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MIDFIRST BANK v. RANIERI: AN UPDATE ON DEFICIENCY JUDGMENTS UNDER MONTANA'S SMALL TRACT FINANCING ACT

Tiffany B. Lonnevik

I. INTRODUCTION

The recent history of Montana secured land transaction law reveals a continuous effort by both the legislative and judicial branches of government to provide fair yet effective means of obtaining loans and securing their repayment. The enactment of the Small Tract Financing Act¹ (the Act) in 1963 evidenced an effort to foster a system mutually beneficial to both borrowers and lenders by creating the trust indenture² as an alternative to the traditional mortgage. Trust indentures provide for the transfer of legal title to property not exceeding thirty acres³ to trustees who, upon borrowers' default, can foreclose the trust deeds judicially or nonjudicially.⁴

In 1987, the judiciary made its contribution to the law governing trust indentures when the Montana Supreme Court decided *First State Bank v. Chunkapura*,⁵ which extended the provisions

1. MONT. CODE ANN. §§ 71-1-301 through -321 (1993) (original version at R.C.M. 1947 §§ 52-401 through -417 (3 Supp. II 1977)).

2. The trust indenture is referred to as "deed of trust" and "trust deed." These phrases are used interchangeably throughout this Note.

3. MONT. CODE ANN. § 71-1-304(1) (1993). The Act was originally limited to tracts of three acres, but was amended in 1974 to involve tracts as large as fifteen acres, and again amended in 1989 to reflect the present limitation of thirty acres.

4. MONT. CODE ANN. § 71-1-304(3) (1993). The procedure for judicial foreclosure elected under § 71-1-304(3) is dictated by the law on foreclosing the traditional mortgage found at § 71-1-222 of the Montana Code. Conversely, the conditions for nonjudicial foreclosure (known as "foreclosure by advertisement and sale" and, alternatively, as "foreclosure by trustee's sale") are embodied in § 71-1-313; the actual sale is governed by the procedures set forth in § 71-1-315.

Two significant differences exist between the two types of foreclosure. First, under judicial foreclosure, the lender can seek a deficiency judgment if proceeds from the sale of the property are insufficient to cover the remaining debt. MONT. CODE ANN. § 71-1-305 (1993) (applying § 71-1-222(2) of traditional mortgage law). In foreclosure by advertisement and sale, the lender has no such right. MONT. CODE ANN. § 71-1-317 (1993).

Second, under judicial foreclosure, the borrower is entitled to remain in possession of the property for one year after the sheriff's sale, during which time the borrower may redeem the obligation. MONT. CODE ANN. § 71-1-305 (1993) (applying §§ 71-1-229 & -228 respectively). In contrast, under foreclosure by advertisement and sale, the borrower must relinquish possession of the property within 10 days after the trustee's sale and is not allowed to redeem the obligation any time after the sale has occurred. MONT. CODE ANN. § 71-1-319 (1993).

5. 226 Mont. 54, 734 P.2d 1203 (1987).

of the Act beyond their textual and literal meaning.⁶ However, with this extension, the court raised a number of questions regarding the implications of this decision on foreclosure proceedings under the Act.⁷ This Note identifies these questions, explores the court's efforts to supply answers, and offers suggestions for clarifying the ambiguities that still remain.

Part II of this Note provides an historical background of deficiency judgment case law by discussing *Chunkapura* and its progeny. Part III examines the most recent case, *Midfirst Bank v. Ranieri*, recounting the facts and charting the Montana Supreme Court's journey through precedent to ultimately resolve the legal issues involved. Part IV provides an analysis of the *Ranieri* decision and its implications on future lender-borrower relations. This section also raises policy concerns affecting improvement of the law of trust deeds⁸ and proposes that Montana employ further efforts to develop concise deficiency judgment guidelines that protect and clarify the rights of both lenders and borrowers. Finally, this Note concludes in Part V with a summary of the effect of *Ranieri* on the law of trust indentures.

II. BACKGROUND

In the landmark case of *First State Bank v. Chunkapura*, the Montana Supreme Court extended section 71-1-317 of the Montana Code, which provides that deficiency judgments are not permitted following nonjudicial foreclosure, to the judicial foreclosure of trust indentures.⁹ On rehearing, the court limited its decision to apply only to judicial foreclosures of trust deeds on "occupied, single family residential property."¹⁰ However, while stating that lenders could not obtain deficiency judgments following judicial or nonjudicial foreclosure of these trust deeds, the court did not define "occupied" or "residential" or specify when these determinations should be made.

The court has been faced with resolving some of the ambiguities that remained following *Chunkapura* by applying *Chunkapura* to new factual situations involving judicial foreclo-

6. See Kathleen M. Magone, *First State Bank v. Chunkapura: New Limitations on Trust Indentures*, 49 MONT. L. REV. 181 (1988).

7. See David J. Dietrich, *The Montana Judicial and Non-judicial Foreclosure Sale: Analysis and Suggestions for Reform*, 49 MONT. L. REV. 285, 310 (1988).

8. This portion of the analysis draws heavily from consultation with University of Montana School of Law Professor Robert G. Natelson.

9. 226 Mont. 54, 734 P.2d 1203 (1987).

