IN THE SUPREME COURT OF MISSOURI

Case No. SC91951

FIRST BANK,

Plaintiff/Respondent

v.

FISCHER & FRICHTEL, INC.,

Defendant/Appellant.

Appeal from the Circuit Court of St. Louis County
Case No. 08SL-CC04789
Honorable John F. Kintz

SUBSTITUTE BRIEF OF RESPONDENT FIRST BANK

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JURISDICTIONAL STATEMENT

First Bank adopts and incorporates the Jurisdictional Statement from Fischer & Frichtel's brief.

STATEMENT OF FACTS

The following is a summary of the facts related to the circuit court's order granting a new trial and the issues raised on appeal.

A. First Bank made a $2,576,000 loan to Fischer & Frichtel that was memorialized in a promissory note and secured by 21 lots pledged under a deed of trust.

On June 30, 2000, First Bank loaned $2,576,000 to Fischer & Frichtel. Tr. at 135:15-21. On that same date, Fischer & Frichtel executed a promissory note in favor of First Bank, in which it agreed to repay the full amount of the loan, plus interest (the "Note"). Tr. at 136:17-138:14; Exhibit 1. The Note was amended six times. Tr. at 138:23-139:2; Exhibits 2, 3, 4, 5, 6, 7. Each amendment extended the Note's maturity date. Tr. at 139:3-4. The final maturity date was September 1, 2008. Tr. at 143:12-15.

The loan was used by Fischer & Frichtel to acquire 21 lots in the Summit at Vineyard Ridge in Franklin County, Missouri. Tr. at 136:8-11. When First Bank made the loan to Fischer & Frichtel on June 30, 2000, Fischer & Frichtel executed a deed of trust for the benefit of First Bank (as modified, the "Deed of Trust"). Tr. at 144:15-25. The Deed of Trust was subsequently modified on 15 occasions. Tr. at 145:13-23. In the Deed of Trust, Fischer & Frichtel pledged as collateral the 21 lots that the loan was used to acquire. Tr. at 145:6-12; 146:12-16; Exhibits 8, 9. During the life of the loan, Fischer & Frichtel sold 12 of the lots. Tr. at 146:22-147:3. At the time of each sale, Fischer & Frichtel made a $126,000 principal payment to First Bank and First Bank released from the Deed of Trust the lot that had been sold. Tr. at 146:17-147:3.

The Deed of Trust provides that upon a default by Fischer & Frichtel, First Bank may foreclose on the collateral and sell that collateral at a foreclosure sale to the highest bidder. Exhibit 8. The Deed of Trust further provides that if the foreclosure sale price is less than the outstanding loan balance, then First Bank is entitled to recover from Fischer & Frichtel the deficiency. Exhibit 8.

B. Fischer & Frichtel is a sophisticated and wealthy business that continued to profit in the declining real estate market.

Fischer & Frichtel is not an inexperienced and destitute home builder that closed its doors when the home building market began to decline, unable to pay its debts. Rather, Fischer & Frichtel continued to sell homes and profit from its developments. In 2005, Fischer & Frichtel earned $100 million in revenue, $18-20 million in gross profits, and $3-8 million in net profits. Tr. at 250:1-17. In 2006, Fischer & Frichtel earned $80 million in revenue, $14.5 million in gross profits, and $2.5-6.5 million in net profits. Tr. at 250:18-251:8. In 2007, Fischer & Frichtel earned $75 million in revenue and $12 million in gross profits. Tr. at 251:9-16. In 2008, Fischer & Frichtel was in business and sold 148 homes. Tr. at 252:4-9. In 2008, Fischer & Frichtel paid its employees, its president John Fischer, its electric bill, and its heating bill, but chose to not pay First Bank the amount due on the Note. Tr. 246:8-250:1.

John Fischer, the owner and President of Fischer & Frichtel, has 34 years of experience in homebuilding with Fischer & Frichtel. Tr. at 208:2-10. He has negotiated between 20-25 loans, reviewed 15 promissory notes, reviewed 15 deeds of trust, and personally negotiated terms of loans with multiple banks. Tr. at 234:11-17. Mr. Fischer admitted that he has meaningful knowledge of and significant experience in the financing of properties. Tr. at 235:18-23.

C. Fischer & Frichtel rejected First Bank's offer to renew the Note on market terms.

In April of 2008, as the real estate and credit markets declined, First Bank offered to renew the loan for one year on the following terms: (1) an interest rate of prime plus one-half percent; (2) a $5,600 renewal fee; (3) an increase from $126,000 to $162,000 in the principal payment required for First Bank to release a sold lot from the Deed of Trust; and (4) a personal guaranty from John Fischer, the owner of Fischer & Frichtel, of up to 50% of the loan or a principal reduction in the amount of $283,000, which was equivalent to 25% of the loan. Tr. at 157:19-158:4; 224:17-225:2; 227:3-6.

First Bank offered these more stringent terms because the loan risk had increased and because Fischer & Frichtel had not sold any lots in two years. Tr. at 158:7-10. Although admitting that in the summer of 2008 the conditions and underwriting standards had changed in real estate lending, Fischer & Frichtel refused to renew the loan on the terms proposed by First Bank, because the terms were different from the terms of the previous renewals and Fischer & Frichtel considered them onerous and unfair. Tr. at 158:14-18; 227:25-228:3; 230:23-231:2.

At that time, Fischer & Frichtel tried to refinance the loan with another bank. Tr. at 229:13-16. Fischer & Frichtel received a loan commitment from Centrue Bank, one of the three banks it approached about refinancing. Tr. at 229:18-23. Centrue Bank offered to refinance 75% of the loan. Tr. at 229:22-230:2. Fischer & Frichtel refused to refinance with Centrue Bank on those terms. Tr. at 230:3-5.

Having failed to find what it believed to be better terms from other banks, Fischer & Frichtel approached First Bank again in the summer of 2008 about renewing the outstanding loan. Tr. at 231:3-11. At that time, the housing and credit markets had worsened, and First Bank was no longer willing to renew the loan on the terms discussed in April 2008. First Bank did offer to renew the loan on the following terms: (1) an interest rate of prime plus three percent; (2) a personal guaranty from Mr. Fischer for the balance of the loan; and (3) a one-year interest reserve. Tr. at 232:8-16. Fischer & Frichtel refused to renew the loan on those terms.

D. Fischer & Frichtel failed to pay the outstanding principal balance due under the Note when it matured, and First Bank acquired the 9 remaining lots at a foreclosure sale.

When the Note matured on September 1, 2008, a principal balance of $1,133,875.75 was due. Tr. at 143:16-21. Although First Bank demanded payment in accordance with the terms of the Note, Fischer & Frichtel never paid the amount due. Tr. at 143:22-144:7.

Because Fischer & Frichtel did not pay the balance due on maturity, First Bank hired AT, Inc. to conduct a foreclosure sale of the nine remaining lots subject to the Deed of Trust. Tr. at 150:22-151:6. AT, Inc. advertised the sale in a Franklin County newspaper and sent Fischer & Frichtel notice of the sale. Tr. at 151:22-152:9. The advertisement and notice, including the amount of notice provided (22 days), were in accordance with the requirements of §§ 443.010-.440, RSMo 2005. LF 673; Tr. at 185:3-7. Fischer & Frichtel has never claimed any aspect of the sale violated the statutory requirements applicable to foreclosure sales or the terms of the Note or Deed of Trust.

A representative of AT, Inc. conducted the foreclosure sale on December 11, 2008, at the Franklin County Courthouse. Tr. at 152:19-153:5. Mr. LaKamp from First Bank, an attorney for Fischer & Frichtel, and the representative of AT, Inc. who conducted the sale were the only people who attended. Tr. at 134:2-5; 152:21-22; 153:6-9. The representative from AT, Inc. opened the bidding on the 9 remaining lots. Mr. LaKamp submitted a bid in the amount of $466,000 on behalf of First Bank. Tr. at 153:21-25; 154:8-11. First Bank arrived at its bid amount by valuing the property at $675,000 and then deducting estimated carrying costs associated with maintaining and owning the property such as insurance, homeowner association fees, and property taxes. Tr. at 161:7-12. Then, First Bank discounted that figure further based on the lack of market activity and economic downturn to arrive at $466,000. Tr. at 161:13-25.

Months before the foreclosure sale, on internal First Bank forms, Paul LaKamp, a Senior Vice President at First Bank, listed the outstanding balance of the loan as $1,133,875.75 and "valued" the nine remaining lots at $126,000 each. Tr. at 170:2-4; 171:12-18; 173:13-17; 179:25-180:12. These valuations were not based on an updated appraisal obtained by First Bank. Mr. LaKamp merely divided the remaining loan balance ($1,133,875.75) by the number of remaining lots (nine), which is approximately $126,000 per lot, because this is how First Bank historically calculated the value of the lots throughout the life of the loan. Tr. at 188:1-5. First Bank did not use this same calculation or valuation when determining the amount it was willing to pay at the foreclosure sale. Tr. at 161:7-25.

Although the representative from AT, Inc. asked for additional bids, no other bids were submitted. Tr. at 154:1-7. First Bank did not write a check for the amount it bid at the foreclosure sale, but credited the amount bid at the foreclosure sale against the principal balance on the Note. Tr. at 154:12-19. There is no evidence that prior to or during the foreclosure sale Fischer & Frichtel ever presented First Bank with an appraisal purporting to show its opinion of the fair market value of the property nor did it claim that the foreclosure sale price was less than the fair market value. There also is no evidence that Fischer & Frichtel informed First Bank that, despite the language of the Deed of Trust or established Missouri law, it would be claiming that the measure of any deficiency would be the difference between an appraiser's opinion of fair market value and the amount due on the Note.

At the time of trial in February of 2010, First Bank still owned and currently still owns all 9 lots it purchased at the foreclosure sale. Tr. at 155:11-12. First Bank tried to sell the lots and listed them on the market for $675,000, but no offers were made to purchase the lots. Tr. at 155:13-14; 155:20-156:10.

E. After crediting the $466,000 First Bank bid at the foreclosure sale for the lots, a principal balance of $667,875.75 and interest totaling $75,642.46 are due on the Note.

