (noting the ambiguity of the lender's situation as he waited for a borrower to seek or not seek relief in equity).

94. *See* Preble & Cartwright, *supra* note 77, at 824 (summarizing the plight of unpredictability of the lender after the arrival of the equity of redemption as an option for the borrower).

95. *See* 5 W.S. HOLDSWORTH, A HISTORY OF ENGLISH LAW 331–32 (3d ed. 1927) (describing the lenders' inevitable response—a waiver of the equity of redemption as a standard provision in mortgages). The chancery courts responded to these attempts to circumvent equitable jurisdiction by creating a prohibition against contemporaneous clogging of the equity of redemption. *See* Preble & Cartwright, *supra* note 77, at 824 ("In essence, the clogging doctrine restricted the lender to only one method of cutting off the borrower's equity of redemption—foreclosure."). Foreclosure thus became the only method for extinguishing the mortgagor's equity of redemption. *See id.* (documenting the courts' limits on lenders' remedies to counteract the borrowers' equity of redemption).

relation to the outstanding indebtedness. The only effect of foreclosure was to terminate the mortgagor's right of redemption: "It did not cause a sale of the property, and it did not establish a deficiency."[96]

The unfairness of strict foreclosure would later be mitigated by providing for open cry public auction of the mortgaged property to the highest bidder, either as a result of a judicial proceeding or under a power-of-sale contained in the mortgage.[97] The foreclosure sale price, net of expenses, provided the basis for an unsatisfied lender to pursue the borrower for a deficiency.[98] The movement away from strict foreclosure and toward public sale was surely not intended to affect the debtor adversely.[99] The

96. *See In re* Mich. Ave. Nat'l Bank, 2 B.R. 171, 179 (Bankr. N.D. Ill. 1980).

97. *See* Kasey Curtis, *The Burst Bubble: Revisiting Foreclosure Law in Light of the Collapse of the Housing Industry*, 36 W. ST. U. L. REV. 119, 123 (2008) ("Not surprisingly, strict foreclosure has been viewed as unduly harsh and modern jurisdictions have abandoned strict foreclosure in favor of methods that result in a judicial sale rather than forfeiture."). All states allow mortgagees to file a civil action seeking judicial foreclosure. *See id.* ("Judicial foreclosure is the only method used in every state, and is the predominate method in about half of the states."). If the court finds that the mortgagor has defaulted under the terms of the loan, the court will order that the property be sold at a public foreclosure sale. *See id.* (pointing out that auction sales are the end result of both judicial foreclosures and foreclosures by power-of-sale). If the mortgagor fails to exercise the right of redemption prior to the sale of the property, the collateral will be sold to the highest bidder at the foreclosure sale. *See id.* (describing how a public auction operates following a foreclosure). The purchaser takes title to the property free of any liens, or other interests or encumbrances, subordinate to the foreclosed mortgage. *See id.* (noting that, after an auction, the winning purchaser receives unencumbered title to the foreclosed property). About half the states by statute permit power-of-sale foreclosure as an alternative to judicial foreclosure if the mortgage contains a power-of-sale clause. *See id.* at 124 (indicating that nearly sixty percent of states permit power-of-sale foreclosure as a more efficient method of foreclosure). The ability to foreclose without resorting to a judicial proceeding is comparatively more advantageous to mortgagees in terms of time and expense. *See id.* at 123 (describing the procedures for a power-of-sale foreclosure, which eliminate many of the required formalities in a judicial foreclosure).

98. *See id.* ("If, however, the amount of debt exceeds the value of the property, the mortgagor can still be held liable for the difference.").

99. *See* Skilton, *supra* note 11, at 443

> It was probably assumed that, at the time of the sale, the property would usually bring more than the mortgage. The assumption was doubtless well founded in a period of rising land values; but the technique did not afford sufficient protection to the debtor in

modern cause of action for a deficiency judgment was an unintended consequence of foreclosure-process reform designed to relieve debtors from the harshness of strict foreclosure.

During the Great Depression, as mortgages went into default, third parties had little money to purchase property at foreclosure sales.[100] The absence of competition enabled mortgagees to behave opportunistically by bidding a nominal amount, obtaining title to the property for a small percentage of its fair market value, and then seeking a judgment for the artificially high difference between the purchase price and the remaining amount of the debt.[101] When market conditions stabilized, lenders were able to resell foreclosed property at a profit, for which the borrower did not receive credit.[102] Lenders realized what amounted to a windfall because the double recovery collectively exceeded the mortgagee's debt.[103] Borrowers suffered not only the loss of title to their property but also liability for a substantial deficiency.[104]

Measures for the relief of debtors are the inevitable byproduct of depression periods in which large numbers of foreclosures occur, eliciting the concern of voters and legislators.[105] To counter unjust enrichment of mortgage lenders

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> depression times . . . In these times, the technique of sale made bad matters worse for the debtor.

Of course, foreclosures were more common during times of declining real estate values. *See id.* (highlighting how times of economic depression generally cause the number of foreclosures to increase).

100. *See* Catherine A. Gnatek, Note, *The New Mortgage Foreclosure Law: Redemption and Reinstatement*, 1989 U. ILL. L. REV. 471, 478 (describing the influence that the Great Depression had on mortgage and foreclosure law, as foreclosure sale prices plummeted while potential purchasers had very little money).

101. *See id.* (asserting that this opportunistic behavior "results in great unfairness to the mortgagor" which was "magnified by the Great Depression").

102. *See* Mattingly, *supra* note 26, at 104 (noting that the Great Depression caused legislatures to seek solutions to help borrowers).

103. *See* Rapoport, *supra* note 27 (using an example to illustrate how lenders potentially realize a windfall before statutory help to borrowers existed).

104. *See* Gnatek, *supra* note 100, at 478 (pointing out the large discrepancy between the benefit to lenders during the Great Depression and the losses of borrowers during the same time period).

105. *See* Skilton, *supra* note 11, at 440 (stating that, during these depression

and the oppressive effect of economic conditions on borrowers, many states codified protections in the form of statutory rights of redemption, anti-deficiency statutes, and fair value legislation.[106]

Statutory rights of redemption exist in approximately three-fifths of the states.[107] They afford mortgagors a second opportunity to redeem, and thereby avoid the loss of title to the property, during a specified period following the foreclosure sale.[108] Most of these statutes permit mortgagors to remain in possession during the redemption period.[109] The period of time during which mortgagors may exercise their statutory right of redemption ranges from three months to two years after the sale.[110] Allowing mortgagors to remain in possession during the redemption period eases the disruption of foreclosure, especially in states that permit power-of-sale foreclosure, which may be accomplished in a matter of weeks.[111] Statutory redemption

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periods, "an increasing class of unfortunate people assumes a position of influence in government").

106. *See id.* (reiterating that depression periods incentivized legislators to pay attention to the distressing position of the mortgage debtor). Many states enacted temporary moratoria on foreclosures. *See id.* (contrasting federal and state legislatures' actions and responses to the poor position of the debtor). These statutes were designed to give debtors an opportunity to refinance once market conditions stabilized or, at least, delay foreclosure until the economy improved with the passage of time and competitive bidding might be expected to resume. *See id.* ("Many state legislatures, in an effort to break the wave of liquidation and afford property owners an opportunity to refinance, passed moratoria."). The constitutionality of moratoria statutes was upheld in *Home Building & Loan Ass'n v. Blaisdell*, 290 U.S. 398 (1934). Most of these statutes expired by their own terms or by additional legislation after the Depression ended. *See* DAVID S. HILL, BASIC MORTGAGE LAW 267 (2001) (noting the short-term nature of the moratoria statutes).

107. *See* Rapoport, *supra* note 27, at n.46 (listing the twenty-nine states that allow the statutory right of redemption).

108. *See id.* (describing how the statutory right of redemption provides protection to borrowers by giving them one last chance to reacquire their homes).

109. *See* THOMPSON ON REAL PROPERTY § 101.07(c)(1), at 469 (David A. Thomas ed., 1994) ("[T]he debtor is invariably allowed to continue to occupy the property during the redemption period.").

110. *Compare* WYO. STAT. ANN. § 1-18-103 (2014) (proscribing a three-month redemption period), *with* S.D. CODIFIED LAWS § 21-52-13 (2014) (instituting a two-year redemption period, provided the redeeming party meets certain requirements within one year of the public auction).

111. *See* NELSON & WHITMAN, *supra* note 81, § 7.19, at 846–48 (noting the

encourages purchasers at foreclosure sales to bid up to the fair market value of the property by affording the mortgagor the opportunity to repurchase the property at the price paid by the buyer at the foreclosure sale.[112]

Anti-deficiency statutes are the most efficacious of the debtor-protection measures.[113] Although no state forbids deficiency judgments in all cases,[114] the California law is the most comprehensive because its protections extend to commercial borrowers.[115] It is also the most complex,[116] frequently creating bewilderment among attorneys in other jurisdictions.[117] Enacted in 1933, the California statute was intended to prevent future real estate recessions from spiraling into depressions.[118] Although

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efficiency of the power-of-sale foreclosure process); *infra* note 235 and accompanying text (describing the short process that accompanies a foreclosure by power-of-sale).

112. *See* Tierney, *supra* note 67, at 190 (concluding that the statutory right of redemption protects the mortgagor from an unfair price on foreclosure sales).

113. In the wake of the Depression, the National Conference of Commissioners on Uniform State Laws called for the elimination of deficiency judgments entirely. *See* MODEL POWER OF SALE MORTGAGE FORECLOSURE ACT (1940), *reprinted in* HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS AND PROCEEDINGS OF THE FIFTIETH ANNUAL CONFERENCE 254, 254–64 (1940) (believing such elimination of deficiency judgment was "urgent" and that its passage would materially benefit "both mortgagors and mortgagees").

114. *See* Pence, *supra* note 22, at 180 (emphasizing that no geographic variation exists for the variable of deficiency judgments).

115. *See* SANDRA H. JOHNSON, ET AL., PROPERTY LAW CASES, MATERIALS AND PROBLEMS 707 (3d ed. 2006) (comparing different states' anti-deficiency statutes and emphasizing the broad nature of California's statute due to its extension of protection to commercial borrowers).

116. *See* Hill, *supra* note 106, at 268 (describing California's statute as not only the most "complex," but also the "most comprehensive anti-deficiency legislation of any state").

117. *See* NELSON & WHITMAN, *supra* note 81, § 8.3 (describing the great variation between California's anti-deficiency laws and those of other states).

118. *See* Cornelison v. Kornbluth, 542 P.2d 981, 989 (Cal. 1975) (explaining how the California statute "prevents the aggravation of the downturn" that would result without it). The statute prohibits a deficiency judgment following any foreclosure by power-of-sale. *See* CAL. CIV. PROC. CODE § 580(d) (West 2015) (prohibiting deficiency judgments for real property sold under a power-of-sale clause contained in the mortgage). This provision is in the nature of a trade off in return for the borrower not having a statutory right of redemption following power-of-sale foreclosure. The statute also prohibits deficiency judgments

the scope of protection is less extensive and more ambiguous than California, several other states similarly prohibit lenders from pursuing borrowers for deficiency judgments under certain circumstances when foreclosure yields proceeds of sale that are insufficient to cover the amount of the debt.[119]

Fair value legislation, while not prohibiting lenders from seeking deficiency judgments, is a significant substantive limitation on their size.[120] Fair value statutes exist in twenty-nine states in various forms,[121] although it is not always possible

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following foreclosure of any mortgage given to the vendor of property to secure the unpaid balance of the purchase price. *See id.* § 580(b) (preventing deficiency judgments that come after a foreclosure to obtain an unpaid balance from the borrower). The rationale for this provision is to protect against sellers' natural tendency to overvalue real property for which there is no independent check when the vendor is also the lender. *See* NELSON & WHITMAN, *supra* note 81, § 8.3, at 959 (identifying the justification for the provisions in the California anti-deficiency statute). This rationale has been criticized as highly dubious. *See id.* (supporting others' criticism of the overvaluation rationale). The statute prohibits deficiency judgments following foreclosure of a purchase-money mortgage on a dwelling containing not more than four families, regardless of the method of foreclosure and the identity of the mortgagee. *See* CAL. CIV. PROC. CODE § 580(b) (listing various situations that do not result in the owing of a deficiency judgment).

119. *See* GHENT, *supra* note 70, at 31–33 (listing states with some form of anti-deficiency legislation).

120. *See* Tierney, *supra* note 67, at 183 (describing New York's fair value legislation as a "decided departure from the previous rule"). New York's fair value statute was the first of its kind. *See id.* ("One of the most notable examples has been the statutory change in New York, since it was the first of its kind . . . ."). It was upheld by the U.S. Supreme Court as enforceable against a constitutional challenge that it violated the Contract Clause. *See* Honeyman v. Jacobs, 306 U.S. 539, 545 (1939) (holding that a lender's contractual rights were not impaired by calculation of a deficiency based on a lower court finding that the fair value of mortgaged property was $25,318, notwithstanding that the lender had acquired the property at a foreclosure sale for $7,500).