10. *Chunkapura*, 226 Mont. at 67, 734 P.2d at 1211.

tures under the Act. For example, the court tried to flesh out the definition of "residential" in *First Federal Savings & Loan v. Anderson*,¹¹ a case involving a trust deed executed by borrowers to secure their family home. When the borrowers eventually put the property up for sale, they rented it out in an unsuccessful effort to make their loan payments.¹² The court extended *Chunkapura*'s anti-deficiency protection to the borrowers in *Anderson*, refusing to allow the brief rental of the property to taint the property's residential nature.¹³

Additionally, in *Trustees of the Washington-Idaho-Montana Carpenters-Employers Retirement Trust Fund v. Galleria Partnership*,¹⁴ the court reiterated its refusal to include commercial trust deeds in *Chunkapura*'s anti-deficiency protection. The *Galleria* court allowed the lender to seek a deficiency judgment following judicial foreclosure of a trust deed securing the borrower's commercial warehouse.¹⁵

Finally, in *First Western Federal Savings Bank v. Lence*,¹⁶ the court attempted to clarify the meaning of "occupied" as the term applied to a debtor's seasonal occupancy and rental of residential property. The *Lence* court held that the *Chunkapura* limitation on deficiency judgments for occupied residences did not apply to a condominium resided in by the borrower during the summer months only and rented out intermittently.¹⁷

Within this legal framework, the Montana Supreme Court made its most recent attempt to remove the uncertainty still existing after *Chunkapura* and its progeny. The 1993 case of *Midfirst Bank v. Ranieri*¹⁸ embodies this effort.

III. MIDFIRST BANK V. RANIERI

The *Ranieri* opinion chronicles the court's confrontation with the *Chunkapura* questions as it progresses through the various factual situations faced in the *Anderson*, *Galleria*, and *Lence* cases. *Ranieri* neatly summarizes the court's earlier attentions to the judicial extension of section 71-1-317 of the Montana Code and anal-

11. 238 Mont. 296, 777 P.2d 1281 (1989).

12. *Anderson*, 238 Mont. at 298, 777 P.2d at 1282.

13. *Lence*, 255 Mont. at 301, 777 P.2d at 1284.

14. *Galleria*, 239 Mont. 250, 780 P.2d 608 (1989).

15. *Galleria*, 239 Mont. at 269, 780 P.2d at 619. For an in depth analysis of *Galleria*, see Margaret K. Bentwood, *Deficiency Judgment Relief in Montana Foreclosures*, 53 MONT. L. REV. 255 (1992).

16. 255 Mont. 7, 839 P.2d 1277 (1992).

17. *Lence*, 255 Mont. at 11-12, 839 P.2d at 1280.

18. 257 Mont. 312, 848 P.2d 1046 (1993).

ogizes the instant facts to precedent.¹⁹ The *Ranieri* case represents the court's continuous struggle to supply meaning to the ambiguities of *Chunkapura* and to provide boundaries for the implications of that decision on foreclosures of trust deeds.

A. *The Facts*

In 1983, Larry Ranieri (Ranieri) fulfilled his daughter's request that he rent out her townhouse in order to cover her monthly loan payments. Because the rents received were inadequate to cover the payments, Ranieri began paying the difference for his daughter the following year and in 1984 gained title to the townhouse.²⁰ Shortly thereafter, Ranieri applied for refinancing in hopes of reducing the monthly payments and possibly moving into the townhouse with his wife until he sold it. To secure the loan, he executed a trust indenture to Midfirst Bank (Midfirst). However, after the refinancing was complete, Ranieri's intent to move into the property was thwarted when his wife rented another house for them to move into, so renters continued to occupy the townhouse.²¹

Between 1984 and 1990, Ranieri rented the townhouse to several tenants and claimed on his tax returns rental income in excess of \$20,000 and depreciation and business deductions totalling over \$50,000. Ranieri had personally stayed in the townhouse intermittently for approximately one month over a seven-year span, although only during periods of marital strife when the building was available between renters.²²

In 1989, Ranieri defaulted on his loan and made no further payments. Consequently, Midfirst initiated a nonjudicial foreclosure of the trust deed, but thereafter canceled the trustee's sale.²³ Midfirst then began judicial foreclosure proceedings and sought a deficiency judgment against Ranieri.²⁴ Disposing of the case on summary judgment, the district court found for Midfirst and authorized both the foreclosure and the deficiency judgment.²⁵ The

19. *Ranieri*, 257 Mont. at 315-18, 848 P.2d at 1048-49.

20. *Id.* at 313-14, 848 P.2d at 1046-47.

21. *Id.* at 314, 848 P.2d at 1047.

22. *Id.*

23. *Id.* Ranieri contends that Midfirst failed to notify him or anyone else of the cancellation. Not until over three months after the originally scheduled sale did the trustee formally cancel the nonjudicial foreclosure by filing a "Cancellation of Notice of Sale Under Trust Indenture." Defendant's/Appellant's Brief at 8, *Ranieri* (No. 92-267) [hereinafter Appellant's Brief].

24. *Ranieri*, 257 Mont. at 314, 848 P.2d at 1047.