On September 1, 2008, the balance due on the Note was $1,113,875.75. Tr. at 156:11-13. After crediting the $466,000 First Bank bid at the foreclosure sale, the balance due on the Note is $667,875.75. Tr. at 156:14-20. In addition, at the time of trial, interest in an amount of $75,642.46 was due under the terms of the Note. Tr. at 156:21-25. First Bank calculated the amount of interest by applying interest to the $1,113,875.75 loan balance from September 1, 2008, through December 11, 2008, and applying interest to $667,875.75 from December 11, 2008 (the date of the foreclosure) through the date of trial. Tr. at 157:1-7. The Note provides that, after default, interest shall accrue at the "Prime Rate" plus 3%. Exhibit 1. "The Prime Rate" is defined in the Note as "a floating per annum rate of interest which at any time, and from time to time, shall be most recently announced by Bank as its Prime Rate, which is not intended to be Bank's lowest or most favorable rate of interest at any one time." Exhibit 1.

F. First Bank sues Fischer & Frichtel for deficiency.

First Bank sued Fischer & Frichtel seeking deficiency damages in an amount equal to the difference between the amount due on the Note and the amount bid at the foreclosure sale, plus interest, attorneys' fees, and costs of collection. LF 9-112, 935; Tr. at 156:11-157:11. At trial, Fischer & Frichtel sought to assert affirmative defenses based on commercial frustration and breach of the duty of good faith and fair dealing. LF 932-934. Fischer & Frichtel also argued for the first time that, if liable for any deficiency, it was liable at most for the difference between the amount due on maturity and the "fair market value" of the property serving as collateral for the Note. LF 929-930. Over First Bank's objection, Fischer & Frichtel presented evidence of an appraiser's opinion of the fair market value of the collateral as of December 11, 2008. LF 715-723, 729-735; Tr. at 299:15-308:9. First Bank did not present any evidence of the fair market value of the property because under the terms of the Deed of Trust and long-standing Missouri law, fair market value was irrelevant to the calculation of the amount of the deficiency First Bank was entitled to recover.

Over First Bank's objection, the trial court gave Fischer & Frichtel's proposed damages instruction, which directed the jury to award as damages the difference between the amount due when the Note matured and the fair market value of the property. LF 929-930; Tr. at 286:8-287:9. The jury returned a verdict based on the instruction given and awarded First Bank far less in damages than the difference between the amount owed on the Note and the amount bid at the foreclosure sale. LF 866-867; Tr. at 156:11-157:11.

Both parties filed post-judgment motions. LF 868-895. First Bank filed a motion asserting one basis for a new trial: that the trial court erred in giving Fischer & Frichtel's damages instruction because it was contrary to Missouri law. LF 868-881. The trial court granted First Bank's motion for new trial on damages only and Fischer & Frichtel appealed. LF 901-27.

POINTS RELIED ON

I.

The trial court properly granted First Bank's motion for new trial on damages only because the submission of Instructions 7 and 8 was reversible error. The proper measure of damages in Missouri in a suit on a note following a foreclosure sale is the difference between the amount due on the note less the proceeds received at the foreclosure sale, not the amount due on the note less the fair market value of the property on the date of the foreclosure sale, as directed in Instruction 7.

Drannek Realty Co. v. Nathan Frank, Inc., 139 S.W.2d 926 (Mo. 1940)

Reed v. Inness, 102 S.W.2d 711 (Mo. App. 1937)

Hewitt v. Price, 102 S.W. 647 (Mo. 1907)

II.

The trial court did not err in denying Fischer & Frichtel's motion for judgment notwithstanding the verdict because First Bank presented sufficient evidence to support the jury's award of interest. Moreover, this point is moot if the court affirms the trial court order granting a new trial.

St. Louis Realty Fund v. Mark Twain S. Cnty. Bank 21, 651 S.W.2d 568 (Mo. App. E.D. 1983)

Student Loan Mktg. Ass'n. v. Raja, 914 S.W.2d 825 (Mo. App. W.D. 1996)

III.

The trial court did not err in rejecting Fischer & Frichtel's proffered affirmative defense instruction based on the doctrine of good faith and fair dealing because First Bank did not have a duty to renew the Note and did not have a duty to pay fair market value for the property at the foreclosure sale as a matter of law, and because the instruction proffered misstated the applicable law and was defective in form.

Zubres Radiology v. Providers Ins. Consultants, 276 S.W.3d 335 (Mo. App. W.D. 2009)

Cordry v. Vanderbilt Mortg. & Fin., Inc., 370 F.Supp. 2d 923 (W.D. Mo. 2005)

Centerre Bank of Kan. City, N.A. v. Distribs., Inc., 705 S.W.2d 42 (Mo. App. W.D. 1985)

IV.

The trial court did not err in rejecting Fischer & Frichtel's affirmative defense instruction on commercial frustration because a downturn in the housing and credit markets is not a basis for a commercial frustration defense under Missouri law and because the instruction proffered misstated the applicable law and was defective in form.

Adbar, L.C. v. New Beginnings C-Star, 103 S.W.3d 799 (Mo. App. E.D. 2003)

Kassebaum v. Kassebaum, 42 S.W.3d 685 (Mo. App. E.D. 2001)

Am. Laminates, Inc. v. J.S. Latta Co., 980 S.W.2d 12 (Mo. App. W.D. 1998)

Shop 'N Save Warehouse Foods, Inc. v. Soffer, 918 S.W.2d 851 (Mo. App. E.D. 1996)

ARGUMENT

I. The trial court properly granted First Bank's motion for new trial on damages only because the submission of Instructions 7 and 8 was reversible error. The proper measure of damages in Missouri in a suit on a note following a foreclosure sale is the difference between the amount due on the note less the proceeds received at the foreclosure sale, not the amount due on the note less the fair market value of the property on the date of the foreclosure sale.

For over 70 years, in Missouri the measure of damages in a suit on a promissory note after foreclosure has been the difference between the amount due on the loan and the price bid at the foreclosure sale. Under that established law, First Bank and Fischer & Frichtel negotiated the Note and the Deed of Trust pursuant to which Fischer & Frichtel, in the event of foreclosure, would be liable to First Bank for any deficiency between the loan balance and the foreclosure sale price. Relying on a section of the Restatement primarily based on statutes enacted by states other than Missouri and contrary to settled Missouri law, appellant Fischer & Frichtel asks this Court to change the law, adopt a new measure of deficiency damages, and apply that new measure to existing loan agreements, regardless of the express terms of those agreements or the law in effect at the time those agreements were made. Fischer & Frichtel's call for a change in law ignores the sound policy on which the current law is based, the practical reality in which foreclosures and deficiency claims occur, and the ramifications its requested change would have on the lending system in Missouri.

Contrary to one of many false premises on which Fischer & Frichtel relies, neither First Bank nor any other bank views foreclosures or deficiency claims as windfall opportunities at the expense of defaulting borrowers. Rather, these collection mechanisms are measures of last resort taken by lenders in an attempt to collect amounts they are contractually entitled to receive, in most cases after loan extensions and other workout attempts have failed.

This situation is not, as Fischer & Frichtel would have the Court believe, the case of a bank manipulating the system in an attempt to take advantage of a troubled borrower. This case involves a savvy and sophisticated developer who borrowed money to take advantage of an expanding real estate market and then, when the market turned, strategically chose to default on its loan obligation and now asks that the Court change the rules and shift to the lender the entire risk of a change in the market, a risk the borrower contractually assumed.

This is not, as Fischer & Frichtel claims, a case that cries out for a change in the law to keep the lender from realizing an unfair windfall. Instead this case highlights why it is inappropriate and unfair to apply an appraiser's opinion of market value as the standard in measuring deficiency damages. Rather than realizing a windfall, First Bank, like many lenders confronted with a defaulting borrower, has been forced to become an owner of property it cannot sell. The change in the law Fischer & Frichtel proposes also would not affect merely the evidence and instructions at a deficiency hearing; it would alter the nature and process of foreclosure sales and the terms of the loan agreements themselves.

Over First Bank's objection, the trial court submitted Instructions 7 and 8 to the jury. LF 756-59; 896-900; 929; Tr. at 284:22-288:11. These instructions improperly directed the jurors to base damages on the difference between the amount due on the promissory note and their opinion of the fair market value of the property on the date of foreclosure. This is not what Fischer & Fricthel agreed to in the Deed of Trust and is not the measure of damages in a suit on a promissory note after foreclosure under Missouri law. The trial court correctly recognized that it had erred in giving Instructions 7 and 8 and properly granted First Bank's motion for new trial on those grounds. This Court should affirm that order.

A. Standard of review.

"The Court may grant a new trial of any issue upon good cause shown." Missouri Supreme Court Rule 78.01. If an error of law occurred in the trial, the trial court must order a new trial. *Chappell v. City of Springfield,* 423 S.W.2d 810, 811 (Mo. 1968). "[A] trial court's authority to grant a new trial is discretionary only as to matters of fact, not as to matters of law." *Meyer v. McGarvie,* 856 S.W.2d 904, 907 (Mo. App. E.D. 1993). "Instructional error involves a question of law; therefore, if a new trial has been granted for such error, the appellate court must examine the record presented to determine whether the challenged instructions were erroneous and, if so, whether such instructions prejudiced the party challenging the instructions." *Id.*

The trial court's error in giving Instructions 7 and 8 was the only basis on which First Bank requested a new trial. LF 868-881. Accordingly, when the trial court granted the motion for a new trial on damages, it was because the trial court recognized that it had erred in giving Instructions 7 and 8. When a trial court grants a motion for a new trial that includes only one basis for relief, by the very act of granting the new trial the trial court specifies the ground on which the new trial is granted and the presumption set forth in Missouri Supreme Court Rule 84.05(c) does not arise. *Ray v. Bartolotta,* 408 S.W.2d 838, 840 (Mo. 1966); *Hall v. Mo. Highway & Transp. Comm'n,* 861 S.W.2d 720, 721 (Mo. App. E.D. 1993).

B. The trial court correctly granted a new trial because it had not properly instructed the jury under Missouri law with respect to the amount owed First Bank under the Note.

At trial, First Bank submitted the following damages instruction, which is consistent with the negotiated terms of the Deed of Trust and Missouri law:

> If you find in favor of plaintiff, then you must award plaintiff such sum as you believe is the balance due plaintiff under the promissory note plus interest and costs of collection.

LF 935; M.A.I. 4.08 [1980 New] Modified. The trial court rejected First Bank's proposed damages instruction and, over First Bank's objection, gave as Instruction 7 the following damages instruction submitted by Fischer & Frichtel:

> If you find in favor of Plaintiff, then you must award Plaintiff the balance due Plaintiff on the promissory note on the date of maturity, less the fair market value of the property at the time of the foreclosure sale, plus interest.

LF 929; Tr. at 284:22-288:11. The trial court also gave Instruction 8, which defined "fair market value." LF 930.