121. *See generally* ARIZ. REV. STAT. ANN. § 33-814 (Westlaw through 2015); ARK. CODE ANN. § 18-50-112 (West, Westlaw through 2014 2d. Ex. Sess.); CAL. CIV. PROC. CODE § 580(b) (West, Westlaw through 2014 Reg. Sess.); COLO. REV. STAT. ANN. § 38-38-106(6) (West, Westlaw through 2014 2d. Reg. Sess.); CONN. GEN. STAT. § 49-14(a) (West, Westlaw through 2014 Sess.); GA. CODE ANN. § 44-14-161 (West, Westlaw through 2014 Reg. Sess.); IDAHO CODE ANN. § 6-108 (West, Westlaw through 2014 2d. Reg. Sess.); KAN. STAT. ANN. § 60-2415(b) (West, Westlaw through 2014 Reg. Sess.); LA. CIV. CODE ANN. arts. 2723, 2771 (Westlaw through 2014 Reg. Sess.); ME. REV. STAT. tit. 14, § 6324 (Westlaw through 2013 2d. Reg. Sess.); MICH. COMP. LAWS ANN. § 600.3280 (West, Westlaw through 2014 Reg. Sess.); MINN. STAT. ANN. § 582.30 (West, Westlaw

to identify and classify a statute with complete confidence.[122] These statutes create what is considered to be a fairer method than the traditional common law mechanism for assessing the debtor's personal liability upon default.[123] They typically limit the deficiency to the difference between the remaining mortgage debt and the fair market value of the collateral at the time of foreclosure or the price paid by the foreclosure sale purchaser, whichever is greater.[124] Depending on the statute, a trial court or a jury is responsible for determining fair value.[125] These statutes reflect the position embodied in section 8.4 of the Restatement.[126]

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through 2015 Reg. Sess.); NEB. STAT. REV. ANN. § 76-1013 (LexisNexis, LEXIS through 2014 2d. Sess.); NEV. REV. STAT. ANN. § 40.459 (West, Westlaw through 2014 Spec. Sess.); N.J. STAT. ANN. § 2A:50-3 (West, Westlaw through 2014 Legis. Sess.); N.Y. REAL PROP. ACTS. LAW § 1371(2) (McKinney, Westlaw through 2014 Legis. Sess.); N.C. GEN. STAT. ANN. § 45-21.36 (West, Westlaw through 2014 Reg. Sess.); N.D. CENT. CODE ANN. § 32-19-03 (West, Westlaw through 2013 Reg. Sess.); OHIO REV. CODE ANN. §§ 2329.17, 2329.20 (West, Westlaw though 2013–2014 Legis. Sess.); OKLA. STAT. ANN. tit. 12, § 686 (Westlaw through 2014 Sec. Sess.); 42 PA. CONS. STAT. ANN. § 8103 (West, Westlaw through 2014 Reg. Sess.); S.C. CODE ANN. § 29-3-700 (Westlaw through 2014 Reg. Sess.); S.D. CODIFIED LAWS § 21-47-16 (Westlaw through 2014 Reg. Sess.); TENN. CODE ANN. § 35-5-118 (West, Westlaw through 2014 Reg. Sess.); TEX. PROP. CODE ANN. § 51.003 (West, Westlaw through 2013 3d. Sess.); UTAH CODE ANN. § 57-1-32 (West, Westlaw through 2014 Gen. Sess.); VT. R. CIV. P. 80.1; WASH REV. CODE. ANN. § 61.12.060 (West, Westlaw through ch. 1–3 2015 Reg. Sess.); WIS. STAT. ANN. § 846.165 (West, Westlaw through 2013 Act 380).

122. Florida's deficiency statute has been characterized as "unique and ambiguous." NELSON & WHITMAN, *supra* note 81, § 8.3, at 945. The statute appears to give trial courts the flexibility to choose between the foreclosure sale price and the market value of the foreclosed real estate in a deficiency judgment proceeding. *See* FLA. STAT. ANN. § 45.031(8) (West, Westlaw through 2014 2d. Reg. Sess.) ("[T]he amount bid at the sale may be considered by the court as one of the factors in determining a deficiency under the usual equitable principles.").

123. *See* Tierney, *supra* note 67, at 183 ("The essence of this change, as it affected the calculation of the deficiency, was that the 'fair value' of the property, rather than the foreclosure sale price, was to be set off against the balance due on the mortgage.").

124. *See id.* (describing the change in the deficiency judgment calculation after fair value legislation passed).

125. *Compare* N.Y. REAL PROP. ACTS. LAW § 1371(2) (McKinney 2011) (limiting deficiency to fair market value, as determined by the court), *with* MINN. STAT. ANN. § 582.30 (West 2012) (providing that all issues of facts, including the fair market value of the property, "shall be tried by a jury").

126. *See* RESTATEMENT (THIRD) OF PROP.: MORTGAGES. § 8.4 cmt. a (1997) ("The approach in this section is embodied in statutes in many jurisdictions, but

No state court has followed the Restatement recommendation to adopt the fair value approach through the exercise of its equity jurisdiction.[127] The few state court decisions applying the fair value approach based on common law in the absence of a statute are states that have traditionally done so.[128] Other courts have declined invitations to adopt the fair value approach,[129] the Missouri Supreme Court being the most recent.[130] The effect of its decision on Mike Matheny's case will be examined in Part IV of this Article.[131]

the principles of this section are applicable whether a statute requires it or not.").

127. *See* First Bank v. Fischer & Frichtel, Inc., 364 S.W.3d 216, 224 (Mo. 2012) (en banc) (pointing out that states do not adopt the fair value approach to deficiency judgments under their equity jurisdictions).

128. *See, e.g.*, Wansley v. First Nat'l Bank of Vicksburg, 566 So. 2d 1218, 1225 (Miss. 1990) (emphasizing that every aspect of a sale must be commercially reasonable and fair); First NH Mortg. Corp. v. Greene, 653 A.2d 1076, 1079 (N.H. 1995) (reprimanding the mortgage company for failing to obtain a fair price); Licursi v. Sweeney, 594 A.2d 396, 401 (Vt. 1991) (preventing a plaintiff creditor from becoming unjustly enriched while relying on the common law).

129. *See* Illini Fed. Sav. & Loan Ass'n v. Doering, 516 N.E.2d 609, 612 (Ill. App. Ct. 1987) ("Our legislature has included no such minimum price provision in the statute governing foreclosure sales, and we find no basis for reading such a provision into the statute."); R.I. Depositors' Econ. Prot. Corp. v. Macomber, 658 A.2d 511, 511 (R.I. 1995) ("In a series of cases this court has determined that the amount realized at a mortgagee's sale, even when bid at less than the appraised value would not be disturbed in the absence of fraud or impropriety in connection with the sale."). After first adopting the judicial fair market value standard, a subsequent decision by the Montana Supreme Court appears to require some individualized showing of unfairness before allowing testimony that the property value exceeds the foreclosure price. *See* FSLIC v. Hamilton, 786 P.2d 1190, 1193 (Mont. 1990) (pointing out the lack of facts demonstrating the price was not fair), *overruling* Trs. of the Wash.-Idaho-Mont.-Carpenters-Emp'rs Ret. Trust Fund v. Galleria P'ship, 780 P.2d 608, 619 (Mont. 1989) (requiring a fairness analysis of the price prior to approving a sale).

130. *See infra* notes 201–202 and accompanying text (retelling the Missouri Supreme Court's decision to forgo adoption of the Restatement position).

131. *See infra* Part IV (discussing Mike Matheny's personal situation and its relation to Missouri law).

IV. Chesterfield of Dreams

Commercial real estate developers are obsessive visionaries and perpetual optimists. While others who gaze upon vacant Blackacre see nothing more than a farm field (except, of course, for property professors, who see a bundle of sticks), a real estate developer pictures a new housing community. A developer sees an underutilized city block and imagines a mixed-use office or retail complex.[132]

The very qualities essential to success in commercial real estate—ambition and audacity—are a lethal admixture during a severe economic downturn.[133] Even a developer with the best track record for performance is at the mercy of changes in market conditions that occur in the interval between land acquisition and completion of construction.[134] Besides marketplace risk, real estate development involves a myriad of temporal and transactional risks, any one of which will likely result in failure.[135] Because of the infinite variety of unanticipated events that can and will occur, real estate development is the prototypical example of the Anna Karenina principle.[136]

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132. *See* ROBIN P. MALLOY & JAMES C. SMITH, REAL ESTATE TRANSACTIONS: PROBLEMS, CASES, AND MATERIALS 1 (4th ed. 2013) (noting how a real estate developer views potential properties and their future purposes).

133. *See generally* STEVEN MILLHAUSER, MARTIN DRESSLER: THE TALE OF AN AMERICAN DREAMER (1996) (describing the melancholy and risky lifestyle of a real estate developer). Millhauser received the Pulitzer Prize for Fiction in 1997 for his exploration of the psyche of a real estate investor in this novel. *1997 Winners and Finalists*, THE PULITZER PRIZES, http://www.pulitzer.org/awards/1997 (last visited Apr. 3, 2015) (on file with the Washington and Lee Law Review).

134. *See* CHARLES J. DELANEY, REAL ESTATE DEVELOPMENT AND THE LAW IN THE 1980S 2 (R. Levitt & A. Ntephe eds., 1983) (noting the high risk, high reward nature of a real estate developer's career). Increased citizen participation in the governmental approval process and the growing popularity of the temporary moratorium on issuance of development permits make it virtually impossible for even the most experienced real estate developers to predict the time and economic climate their finished product will face when it comes on the market. *See id.* (citing various factors as significant developments affecting the permitting process in the 1980s).

135. *See infra* note 151 and accompanying text (discussing the myriad of risks associated with real estate ventures).

136. The Anna Karenina principle describes an endeavor where a deficiency in any one of a number of factors will cause the endeavor to fail. *See, e.g.*, David

In July 2006, Daryl Doran left MPD to start a gym.[137] In January 2007, the remaining members, Matheny and Brett Phillips, obtained a line-of-credit loan from The Business Bank of St. Louis to market, and perhaps ultimately develop, eleven acres of vacant land situated in Chesterfield,[138] a densely populated and affluent second-ring suburb approximately twenty-five miles west of St. Louis.[139] The loan was evidenced by a promissory note in the principal sum of $6.3 million and secured by a deed of trust.[140] In June 2007, MPD signed a second promissory note in the principal sum of $5 million, also secured by a deed of trust, to

Roher, *Strikeouts and the Anna Karenina Principle, or: Why Ks Don't Hurt MLB Batters*, THE HARVARD SPORTS ANALYSIS COLLECTIVE (Nov. 25, 2009), https://harvardsportsanalysis.wordpress.com/2009/11/25/strikeouts-and-the-anna-karenina-principle-or-why-ks-dont-hurt-mlb-batters/ (last visited Apr. 3, 2015) (describing the Anna Karenina principle and its alternative correlation) (on file with the Washington and Lee Law Review). Thus, a successful endeavor is one that avoids every possible deficiency. The name of the principle derives from the opening sentence of Leo Tolstoy's 1878 masterpiece: "Happy families are all alike; every unhappy family is unhappy in its own way." *See id.* (quoting Leo Tolstoy's novel at the beginning of the article). Scholars and authors have extended this idea beyond families to other endeavors where success requires avoiding many separate possible causes of failure. *See id.* (extending the principle to baseball).

137. Hunn & Goold, *supra* note 55. Following Doran's departure, MPD consisted of two members: Mikris Investments, L.L.C., an entity owned by Michael and Kristin Matheny in equal shares; and Monarch Holdings, L.L.C., owned by Brett Phillips and his wife. *See* Defendants' Response to Plaintiff's Statement of Uncontroverted Material Facts in Support of Plaintiff's Motion for Summary Judgment and Defendants' Statement of Additional Material Facts at 3, Bus. Bank of St. Louis v. MPD Invs. L.L.C., No. 10SL-CC02512 (Mo. Cir. 2013) (describing the membership of MPD as of October 16, 2008).

138. *See* GREAT RIVERS GREENWAY, MISSOURI RIVER GREENWAY—MONARCH-CHESTERFIELD LEVEE TRAIL (describing the Chesterfield Valley and its history). Located near the confluence of the Missouri and Mississippi Rivers, Chesterfield has become "one of the region's hottest retail markets" since being redeveloped after the Great Flood of 1993, which caused fifty deaths and $12 billion in property damage. *Id.*

139. *See* TAUBMAN, TAUBMAN PRESTIGE OUTLETS CHESTERFIELD (2014) (reporting that more than 1.6 million people live within twenty miles of the property, and the average household income within ten miles of the property is approximately $100,000).

140. *See* Order at 2, Bus. Bank of St. Louis v. MPD Invs. L.L.C., No. 10SL-CC02512 (Mo. Cir. 2013) (noting that, on January 4, 2007, MPD delivered a promissory note to the bank, agreeing to repay the bank the principal sum of over $6.3 million, plus interest).

evidence debt incurred to refinance a mortgage encumbering an adjacent parcel of improved property, known as the U.S. Turf Building, and to provide funds for tenant improvements.[141]

An observation of the property discloses why it would have been irresistibly attractive to Matheny at the height of the bubble in real estate values. Although the eleven-acre parcel remains undeveloped and listed for sale at the time of this Article, the property enjoys a prime location accessible to, and visible from, a major interstate highway. It is proximate to two outlet malls that collectively house 120 stores[142] and Chesterfield Commons, which is reported to be the largest strip mall in the nation.[143] A levee fitness trail at the rear of the parcel enhances its value for retail or corporate use.[144] There are no apparent topographical or site conditions that would prevent its development in a manner comparable to the neighboring property, assuming that the real estate market continues to strengthen and that lenders regain confidence.[145] Its location has been marketed by the city as "Chesterfield of Dreams."[146] Gazing upon the vacant field, Matheny likely would have envisioned a big-box retail store with acres of surrounding parking or perhaps a health-care facility.

Because MPD was a limited liability entity, Mike and Kristin Matheny were required to personally guarantee a portion of the

141. *Id.* at 3. The first note matured on January 4, 2009, and the second on March 31, 2009. *Id.* at 3–4.

142. *See Explore the Taubman Properties*, TAUBMAN, www.taubman.com/taubman-properties (last visited Apr. 3, 2015) (marketing the Taubman Prestige Outlets to residents and out-of-town visitors by virtue of its open-air village design, brand-name stores, amenities, and special events) (on file with the Washington and Lee Law Review).

