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

APPELLANT'S SUBSTITUTE BRIEF

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JURISDICTIONAL STATEMENT

This case arises from Plaintiff/Respondent's Petition against Defendant/Appellant seeking damages under a suit on a note. After a jury trial, the Court entered judgment pursuant to the jury verdict and awarded Plaintiff/Respondent a money judgment for an amount that was less than what it sought. The Court then granted Plaintiff/Respondent's Motion for New Trial or to Amend Judgment and granted a new trial. Defendant/Appellant appeals from the Circuit Court's judgment.

Given that the issues in this appeal do not involve the validity of a treaty or statute of the United States, the validity of a Missouri statute, or the construction of a provision of the United States Constitution or the Constitution of the State of Missouri, jurisdiction over this appeal was vested in the Missouri Court of Appeals, Eastern District, pursuant to Article V, Section 3 of the Missouri Constitution. The judgment was entered in the Circuit Court of St. Louis County, which is within the territorial jurisdiction of the Missouri Court of Appeals, Eastern District. Section 477.050 RSMo.

On August 9, 2011, the Missouri Court of Appeals, Eastern District, transferred the case by per curiam opinion pursuant to Missouri Supreme Court Rule 83.02 due to the general interest or importance of a question involved in the case.

STATEMENT OF THE FACTS

The following is a summary of the key facts presented at trial in Division 5 of the Circuit Court of St. Louis County on January 25 and 26, 2010:

A. Fischer & Frichtel sought to develop home lots, obtained a loan from First Bank secured by a deed of trust granting a security interest in the subject property, and amended the loan documents repeatedly while it sold lots until the severe recession prohibited sales.

In 2000, Defendant/Appellant Fischer & Frichtel, Inc. ("Fischer & Frichtel") purchased 21 lots in a subdivision in the larger St. Alban's development. Transcript ("Tr.") at 211:11-15. Fischer & Frichtel's business model was to purchase lots in subdivisions, market the lots and its home plans to home buyers, and then construct and sell the homes to the home buyers. Tr. at 208:24-209:8. Fischer & Frichtel financed the purchase of the 21 lots by acquiring a loan from First Bank. Tr. at 136:10-13; 210:13-211:3; 212:1-4; 213:1-7; 214:12-22; 217:9-14.

On June 30, 2000, First Bank loaned $2,576,000.00 to Fischer & Frichtel. Tr. at 135:19-23; Exhibit 1. This was the full purchase price of the lots. Tr. at 213:8-11. The loan was memorialized by a promissory note executed by Fischer & Frichtel ("Note"). Tr. at 136:22-138:16. The Note's maturity date was July 1, 2005. Tr. at 138:22-23. Fischer & Frichtel made principal payments on the Note only when a home (and lot) were sold, as called for in the loan documents with First Bank. Tr. at 213:11-19. The payment was $126,000.00 per lot sold ("lot payoff amount"). Tr. 146:19-147:5. Fischer &

Frichtel put in no cash equity when acquiring the loan. Tr. at 214:23-215:1. Fischer & Frichtel would not have acquired the loan if cash equity was required, because its business model called for revenue to be used to pay employees and to construct and sell homes. Tr. at 215:7-18. From 2000 to 2005, Fischer & Frichtel had "pretty strong" sales of the lots. Tr. at 219:5-8. During that time, Fischer & Frichtel sold 12 of the 21 lots. Tr. at 219:9-10.

Beginning in 2005, the housing market burst and demand for new homes declined sharply. Tr. at 220:19-221:3. First Bank's vice president testified that, in his time and experience as a banker, including 17 years in commercial lending, there had not been a more significant downturn in home sales. Tr. at 135:12-14; 182:22-25. The decline affected the St. Alban's development specifically. Tr. at 221:6-9. In 2005, there were 15 sales in St. Alban's; in 2008, there were only five. Tr. at 221:10-15. Fischer & Frichtel was selling high-end homes in the subdivision, and that area of the home market was experiencing a worse market than low and mid-priced homes. Tr. at 221:19-222:3. First Bank agreed that this aspect of the development made sales of the subject lots especially difficult. Tr. at 182:3-8; 18-21. Fischer & Frichtel sold only one of its St. Alban's lots from 2006 through mid-year 2008. Tr. at 222:25-223:7. The economic decline and Fischer & Frichtel's problems selling lots in St. Alban's were worsened by a requirement imposed by St. Alban's allowing only Fischer & Frichtel and one other homebuilder to build homes in St. Alban's. Tr. at 223:8-14. This "preferred builder" provision restricted Fischer & Frichtel from selling its lots to other builders. Tr. at 223:12-14. First Bank

was aware of the preferred builder provision when First Bank and Fischer & Frichtel began their relationship in 2000. Tr. at 223:15-21. The economic downturn and its particular effect on the subject lots was not foreseen by the bank or Fischer & Frichtel. Tr. at 242:6-10.

The Note was amended six times, each time only extending the maturity date. Tr. at 138:25-139:6; Exhibits 2-7. The amendments changed no other terms. Tr. at 138:25-143:13; Exhibits 2-7. The Note's final modified maturity date was September 1, 2008. Tr. at 142:25-143:4. By that date, Fischer & Frichtel had paid First Bank approximately $1.4 million in principal on the Note from the proceeds of lot sales, and had paid $632,000.00 in interest. Tr. at 219:15-23. At that time, the outstanding balance on the principal amount of the Note was $1,133,875.75. Tr. at 143:18-23. In April 2008, First Bank and Fischer & Frichtel began negotiating for another renewal of the Note. Tr. at 224:9-12. First Bank, for the first time in the parties' history, presented several additional terms as conditions for renewal of the Note. Tr. at 224:13-18. First Bank requested a $283,000.00 cash payment or a personal guarantee from a Fischer & Frichtel principal; an increase in the Note's interest rate from prime minus one-half to prime plus one-half; $13,100.00 in renewal fees; and an increase in the lot payoff amount from $126,000.00 to $162,000.00. Tr. at 224:19-225:5; Exhibit D. First Bank stated in its request that the $283,000.00 cash payment was equal to 25% of the value of the remaining real estate. Tr. at 225:25-226:1; Exhibit D.

The proposed renewal terms were onerous and unfair to Fischer & Frichtel. Tr. at 227:23-228:8. Fischer & Frichtel particularly could not satisfy the $283,000.00 cash payment request. Tr. at 228:9-19. First Bank refused to meet with Fischer & Frichtel to discuss loan renewal. Tr. at 229:1-15.

Fischer & Frichtel reached out to other lenders to refinance the First Bank loan, but was unable to reach agreement. Tr. at 229:16-231:5. Fischer & Frichtel offered a deed in lieu of foreclosure to First Bank. Tr. at 231:6-8. First Bank declined, stating that it was not interested. Tr. at 231:22-25. After Fischer & Frichtel offered the deed in lieu of foreclosure, First Bank stated that it was changing the terms of renewal, and that they were "worse" than previously offered: the interest rate would be prime plus three, $283,000.00 in cash would be paid, and a personal guarantee from a Fischer & Frichtel principal was required, along with one year's interest reserve. Tr. at 232:9-24. At the same time, First Bank threatened to foreclose on the remaining lots and sue Fischer & Frichtel for a deficiency, which First Bank threatened would put Fischer & Frichtel "out of business." Tr. at 232:25-233:12.

B. First Bank arranged the foreclosure sale in a manner to make itself the only bidder so that it could make a winning bid at less than fair market value.

After the latest Note maturity date, September 1, 2008, passed, First Bank sought to foreclose on the nine unsold lots. Tr. at 150:17-22. First Bank hired a trustee to conduct the foreclosure sale. Tr. at 151:4-8. The foreclosure sale was scheduled for December 11, 2008, at the Franklin County Courthouse. Tr. at 152:12-153:5. First Bank required any purchaser to pay cash for the full purchase price of the property on the day of the sale. Tr. at 150:12-16. At the foreclosure sale, First Bank made the only bid, for $466,000.00, and purchased the nine remaining lots. Tr. at 153:23-154:13. First Bank paid no cash for the lots, but instead reduced the outstanding indebtedness of the Note principal by the purchase amount to $667,875.75. Tr. at 154:14-21; 156:13-22.

The foreclosure sale notice was sent only 22 days before the sale took place. Tr. at 185:5-9. First Bank's representative, Paul LaKamp, who had 20 years' banking experience and 17 years in commercial lending, testified that he was very familiar with the process of a customer applying for a loan to purchase property, closing on the loan and property, and the loan being funded. Tr. at 134:12-135:14; 332:3-7. He testified that an applicant who applied for a loan to purchase property such as the subject property would have to undergo a thorough vetting process. *See* Tr. at 332:15-333:16. This can include submitting financial statements, having title work done, commissioning an appraisal, and/or environmental analysis. Tr. at 332:25-333:16. In his experience, "the shortest amount of time and the number of days that the whole process has ever taken"

was 45 days. Tr. at 333:17-24. He could "conceive" the shortest amount of time the process could take as "[a]pproximately 30, 45 days." Tr. at 334:8-10. This was in contrast to the 22 days' notice that First Bank provided before foreclosing on the property. Tr. at 185:5-9.

C. First Bank arbitrarily reduced its bid amount twice based on the same "rationale," and admitted that it did not pay fair market value for the subject property. First Bank also admitted that the manner in which it determined the foreclosure price for the property was not fair.

To arrive at the $466,000.00 bid at the foreclosure sale, First Bank first determined that the value of the lots was $675,000.00. Tr. at 161:4-10. First Bank did not introduce any evidence at trial supporting this alleged value. This amount included a discount "[b]ased on the carrying costs to keep the property up as the new owner of, the HOA fees, [and] . . . the property taxes[.]" Tr. at 161:8-13. First Bank then decided to "further discount[] it from 675 to $466,000[.]" Tr. at 161:13-14. The bank's corporate representative testified that this amounted to unfairly discounting twice for the same thing: the "carry" of the property over a period of time before all lots could be sold. Tr. at 273:6-10 ("Q. Okay. So my question is, in determining the price that it decided to pay at the foreclosure sale, isn't it true that First Bank double-counted the discount for the carry? A. Yes. Q. Your answer is yes? A. Yes. Q. Do you think that's fair? A. No.").

D. Fischer & Frichtel presented substantial evidence that the property's fair market value was substantially more than the amount bid by First Bank at foreclosure.

In its initial demand, on April 15, 2008, that Fischer & Frichtel accept new terms to renew the Note, First Bank demanded $283,000.00 in a cash payment towards the Note. Tr. at 166:19-167:22. First Bank stated in its demand that the proposed $283,000.00 payment towards the $1,133,875.75 Note would have reduced the amount of the loan to 75% of the property's value (the "loan to value," or "LTV"). Tr. at 167:23-168:12. By this demand, First Bank "indicat[ed] . . . that the property had a value of $1,133,000" at that time. Tr. at 169:2-5.