25. *Id.* at 314-15, 848 P.2d at 1047.

district court held that Ranieri did not qualify for the exception to deficiency judgments set out by the Montana Supreme Court in *Chunkapura* because he spent an insufficient amount of time at the townhouse, choosing instead to rent it out for nearly seven years.²⁶ Ranieri appealed, arguing that the townhouse was neither commercial nor unoccupied and thus was eligible for *Chunkapura* protection.²⁷

B. *The Holding*

The Montana Supreme Court unanimously affirmed the district court's ruling.²⁸ The court held that Ranieri fell short of the established requirements²⁹ necessary to invoke the *Chunkapura* prohibition of a deficiency judgment following judicial foreclosure of a trust deed.³⁰ Because Ranieri rented the townhouse most of the time instead of inhabiting it as his primary residence, he had not occupied the property as required. Further, the court found that in Ranieri's hands, the subject property of the trust indenture was commercial in nature.³¹ Thus, Ranieri was not entitled to the *Chunkapura* protection, which over time had become limited in application to trust deeds relating to "single family residential property occupied by the borrower as his . . . primary legal residence."³²

C. *The Reasoning*

The supreme court relied exclusively on precedent to decide

26. *Id.* at 315, 848 P.2d at 1047.

27. *Id.* at 315, 848 P.2d at 1047-48. Additionally, Ranieri argued that the lower court had offended both the Act and the "election of remedies" doctrine by allowing Midfirst to switch before the scheduled trustee's sale from nonjudicial to judicial foreclosure. *Id.* at 318, 848 P.2d at 1049. The Montana Supreme Court dismissed this argument, holding that neither any provision in the Act nor the election of remedies doctrine prohibited Midfirst from halting the foreclosure by advertisement and sale prior to the trustee's sale and electing instead to proceed with a judicial foreclosure. *Id.* at 319-20, 848 P.2d at 1050.

28. *Id.* at 313, 320, 848 P.2d at 1046, 1050.

29. *See* First W. Fed. Sav. Bank v. Lence, 255 Mont. 7, 839 P.2d 1277 (1992) (requiring that borrower occupy the deeded property as his primary residence); Trustees of the Wash.-Idaho-Mont. Carpenters-Employers Retirement Trust Fund v. Galleria Partnership, 239 Mont. 250, 780 P.2d 608 (1989) (excluding trust indenture on commercial property from anti-deficiency protection); First Fed. Sav. & Loan v. Anderson, 238 Mont. 296, 777 P.2d 1281 (1989) (including in anti-deficiency protection trust deed on residential property occupied by borrowers as single-family home); First State Bank v. Chunkapura, 226 Mont. 54, 734 P.2d 1203 (1987) (granting anti-deficiency protection to deeds of trust relating to occupied, single-family residential property).

30. *Ranieri*, 257 Mont. at 318, 848 P.2d at 1049.

31. *Id.*

32. *Id.*

the *Ranieri* case. By applying *Chunkapura* and its progeny to the instant facts, the court dismissed each of Ranieri's arguments and reached a conclusion consistent with the lower court as well as prior case law.

In contesting the appropriateness of allowing a deficiency judgment, Ranieri initially argued that although he rented the townhouse, he did so only to cover his loan payments. Hence, the property of the trust deed was not commercial so as to prevent the invocation of the *Chunkapura* exception, especially, he argued, given his intention to make the townhouse his residence.³³

To the contrary, the court held that the property was commercial in nature. Ranieri's own tax returns, in which he claimed rental income and took deductions for the property, were irrefutable manifestations of the property's commercial character.³⁴ Further, Ranieri continued to collect rents from townhouse tenants even after he defaulted on his loan.³⁵ Reiterating its decision from *Galleria*,³⁶ the court in *Ranieri* held that the anti-deficiency provision created in *Chunkapura* does not apply to trust deeds on commercial property such as Ranieri's.³⁷

In *Galleria*, the borrower procured a loan secured by a trust indenture on a commercial warehouse that housed business ventures.³⁸ Like Ranieri, the borrower leased the property to various tenants to make the monthly loan payments.³⁹ However, when the borrower defaulted and the sole bid by the lender at the sheriff's sale was insufficient to pay the indebtedness,⁴⁰ the court in *Galleria* allowed the lender to obtain a deficiency judgment against the borrower given the trust deed's commercial nature.⁴¹ The *Ranieri* court found the commercial classification of Ranieri's trust deed equally applicable, thus allowing a deficiency judgment against the borrower.⁴²

Ranieri contested this comparison by asserting that the facts of his case were more analogous to those in *Anderson*, in which the court denied the lender the right to a deficiency judgment under a rental situation.⁴³ In *Anderson*, the borrowers purchased a home

33. *Id.* at 315-16, 848 P.2d at 1047-48.

34. *Id.* at 316, 848 P.2d at 1048.

35. Memorandum and Order at 3, *Ranieri*, No. CDV-90-942 (April 27, 1992).

36. 239 Mont. 250, 258, 780 P.2d 608, 613 (1989).

37. *Ranieri*, 257 Mont. at 316, 848 P.2d at 1048.

38. *Galleria*, 239 Mont. at 253, 780 P.2d at 610.