Under the measure of damages proffered by Fischer & Frichtel and embodied in Instruction 7, a holder of a promissory note who foreclosed on collateral securing the note would no longer be entitled to recover the principal balance of the loan, after accounting for any proceeds from the foreclosure sale. Rather, the holder of the note could only recover the balance due on the note less an estimated "fair market value" of the collateral on the date of the foreclosure sale, regardless of what amount was actually paid at the sale or whether the lender was able to sell the property for the purported fair market value. In changing the measure of damages to one based on an appraiser's opinion of fair market value, Instruction 7 shifted the entire risk of real estate fluctuations from the developer who is in the real estate business to the bank which is in the business of assessing credit risk.

The trial court committed prejudicial error by giving Instruction 7 because the instruction required the jury to return a verdict in an amount substantially less than the amount to which First Bank was entitled under the Deed of Trust and Missouri law: the balance due under the Note, less the amount bid at the foreclosure sale.

1. Under both the Deed of Trust and Missouri law, First Bank is entitled to recover the difference between the amount due on the Note and the amount bid at the foreclosure sale.

First, the measure of damages embodied in Instruction 7 violates the terms of the negotiated agreement between First Bank and Fischer & Frichtel setting the amount of any deficiency to which First Bank was entitled. In the Deed of Trust, Fischer & Frichtel gave the trustee the authority to sell the property at a foreclosure sale to "the highest bidder" and agreed to "pay upon demand any deficiency remaining," necessarily referring to the difference between the amount due on the Note and the foreclosure bid price. Exhibit 8. The terms of the Note and Deed of Trust control the amount of the deficiency that First Bank is entitled to recover. *Robbins v. McDonnell Douglas Corp.,* 27 S.W.3d 491, 496 (Mo. App. E.D. 2000); *Lake Cable, Inc. v. Trittler,* 914 S.W.2d 431, 436 (Mo. App. E.D. 1996). If the Court simply applies the terms of the Deed of Trust, it should affirm the trial court and need not address the broader issues Fischer & Frichtel seeks to raise on appeal.

Even assuming that the terms of the Deed of Trust by themselves are not dispositive, Missouri law also requires a new trial. It is well-settled that a holder of a promissory note is entitled to recover the balance due under the note, plus interest, when the debtor fails to make payment required by the note. *Pac. Carlton Dev. Corp. v. Barber,* 95 S.W.3d 159, 162-63 (Mo. App. W.D. 2003); *Cadle Co. v. Shearer,* 69 S.W.3d 122, 125 (Mo. App. W.D. 2002); *Dixon v. Brannan,* 970 S.W.2d 384, 385 (Mo. App. E.D. 1998). When the promissory note is secured by a deed of trust and the property subject to the deed of trust is sold at a foreclosure sale, Missouri law allows a deficiency in the amount of the balance due under a promissory note less the amount paid for the property at a properly conducted foreclosure sale. *See Drannek Realty Co. v. Nathan Frank, Inc.,* 139 S.W.2d 926, 928 (Mo. 1940); *Hewitt v. Price*, 102 S.W. 647, 651 (Mo. 1907); *Reed v. Inness*, 102 S.W.2d 711, 713-15 (Mo. App. 1937). Instructions 7 and 8 submitted by Fischer & Frichtel are inconsistent with this measure of damages long recognized by Missouri law and relied upon by the parties negotiating the lending relationship.

Indeed, Missouri courts have expressly rejected the measure of damages embodied in Instruction 7 and requested by Fischer & Frichtel in this appeal. *Reed,* 102 S.W.2d at 715; *see Drannek Realty,* 139 S.W.2d at 928; *Hewitt*, 102 S.W. at 651. In *Reed,* the holder of the promissory note conducted a foreclosure sale on property pledged by the defendant in a deed of trust, purchased the property at the foreclosure sale through a credit bid, and brought a claim on the promissory note to collect the deficiency. The plaintiff sought an amount equal to the principal balance due under the promissory note on the date of the foreclosure sale less the amount of the credit bid at the foreclosure sale ($1,000). *Reed*, 102 S.W.2d at 713. In a bench trial, the defendant introduced evidence, over the plaintiff's objection, that the alleged market value of the property on the date of the foreclosure sale was $6,500 and that the plaintiff's deficiency should be calculated by taking the principal balance on the promissory note less the market value of the property on the date of the foreclosure sale. *Id.* at 713-14. The trial court utilized the defendant's calculation (balance minus alleged market value), rejected the plaintiff's calculation (balance minus credit bid at foreclosure sale), and entered a judgment in favor of the defendant.[1]

[1] In *Reed,* the purported fair market value of the property at the time of the foreclosure sale exceeded the principal amount owed on the promissory note.

The court of appeals held it was reversible error for the trial court to employ the fair market value calculation advanced by the defendant, reversed the judgment, and remanded for entry of a judgment in favor of the plaintiff in the amount equal to the principal balance less the credit bid at the foreclosure sale, plus interest. *Id.* at 718.

In *Drannek Realty* and *Hewitt,* this Court also explicitly rejected the position advanced by Fischer & Frichtel. In a suit for a deficiency after a foreclosure sale, the Court "held that a chancellor had no power to fix a fair value on the land foreclosed and impose that amount as the purchase price, in order to fix the mortgagor's liability. Where the sale is fairly conducted the amount bid must stand." *Drannek Realty,* 139 S.W.2d at 928; *see also Hewitt,* 102 S.W. at 651.

2. Section 8.4 of the Restatement (Third) of Property: Mortgages is contrary to Missouri law and has not been adopted by Missouri Courts.

The only authority Fischer & Frichtel cites in support of its damages instruction is section 8.4 of the Restatement (Third) of Property: Mortgages. Under section 8.4(c), the court will apply a "market value" standard if the borrower requests a determination of fair market value in the deficiency proceeding. Absent such a request, section 8.4 of the Restatement would measure the deficiency as "the amount by which the mortgage obligation exceeds the foreclosure sale price." Contrary to the suggestion in Fischer & Frichtel's brief, section 8.4 is not based on a single uniform common law, but instead is derivative of mostly statutory, not common law, standards adopted by other states.

Missouri has not adopted the fair market value provisions of the Restatement and no Missouri appellate court has ever applied it. Missouri law does not calculate a deficiency owed on a promissory note based on the difference between the amount of the mortgage debt and the alleged market value of the property on the date of the foreclosure sale. Restatement section 8.4 is simply not the law in Missouri.

And, notwithstanding the Restatement's position, Missouri does not stand alone on this issue. Many states, including Illinois, Indiana, Kentucky, Louisiana, Maryland and Rhode Island, do not reduce the amount of a deficiency judgment based on a purported fair market value of the property sold at foreclosure. *See, e.g., Abrams v. F.D.I.C.*, 5 F.3d 1013, 1015 (6th Cir. 1993) (applying Kentucky law); *R.I. Depositors' Econ. Prot. Corp. v. Macomber*, 658 A.2d 511, 511 (R.I. 1995); *Arnold v. Melvin R. Hall, Inc.*, 496 N.E.2d 63, 65 (Ind. 1986); *Garland v. Hill*, 357 A.2d 374 (Md. 1976); *Illini Fed. Sav. & Loan Ass'n v. Doering*, 516 N.E.2d 609, 611 (Ill. App. Ct. 1987); *Pitts v. Mason*, 418 So.2d 27, 29 (La. Ct. App. 1982). According to the Reporter's Notes to section 8.4, only Mississippi, Montana, and Vermont have adopted a "fair value" approach by case law, while Florida courts are split. *See F.D.I.C. v. Hy Kom Dev. Co.,* 603 So.2d 59 (Fla. Dist. Ct. App. 1992) (deficiency judgment based on foreclosure sale price is the rule rather than the exception, unless fraud or other inequitable conduct infects the sale process). Comment to section 8.4 of the Restatement recognizes that the "traditional view" is that the amount realized at the foreclosure sale is applied to the mortgage obligation and the mortgagee is entitled to the difference.

Before conceding that in fact it is asking the Court to change Missouri law, Fischer & Frichtel makes a passing attempt to suggest that section 8.4 of the Restatement already is the law of Missouri because Missouri courts have cited *other* sections of the Restatement (Third) of Property: Mortgages. Missouri's acceptance of other restatement sections, of course, is irrelevant to the adoption of section 8.4. None of the cases Fischer & Frichtel cites mention section 8.4 or suggest that Missouri has adopted every section of the Restatement. Moreover, in the cases on which Fischer & Frichtel relies, Missouri law already was in accord with the standard discussed in the applicable Reinstatement section. *See Bob DeGeorge Assocs., Inc. v. Hawthorn Bank,* No. WD 72651, 2011 WL 1988416, at *2 (Mo. App. W.D. May 24, 2011); *Bellistri v. Ocwen Loan Servicing, LLC,* 284 S.W.3d 619, 623 (Mo. App. E.D. 2009); *Sutton Funding, LLC v. Mueller,* 278 S.W.3d 702, 705 (Mo. App. E.D. 2009); *Golden Delta Enters., L.L.C. v. US Bank,* 213 S.W.3d 171, 176 (Mo. App. E.D. 2007).

In *Bellistri,* for example, the court referred to a Restatement section when explaining the effect on a mortgage loan when one party holds the promissory note and another party holds the deed of trust – the loan, as a practical matter, becomes unsecured. 284 S.W.3d at 623. This generally accepted statement of law is consistent with Missouri law. Similarly, in *Bob DeGeorge Associates, Sutton Funding*, and *Golden Delta Enterprises,* the court made reference to Restatement sections because they reflected then-existing Missouri law on the subjects at issue. *Bob DeGeorge Assocs.,* 2011 WL 1988416, at *2; *Sutton Funding,* 278 S.W.3d at 705; *Golden Delta,* 213 S.W.3d at 176. The courts in these cases did not change well-established Missouri property law by adopting any sections of the Restatement, as Fischer & Frichtel asks the Court to do here. These cases do not support Fischer & Frichtel's argument that Missouri courts have adopted or should adopt Restatement sections inconsistent with Missouri law.

Section 8.4 and Instructions 7 and 8 are contrary to Missouri law. By giving Instructions 7 and 8, the trial court erroneously directed the jury to award First Bank an amount less than the balance due on the Note minus the amount of the credit bid at the foreclosure sale, and the jury followed those directions. The trial court correctly recognized its error and granted First Bank's motion for a new trial on damages. Application of settled Missouri law establishing the measure of deficiency damages after a foreclosure sale requires affirmance of the trial court's order.