As part of the process of having First Bank approve an extension of the maturity date in 2008, the bank prepared a Commercial Credit Approval Form on June 3, 2008. Tr. a 169:22-170:4; Exhibit D. First Bank believed that all information in the Commercial Credit Form was true and accurate, and the form was relied on by First Bank employees. Tr. at 171:2-13. The outstanding loan balance stated on the Commercial Credit Form was $1,133.875.75. Tr. at 171:14-16; Exhibit D. Each of the nine remaining lots was valued at $126,000.00, and First Bank believed that this value was reasonable. Tr. at 171:17-23; Exhibit D. Nine lots, valued at $126,000.00 each, meant that the total value of the lots was $1,134,000.00. Tr. at 173:15-19. Further, First Bank stated on the Commercial Credit Form that the loan to value ratio of the Note to property was 100%. Tr. at 173:25-174:3; Exhibit D. First Bank found this value reasonable as of June 3,

2008. Tr. at 174:4-8. At the time the Commercial Credit Form was created and distributed at First Bank, no one suggested that the value of the lots was less than the amount indicated or stated that the value was incorrect. Tr. at 174:18-24.

On or about September 4, 2008, Paul LaKamp of First Bank prepared a Residential and LAD Trend Review document. Tr. at 181:17-22; Exhibit F. Mr. LaKamp prepared the form accurately. Tr. at 181:23-182:2. Mr. LaKamp wrote on the form that he had "discussed the value of the remaining nine lots with [a First Bank appraiser] and determined that [$]126,000 per lot is appropriate." Tr. at 183:1-14; Exhibit F. He also wrote that the loan to value ratio remained at 100%; therefore, the value of the property was the same as the outstanding amount of the Note. Tr. at 183:18-184:1.

On or about September 5, 2008, Mr. LaKamp also prepared a Change in Loan Status form addressing the Fischer & Frichtel Note. Tr. at 179:24-180:4; Exhibit G. He prepared the document accurately. Tr. at 180:5-7. Mr. LaKamp concluded on the form that the lots were valued at $1,134,000.00, and that the loan to value ratio was 100%. Tr. at 180:8-14. Mr. LaKamp and two other First Bank employees signed the Change in Loan Status form, indicating that they agreed with the information provided. Tr. at 180:19-181:11.

In October 2008, First Bank received a copy of an appraisal of the property that was commissioned by Centrue Bank and prepared by Albert Westover, an independent MAI appraiser, in August 2008 ("August 2008 Appraisal"). Tr. at 174:25-175:12. The August 2008 Appraisal's appraisal method was the "discounted wholesale value" method.

Tr. at 176:24-177:2. This meant that the appraised value "takes into consideration the cost of keeping the land for a period of time, including taxes, marketing, insurance, and the time value of money[.]" Tr. at 177:23-178:2. The August 2008 Appraisal assumed a four and a half year period of keeping the land. Tr. at 178:13-16. The August 2008 Appraisal appraised each lot at $111,000.00, with a total property value of $999,000.00. Tr. at 176:12-17.

Mr. Westover later prepared another appraisal. Tr. at 299:7-10; Exhibit B. This appraisal, although prepared after the foreclosure sale, appraised the property's value on the date of the foreclosure sale, December 11, 2008 ("Foreclosure Appraisal"). Tr. at 299:17-23. The appraised value was based on the discounted wholesale value method, which is an accepted practice in the appraisal field and reasonably and customarily relied on by appraisal experts. Tr. at 304:5-7; Exhibit B. This is the same appraisal method that was used in the appraisal prepared for Centrue Bank. Tr. at 176:24-177:2. Mr. Westover concluded within a reasonable degree of certainty for appraisal experts that the discounted wholesale value of each lot was $102,000.00, for a total of $918,000.00 fair market value of the property on the date of the foreclosure sale. Tr. at 304:8-19; Exhibit B.

First Bank's representative testified at trial that First Bank purchased the property for less than the discounted wholesale value in the August 2008 Appraisal. Tr. at 185:18-22. First Bank also "purchased the property for less than the value of the property that [First Bank] had stated time and time again in [its] report[.]" Tr. at 185:23-184:2. First

Bank admitted that it purchased the property "for less than its fair market value[.]" Tr. at 186:3-6.

E. First Bank seeks a deficiency judgment and the trial court denied its motions to exclude Fischer & Frichtel's defenses prior to trial.

On November 13, 2008 – prior to the foreclosure sale – First Bank filed suit against Fischer & Frichtel, seeking to recover the Note deficiency, plus interest, attorney's fees and costs. Legal File ("L.F.") 9-112. Following service, Fischer & Frichtel filed its Answer and Affirmative Defenses. L.F. 113-116. Fischer & Frichtel's Affirmative Defenses included: (1) First Bank's breaches of the duty of good faith and fair dealing (paragraph 2); (2) First Bank's failure to sell the property in a commercially reasonable manner (paragraph 2); and (3) Fischer & Frichtel's obligations being excused by the doctrine of commercial frustration (paragraph 3). L.F. 114-115.

On August 26, 2009, First Bank filed its Motion for Summary Judgment and corresponding pleadings. L.F. 166-213. In its Motion for Summary Judgment, First Bank sought judgment as a matter of law that Fischer & Frichtel owed $667,875.75 in principal on the Note, plus $57,455.12 in accrued interest through August 26, 2009, and at least $54,362.07 in attorney's fees. L.F. 175-181. Fischer & Frichtel's response argued that the doctrine of commercial frustration excused Fischer & Frichtel from performance, that First Bank violated the duty of good faith and fair dealing, and that the deficiency should be measured by the outstanding balance of the Note less the property's fair market value at the time of foreclosure. L.F. 216-235. Fischer & Frichtel presented

extensive facts, supported by documentary evidence and testimony, demonstrating that First Bank was not entitled to summary judgment. L.F. 239-663. The parties filed further briefs in reply and sur-reply. L.F. 664-713. After reviewing the memoranda and case law submitted, and hearing argument from counsel, the Court found that First Bank was not entitled to summary judgment on the Note deficiency and denied the Motion for Summary Judgment. L.F. 714.

Approximately two weeks before trial, First Bank filed motions to strike (or motions in limine to preclude) Fischer & Frichtel's Second, Third, Sixth and Seventh Affirmative Defenses. L.F. 715-735. Fischer & Frichtel's Second Affirmative Defense alleged in part that First Bank breached the duty of good faith and fair dealing and failed to sell the property in a commercially reasonable manner. L.F. 114-115. The Third Affirmative Defense alleged that Fischer & Frichtel's performance was excused by the doctrine of commercial frustration. L.F. 115. The Sixth and Seventh Affirmative Defenses alleged that First Bank sought an inequitable windfall by acting in an unfair manner and with unclean hands to pay a grossly inadequate price at the foreclosure sale and discourage other purchasers or refinancing. L.F. 115. Days after these motions were filed, First Bank also filed a motion in limine to preclude Fischer & Frichtel's "Commercial Unreasonableness Defense." L.F. 736-738. On January 20, 2010, the Court denied First Bank's motions to strike the Second, Third, Sixth and Seventh Affirmative Defenses, and denied its motion in limine as to the "Commercial Unreasonableness Defense." L.F. 741.

F. At trial, First Bank did not present substantial evidence of the interest owed on the Note deficiency and the trial court rejected Fischer & Frichtel's Affirmative Defense instructions after substantial evidence was presented to support them.

The case was tried to a jury in Division 5 before the Honorable John F. Kintz on January 25 and 26, 2010. The facts set out above were presented as evidence to the jury. *See* Fischer & Frichtel's Statement of Facts, *supra,* and citations to the transcript and legal file therein.

At trial, First Bank's representative was asked on direct examination about interest on the principal Note amount, and this exchange occurred:

> Q: Is there any interest calculated on the balance of the promissory note?
>
> A: Yes, there is.
>
> Q: What is the amount of that?
>
> A: $75,642.46.
>
> Q: How did First Bank calculate that interest?
>
> A: We took the interest based on the balance that was due when the loan matured of [$]1,133,875.75 and applied that for the number of days to foreclosure, then on the foreclosure dates, we used a lower principal balance of the [$]667,875.75, through that date through today's trial date.

Tr. at 156:23-157:13. This was the only testimony at trial addressing the calculation of interest. The Note itself stated that Fischer & Frichtel was "to pay interest on [the

principal] . . . at a rate per annum equal to the Prime Rate (hereinafter defined) . . . minus one-half of one percentage point (50%), but in no event to exceed the maximum rate permitted by law." Exhibit 1. "Prime Rate" was defined in the Note as follows: "as of any date, a floating per annum rate of interest which at any time, 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 of interest at any one time." Exhibit 1. In total, First Bank sought $743,518.21 from Fischer & Frichtel at trial. Tr. at 157:10-13. No further evidence regarding the interest rate was introduced.

If First Bank was awarded the full amount it sought at trial (over $700,000.00), First Bank would earn approximately $1.4 million ($700,000.00 plus the lowest suggested value of the property, $675,000.00),[1] which was more than the principal amount of the Note (approximately $1.1 million). Tr. at 273:22-274:1. By contrast, if the property had a fair market value of $918,000.00, as Mr. Westover testified was the fair market value on the date of foreclosure, and First Bank was awarded the full amount sought at trial, it would realize approximately $1.6-1.7 million. Tr. at 273:22-271:1; 304:8-19; Exhibit B. Further, if the property has a fair market value of $1.1 million, as First Bank repeatedly

[1] First Bank presented no evidence of the fair market value of the property at trial. The amount that would be realized is calculated here by adding the amount sought as a deficiency by First Bank plus the value of the property acquired by First Bank through the foreclosure sale.

stated in its internal valuations of the property was the fair market value, and it was awarded the full amount sought at trial, it would realize approximately $1.8 million. Tr. at 169:2-5;173:15-19; 180:8-14; 183:18-184:1; 273:22-274:1; Exhibits D, F and G.

At the close of First Bank's case-in-chief, Fischer & Frichtel moved for a directed verdict. Tr. at 205:9-207:9. Fischer & Frichtel's counsel argued, among other things, that First Bank had: (1) failed to give substantial evidence of the amount due on the note; (2) failed to give substantial evidence of the fair market value of the property at the time of the sale; and (3) failed to give any evidence upon which the jury could calculate interest on the Note. Tr. at 205:18-206:13. The Court denied the motion. Tr. at 207:6-8.

At the jury instruction conference, First Bank and Fischer & Frichtel submitted differing verdict directors, damages instructions and supporting instructions. *See* L.F. 928-935. First Bank filed written objections to several of Fischer & Frichtel's proposed instructions that were based on its Affirmative Defenses and the commercial frustration doctrine. L.F.756-770. Fischer & Frichtel's proposed verdict director, which included a tail for consideration of Affirmative Defenses, was refused. L.F. 931; Tr. 275:23-276:24. The Court accepted First Bank's proposed verdict director without an Affirmative Defense tail. L.F. 928; Tr. 275:23-276:24. The Court rejected Fischer & Frichtel's submitted instructions on its Affirmative Defenses of commercial frustration and good faith and fair dealing, along with a definition of "good faith and fair dealing." L.F. 932-934; Tr. 276:25-279:24; 280:2-284:24..