143. *See* Mary Delach Leonard, *After the Great Flood of '93, Chesterfield Valley Emerged From Gumbo Flats*, ST. LOUIS BEACON (Aug. 7, 2013, 6:46 AM), https://www.stlbeacon.org/#!/content/32199/chesterfield_valley_one_080513 (last visited Apr. 3, 2015) (denoting Chesterfield Commons as the largest strip mall in the country) (on file with the Washington and Lee Law Review).

144. *See id.* (depicting the paved trail on top of the levee).

145. *See id.* (remarking on the high quality of the land as one of the reasons Chesterfield Valley rebuilt so strongly).

146. *See id.* (explaining that the city marketed the valley in this way and set about rebuilding despite the "nationwide calls by engineers and environmentalists to limit floodplain development after the '93 flood").

debt in the total sum of $4.2 million.[147] A personal guarantee of repayment, a material credit enhancement from the lender's perspective, is the most dreaded concession a real estate developer can make.[148] A guarantor assumes a compound triple risk of potential liability in the event of default by the principal obligor, consisting of liability on the guarantee, liability for the guarantor's own attorney's fees to defend against the creditor's claim, and liability for the creditor's attorney's fees in seeking to enforce the guarantee.[149]

Once a developer accumulates sufficient net worth and a solid track record, institutional lenders are more willing to forgo personal guarantees. Until then, a novice real estate investor like Matheny is likely to be confronted with a demand for a guarantee that, if called and honored, could wipe out a lifetime of accumulated assets.[150] In this sense, a personal guarantee is no different from, and no less attractive than, investing one's own cash in the deal.

In the context of a loan secured by improved property already under lease, a personal guarantee may be relatively benign. To a certain extent, the location has already been proven. The property may have a record of generating sufficient rental income to cover operating expenses. Yet personal liability in a loan transaction involving investment property is hardly risk free. Even the most credit-worthy tenant can become bankrupt or

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147. *See* Order, *supra* note 140, at 5, para. 26 (noting that "[t]he Bank relied on the Matheny Guaranty in extending credit to MPD pursuant to the MPD Notes"). Brett Phillips and his wife, Kelly, also signed a personal guarantee. *See* Plaintiff's Petition at 97, Bus. Bank of St. Louis v. MPD Invs. L.L.C., No. 10SL-CC02512 (Mo. Cir. 2013) (alleging that the Bank relied on this guarantee in extending credit to MPD). Initially, the principals had agreed to guarantee fifty percent of the debt. As part of an extension of the maturity date in June 2009, the Mathenys' guarantee was modified to provide that their liability was limited to $4.2 million, plus costs of enforcement. *See id.*, at 108 (stating the costs of enforcement included attorneys' fees and legal expenses).

148. *See* TIMOTHY J. TRYNIECKI, 18A MISSOURI PRACTICE SERIES, REAL ESTATE LAW—TRANSACTIONS AND DISPUTES § 56:1 (3d ed. 2006) (noting all of the multifarious risks attending personal guarantees of repayment).

149. *See id.* (describing the underappreciated and palpable risks associated with personal guarantees of repayment).

150. *See id.* (noting the numerous serious risks attending personal guarantees that can devastate one's financial security).

engage in strategic default. Insurance proceeds may be inadequate to cover a catastrophic loss. The economic viability of a location may change.

The risks involved in development projects are exponentially greater. They include, but are not limited to, adverse environmental, geological, or other site conditions; inability to obtain, or delay in obtaining, governmental permits; changes in zoning, land use regulations, and building codes; delays due to severe weather or other acts of God; and the bankruptcy of the general contractor or a key subcontractor.[151]

Matheny's downfall was the result of the inability to lease space as quickly as projected when the commercial real estate market plummeted. MPD spent three years in an unsuccessful attempt to market the property, with Brett Phillips leading the effort.[152] St. John's Mercy Hospital and a flooring company, among others, expressed interest in leasing space. After they backed out as potential tenants, MPD's plans for the property seemed to unravel. From Matheny's deposition testimony,[153] and consistent with his track record,[154] MPD's intentions for the property were ambiguous and likely included either development or sale to a third party for a profit.[155] Matheny would later

151. *See* MALLOY & SMITH, *supra* note 132, at 13–17 (illuminating the numerous risks and obstacles attending development projects); *see also* Boris Agranovich, *How Real Estate Developers Manage Their Risks?*, GLOBAL RISK CONSULT, http://www.globalriskconsult.com/article-6-real-estate.php (last visited Apr. 3, 2015) (enumerating and categorizing the different types of risks associated with development projects) (on file with the Washington and Lee Law Review).

152. *See* Reply Memorandum in Support of Plaintiff's Motion for Summary Judgment at 25 n.9, Bus. Bank of St. Louis v. MPD Invs., L.L.C., No. 10SL-CC02512 (Mo. Cir. 2013) ("Defendants unsuccessfully attempted to market the projects at issue for over three years.").

153. *See* Defendants' Response, *supra* note 137, at 12 para. 29 (quoting Matheny's deposition from Sept. 12, 2011).

154. *See supra* note 58 and accompanying text (suggesting that Matheny was investing with an expectation of certainty in profits, regardless of whether the real estate was acquired for development or "flipping").

155. *See* Defendants' Response, *supra* note 137, at 6 para. 14 (indicating that MPD's intentions regarding whether it was going to develop or sell the property to a third party for profit were unclear).

acknowledge that there might not have been much of a plan to begin with.[156]

During this period the parties agreed to a series of loan modifications where the maturity dates of the two promissory notes were extended.[157] After Phillips filed for bankruptcy,[158] and as part of a loan modification in June 2009, the Mathenys complied with a demand by the lender to furnish additional collateral, consisting of a $1 million mortgage lien against their principal residence and a pledge of a $1 million investment account maintained at the bank.[159]

Matheny made the last $16,000 monthly debt service payment on March 30, 2010.[160] At a meeting with bank officers on May 3, 2010, Matheny informed the lender that he would make no further payments on the loan.[161] On June 24, 2010, the lender filed suit against MPD in St. Louis County Circuit Court seeking to collect the unpaid balance, including interest, late charges, and expenses.[162] The Mathenys were named as defendants in their

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156. *See* Wagman & Mann, *supra* note 10 ("'At the time of purchase, I don't think there was much of a plan,' Matheny said.").

157. *See* Order, *supra* note 140, at 5 ("The parties entered in negotiations . . . that culminated in a further Modification Agreement dated June 30, 2009 whereby the Bank agreed to further extend the maturity date of the MPD Notes to May 31, 2010, and limited the Matheny Guarantors' liability.").

158. The lender's complaint against Phillips was returned unopened. Bus. Bank of St. Louis v. MPD Invs. L.L.C., No. 10SL-CC02512 (Mo. Cir. 2013) [*hereinafter* Docket Sheet] (on file with the Washington and Lee Law Review). A default judgment in the sum of approximately $5 million was entered against him on September 16, 2013. *Id.*

159. *See* Rick Desloge, *Former Cardinal Mike Matheny Out At Home*, ST. LOUIS BUS. J. (July 11, 2010), http://www.bizjournals.com/stlouis/stories/2010/07/12/story4.html?page=all (last visited Apr. 3, 2015) (detailing the Mathenys' obligations under the modified loan arrangement) (on file with the Washington and Lee Law Review).

160. *See* Order, *supra* note 140, at 6 para. 28 ("The last monthly payment the Bank received from MPD for the MPD Notes was on March 30, 2010.").

161. *See id.* at 7 para. 41 ("At that meeting, Mike Matheny informed the Bank that MPD would not be making any more interest and principal payments under the MPD Notes."). By letter dated May 11, 2010, Matheny affirmed that he would make no further payments. Defendants' Response *supra* note 137, at 28 para. 63.

162. Plaintiff's Petition, *supra* note 147.

capacity as guarantors.[163] The Business Bank foreclosed on both properties by power-of-sale, and they were sold at auction at the St. Louis County Courthouse on July 12, 2010.[164] The lender purchased the eleven-acre parcel for $2.5 million and the U.S. Turf Building for $2 million, for a total of $4.5 million, which it credited against the debt.[165] There were no other bidders.[166]

David Gamache, a loan officer for The Business Bank, testified during pretrial discovery that the lender resold the U.S. Turf Building to Frisella Properties for $2,650,000 in November 2010, four months after acquiring title at the foreclosure sale for $2 million.[167] Matheny received no credit for the $650,000 gross

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163. *See id.* at 7, 9 (naming Mikris Investments, L.L.C. and Monarch Holdings, L.L.C. also as guarantor defendants).

164. *See* Order, *supra* note 140, at 7 para. 43 ("On July 12, 2010, the Bank conducted a non-judicial foreclosure sale of the 11 Acre Parcel and the US Turf Building pursuant to Deeds of Trust the Bank held relating to those properties."). Notice of the foreclosure sale was published in twenty-one consecutive issues of the *St. Louis Countian* in compliance with the Missouri power-of-sale foreclosure statute. *See* Defendants' Response, *supra* note 137, at 44 para. 107 ("The Bank conducted a non-judicial public foreclosure sale for the 11 Acre Parcel and US Turf Building in accordance with Missouri law on July 12, 2010.").

165. *See* Jake Wagman, *Missouri Supreme Court Decision Could Hit Matheny in the Wallet*, ST. LOUIS POST-DISPATCH (Apr. 18, 2012), http://www.stltoday.com/news/local/govt-and-politics/political-fix/missouri-supreme-court-decision-could-hit-matheny-in-the-wallet/article_c34069aa-88d1-11e1-92b5-0019bb30f31a.html (last visited Apr. 3, 2015) ("The bank 'purchased' the land for $4.5 million, which is to say it took the property and credited the sale amount to Matheny's debt.") (on file with the Washington and Lee Law Review).

166. *See id*. (noting that a bank is often the only bidder at foreclosure auctions). As is typically the case in foreclosure sales, The Business Bank acquired title to the property in the name of an affiliated entity, Maryland Land Co., L.L.C. *See* Rick Desloge, *Business Bank of St. Louis Gets Foreclosed Matheny Property*, ST. LOUIS BUS. J. (July 12, 2010), http://www.bizjournals.com/stlouis/stories/2010/07/12/daily17.html?page=all (last visited Apr. 3, 2015) ("[The Business Bank] bid for the property through a company related to Business Bank, Maryland Land Co. L.L.C.") (on file with the Washington and Lee Law Review). MPD Investments, L.L.C. was formally dissolved on September 9, 2013, the eighth anniversary of its organization. MO. SEC'Y OF STATE, ADMINISTRATIVE DISSOLUTION OR CANCELLATION FOR A LIMITED LIABILITY COMPANY (Sept. 9, 2013) (on file with the Washington and Lee Law Review).

167. *See* Appellant's Substitute Reply Brief at 7, First Bank v. Fischer & Frichtel, Inc., 364 S.W.3d 216 (Mo. 2012) (en banc) (No. SC91951) (referencing

profit. Gamache estimated that the lender spent between $70,000 and $100,000 on tenant improvements before the sale to Frisella.[168] Responding to defense counsel's questioning, Gamache conceded that the contract of sale was signed a month after the foreclosure and provided for a relatively short executory period but denied that The Business Bank had any discussions with Frisella prior to the foreclosure.[169] Regarding the eleven-acre parcel, Gamache acknowledged that The Business Bank did not pay fair market value, which he estimated as "closer to $3 million."[170] He said the lender discounted the purchase price by the broker's commission it would have to pay upon resale and expenses it expected to incur during its ownership of the property.[171]

The Matheny residence was sold in advance of a scheduled foreclosure for $1.9 million, of which $1 million was credited against the debt.[172] Matheny's investment account was seized, and its $1.1 million value was credited against MPD's indebtedness.[173] Calculated in the traditional arithmetical manner, and after receiving credit for these two items of collateral, the deficiency exceeded the $4.2 million for which the Mathenys had agreed to be personally liable.[174]

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the fact that The Business Bank had paid $2 million for property that it sold four months later for $2,650,000).

168. *See* Gamache Dep., 129:16–19, Oct. 17, 2011, Bus. Bank of St. Louis v. MPD Invs. L.L.C., No. 10SL-CC02512 (Mo. Cir. 2013) (providing additional explanation that "there was some build-out done for the tenant, but there was also some work that needed to be done to the building itself that was not the tenant's responsibility").

169. *Id.* at 132–37.

170. *Id.* at 11.

171. *Id.* at 113–15.

172. Reply Memorandum, *supra* note 152, at 26.

173. *Id.* at 26–27.

174. *See id.* at 28 (noting that the agreements between the parties did not contemplate that the Mathenys' guaranties will be reduced by amounts received from the sale of the Matheny residence or from the sale of the Matheny Trust's investment account). After all applicable credits, the lender claimed it was still owed a total of $4.9 million on the two notes, including unpaid principal, accrued interest, late charges, and expenses. *Id.* Matheny claimed that his guaranty obligation should have been credited with the proceeds from the sale of his residence and the value of his investment account, a claim that was contrary

The defense of a solvent guarantor involves a predictable strategy. Through exhaustive pretrial discovery and motion practice, guarantor's counsel demonstrates its ability and willingness to outwork the silk-stocking law firm that typically represents an institutional lender. Besides the voluminous loan instruments following a series of modifications and extensions, documents produced through discovery include thick binders filled with underwriting and administration guidelines, which no lender ever follows without some deviation. If introduced into evidence at trial, the potential for generating confusion and sympathy will motivate the lender to settle, rather than risk trying the case to a jury of the guarantor's peers or, in Matheny's case, a jury of his fans.[175]

The success of this defense strategy requires surviving the lender's motion for summary judgment.[176] Conventional wisdom once held that courts were reluctant to grant even partial summary judgment.[177] It is a relatively recent phenomenon for lenders to expect guarantees to be fully enforceable as a matter of law.[178] A state-of-the-art guarantee is unambiguous and tightly drafted, with waivers of every conceivable defense.[179] Reflecting a nationwide trend, Missouri trial judges have become less

to the express language of the Mathenys' guarantees. *See* Order, *supra* note 140, at 16 ("[T]he January 4, 2007 guaranty and the guaranty executed in June, 2009 specifically provide that the Matheny Guaranty 'will only be reduced by sums actually paid by Guarantor under this Guaranty, but will not be reduced by sums from any other sources . . . .'").

