

## Deficiency Judgments: A Louisiana Overview

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# Deficiency Judgments: A Louisiana Overview

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## I. INTRODUCTION

At its most basic, a deficiency judgment is a procedural tool that allows a secured creditor who sells collateral for less than the total amount owed on a loan to collect the difference (the deficiency) from a defaulting borrower. The Louisiana Deficiency Judgment Act<sup>1</sup> is not a solution unique to Louisiana, as many other states employ statutes and follow jurisprudential pronouncements that recognize deficiency judgments in some form or fashion,<sup>2</sup> and numerous courts even use the phrase “deficiency judgment” when describing their state’s rules.<sup>3</sup>

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1. The Louisiana Deficiency Judgment Act consists of LA. REV. STAT. ANN. §§ 13:4106–4108.3 (2006).

2. See, e.g., Terry M. Anderson, *Noncomplying Secured Creditors, Deficiency Judgments, and Implied Satisfaction Under the Nebraska Uniform Commercial Code*, 26 CREIGHTON L. REV. 1 (1992); Bruce J. Bergman, *Insurance Claims and the Deficiency Judgment*, 54 CONSUMER FIN. L.Q. REP. 328 (2000); Joseph P. Cook, *The Secured Party’s Right To A Deficiency Judgment After Violating U.C.C. Section 9-504(3): A Tabular Approach*, 49 CONSUMER FIN. L.Q. REP. 242 (1995); Ellen Barrie Corenswet, *I Can Get It For You Wholesale: The Lingering Problem of Automobile Deficiency Judgments*, 27 STAN. L. REV. 1081 (1975); Michael W. Dunagan, *Repossession Issues, Deficiency Judgments and Bankruptcy Considerations For Sub-Prime Auto Lenders*, 49 CONSUMER FIN. L.Q. REP. 384 (1995); Craig W. Friedrich, *Workouts: Separate Surviving Deficiency Judgment Reduces Amount Realized On Foreclosure*, 20 J. REAL EST. TAX’N 189 (1993); Benjamin Gruberg, *When Is a Mortgage Guarantee Not Worth the Price of a Notary?—The Incongruent Judicial Application of New York’s Deficiency Judgment Statute*, 18 CARDOZO L. REV. 2053 (1997); James S. Hering, *Real Property Foreclosure In Texas: What Is Deficient About the Texas Deficiency Judgment Statute?*, 37 S. TEX. L. REV. 377 (1996); Tiffany B. Lonnevik, *Midfirst Bank v. Ranieri: An Update On Deficiency Judgments Under Montana’s Small Tract Financing Act*, 55 MONT. L. REV. 547 (1994); David B. McMahon, *Commercially Reasonable Sales and Deficiency Judgments Under U.C.C. Article 9: An Analysis of Revision Proposals*, 48 CONSUMER FIN. L.Q. REP. 64 (1994); David Lance Swanson, *The Disposition of Repossessed Collateral In Tennessee: Notice, Commercial Reasonableness, and Deficiency Judgments*, 16 MEM. ST. U. L. REV. 375 (1986); Wanda M. Temm, *Creditor Beware: From Default Through Deficiency Judgment*, 60 J. KAN. B.A. 17 (Oct. 1991); Timothy J. Thomason, James J. Pisanelli & Mark Deatherage, *Arizona’s Deficiency Laws: When Is a Deficiency Judgment Available and How Is One Obtained?*, 28 ARIZ. ATT’Y 23 (Apr. 1992).

3. See, e.g., Wash. Mut. Bank, F.A. v. Archer Bank, 895 N.E.2d 677, 682 (Ill. App. Ct. 2008) (overturning a trial court’s procedural ruling, noting that it “increased the likelihood that [the debtor] would face a deficiency judgment”); Balvich v. Spicer, 894 N.E.2d 235, 236 (Ind. App. 2008) (involving a claim “for contribution on various deficiency judgments that had been entered . . .”); Wellington Co., Inc. Profit Sharing Plan & Trust v. Shakiba, 952 A.2d 328, 336 (Md. App. 2008) (stating that, under Maryland statutes, a creditor is “required to file a motion for a deficiency judgment within three (3) years”); Viafax Corp. v. Citicorp Leasing, Inc., 54 A.D.3d 846, 848 (N.Y. App. Div. 2008) (involving a

The concept underlying all deficiency judgment rules represents a balancing of the interests of creditors (who desire to be paid in full), debtors (who desire to have the maximum value of the collateral which secures their obligation applied to their debt before they are pursued personally), and public policy (which seeks to prevent creditors from receiving a windfall either by under-valuing collateral or by selling collateral in a fashion that brings less than its true value). Each state balances these interests in a different fashion: some mandate procedural steps be followed,<sup>4</sup> others set time limits for obtaining a deficiency,<sup>5</sup> and others look to the method by which the collateral was sold.<sup>6</sup>