First Bank submitted a damages instructions instructing the jury that, if it found in favor of the bank, it must award the bank such sum as it believed was due under the Note plus interest and collection costs. L.F. 935. The instruction was rejected in favor of Fischer & Frichtel's proposed damages instruction that, if the jury found for First Bank, it must award the amount due on the maturity date, less the fair market value at the time of the foreclosure sale, plus interest. L.F. 929; Tr. 284:25-287:12; 288:2-16. The Court also accepted Fischer & Frichtel's proposed instruction defining fair market value, which was based on MAI 16.02. L.F. 930; Tr. at 287:15-288:1.

In its closing argument, First Bank asked for $743,518.21, including $667,876.75 in principal and $75,642.46 in interest on the Note. Tr. at 343:24-344:2; 348:2-7; 360:14-19.

On January 26, 2010, during jury deliberations, a juror sent a note to the Court asking, "Do we need to calculate a specific amount for the interest or can we award a specific balance due and list 'plus interest on $x' on the verdict form." L.F. 771; Tr. at 360:23-361:25. The Court wrote back: "Yes, you must calculate a specific amount for interest and place it in the verdict form." L.F. 771; Tr. at 361:14-25.

Later that day, the jury returned a verdict in favor of First Bank. L.F. 937; Tr. at 362:1-363:4. The jury awarded $215,875.00 on the balance of the Note, and $37,500.00 in interest. L.F. 937.

G. First Bank moved for its attorneys' fees. The trial court entered a Judgment favorable to Fischer & Frichtel's presentation of the property's fair market value and, therefore, the amount of deficiency.

On March 16, 2010, First Bank filed affidavits supporting its request for attorney's fees. L.F. 846-854.[2] First Bank sought $111,084.83 in attorney's fees and $4,779.19 in costs. L.F. 847-848.

On April 5, 2010, the Court issued its Order and Judgment. L.F. 866-867. The Court awarded First Bank $215,875.00 in principal and $37,500.00 in interest on the Note. L.F. 866. The Court also awarded First Bank $75,000.00 in attorney's fees. L.F. 866.

H. The trial court granted First Bank's motion for a new trial.

On May 5, 2010, First Bank and Fischer & Frichtel filed post-trial motions. L.F. 868-895. First Bank argued error in giving the damages instruction submitted by Fischer & Frichtel and awarding less attorney's fees than it sought. L.F. 868-881. Fischer & Frichtel argued that the Court erred in: (1) entering judgment on the jury's incorrect and

[2] The parties' billing records, originally submitted as exhibits along with the affidavits supporting the parties' fee requests, were withdrawn by consent and are not part of the Record on Appeal. *See* L.F. 863-864 (motion to withdraw); L.F. 865 (Order granting withdrawal).

unsupported calculation of interest; (2) refusing to submit Fischer & Frichtel's Affirmative Defense instructions on the duty of good faith and fair dealing and the doctrine of commercial frustration. L.F. 882-895. On June 23, 2010, First Bank filed its Restated Objection to Defendant's Proposed Jury Instruction as to Damages. L.F. 896-900.

On July 13, 2010, the Court granted First Bank's Motion for New Trial and to Amend Judgment, without specifying a reason for granting the Motion. L.F. 901. The Court ordered that Fischer & Frichtel's Motion for JNOV, New Trial and/or Remittitur was therefore moot. L.F. 901. Fischer & Frichtel filed its Notice of Appeal on July 21, 2010. L.F. 902-927.

POINTS RELIED ON

I.

THE TRIAL COURT ERRED IN GRANTING PLAINTIFF'S MOTION FOR NEW TRIAL AND TO AMEND JUDGMENT BECAUSE THERE WAS NO ERROR IN SUBMITTING INSTRUCTIONS 7 AND 8 AND THERE WAS SUBSTANTIAL EVIDENCE TO SUPPORT THE INSTRUCTIONS IN THAT THE PROPER MEASURE OF DAMAGES IN A SUIT ON A NOTE FOLLOWING A FORECLOSURE SALE IS THE DIFFERENCE BETWEEN THE FAIR MARKET VALUE OF THE PROPERTY ON THE DATE OF THE FORECLOSURE SALE AND THE AMOUNT DUE ON THE NOTE, AND DEFENDANT PRESENTED EVIDENCE THAT FIRST BANK INTENTIONALLY FAILED TO PAY THE FAIR MARKET VALUE FOR THE SUBJECT PROPERTY, DOUBLE-COUNTED ITS DEDUCTIONS AND ARRANGED THE FORECLOSURE SALE TO AVOID ANY COMPETITIVE BIDDING.

Restatement (Third) of Property: Mortgages § 8.4 (2010)

Bellistri v. Ocwen Loan Servicing, LLC, 284 S.W.3d 619 (Mo. App. E.D. 2009)

Sutton Funding, LLC v. Mueller, 278 S.W.3d 702 (Mo. App. E.D. 2009)

Golden Delta Enterprises, LLC v. US Bank, 213 S.W.3d 171 (Mo. App. E.D. 2007)

II.

THE TRIAL COURT ERRED IN DENYING FISCHER & FRICHTEL'S MOTIONS FOR DIRECTED VERDICT AND JNOV BECAUSE A SUBMISSIBLE CASE REQUIRES SUBSTANTIAL EVIDENCE FOR EVERY FACT ESSENTIAL TO LIABILITY AND DAMAGES IN THAT FIRST BANK FAILED TO PRESENT EVIDENCE TO SUPPORT THE CALCULATION OF INTEREST FOR WHICH FISCHER & FRICHTEL, INC., WAS ALLEGEDLY LIABLE AND THEREFORE THE VERDICT WAS NOT BASED ON SUBSTANTIAL EVIDENCE AS REQUIRED BY LAW.

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

Holley v. Caulfield, 49 S.W.3d 747 (Mo. App. E.D. 2001)

III.

THE TRIAL COURT ERRED IN REJECTING FISCHER & FRICHTEL, INC.'S PROFFERED AFFIRMATIVE DEFENSE INSTRUCTION BASED ON THE DOCTRINE OF GOOD FAITH AND FAIR DEALING BECAUSE AN INSTRUCTION MUST BE GIVEN WHERE THERE IS SUBSTANTIAL EVIDENCE TO SUPPORT THE ISSUE SUBMITTED IN THAT FISCHER & FRICHTEL, INC., PRESENTED SUBSTANTIAL EVIDENCE TO SUPPORT AN INSTRUCTION UNDER THE DOCTRINE OF GOOD FAITH AND FAIR DEALING, INCLUDING: THE NOTE CONFERRED UPON FIRST BANK A DISCRETIONARY POWER TO FORECLOSE ON THE PROPERTY IN THE EVENT OF NON-PAYMENT, AND FIRST BANK EXERCISED ITS DISCRETIONARY POWER UNDER THE NOTE IN VIOLATION OF THE DUTY OF GOOD FAITH AND FAIR DEALING BY PURCHASING THE PROPERTY FOR LESS THAN FAIR MARKET VALUE, BY ARRANGING THE FORECLOSURE SALE TO AVOID ANY OTHER BIDDERS, OR BY FAILING TO RENEW THE NOTE ON COMMERCIALLY REASONABLE TERMS, WHEN IT HAD PREVIOUSLY DONE SO ON NUMEROUS OCCASIONS.

City of St. Joseph v. Lake Contrary Sewer District, 251 S.W.3d 362 (Mo. App. W.D. 2008)

Regional Inv. Co. v. Willis, 572 S.W.2d 191 (Mo. App. K.C. 1978)

IV.

THE TRIAL COURT ERRED IN REJECTING FISCHER & FRICHTEL, INC.'S PROFFERED AFFIRMATIVE DEFENSE INSTRUCTION BASED ON THE DOCTRINE OF COMMERCIAL FRUSTRATION BECAUSE AN INSTRUCTION MUST BE GIVEN WHERE THERE IS SUBSTANTIAL EVIDENCE TO SUPPORT THE ISSUE SUBMITTED IN THAT FISCHER & FRICHTEL, INC., PRESENTED SUBSTANTIAL EVIDENCE TO SUPPORT AN INSTRUCTION UNDER THE DOCTRINE OF COMMERCIAL FRUSTRATION, INCLUDING: THAT THERE WAS A DRAMATIC AND UNPRECEDENTED DOWNTURN IN THE HOUSING MARKET AND AVAILABILITY OF CREDIT WHICH PARTICULARLY AFFECTED THE SUBJECT PROPERTY; THAT THE DRAMATIC DOWNTURN WAS NOT FORESEEN BY THE PARTIES AND NOT CAUSED BY OR UNDER THE CONTROL OF EITHER PARTY; AND THAT THE DOWNTURN DESTROYED OR NEARLY DESTROYED THE VALUE OF THE PERFORMANCE OR THE OBJECT OR PURPOSE OF THE NOTE.

Howard v. Nicholson, 556 S.W.2d 477 (Mo. App. 1977)

ARGUMENT

I. THE TRIAL COURT ERRED IN GRANTING PLAINTIFF'S MOTION FOR NEW TRIAL AND TO AMEND JUDGMENT BECAUSE THERE WAS NO ERROR IN SUBMITTING INSTRUCTIONS 7 AND 8 AND THERE WAS SUBSTANTIAL EVIDENCE TO SUPPORT THE INSTRUCTIONS IN THAT THE PROPER MEASURE OF DAMAGES IN A SUIT ON A NOTE FOLLOWING A FORECLOSURE SALE IS THE DIFFERENCE BETWEEN THE FAIR MARKET VALUE OF THE PROPERTY ON THE DATE OF THE FORECLOSURE SALE AND THE AMOUNT DUE ON THE NOTE, AND DEFENDANT PRESENTED EVIDENCE THAT FIRST BANK INTENTIONALLY FAILED TO PAY THE FAIR MARKET VALUE FOR THE SUBJECT PROPERTY, DOUBLE-COUNTED ITS DEDUCTIONS AND ARRANGED THE FORECLOSURE SALE TO AVOID ANY COMPETITIVE BIDDING.

STANDARD OF REVIEW

"[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.*

"Where a trial court grants a new trial without specifying of record the ground or grounds on which the new trial is granted, the presumption shall be that the trial court erroneously granted the motion for new trial and the burden of supporting such action is placed on the respondent." Missouri Supreme Court Rule 84.05(c) (2010).

PRESERVATION OF ERROR

The Court granted First Bank's Motion for New Trial and to Amend Judgment on July 13, 2010. L.F. 901. Fischer & Frichtel timely filed its Notice of Appeal on July 21, 2010. L.F. 902-927; Rule 81.04(a).

ARGUMENT

A. First Bank paid less than fair market value for the property and the Court properly instructed the jury on the measure of damages.

