

Summary of SC91951, *First Bank v. Fischer & Frichtel, Inc.*

Appeal from the St. Louis County circuit court, Judge John F. Kintz
Argued and submitted Jan. 11, 2012; opinion issued April 17, 2012

Attorneys: Fischer & Frichtel was represented by R. Thomas Avery, Robert D. Blitz and Jason K. Turk of Blitz, Bardgett & Deutsch LC in St. Louis, (314) 863-1500; and First Bank was represented by Thomas B. Weaver, Matthew J. Reh and Sara Finan Melly of Armstrong Teasdale LLP in St. Louis, (314) 621-5070. The Missouri Bankers Association, which submitted a brief as a friend of the Court, was represented by Brian C. Walsh and K. Lucinda McRoberts of Bryan Cave LLP in St. Louis, (314) 259-2000. The Business Bank of St. Louis, which also submitted a brief as a friend of the Court, was represented by John L. Davidson, an attorney from St. Louis, (314) 725-2898.

This summary is not part of the opinion of the Court. It has been prepared by the communications counsel for the convenience of the reader. It neither has been reviewed nor approved by the Supreme Court and should not be quoted or cited.

Overview: A real estate developer appeals the trial court's grant of a new trial to a bank, claiming that the trial court properly instructed the jury to use the fair market value of the property at the time of foreclosure to measure the amount of the deficiency the developer owed the bank, even though Missouri precedent stretching back more than a century holds that the foreclosure sale price is the proper measure of a deficiency. In a 6-1 decision written by Judge Laura Denvir Stith, the Supreme Court of Missouri affirms the trial court's grant of a new trial. Every jurisdiction that has switched from the foreclosure sale price to fair market value has done so by statute, not the common law. Furthermore, the developer's argument that the limited notice period between foreclosure and sale prevents competitive bidding and leads to below market value sale prices does not apply to sophisticated commercial entities such as the developer, which have the resources to obtain financing and bid at the foreclosure sale. Finally, this Court will not overturn longstanding precedent lightly, especially when overruling the precedent would modify thousands of existing contracts.

Chief Justice Richard B. Teitelman dissents. He would reverse the court's grant of a new trial for the bank and would order the trial court to enter judgment consistent with the jury's finding. He further would hold that the Court should alter the common law measure of damages in a deficiency action so it comes in line with the common law for most damages, which are based on fair market value and, therefore, avoid giving the lender a windfall.

Judge T. Bennett Burkemper Jr., an associate circuit judge from Lincoln County, sat by special designation in place of Judge William Ray Price Jr., and Judge John E. Parrish, a senior judge of the Missouri Court of Appeals, Southern District, sat by special designation in place of Judge George W. Draper III.

Facts: In 2000, First Bank loaned Fischer & Frichtel \$2,576,000 to purchase land in Franklin County for a residential development. The original maturity date on the loan was July 1, 2003, but First Bank extended the date six times to September 1, 2008. Between 2000 and 2005 Fischer & Frichtel sold 12 of the 21 lots in the development, and although it failed to sell any lots in the

development from 2005 to 2008, its general business brought in hundreds of millions of dollars in revenue. When the loan matured, Fischer & Frichtel defaulted and First Bank foreclosed on the nine unsold lots. The foreclosure sale was held in December 2008, and First Bank made the sole bid of \$466,000. In November 2008, First Bank filed suit against Fischer & Frichtel to recover the unpaid principal and interest on the loan, and, at the January 2010 trial, Fischer & Frichtel presented evidence from an appraiser that the property was worth \$918,000 as well as internal First Bank documents valuing the property at \$1,134,000. First Bank argued that the property was only worth \$675,000 and that it had discounted this amount to \$466,000 because the depressed real estate market made finding a buyer for sale of the lots in bulk extremely difficult. At the close of trial, the court instructed the jury to determine the amount of the deficiency based on the fair market value of the property at the time of the foreclosure sale, and the jury returned a verdict valuing the property at \$918,000. First Bank filed a motion for a new trial, arguing that the jury instruction was erroneous because it directed the jury to measure the deficiency based on the fair market value of the property not the foreclosure sale price. The trial court granted a new trial, and Fischer & Frichtel appeals.