This Article explores Louisiana's rules on deficiency judgment and how these rules have changed over time. The rules on deficiency judgment in Louisiana are statutory and flow from two separate sources—the Deficiency Judgment Act<sup>7</sup> and the provisions of Louisiana's version of U.C.C. article 9.<sup>8</sup>

## II. IN LOUISIANA, A DEBTOR RETAINS TITLE TO COLLATERAL; THE CREDITORS MERELY GET A RIGHT TO SEIZE AND SELL THE ASSET AND GET A PRIVILEGE ON THE PROCEEDS OF THE SALE

To fully appreciate Louisiana's rules on deficiency judgments, one must first take into account Louisiana's "title theory" of security devices and the fact that Louisiana, traditionally, has rejected self-help and has required creditors to use lawsuits to foreclose on the collateral that secures their loans.

As a civil law state, Louisiana has long-rejected the notion that the way a creditor obtains security for a loan is by a transfer (be it real or fictitious) of the ownership of collateral to the creditor.<sup>9</sup> The

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creditor who was "not entitled to a deficiency judgment . . ."); *Brown v. Household Realty Corp.*, 189 P.3d 233, 238 (Wash. Ct. App. 2008) (noting that, under Washington state law, "nonjudicial foreclosure procedure [by a] trustee's sale bars any deficiency judgment").

4. *Cf. Wash. Mut. Bank*, 895 N.E.2d 677; *Brown*, 189 P.3d at 238.

5. *See, e.g., Wellington*, 952 A.2d at 336.

6. *See, e.g., Gen. Motors Acceptance Corp. v. Stoval*, 872 N.E.2d 91 (Ill. App. Ct. 2007); *Merchants Bank of N.Y. v. Gold Lane Corp.*, 814 N.Y.S.2d 99 (N.Y. App. Div. 2006).

7. LA. REV. STAT. ANN. §§ 13:4106–4108.3 (2006).

8. *See* LA. REV. STAT. ANN. §§ 10:9-101–9-710 (2002), specifically referring to LA. REV. STAT. ANN. §§ 10:9-610–9-624.

9. Louisiana Civil Code article 3278 defines mortgage. Official comment (b) states that a "mortgage neither gives 'title' nor possession to the mortgagee." LA. CIV. CODE art. 3278 cmt. b (2009). The comment cites *Howe v. Austin*, 40 La. Ann. 323 (La. 1888); *Miller v. Shotwell*, 38 La. Ann. 890 (La. 1886);

Louisiana approach recognizes that ownership of the collateral always remains with the debtor and that all the creditor can obtain is (1) a conventional security interest or mortgage<sup>10</sup> that affects third parties, and (2) a right to seize and sell the collateral and obtain a privilege on the proceeds of the sale.<sup>11</sup> The Louisiana rule is so strong that public policy forbids a debtor, at the time of giving a security interest in collateral, to agree that if the debtor ever defaults, the creditor automatically becomes owner of the collateral.<sup>12</sup>

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Duclaud v. Rousseau, 2 La. Ann. 168 (La. 1847). *See also* Alcolea v. Smith, 90 So. 769 (La. 1921).

10. In this sentence, “security interest” is used in its broadest sense and includes all forms of contractual methods of securing loans including antichresis, Louisiana’s pledge of immovable property (LA. CIV. CODE art. 3176 and following), Louisiana’s version of the Uniform Commercial Code (LA. REV. STAT. ANN. § 10:8-101 (2003) and following, and LA. REV. STAT. ANN. § 10:9-101 and following) as well as other contractual methods of securing loans, such as assignments of rent (LA. REV. STAT. ANN. § 9:4401 (2009)).

11. *See, e.g.*, LA. CIV. CODE art. 3279 (providing that a mortgage gives “the right to cause the property to be seized and sold . . . and to have the proceeds applied toward the satisfaction of the obligation in preference to claims of others”); LA. CIV. CODE art. 3179, concerning antichresis (the “creditor does not become owner of the pledged immovable by failure of payment at the stated time; any clause to the contrary is null, and in this case it is only lawful for him to sue his debtor before the court in order to . . . cause the objects which have been put in his hands in pledge to be seized and sold.”); LA. CIV. CODE arts. 3157, 3165, concerning pawn (the pledge of movables or personal property).