C. This Court should not adopt section 8.4 of the Restatement (Third) of Property: Mortgages.

In an attempt to avoid affirmance of the new trial order, Fischer & Frichtel asks this Court to change the law and invalidate the terms of the Deed of Trust. Peppering its argument with misguided references to "fairness" and relying on a series of false premises, Fischer & Frichtel ignores the sound policy reasons for the long-settled measure of damages, mischaracterizes the nature and purpose of foreclosure and deficiency proceedings, and grossly understates the effect of the new standard they advocate. For the reasons discussed below, the Court should reject appellant's request to adopt a new standard for measuring deficiency damages.

1. Existing law appropriately allocates the risks of foreclosure between the borrower and the lender.

The concept of "fairness" in conjunction with a deficiency proceeding must take into consideration the exposure not only of a defaulting borrower, but also of the lender who has not been repaid; the standard for measuring deficiency damages should reflect a fair allocation of the risk of loss between the defaulting borrower and the lender. Current Missouri law appropriately allocates that risk based on the respective interests of the lender and the borrower in the transaction, the benefits they hope or expect to obtain, and the risks they should expect to bear. On the other hand, the standard urged by Fischer & Frichtel allows the borrower to benefit from a strong real estate market while unfairly shifting all the risk of a declining real estate market to the lender. According to Fischer & Frichtel, "fairness" in a deficiency proceeding apparently means adopting whatever standard will minimize the potential exposure of the defaulting borrower, even when that borrower is a sophisticated developer with tens of millions of dollars in annual revenues and profits over the term of the loan who strategically defaults rather than renegotiating or repaying the loan.

When the parties negotiated the loan agreement, First Bank bargained for and expected one thing when it agreed to make the loan: that the loan would be repaid on the terms memorialized in the loan documents. It also assumed the credit risk that Fischer & Frichtel would default. Whether Fischer & Frichtel lived up to its contractual obligations and repaid the loan or defaulted and failed to repay was beyond First Bank's control. To control the potential loss in the event of a default, First Bank required collateral and the right to foreclose on that collateral and to seek any deficiency from the borrower. If Fischer & Frichtel failed to repay the loan, First Bank potentially would be made whole by selling the collateral at a foreclosure sale and obtaining a deficiency judgment against Fischer & Frichtel for the difference between the loan balance and the price paid at the foreclosure sale. Contrary to Fischer & Frichtel's premise, the existing law does not guarantee that First Bank will be made whole, much less obtain a windfall. First Bank continues to bear the risk that it will be unable to sell the property for the foreclosure bid price, or unable to sell the property at all (as has been the case here), and that any deficiency claim will be futile.

But, First Bank, like other lenders, does not assume the risk of failure of the underlying transaction for which the borrower is obtaining the loan (*i.e.*, home building), just as it does not expect to receive more than repayment of the underlying indebtedness if the borrower's transaction is successful and profitable. For example, during the first half of the loan term, when the real estate market was strong, home sales were high, and Fischer & Frichtel was making millions of dollars in annual profits, First Bank did not expect to share in those profits.

Fischer & Frichtel, on the other hand, entered into the loan agreement with First Bank in 2000 with the hope and expectation of using the loan proceeds to generate profits from a real estate development, which is what happened for the first several years of the loan. Fischer & Frichtel also assumed the risk that its development plans would not fully succeed – either because of Fischer & Frichtel's management of the project, a change in market conditions, or a myriad of other reasons. As part of that risk, Fischer & Frichtel understood that, if it defaulted on the loan, First Bank could foreclose and pursue a deficiency claim. And throughout the life of the loan, Missouri law appropriately allocated to Fischer & Frichtel, as borrower and developer, both the risk that the amount bid at the foreclosure sale would be less than the amount due on the loan and the obligation to pay the difference.

2. Fischer & Frichtel's argument is based on the false premise that lenders use foreclosure sales and deficiency claims to obtain windfall profits on secured loans.

Fischer & Frichtel argues that this allocation of risk is unfair because it allows a lender to receive a windfall if the combined "value" of the foreclosed property and the deficiency judgment exceeds the debt, regardless of the foreclosure bid price and regardless of any price obtained if and when the property is resold. In an attempt to bolster its argument that the settled law on deficiency damages is unfair, Fischer & Frichtel relies on the wholly unsupported assumption that deficiency claims after foreclosure sales commonly result in windfalls to banks or other lending institutions and are viewed and used by banks as a mechanism for increasing profits. The reality is that banks have no desire or incentive to own property, many banking laws and regulations restrict a bank's ownership of real estate, foreclosures are expensive, and foreclosed properties are difficult to sell and generally sell at depressed prices.

Foreclosures and deficiency claims resulting in windfalls are not common. What is common is that lenders lose money when a borrower defaults and the lender is forced to foreclose. *See* Amy Crews Cutts & Richard K. Green, *Innovative Servicing Technology: Smart Enough to Keep People in Their Houses?*, (Freddie Mac, Working

Paper No. 04-03, July 2004), at 5[2]; Karen M. Pence, *Foreclosing on Opportunity: State Laws and Mortgage Credit,* Board of Governors of the Federal Reserve System (May 13, 2002), at 1.[3] What is common is that the lender is unable to sell the property for the amount bid at the foreclosure sale, if at all, and will not be made whole even if it fully collects its deficiency claim. And while there is the possibility that a lender might be able to resell the foreclosed property at a price greater than the foreclosure bid price, that difference is often offset by carrying and transaction costs. A bank acquiring property at a foreclosure sale does not expect to sell the collateral for a windfall, particularly when, as here, the defaulting borrower is a successful real estate developer which has developed this type of property. Presumably, if the property could be readily sold at some idealized fair market value equal to or greater than any secured indebtedness, a sophisticated developer like Fischer & Frichtel would have done so, paid off the loan, and moved on. It is nonsensical to argue, as Fischer & Frichtel does here, that First Bank manipulated the process and acquired this property with the goal and expectation of flipping it for a substantial "windfall," when this wealthy developer saw the prospects for this property to be so bleak that it decided to just walk away.

There also is no evidence that First Bank acted improperly in any way with regard to the loan transaction. First Bank renewed the Note multiple times to accommodate

[2] Available at http://www.freddiemac.com/news/pdf/fmwp_0403_servicing.pdf.

[3] Attached to First Bank's Appendix at A-1.

Fischer & Frichtel's development plans.[4] Its final refinancing terms were consistent with the only terms Fischer & Frichtel could get from any other bank. There is no evidence that First Bank violated any statutes or regulations. When Fischer & Frichtel chose to default, First Bank sought only to enforce its rights under the Deed of Trust and Missouri law. As a last resort, First Bank resorted to foreclosure and a deficiency claim to protect its interests and attempt to minimize its losses in a declining market. First Bank took this step only after Fischer & Frichtel rejected renewal terms that were consistent with that market and chose to default, fully aware of the limited remedies available to First Bank. Particularly on this record, Fischer & Frichtel never explains where the fairness lies in its contention that, since the real estate market fell and its profits slowed, the Court should shift to First Bank the risk that the amount due on the Note exceeded the "value" of the collateral or that the collateral could never be sold for an appraiser's estimate of its value.

Inherent in any foreclosure transaction is the uncertainty about how long it will take the lender to resell the collateral after foreclosure (with all the attendant carrying and transactional costs), and the price it will receive on resale, if and when it occurs. That uncertainty is a function of the real estate market in which the developer-borrower operates, and the risk inherent in that uncertainty is one properly shared by the real estate developer borrowing the money and seeking to profit from it, not one borne solely by the

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[4] If foreclosure and deficiency claims were the profit center that Fischer & Frichtel claims they are, First Bank would have foreclosed at the first opportunity, rather than working with the borrower on loan renewals.

bank making the loan. While Fischer & Frichtel is the only party who profited from the benefits of strong home sales and a lucrative real estate market, it now asks First Bank to bear all the risk of depressed home sales and a declining real estate market. This is neither the bargained-for allocation of risk nor an allocation that reflects the realities of foreclosure sales and deficiency claims.

First Bank did not expect to share in Fischer & Frichtel's profits when the real estate market was doing well, and it should not be asked to bear the entire risk in trying to sell foreclosed property when the market changed and Fischer & Frichtel decided to default rather than renegotiate or repay.

3. Existing Missouri law protects the interests of both the borrower and the lender.

Fischer & Frichtel incorrectly claims that the standard set forth in section 8.4 offers "protections for both the mortgagor and the mortgagee." App. Br. 29. Section 8.4(c) instead only protects the mortgagor by potentially relieving a mortgagor from repaying its full debt obligations by giving it credit for an estimated market value that may never be realized. The mortgagee, on the other hand, unfairly assumes all of the risk that its deficiency will be reduced by an amount deemed to be the "fair market value" of the foreclosed property, with no assurance that it will be able to sell the property for the alleged market value.

Missouri foreclosure law already provides a mechanism that in fact protects both the mortgagor and the mortgagee – statutory redemption. Under Missouri's statutory redemption scheme, a borrower can redeem property purchased by its lender at a foreclosure sale if it pays the outstanding debt within a year after the sale. *See* §§ 443.410-.440, RSMo 2005. If a borrower does so, the foreclosure sale is cancelled, ownership of the property reverts back to the borrower, and the lender has been paid back on the loan. Under the redemption statutes, a mortgagor who believes the foreclosure price to be unfair can avoid the sale and reclaim its property by repaying the lender. In that situation, the borrower has recourse to reclaim property it believes to be worth more than the price paid at the foreclosure sale and the lender is simply paid in full for the debt.

4. The lender should not have to bear the uncertainty inherent in an appraiser's estimate of market value.

Fischer & Frichtel also erroneously assumes that appraised "fair market value" in this context is a set figure on which parties always agree, when in reality "fair market value" determined in a legal proceeding is simply the opinion of an appraiser based on a subjective assessment of market information. Even a cursory review of condemnation cases shows that two appraisers in a single case may offer opinions about fair market value of the same property that are hundreds of thousands of dollars apart. *See, e.g., State ex rel. Mo. Highway & Transp. Comm'n v. Modern Tractor & Supply Co.,* 839 S.W.2d 642, 646-57 (Mo. App. S.D. 1992). As the Restatement itself acknowledges, there is not even an agreed upon definition of fair market value among the states. Some states use a "fair value" standard which is altogether different than "fair market value." *Nat'l Bank of Wash. v. Equity Investors,* 506 P.2d 20, 46 (Wash. banc 1973); *Rainer Mortg. v. Silverwood, Ltd.,* 209 Cal.Rptr. 294, 300 (Cal. Ct. App. 1985).