175. A third-party guarantor has defenses that are unavailable to a principal like Matheny, such as lack of notice of extensions granted to the obligor by the lender and modifications made without the guarantor's consent.

176. *See* TRYNIECKI, *supra* note 148, § 56:6 (explaining that, despite the availability of multiple defenses, "lenders are often able to obtain summary judgment to enforce liability under guarantees").

177. *See id.* ("The common experience was that trial judges did not grant summary judgment, and if they did, appellate courts would not uphold them.").

178. *See id.* (stating that the U.S. Supreme Court's decision in *Celotex Corp. v. Catrett*, 477 U.S. 317 (1986), helped revitalize the use of the summary judgment motion as an effective approach to litigation).

179. *See id.* (noting that the viability of the summary judgment motion encourages holders of guaranties "to draft and administer their guaranty to maximize the potential for summary judgment").

reluctant to grant summary judgment in cases seeking to enforce personal guarantees.[180]

On November 1, 2011, The Business Bank filed its motion for summary judgment against the Mathenys.[181] On November 4, 2011, Circuit Court Judge Tom W. DePriest Jr. stayed the Matheny litigation pending the outcome of the appellate process in the case of *First Bank v. Fischer & Frichtel*.[182] Homebuilder Fischer & Frichtel had borrowed $2,576,000 from First Bank to finance construction of a twenty-one-lot residential subdivision in Franklin County, Missouri.[183] Between 2000 and 2005, Fischer & Frichtel sold twelve of the twenty-one lots.[184] It was unable to sell the remaining nine lots after the housing market began to deteriorate.[185] Fischer & Frichtel ultimately defaulted, and the lender commenced foreclosure proceedings.[186] At a public sale held in December 2008, the lender was the only bidder and acquired the nine unsold lots for $466,000.[187]

First Bank filed suit seeking to recover a deficiency in the sum of $677,875, calculated in the traditional common law manner.[188] At trial, Fischer & Frichtel presented expert testimony from an appraiser that the market value of the lots at the time of foreclosure was $918,000, double the amount of the lender's winning bid.[189] Internal First Bank documents

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180. *See id.* ("Recent Missouri Supreme Court decisions have helped give vitality to such motions in state court.").

181. Docket Sheet, *supra* note 158.

182. 364 S.W.3d 216 (Mo. 2012) (en banc); *see* Docket Sheet, *supra* note 158.

183. *First Bank*, 364 S.W.3d at 218.

184. *See id.* (describing the factual background of the residential development project).

185. *See id.* ("Beginning in 2005, the housing market began to decline, and Fischer & Frichtel was unable to sell any of the nine remaining lots in this particular development.").

186. *See id.* (noting that Fischer & Frichtel chose to default on the loan instead of paying the remaining principal when the loan matured on September 1, 2008).

187. *See id.* ("First Bank acquired the nine unsold lots after making the sole bid of $466,000.").

188. *See id.* (noting that First Bank sought to recover the difference between the principal due on the loan and the amount it had paid for the nine unsold lots at the foreclosure sale).

189. *See id.* (noting testimony presented by Fischer & Frichtel that sought to

introduced as evidence valued the property at $1,134,000 at the time of default in September 2008.[190] A First Bank employee testified that the bank determined the amount to bid by estimating that, in the declining real estate market, the value of the property was only $675,000, which should be discounted to $466,000 because the lender would need to sell the property in bulk rather than as individual lots.[191]

The court instructed the jury to award the lender the difference between the balance due on the loan less the fair market value at the time of foreclosure.[192] The jury found that the fair market value of the lots was $918,000, the value assigned by the borrower's expert, and that Fischer & Frichtel therefore owed First Bank $215,875.[193] First Bank filed a motion for a new trial based on improper jury instructions, which the trial court granted.[194] Fischer & Frichtel appealed to the Missouri Court of Appeals, which transferred the case to the Missouri Supreme Court given the importance of the issue at stake.[195]

The Missouri Supreme Court accepted transfer to re-examine Missouri's common law approach in light of the Restatement position,[196] as adopted by statute in a number of other

imply that the price paid for the nine unsold lots by First Bank grossly undervalued their market value, and thereby greatly increased the deficiency sum due to it).

190. *See id.* (describing evidence introduced by Fischer & Frichtel to demonstrate that First Bank knew its bid significantly undervalued the nine unsold lots).

191. *See id.* (relaying trial testimony by a First Bank employee that described the factors driving First Bank's bid amount at the foreclosure sale).

192. *See id.* ("[I]f you find in favor of [First Bank], then you must award [First Bank] the balance due [First Bank] on the [loan] on the date of maturity, less the fair market value of the property at the time of the foreclosure sale, plus interest." (internal quotation marks omitted)).

193. *See id.* at 218–19 (noting that the jury found that Fischer & Frichtel owed First Bank $215,875 plus $37,500 in interest).

194. *See id.* at 219 ("[First Bank] argu[ed] that the damage instruction was contrary to Missouri law because it directed the jury to base the amount of the deficiency on the fair market value of the property at the time of the foreclosure sale instead of on the amount obtained at the foreclosure sale.").

195. *See id.* (explaining that the Missouri Court of Appeals transferred the case to the Missouri Supreme Court to "address the issue of how to determine the amount of the deficiency after a foreclosure sale").

196. *See id.* at 217 (implying that the Missouri Supreme Court took the case

states.[197] The court heard oral argument on January 11, 2012.[198] It was apparent from their questions that the judges' principal concern was whether, as a matter involving the balancing of competing public policies, this was a decision better left for the legislature rather than common law development.[199] Creditors who can rely on the availability of an efficient method of enforcing their mortgage documents reduce their overhead by minimizing losses attributable to inefficiency in attempting to collect nonperforming loans. Assuming this saving is passed through to borrowers, the net result should be lower costs and increased availability of mortgage credit to a broad category of borrowers at the time of loan origination. It is unsurprising that the Missouri Supreme Court would want elected officials to determine whether the public benefit of a state's foreclosure laws outweighs the harm to individual defaulting borrowers.[200]

In a 6–1 decision filed on April 12, 2012,[201] the Missouri Supreme Court declined the opportunity to change long-standing Missouri law by adopting the Restatement position.[202] The court

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to examine whether Missouri's common law approach led to unfairness, warranting a modification of this approach).

197. *See id.* ("Each jurisdiction cited by Fischer & Frichtel that has changed from basing the deficiency on the foreclosure price to basing it on the property's fair market value made that change by statute.").

198. Oral Argument, First Bank v. Fischer & Frichtel, Inc., 364 S.W.3d 216 (Mo. 2012) (en banc) (No. SC91951), *available at* http://www.courts.mo.gov/SUP/index.nsf/fe8feff4659e0b7b8625699f0079eddf/cf8964e9c2a28c4d8625794b005022a6?OpenDocument.

199. *See id.* (evincing a reluctance to decide an issue that the judges viewed as better fit for legislative resolution).

200. *See* TRYNIECKI, *supra* note 148, § 58:1 ("Missouri's power of sale foreclosure statute is an extraordinary piece of legal machinery. It is theoretically possible to foreclose a major property in little more than a month. Compared with most legal remedies, this is a millisecond.").

201. Judges William Ray Price, Jr. and George W. Draper did not participate in the decision. First Bank v. Fischer & Frichtel, Inc., 364 S.W.3d 216, 224 (Mo. 2012) (en banc).

202. *See* Frontenac Bank v. T.R. Hughes, Inc., 404 S.W.3d 272, 279 (Mo. Ct. App. 2012) (ruling "[i]n accordance with the Missouri Supreme Court's affirmation of well-established law in Missouri" that the "[d]efendants' loans were credited properly with the amounts paid by Frontenac at the foreclosure sales"). "Missouri is not one of those states that goes to great pains to protect makers and guarantors of secured obligations from deficiency judgments." TRYNIECKI, *supra* note 148, § 61:7.

ordered a new trial based on the improper instruction to the jury to credit Fischer & Frichtel with the fair market value of the nine empty lots acquired by the bank at the foreclosure auction, rather than the $466,000 purchase price paid by First Bank.[203]

Chief Justice Richard B. Teitelman disagreed.[204] In a spirited dissent,[205] he characterized the arithmetical method of calculating deficiency judgments as an anomaly in the law of awarding damages and inconsistent with the purpose of making an injured party whole while avoiding a windfall.[206] He described the inability to recover the debt through foreclosure in the event of default as an inherent risk of lending—a risk for which the lender is compensated through the interest rate.[207] "That risk of loss should not be borne solely by the borrower and then

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203. *See First Bank*, 364 S.W.3d at 220, 224 (affirming the trial court's award of a new trial on the ground that Missouri and other states following the common law method for measuring deficiencies "require a debtor to pay as deficiency the full difference between the debt and the foreclosure sale price").

204. *See id.* at 225 (Teitelman, J., dissenting) (arguing that Missouri law measures damages by reference to fair market value in every context except the foreclosure context, and that this "anomaly" often results in the defaulting party subsidizing "a substantial windfall to the lender"). The Chief Justice of the Missouri Supreme Court is the only state court judge who is referred to as "Justice," while other members of the court are referred to as "Judge." MO. CONST. art. V, § 8 (amended 1976).

205. *See First Bank*, 364 S.W.3d at 225 (Teitelman, J., dissenting) (conveying the passion of a lone appellate judge sufficiently exercised to take pen in hand and, on his own time, write in opposition to the majority). It exemplifies Justice Benjamin Cardozo's classic description of the genre: "The dissenter speaks to the future, and his voice is pitched to a key that will carry through the years." BENJAMIN N. CARDOZO, *Law and Literature*, *in* LAW AND LITERATURE AND OTHER ESSAYS AND ADDRESSES 36 (1931).

206. *See First Bank*, 364 S.W.3d at 226 (Teitelman, J., dissenting)

> It is plainly evident that the practical effect of calculating a foreclosure deficiency by reference to the foreclosure sale means that the secured lender benefits from an often substantial windfall by purchasing the property at a discounted price from fair market value while also obtaining an inflated deficiency judgment. This windfall is subsidized by the already financially distressed debtor.

207. *See id.* at 227 n.5 ("A lender compensates for risk by charging an interest rate that is set both by the financial markets and by the lender's assessment of the borrower's creditworthiness.").

amplified by measuring the deficiency by reference to the foreclosure sale price."[208]

The court signaled its willingness, under different factual circumstances, to consider adopting the Restatement approach.[209] The first sentence of Judge Laura Denvir Stith's majority opinion described Fischer & Frichtel as "a sophisticated commercial debtor."[210] She reiterated this characterization in the penultimate paragraph of her opinion.[211] The decision noted that, with more than six decades of experience in real estate development, Fischer & Frichtel earned revenues in the hundreds of millions of dollars, and profits in the tens of millions of dollars, from 2005 to 2008.[212]

Although the Matheny litigation resumed following the decision in *First Bank*, it now had an anticlimactic quality. The court heard oral argument on The Business Bank's motion for summary judgment on October 30, 2012.[213] By order dated January 11, 2013, Judge DePriest granted summary judgment in favor of the lender.[214]

The court considered and rejected the defenses left to Matheny in the wake of *First Bank*. Defendants argued that The Business Bank violated the Equal Credit Opportunity Act by

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208. *Id.*

209. *See id.* at 217 (finding no need to modify the current approach as "nearly all of the problems that Fischer & Frichtel alleges concern *not the fairness of the deficiency determination itself but the fairness of the foreclosure sale price* due to lack of sufficient notice to obtain alternative financing or other bidders" (emphasis added)).

210. *Id.*

211. *See id.* at 224 ("Here, the public policy reasons that form the basis of Fischer & Frichtel's argument for modification of the more than century-old practice of using the foreclosure sale price have no application to a sophisticated debtor such as it.").

212. *See id.* at 217–18 (implying that little rationale for modifying the current approach exists here as Fischer & Frichtel is not an ordinary bidder, such as a homeowner, who often cannot secure financing as a potential bidder within the often short statutory minimum time period between the notice of foreclosure and the sale).

213. Docket Sheet, *supra* note 158.

214. *See* Order, *supra* note 140, at 17 (granting summary judgment for The Business Bank on Counts I through III of its First Amended Petition and on all of Defendants' First Amended Affirmative Defenses and Counterclaims).

requiring Kristin Matheny to execute a guarantee.[215] The court held that the statute was inapplicable, both because Kristin Matheny was a joint applicant for the loan in her capacity as a 50% owner of one of the members of MPD and because she had expressly waived the defense at the time of the June 2009 loan modification.[216]

Matheny claimed that the lender was the first to breach the loan agreement.[217] He argued that The Business Bank committed a material breach by refusing to advance $75,000 of loan proceeds for needed tenant improvements at the U.S. Turf Building in Spring 2010 and by unlawfully freezing an operating account maintained by MPD at the bank at a time when MPD was engaged in negotiations with an existing tenant to lease additional space and in the process of actively negotiating with prospective tenants.[218] Matheny sought to portray these actions as part of a strategy by the lender to usurp the property and profit from its sale.[219] The court held that these actions did not constitute a breach because they occurred only after Matheny had

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215. *See id.* at 14 ("Kristin Matheny claims that the Bank violated the ECOA . . . in seeking her spousal guaranty.").

216. *See id.* at 14–16 (noting that "there was no ECOA or Regulation B violation," and that Matheny agreed in the Modification Agreement that "she had 'no defense setoff or counterclaim of any kind whatsoever against the Bank.'").