12. *Alcolea*, 90 So. at 771:

Since the edict of Constantine annulling and prohibiting what was known as the *lex commissoria* and the stipulation in the contract of pledge which it authorized, whereby, in default of payment by the pledgor, the thing pledged became the property of the pledgee without further action on his part, such stipulations have been prohibited in all countries where the civil law prevails, and the prohibition has long since become part of the common law, the commentators on both systems agreeing that they are *contra bonos mores* and oppressive; that they involve the abuse of the power of the strong over the weak, represent odious speculations by those who have money, at the expense of those who need it, and are unconscionable. Denis on Contracts of Pledge, c. XXIV, p. 253 et seq., citing Troplong, *Nantissement*, § 379 et seq.; Pothier, *Nantissement*, § 18; De St. Joseph, *Concordance des Codes Civils*, p. 109; Merlin, *Rept. verbo ‘Gage’*; C. N. 2578; Story on Bailments, § 345; Kent’s Com. vol. 2, § 583; Jones on Pledges, § 553; Rev. Civ. Code La. art. 3132; Russell v. Southard, 53 U.S. 139, 12 How. 139, 13 L. Ed. 927; Peugh v. Davis, 96 U. S. 332, 24 L. Ed. 775; Pritchard v. Elton, 38 Conn. 434.

This rule, however, applies only to agreements between a creditor and debtor prior to a default; after a default occurs, the creditor and debtor may agree to a *dation en paiement*, the Louisiana term for a “giving in payment”—a complete

Louisiana's refusal to recognize real or fictional transfers of title to a creditor as a method of securing loans<sup>13</sup> is different from the common law "deed of trust" theory (in which title is deemed to be transferred to the creditor until the loan is paid).<sup>14</sup> In fact, the use of a "deed of trust" in Louisiana has been held to result not in a transfer of title but merely a Louisiana mortgage, with no transfer of title to the creditor, for Louisiana puts the substance of the transaction over the form when the substance is apparent on the face of the document.<sup>15</sup>

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or partial satisfaction of the debt by transferring the ownership of the collateral to the creditor. See LA. CIV. CODE arts. 2655-2657; LA. REV. STAT. ANN. §§ 13:4108.1, 4108.2; *infra* note 23.

13. Out of state attorneys should not be confused by the fact that sometimes the term "assignment" is used in Louisiana law to refer to a transfer of title and other times as a security interest. See, e.g., LA. REV. STAT. ANN. § 9:4401 (regarding a lessor giving a security interest in the rental stream from immovable property). However, it is clear that even though an "assignment" is usually thought of as part of the "sale" articles of the Louisiana Civil Code (*cf.* LA. CIV. CODE arts. 2438 and following), when an "assignment" is for the purpose of granting a security interest, the debtor never loses ownership of the collateral. See LA. REV. STAT. ANN. § 9:4401 (expressly stating that "[a]ny obligation *may be secured by an assignment* by a lessor or sublessor of leases or rents, or both leases and rents, pertaining to immovable property") (emphasis added).

14. See *In re Roberts*, 26 B.R. 397, 399 (Bankr. D. Me. 1983) ("Maine has adopted the title theory of mortgages which provides that a mortgage is a conditional conveyance that vests legal title in the mortgagee."); *Bailey Mortgage Co. v. Gobble-Fite Lumber Co., Inc.*, 565 So. 2d 138, 143 (Ala. 1990) ("Alabama is a title theory state . . . a mortgage passes legal title to the mortgagee, and the mortgagor is left with the equity of redemption."); *Conference Ctr. Ltd. v. Research Corp. of New England*, 455 A.2d 857, 860 (Conn. 1983) ("[A] mortgagee . . . both by common-law rule and by statute, is deemed to have taken legal title upon the execution of the mortgage . . . . As a titleholder, in the absence of any agreement to the contrary, the mortgagee has a right to immediate possession against the mortgagor."); *Houle v. Guilbeault*, 40 A.2d 438, 440 (R.I. 1944) ("In this state a first mortgage is a conveyance to [the] mortgagee of the legal fee in the land defeasible upon condition that the mortgagor will perform the condition of the mortgage."). See also RESTATEMENT (THIRD) OF PROP.: MORTGAGES §4.1, at 191-201 (1997).

15. In *Miller v. Shotwell*, 38 La. Ann. 890, 892 (La. 1886), the parties used an Alabama deed of trust form concerning property located in Louisiana. The Louisiana Supreme Court looked at the entirety of the form and concluded that because, on the face of the document, the creditor was the buyer of the property rather than the seller (as would usually be the case with a credit sale), the document in fact was a mortgage and not a transfer of ownership. As the court stated:

The text of the instrument, viewed in the light of our jurisprudence, and of the laws of Alabama, as shown both by evidence and authority, leaves no doubt in our minds as to the true intention of the parties thereto. It was clearly to create a mortgage by way of security for the purchase price of the lands therein described.