The question presented here is who between the lender and the borrower should fairly bear the risk that the appraiser with the highest value or the most convincing courtroom presence is wrong. In clamoring about fairness, Fischer & Frichtel again never explains why it should receive the benefit of an appraiser's opinion of fair market value which may far exceed what the lender is eventually able to sell the collateral for, while the lender should bear the entire risk that it will be unable to sell the property for an appraiser's estimate of value.

In citing the use of "fair market value" in condemnation actions, Fischer & Frichtel ignores the fundamental difference between the nature of a condemnation proceeding and a deficiency claim. In a condemnation action, the condemning authority is taking the property in circumstances wholly unrelated to any action or inaction of the defendant property owner. The property owner has not pledged the property in exchange for an opportunity for financial gain, as Fischer & Frichtel did here. The condemning authority is not acquiring the property for resale but so that it can be put to a public purpose. There is no sale of any type involved, the property owner needs to be compensated for what is being taken from it, and a judicially determined estimate of fair market value is the only way to measure the compensation for the property being taken. Because the condemnor is compelling the transfer, it is appropriate that it bear the risk that a jury will agree with the property owner's opinion of fair market value.

In the case of a foreclosure sale and a deficiency claim, however, the issue is not the measure of damages to the borrower for the taking of its property but how best to make the lender whole through foreclosure of the property that the borrower pledged as collateral for the now defaulted loan. When the borrower has benefitted from the loan secured by the collateral, the lender should not have to bear entirely the risk that a judge or jury will adopt the opinion of value offered by the borrower's appraisal, regardless of whether it accurately reflects what the property can or will actually sell for.

5. Current economic conditions do not warrant abandoning settled law.

Fischer & Frichtel argues that this Court should abandon the holdings in *Reed, Drannek,* and *Hewitt* and adopt section 8.4 of the Restatement because those case do not reflect the "contemporary understanding of deficiency actions following foreclosure." App. Br. 26. Fischer & Frichtel never explains what "contemporary understanding" it is referring to or how the nature of deficiency actions following foreclosure are different now than they have ever been. If Fischer & Frichtel is referring to the current state of the economy, including the real estate market, the timing of the decisions in *Reed, Drannek Realty,* and *Hewitt* supports the continued application of the measure of damages applied by Missouri courts over the last seven decades. The Supreme Court of Missouri made the same decision in *Hewitt* in 1907 following the depression of 1893. *Reed* and *Drannek Realty* were decided in 1937 and 1940, respectively, during the Great Depression. Consistent with these prior holdings, this Court should not abandon well-settled law with respect to the recovery of debts owed on promissory notes because of the economic downturn experienced at the end of the last decade.

Contrary to the entire theme of Fischer & Frichtel's brief, the facts of this case highlight the practical realities that support the current measure of damages and directly rebut Fischer & Frichtel's false premise that a deficiency based on the foreclosure bid price leads to a windfall. Since foreclosing on the property, First Bank has been unable to sell the property even at a price far below the purported fair market value provided by Fischer & Frichtel's appraiser. If the amount due on the Note were offset by Fischer & Frichtel's estimate of "fair market value," First Bank would suffer additional losses of hundreds of thousands of dollars because it cannot sell the property for anything close to what the borrower's appraiser claimed it is worth.

The existing law reflects an appropriate allocation between the lender and borrower of the risks inherent in a loan secured by a deed of trust, including the risks associated with a lender's attempt to sell property at and after a foreclosure sale. The Court should reject Fischer & Frichtel's request that it change the law and shift that entire risk to the lender, so that Fischer & Frichtel can walk away from the obligations that it assumed under contract and Missouri law.

6. A change in the deficiency standard would affect the entire secured lending system.

Contrary to Fischer & Frichtel's claim that its new standard would only affect the evidence and instructions at a deficiency hearing, the measure of damages set forth in Instruction 7 would implicate Missouri's entire secured lending system involving real property. Missouri's statutory process for foreclosure is not designed for the determination of fair market value, but is intended to provide a fair and reasonable procedure for selling collateral while leaving a share of the ultimate risk on the borrower who defaulted under the terms of the loan documents. Implementation of a "fair market value" standard would necessarily affect not only that statutory foreclosure procedure but also the loan terms themselves. Changing the measure of deficiency damages would inject into every foreclosure the issue of fair market value, involving a battle of competing appraisers and increasing the burden on the courts.

Adoption of a “market value” standard will trigger appraisals and “fair market value” disputes long before the deficiency hearing. As a practical matter, the issue of “fair market value” will have to be addressed prior to the foreclosure sale, because the lender could not allow a third party to purchase the property at a foreclosure sale unless the market value is established before the sale or the borrower agreed that the foreclosure sale price paid by the third party reflected fair market value.

Consider, for example, a foreclosure sale in which, in addition to the holder of the promissory note, other parties appear, competitive bidding occurs, and one of those other parties bids a higher amount than the lender and purchases the property. What if, in subsequent litigation to recover the deficiency from the borrower, the amount paid at the foreclosure sale is deemed to be less than the “market value” for the property at the time and the deficiency is reduced based on appraised market value? Even if the lender is able to recover the deficiency (usually a big if), it will never be made whole because the foreclosed property was sold to a third party. Indeed, even if the property is sold at the foreclosure sale for an amount the lender believes to be or is told by its appraiser is the fair market value of the property, the lender is still subject to claims by the borrower that the fair market value, as estimated by another appraiser, was higher than the market value as determined by a competitive bidding process.

Adoption of a fair market value standard would also affect the original loan negotiations themselves. If the law is changed and lenders are forced to assume the risk that they cannot sell the property for a "market value" the borrower's appraiser or a jury assigns to it, lenders will be forced to protect themselves by changing the terms of the loan to account for that increased risk by increasing interest rates, adjusting other loan terms, or requiring a borrower to contribute substantial equity or other collateral. Loans will become more costly for borrowers and harder to obtain. This simply is not the quick and easy "fix" Fischer & Frichtel pretends it to be, and may ultimately harm the very borrowers whose interests Fischer & Frichtel claims to be protecting.

D. Any change to the standard for measuring deficiency damages should be made by the legislature.

As discussed above, the change in law requested by Fischer & Frichtel would affect the entire lending process, from the negotiation of the loan terms through any foreclosure and deficiency claim. If there is to be a fundamental policy change like the one Fischer & Frichtel proposes – from the existing law that is reasonably based on the realities of the marketplace to one that favors even a sophisticated developer who chooses strategic default over renegotiation and payment – then that policy change should be made by the legislature after considering its broader impact on the lending system.

Before a change of this scope is adopted – particularly when all existing loans were negotiated based on the existing law – a multitude of issues must be considered and answered. How is fair market value defined? Would the reasonable costs of resale of the property be added to the judgment? Does a fair market value standard adequately take into account holding costs, such as real estate taxes and maintenance costs, which will be incurred by a lender prior to resale of the property? How will fair market value be determined if the foreclosure is by a junior lien holder who purchases the property at a foreclosure sale subject to a senior mortgage? Would this standard apply when a third party purchases the property at a sale? If a third party purchases the property, is the price paid by that party deemed to be the fair market value? Does the standard apply to guarantors as well even though they guaranty the debt regardless of the collateral values? Will a fair market value standard apply to all secured transactions or only to homestead properties? Can the parties agree to a different standard? In addition incorporation of a market value component also necessarily requires a mechanism or procedure for resolving disagreements over that value, whether that be before or after the foreclosure sales. As discussed above, unless the parties agree to a market value, each and every foreclosure sale would necessitate a determination of fair market value so that the lender can fairly assess the risks of selling the property to a third party.

Moreover, adopting the Restatement (Third) of Property standard cannot be done in isolation without reevaluating Missouri's entire statutory foreclosure scheme. The Missouri legislature has enacted statutes that provide for an expedited foreclosure process. *See* §§ 443.010-.440, RSMo 2005. These statutes, including amendments, were passed in the context of Missouri common law. "[T]he legislature is presumed to know the state of the law when enacting a statute." *Wiley v. Homfeld,* 307 S.W.3d 145, 149 (Mo. App. W.D. 2009). The Court must presume that when adopting Missouri's expedited foreclosure process the legislature was aware that Missouri law allowed a lender to recover damages based on the difference between the amount due and the prevailing bid at the foreclosure sale.

The change in law that Fischer & Frichtel requests also would require a fundamental restructuring of foreclosure sales, in an attempt to generate fair market value at a sale. In order to increase the possibility that a foreclosure sale would generate an offer equal to an appraiser's opinion of fair market value, a long process of advertising the property for sale, employing brokers, and allowing prospective purchasers access to the property would be necessary with no guarantee that anyone would bid fair market value. The expedited foreclosure process long settled in Missouri was never designed to accommodate such a process nor has it ever been contemplated. While some states, such as New Jersey, Connecticut, and Florida, have adopted such a "fair market value approach," many are judicial foreclosure states with long foreclosure processes involving laws much different than Missouri's. These issues should not be addressed by the courts on an *ad hoc* basis, as they arise in litigation. If any change is to be made in Missouri, it should be made by the legislature.

The vast majority of states that utilize some market value component have done so by statute, and the circumstances in which market value is considered vary widely. For example, in some states, a deficiency is only reduced by the fair market value when the foreclosed property is a residential homestead. *See, e.g.*, N.J. Stat. Ann. § 2A:50-3 (West 2000); *cf.* N.J. Stat. Ann. § 2A:50-2.3 (West 2000). In other states, the property's fair market value is considered only when it is raised as an affirmative defense by the debtor (as does Restatement section 8.4 when read in its entirety). *See, e.g.*, Colo. Rev. Stat. §

38-38-106(6) (2007); Tex. Prop. Code Ann. § 51.003(c) (West 2007). Some states only allow a fair market value defense when the mortgagee is the purchaser at the foreclosure sale. *See, e.g.*, N.C. Gen. Stat. § 45-21.36 (2007); S.D. Codified Laws §§ 21-48-14; 21-47-16 (2004). Other states that employ the fair market value standard are judicial foreclosure states that do not provide for a non-judicial foreclosure process like Missouri. *See, e.g.*, Kan. Stat. Ann. § 60-2415 (2005); N.D. Cent. Code § 32-19-06.1 (2010); S.C. Code Ann. § 29-3-660 *et seq.* (2007).