217. *See id.* at 7–8 (noting that Defendants claimed that First Bank was "first to materially breach the MPD Notes by refusing to advance available credit or additional credit for tenant improvements at the US Turf Building," and "by unlawfully seizing funds MPD" had on account at First Bank).

218. *See* Reply Memorandum, *supra* note 152, at 19, 23 ("Defendants claim the breach was material because the referenced tenant improvements 'were necessary to bring adequate revenue to MPD in order to service the loans, if not a breach of an express agreement, it was a breach of the implied covenant of good faith and fair dealing'"); *see also* Defendants' Counterclaim at 3–4, Bus. Bank of St. Louis v. MPD Invs. L.L.C., No. 10SL-CC02512 (Mo. Cir. 2013) (alleging that the Bank's breach occurred "[p]rior to any alleged default on the loan" and that the Bank tried to use "the Seized Funds to pay for all or a portion of the tenant improvements").

219. *See* Reply Memorandum, *supra* note 152, at 25 ("Defendants argue the Bank executed a grand scheme to prevent Defendants from making needed tenant improvements so it could ultimately oust Defendants from these projects, make tenant improvements itself, and then sell the projects for a profit.").

already told the lender that he would not make any further payments.[220]

Matheny argued that the lender should be barred from recovery under the doctrine of commercial frustration.[221] He argued that his nonperformance should be excused by the economic crisis in the real estate and financial markets, events which were beyond his control.[222] The court cited the decision by the Missouri Court of Appeals in *First Bank* for the proposition that the doctrine of commercial frustration was inapplicable.[223]

Citing the recent holding in *First Bank*, Judge DePriest summarily rejected Matheny's argument that he was entitled to credit for the fair market value of the properties acquired by the lender through foreclosure.[224] Judge DePriest may be faulted for ignoring the multiple signals in Judge Stith's opinion that provided the basis for distinguishing *First Bank* in a case involving a less sophisticated borrower with virtually no expertise in commercial real estate.[225]

It would be pure speculation to consider whether Judge Stith's majority opinion was written with the pending Matheny

220. *See* Order, *supra* note 140, at 13 (noting that MPD had already defaulted at the time of the alleged request for loan proceeds because it failed to make its April 2010 principal and interest payments).

221. *See id.* at 8 (reciting the multiple defenses asserted by the defendants, including material breach of the notes, violation of the Equal Credit Opportunity Act, and the doctrine of commercial frustration).

222. *See id.* (granting the Plaintiffs' motion for summary judgment despite the defendants' affirmative defenses and counterclaims).

223. *See id.* at 11 ("[T]he Court of Appeals has held, in similar cases, that the doctrine of "commercial frustration" is inapplicable in cases like this case.").

224. *See id.* at 14 (declaring that "[d]efendants are entitled to a credit for the price bid at foreclosure (which they have received), and nothing more under the pertinent loan documents and Missouri law").

225. By way of contrast, just two months after the *First Bank* decision was filed, Senior U.S. District Judge Scott O. Wright of the Western District of Missouri concluded 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." M & I Marshall & Ilsley Bank v. Sunrise Farms Dev., L.L.C., No. 10-0627-CV-W-SOW, 2012 WL 2522671, at *8 (W.D. Mo. June 28, 2012) (emphasis added), *rev'd*, 737 F.3d 1198 (8th Cir. 2013). In an opinion filed on June 28, 2012, Judge Wright cited "clear evidence that the state's highest court would not uphold the prior decision" and determined that he was not bound to follow it in a diversity case. *Id.*

litigation in mind. Although not a party in the case, The Business Bank had filed a sixty-one-page amicus brief in support of First Bank.[226] The appellate brief filed by Robert Blitz (an experienced commercial litigator who was simultaneously representing the Mathenys) on behalf of Fischer & Frichtel contained an explicit reference to facts in the Matheny case.[227] It is not inconceivable that, to borrow a baseball metaphor, Judge Stith attempted to give Judge DePriest a sequence of signs that he simply or intentionally missed.

It would also be pure speculation to consider whether the outcome would have been different if the Matheny case had reached the Missouri Supreme Court ahead of *First Bank*. However, it would not have been the first time that the order in which cases arrived for appellate review may have been outcome determinative.[228]

V. A Modest Proposal

We saw in Part III that foreclosure historically was never intended to effect a liquidation of the mortgaged property, obtain repayment of the debt, or determine the extent of the borrower's liability for a deficiency.[229] The purpose was simply to transfer

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226. Brief for Bus. Bank of St. Louis as Amicus Curiae Supporting Respondent, First Bank v. Fischer & Frichtel, Inc., 364 S.W.3d 216 (Mo. 2012) (en banc) (No. SC91951).

227. *See* Appellant's Substitute Reply Brief at 7, First Bank v. Fischer & Frichtel, Inc., 364 S.W.3d 216 (Mo. 2012) (en banc) (No. SC91951) ("In fact, Fischer & Frichtel is aware of a recent situation in which Business Bank itself was the only bidder at the foreclosure sale of its borrower's commercial property . . . ."). The brief referenced the fact that The Business Bank had paid $2 million for property that it sold four months later for $2,650,000. *See id.* (noting further that "Business Bank did not credit any portion of the $650,000.00 difference to the borrower or guarantors in its deficiency action").

228. *See, e.g.*, ROBERT C. CLARK, CORPORATE LAW 320 (1986) (implying that the U.S. Supreme Court might not have created a narrow standing doctrine for plaintiffs bringing Rule 10b-5 actions under the Securities Exchange Act of 1934 if the Court first heard the case of *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), before deciding *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975)).

229. *See supra* note 96 and accompanying text (explaining that foreclosure only terminated the right of redemption and did not result in a deficiency or

title from the borrower so that the lender might gain control of the property.[230] Only then, in the case of improved property, does the lender have an opportunity to inspect the collateral to ascertain the degree to which its value has deteriorated from the effects of deferred maintenance, neglect, or intentional waste, which is not uncommon.[231] The lender must also anticipate that it may bear the real estate taxes, insurance, and other carrying costs of ownership for an extended period of time before foreclosed property can be resold, as well as the broker's commission and closing costs.[232] A foreclosing lender takes these factors into account in determining the maximum amount of its bid.[233]

From its historical roots and by its very nature, foreclosure was not designed to generate the best possible price or even a fair price.[234] This may be assumed to reflect legislative intent in the more-than-half of the states that allow foreclosure by power-of-sale, where the statutory minimum time period between notice of foreclosure and actual sale is often less than a month.[235] Given

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sale).

230. *See In re* Mich. Ave. Nat'l Bank, 2 B.R. 171, 179 (Bankr. N.D. Ill. 1980) (indicating that the original purpose of foreclosure was a simple and limited one of transferring title).

231. *See, e.g.*, TRYNIECKI, *supra* note 69, § 18:1 (explaining that "[l]oan documents often required that the mortgagor maintain the value of improvements on the mortgaged property until the mortgage is paid in full").

232. *See* TRYNIECKI, *supra* note 148, § 59:2 (setting forth a list of issues a lender must consider upon the possibility of default, which ultimately determine the timing of foreclosure and the appropriate foreclosure bids).

233. *See* Brief for Mo. Bankers Ass'n as Amicus Curiae Supporting Respondent at 17, First Bank v. Fischer & Frichtel, Inc., 364 S.W.3d 216, 217, 221 (Mo. 2012) (en banc) (No. SC91951) ("A reasonable lender that contemplates purchasing its collateral at a foreclosure sale must anticipate these expenses and assume that they will continue over what may be a lengthy period.").

234. *See* Mattingly, *supra* note 26, at 95 (recognizing that "[a] good price at a foreclosure sale is an accident"). "After buying the property, the lenders take the property into their portfolios. They then can take such action as is necessary to obtain a fair price, such as publicizing the availability of the property in publications likely to engender interest in the property . . . [and] hir[ing] real estate agents." Maury B. Poscover, *A Commercially Reasonable Sale Under Article 9: Commercial, Reasonable, and Fair to All Involved*, 28 LOY. L.A. L. REV. 235, 246 (1994) (drawing an unfavorable comparison between real and personal property foreclosures).

235. *See* NELSON & WHITMAN, *supra* note 81, § 7.19 (explaining that power-

the grossly inadequate time for potential bidders to secure financing or engage in due diligence,[236] the depressed price paid by the lender as high bidder, and often sole bidder, is an incurable structural defect of the system.[237] Legislators in non-judicial-foreclosure states may be presumed to understand that property sold at foreclosure, through a process that bears little relationship to a negotiated transaction between willing parties, is likely to yield considerably less than fair market value.

Because it ignores these historical and practical realities, the traditional common law method of arithmetically calculating deficiency judgments is a tool of ignorance. At the other end of the extreme, anti-deficiency legislation ignores economic reality. Real estate investors enjoy unlimited upside potential through their ability to leverage other people's money.[238] Lenders who earn a fixed rate of return should not be expected to bear the full burden of the risk of declining property values. Protecting defaulting borrowers against deficiencies adversely affects a broader category of nondefaulting borrowers by increasing the cost and reducing the availability of credit.[239]

The fair value approach attempts to thread the needle; however, in their present form, fair value limitations are subject to criticism for their unintended consequences, the soundness of

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of-sale foreclosure is permitted in over thirty jurisdictions and that notice requirements under power-of-sale foreclosure are usually significantly less rigorous than those associated with judicial foreclosure).

236. *See* First Bank v. Fischer & Frichtel, Inc., 364 S.W.3d 216, 222 (Mo. 2012) (en banc) (noting that the statutory minimum time period between notice of foreclosure and the actual sale is often less than a month).

237. *See* Brief for Mo. Bankers Ass'n, *supra* note 233, at 15–16 (noting that "[a] foreclosure sale, by definition, involves an unwilling seller, which is inconsistent with fair-market value," and that the foreclosure statutes that the legislature has enacted are "not structured to produce sales at fair-market value").

238. *See id.* at 8–9 (explaining that, ordinarily, the borrower has the potential to earn returns that dwarf the maximum recovery of the lender and that the leverage provided by a lender permits borrowers to obtain a higher return on investment than cash purchasers of real estate could obtain in the same transaction).

239. *See infra* notes 243–246 and accompanying text (elucidating some of the potential unintended consequence of a defaulter-friendly approach to foreclosure).

their rationale, and especially their failure to provide clarity and guidance to triers of fact charged with giving concrete meaning to the concept of "fair value."[240]

The fair value approach, as with other defaulter-friendly foreclosure laws, has unintended consequences. Adjudicating fair value delays final judgment and increases lenders' foreclosure costs.[241] The fair market value standard could require costly judicial intervention to resolve very small discrepancies between the foreclosure price and intrinsic value.[242] Lenders predictably respond to more burdensome foreclosure laws by charging higher interest rates and reducing loan supply.[243] For example, mortgage loans are statistically significantly smaller in states that require judicial foreclosure and limit deficiency judgments than those states that do not.[244] Smaller loan sizes adversely affect real estate values.[245] The price that buyers are willing and able to pay

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240. *See* Michael H. Schill, *An Economic Analysis of Mortgagor Protection Laws*, 77 VA. L. REV. 489, 489 (1991) ("Among the laws that have been subjected to particularly strong criticism are those that protect mortgagors from the adverse effects of mortgage default and foreclosure, such as prohibitions on deficiency judgments and statutory rights of redemption.").

241. *See* LEFCOE, *supra* note 17, at 476 (suggesting that this defeats the purpose of a process that was developed for its ease, certainty, and finality).

242. *See Teacher's Manual* to STEVEN W. BENDER ET AL., MODERN REAL ESTATE FINANCE AND LAND TRANSFER, at 96 (4th ed. 2008) (noting a potentially disconcerting unintended consequence of adjudicating fair value as opposed to using the common law method).

243. *See* Mark Meador, *The Effects of Mortgage Laws on Home Mortgage Rates*, 34 J. ECON. & BUS. 143, 146 (1982) (concluding that borrower protection laws place upward pressure on interest rates charged by lenders); *see also* Ronald Goldstein, *Reforming the Residential Mortgage Foreclosure Process*, 97 COM. L. J. 255, 262 (1992) (explaining that, although anti-deficiency legislation may attempt to place the risk of inadequate security on the lender, lenders counter by "simply shift[ing] that increased risk to their borrowers in the form of higher interest rates"). *But see* Schill, *supra* note 240, at 500 (arguing that mortgagor protection laws may serve an insurance function and that they "may also promote economic efficiency by minimizing the risk of homebuying, leading to higher levels of individual well-being and a more optimal level of housing consumption").

244. *See* Pence, *supra* note 22, at 22 (controlling for geographical variations by comparing census tracts that border each other but are located in neighboring states with different foreclosure laws).

245. *See id*. at 3 ("Smaller loan sizes may also reflect, in part, an effect of the laws on house prices . . . .").

for property is directly related to the cost and availability of mortgage financing.[246]

The fair value approach is explicitly intended to prevent unjust enrichment of the mortgagee through the double recovery that would result if it purchases the property at foreclosure at a deflated price, obtains a deficiency judgment, and later resells the collateral at a profit.[247] The problem with this rationale is that there are legitimate reasons why a mortgage lender may be unwilling to make a higher bid: "The mortgagee might decide to let the property go for less if [the lender believes] it is . . . worth less than the mortgage balance or if it simply does not want the property in its portfolio" for a variety of reasons.[248] Another problem is that this rationale is only applicable in situations where the mortgagee purchases at the foreclosure sale because it may realize the amount of the debt or more upon resale. It protects mortgagors at the expense of nonpurchasing mortgagees in situations where a third party purchases.[249]

The drafters of the Restatement acknowledged *in extenso*, both in the Comments and Reporters' Notes to sections 8.3 and 8.4, the most significant problem with their approach—the challenge courts face in adjudicating fair value and the absence of clarity or meaningful guidance on the subject.[250]

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246. *See id.* ("[B]uyers may not be willing to pay as much for a house if they have difficulty obtaining financing.").