39. *Id.* at 254, 780 P.2d at 610.

40. *Id.* at 255, 780 P.2d at 611.

41. *Id.* at 258, 780 P.2d at 613.

42. *Ranieri*, 257 Mont. at 316, 848 P.2d at 1048.

43. *Id.* (citing *Anderson*, 238 Mont. 296, 777 P.2d 1281).

with a loan secured by a trust deed to the property.⁴⁴ For the next seven years, the borrowers used and occupied the dwelling on the property as their principal residence.⁴⁵ However, upon realizing they could no longer afford to keep it, the borrowers put the real estate up for sale. During the eighteen months the property was on the market, the borrowers found it necessary to rent the property to various individuals to make their loan payments. When they ultimately defaulted on the loan, the court allowed the lender to judicially foreclose on the property but denied a deficiency judgment against the borrowers despite the brief rental period.⁴⁶

Ranieri maintained that the court's failure to attach a commercial classification to the property rented in *Anderson* should extend to the townhouse he rented, especially given the factual similarities between the two cases: both the Andersons and Ranieri financed the disputed property pursuant to the Act and both lived in the property at times while renting it at other times.⁴⁷ Since the court refused to permit a deficiency judgment in *Anderson*, Ranieri asserted that the court should defer to that ruling in the instant case.⁴⁸

The *Ranieri* court, however, disagreed, finding no comparison between the eighteen-month rental in *Anderson* and Ranieri's seven-year rental. Further, the court noted that when the lender in *Anderson* accepted the trust deed, the deed related to an occupied, single-family residence, whereas the *Ranieri* trust indenture related to a townhouse operated as a rental unit.⁴⁹ The significance of this distinction compelled the court to maintain its position regarding the commercial nature of Ranieri's property. Ranieri did not satisfy the required residential prong of the *Chunkapura* standard so as to invoke its protection from a deficiency judgment.⁵⁰

Ranieri then argued that he had met the "occupied" aspect of *Chunkapura*, which did not specify occupancy by the borrower himself as a prerequisite to the invocation of the deficiency protection.⁵¹ However, the court had already rejected this argument in *First Western Federal Savings Bank v. Lence*.⁵² There, the bor-

44. *Anderson*, 238 Mont. at 297, 777 P.2d at 1282.

45. *Id.* at 298, 777 P.2d at 1282.

46. *Id.* at 301, 777 P.2d at 1284.

47. Appellant's Brief at 14, *Ranieri* (No. 92-267).

48. *Ranieri*, 257 Mont. at 316, 848 P.2d at 1048.

49. *Id.*

50. *Id.*

51. *Id.* at 317, 848 P.2d at 1048.

52. 255 Mont. 7, 839 P.2d 1277.

rower delivered a promissory note to the lender for the purchase of a condominium in Crystal Lakes, Montana, and secured the note by a trust deed on the condominium. The borrower's primary residence was in Whitefish. The borrower occupied the condominium for approximately eight years, but only as a secondary summer residence which he eventually rented on an intermittent basis. When the borrower defaulted on the note, the lender brought suit to judicially foreclose on the trust deed and to recover a deficiency judgment.⁵³

The court in *Lence* found in favor of the lender, holding that a deficiency judgment was available following judicial foreclosure of the trust deed.⁵⁴ Under Montana law, a person has only one legal residence,⁵⁵ and the *Chunkapura* protection from deficiency judgments applies to that residence exclusively.⁵⁶ Because the borrower never intended, nor ever made, the condominium his primary residence, as evidenced by his limited three-to-four-month occupancy each year, he could not claim he occupied the unit under the *Chunkapura* standard.⁵⁷ Accordingly, the court in *Ranieri* refused to accept Ranieri's claim of occupancy since he never made the townhouse his primary residence but "spent, at the most, one month [there] over [a] seven year span."⁵⁸ Further, Ranieri himself admitted that the townhouse was not his personal primary residence.⁵⁹

Nor did the court accept Ranieri's contention that although he did not personally reside in the townhouse, the tenants' inhabitation of the property fulfilled the occupied aspect of *Chunkapura*.⁶⁰ That proposition was also rejected in *Lence*, where the court clarified this prong as requiring occupancy by the borrower as his actual, personal, and primary residence.⁶¹ The *Lence* court explained that a borrower cannot invoke the *Chunkapura* exception where the property borrowed against is occupied by someone other than the borrower.⁶² To hold to the contrary on the issue of occupied, the court stated,

53. *Lence*, 255 Mont. at 8-9, 839 P.2d at 1278.

54. *Id.* at 12, 839 P.2d at 1280.

55. MONT. CODE ANN. § 1-1-215 (1993) (defining a person's one legal residence in the state as "the place where one remains when not called elsewhere for labor or other special or temporary purpose").

56. *Lence*, 255 Mont. at 11, 848 P.2d at 1280.

57. *Id.* at 12, 848 P.2d at 1280.

58. *Ranieri*, 257 Mont. at 318, 848 P.2d at 1049.

59. *Id.* at 317, 848 P.2d at 1049.

60. *Id.* at 317, 848 P.2d at 1048-49.