The variation in how states consider a property's fair market value in calculating a deficiency judgment reflects the complexity of the issues involved and the different approaches to those issues. Any adoption of a system that includes a market value component should be made by the legislature after it has addressed the policy issues raised above and assessed the effect any change would have on Missouri's lending system.

E. If the Court adopts Restatement section 8.4, it should only apply prospectively.

Not only is Fischer & Frichtel urging the Court to disregard the express terms of the Deed of Trust, it also is asking the Court to apply retroactively a new legal standard to Fischer & Frichtel's loan transaction with First Bank. If the Court is inclined to change the standard with respect to calculating the amount of deficiency judgments urged by Fischer & Frichtel, it should not apply any such new standard to this case or any existing loan.

Fundamental notions of fairness dictate that the transaction between First Bank and Fischer & Frichtel be governed by the well-settled law that was in place when the parties entered into that transaction. For example, when the Missouri legislature revised section 443.310 to require 20-days notice of foreclosure sales, the new law only applied to deeds of trust executed after its enactment. § 443.310, RSMo 2005. It did not apply retroactively to deeds of trust executed under the prior law. First Bank should not be penalized by a retroactive application of any new standard when it reasonably assumed that existing Missouri law would govern this loan transaction, including available remedies upon a default by the borrower.

For the same reasons ex post facto laws are prohibited – fairness, notice to the public of the law and the consequences for failing to adhere to it, and due process – the Court should not impose changes to existing law that materially alter the costs and benefits associated with a bargained-for contract.

Moreover, changing Missouri law to require consideration of a purported market value, as reflecting the opinion of an appraiser, should not, by itself, alter existing contracts that provide otherwise. Here, the Deed of Trust expressly states that the property shall be sold to the "highest bidder" at the foreclosure sale and that First Bank is entitled to the deficiency remaining after accounting for such bid. Exhibit 8. If the Court does adopt the portion of the Restatement section advocated by appellant, it should only apply the new standard prospectively to transactions in which the deed of trust does not provide otherwise. It should not apply to this case.

F. Even if the Court adopts Restatement section 8.4 and applies it to this case, the proper remedy is a retrial so that First Bank can present evidence of market value.

Fischer & Frichtel argues that if the Court adopts a "fair market value" standard and applies it to this case, the relief should be reinstatement of the jury verdict. First Bank did not present any evidence at trial of the fair market value at the time of the foreclosure sale. First Bank cannot be faulted and should not be penalized for failing to present evidence that was irrelevant under well-settled law and the terms of the governing contract when the case was tried. If the Court adopts the fair market value standard and applies it to this case, the Court should order a retrial to allow First Bank to present evidence of fair market value, so that the case may be fairly tried under the new standard.

The damages instruction the trial court gave the jury was reversible error because it was contrary to Missouri law and contrary to the express terms of the Deed of Trust. The instruction resulted in a verdict for substantially less than the amount to which First Bank is entitled. For that reason, First Bank is entitled to a new trial to establish the amount of damages owed by Fischer & Frichtel under the Note, and the Court should affirm the trial court's order granting First Bank's motion for a new trial on damages.

II. The trial court did not err in denying Fischer & Frichtel's motion for judgment notwithstanding the verdict because First Bank presented sufficient evidence to support the jury's award of interest.

A. Standard of Review.

In reviewing the denial of a motion for directed verdict or JNOV, the appellate court must "view the evidence in the light most favorable to the verdict, considering only that which supports it, and disregarding contrary evidence and inferences." *Roark Motor Lodge Interval Sales Corp. v. Lindner*, 779 S.W.2d 684, 686 (Mo. App. E.D. 1989). The "amount of damages awarded to a successful party is primarily for the jury, and its broad discretion in fixing the amount is conclusive on appeal . . . ." *Id.* "An appellate court should exercise its power to interfere with the judgment of the jury and trial court with hesitation and only when the verdict is manifestly unjust." *Alcorn v. Union Pac. R.R.*, 50 S.W.3d 226, 249-50 (Mo. banc 2001).

An appellate court may "reverse the jury's verdict for insufficient evidence only where there is a complete absence of probative fact to support the jury's conclusion." *Klotz v. St. Anthony's Med. Ctr.*, 311 S.W.3d 752, 769 (Mo. banc. 2010); *see also Newell Rubbermaid, Inc. v. Efficient Solutions*, *Inc.,* 252 S.W.3d 164, 170 (Mo. App. E.D. 2007). The appellate court "is not required to determine the mental process by which the jury could have reached its conclusion; it is only obliged to determine that there was evidence from which such conclusion could have been reached by a jury composed of reasonable men and women." *Reed v. Sale Mem'l Hosp. & Clinic*, 698 S.W.2d 931, 936 (Mo. App. S.D. 1985).

B. If the trial court's order granting First Bank's motion for a new trial is affirmed, the amount of interest the jury awarded in the first trial is irrelevant.

This Court does not need to address the issue raised by Fischer & Frichtel with respect to the jury's award of interest if it affirms the trial court's order granting First Bank's motion for a new trial on damages. The interest issue will be moot if First Bank is entitled to a new trial on damages because the jury will be asked to calculate interest on a different damages number and for a longer period of time. Accordingly, the argument that follows need only be considered if this Court reverses the trial court's order granting First Bank a new trial.

C. First Bank presented sufficient evidence of the amount of interest due under the Note.

First Bank introduced the Note, which included the interest-rate terms for the loan. Exhibit 1. First Bank also presented witness testimony as to the amount of outstanding interest owed on the Note. Tr. at 156:21-25. The witness also testified as to how that amount was calculated. Tr. at 157:1-7. Thus, the trial court did not err in denying Fischer & Frichtel's motion for JNOV because First Bank presented evidence sufficient to support the jury's verdict.

Fischer & Frichtel's contention that a plaintiff seeking to recover interest on a variable-rate note must introduce evidence of every fluctuation in the interest rate is not supported by Missouri law. In support of its argument, Fischer & Frichtel relies solely on *St. Louis Realty Fund*, which is distinguishable.

In *St. Louis Realty Fund v. Mark Twain South County Bank 21*, 651 S.W.2d 568 (Mo. App. E.D. 1983), borrowers on a promissory note brought an action to reform the note's interest-rate terms. The trial court entered an order clarifying the interest terms and assessed an amount of accrued unpaid interest against the borrowers. *Id*. at 572. Unlike the current case, the lender did not introduce any evidence regarding the total amount of interest owed. The court of appeals agreed with the borrowers and held that there was "no substantial evidence to support" the trial court's award of interest. *Id*. at 575.

In *Student Loan Marketing Ass'n v. Raja*, 914 S.W.2d 825 (Mo. App. W.D. 1996), the court of appeals affirmed an award for accrued interest on a variable-rate note when evidence of all the applicable interest rates had not been introduced. The notes at issue in *Raja* had variable interest rates "based on the 90-day Treasury bill, plus 3.5 percentage points . . . ." *Id*. at 827. The borrower appealed the trial court's assessment of accrued interest due under the notes. *Id*. at 831. The borrower argued that the award was not supported by substantial evidence because "the record [was] devoid of any evidence regarding the interest rates that were charged on the three notes . . . ." *Id*. The court held "there was substantial evidence to support the trial court's determinations regarding the amount of interest accrued." *Id*. The court noted that the documents entered into evidence contained principal calculations "based upon" the interest rates, the lender introduced testimony regarding the amounts due on the notes, and the borrower did not present any evidence challenging the interest calculations. *Id*.

Unlike the plaintiff in *St. Louis Realty Fund* and like the plaintiff in *Raja*, First Bank did offer evidence of how much interest had accrued on the Note: First Bank's representative testified that $75,642.46 in interest was due on the Note. Tr. at 156:21-25. Furthermore, First Bank's representative explained how that amount was calculated. Tr. at 157:1-7. First Bank introduced the Note into evidence. Exhibit 1. Fischer & Frichtel did not introduce any evidence at trial to challenge the amount of outstanding interest submitted by First Bank. First Bank was not required to introduce evidence of the amount of the "Prime Rate" at every given time over the life of the Note. *Raja,* 914 S.W.2d at 831.

When viewed in the light most favorable to the jury's interest award, the jury's verdict should be affirmed. Thus, Fischer & Frichtel's motions for directed verdict and JNOV on the issue of interest were properly denied.

In the event the Court reverses the trial court's order granting First Bank's motion for a new trial and then also finds the jury's verdict as to the amount of interest owed unsupported by evidence, the Court should still remand to the trial court to hear additional evidence on the interest issue. In *St. Louis Realty Fund*, the court remanded only the part of the judgment found to be unsupported by evidence: "This part of the judgment must be reversed and remanded to allow the trial court the opportunity to hear additional evidence sufficient to support its finding." 651 S.W.2d at 575. Once a jury has found for the holder of a promissory note, its damages in the form of principal, interest, and attorney fees follow as a matter of law. The trial court may calculate these amounts and enter judgment accordingly. *Campbell v. Kelley,* 719 S.W.2d 769, 772 (Mo.

banc 1986) (after jury returned a verdict for the holder of a promissory note but did not award any interest, the Supreme Court of Missouri remanded to the trial court to modify the judgment to include an award of interest at the rate specified in the promissory note).

III. The trial court did not err in rejecting Fischer & Frichtel's proffered affirmative defense instruction based on the doctrine of good faith and fair dealing. First Bank did not have a duty to renew the note and did not have a duty to pay fair market value for the property at the foreclosure sale as a matter of law, and the instruction proferred misstated the applicable law and was defective in form.

A. Standard of review.

An appellate court reviews the trial court's refusal to give a proffered instruction *de novo*. *Ploch v. Hamai*, 213 S.W.3d 135, 139 (Mo. App. E.D. 2006). The instruction must be supported by the evidence and the law. *Id.* The court reviews the refused instruction in the light most favorable to submission of the instruction and will only reverse if the error resulted in prejudice and materially affected the merits of the action. *Id*.

B. The trial court did not err in rejecting Fischer & Frichtel's proffered jury instruction on the affirmative defense of breach of the duty of good faith and fair dealing because, as a matter of law, First Bank did not have a duty to renew the Note and did not have a duty to pay fair market value for the property at the foreclosure sale.

Missouri law implies a covenant of good faith and fair dealing in the performance and enforcement of existing contracts. *Cordry v. Vanderbilt Mortg. & Fin., Inc.,* 370 F.Supp. 2d 923, 930 (W.D. Mo. 2005). "The covenant of good faith and fair dealing is not an overflowing cornucopia of wished-for legal duties." *Zubres Radiology v.*

Providers Ins. Consultants, 276 S.W.3d 335, 340 (Mo. App. W.D. 2009). Rather, it only acts to prevent "opportunistic behavior, that is, the exploitation of changing economic conditions to ensure gains in excess of those reasonably expected at the time of contracting." *Id.* (emphasis added).