The appropriate measure of damages on a note deficiency action following a foreclosure sale is the outstanding note balance less the fair market value of the subject property on the date of the foreclosure sale. First Bank admitted that it paid less than fair market value for the property at the foreclosure sale, and it is the law that the amount paid at foreclosure does not reflect a property's fair market value. Tr. at 186:3-6; *see Shirley's Realty, Inc. v. Hunt*, 160 S.W.3d 804, 808 (Mo. App. W.D. 2005). At trial, Fischer & Frichtel entered evidence of the property's fair market value, and the jury used the property's fair market value to decide First Bank's damages on the Note. First Bank

submitted no evidence of the property's fair market value. The trial court therefore erred in granting First Bank's Motion for New Trial and to Amend Judgment following a verdict favorable to Fischer & Frichtel after properly instructing the jury.

B. The Court's instruction reflected the contemporary law that Missouri has been adopting in all aspects of property and mortgage law.

The Court gave the appropriate damages instructions to the jury. A deficiency should be measured by the fair market value at the time of the foreclosure, not the price paid at the foreclosure sale – particularly where the security interest holder, and only bidder at the foreclosure sale, admits that it is virtually impossible for competitive bidding at the sale, and admits that the price it paid was less than the fair market value.

The Restatement (Third) of Property: Mortgages § 8.4 (originally published 1997) states that:

> (d) If it is determined that the fair market value [of the subject property] is greater than the foreclosure sale price, the persons against whom recovery of the deficiency is sought are entitled to an offset against the deficiency in the amount by which the fair market value, less the amount of any liens on the real estate that were not extinguished by the foreclosure, exceeds the sale price.

Consistent with the Restatement, Fischer & Frichtel submitted the following damages instruction, which was accepted by the trial court and given to the jury:

> 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.

L.F. 929; Tr. at 284:22-288:11. First Bank submitted the following instruction, which was rejected by the trial court:

> 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.

L.F. 935.

First Bank argued at the trial level that the Restatement (Third) of Property is not the law in Missouri. All authority cited in support is either distinguishable or significantly pre-dates the publication of the Restatement provision and Missouri Courts' adoption of Restatement sections. For example, in its Motion for New Trial and to Amend Judgment, First Bank relied heavily on *Reed v. Inness*, 102 S.W.2d 711 (Mo. App. 1937), a case that pre-dates the publication of the Restatement (Third) of Property by sixty years. The Court in *Reed* did not consider the contemporary understanding of deficiency actions following foreclosure. The same can be said of the opinions in First Bank's other authority, *Drannek Realty Co. v. Nathan Frank*, 139 S.W.2d 926 (Mo. 1940) and *Hewitt v. Price*, 102 S.W. 647 (Mo. 1907). None of these cases rely on a statute for the deficiency-measuring proposition. The cases are supported only by Court-made law,

and rely on each other. In *Reed*, the case that First Bank cited extensively in its Motion for New Trial and to Amend Judgment, the Court relied on a treatise or restatement of the law to define the deficiency. *See Reed*, 102 S.W.2d at 715 (quoting from "42 C.J. p. 284," and "42 C.J. p. 295," presumably the then-contemporary edition of Corpus Juris Secundum). Therefore, Missouri Courts relied on secondary authority defining contemporary law to establish the deficiency then, and it is appropriate that they also use secondary authority defining contemporary law to establish the deficiency now. As explained below, Missouri already relies on the contemporary law set out in the Restatement.

Missouri already follows the Restatement (Third) of Property: Mortgages. Recently, in *Bellistri v. Ocwen Loan Servicing, LLC*, 284 S.W.3d 619 (Mo. App. E.D. 2009), the Eastern District was faced with determining the interest of a mortgagee following the issuance of a Collector's Deed. The Court stated that it would "turn to the law of mortgages to understand [the mortgagee's] interest." *Id.* at 623. To determine the effect of a note and a deed of trust being held by two different entities, the Court exclusively referenced the Restatement (Third) of Property (Mortgages) § 5.4. *Id.* It relied heavily on the Restatement to better explain why the mortgagee lost its security upon separation of the note and deed of trust. *Id.*

The Restatement was relied upon again in *Sutton Funding, LLC v. Mueller*, 278 S.W.3d 702 (Mo. App. E.D. 2009). There, the Court was determining priority between two deeds of trust. *Id.* at 704. The Court turned to the Restatement in order to define

"purchase money mortgage" and the effect of a purchase money mortgage on priority. *Id.* at 704-05. The Court stated that "**Missouri law is in accord with section 7.2 of the Restatement (Third) of Property (Mortgages)**." *Id.* at 705 (emphasis added).[3] Further, in *Golden Delta Enterprises, LLC v. US Bank*, 213 S.W.3d 171, 176 (Mo. App. E.D. 2007), the Court stated that "**The Restatement of Property concisely states the rule of law applied in Missouri case law**. . . ." (emphasis added) (relying on Restatement to determine priority of mortgages). Missouri courts therefore have regularly relied upon the Restatement (Third) of Property (Mortgages).

C. The Restatement will protect borrowers and lenders.

The Restatement's application to this situation is evident in the policy behind the Restatement provision. Section 8.4 "is aimed primarily at preventing the unjust enrichment of the mortgagee. This section also protects the mortgagor from the harsh consequences of suffering both the loss of the real estate and the burden of a deficiency judgment that does not fairly recognize the value of that real estate." Restatement (Third)

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[3] *Sutton Funding* and section 7.2 of the Restatement were again recently cited by the Western District in *Bob DeGeorge Associates, Inc. v. Hawthorn Bank*, 2011 WL 1988416, at *2 (Mo. Ct. App. W.D. May 24, 2011) (transfer and/or rehearing denied by this Court on July 5, 2011). The *Bob DeGeorge* Court stated that "Missouri follows the Third Restatement of Property," and agreed with the Restatement's reasoning that avoids granting windfalls. *Id.*

of Property (Mortgages) § 8.4, Comment a (2010). The approach offers protections for both the mortgagor and the mortgagee. It "enables the mortgagee to be made whole where the mortgaged real estate is insufficient to satisfy the mortgage obligation, but at the same time protects against the mortgagee purchasing the property at a deflated price, obtaining a deficiency judgment and, by reselling the real estate at a profit, achieving a recovery that exceeds the obligation." *Id.* The evidence presented in this case showed the presence of the dangers that the provision was designed to combat. Further, while Missouri has not adopted a statute embodying this policy, "the principles of this section are applicable whether a statute requires it or not." *Id.*

A fair market value standard has been adopted by a number of courts where, like Missouri, the legislature does not control deficiency actions. The Restatement lists several states, including Florida, Mississippi, Montana and Vermont. *See id.* at § 8.4, Reporter's Note comment a. Further, the fair market value standard has been recognized in Tennessee and justified by the same "goal of fairness [that] underlies the deficiency judgment approach taken by the Restatement[.]" *Lost Mountain Dev. Co. v. King*, 2006 WL 3740791, at *7 (Tenn. Ct. App. Dec. 19, 2006).

First Bank has argued that the foreclosure sale is open to all and that it is designed to protect borrowers because it brings a true price for the property. This theory is an absolute illusion. The foreclosure sale notice was sent only 22 days before the sale took place. Tr. at 185:5-9. A bidder other than First Bank had to bid in cash. Tr. at 150:12-16. First Bank's representative, Paul LaKamp, who had 20 years' banking experience,

testified that he was very familiar with the process of a customer applying for a loan to purchase property, closing on the loan and property, and the loan being funded. Tr. at 134:12-135:14; 332:3-7. In his experience, "the shortest amount of time and the number of days that the whole process has ever taken" was 45 days. Tr. at 333:17-24. He could "conceive" the shortest amount of time the process could take is "[a]pproximately 30, 45 days." Tr. at 334:8-10. In other words, there was no way that a borrower could obtain from a loan the significant cash required to purchase the property in time for the foreclosure sale. First Bank's foreclosure therefore could not possibly protect a borrower by realizing a fair price for the property – it was arranged so that there could not be competitive bidding.

The authority relied upon by First Bank – *Reed*, *Drannek Realty Co.*, and *Hewitt* – provide no protections for what occurred in Fischer & Frichtel's foreclosure and deficiency action. If that authority is followed, First Bank is permitted to name its price at foreclosure and seek a windfall in a deficiency action. Here, it paid $466,000.00, but, given that line of cases, what is to stop it from bidding $400,000.00, or $300,000.00? If the measure of a deficiency is the amount paid at the foreclosure sale, and First Bank had chosen to pay $100,000.00 at this foreclosure sale, it would be entitled to sell the property at its fair market value *and* seek a deficiency of approximately $1,000,000.00. The windfall potential is enormous. The Restatement provision provides what this caselaw does not; it protects the borrower by allowing a deficiency action measured by the fair market value of the property.

D. The Court has the power to adopt the Restatement provision to measure deficiencies in Missouri.

To the extent that the Court believes that section 8.4 of the Restatement (Third) of Property (Mortgages) has not been formally adopted, this Court should do so now to stop banks from this type of abuse. Protecting property owners with the Restatement will not confound banks' ability to do business. They will merely have to follow the guidance of competent evidence of fair market value when bidding at a foreclosure sale. The alternative, which played out in this foreclosure sale, is that the lender chooses its price, no matter the fair market value, and then pursues a windfall deficiency judgment that burdens the borrower beyond what is due under the note. It is patently unfair to allow First Bank to purchase property at a foreclosure sale for less than half the fair market value, and seek a deficiency from the borrower that, when combined with the value of the property, far exceeds the balance due on the loan. This type of manufactured deficiency cannot be in accord with the law and should not be tolerated.

There is nothing to stop this Court from providing deficiency suit defendants a defense against lenders who take their property and attempt to credit them less than fair market value. The Court would not overrule or contradict any statute; in fact, the law at issue is entirely judge-made. Nothing within the Restatement provision affects the statutory foreclosure procedure. Further, the Court has the authority to adopt a Restatement provision to remain consistent with contemporary law and fairness. This would not be the first time that the Court has decided to modernize an area of law

controlled by judicial holdings, not legislation or regulations. In *Kennedy v. Dixon*, 439 S.W.2d 173, 180 (Mo. banc 1969), the Court faced the aging *lex loci delicti* rule in resolving conflict of laws. The rule had, up to that time, been applied in Missouri. *Id.* The Court noted that, although a majority of the states still adhered to the old rule, it imposed hardships on litigants. *Id.* at 181-82. The Court "concluded that [it] should abandon the inflexible *lex loci delicti* rule in favor of the rule set forth in [the then-draft Restatement]." *Id.* at 184.

The *Kennedy* Court also addressed a concern raised by First Bank: that adoption of a new rule will create uncertainties in its application. The Court stated that "[t]his new rule for the choice of law will make the judicial task more difficult, at least until additional cases have established further guidance." *Id.* at 185. There would no longer "be a mere mechanical determination" of the choice of laws, but the Courts would work through establishing a procedure for difficult cases. *Id.* Similarly, the minor procedural issues that arise in adopting the Restatement – the same issues that were resolved by the trial court in this trial – would be worked out by the courts, and the Restatement provision is far better than the "mechanical determination" of deficiency set by the price the lender decides to pay itself at the foreclosure sale. *See also Keener v. Dayton Electric Manufacturing Co.*, 445 S.W.2d 362, 364-65 (Mo. 1969) (adopting Restatement provision to hold that strict liability applied in products liability and allowing recovery for wrongful death); *Annbar Associates v. American Express Co.*, 565 S.W.2d 701 (Mo. App. 1978) (adopting elements of injurious falsehood tort from Restatement). Law made in the

Courts governs deficiency suits, and the Court can adopt a defense to protect borrowers. The standard should be adopted to protect against lenders' contemporary foreclosure and deficiency suit conduct.