The *Restatement of the Law of Property, Mortgages* has rejected the “title transfer” theory in deed of trust transactions and recognizes that the essence of a secured loan is that the ownership of the collateral should be seen as remaining with the debtor until default.<sup>16</sup> Because title to the collateral always remains with the debtor, a default by the debtor does not result in an immediate transfer of ownership to the creditor in Louisiana. Rather, the creditor must take steps to seize and dispose of the collateral and seek to apply the proceeds of the sale to the debt. The secured creditor’s rights to the proceeds are said to be a “privilege,” because if the security interest is properly perfected, the secured creditor is entitled to the proceeds in preference to the claims of the debtor and all other third parties whose security interests are inferior to those of the foreclosing creditor.<sup>17</sup>

### III. LOUISIANA HAS TRADITIONALLY REQUIRED A CREDITOR TO USE JUDICIAL PROCESS TO SELL THE COLLATERAL WHICH SECURES A LOAN

A Louisiana creditor is permitted to foreclose on collateral only upon the debtor’s default.<sup>18</sup> Louisiana has always rejected “self-

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16. RESTATEMENT (THIRD) OF PROP.: MORTGAGES §4.1, at 182–204 (1997).

17. See LA. CIV. CODE art. 3278 (a mortgage creates a “nonpossessory” right over property securing certain obligations). Civil Code article 3279 outlines the rights granted to the mortgagee by virtue of its security. Among those include: the “right to cause the property to be seized and sold in the manner provided by law” upon the default of the mortgagor. The article continues by noting that the proceeds of the sale are to be “applied toward the satisfaction of the obligation in preference to the claims of others.” *Id.* art. 3279. Civil Code article 3307 generally delineates the order of preference that proceeds are distributed to creditors when a debtor’s property is sold. The article states that the “mortgagee is preferred to [1] the unsecured creditor and [2] to [other mortgagees] whose rights became effective after the mortgage becomes effective as to them.” *Id.* art. 3307. Civil Code article 3338 provides that an instrument creating real rights in immovable property (such as mortgage) must be recorded in the mortgage or conveyance record to have effect as to third persons (such as unsecured creditors or superior or future inferior mortgagees). Civil Code article 3347 provides that the effect of recordation on third parties begins when the instrument is filed with the recorder of mortgages. The article further provides that the document is considered filed when accepted by the recorder for filing. Earlier filed mortgages outrank those that are subsequently filed, and the earlier or superior mortgage will be paid in preference to the later or inferior mortgage.

18. Louisiana law prohibits the creditor from obtaining ownership of the collateral prior to default. See *Alcolea v. Smith*, 90 So. 769, 771 (La. 1921). See also LA. CIV. CODE art. 3279 (conditioning the right to seize and sell collateral “upon failure of the obligor to perform the obligation that the mortgage secures”).



help”]; with only a few limited exceptions,<sup>19</sup> a creditor who attempts to take control of collateral outside of judicial process commits a tort.<sup>20</sup> Thus, to distinguish these unlawful transactions from proper situations where the creditor does not commit a tort but where the question is the availability of a deficiency judgment, the remainder of this Article uses the phrase “private sale” only in reference to debtors who have voluntarily turned possession of the collateral over to the creditor for disposition.

Louisiana creditors may utilize one of three methods to recoup value from collateral: by judicial sale,<sup>21</sup> by a private sale conducted

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19. Louisiana law provides few self-help provisions. For instance, Revised Statutes section 9:4759 gives the owner of a self-storage facility, upon the default of a person leasing storage space, the right to “remove any lock on the rented self-storage space . . . compile a brief and general description of the movable property upon which a privilege is claimed and shall be entitled to place his own lock upon such space until his privilege is satisfied.” LA. REV. STAT. ANN. § 9:4759 (2007). The statute details further steps to be taken to notify the lessee of the intent to sell the seized property in order to satisfy the privilege.

Section 9:4502(C) gives the repairmen of movable goods (personal property) the right to sell collateral under \$10 in value in the event of default. The provision states, in pertinent part, that where collateral:

is of a value of ten dollars or less . . . then it shall not be necessary to advertise such property for sale, but in lieu thereof the privilege holder shall, at least ten days prior to such sale, mail by registered mail to the owner or apparent owner at his last known address a notice stating the intention to sell such property and giving the date, time and place of the sale.

*Id.* § 9:4502(C).

20. See, e.g., *Bryant v. Sears Consumer Fin. Corp.*, 617 So. 2d 1191 (La. App. 3d Cir.), writ denied, 619 So. 2d 533 (La. 1993). Cf. *Dixie Sav. & Loan Ass’n v. Pitre*, 751 So. 2d 911 (La. App. 5th Cir.), writ denied, 751 So. 2d 855 (La. 1999).