61. *Lence*, 255 Mont. at 11-12, 839 P.2d at 1280.

62. *Id.*

would pervert the limited nature of the *Chunkapura* exception; it would allow a person to avoid the possibility of deficiency judgment on virtually unlimited numbers of properties by merely ensuring that each property was a residential unit and without regard to whether the property was ever intended or used as a personal, primary residence.⁶³

Here, even though renters inhabited the townhouse, Ranieri did not meet the occupied element necessary to qualify him for the judicial exception to deficiency judgments enunciated in *Chunkapura*.⁶⁴

IV. ANALYSIS

Since 1987, the Montana Supreme Court, on four separate occasions, interpreted its landmark decision in *Chunkapura* and announced the extent of that case's applicability to secured land transactions.⁶⁵ On the most recent occasion, the court in *Ranieri* continued a pattern of distinguishing *Chunkapura* by eliminating situations to which *Chunkapura* applies. Unfortunately, the court also continued an established pattern of maintaining the obscurity of the *Chunkapura* rule by leaving unanswered questions of primary importance to the effectiveness of the Small Tract Financing Act. Of greatest significance is the court's failure to define "residential" and its failure to specify the time when that designation should be made to determine whether the protection against deficiency judgments applies to certain property.

A. Definitions of "Residential" Versus "Commercial"

While the court has made clear that the protection from deficiency judgments applies only to residential and not commercial trust deeds,⁶⁶ it has failed to delineate what constitutes "residential." Nor has the court precisely characterized the elements of "commercial."

The defendant in *Ranieri* tried to use to his advantage the court's oversight of these matters by suggesting a definition of commercial under which he would not qualify. Ranieri argued that

63. *Id.* at 12, 839 P.2d at 1280.

64. *Ranieri*, 257 Mont. at 318, 848 P.2d at 1049.

65. *Midfirst Bank v. Ranieri*, 257 Mont. 312, 848 P.2d 1046 (1993); *First W. Fed. Sav. Bank v. Lence*, 255 Mont. 7, 839 P.2d 1277 (1992); *Trustees of the Wash.-Idaho-Mont. Carpenters-Employers Retirement Trust Fund v. Galleria Partnership*, 239 Mont. 250, 780 P.2d 608 (1989); *First Fed. Sav. & Loan v. Anderson*, 238 Mont. 296, 777 P.2d 1281 (1989).

66. See *Galleria*, 239 Mont. at 258, 780 P.2d at 613; *Anderson*, 238 Mont. at 300-01, 777 P.2d at 1284; *Chunkapura*, 226 Mont. at 67, 734 P.2d at 1211.

the court's holdings in *Chunkapura* and *Anderson* had contemplated a definition of commercial property like that found in section 69-5-102(1) of the Montana Code, which states: "'Commercial premises' means the premises where the business of selling, warehousing, or distributing a commodity or other business activity is carried on or professional or other services are rendered."⁶⁷ As such, Ranieri argued that his renting the townhouse did not qualify the property as commercial since it was utilized solely as a personal home (albeit home to various renters), not as a business, and thus could be distinguished as residential.⁶⁸

However, as Midfirst pointed out, the statute on which Ranieri relied was taken out of context and had no application to the instant circumstance.⁶⁹ Rather, Midfirst suggested a more common definition of commercial, such as that found in *Black's Law Dictionary*: "relating to or connected with trade and traffic or commerce in general" and "occupied with commerce."⁷⁰ Additionally, Midfirst urged the adoption of a definition previously enunciated by other courts: "suggesting commerce, trade, business, industry, [or] having financial profit as the primary aim."⁷¹

While not specifically adopting Midfirst's proposed definition, the Montana Supreme Court apparently was convinced by the former's suggestion. The court looked to the profit-producing nature of the townhouse as evidenced by Ranieri's tax returns and held that sufficient to classify the property as commercial.⁷² However, by not seizing the opportunity to adopt a detailed definition of residential, the court left unresolved issues regarding the applicability of *Chunkapura* that, absent legislative action, the court must eventually address when new fact situations arise.

For example, whether a duplex, four-plex, or similar multi-unit arrangement, one unit of which the borrower occupies as a

67. Appellant's Brief at 16, *Ranieri* (No. 92-267) (citing MONT. CODE ANN. § 69-5-102(1) (1993)).

68. Appellant's Brief at 17-18, *Ranieri* (No. 92-267).

69. Plaintiff/Respondent's Brief at 13, *Ranieri* (No. 92-267) [hereinafter Respondent's Brief] (noting that the statute in question defines territory for electric utilities).

70. Respondent's Brief at 12, *Ranieri* (No. 92-267) (quoting BLACK'S LAW DICTIONARY 337 (4th ed. 1951) (similarly defined in BLACK'S LAW DICTIONARY 270 (6th ed. 1990)).

71. Respondent's Brief at 12-13, *Ranieri* (No. 92-267) (quoting *Roberts Enterprises, Inc. v. Secretary of Transp.*, 699 P.2d 479 (Kan. 1985)). Midfirst also mentions in its brief other cases in which the renting of property was found a commercial activity. *Id.* (citing *Littlehales v. District of Columbia*, 130 F.2d 402 (D.C. Cir. 1942) (finding rents from office buildings and apartment houses were derived from "business" or "commercial activity"); *Stewart v. 104 Wallace St., Inc.*, 432 A.2d 881 (N.J. 1981) (considering apartment buildings "commercial" properties)).