Express adoption of section 8.4 will place no additional burden on secured lenders such as First Bank. The provision does not stop foreclosure and transfer of the property. Further, the determination of a property's fair market value is customary for a lender such as a bank – banks routinely engage appraisers to determine the value of collateral. In fact, First Bank used its own appraiser here to determine that the property was worth the full amount of the Note only three months before it paid approximately one-third that amount at the foreclosure sale. Tr. at 152:12-153:5; 183:1-14. Finally, there will be no additional burden to courts because the Restatement provision is only invoked where there is an action for a deficiency. Restatement (Third) of Property: Mortgages § 8.4. ("[P]ersons against whom recovery of the deficiency is sought are entitled to an offset . . ."). The provision would be used in the types (and volume) of deficiency cases that already exist. This reaches a fair, economically realistic result that is fair to both the lender and borrower.

The fair market value issue would not arise in the foreclosure action itself. There would be no effect on foreclosure statutes. Again, the Restatement provision is only invoked where the lender seeks a deficiency. The deficiency is sought through a lawsuit. In a lawsuit, the defendant is entitled to defenses. First Bank's position here only affirms that it would rather borrowers have no defenses to the deficiency suit, and that the

foreclosure and deficiency process be streamlined entirely in the lenders' favor, no matter how inequitable the price paid at a foreclosure that is more likely than not controlled and conducted entirely by the lender itself. Further, there would have been no burden on First Bank in this instance to learn the fair market value, as it repeatedly appraised the property, internally and through the use of an appraiser, in the months leading to the foreclosure sale. The bank valued the property at approximately $1,133,000.00 four times in 2008. Tr. at 169:2-5; 173:15-19; 179:24-180:4; 183:1-14; Exhibit D; Exhibit F; Exhibit G. In October 2008, shortly before the foreclosure sale, the bank received an independent appraisal valuing the property at $999,000.00. Tr. at 176:12-17. Still, at the foreclosure sale, First Bank bid only $466,000.00. Tr. at 153:23-154:13. First Bank had many opinions of the property's fair market value, yet bid less than half any of those amounts. Lenders have a vested interest in knowing the value of their collateral. Any suggestion that lenders fly blindly into foreclosure without understanding a property's fair market value is specious.

Further, many of the procedural details of determining fair market value are addressed by the Restatement ("The fair market value determination under this section may be made either by the court or a jury in accordance with local law."). Restatement (Third) of Property: Mortgages § 8.4 comment b. Other procedural issues are answered by the normal machinations of litigation. The fair market value determination would be akin to a condemnation suit. In fact, the jury instruction defining "fair market value" in the instant trial was MAI 16.02, which is used in a variety of cases to instruct the jury to

determine fair market value. *See, e.g.*, MAI 16.02 Notes on Use (contemplating using the definition in eminent domain cases and "other types of cases involving the fair market value definition"). What First Bank characterizes as a burden on the courts would instead be a defense against a lender unfairly seeking a windfall at the borrower's expense. The courts are fully equipped to make a fair market value determination or to instruct a jury on the same.

The Restatement provision should be applied simply because it is the most reasonable path to determining a deficiency amount and protects borrowers. The Restatement provision measures the deficiency on the value the bank actually received, not what it chose to bid at the foreclosure sale. It is the most economically realistic standard. Allowing a secured lender to pay whatever amount it wants sets up a windfall for the lender because it receives the value of the property plus the inflated deficiency. In this case, a judgment based on the foreclosure sale price would have allowed the bank to receive hundreds of thousands of dollars over the amount due on the loan. First Bank's unstated concern with the Restatement is that it prevents windfall-seeking practices by lenders. The implication is that this is commonplace in lending – to foreclose on property, purchase it for well below fair market value, and pursue the exaggerated deficiency from the borrower. The Restatement provides borrowers protection against such aggressive lending practices, and this protection should be available to Missouri borrowers. The principles are exemplified under the facts, set out below, that

demonstrate that First Bank knowingly and intentionally paid less than fair market value for the Note's collateral.

E. Fischer & Frichtel presented substantial evidence to support the instruction.

An instruction must be given where there is substantial evidence to support the issue submitted. *Ploch v. Hamai,* 213 S.W.3d 135, 139-40 (Mo. App. E.D. 2006). "Substantial evidence is that which, if true, is probative of the issues and from which the jury can decide the case." *Id.* at 140.

Fischer & Frichtel presented substantial evidence that First Bank failed to pay fair market value for the property. As set out below, this included several valuations of the property, as well as admissions that First Bank paid less than any of the valuations and an admission that First Bank paid less than fair market value. First Bank presented no contradictory evidence.

1. First Bank stated that the property was worth the full amount of the Note.

In the months leading up to the December 11, 2008, foreclosure sale, First Bank repeatedly stated that the property was worth approximately $1.133 million. The value was indicated in documents drafted by First Bank employees and affirmed by testimony of the bank's vice-president at trial.

On April 15, 2008, First Bank proposed new terms to renew the Fischer & Frichtel Note. First Bank demanded $283,000.00 in a cash payment towards the Note. Tr. at 166:19-167:22. First Bank stated in its demand that the proposed $283,000.00 payment

towards the $1,133,875.75 Note would have reduced the amount of the loan to 75% of the property's value (the "loan to value," or "LTV"). Tr. at 167:23-168:12. First Bank's representative, Paul LaKamp, testified that, by this demand, First Bank "indicat[ed] . . . that the property had a value of $1,133,000[.]" Tr. at 169:2-5.

As part of the process of having First Bank approve an extension of the maturity date in 2008, the bank prepared a Commercial Credit Approval Form on June 3, 2008. Tr. a 169:22-170:4; Exhibit D. First Bank believed that all information in the Commercial Credit Form was true and accurate, and the form was relied on by First Bank employees. Tr. at 171:2-13. The outstanding loan balance on the Commercial Credit Form was $1,133.875.75. Tr. at 171:14-16. Each of the nine remaining lots was valued at $126,000.00, and First Bank believed that this value was reasonable. Tr. at 171:17-23. Nine lots, valued at $126,000.00 each, meant that the total value of the lots was $1,134,000.00. Tr. at 173:15-19. Further, First Bank stated on the Commercial Credit Form that the LTV of the Note to property was 100%. Tr. at 173:25-174:3. First Bank found this value reasonable. Tr. at 174:4-8. No one at the bank suggested that the lots' value was less than the amount indicated or stated that the value was incorrect. Tr. at 174:18-24.

In early September 2008, only three months before the foreclosure sale, Paul LaKamp of First Bank prepared two documents: (1) a Residential and LAD Trend Review and (2) a Change in Loan Status Form. Tr. at 179:24-180:4, 181:17-22; Exhibits F and G. Mr. LaKamp prepared the forms accurately. Tr. at 180:5-7, 181:23-182:2. In

both forms, he indicated that the LTV of the Note and property was 100%, and that the property was therefore worth approximately $1.133 million. Tr. at 180:8-14, 180:19-181:11, 183:1-14, 183:18-184:1; Exhibits F and G. Mr. LaKamp and two other First Bank employees signed the Change in Loan Status form, indicating that they agreed with the information provided. Tr. at 180:19-181:11.

In its internal documents and testimony, First Bank admits that the fair market value of the property in the months leading up to foreclosure was approximately $1.1 million. That is the outstanding amount of the loan. It was not until the foreclosure sale and this suit that First Bank first took the position that the property was worth less. This shows that First bank was trying to take advantage of its situation. The change is beneficial to First Bank, of course, because it used a lower value as justification for pursuing a larger deficiency against Fischer & Frichtel. First Bank's statements were not the only statements about the property's value presented at trial. As set out below, Fischer & Frichtel presented third-party appraisals of the property's value to establish the fair market value.

2. Independent appraisals showed that the property was worth significantly more than the amount paid at the foreclosure sale.

In addition to First Bank's own valuations of the property, the jury heard of two other appraisals by a third party professional appraiser. One appraised the property in the months leading to the foreclosure, and one appraised the property on the day of the

foreclosure sale. The latter was the only evidence presented of the fair market value of the property on the date of the foreclosure.

In October 2008, First Bank received a copy of an appraisal of the property prepared by Albert Westover in August 2008 ("August 2008 Appraisal"). Tr. at 174:25-175:12. The August 2008 Appraisal's appraisal method was the "discounted wholesale value" method, meaning that the appraised value "[took] into consideration the cost of keeping the land for a period of time, including taxes, marketing, insurance, and the time value of money[.]" Tr. at 176:24-177:2, 177:23-178:2. The August 2008 Appraisal assumed a four and a half year period of keeping the land. Tr. at 178:13-16. The August 2008 Appraisal appraised each lot at $111,000.00, with a total property value of $999,000.00. Tr. at 176:12-17.

Mr. Westover later prepared another appraisal. Tr. at 299:7-10. This appraisal, although prepared after the foreclosure sale, appraised the property's value on the date of the foreclosure sale, December 11, 2008 ("Foreclosure Appraisal"). Tr. at 299:17-23; Exhibit B. Mr. Westover concluded and testified at trial that the discounted wholesale value of each lot was $102,000.00, for a total of $918,000.00 fair market value of the property. Tr. at 304:8-19; Exhibit B. Mr. Westover's opinion was admitted into evidence. Tr. at 304:8-19; Exhibit B.

3. First Bank paid less than fair market value.

First Bank's representative agreed at trial that First Bank "purchased the property for less than the value of the property that [First Bank] had stated time and time again in

[its] report[.]" Tr. at 185:23-184:2. First Bank also paid less than the discounted wholesale value in the August 2008 Appraisal. Tr. at 185:18-22. First Bank admitted that it purchased the property "for less than its fair market value[.]" Tr. at 186:3-6.

First Bank did not pay fair market value for the property at the foreclosure sale. First Bank did not pay fair market value because it could reduce its own losses, maximize the potential profit from resale of the property under more favorable sale and economic conditions, and seek a large deficiency from Fischer & Frichtel, in pursuit of ultimately enriching First Bank beyond the terms of the original loan amount and seeking a windfall. This is precisely the situation that the Restatement guards against: "If it is determined that the fair market value [of the subject property] is greater than the foreclosure sale price, the persons against whom recovery of the deficiency is sought are entitled to an offset against the deficiency in the amount by which the fair market value . . . exceeds the sale price." Restatement (Third) of Property: Mortgages § 8.4 (2010). There is no dispute that the fair market value of the property was significantly greater than the foreclosure sale price. First and foremost, *First Bank admitted that it did not pay fair market value*. This invokes a fundamental tenet of section 8.4: to protect against "a deficiency judgment that does not fairly recognize the value of that real estate." *Id.* at comment a. First Bank exemplified the need for this protection by admitting that it did not attempt to pay fair market value, and by admitting that its method in doing so was not fair to Fischer & Frichtel. *See* Tr. at 273:6-10 ("Q. Okay. So my question is, in determining the price that it decided to pay at the foreclosure sale, isn't it true that First Bank double-counted the

discount for the carry? A. Yes. Q. Your answer is yes? A. Yes. Q. Do you think that's fair? A. No.").