21. Louisiana Code of Civil Procedure article 2291 states that money judgments can be satisfied by seizure and sale of property. The following procedural code articles describe the process of seizure under Louisiana’s writ of *feri facias* and subsequent judicial sale. LA. CODE CIV. PROC. 2291 (2009). Code of Civil Procedure article 2253 allows a judgment creditor to obtain a writ “directing the sheriff of the parish where the judgment is to be executed to enforce [the writ].” Under article 2294, seizure by a writ of *feri facias* must be made within one year. Code of Civil Procedure article 2293 directs the sheriff to file a notice of seizure in the mortgage records of the parish where the immovable property is located, to serve the judgment debtor and the occupants of the property with a notice of seizure that lists the property that has been seized, and to file an affidavit with the Clerk of Court who issued the writ listing the names of all persons provided notice of the seizure. Article 2294 mandates that when seizure has been made, the sheriff must proceed with a sale. Article 2331 directs the sheriff to publish notice of sale, twice in the event that the seized property is immovable. Article 2332 provides that the property shall be appraised unless the mortgage contains a waiver of appraisal and the seizing creditor directs the sale to be conducted without appraisal. The property is sold subject to any superior mortgages. *Id.* art. 2335.

after the debtor has voluntarily turned over the collateral to the creditor,<sup>22</sup> or by the debtor's voluntary transfer of ownership to the creditor *after* default.<sup>23</sup> In each instance, the creditor must apply the proceeds realized from disposition of collateral to the debtor's outstanding debt. If a balance remains owing to the creditor after applying the sales proceeds to the debt, Louisiana law prevents the creditor from pursuing the debtor personally for the balance (the "deficiency") unless the creditor has followed certain procedures and complied with certain statutory conditions. Following these procedural and statutory requirements are key to the creditor's rights to a deficiency judgment.

The outline of the rules can be generally summarized as follows and are explored in detail in the rest of this Article:

- If the creditor forecloses by a judicial sale, the creditor is forbidden from pursuing a deficiency unless the judicial sale strictly complies with the judicial appraisal procedures,<sup>24</sup>
- If the creditor conducts a private sale and the security interest is anything except a security interest under Louisiana's version of U.C.C. articles 8<sup>25</sup> or 9,<sup>26</sup> the creditor is forbidden from pursuing a deficiency unless, after default, the debtor and creditor have reached a written agreement that meets Louisiana statutory requirements.<sup>27</sup> A creditor, however, cannot use "self help" to seize the

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22. The Louisiana Deficiency Judgment Act allows a creditor and debtor to agree to a private sale and still obtain a deficiency judgment under certain conditions. See LA. REV. STAT. ANN. §§ 13:4108.1, 4108.2 (2006). See also LA. CIV. CODE art. 3165 (2009) (prior to 1990 (the effective date of Louisiana's adoption of its version of U.C.C. article 9 by 1989 La. Acts No. 12, § 4 and 1989 La. Acts No. 135, § 12) dealt with private sales of movable items pledged to a creditor).

23. Civil Code article 2655 defines a "giving in payment" as a "contract whereby an obligor gives a thing to the obligee, who accepts it in payment of a debt." LA. CIV. CODE art. 2655 (2009). This process is referred to in Louisiana by its French term, a *dation en paiement*. See 2 MARCEL PLANIOL, CIVIL LAW TREATISE Pt. 1, No. 522, at 291 (La. State Law Inst. trans., 11th ed. 1959) (1939). See also *Mack Trucks, Inc. v. Magee*, 141 So. 2d 85, 87 (La. App. 1st Cir. 1962).

24. LA. CODE CIV. PROC. art. 2771. A "creditor may obtain a judgment against the debtor for any deficiency due on the debt after the distribution of the proceeds of the judicial sale *only* if the property has been sold under the executory proceeding after appraisal in accordance with the provisions of Article 2723." *Id.* (emphasis added). If the creditor has proceeded by an ordinary (as opposed to executory) proceeding, however, the judgment in the ordinary proceeding results in personal liability for the debtor. Thus, in those instances, the court has already declared that the debtor personally owes the money and the sale of collateral occurs *after* that personal judgment.

25. LA. REV. STAT. ANN. §§ 10:8-101-10:8-511 (2002).

26. *Id.* §§ 10:9-101-10:9-710.