A breach of the duty of good faith and fair dealing occurs when a party, in bad faith, utilizes contract language that provides for unilateral action to improperly deny the other party the expected benefits flowing from the contract. *Cordry,* 370 F.Supp. 2d at 930. The implied duty of good faith and fair dealing does not operate to override the express terms of an agreement. *Id.* Missouri courts have rejected the notion that a general obligation of good faith in the performance of a contract gives rise to liability where a lender demands repayment or takes other action expressly authorized by a loan document. *Id.* at 930-31; *Centerre Bank of Kan. City, N.A. v. Distribs., Inc.*, 705 S.W.2d 42, 46-48 (Mo. App. W.D. 1985).

Fischer & Frichtel did not introduce any evidence to establish, and has not claimed, that First Bank violated the terms of any loan documents. In its proffered jury instruction, Fischer & Frichtel set forth two bases for First Bank's alleged breach of the duty of good faith and fair dealing: (1) First Bank failed "to renew the note on commercially reasonable terms" or (2) First Bank purchased "the property at foreclosure for less than fair market value."[5] LF 933. In its brief, Fischer & Frichtel claims a third

[5] Fischer & Frichtel's proposed instruction read: "You must find for Defendant if you believe that: 1. The Note conferred upon Plaintiff a discretionary power to fail to renew

basis ("by arranging the foreclosure sale to avoid any other bidders"); however, because this basis was not set forth in the proffered instruction, it should be disregarded. *Belden v. Donohue,* 325 S.W.3d 515, 518 (Mo. App. S.D. 2010) ("An issue raised for the first time on appeal and not presented to or decided by the trial court is not preserved for appellate review."). Through its proposed instruction, Fischer & Frichtel attempted to impose obligations on First Bank that are not contained in the Note or Deed of Trust, but in fact undermine the very terms and purpose of those documents.

Pursuant to the express terms of the Note, Fischer & Frichtel agreed that "this Note may, at the sole option of Bank, be extended or renewed one or more times . . ." Exhibit 1. In addition, the Deed of Trust provides that "Bank may bid and become purchaser at any sale under this Deed of Trust" without specifying any minimum price that First Bank, or any other purchaser, is required to pay at a foreclosure sale. Exhibit 8 at ¶ 12.

In light of the express authority contained in the Note and Deed of Trust and under Missouri law, First Bank could refuse to renew the Note and could purchase the property

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the note and to initiate foreclosure of the subject property in the event of non-payment; and 2. Plaintiff exercised its discretionary power under the Note in violation of the duty of good faith and fair dealing, as that term is defined in Instruction No. __ by failing to renew the note on commercially reasonable terms or by purchasing the property at foreclosure for less than fair market value." LF 894.

at the foreclosure sale if it was the highest (or only) bidder. *State v. Nationwide Life Ins. Co.,* 340 S.W.3d 161, 194 (Mo. App. W.D. 2011). As a matter of law, First Bank did not have a duty to renew the Note at all, much less on terms that Fischer & Frichtel may have preferred, and did not have a duty to pay "fair market value" for the property at the foreclosure sale. *Cordry*, 370 F. Supp. 2d at 930-31; *Centerre Bank,* 705 S.W.2d at 46-48. Accordingly, the trial court properly refused this instruction.

Although Fischer & Frichtel claims First Bank had a duty to renew the Note on "commercially reasonable terms" and to pay "fair market value" for the property at the foreclosure sale, it has not provided any legal support for that contention.[6] Rather, it cites two cases, *Regional Investment Co. v. Willis,* 572 S.W.2d 191 (Mo. App. 1978) and *City of St. Joseph v. Lake Contrary Sewer District,* 251 S.W.3d 362 (Mo. App. W.D. 2008), neither of which is applicable.

In *Willis*, the plaintiff lender held a deed of trust to property that the defendant borrower pledged as collateral to secure a $27,500 promissory note. *Id.* at 192. After the defendant borrower defaulted on the note, the plaintiff purchased the property at a foreclosure sale for approximately $21,000—less than the full amount owed under the note—and filed a petition against the borrower for the deficiency of approximately

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[6] Remarkably, Fischer & Frichtel also seems to suggest that First Bank had an obligation to renew the Note only on the same terms as previous renewals. Fischer & Frichtel offers no support for this meritless argument, which would require a lender considering renewal to ignore changing market conditions.

$6,500. However, before the foreclosure sale, the plaintiff had already entered into a contract with a third party for the sale of the subject property. The sale price under the pre-foreclosure contract was $29,000—an amount greater than the balance due on the note. The contract between the plaintiff and third-party purchaser expressly provided that the sale would be completed after the plaintiff obtained title to the property at the foreclosure sale. *Id.*

The *Willis* court reversed the trial court's entry of summary judgment in favor of the plaintiff for the amount of the deficiency. *Id.* at 191. In doing so, it held genuine issues of fact existed as to whether the plaintiff was entitled to a deficiency because of the questionable fairness of the sale in light of the plaintiff's pre-foreclosure contract for the sale of the property for an amount greater than the defendant's debt.

Willis is easily distinguishable from the case before the Court because there was no evidence that before the foreclosure sale First Bank entered into a contract for the sale of the property for an amount greater than the balance due under the Note. Rather, First Bank introduced evidence that at the time of trial, over a year after the foreclosure sale, it still owned the nine lots and had not received any proceeds from a sale to a third party. Tr. at 155:11-12. There is no evidence that First Bank manipulated the process to ensure gains in excess of those contemplated by the terms of the Note.

City of St. Joseph is also distinguishable. The plaintiff in *City of St. Joseph* had contracted to treat the sewage of two neighboring suburbs. *City of St. Joseph,* 251 S.W.3d at 365. The plaintiff then passed an ordinance that required the two suburbs to perform comprehensive and expensive testing and inspections of their sewer lines, with which the suburbs refused to comply. Thereafter, the plaintiff filed an action against the suburbs seeking, along with injunctive relief, a declaration that they were required to comply with the new ordinance. *Id.* Although the original contract specifically required the suburbs to comply with any sewer ordinances the plaintiff passed in the future, the court held the new ordinance did not comport with the covenant of good faith and fair dealing and thus denied the plaintiff the equitable relief it sought. *Id.* at 365, 368.

The ordinance in *City of St. Joseph* was not applicable to the plaintiff's own sewer system—only the defendants' systems. *Id.* at 366. Complying with the ordinance would cost the defendants between $50,000 and $150,000 each. *Id.* "The 2005 ordinance attempts to fundamentally restructure the agreements in a manner that provides negligible benefit to [the plaintiff] at a significant cost to [the defendants] without a reasonable motive or purpose for imposing such a cost." *Id.* at 370. Although the plaintiff argued its contract with the defendants gave it the express right to pass the subject ordinance, the court disagreed and held that the plaintiff did not pass the ordinance in good faith. *Id.* at 370-72.

Again, none of the facts giving rise to the claim of breach of the duty of good faith and fair dealing in *St. Joseph* are present here. First Bank only took actions expressly authorized by and provided for in the loan documents. It did not make any unilateral changes to Fischer & Frichtel's obligations under the loan documents, much less force any fundament changes, as the plaintiff did in *St. Joseph.* Moreover, unlike the situation in *St. Joseph*, the loan documents expressly gave First Bank the right, at its sole discretion, not to renew the Note and to purchase the property at a foreclosure sale, without specifying a required minimum price. Exhibits 1, 2 at ¶ 12; *Nationwide Life Ins. Co.*, 340 S.W.3d at 194. *St. Joseph* does not support Fischer & Frichtel's argument that the trial court erred in rejecting the proffered instruction on the affirmative defense of breach of the duty of good faith and fair dealing.

The record does not support any claim that First Bank acted in bad faith with regard to the renewal of the Note or the foreclosure of the property. Not only did First Bank renew the Note multiple times, but it offered to renew again on terms that reflected the changing market and were consistent with the terms Fischer & Frichtel were offered by Centrue Bank. Apparently, Fischer & Frichtel defines "commercially reasonable" with reference only to its own preferences and without reference to the realities of the marketplace. Fischer & Frichtel chose to reject loan renewal terms consistent with those offered by other banks and opted instead for a strategic default, leaving First Bank no choice but to foreclose. First Bank did nothing wrong, Fischer & Frichtel's allegations of a lack of good faith are spurious, and the court properly rejected the proffered instruction.

C. The trial court did not err in rejecting Fischer & Frichtel's proffered jury instruction on the affirmative defense of breach of the duty of good faith and fair dealing because the instruction misstates the applicable law and is defective in form.

Even assuming Missouri law supported the submission of an affirmative defense of breach of the duty of good faith and fair dealing, the instruction proffered by Fischer & Frichtel misstates Missouri law and is defective in form.

"The test of correctness of an instruction is how the instruction will naturally be understood by the average juror. Jurors should be credited with ordinary intelligence, common sense, and an average understanding of the English language." *Columbia Mut. Ins. Co. v. Long,* 258 S.W.3d 469, 474 (Mo. App. W.D. 2008). Instructions that are confusing, that misstate Missouri law, and that create a roving commission by submitting abstract legal questions to the jury are defective in form and should not be submitted to the jury. *Id.* at 476-77. An instruction improperly constitutes a roving commission when it submits "a 'pure question of law' in such broad language as to permit the jury to find a verdict 'without being limited to any issues of fact or law developed in the case.'" *Hustad v. Cooney,* 308 S.W.2d 647, 650 (Mo. 1958).

The language in the proposed instruction, including "discretionary power" and "on commercially reasonable terms," is vague and confusing. This language, particularly the phrase "on commercially reasonable terms," fails to provide adequate guidance to the jury on what conditions must exist or the context in which the jury must consider the evidence in determining whether or not First Bank's renewal terms were commercially reasonable. The giving of Fischer & Frichtel's proffered instruction would have created a roving commission because the jury would have been free to apply its own standards in deciding whether First Bank's conduct was commercially reasonable.[7]

Moreover, the second half of the instruction would have directed a verdict for Fischer & Frichtel because it only required the jury to find that First Bank "purchas[ed] the property at foreclosure for less than fair market value." Because First Bank itself

[7] Fischer & Frichtel did not present any expert testimony at trial about what constituted commercially reasonable terms.

admitted that it did not pay market value at the foreclosure sale due to the very nature of a foreclosure sale, giving the proffered instruction would have necessarily and improperly resulted in a verdict in favor of Fischer & Frichtel. Tr. at 159:4-10.