Further, each and every valuation of the property, including First Bank's own and those from a third party, greatly exceeded the amount paid by First Bank. The value was anywhere from approximately 50% more to over 100% more than the amount paid. In this instance, Fischer & Frichtel is at the very least entitled to an offset of the deficiency of between $209,000.00 ($675,000.00 value minus sale price) and $668,000.00 ($1.134 million value minus sale price). A failure to provide an offset is tantamount to allowing First Bank to underpay for the property and charging Fischer & Frichtel for the privilege of doing so.

D. Conclusion

Missouri Courts have adopted several provisions of the Restatement and, consistent with that policy, adoption of section 8.4 will protect borrowers at foreclosure sales from windfall-seeking lenders. The trial court permitted Fischer & Frichtel to present its evidence and damages instruction based on the Restatement provision, and the jury agreed that First Bank was entitled to an award for the outstanding amount of the Note at the time of default less the fair market value. The trial court erred in then granting a motion for new trial to overturn the jury's will based on the law and evidence.

This Court should reverse the grant of a motion for new trial and remand for the trial court to enter judgment on the jury's verdict.[4]

II. THE TRIAL COURT ERRED IN DENYING FISCHER & FRICHTEL'S MOTIONS FOR DIRECTED VERDICT AND JNOV BECAUSE A SUBMISSIBLE CASE REQUIRES SUBSTANTIAL EVIDENCE FOR EVERY FACT ESSENTIAL TO LIABILITY AND DAMAGES IN THAT FIRST BANK FAILED TO PRESENT EVIDENCE TO SUPPORT THE CALCULATION OF INTEREST FOR WHICH FISCHER & FRICHTEL, INC., WAS ALLEGEDLY LIABLE AND THEREFORE THE VERDICT WAS NOT BASED ON SUBSTANTIAL EVIDENCE AS REQUIRED BY LAW.

STANDARD OF REVIEW

"The questions of whether evidence in a case is substantial and whether inferences drawn are reasonable are questions of law." *Holley v. Caulfield*, 49 S.W.3d 747, 750 (Mo. App. E.D. 2001). In determining whether a plaintiff has made a submissible case, the appellate court "do[es] not supply missing evidence or give the plaintiff the benefit of unreasonable, speculative, or forced inferences. The plaintiff's evidence and inference

[4] Fischer & Frichtel also requests that the Court reduce the amount of interest awarded in accordance with its argument under Point II of this brief.

must establish every element and not leave any issue to speculation." *Id.* (citations removed).

PRESERVATION OF ERROR

Fischer & Frichtel moved for a directed verdict after the close of First Bank's case-in-chief. Tr. at 205:9-207:9; Rule 72.01(a). Fischer & Frichtel's counsel argued, among other things, that First Bank had failed to give substantial evidence of the amount due on the Note and failed to give any evidence upon which the jury could calculate interest on the Note. Tr. at 205:18-206:13. The Court denied the motion. Tr. at 207:6-8. On April 5, 2010, the Court issued its Order and Judgment. L.F. 866-867. On May 5, 2010, Fischer & Frichtel filed its Motion for New Trial, JNOV, and/or Remittitur, arguing, in part, that First Bank had failed to make a submissible case on the Note because it failed to give substantial evidence of the alleged debt's interest calculation. L.F. 868-895; Rule 72.01(b).

ARGUMENT

This error is simple. First Bank did not present substantial evidence upon which a jury could determine the interest owed to it on the Note. There was no evidence of the interest rate. This made it impossible to calculate the interest owed where, as the jury did, the jury found that First Bank was owed less than the amount sought.

"The denial of a motion for JNOV presents the same issue as a motion for directed verdict. The question in both cases is whether plaintiff has made a submissible case." *Holley*, 49 S.W.3d at 750. "A submissible case requires substantial evidence for every fact essential to liability." *Id.* Substantial evidence has probative force upon the issues a trier of fact can use to reasonably decide a case. *Id.*

Further, where the plaintiff seeks to recover interest on a note and the interest rate is variable, there must be evidence of the varying rate. In *St. Louis Realty Fund v. Mark Twain South County Bank 21*, a developer appealed a trial court's finding that it owed $30,878.45 in accrued interest on the unpaid balance of a note. 651 S.W.2d 568, 575 (Mo. App. E.D. 1983). The Note was a "prime plus 1 ½ % interest note payable on demand." *Id.* at 574. The Court found that there was evidence presented of the prime rate only on the date of the note's execution and the date of trial (two years later and seven percent higher). *Id.* at 575. "There was no evidence as to the prime rate fluctuations during the two year interim period. Absent such a showing, the trial court's finding that $30,878.45 in accrued interest is unpaid is not based on substantial evidence." *Id.* The Court reversed and remanded this part of the judgment. *Id.*

First Bank here presented even less evidence of the calculation of interest on the debt it sought to collect. The entirety of testimony on the subject reflects this:

Q: Is there any interest calculated on the balance of the promissory note?

A: Yes, there is.

Q: What is the amount of that?

A: $75,642.46.

Q: How did First Bank calculate that interest?

A: We took the interest based on the balance that was due when the loan matured of [$]1,133,875.75 and applied that for the number of days to foreclosure, then on the foreclosure dates, we used a lower principal balance of the [$]667,875.75, through that date through today's trial date.

Tr. at 156:23-157:13. The testimony sheds no light on how interest is actually calculated: the rate, whether it compounds, or at what intervals, etc. The Note was entered as evidence at trial, but it provides no additional insight. The Note stated that Fischer & Frichtel was "to pay interest on [the principal] . . . at a rate per annum equal to the Prime Rate (hereinafter defined) . . . minus one-half of one percentage point (50%), but in no event to exceed the maximum rate permitted by law." Exhibit 1. "Prime Rate" was defined in the Note as follows: "as of any date, a floating per annum rate of interest which at any time, 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 of interest at any one time." Exhibit 1. Just as in *St. Louis Realty Fund*, First Bank presented no evidence of what the "Prime Rate" was on any date, or any evidence of the fluctuations in the multi-year history of the Note. Without this information, there is no way that the jury could have determined what the interest rate was, or how to calculate interest on an award.

The jury's confusion from the lack of evidence was exemplified in two ways: first, it questioned the interest award in a note to the Court during its deliberations. The jury

asked, “Do we need to calculate a specific amount for the interest or can we award a specific balance due and list ‘plus interest on $x’ on the verdict form.” L.F. 771; Tr. at 360:23-361:25. The Court wrote back: “Yes, you must calculate a specific amount for interest and place it in the verdict form.” L.F. 771; 361:14-25.

The jury further showed its confusion in its award. First Bank had sought $667,875.75 in principal and $75,642.46 in interest. Tr. at 156:23-157:13. The jury awarded $215,875.00 on the balance of the Note, and $37,500.00 in interest. L.F. 937. This amounts to awarding approximately one-third of the requested principal amount, but one-half of the interest. There is no basis in evidence or logic for doing so.

There was no substantial evidence presented to support the interest award. First Bank did not introduce the prime rate on any day, and the jury therefore could not calculate the interest rate. The trial court therefore erred in not granting Fischer & Frichtel’s motions for directed verdict or JNOV.

III. THE TRIAL COURT ERRED IN REJECTING FISCHER & FRICHTEL, INC.'S PROFFERED AFFIRMATIVE DEFENSE INSTRUCTION BASED ON THE DOCTRINE OF GOOD FAITH AND FAIR DEALING BECAUSE AN INSTRUCTION MUST BE GIVEN WHERE THERE IS SUBSTANTIAL EVIDENCE TO SUPPORT THE ISSUE SUBMITTED IN THAT FISCHER & FRICHTEL, INC., PRESENTED SUBSTANTIAL EVIDENCE TO SUPPORT AN INSTRUCTION UNDER THE DOCTRINE OF GOOD FAITH AND FAIR DEALING, INCLUDING: THE NOTE CONFERRED UPON FIRST BANK A DISCRETIONARY POWER TO FORECLOSE ON THE PROPERTY IN THE EVENT OF NON-PAYMENT, AND FIRST BANK EXERCISED ITS DISCRETIONARY POWER UNDER THE NOTE IN VIOLATION OF THE DUTY OF GOOD FAITH AND FAIR DEALING BY PURCHASING THE PROPERTY FOR LESS THAN FAIR MARKET VALUE, BY ARRANGING THE FORECLOSURE SALE TO AVOID ANY OTHER BIDDERS, OR BY FAILING TO RENEW THE NOTE ON COMMERCIALLY REASONABLE TERMS, WHEN IT HAD PREVIOUSLY DONE SO ON NUMEROUS OCCASIONS.

STANDARD OF REVIEW

An appellate court reviews the trial court's refusal to give a proffered instruction *de novo*. *Ploch*, 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. *Id.*

PRESERVATION OF ERROR

Fischer & Frichtel's proposed verdict director, which included a tail for consideration of Affirmative Defenses, was denied. L.F. 931. The Court accepted First Bank's proposed verdict director without an Affirmative Defense tail. L.F. 928. The Court rejected Fischer & Frichtel's submitted instructions on its Affirmative Defenses of commercial frustration and good faith and fair dealing, along with a definition of "good

faith and fair dealing." L.F. 932-934;[5] *Koppe v. Campbell,* 318 S.W.3d 233, 243 (Mo. App. W.D. 2010) (preserving instructional error).

Fischer & Frichtel filed a Motion for New Trial, JNOV and/or Remittitur, arguing in part that the Court erred in refusing to submit Fischer & Frichtel's Affirmative Defense

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[5] The rejected Affirmative Defense instruction stated:

> You must find for Defendant if you believe that:
>
> 1. The Note conferred upon Plaintiff a discretionary power to fail to renew 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.

L.F. 933. The rejected definition of good faith and fair dealing stated:

> "Good faith and fair dealing," as used in these instructions, is a duty imposed 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.

L.F. 934.

instructions on the duty of good faith and fair dealing and the doctrine of commercial frustration. L.F. 882-895; *Koppe*, 318 S.W.3d at 243 (stating that error must be alleged in post-trial motion); Rule 72.01(b).

ARGUMENT

The duty of good faith and fair dealing is inherent in every contract. *City of St. Joseph v. Lake Contrary Sewer District*, 251 S.W.3d 362, 369 (Mo. App. W.D. 2008). First Bank violated this duty in its dealings with Fischer & Frichtel. An instruction must be given where there is substantial evidence to support the issue submitted. *Ploch*, 213 S.W.3d at 139-40. "Substantial evidence is that which, if true, is probative of the issues and from which the jury can decide the case." *Id.* at 140. Fischer & Frichtel presented substantial evidence of First Bank's violation of the duty of good faith and fair dealing, and the trial court erred in rejecting an instruction based on the affirmative defense.