27. *Id.* § 13:4108.2.

collateral if the debtor does not voluntarily turn it over to the creditor. Louisiana historically has rejected “self help” remedies by creditors<sup>28</sup> except in very limited statutorily-allowed circumstances.<sup>29</sup>

- If the creditor conducts a private sale and the security interest has been perfected under Louisiana’s version of U.C.C. articles 8<sup>30</sup> or 9,<sup>31</sup> then the sale will be presumed to satisfy the debt unless the creditor has proceeded by way of a commercially reasonable sale, and in such instance the burden of proof is on the creditor to prove that the sale was conducted in a commercially reasonable manner.<sup>32</sup>

#### IV. JUDICIAL SALES

A Louisiana creditor with a mortgage, privilege, or security interest (other than a security interest under Louisiana’s versions of U.C.C. arts. 8 or 9) has two judicial mechanisms to foreclose on collateral in the event of debtor default—ordinary process or executory process.

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28. See *Guste v. Hibernia Nat’l Bank*, 655 So. 2d 724, 729–30 (La. App. 4th Cir. 1995), in which the court noted:

Paragraph (b) of the official comments [of Civil Code article 3279] states, in part: The requirement that the seizure and sale must be “in the manner provided by law” emphasizes the long tradition in Louisiana of requiring recourse to judicial procedures and generally rejecting private sale or self-help as a method of execution. Accordingly, it is against the public policy of this state for mortgagor and mortgagee to incorporate in the mortgage instrument any procedure designed to completely bypass and waive the laws regarding foreclosure so that the mortgagor regains title merely upon default of payment without the necessity of a seizure and judicial sale and with the mortgagor forfeiting any claim on the surplus remaining because of prior payment or because of enhancement of the value of the mortgaged property.

See also *Atkinson v. Sumrall*, 598 So. 2d 1166, 1168 (La. App. 1st Cir. 1992), in which the court stated that Revised Statutes section 13:4108.1:

allows a creditor to seek a deficiency judgment against a debtor, in a commercial transaction, even in the absence of judicial process, when the creditor and debtor have reached an agreement as to the value to be attributed to the property. Contrary to plaintiff’s argument, the statute does not sanction self-help foreclosure, which has been intentionally rejected in Louisiana law.

29. See, e.g., LA. REV. STAT. ANN. §§ 9:4502, 9:4759 (2006), respectively giving the repairman of movables and warehousemen the right to seize movables, without resort to court proceedings, in anticipation of sale to satisfy outstanding obligations.

30. *Id.* §§ 10:8-101–10:8-511.

31. *Id.* §§ 10:9-101–10:9-710.

32. *Id.* §§ 10:9-610, 10:9-616, 10:9-626.

A suit by “ordinary process” entails a full-fledged lawsuit, with all the usual and customary requirements that any lawsuit entails.<sup>33</sup> There is a petition,<sup>34</sup> a citation<sup>35</sup> (which must be served on the defendant by the sheriff),<sup>36</sup> and an opportunity for the debtor to file an answer.<sup>37</sup> The debtor may propound discovery if desired<sup>38</sup> or object to the procedure through dilatory,<sup>39</sup> declinatory,<sup>40</sup> or peremptory exceptions.<sup>41</sup> Even if a defendant fails to file an answer or exception, a judgment cannot be taken against the defendant until the lapse of certain statutorily specified time limits.<sup>42</sup>

In ordinary proceedings, the judgment obtained grants the creditor a personal judgment against the debtor, collectable out of all of the debtor’s assets and, if the creditor has requested this in its petition, recognizes the validity of the creditor’s security interest. Once this judgment in an ordinary proceeding has been obtained, the creditor may (1) have the court issue a writ to seize<sup>43</sup> and sell<sup>44</sup>

33. Ordinary proceedings are discussed extensively in Book II of the Louisiana Code of Civil Procedure. It encompasses articles 851 to 2031. A full discussion of the procedural rules is beyond the scope of this Article; for a more detailed discussion of Louisiana procedural requirements on ordinary lawsuits, see FRANK L. MARAIST, CIVIL PROCEDURE §§ 5–10, in 1 LOUISIANA CIVIL LAW TREATISE 125–363 (2008).

34. LA. CODE CIV. PROC. arts. 852, 891–893 (2009).

35. *Id.* art. 1201.

36. *Id.* art. 1291 (directing that service “shall be made by the sheriff of the parish where service is to be made or of the parish where the action is pending”). Code of Civil Procedure article 1201 states that citation and service “are essential in all civil actions except . . . executory proceedings . . . Without them all proceedings are absolutely null.”

37. *Id.* arts. 1001–1006 (governing answers to petitions).

38. *Id.* arts. 1420–1475.

39. *Id.* art. 926.

40. *Id.* art. 925.

41. *Id.* art. 927.

42. Code of Civil Procedure article 1001 requires defendants to file their answer within fifteen days of service of citation; failure to do so cuts off certain procedural defenses. *See id.* art. 928.