247. *See* RESTATEMENT (THIRD) OF PROP.: MORTGAGES. § 8.4 cmt. a (1997) (noting that the fair value approach "protects against the mortgagee purchasing the property at a deflated price, obtaining a deficiency judgment and, by reselling the real estate at a profit, achieving a recovery that exceeds the obligation").

248. *See* MADISON, DWYER & BENDER, *supra* note 21, § 12:37 (providing potential explanations for this phenomenon, including avoidance of adverse publicity, environmental liability, and the fact that the lender already has an excess of distressed property, known as "Real Estate Owned," on its books). A lender may be seeking a bad debt deduction as an offset against taxable income. *See id.* (explaining some of the reasons why "the decision as to how much to bid at the foreclosure sale is a complex one for the mortgagee").

249. *See* Washburn, *supra* note 31, at 939 ("Fairness in the mortgage foreclosure process can be achieved only by balancing the rights of the mortgagee with the need to protect the mortgagor. The fulcrum of this balance is the market value of the foreclosed property.").

250. *See* RESTATEMENT (THIRD) OF PROP.: MORTGAGES §§ 8.3, 8.4 (1997) (describing the different approaches taken by courts in adjudicating fair value);

On this most critical of subjects, the only common feature of fair value limitation is that the foreclosure sale price should not be determinative of the amount of the deficiency.[251] As far as measuring the value to be credited against the debt, there are almost as many variations as there are statutes.[252] It is a fair criticism that fair value is left to be determined on an ad hoc basis and that the number of relevant factors to be considered is mind boggling.[253] Is "value" determined solely by reference to prevailing prices of comparable property at the time the sale was held? Or should the trier of fact consider potential future value based on the eventual reversion of prices to the norm? In essence, "the rule seems to be that after all the suggested factors have been considered, they are to be combined in some mystical manner to determine the final 'value' through the exercise of judgment."[254]

It would be naïve to attribute section 8.4 to magical thinking or lack of intent on the part of the drafters.[255] The vagueness and

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see also Skilton, *supra* note 11, at 451

> The chief weakness of these statutes would appear to be that they speak in terms of 'fair value,' but usually set forth no definition of 'fair value.' The determination of 'fair value' was a difficult, nebulous problem . . . . [T]here were no instructions set forth in the statutes to define and clarify the meaning of that rather vague term. And yet this was the most important problem.

251. *See* RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 8.4 reporters' note (cataloguing the myriad variations in the way states define "value" for purposes of measuring a deficiency judgment, including "fair market value," "actual value," "true market value," "fair value," "reasonable value" and "fair and reasonable market value"). The Restatement's drafters acknowledge that it is conjectural whether or not this disarray among states in defining "value" for a deficiency judgment is substantive. *Id.*

252. *See* THOMPSON ON REAL PROPERTY, *supra* note 109, § 101.07(f) (noting the different approaches to calculating fair value); NELSON & WHITMAN, *supra* note 81, § 8.3 n.6 (illustrating the great variation among jurisdictions at determining how to assess how to credit value against the debt).

253. *See, e.g.*, Fed. Land Bank of St. Paul v. Bergquist, 425 N.W.2d 360, 364 (N.D. 1988) ("We believe the Legislature intended to let the jury decide, on the basis of the facts in each individual case, whether a deficiency judgment is appropriate.").

254. Tierney, *supra* note 67, at 187.

255. The Restatement is published by the prestigious American Law Institute. Professors Grant Nelson and Dale Whitman, co-authors of the leading treatise on land finance law, served as coreporters. *See* RESTATEMENT (THIRD) OF

subjectivity of section 8.4 confers unlimited discretion upon triers of fact to bring their sense of intuitive fairness to bear in granting relief to their defaulting neighbors.[256] One court has candidly acknowledged that the real purpose of the fair value approach is to provide a mechanism to force lenders to "share the risk of loss if market values fall."[257] Institutional lenders are mindful of the unfavorable dynamics of the courtroom setting where triers of fact personally confront the victims of economic dislocation.[258]

PROP.: MORTGAGES § 8.4 at v.

256. *See* THOMPSON ON REAL PROPERTY, *supra* note 109, § 101(g)(1) ("Such vagueness seems designed to sanction relief on subjective bases to their defaulting neighbors and reflects a legislative determination that lenders should 'share the risk of loss if market values fall.'" (quoting *Fed. Land Bank*, 425 N.W.2d at 363)). Courts interpreting fair value statutes have acknowledged that the textbook definition of fair market value (the price a willing buyer will pay to a willing seller in an open market) is only one factor among many to be considered in determining "fair value." *See* Rainer Mortg. v. Silverwood, Ltd., 209 Cal. Rptr. 294, 300 (Cal. Ct. App. 1985) ("[M]arket value is only one factor the court should consider when determining 'fair value.'"); *see also* Nat'l Bank of Wash. v. Equity Investors, 506 P.2d 20, 46 (Wash. 1973) (en banc)

> [I]n deciding upon fair value at a foreclosure sale, the court may consider the state of the economy and local economic conditions, the usefulness of the property under normal conditions, its potential or future value, the type of property involved, its unique qualities, if any, and any other characteristics and conditions affecting its marketability along with any other factors which such a bidder might consider in determining a fair bid for the mortgaged property.

257. *Fed. Land Bank*, 425 N.W.2d at 363. *See* Tierney, *supra* note 67, at 192 ("A candid recognition that the statutory requirement has been adopted as an expedient to force an equitable sharing of losses in a period of economic and financial difficulties would avoid much of the confusion . . . .").

258. Under these circumstances, it is foreseeable that emotional impulses may influence judgment, notwithstanding Justice Cardozo's warning that a judge "is not to yield to spasmodic sentiment, to vague and unregulated benevolence." BENJAMIN CARDOZO, THE NATURE OF THE JUDICIAL PROCESS 141 (1921). "[J]udges, like everyone else, have two cognitive systems for making judgments—the intuitive and the deliberative—and the intuitive system appears to have a powerful impact on judges' decision making." Chris Guthrie et al., *Blinking on the Bench: How Judges Decide Cases*, 93 CORNELL L. REV. 1, 43 (2007). Hardship cases from the Great Recession invoked powerful forces of human nature, such as empathy, indignation, and outrage. For no apparent good reason, Miami–Dade County Circuit Court Judge Valerie Schurr in the summer of 2009 granted a request by Joseph and Bianca Doyle for continuance of Republic Federal Bank's residential mortgage foreclosure. Republic Fed. Bank v. Doyle, 19 So. 3d 1053, 1054 (Fla. Dist. Ct. App. 2009). "I was trying to make everybody happy," Judge Schurr explained in her opinion:

Unpredictability of outcome is anathema to the institutional lender's mindset. The fair value concept appears to have been designed to motivate the parties to reach a settlement.[259]

Nevada is widely considered the epicenter of the collapse in real estate values during the Great Recession.[260] A recent case from the Silver State illustrates the guesswork involved in adjudicating property value in fair value states. In *Oreo Corp. v. Nielson*,[261] Centennial Hills, L.L.C. entered into a construction

> We have so many foreclosures here and I give continuances on these sales. I just do. . . . [Y]ou know, people are having a hard time now. They are having a difficult time. Everybody knows it. Businesses are failing. People are losing money in the stock market. You know, unemployment is high. It's just everybody knows that we are in a bad time right now and I hate to see anybody lose their home.

Id. at n.1. A Long Island couple was left debt free as a result of a Suffolk County judge's indignation after hearing testimony by the regional manager for IndyMac Bank. *See* IndyMac Bank F.S.B. v. Yano-Horoski, 890 N.Y.S.2d 313, 319–20 (N.Y. Sup. Ct. 2009) ("Thus, where a party acts in a manner that is offensive to good conscience and justice, he will be completely without recourse in a court of equity, regardless of what his legal rights may be."). The lender's intransigent refusal to restructure the couple's subprime loan, or otherwise cooperate in avoiding foreclosure was, according to Judge Jeffry Spinner, not only "harsh, repugnant, shocking and repulsive," but also "inequitable, unconscionable, vexatious and opprobrious." *Id.* at 319. Noting that "Suffolk County is in the yawning abyss of a deep mortgage and housing crisis with foreclosure filings at a record high rate," Judge Spinner *sua sponte* invoked his equitable jurisdiction to void the mortgage, erasing the $290,000 principal balance and an additional $235,000 in accrued interest and penalties. *Id.* at 317.

259. *See* Kevin J. Morley, *Pension Deficits in Canada—Lenders React to Indalex Decision*, ABL ADVISOR (June 19, 2013, 7:00 AM), http://www.abladvisor.com/articles/2574/pension-deficits-in-Canada-lenders-react-to-Indalex-decision (last visited Apr. 3, 2015) (analyzing the likely effects of the Canadian Supreme Court's recent *Indalex* decision on Canadian asset-based lending practices) (on file with the Washington and Lee Law Review); Floyd Norris, *After Crisis, A New Spirit of Reining In the Banks*, N.Y. TIMES (May 29, 2014), http://www.nytimes.com/2014/05/30/business/after-crisis-a-new-spirit-of-reining-in-the-banks.html?_r=0 (last visited Apr. 3, 2015) (discussing renewed debate over banking reform and whether regulatory changes have, in fact, changed banks' behavior) (on file with the Washington and Lee Law Review).

260. *See* Mark Roth, *Las Vegas is Ground Zero for America's Housing Collapse*, PITTSBURGH POST-GAZETTE (Dec. 4, 2011), http://www.post-gazette.com/business/businessnews/2011/12/04/Las-Vegas-is-ground-zero-for-America-s-housing-collapse/stories/201112040240 (last visited Apr. 3, 2015) ("[H]ome prices in southern Nevada have dropped 65 percent in the past four years.") (on file with the Washington and Lee Law Review).

261. No. 2:10-cv-00352-PMP-VCF, 2013 WL 6384535 (D. Nev. Dec. 5, 2013).

loan agreement with KeyBank National Association for $14.1 million.[262] After multiple project delays and resulting extensions, the loan finally matured on November 1, 2009.[263] After Centennial defaulted, a successor to KeyBank purchased the property for $5.3 million on March 31, 2010.[264] As of that date, Centennial owed almost $12.3 million.[265] KeyBank's successor sought a deficiency judgment against Centennial for the $7 million difference between the amount owed by Centennial and the purchase price paid at the foreclosure sale.[266] Centennial claimed that the fair market value of the property at the date of the foreclosure sale was $14.9 million and, accordingly, that there should be no deficiency judgment.[267]

Like other fair value states, Nevada limits deficiency judgments to the amount by which the debt exceeds the greater of the fair market value of the collateral on the date of foreclosure or the high bid at the foreclosure sale.[268] An appraiser for KeyBank's successor testified that the fair market value of the property was $4.35 million at the time of the foreclosure sale.[269] Centennial's appraiser determined the fair market value on that date was $14,905,000.[270]

What is a trial court to do under such circumstances? In this case, the court heard the testimony of a third appraiser who testified that the value of real property had fluctuated wildly during the real estate recession in Southern Nevada from 2007 until the time of foreclosure in 2010.[271] The third appraiser testified to appraisals with the following values: July 2007, $23.3 million; October 2008, $21.6 million; December 2009, $11.4

262. *Id.* at *1.

263. *Id.*

264. *Id.* at *2.

265. *Id.*

266. *Id.*

267. *Id.*

268. *See id.* ("The task of the Court in determining whether a judgement [sic] creditor or beneficiary under a deed of trust is entitled to recover a deficiency judgement [sic] is a relatively straight forward one.").

269. *Id.*

270. *Id.*

271. *Id.*

million; and March 2010, $7.8 million.[272] In the final analysis, the court gave marginal weight to the appraisal evidence introduced by the parties for the reason that it was utterly irreconcilable.[273] Compelled to reach a result notwithstanding such evidence, the court determined that the third appraiser's results were more reliable and that the fair market value of the property as of the date of foreclosure was $7.77 million.[274] The court awarded KeyBank's successor a deficiency judgment of $4.6 million.[275]

Adjudging property value for deficiency purposes without direction or meaningful guidance is an exercise in judicial guesswork.[276] In remanding a case to the trial court for further consideration of a deficiency judgment determined on the basis of the arithmetical method, the Montana Supreme Court blithely wrote, "[t]he method of determining fair market value we will leave to the District Court."[277] Left with little practical guidance, and faced with evidence of appraisals that ranged from $562,736 to $1,595,000, the trial court simply averaged the experts' values at $1.1 million, a result that the state supreme court affirmed.[278]

A provocative 1940 law review article contained an audacious proposal for reforming the mortgage foreclosure process.[279] Describing the foreclosure sale as "a meaningless farce and an entirely unnecessary expense" for which the mortgagor is

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272. *Id.*

273. *See id.* at *3 ("The Court finds the significantly disparate appraised values provided by Lowe and Smith to be irreconcilable and accords marginal weight to both.").

274. *Id.*

275. *Id.*

276. *See* BENDER, *supra* note 242, at 441 (presenting examples of judicial discretion in determining property value during deficiency proceedings).

277. Trs. of the Wash.-Idaho-Mont. Carpenters-Emp'rs Ret. Trust Fund v. Galleria P'ship, 780 P.2d 608, 617 (Mont. 1989).

278. Trs. of the Wash.-Idaho-Mont. Carpenters-Emp'rs Ret. Trust Fund v. Galleria P'ship, 819 P.2d 158, 163 (Mont. 1991). Because the appraisals were so disparate, the Montana Supreme Court stated that the district court "was entitled to discount [all of] the appraisals." *Id.* at 165.