72. *Ranieri*, 257 Mont. at 316, 848 P.2d at 1048.

primary residence but the remaining units of which produce income to the borrower, qualifies for the *Chunkapura* exception remains unclear. Nor is it clear whether a dwelling, housing not only the borrower but also the borrower's business, qualifies as residential to receive the protection *Chunkapura* affords from deficiency judgments. Unless the legislature clarifies the ambiguities inherent in the existing statute, the court inevitably will face the task of resolving these matters.

The Montana Legislature has entertained several proposals to resolve the ambiguities by codifying detailed definitions of "residential." For example, in 1989 two bills were introduced that recommended such definitions as "real property that is a residential dwelling for four or fewer families"⁷³ and the more detailed proposal:

[P]roperty that . . . is the principal place of residence of the grantor. The term is limited to:

(a) a single-family residence or a single unit of a condominium as defined in Title 70, chapter 23;

(b) a duplex, one unit of which is the principal place of residence of the grantor; or

(c) a mobile home as defined in 61-4-309 or a trailer if the mobile home or trailer is described in the trust indenture and is placed on or affixed to the real property that is the subject of the trust indenture.⁷⁴

Yet, despite these appealing clarifications of the law, the legislature enacted neither of these proposals.⁷⁵

Other western states have enacted definitional legislation in an effort to clarify their statutes (nearly identical to Montana's) regarding deficiency judgments on trust indentures. Oregon, for example, defines residential as "property upon which are situated four or fewer residential units and one of the residential units is occupied as the principal residence of the grantor, the grantor's

73. H.B. 511, 51st Mont. Leg., Reg. Sess. (1989).

74. S.B. 313, 51st Mont. Leg., Reg. Sess. (1989). In addition, this proposal, along with House Bill 511, recommended as a corresponding definition of commercial "real property other than residential real property."

75. The House passed House Bill 511 by an overwhelming majority vote of 92:3 after the second reading and 98:1 after the third reading, but the Senate Judiciary Committee tabled the bill per recommendation of the bill's sponsor, who felt Senate Bill 313 adequately addressed the issues at hand. The Senate passed Senate Bill 313 by an overwhelming majority vote of 43:1 after the second reading and 49:1 after the third reading, but the House rejected the bill 34:60. MONTANA LEGISLATIVE COUNCIL, HISTORY & FINAL STATUS OF BILLS & RESOLUTIONS OF THE SENATE & HOUSE OF REPRESENTATIVES OF THE STATE OF MONTANA FIFTY-FIRST LEGISLATURE 405, 132 (1989).

spouse or the grantor's minor or dependent child."⁷⁶ Similarly, California defines residential as "a dwelling for not more than four families."⁷⁷

Why Montana has refused to follow the lead of its sister states, or to adopt the useful recommendations of Montana legislators and lobbyists, is unclear. In any event, absent legislative action, the court should consider adopting a definition of residential for the purpose of discerning the availability of deficiency judgments following judicial foreclosure of trust deeds. By adopting definitions such as those previously submitted to the Montana Legislature, the court may avoid confusion in the future and divert unnecessary litigation over the matter.

B. When Is the Nature of the Property Determined?

Even assuming that concise definitions of "residential" or "commercial" existed, when to apply those definitions to determine the nature of the property still would remain unclear. Under the Small Tract Financing Act in its present form, it is indiscernible whether property is to be classified as residential or commercial at the time of execution of the trust deed or, alternatively, at foreclosure. This determination is crucial to the lender's ability to obtain a deficiency judgment following judicial foreclosure and is equally crucial for the borrower, who must ascertain at the contractual outset the penalties that will attach to default.

From judicial interpretations of the Act—most recently *Ranieri*—the question of whether lenders can take deficiency judgments upon foreclosure seems to hinge on whether the debtor lived in the residence the day the lenders closed the loan. The court in *Ranieri* distinguished the borrower's position from that of the borrowers in *Anderson* by specifically noting: "[W]hen the lender [in *Anderson*] accepted the trust indenture, the deed related to occupied, single family residential property, and the fact that the family had rented it out briefly before sale did not preclude application of *Chunkapura*."⁷⁸ Thus, the borrowers in *Anderson* could escape the classification of their property as commercial despite their brief use of the real estate for monetary gain, because the property was not so used at the time the trust deed was executed. Contrarily, in *Ranieri*, the borrower rented the property at the time the lender accepted the trust indenture and continued to be

76. OR. REV. STAT. § 86.705(3) (Supp. II 1991).

77. CAL. CIV. PROC. CODE § 580(b) (West Supp. 1994).

78. *Ranieri*, 257 Mont. at 316, 848 P.2d at 1048.

rented throughout Ranieri's ownership; thus, the property was not immune from designation as commercial in nature.⁷⁹