Article 1002 provides that, notwithstanding the fifteen day answer delay, a defendant may file an answer at any time prior to confirmation of a default judgment. Code of Civil Procedure articles 1701 to 1704 address the process of entering and confirming a default judgment. Article 1701 provides that when the defendant fails to file an answer within the delay allowed, the plaintiff may obtain a judgment of default on written or oral motion before the court. Article 1702 provides that a judgment of default may be confirmed two days, exclusive of holidays, after entry of a judgment of default provided that proof of demand to prove a *prima facie* case has been submitted.

43. The seizure is executed through a writ of *feri facias*. The writ of *feri facias* is discussed at Louisiana Code of Civil Procedure article 2291.

44. LA. CODE CIV. PROC. arts. 2331–2343 (addressing the requirements of the judicial sale under the writ of *feri facias*).

the property to which the security interest attaches and (2) record the personal judgment in the mortgage records, transforming the personal judgment into a judicial mortgage affecting all of the debtor's presently owned property in that parish as well as all property the debtor may later acquire in that parish.<sup>45</sup>

Executory process, by contrast, is a pre-judgment remedy.<sup>46</sup> Executory process begins with the filing of a special kind of lawsuit; there is no citation and no service of process on the debtor.<sup>47</sup> The creditor, with proper paperwork attached to the suit,<sup>48</sup>

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45. Civil Code article 3284 provides that a judicial mortgage "is established by law to secure a judgment." The judicial mortgage is created by "filing a judgment with the recorder of mortgages." LA. CIV. CODE art. 3300 (2009). Article 3302 directs that the judicial mortgage burdens "all the property of the obligor that is made susceptible of mortgage" by law. The effect of the mortgage is limited to property encompassed within the Parish where the judgment is filed. The judicial mortgage is a general mortgage. Article 3303 explains that, once recorded in a parish, the mortgage encumbers all property owned by the judgment debtor at the time of its creation as well as all future property of the obligor upon acquisition. A non-Louisiana judgment can create a judicial mortgage only after statutory procedures are followed to make the non-Louisiana judgment recognized as a Louisiana judgment. LA. CIV. CODE art. 3305 (2003).

46. LA. CODE CIV. PROC. art. 2631. The article states that executory proceedings are "those which are used to effect the seizure and sale of property, without previous citation and judgment, to enforce a mortgage or privilege thereon evidenced by an authentic act importing a confession of judgment, and in other cases allowed by law." *Id.*

47. *Id.* art. 2631. *See also id.* art. 2640 (stating that citation "is not necessary in an executory proceeding").

48. A petition for executory process must comply with the general requirements for petitions, but be "accompanied by sufficient written proof that the creditor is entitled to . . . executory process." 1A FRANK L. MARAIST, CIVIL PROCEDURE § 3.3, in 1A LOUISIANA CIVIL LAW TREATISE 36 (2005). *See also* LA. CODE CIV. PROC. art. 2635.

In addition, attached to the petition must be certain statutorily required evidence (LA. CODE CIV. PROC. art 2634), some of which must be in "authentic form." A document in Louisiana is in authentic form if it is executed in the presence of a notary and two witnesses. LA. CIV. CODE art. 1833 (2009).

Pursuant to Civil Procedure article 2635, attached to the executory process petition must be: (1) "authentic evidence" of the "note, bond, or other instrument evidencing the obligation secured by the mortgage, security agreement or privilege" (although the note need not be in authentic form if it is paraphed for identification with the mortgage (LA. CODE CIV. PROC. art 2636) or, in the event the note was not paraphed, there is an affidavit by the creditor (LA. REV. STAT. ANN. § 9:5555 (2007))); and (2) the authentic act of mortgage or privilege on immovable property importing a confession of judgment. A "paraph" is a flourish at the end of a signature (think of how John Hancock signed the Declaration of Independence); in Louisiana law, however, a "paraph" is a mechanism used by a notary public to identify a note (held by the creditor) with a mortgage (which is to be recorded in the mortgage records). The usual form of

can obtain an immediate judgment that orders the seizure and sale of the property, although the judgment is only against the property and does not constitute a personal judgment against the debtor. Thus, the executory process judgment is “*in rem*”: it allows only for the seizure and sale of property and does not determine whether the debtor is personally liable on the debt.<sup>49</sup> Executory process is substantially faster than ordinary process<sup>50</sup> and limits the types of defenses a debtor may raise.<sup>51</sup>

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a paraph is a statement on the note reading: “Ne Varietur for identification with an Act of Mortgage passed before me this \_\_\_ day of \_\_\_, 20\_\_\_,” followed by the notary’s signature.

If the security interest is on movable property, the security document must contain a confession of judgment but need not be in authentic form. If the security interest is made pursuant to U.C.C. article 9, it need not be executed or acknowledged before a notary. *See* LA. CODE CIV. PROC. art. 2636(5); LA. REV. STAT. ANN. § 10:9-629 (2002).