A. The Instruction was supported by the law.

It is black letter law that every contract includes an implied duty of good faith and fair dealing. *City of St. Joseph*, 251 S.W.3d at 369. That covenant is an inherent part of the contracts in this case, including the Note, deed of trust, and other loan documents. In *City of St. Joseph*, the Court found that where a contract confers upon one party "a discretionary power affecting the rights of the other party, a duty is imposed to exercise the discretion in good faith and in accordance with fair dealing." *Id.* at 369-70. *City of St. Joseph* specifically noted as follows with respect to the exercise of discretion under a contract:

> The covenant of good faith and fair dealing encompasses an "obligation imposed by law 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. at 370 (emphases added) (quoting *Spencer Reed Group, Inc. v. Pickett*, 163 S.W.3d 570, 574 (Mo. App. W.D. 2005)). What this holding means, and what First Bank violated here, is that just because a party to a contract can take an action under a contract's express terms does not mean that it does not violate the duty of good faith and fair dealing, which exists outside of the express terms.

In a case similar to *City of St. Joseph*, the Court of Appeals in *Regional Inv. Co. v. Willis*, 572 S.W.2d 191 (Mo. App. K.C. 1978), held that the plaintiff holder of a promissory note and deed of trust was not entitled to summary judgment granting it a deficiency judgment because a genuine issue of material fact existed regarding its right to judgment as a matter of law in that the borrower presented substantial evidence in an affidavit that the plaintiff did not act in good faith in bidding at the foreclosure sale. *Id.* at 192-93.

In *Willis*, the plaintiff lender bid on the foreclosed property an amount substantially less than the amount then outstanding on the note ($21,083.94 vs. $27,750.00). *Id.* at 191-92. After the foreclosure sale, the defendant borrower was left with an outstanding amount due of $6,666.06, plus attorney's fees and costs. *Id.* at 192.

The plaintiff lender then sought a deficiency judgment for said amount, and filed a motion for summary judgment. *Id.* Upon finding that the defendant admitted the execution of the promissory notes, the defaults, the trustee's sale, and the resulting deficiencies, the trial court granted plaintiff's motion. *Id.* However, in opposition to the plaintiff's motion for summary judgment, the defendant filed an affidavit stating that, prior to the foreclosure sale, the note-holder had entered into a contract to sell the soon-to-be foreclosed property to a third-party for $29,000.00 (which was more than the amount due on the note), contingent upon the note holder's successful acquisition of the property at the foreclosure sale. *Id.* The borrower argued that the note holder's actions were in bad faith, where the note holder intentionally bid an amount less than the amount outstanding on the note, creating a deficiency for the borrower, while also creating a windfall profit for the note-holder upon the subsequent sale of the property to a third-party. *Id.*

The Court held that summary judgment in favor of the note-holder was not appropriate, where the borrower's allegations regarding the note-holder's subsequent sale of the property for $29,000.00 created a genuine question of material fact regarding the note holder's right to judgment as a matter of law. *Id.* Specifically, the Court noted that, "[t]he facts stated in Willis's affidavit do raise a question of fact as to the existence of a deficiency because of the inadequacy of Regional's bid and the fairness of the sale in light of the prior contract for an amount greater than the debt. *Id.* Accordingly, the Court concluded by noting that, "[t]he facts in Willis's affidavit show there is a doubt as to the fairness of the trustee's sale because of the conduct of Regional." *Id.* at 193.

These holdings apply directly to the situation created by First Bank here. Their bond is this: the law recognizes that a party may follow the letter of its contracts, but where those contracts give one party discretion, that discretion must be exercised fairly. As more fully set forth below, First Bank did not exercise its discretion fairly in its conduct around the foreclosure sale, and in seeking the Note deficiency.

B. Substantial evidence of First Bank's breach of the duty of good faith and fair dealing was presented to the jury.

The jury was presented with substantial evidence of First Bank's violations of the duty of good faith and fair dealing. The jury was presented with this evidence after First Bank attempted to restrict it with motions for summary judgment and to strike the affirmative defenses (and evidence supporting them). L.F. 166-713; L.F. 715-735. The motions were denied and the evidence was presented to the jury. L.F. 714; L.F. 741. Fischer & Frichtel presented evidence of three types of violations of the duty of good faith and fair dealing: (1) arrangement of the foreclosure sale to exclude competitive bidding; (2) calculating a foreclosure sale bid that double-discounted for the amount of time the property would be held in the economic conditions before being sold; and (3) failing to renew the note on reasonable terms after having repeatedly done so.

First, First Bank breached the duty of good faith and fair dealing by arranging the foreclosure sale so that it would remove chances of competitive bidding and be the only possible bidder. The foreclosure sale notice was sent 22 days before the sale took place. Tr. at 185:5-9. First Bank's representative, Paul LaKamp, testified that it was essentially

impossible for any other bidder to make a bid at the foreclosure sale. First Bank set up the foreclosure sale so that a bidder had to pay in cash. Tr. at 150:12-16. Bidders pay cash – that is, except for First Bank at this foreclosure sale. Because First Bank was instigating the foreclosure sale, its bid was made in credit only, to reduce the indebtedness on the Note. Tr. at 154:14-21; 156:13-22. The requirement to have any other bidders bid in cash is not required by any law; it is just the way that First Bank has set up its foreclosure process to its advantage.

While First Bank has argued that anyone could have made a bid at the foreclosure sale, there were no other bidders. *See* Tr. at 153:23-154:13. That is because, as First Bank testified, it would be nearly impossible for any other prospective bidder to acquire a loan to make a bid in the time that First Bank provided from notice of the sale to the sale itself. He testified that he was very familiar with the process of a customer applying for a loan to purchase property, closing on the loan and property, and the loan being funded. Tr. at 332:3-7. He testified that an applicant who applied for a loan to purchase property would have to undergo a thorough vetting process, including submitting financial statements, having title work done, commissioning an appraisal, and/or environmental analysis. Tr. at 332:15-333:16. In his experience, "the shortest amount of time and the number of days that the whole process has ever taken" was 45 days. Tr. at 333:17-24. He could "conceive" the shortest amount of time the process could take as "[a]pproximately 30, 45 days." Tr. at 334:8-10. Yet, knowing that it has always taken at least 45 days to acquire such funding, First Bank scheduled the foreclosure for 22 days

after notice. It was extremely unlikely for any other prospective purchaser to make a bid. This was a textbook example of a breach of the duty of good faith and fair dealing. First Bank had discretion under the contract terms to foreclose on the property upon occurrence of a default, but it had to exercise its discretion in a fair and equitable manner. First Bank could have given more time prior to notice, or allowed payment over time. It chose not to do so. This harmed Fischer & Frichtel by removing chances for competitive bidding to reduce or eliminate the deficiency.

First Bank also breached the duty of good faith and fair dealing in the way it arrived at its $466,000.00 foreclosure sale bid. First Bank first determined that the value of the lots was $675,000.00, "[b]ased on the carrying costs to keep the property up as the new owner of, the HOA fees, [and] . . . the property taxes[.]" Tr. at 161:4-13. First Bank then decided to "further discount[] it from 675 to $466,000[.]" Tr. at 161:13-14. The representative testified that this amounted to discounting twice for the same thing: the "carry" of the property over a period of time before all lots could be sold. Tr. at 273:6-10 ("Q. Okay. So my question is, in determining the price that it decided to pay at the foreclosure sale, isn't it true that First Bank double-counted the discount for the carry? A. Yes. Q. Your answer is yes? A. Yes.") Finally, First Bank's representative expressly testified that its double-discounting behavior was not fair to Fischer & Frichtel. Tr. at 273:9-10 ("Q. Do you think that's fair? A. No.").

This is precisely the opportunistic behavior that the duty of good faith and fair dealing forbids. First Bank even admitted that it sought gains in excess of those expected

at the time of contracting, which, again, is exactly what the duty seeks to prevent. *See City of St. Joseph*, 251 S.W.3d at 370. First Bank's representative testified that, in the sale of the lots it owned after foreclosure and the deficiency action, it sought $1.4 million, plus interest and attorney's fees and costs, on a Note with a principal indebtedness at the time of the foreclosure sale of $1,133,875.75. Tr. at 143:18-23; 273:22-274:1. First Bank therefore sought a windfall.

The foreclosure was First Bank's discretionary power that affected Fischer & Frichtel's rights, and First Bank was obligated to "exercise [its] discretion in good faith and in accordance with fair dealing." *See City of St. Joseph*, 251 S.W.3d at 369-70. First Bank engaged in opportunistic behavior to "ensure gains in excess of those reasonably expected at the time of contracting." *See id.* at 370. First Bank admitted that it sought a windfall, and even admitted that it knew that its behavior was not fair. It violated the letter and the spirit of the covenant of good faith and fair dealing by arranging a foreclosure sale to exclude competitive bidding, control the sale, minimize its exposure and maximize its profits beyond what was contemplated by the Note and loan documents. First Bank's actions harmed Fischer & Frichtel by manufacturing a greater deficiency, unless the Court measures the deficiency by the fair market value as discussed in Point I above, than would have occurred if it had acted in good faith and fairly. Further, as set out above, Fischer & Frichtel introduced substantial evidence to make a submissible case on its affirmative defense of a violation of the duty of good faith and fair dealing.

Finally, First Bank failed to renew the Note on reasonable terms. First Bank and Fischer & Frichtel began negotiating to renew the Note in April 2008. Tr. at 224:9-12. After six renewals that only changed the maturity date, First Bank presented several additional terms as conditions for renewal of the Note. Tr. at 224:13-18. First Bank requested an increase in the Note's interest rate from prime minus one-half to prime plus one-half; $13,100.00 in renewal fees; an increase in the lot payoff amount from $126,000.00 to $162,000.00; and a $283,000.00 cash payment or a personal guarantee from a Fischer & Frichtel principal. Tr. at 224:19-225:5; Exhibit D. The proposed renewal terms were onerous and unfair to Fischer & Frichtel. Tr. at 227:23-228:8. First Bank refused to meet with Fischer & Frichtel to discuss loan renewal. Tr. at 229:1-15.

First Bank refused Fischer & Frichtel's offer of a deed in lieu of foreclosure. Tr. at 231:6-8, 22-25. This offer was reasonable because First Bank's internal documents said that the property was worth the same amount as the loan. *See* Exhibits D, F & G. After Fischer & Frichtel offered the deed in lieu of foreclosure, First Bank stated that it was changing the terms of renewal, and that they were "worse" than previously offered: the interest rate would be prime plus three, $283,000.00 in cash would be paid, and a personal guarantee from a Fischer & Frichtel principal was required, along with one year's interest reserve. Tr. at 232:9-24. At the same time, First Bank threatened to foreclose on the remaining lots and sue Fischer & Frichtel for a deficiency, which First Bank said would put Fischer & Frichtel "out of business." Tr. at 232:25-233:12.