However, on appeal, Ranieri showed a weakness in the court's reasoning by proposing two hypotheticals.⁸⁰ Under what appears to be the current rule of characterizing property at the time of execution of the trust deed, a lender could take a deficiency judgment against borrowers who rent out their home on the day the loan closes, move into the home one week later, and occupy the home for the next seventeen years. On the other hand, the lender could not get a judgment against the borrowers who live in the home the day the loan closes, but who in the next week move out and subsequently rent the property for the next seventeen years.⁸¹

In response, Midfirst suggested that it would be unfair to have as the point of determination the time of foreclosure, because

to leave the rights of a lender unknown at the time of the closing, and completely dependent upon the use of the property and the decisions by the borrower long after the loan has been closed, and long after the lender had any right or ability to negotiate terms or to make any decisions concerning the use of the property . . . would leave the lender without sufficient information to decide whether or not to grant the loan. That detrimental effect to potential lenders, and the resultant limitation on lending, certainly was not the intent of the Small Tract Financing Act.⁸²

Agreeing with Midfirst, the Montana Supreme Court impliedly selected the date of closing as the proper classification date.⁸³ Perhaps finding itself limited to the facts at bar, however, the court did not address Ranieri's hypotheticals. By leaving the proper course of action in these scenarios unstated, the court failed to remove a certain obscurity still plaguing secured land transactions.

As with the unclear definitions under *Chunkapura* and the Act, the legislature considered proposals to set the timing for classification of the nature of a property.⁸⁴ Like the definitional proposals, however, suggestions for codifying the designation timing

79. *Id.*

80. Appellant's Brief at 15, *Ranieri* (No. 92-267).

81. *Id.*

82. Respondent's Brief at 20-21, *Ranieri* (No. 92-267).

83. *Ranieri*, 257 Mont. at 316, 848 P.2d at 1048.

84. *See, e.g.*, S.B. 313, 51st Mont. Leg., Reg. Sess. (1989) (originally proposing as the time of designation of property as residential "the time the trust indenture is executed or within 60 days thereafter," then amended to require the property "be continuously occupied by the grantor or his successor in interest from the time the trust indenture is executed or within 60 days of its execution through the date of the default and within 30 days of the date of the trustee's sale").

failed.⁸⁵ Montana could follow the approach taken by neighboring states such as Oregon, which enacted a classification date.⁸⁶ Unfortunately, lenders and borrowers in Montana remain without answers and will continue to dispute the issue in and out of court.

C. Policy Considerations and Suggestions for Reform

To provide consistent instruction for parties to secured land transactions, the court or legislature should closely examine the intent of the Small Tract Financing Act and select definitions and timing provisions that best further the Act's objectives.⁸⁷ Assessing the purpose of the Act initially seems easy given the codification of the legislature's intentions in the Act itself.⁸⁸ However, in examining both the legislative and judicial history of the Act and its application, several policies are in fact at play, including protecting (1) lenders' expectancies, (2) the availability of credit, and (3) borrowers' financial stability. Where assessment becomes difficult, then, is in determining which policies should predominate.

Since the enactment of the Act, the Montana Supreme Court has continuously struggled to strike a balance between the various policies and parties involved in executing trust deeds. For example, the court in *Chunkapura* acknowledged that the Act was adopted at the suggestion and for the benefit of the banking and lending industry, which was becoming increasingly unwilling to extend credit when on a borrower's default the lender's funds would be tied up for the one-year period of redemption.⁸⁹ Yet, the *Chunkapura* court also recognized that the Act was intended to protect borrowers against deficiency judgments in exchange for removing their rights of redemption and possession for the benefit of

85. As mentioned previously, Senate Bill 313 was rejected after its second reading in the House by a vote of 34:60. See *supra* note 75.

86. OR. REV. STAT. § 86.705(3) (Supp. II 1991) (codifying the characterization of property "at the time a trust deed foreclosure is commenced").

87. Perhaps the legislature would be the more appropriate forum for addressing these matters since the court cannot randomly make such selections until a case specifically requiring the court to do so comes along.

88. Section 71-1-302 of the Montana Code reads:

Because the financing of homes and business expansion is essential to the development of the state of Montana and because financing of homes and business expansion . . . has been restricted by the laws relating to the mortgages of real property and because more financing of homes and business expansion is available if the parties can use security instruments and procedures not subject to all the provisions of the mortgage laws, it is hereby declared the public policy of the state of Montana to permit the use of trust indentures for estates in real property of not more than thirty acres as provided in this [Act].

MONT. CODE ANN. § 71-1-302 (1993).

89. *Chunkapura*, 226 Mont. at 56-58, 734 P.2d at 1204-05.

lenders.⁹⁰ This protection was necessary given the traditional failure of a foreclosure sale to bring in a price adequate to discharge the debt and to avoid the resulting disastrous consequences to the borrower, whose remaining real or personal property could then be seized in satisfaction of the debt.⁹¹

The court decided *Chunkapura* at a time characterized by a depressed economy, marked depreciation in property values, and an increased number of foreclosures.⁹² The court likely believed it was benefitting both lenders and borrowers by precluding deficiency judgments on the judicial foreclosure of trust deeds. However, the court was quick to limit its decision on rehearing, excluding commercial loans from the deficiency protection to reduce the potentially adverse effect that protection could have on lenders.⁹³

Undoubtedly, continuing to subject commercial borrowers to deficiency judgments appears to be the wisest policy decision from both the lenders' and borrowers' perspectives. Extending *Chunkapura* protection to businesses could have a devastating impact on lenders, who would be left with huge sums owing on defaulted business loans but no method of recourse. In response, lenders might have to increase the cost of credit by requiring larger down payments and increasing interest rates to protect themselves against such huge losses.⁹⁴ Correspondingly, business expansion

90. *Id.*

91. See George M. Platt, *Deficiency Judgments in Oregon Loans Secured by Land: Growing Disparity Among Functional Equivalents*, 23 WILLAMETTE L. REV. 37, 40 (1987).