279. *See* Vaughan, *supra* note 87, at 977–80 (proposing a solution that retains traditional foreclosure practices that "are essential in producing a more equitable balance of the conflicting interests involved" while eliminating those that "have become mere form, to be discarded in the interests of an improved procedure").

ultimately liable,[280] the author called for a return to the practice of strict foreclosure as serving the best interests of both parties.[281] The proposal was not well received,[282] although it is hard to quarrel with the author's underlying assumptions about the play-acting nature of open cry auction sales.

One aspect of the proposal deserves to be revisited. If a lender wanted to preserve the ability to pursue the borrower for a deficiency, the proposal still called for strict foreclosure, but coupled with appraisal of the property to determine its fair market value.[283] This Article proposes a variation of the appraisal mechanism as a means of solving the fundamental problem with the Restatement's approach that was identified by courts and commentators seventy-five years ago but remains unaddressed.[284]

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280. *Id.* at 979. The principal advantage of the proposal is that it would significantly reduce transaction costs, including auctioneer's fees and advertising that is read by no one.

281. *See id.* at 978 ("With certain modifications, it is believed that under [a strict foreclosure] procedure, the courts will be better equipped to serve the interests of both parties, and at much lower cost."). The proposal would create an exception for the rare situation when the borrower believed the property was worth more than the debt and was willing to incur the risk of being wrong. In such a case, the debtor may demand a foreclosure sale but would be personally liable for the deficiency if the price realized at sale was insufficient to discharge the debt plus expenses of sale. *See id.* ("In this situation, where the foreclosure sale is manifestly to the defendant's benefit, he should be permitted to demand one.").

282. Only four states (Connecticut, Illinois, Maryland and Vermont) still permit lenders to use the strict foreclosure method and only under limited circumstances. *See* KORNGOLD & GOLDSTEIN, *supra* note 16, at 510 (noting examples of cases from states where strict foreclosure is still practiced).

283. *See* Vaughan, *supra* note 87, at 797 ("On defendant's default in pleading or failure to sustain an alleged defense, plaintiff should be required to make a motion on notice . . . for the determination of the fair market value of the property.").

284. Given that only about half the states have enacted fair value statutes in the decades since New York first adopted its statute in the post-Depression era, section 8.4 is less of a restatement of the law, in the plain meaning of the phrase, than it is an advocacy for law reform. It is similar in this respect to other sections of the Restatement of Property. *See* RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 3.2 (2000) (eliminating the requirement that a covenant must touch and concern the land to be enforceable against subsequent owners); *Id.* § 2.4 (eliminating the horizontal privity requirement for covenants running with the land).

First Bank was a closely watched and well litigated case in the immediate aftermath of the worst economic downturn since the Great Depression, a time when attention is likely to be focused on deficiency judgments.[285] The opportunity to adopt section 8.4 by judicial decision was squarely presented and decisively rejected.[286] The task of sifting through irreconcilable appraisal testimony to adjudicate the fair market value of real property may not be something appellate court judges are willing to impose on their trial court counterparts. The direct examination of each appraiser in a fair value determination proceeding tends to last several hours.[287] Cross-examination may be expected to take at least as long. When the results are given only marginal weight in the final determination,[288] and when the same result can be reached through a streamlined process,[289] it is hard to justify the commitment of judicial resources to the exercise.

No state has followed the recommendation of the American Law Institute to adopt fair value by judicial decision,[290] and it is time that it should be withdrawn. In its place the National Conference of Commissioners on Uniform State Laws should propose model legislation along the lines of existing statutes in

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285. *See* J. Louis Warm, *A Study of Some of the Problems Concerning Foreclosure Sales and Deficiency Judgments*, 6 BROOK. L. REV. 167, 167 (1936) ("The economic depression has focused the attention of thoughtful persons upon the problems relating to foreclosure sales and deficiency judgments . . . ."). *First Bank* appears as a principal case in a newly published casebook in the field. MALLOY & SMITH, *supra* note 132, at 470–77.

286. *See* First Bank v. Fischer & Frichtel, Inc., 364 S.W.3d 216, 220 (Mo. 2012) (en banc) (noting Fischer & Fritchel's argument that Missouri should adopt the liberal standard presented by section 8.4, an argument that the court rejected).

287. *See, e.g.*, Margaret K. Bentwood, Comment, *Deficiency Judgment Relief in Montana Foreclosures*, 53 MONT. L. REV. 255, 274 (1992) (describing the appraiser's testimony in the *Galleria* case).

288. *See supra* notes 278 and accompanying text (describing the ultimate decision to average the appraisal estimates in *Galleria*).

289. *See infra* notes 313–323 and accompanying text (presenting an approach to deficiency judgment appraisals informed by alternative dispute resolution regimes found in long-term ground leases).

290. *See supra* notes 127–130 and accompanying text (enumerating the few states that apply the fair value approach in very limited circumstances).

the two states that have achieved a workable solution to the problem of calculating deficiency judgments in a fair and efficient manner.[291]

By statute in South Carolina and Louisiana, a deficiency is measured by the difference between the foreclosure sale price and the value of the property as established by professional appraisal.[292] In these states, real estate appraisers act in a quasi-judicial capacity to make a factual determination of the value of the property.[293] These statutes strike an appropriate balance among the legitimate interests of both the lender and borrower, and the public's interest in judicial economy and the cost of borrowing to finance the purchase and improvement of real estate.

The statutes contain significant variations. Louisiana's statute has existed in various forms since 1805.[294] It reflects a strong public policy of protecting debtors against possible abuse from the mortgagee buying the property at a price substantially less than its actual market value.[295] The legislative intent was to avoid the injustice of a mortgagee obtaining a deficiency judgment and later reselling the property and realizing a total

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291. UNIF. NONJUDICIAL FORECLOSURE ACT (UNFA) (2002), http://www.uniformlaws.org/shared/docs/nonjudicial%20foreclosure/njf_amo2_final.pdf.

292. LA. CODE CIV. PROC. ANN. arts. 2336–37 (Westlaw through 2014 Reg. Sess.); S.C. CODE ANN. §§ 29-3-660 to 29-3-760 (Westlaw through 2014 Reg. Sess.).

293. *See, e.g.*, S.C. CODE ANN. § 29-3-720 (outlining the duty of an appraiser to make a sworn return stating the value of the property). The U.S. Supreme Court has commented favorably on the ability of appraisers to reconcile the difference between foreclosure sale value and fair market value. *See* BFP v. Resolution Trust Corp., 511 U.S. 531, 539 (1994) ("An appraiser's reconstruction of 'fair market value' could show what similar property would be worth if it did not have to be sold within the time and manner strictures of state-prescribed foreclosure.").

294. *See* Henry G. McMahon, *The Proposed Louisiana Code of Practice: A Synthesis of Anglo-American and Continental Civil Procedures*, 14 LA. L. REV. 36, 43 (1953) (discussing the writ-issuing powers the Practice Act of 1805 granted Louisiana courts).

295. *See* Michael H. Rubin & Jamie D. Seymour, *Deficiency Judgments: A Louisiana Overview*, 69 LA. L. REV. 783, 786 (2009) (describing the influence of Louisiana's civil law system on the way it balances the competing interests in deficiency judgments).

recovery far in excess of the remaining balance owed.[296] Both the debtor and creditor have a right to appoint an appraiser.[297] If either party does not timely appoint an appraiser, the sheriff makes the appointment on behalf of the party.[298] If the two appraisers differ by less than $250,000, the appraised value is the average of the two.[299] If their difference is greater than $250,000, the sheriff appoints a third appraiser whose determination becomes the value.[300]

In South Carolina, the deficiency is measured by the higher of the foreclosure sale price and the appraised value.[301] The borrower has thirty days after the foreclosure sale to ask the court for an order of appraisal.[302] If the borrower exercises this right, the borrower and lender each select an appraiser, and the court selects a third.[303] Within thirty days of appointment, all or a majority of the appraisers must agree on the value of the property as of the date of sale.[304] The report of the appraisers is then recorded as a judgment of the court.[305] If a majority is unable to agree within the prescribed time period, another set of

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296. *See* Fed. Sav. & Loan Ins. Corp. v. Tri-Parish Ventures, Ltd., 881 F.2d 181, 182 (5th Cir. 1989) ("The rationale of Louisiana's Deficiency Judgment Act is the strong public policy of protecting a debtor from possible abuse resulting from the judicial sale of his property without notice and without the benefit of proper appraisement." (internal quotation marks omitted)).

297. LA. REV. STAT. ANN. § 13:4363 (Westlaw through 2014 Reg. Sess.).

298. *Id.* § 13:4364.

299. *Id.* § 13:4365(B).

300. *Id.*

301. S.C. CODE ANN. § 29-3-680 (Westlaw through 2014 Reg. Sess.).

302. S.C. CODE ANN. REGS. § 29-3-680 (1988).

303. S.C. CODE ANN. § 29-3-710 (specifying that the appraisers must be state-licensed and disinterested parties).

304. *Id.*

305. *Id.* § 29-3-740. Either party can appeal to the court. *Id.* In the event of an appeal, the only discretion the court has is to order reappraisal. *Id.* A South Carolina bank challenged the constitutionality of the statute claiming that due process required it have an opportunity to attend the appraisers' viewing of the property or to present evidence to the appraisers. S.C. Nat'l Bank v. Cent. Carolina Livestock Mkt., Inc., 345 S.E.2d 485, 487 (S.C. 1986). The court held that the right of appeal afforded the parties sufficient opportunity to be heard. *See id.* at 488–89 ("During the depositions, the Bank was given an opportunity to fully examine the appraisers and other witnesses. The parties were also given an opportunity to file briefs in support of their respective positions.").

appraisers is appointed until a majority is able to reach agreement.[306]

Institutional lenders reacted predictably by including boilerplate waivers of appraisal rights in mortgage loan documents. The South Carolina Supreme Court held that contractual waiver of appraisal rights was unenforceable.[307] The South Carolina legislature responded by amending the statute in 1996 to allow waiver in commercial transactions if disclosed in a capitalized sentence that is underlined, or highlighted in another prominent manner, on the signature page of one of the loan documents.[308]

The involvement of appraisers in a quasi-judicial capacity in South Carolina and Louisiana reflects the growing trend toward alternative dispute resolution. Since its inception more than thirty years ago, alternative dispute resolution has become increasingly popular in response to what is perceived as the courts' inability to resolve commercial disputes in a cost-efficient, time-effective manner.[309] Conflicts that best lend themselves to resolution through alternative means tend to be unnecessarily costly, time consuming, and complex if pursued through formal court proceedings.[310] The public benefits from more efficient and

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306. S.C. CODE ANN. § 29-3-730. This aspect of the statute creates the potential for unnecessary additional cost and delay. The approach recommended in this Article corrects for that defect.

307. *See* SCN Mortg. Corp. v. White, 440 S.E.2d 868, 869 (S.C. 1994), *overruling* Tri-South Mortg. Investors v. Fountain, 221 S.E.2d 861 (S.C. 1976) ("We now join those jurisdictions that give effect to a debtor's statutory rights and hold the contractual waiver of appraisal rights invalid as against public policy.").

308. S.C. CODE ANN. § 29-3-680.

309. *See* Steven A. Weiss, *ADR: A Litigator's Perspective*, A.B.A. (March/April 1999), http://apps.americanbar.org/buslaw/blt/8-4adr.html (last visited Apr. 3, 2015) ("As alternative dispute resolution becomes more accepted, and the arbitrators and mediators become more successful in resolving disputes, we will probably see even more dispute resolution.") (on file with the Washington and Lee Law Review).

310. *See id.* ("[A]rbitration and mediation tend to require significantly less cost and time than litigation and thus can alleviate some of the pain of litigation.").

effective dispute resolution, which streamlines overcrowded court dockets.[311]

The approach recommended by this Article is informed by the alternative dispute resolution regimen that is intricately woven into the long-term ground leases that are frequently used for office buildings, shopping centers, hotels, and other commercial real estate projects.[312] Because of their extended terms (typically ranging from fifty to ninety-nine years), ground leases necessarily include provisions to adjust the rent periodically to accommodate inevitable changes in economic conditions.[313] The rent-adjustment mechanism is designed to assure the lessor a reasonable rate of return decades into the future.[314] From the tenant's perspective,

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311. *See* STATE BAR OF MICH., ALT. DISPUTE RESOLUTION SECTION, ALTERNATIVE DISPUTE RESOLUTION COMPENDIUM (2011), http://www.michiganmediates.net/files/Website%20Files/ADR%20Compendium.pdf (demonstrating the cost-effectiveness and efficiency of resolving conflicts in the public and private sectors through alternative dispute resolution).

312. The concept of ground leasing dates back to the Old Testament. *See* Emanuel B. Halper, *Planning and Construction Clauses in a Subordinated Ground Lease*, 17 REAL EST. L J. 48, 48 n.1 (1988) (citing *Leviticus* 25:10-24). Many of the largest metropolitan area commercial properties have long been constructed on ground-leased land. *See, e.g.*, TRYNIECKI, *supra* note 69, § 15.2 ("For example, many of the old commercial properties in downtown St. Louis were built on 99-year leases."). The *New York Times* reported in 1909 that "nearly all" of the "skyscrapers" in St. Louis were built on leaseholds. *St. Louis Thriving on Leasehold Idea*, N.Y. TIMES, Oct. 10, 1909.