Fischer & Frichtel also proposed a definition of good faith and fair dealing that is defective in form.[8] The language of the proposed definition, particularly the terms "opportunistic way," "exploitation of changing economic conditions," and "gains in excess of those reasonably expected at the time of contracting," is argumentative, vague, confusing, and would have constituted a roving commission. Such a definition would not have provided the jury adequate guidance to understand the context in which they were to determine whether First Bank breached any duty of good faith and fair dealing.

Not only does Missouri law support the trial court's refusal to give Fischer & Frichtel's proposed instruction on breach of the duty of good faith and fair dealing, but the instruction itself misstates Missouri law and is defective in form. Accordingly, the trial court did not err in rejecting the instruction. *Columbia Mut.,* 258 S.W.3d at 477.

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[8] Fischer & Frichtel's proposed instruction read: "'Good faith and fair dealing,' as used in these instructions is a duty on a party to a contract which prohibits it to exercise any discretionary power granted to it in that contract in an opportunistic way, that is, the exploitation of changing economic conditions to ensure gains in excess of those reasonably expected at the time of contracting." LF 895.

IV. The trial court did not err in rejecting Fischer & Frichtel's affirmative defense instruction on commercial frustration because the downturn in the housing and credit markets is not a basis for a commercial frustration defense under Missouri law and because the instruction proferred misstated the applicable law and was defective in form.

A. Standard of review.

First Bank adopts and incorporates the Standard of Review set out under Point III.

B. The trial court did not err in rejecting Fischer & Frichtel's proffered jury instruction on the commercial frustration affirmative defense because a downturn in the housing and credit markets is not a basis for such defense as a matter of law.

Missouri law does not support Fischer & Frichtel's proffered jury instruction on the commercial frustration affirmative defense.[9] It is clear that a "dramatic downturn" in the "housing market" and "availability of credit" do not excuse a borrower from its obligation to repay a lender under the doctrine of commercial frustration. The *Reed, Drannek Realty,* and *Hewitt* courts all expressly refused to excuse a borrower from its

[9] Fischer & Frichtel's proposed instruction read: "You must find for Defendant if you believe: 1. There was a dramatic downturn in the housing market and availability of credit which particularly affected the St. Albans subdivision; 2. That the dramatic downturn was not foreseen by the parties and not caused by or under the control of either party; and 3. That the downturn destroyed or nearly destroyed the value of the performance or the object or purpose of the Note." LF 893.

original loan obligations because of a "dramatic downturn" in the country's economic conditions. *Drannek Realty,* 139 S.W.2d at 928; *Hewitt,* 102 S.W. at 651; *Reed*, 102 S.W.2d at 713-15. Fischer & Frichtel has not cited any Missouri law authorizing application of the doctrine of commercial frustration to these facts.

The Missouri Court of Appeals has only upheld the application of the doctrine of commercial frustration one time since the Supreme Court of Missouri first recognized this defense in 1949. In *Howard v. Nicholson,* 556 S.W.2d 477 (Mo. App. 1977), the court applied the doctrine of commercial frustration to excuse a landlord from a contract with a third-party contractor to construct a building for the specific needs of a proposed tenant, after the proposed tenant went into bankruptcy. The purpose of the contract – the construction of a building for the tenant – was completely destroyed by the tenant's bankruptcy. *Id.* at 483. Because the contractor was aware of the sole purpose for the construction of the proposed building, the court held that, under the doctrine of commercial frustration, the tenant's unforeseen bankruptcy excused the landlord's performance under the construction contract. *Id.* at 483-84.

In this case, the purpose of the Note – to loan Fischer & Frichtel money – was not completely destroyed by the downturn in the housing or credit market. First Bank did, in fact, loan $2,576,000 to Fischer & Frichtel and Fischer & Frichtel developed and sold 12 of the 21 lots it acquired. Tr. at 135:17-21; 146:22-147:3. Fischer & Frichtel then failed to pay the balance due when the loan matured and failed to sell the remaining 9 lots. Tr. at 143:12-24. Because the purpose of the Note was not completely destroyed by the downturn in the housing or credit market, the court's holding in *Howard* did not support the giving of the proffered commercial frustration instruction in this case.

In opinions since *Howard,* Missouri courts have repeatedly held the doctrine of commercial frustration should be applied sparingly so as to preserve the certainty of contracts. *Adbar, L.C. v. New Beginnings C-Star*, 103 S.W.3d 799, 802 (Mo. App. E.D. 2003) (reversing the trial court's judgment and holding the trial court erroneously applied the law when it excused the tenant's performance under the lease because of the doctrine of commercial frustration); *Kassebaum v. Kassebaum*, 42 S.W.3d 685, 699 (Mo. App. E.D. 2001) ("the trial court did not err in failing to apply the doctrine of commercial frustration"); *Am. Laminates, Inc. v. J.S. Latta Co.,* 980 S.W.2d 12, 19 (Mo. App. W.D. 1998); *Shop 'N Save Warehouse Foods, Inc. v. Soffer,* 918 S.W.2d 851, 863 (Mo. App. E.D. 1996).

Fischer & Frichtel is again asking this Court to create new law – law which would excuse a borrower from its obligation to repay a lender if the housing market or the economy does not perform as well as a borrower had hoped. Enlarging the scope of this doctrine to apply in circumstances urged by Fischer & Frichtel would take the certainty out of the repayment of all loans and would turn commercial lending on its head. This is the precise result that Missouri courts have repeatedly shunned and that the trial court properly avoided in refusing to submit Fischer & Frichtel's proposed instruction on this affirmative defense.

Fischer & Frichtel attempts to downplay the impact of the change in law it advocates by claiming that its circumstances were unique, in that the agreement with St.

Albans allowed one other approved developer and the high-end home market was particularly hard hit by the economic downturn. The first factor is immaterial and certainly was not unexpected. Fischer & Frichtel knew from the beginning that there was only one other approved developer. Tr. at 212:3-12.

Moreover, Fischer & Frichtel is not a destitute home builder suffering some unique impact from an economic downturn. In 2005, Fischer & Frichtel earned $100 million in revenue, $18-20 million in gross profits, and $3-8 million in net profits. Tr. at 250:1-17. In 2006, Fischer & Frichtel earned $80 million in revenue, $14.5 million in gross profits, and $2.5-6.5 million in net profits. Tr. at 250:18-251:8. In 2007, Fischer & Frichtel earned $75 million in revenue and $12 million in gross profits. Tr. at 251:9-16. In 2008, Fischer & Frichtel was in business and sold 148 homes. Tr. at 252:4-9. In 2008, Fischer & Frichtel paid its employees, its president John Fischer, its electric bill, and its heating bill, but chose to not pay First Bank the amount due on the Note. Tr. 246:8-250:1.

The argument that a successful home builder such as Fischer & Frichtel should get the benefit of this doctrine because it claims to have been affected more severely by an economic downturn would result in an absurdly haphazard expansion of this narrow doctrine. Would it apply on an industry by industry basis (car dealers could claim it but not pharmaceutical companies)? On a product by product basis (RV dealers but not small car dealers)? On a geographic basis (businesses in Michigan but not Texas)? And by what standards would jurors be expected to assess whether the impact was sufficiently worse on a particular defendant to allow that defendant to avoid its contractual obligations while others were required to honor theirs? Fischer & Frichtel proposes an expansion of the commercial frustration doctrine that is not only contrary to Missouri law, but is unfair, unworkable, and predictably self-serving.

Under Missouri law, the downturn in the housing or credit markets is not a basis to excuse Fischer & Frichtel from its obligations to First Bank on a theory of commercial frustration. The trial court did not err when it refused the instruction tendered by Fischer & Frichtel.

C. The trial court did not err in rejecting Fischer & Frichtel's proffered jury instruction on the commercial frustration affirmative defense because the instruction misstates the applicable law and is defective in form.

Even if Missouri law supported the submission of the commercial frustration affirmative defense, the trial court properly rejected the instruction proffered by Fischer & Frichtel because it misstates the applicable law and is defective in form.

"The test of correctness of an instruction is how the instruction will naturally be understood by the average juror. Jurors should be credited with ordinary intelligence, common sense, and an average understanding of the English language." *Columbia Mut.,* 258 S.W.3d at 474. Instructions that are confusing, that misstate Missouri law, and that create a roving commission by submitting abstract legal questions to the jury are defective in form and should not be submitted to the jury. *Id.* at 476-77. An instruction improperly constitutes a roving commission when it submits "a 'pure question of law' in such broad language as to permit the jury to find a verdict 'without being limited to any issues of fact or law developed in the case.'" *Hustad,* 308 S.W.2d at 650.

The language in the proposed instruction, including "dramatic downturn in the housing market," "particularly affected the St. Albans subdivision," and "destroyed or nearly destroyed the value of the performance or the object or the purpose of the note," is argumentative, vague, and confusing. This language fails to provide adequate guidance to the jury on what conditions must exist or the context in which the jury must consider the evidence in determining whether or not the requirements for commercial frustration have been met. The giving of Fischer & Frichtel's proffered instruction would have created a roving commission because the jury would have been free to apply its own standards in deciding whether the requirements for commercial frustration existed.

In addition to the fact that the instruction is unsupported by Missouri law, it misstates the applicable law on the commercial frustration defense and is defective in form. For those reasons, the trial court did not err in refusing to submit the instruction to the jury. *Columbia Mut.,* 258 S.W.3d at 477.

CONCLUSION

The Circuit Court's judgment granting First Bank's motion for new trial should be affirmed and the case remanded for a new trial on damages only.

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that on the 11th day of October, 2011, I electronically filed this Plaintiff/Respondent's Supplemental Brief and the accompanying Appendix with the Clerk of the Court using the electronic-filing system. Pursuant to Rule 103.08, service on registered users will be accomplished by the electronic-filing system. I understand that at least one attorney of record for each party is a registered user.

/s/ Thomas B. Weaver

RULE 84.06(C) CERTIFICATE

Pursuant to Rule 84.06(c), the undersigned hereby certifies that Plaintiff/Respondent's Supplemental Brief contains 16,062 words, exclusive of the cover, certificate of service, signature block, this certificate, table of contents and table of authorities, according to the word-processing system's word count, and thus, complies with Rule 84.06(b).

/s/ Thomas B. Weaver