It is also interesting to note that other states have adopted fair market value statutes in an effort to protect the borrower from egregious consequences. See generally *Chunkapura*, 226 Mont. at 60-62, 734 P.2d at 1206-08. For example, Washington law provides that, in rendering judgment of foreclosure of a mortgage or trust deed, the court "may in its discretion, take judicial notice of economic conditions, and after a proper hearing, fix a minimum or upset price to which the mortgaged premises must be bid or sold before confirmation of the sale." WASH. REV. CODE ANN. § 61.12.060 (West 1993). For further examples, see UTAH CODE ANN. § 57-1-32 (1993); ARIZ. REV. STAT. ANN. § 45-1512 (1993) (mandating that before rendering deficiency judgment, "the court shall find the fair market value of the real property sold at the time of sale . . . [and] may not render judgment for more than the amount by which the entire amount of indebtedness due at the time of the sale exceeds the fair market value").

92. *Chunkapura*, 226 Mont. at 62-63, 734 P.2d at 1208.

93. *Id.* at 66-67, 734 P.2d at 1210-11.

94. Third-Party Respondent's Reply Brief at 9, 15, *Trustees of Wash.-Idaho-Mont. Carpenters-Employers Retirement Trust Fund v. Galleria Partnership*, 239 Mont. 250, 780 P.2d 608 (1989) (No. 89-29). The respondent also noted that a holding which rendered all non-complex commercial trust deed loans non-recourse "would result in numerous required factual determinations by Montana's District Courts thereby opening wide the floodgates of unnecessary and unuseful litigation." *Id.* at 9; see also *Hearings on S.B. 313 Before the House Bus. & Indus. Comm.*, S.B. 313, 51st Mont. Leg., Reg. Sess. (Mar. 8, 1989) (statement of proponent Chip Erdmann reporting that many lending institutions have had to raise down payments "so that the borrowers have a sufficient investment in the property to pre-

would be hampered due to borrowers' inability to furnish these substantial down payments or pay higher interest.

This sort of balancing must be employed when critiquing the law in its current form. Certainly, the oscillation that has plagued the court in the past will continue absent some degree of reform. The court or legislature must weigh heavily the interests involved and the policies underlying the Act in designing much-needed improvement in the existing law. Further, reformation will entail the integration of *Chunkapura* and its progeny with these interests and policies.

For instance, consider the establishment of a specific point at which the property of a trust deed will be classified as either residential or commercial for purposes of deficiency judgment availability. If protecting the lender's expectancy is to predominate schematic reform, the court or legislature should adopt a time-of-loan distinction. Under this option, lenders will know at the contractual outset what risks they are assuming, and can better assess their financial security. On the other hand, if protecting borrowers is of primary concern, the court or legislature should adopt a foreclosure date rule, thereby allowing borrowers to dictate how lenders may proceed against them and thus securing their economic stability. Finally, if protecting the availability of credit is to prevail, perhaps *Chunkapura* and its progeny, including *Ranieri*, should be discarded, since lenders who are precluded from obtaining deficiency judgments in many circumstances will be less willing to extend credit given their inability to insure their pecuniary interest.

Unquestionably, any lean toward one policy over the others, while satisfying one party's interests, will by its very nature dissatisfy the other party involved. That is what makes any court or legislative action prospectively so difficult. Nevertheless, either branch of government would undoubtedly better the relations between lenders and borrowers, as well as improve the effectiveness of trust indentures, by issuing specific definitions of residential and commercial property and establishing classification dates.

V. CONCLUSION

In the absence of legislative codification of the *Chunkapura* rule, the Montana Supreme Court in recent decisions has interpreted and refined the rule by applying *Chunkapura* to different factual circumstances. In so doing, the court has tried to make one

clude them from merely abandoning it . . . [thereby] preclud[ing] many buyers from entering the market").

thing clear: the prohibition against deficiency judgements following judicial foreclosure applies only to trust deeds involving property that is (1) occupied by the borrower and (2) the borrower's primary residence.

While the rule in its most basic form may seem clear, its subtleties and practicalities are not. The *Midfirst Bank v. Ranieri* decision is just one link in a chain of cases which have sought to clarify *Chunkapura's* muddy waters. Yet the court has left unaddressed important questions, the answers to which are paramount to removing the ambiguities now inherent in Montana law. Additionally, *Ranieri*, while helpful, calls into question the success of any reform in striking a balance between all interested parties and in reaching results consistent with the purposes of the Act.

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