313. *See* Lawrence Teplin & Heather Stern, *Well-Grounded: A Well-Drafted Provision for Future Rent Adjustments is Critical in the Negotiation of a Ground Lease*, A.B.A., http://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&ved=0CB0QFjAA&url=http%3A%2F%2Fapps.americanbar.org%2Fdch%2Fthedl.cfm%3Ffilename%3D%2FRP540380%2Frelatedresources%2Frentadjustments.pdf&ei=493jU5L6CMOZyATEooKYBw&usg=AFQjCNGsdxs0Tgwnrbv3TnbVufvEOqhXXg (last visited Apr. 3, 2015) ("In the context of a ground lease, the parties must agree to a rent that will be paid over decades and adjusted under economic or financial circumstances that will almost invariably differ from what at least one, if not both, parties expected when they first entered into the lease.") (on file with the Washington and Lee Law Review). Ground leases frequently include an option for the tenant to purchase the fee, exercisable at various intervals during the term, at a purchase price determined by an appraisal mechanism that closely resembles the rent-adjustment provision. *See* 936 Second Ave. L.P. v. Second Corporate Dev. Co., 891 N.E.2d 289, 291–92 (N.Y. 2008) (illustrating operation of appraisal process for calculating ground rent).

314. *See* Teplin & Stern, *supra* note 313 (describing the procedures parties can use to ensure that the lease includes a rent adjustment mechanism that can

the rent obligation should continue to bear a reasonable relationship to the income-producing capacity of the improvements over time.

Although there are alternative means of accomplishing the rental adjustment,[315] the most common method involves the appointment of a panel of appraisers tasked with reaching a final determination of fair rental value.[316] As codified in California, the panel is the functional equivalent of an arbitrator whose decision is final.[317]

A well-drafted ground lease addresses the number of appraisers to be appointed, their qualifications,[318] the process of appointment, and the time frame within which the process must occur, and allocates responsibility for the payment of fees. A ground lease typically contains one of three possible appraisal processes:[319]

1. Each party selects an appraiser, and the two appraisers jointly select a third appraiser who is charged with determining fair market rental value. The clause must address the possibility that the two appraisers may be unable to agree on a third

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be effectively implemented over the entire term of the lease).

315. For example, a ground lease may provide for adjustment of rent based on changes in the Consumer Price Index or other benchmark.

316. *See* Teplin & Stern, *supra* note 313 ("The decisive factor in resolving many of the issues associated with defining the rent adjustment mechanism—including the number of appraisers and their qualifications—is the provision that defines who will appoint the appraisers and set the appointment process.").

317. *See* CAL. CIV. PROC. CODE § 1280(a) (West 2014) (providing that this alternative dispute resolution process is binding on the parties and enforceable in the same manner as a result reached through arbitration).

318. MAI (Member of the Appraisal Institute) designation is considered the gold standard appraisal accreditation. *See* EUNICE A. EICHELBERGER, 11 ILL. REAL PROPERTY § 59:11 (explaining that "[t]hose with the designation MAI are appraisers who specialize in the appraisal of commercial, industrial, residential and other types of property"). It is granted to appraisers who are experienced in the valuation of commercial and industrial property, as well as residential property, with at least 4,500 hours of field experience. *See AI Regulations and Bylaws*, APPRAISAL INST., www.appraisalinstitute.org/designatedcandidate affiliate/ai-regulations-and-bylaws/ (last visited Apr. 3, 2015) (on file with the Washington and Lee Law Review).

319. *See* Teplin & Stern, *supra* note 313 (describing common appraisal procedures found in commercial ground leases).

appraiser. In such event, the parties may agree to petition the court to appoint a third appraiser, or the president of the local board of realtors may be tasked with making the appointment.

2. Each party selects an appraiser, and the two jointly select a third appraiser. The first two appraisers each make a determination of value, and the third appraiser chooses between them.[320] Because it requires multiple determinations of value, this process is more expensive and less efficient than the first. Because the third appraiser's discretion is limited to choosing between the determinations of the party-appointed appraisers, this method may also produce an outcome that lies at an extreme end of the range of reasonable value.
3. Each party selects an appraiser who makes a determination of value. If the two are unable to agree, they together choose a third appraiser who makes an independent determination of value. If a majority of the three is unable to agree, the three are averaged together. A variation of this approach is to have the middle appraisal govern. An alternative variation is to disregard any low or high appraisal that varies by more than 10% from the middle appraisal before averaging the results.

Because up to three separate appraisals may need to be conducted, the third method is likely to be the most expensive and time consuming. Nevertheless, in the Author's experience, it is the most widely used method. Parties are rarely willing to rely on the determination of a single appraiser, who may be biased

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320. This approach is similar to the way salary arbitrations in Major League Baseball are conducted. *See* Spencer Wingate, *Salary Arbitration: What it Is and How It Works in Major League Baseball*, INT'L BUS. TIMES (Mar. 22, 2012), www.ibtimes.com/sportsnet/salary-arbitration-what-it-how-it-works-major-league-baseball-705189 (last visited Apr. 3, 2015) ("At the hearing each case presents why the player should be awarded the salary they have requested for the upcoming season. The panel decides to award the higher or lower yearly salary. There is no middle ground [sic] either the team or player wins.") (on file with the Washington and Lee Law Review).

and is surely fallible. If nothing else, a panel of deciders is beneficial on the theory that "three heads are better than one."[321]

Borrowers facing personal liability for sizeable deficiency judgments are entitled to the same kind of rigorous appraisal regimen that sophisticated parties to commercial ground leases choose for themselves when important financial consequences are at stake.[322] The statutory proposal that follows is aimed at accomplishing this objective:

Foreclosure: Action for a Deficiency

(a) If the foreclosure price is less than the unpaid balance of the mortgage obligation, an action may be brought to recover a deficiency judgment against any person liable on the mortgage obligation in accordance with the provisions of this section.

(b) Subject to subsection (e) of this section, the deficiency judgment is for the amount by which the mortgage obligation exceeds the foreclosure sale price.

(c) Any person against whom recovery of a deficiency is sought may request in the proceeding in which the action for a deficiency is pending a determination of the appraised value of the real estate as of the date of the foreclosure sale by designating an appraiser within thirty (30) days following commencement of such action. Such designation shall be made to the clerk of the court, and a copy of such designation shall be served upon the creditor or its attorney of record. Such appraiser shall make an independent determination of value within thirty (30) days of such selection, which shall constitute the appraised value of the real estate for purposes of subsection (e), unless the party seeking a deficiency

321. Research has repeatedly shown that aggregating a number of individual judgments provides a significantly more reliable result. *See* Cassandra Burke Robertson, *The Right to Appeal*, 91 N.C. L. REV. 1219, 1264 (2013) ("[T]here is the advantage of probability—the idea that having more people answer a particular question can increase the probability of reaching a correct answer, even when their conclusions are independent of each other.").

322. *See supra* note 312 (describing the history of commercial ground leases).

designates a second appraiser within thirty (30) days after receiving the first appraiser's determination of value. If the two appraisers thus selected are unable to agree upon the appraised value of the real estate within thirty (30) days after selection of the second appraiser, they together shall designate a third appraiser who shall make an independent determination of value within thirty (30) days after selection, in which event the middle of the three appraisers' determinations of value shall constitute the appraised value of the real estate for purposes of subsection (e). The appraised value thus determined shall be filed and recorded by the clerk as a judgment of the court.

(d) If the first two appraisers designated by the parties are unable to agree upon the appraised value of the real estate and fail to designate a third appraiser within thirty (30) days after their selection, then the court having jurisdiction of the action or any judge thereof shall appoint a third appraiser.

(e) If it is determined that the appraised value of the real estate is greater than the foreclosure sale price, any person against whom recovery of the deficiency is sought is entitled to an offset against the deficiency in the amount by which the appraised value exceeds the sale price.

(f) For purposes of this section, any appraiser (i) shall have the designation MAI; (ii) shall be state-licensed; and (iii) shall not be a party to the action, or affiliated in business with, or related by blood or marriage to, any party to the action. Each appraiser shall be compensated by the party who selected such appraiser. The costs of the third appraiser, if necessary, shall be paid one-half by the party seeking to recover the deficiency and one-half by the party or parties against whom such a recovery is sought.[323]

323. The following illustration of the operation of the proposed statute is based on the facts of *Oreo Corp. v. Nielson*, No. 2:10-cv-00352-PMP-VCF, 2013 WL 6384535, at *1 (D. Nev. Dec. 5, 2013). The borrower selects Appraiser *A*, who values the subject property as of the date of foreclosure at $14.9 million. The lender selects Appraiser *B*, who values the property at $4.35 million.

VI. Conclusion

One of millions of borrowers affected by the 2008 economic crisis and Great Recession, Mike Matheny's story may be difficult to distinguish from so many others.[324] Yet sometimes a story is not just a story. A detailed account from a human perspective, involving a high-visibility figure recognizable by fans of the Great American Pastime, provides a compelling narrative and framework for examining a persistent problem in land finance law. Deficiency judgments have long been recognized as the greatest obstacle to devising a mortgage foreclosure process that accommodates the legitimate interests of lenders and borrowers, along with the public interest in judicial efficiency and access to affordable credit.[325] Sadly, but predictably, it takes a severe economic downturn like the Great Recession to focus attention to the problem of calculating deficiency judgments.

Because the two appraisers are unable to agree, they together select Appraiser *C*, who values the property at $7.8 million. As the middle appraisal of the three, Appraiser *C*'s valuation governs, and the appraised value will be $7.8 million, which corresponds to the outcome of the case.

324. According to the National Association of Realtors, there have been an estimated five million completed foreclosures nationwide since September 2008. *Foreclosures Drop to Lowest Level Since Great Recession*, NAT'L ASS'N OF REALTORS (May 30, 2014), http://realtormag.realtor.org/daily-news/2014/05/30/foreclosures-drop-lowest-level-great-recession (last visited Apr. 3, 2015) (on file with the Washington and Lee Law Review). Business schools have responded to recent accounts of former athletes falling into financial distress by creating specialized executive MBA programs for athletes. *See* Akane Otani, *Basketball Star Who Went Bankrupt Wishes He'd Gotten an MBA*, BUS. WK. (Oct. 23, 2014), www.businessweek.com/articles/2014-10-23/basketball-star-who-went-bankrupt-wishes-hed-gotten-an-mba (last visited Apr. 3, 2015) ("Citing a report that about 60 percent of former NBA players go broke within five years of retirement, Walker says teaching athletes—no matter what sport they play—how to manage their own money is a good step in bringing the number of debt-ridden athletes down.") (on file with the Washington and Lee Law Review).

325. *See* Vaughan, *supra* note 87, at 958 ("At any rate, the fact of this continuing struggle between the creditor and debtor is a primary consideration well to bear in mind."); *see also* Warm, *supra* note 285, at 167 ("Where, in earlier days, it was thought that only the concerns of individuals or of classes were involved, and that those of the State itself were touched only remotely, it has later been found that the fundamental interests of the State are directly affected.").

A foreclosure sale does not always make for complete justice.[326] Most states allow a lender whose loan remains unsatisfied following foreclosure to seek recourse for the deficiency against its borrower's other assets.[327]

The traditional common law method for calculating deficiency judgments has been criticized by courts and commentators as unjust and overdue for reform.[328] The fair value concept is the alternative most widely adopted and recommended by the Restatement.[329] This approach is itself subject to criticism. First, although packaged as a restatement of law, it is in fact a proposal for law reform in almost half the states.[330] Property law evolves at a glacial pace that frustrates advocates of reform; however, characterizing law reform as restatement creates uncertainty that threatens the persuasive precedential value of Restatements generally.[331] Second, the fair value concept is hollow at its core. Proponents concede it is vague and subjective.[332] It provides no meaningful guidance to triers of fact charged with adjudicating value.[333] It is fair to assume that the

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326. *See* MADISON, DWYER & BENDER, *supra* note 21, § 12:41 (describing the rights of senior parties during judicial foreclosure).

327. *See* Skilton, *supra* note 11, at 442 (stating that the lender can satisfy the personal judgment via the borrower's other assets or levy against the mortgaged premises).

328. *See supra* notes 28–30 and accompanying text (providing the chief criticisms against the traditional arithmetical method for calculating deficiency judgments).

329. *See supra* notes 120–126 and accompanying text (describing the adoption of the fair value approach by states and through the Restatement).

330. *See supra* note 127 and accompanying text (explaining that, despite the Restatement's urging, no state court has decided to adopt the fair value approach through the exercise of its equity jurisdiction).

331. In fairness, the American Law Institute, which has published Restatements since 1923, receives even more scholarly criticism for the perception that it is dominated by elitists and resistant to liberalization of the common law. *See generally* Kristen David Adams, *Blaming the Mirror: The Restatements and the Common Law*, 40 IND. L. REV. 205 (2007); David A. Logan, *When the Restatement Is Not a Restatement: The Curious Case of the "Flagrant Trespasser*,*"* 37 WM. MITCHELL L. REV. 1448 (2011).

332. *See supra* note 240 and accompanying text (revealing the reasoning behind the strong criticism against the fair value approach).

333. *See supra* note 250 and accompanying text (explaining that the Restatement's drafters viewed uncertainty as the primarily weakness in the fair

fair value approach is designed to benefit debtors at the expense of creditors by generating uncertainty and encouraging settlement of cases that are emotionally fraught by their very nature, or by discouraging lenders from pursuing deficiency judgments entirely.

Defaulter-friendly foreclosure laws impose transaction costs that adversely affect the availability of mortgage financing and real estate values.[334] Fair value limitations in their current form benefit certain overburdened borrowers while a much larger category of nondefaulting borrowers may face a reduced supply of mortgage credit, and less favorable terms, at the time of loan origination.

This Article recommends a more structured approach modeled after statutes in South Carolina and Louisiana.[335] It would vest well qualified real estate appraisers with the quasi-judicial function of determining value for purposes of calculating deficiency judgments. By incorporating the benefits of alternative dispute resolution and the experience of transactional practice, this approach will make the system of foreclosure more cost effective, expeditious, and equitable to both parties.

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value approach).

334. *See supra* notes 243–246 and accompanying text (elucidating the unintended consequences of defaulter-friendly foreclosure laws).

335. *See supra* Part V (describing the approach of Louisiana and South Carolina and how these approaches inform this Article's statutory proposal).