First Bank's behavior in these negotiations, while the parties were still operating under the renewed Note, violated the duty of good faith and fair dealing. It imposed obligations on Fischer & Frichtel that First Bank knew Fischer & Frichtel could not fulfill. When Fischer & Frichtel offered to turn the property over to First Bank in exchange for extinguishing the Note, First Bank refused and vindictively raised the stakes, making renewal an impossibility. This is opportunistic behavior that is guarded by the duty of good faith and fair dealing, particularly during changing economic conditions. *City of St. Joseph*, 251 S.W.3d at 369-70. After this, knowing that the economic conditions had changed and that Fischer & Frichtel could not meet its demands, First Bank initiated a foreclosure sale that ensured it a windfall profit.

Even after finding in favor of Fischer & Frichtel in all pre-trial pleadings and allowing Fischer & Frichtel to introduce evidence supporting its affirmative defense, the trial court rejected its proffered verdict director, with a tail to include affirmative defenses. L.F. 928 (accepted instruction); L.F. 931 (rejected instruction). Fischer & Frichtel's proffered instructions on the duty of good faith and fair dealing, and a definition thereof, were rejected. L.F. 932-934; Tr. 280:2-284:24.

Fischer & Frichtel was prejudiced by the instruction's rejection. Fischer & Frichtel was unable to argue to the jury that First Bank could not recover on the Note deficiency for its behavior in purchasing the property at less than its fair market value. Fischer & Frichtel was denied an avenue to argue that First Bank should not recover

anything due to its violations. The instruction properly stated the well-established law of the duty of good faith and fair dealing. *See City of St. Joseph*, 251 S.W.3d at 369.

C. Conclusion

The duty of good faith and fair dealing is inherent in every contract, including the Note. Fischer & Frichtel presented substantial evidence of First Bank's violations of the duty by engaging in opportunistic behavior to exploit changing economic conditions to ensure gains in excess of those reasonably expected at the time of contracting. Fischer & Frichtel was therefore entitled to an instruction on its affirmative defense. This Court should reverse the judgment and remand with instructions to submit the instruction upon retrial.

IV. THE TRIAL COURT ERRED IN REJECTING FISCHER & FRICHTEL, INC.'S PROFFERED AFFIRMATIVE DEFENSE INSTRUCTION BASED ON THE DOCTRINE OF COMMERCIAL FRUSTRATION BECAUSE AN INSTRUCTION MUST BE GIVEN WHERE THERE IS SUBSTANTIAL EVIDENCE TO SUPPORT THE ISSUE SUBMITTED IN THAT FISCHER & FRICHTEL, INC., PRESENTED SUBSTANTIAL EVIDENCE TO SUPPORT AN INSTRUCTION UNDER THE DOCTRINE OF COMMERCIAL FRUSTRATION, INCLUDING: THAT THERE WAS A DRAMATIC AND UNPRECEDENTED DOWNTURN IN THE HOUSING MARKET AND AVAILABILITY OF CREDIT WHICH PARTICULARLY AFFECTED THE SUBJECT PROPERTY; THAT THE DRAMATIC DOWNTURN WAS NOT FORESEEN BY THE PARTIES AND NOT CAUSED BY OR UNDER THE CONTROL OF EITHER PARTY; AND THAT THE DOWNTURN DESTROYED OR NEARLY DESTROYED THE VALUE OF THE PERFORMANCE OR THE OBJECT OR PURPOSE OF THE NOTE.

STANDARD OF REVIEW

Fischer & Frichtel adopts and incorporates the Standard of Review set out under Point III.

PRESERVATION OF ERROR

Fischer & Frichtel adopts and incorporates the Preservation of Error set out under Point III.

ARGUMENT

The trial court erred in refusing an instruction based on Fischer & Frichtel's commercial frustration defense because performance of the contract under which First Bank is pursuing a deficiency is excused under the commercial frustration doctrine. An instruction must be given where there is substantial evidence to support the issue submitted. *Ploch*, 213 S.W.3d at 139-40. "Substantial evidence is that which, if true, is probative of the issues and from which the jury can decide the case." *Id.* at 140.

A. The law supports giving the instruction.

The doctrine of commercial frustration supports the instruction submitted by Fischer & Frichtel.[6] Under the doctrine of commercial frustration, if the occurrence of an

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[6] The rejected Affirmative Defense instruction stated:

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.

event, not foreseen by the parties and not caused by or under the control of either party, destroys or nearly destroys the value of the performance or the object or purpose of the contract, then the parties are excused from further performance. *Howard v. Nicholson*, 556 S.W.2d 477, 481 (Mo. App. 1977). The doctrine of commercial frustration "grew out of the demands of the commercial world to excuse performance in cases of extreme hardship." *Id.* at 483.

In *Howard*, a contractor sued property owners after the owners failed to pay the contractor pursuant to a contract to construct a bridal salon to specifications provided by a prospective tenant. *Id.* at 478. The tenant filed a bankruptcy petition during construction and the owners cancelled the contract with the contractor. *Id.* at 478-479. After the contractor filed suit against the owner, the owners argued in their defense that their performance was excused by the doctrine of commercial frustration. *Id.* at 481-84. The court studied the history of the doctrine and found that "Courts consider the relation of the parties, the terms of the contract and the circumstances surrounding its formation in determining whether the supervening event was reasonably foreseeable." *Id.* at 482. "It is also necessary to establish that there was a total or practically total destruction of the purpose or object of the transaction." *Id.* at 483. The Court found that it was "not inequitable to maintain that [the contractor] had assumed part of the risk in the contract in light of [its] active participation in and knowledge of the entire transaction." *Id.* The

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L.F. 932.

contractor knew the purpose of the contract and construction, and when that purpose was destroyed by bankruptcy, the doctrine of commercial frustration excused further performance. *Id.* at 483-84.

Missouri Courts therefore recognize and support an affirmative defense that excuses performance where the elements of commercial frustration are fulfilled. The trial court recognized this defense by denying First Bank's Motion for Summary Judgment and motions to strike the affirmative defense. L.F. 714, 741. As described below, the Court allowed extensive evidence supporting the defense to be admitted.

B. Fischer & Frichtel presented substantial evidence to support the commercial frustration instruction.

Fischer & Frichtel introduced substantial evidence that an event, not foreseen by the parties and not caused by or under the control of either party, destroyed or nearly destroyed the value of the performance or the object or purpose of the Note. Fischer & Frichtel borrowed money from First Bank in order to acquire lots upon which to build and sell homes. Tr. at 136:10-13; 210:13-211:3; 212:1-4; 214:12-22 ("Q. What was Fischer & Frichtel's purpose in entering into that [Note] and deed of trust? A. The purpose was to acquire the property, find buyers, and construct homes and pay down the note through that process."); 217:9-14 (testifying that First Bank was aware of the purpose). That purpose was destroyed or nearly destroyed by the economic downturn, which affected the St. Alban's development in a particular way.

Demand for new homes declined sharply beginning in 2005. Tr. at 220:19-221:3. The decline affected the St. Alban's development, with sales dropping from 15 homes in 2005 to only five in 2008. Tr. at 221:6-15. Fischer & Frichtel was selling high-end homes in the subdivision, and that area of the home market was experiencing a worse market than low and mid-priced homes. Tr. at 221:19-222:3. First Bank does not deny that this is the case. First Bank testified that this aspect of the development made sales especially difficult. Tr. at 182:3-8; 18-21. First Bank's vice president testified that, in his time and experience as a banker for approximately 20 years, there had not been a more significant downturn in home sales. Tr. at 134:12-135:14; 182:22-25.

The economic decline, and Fischer & Frichtel's problems selling lots in St. Alban's, were worsened by a requirement imposed by St. Alban's allowing only Fischer & Frichtel and one other homebuilder to build homes in St. Alban's. Tr. at 223:8-14. This "preferred builder" provision restricted Fischer & Frichtel from selling its lots to other builders. Tr. at 223:12-14. First Bank was aware of the special circumstances of the preferred builder provision when First Bank and Fischer & Frichtel began their relationship in 2000. Tr. at 223:15-21. As a result of this recession and the special conditions at the St. Alban's development, Fischer & Frichtel sold only one of its St. Alban's lots from 2006 through mid-year 2008, effectively destroying the purpose of the Note. Tr. at 222:25-223:7.

Neither Fischer & Frichtel nor First Bank foresaw the economic recession. Tr. at 242:6-10 ("Q. Now, Fischer & Frichtel alleges it couldn't have foreseen this downturn in

the economy, isn't it true? A. That's correct. Q. And isn't it true that nobody foresaw that? A. Yes."). The unforeseen economic downturn destroyed Fischer & Frichtel's ability to sell homes, which was the purpose of entering into the Note and loan documents. It thereby destroyed the value of performance or purpose of the agreement. *See Howard*, 556 S.W.2d at 481.

The policy behind the commercial frustration doctrine drives its applicability to Fischer & Frichtel's deficiency here. The doctrine allows for performance to be excused in cases of extreme hardship. *See Howard*, 556 S.W.2d at 483. The parties agree that the economic downturn in the second half of the last decade was an extreme hardship. First Bank's representative testified that there had never been a more significant downturn in home sales. Tr. at 182:22-25. The numbers support this: Fischer & Frichtel was unable to sell homes in the development in order to satisfy the Note. Missouri law protects the parties to a contract in exactly this situation.

The doctrine of commercial frustration excuses parties' performance under a contract where the contract's purpose is destroyed by an event unforeseen by the parties. Fischer & Frichtel presented substantial evidence of the parties' purpose in executing the Note and loan documents, the unforeseeability of the economic decline nationwide and within the St. Alban's development, and how that destroyed the purpose of the Note. Fischer & Frichtel was therefore entitled to an instruction allowing the jury to consider whether to excuse its performance because of that evidence. The judgment should be reversed with an order on remand to submit the instruction upon retrial.

CONCLUSION

WHEREFORE, the Circuit Court's judgment granting First Bank's Motion for New Trial or to Amend Judgment should be reversed and remanded with instructions to enter judgment on the jury's verdict less the interest awarded. In the alternative, if the Court affirms the Circuit Court's grant of a new trial, this Court should remand with instructions to submit Fischer & Frichtel's Affirmative Defenses based on the duty of good faith and fair dealing and doctrine of commercial frustration to the jury.

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that on the 29th day of August, 2011, the original and nine (9) copies of Defendant/Appellant's Substitute Brief and a virus-free disk were filed with the Court, and two copies of the brief and a virus-free disk were mailed to the following party of record:

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RULE 84.06(c) CERTIFICATE

Pursuant to Rule 84.06(c), the undersigned hereby certifies that Defendant/ Appellant's Substitute Brief contains 15,651 words, exclusive of the cover, certificate of service, this certificate, Table of Contents and Table of Authorities, according the word-processing system's word count, and thus, complies with Supreme Court 84.06(b). The disk containing Defendant/Appellant's Substitute Brief has been scanned for viruses and is virus free, in accordance with Rule 84.06(g).