AFFIRMED.

Court en banc holds: There are two general approaches to reviewing the adequacy of a foreclosure price. One approach is to use the fair market value to determine the amount of a deficiency, if, depending on the jurisdiction, the foreclosure sale price is below market value, substantially below market value or shockingly below market value. The second approach, followed by Missouri, does not allow the debtor to contest the sufficiency of the foreclosure sale price in determining the amount of the deficiency but does allow the debtor to bring an action to void the foreclosure sale if she believes the foreclosure sale price was so inadequate as to shock the conscience and raise an inference of fraud. While other states also use a “shock the conscience” standard, Missouri’s determination of what is sufficient to shock the conscience is very strict, with some cases approving sale prices that were as low as 20 percent of the fair market value.

Although Fischer & Frichtel presents valid policy concerns with the foreclosure process in Missouri, nearly all its concerns involve the foreclosure sale, not the fairness of the deficiency determination itself. Nevertheless, Fischer & Frichtel does not challenge this Court’s past interpretation of the “shock the conscience” standard for voiding foreclosure sales, even though this Court has not reviewed that standard in more than 60 years. Furthermore, the policy issues raised by Fischer & Frichtel principally apply to individuals and small businesses realistically that cannot bid at a foreclosure sale and not to sophisticated businesses such as Fischer & Frichtel, which has not shown or alleged that it did not have the financial means to bid at the foreclosure sale. Moreover, every jurisdiction that Fischer & Frichtel cited as rejecting the foreclosure sale price approach in favor of the fair market value approach did so based on statute – not the common law.

More than a century of Missouri precedent holds that the foreclosure sale price is the proper measure of a deficiency, and both First Bank and Fischer & Frichtel relied on the applicability of this standard when entering into their loan agreement more than a decade ago. The public policy reasons for modifying Missouri’s traditional measure of a deficiency do not apply to this case,

and the principle of *stare decisis* advises that precedent should not be overruled lightly, especially when it has remained unchanged for many years. This Court will not overrule such precedent here.

Dissenting opinion by Chief Justice Teitelman: The author would hold that damages in a deficiency action should be measured by reference to the fair market value of the foreclosed property to prevent a windfall to the lender. The underlying deficiency judgment is nothing more than a means of calculating First Bank's damages for Fischer & Frichtel's breach of a contract that was secured by the foreclosed property. The issue simply is assigning a value to the foreclosed property to calculate the bank's damages fairly. Most common law damages calculations use fair market value as a baseline for awarding damages. In contrast, Missouri's current common law rule for calculating damages in a deficiency proceeding is inconsistent with the underlying purpose of awarding damages, which is to make a party whole. It is well known that property sold at a forced foreclosure sale has the potential of bringing only a fraction of the fair market value. The practical effect of calculating a foreclosure deficiency by reference to the foreclosure sale, then, is that the secured lender benefits from an often substantial windfall by purchasing the property at a discount from the fair market value while also obtaining an inflated deficiency judgment. While the passage of time can confirm the validity and wisdom of a common law rule, it also can demonstrate its shortcomings. As such, when the common law is demonstrably inconsistent with common knowledge and experience, this Court has exercised its constitutional authority to modify the common law accordingly. Further, it is neither realistic nor consistent with common law tradition to wait on the legislature to correct an outmoded rule of case law. The fact that other states legislatively have adopted a fair market valuation is relevant and further buttresses the conclusion that Missouri's current common law rule is deficient. There is no reason but tradition to perpetuate this anomaly in Missouri law. This Court should alter the common law measure of damages in a deficiency action and define damages with reference to fair market value. The author would reverse the judgment granting the bank a new trial and order the trial court to enter judgment consistent with the jury's finding using the fair market value of the foreclosed property.