49. Code of Civil Procedure article 2638 directs that an order of seizure and sale issue as opposed to requiring entry of judgment.

50. As noted, under ordinary process the creditor must file its petition, and have the debtor cited and served with the judicial demand.

There typically is some delay between the period of time that the petition is filed and the sheriff receives the request for service. In practice, a creditor can expect a week or more to elapse between the time its petition is filed and the debtor is served and cited. LA. CODE CIV. PROC. arts. 1201–1314. After service, the debtor has fifteen days to file an answer (*id.* art. 1001) if there have been no extensions are granted by the trial court or allowed by counsel for the creditor. In the event that an answer is not timely filed, the creditor may seek a judgment of default. *Id.* art. 1701. Two days later, exclusive of holidays, the preliminary default judgment may be confirmed. *Id.* arts. 1202, 1702.1.

After judgment is entered, the debtor has a seven day window within which to new trial. *Id.* art. 1974. The debtor has thirty days from the expiration of the new trial delays (or the denial of a timely motion for new trial) to seek a suspensive appeal. *Id.* art. 2123. Only after the suspensive appeal delays have run can a creditor begin to execute on the judgment. Thus, under the best case scenario where no delays were encountered by the creditor (a situation that any practicing attorney will agree rarely, if ever, occurs) a creditor can expect to execute on its judgment no sooner than three months after filing a lawsuit. Only at this point can the creditor seek a writ of seizure and sale from the Sheriff. In general, the delay between seeking seizure and the eventual sale of collateral and distribution of proceeds must be a minimum of thirty days for immovable property because of the requirements that the sale be advertised twice, with the first advertisement occurring at least thirty days prior to the judicial sale. *Id.* art. 2331; LA. REV. STAT. ANN. § 43:203 (2007). In reality, the delay from the time the writ of seizure reaches the sheriff’s office until the judicial sale is held is a minimum of forty-five days and often takes longer.

As a practical matter, the time from filing of suit through judicial sale (assuming that the debtor does not file an answer and the default judgment is not appealed) takes between three to five months. Because most creditors do not file suit the instant that a debtor defaults, it can be presumed that a creditor

Until 2001, executory process had an additional advantage, particularly if the creditor was over-secured. If the value of the asset exceeded the outstanding debt, creditors who wished to proceed rapidly would use executory process. Not only were executory procedural delays truncated in comparison to ordinary proceedings, but the law also provided that a creditor could proceed with a sale of the collateral with or without appraisal.<sup>52</sup> In other words, a creditor was given the option in executory proceedings of obtaining an immediate judgment and a quick sale of the collateral in exchange for voluntarily forgoing any chance of a deficiency if the creditor's pre-judgment evaluation of the collateral's value was wrong. Of course, the creditor could always proceed by executory process with appraisal and preserve the right to seek a deficiency.

Prior to 2001, there was no mechanism in the slower, ordinary process suit to sell the asset without appraisal. Sales without appraisal cost less,<sup>53</sup> and executory proceedings in general are far

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proceeding through ordinary process can expect at least a six month or more delay in obtaining a foreclosure from the time the debtor defaults. Conversely, creditors proceeding by executory process need only file their petition for executory process with the trial court. If the petition contains the proper documentation, the creditor is entitled to an immediate court order directing the sheriff to seize and sell the collateral securing the debt. As noted above, the delay between seizure and sale is usually a minimum of forty-five days.

Comparing the two methods (ordinary and executory), it is apparent that executory proceedings result in a far more expeditious seizure and sale of the property (although the executory judgment is *in rem* only and does determine whether the debtor is personally liable on the debt)

51. Code of Civil Procedure article 2642 limits the defenses available to the debtor to (1) injunction of seizure and sale, and (2) a suspensive appeal of the order of seizure and sale. Code of Civil Procedure article 2751 further limits the grounds for granting an injunction to claims that (1) the debt is extinguished, (2) the privilege is unenforceable, or (3) the incorrect procedure was followed.

52. Louisiana Code of Civil Procedure article 2723 provides that "property seized must be appraised . . . unless appraisal has been waived in the act evidencing the mortgage." Usually, all mortgages contain a clause in which the debtor waives the appraisal requirement; this allows the creditor the option to proceed with or without appraisal.

53. LA. REV. STAT. ANN. § 13:4363 (2006), directing the creditor and judgment debtor to

name an appraiser to value the property and to notify the sheriff of his appointment . . . prior to the time of the sale. The appraisal of the debtor and seizing creditor shall be made and delivered to the sheriff at least two days, exclusive of holidays, prior to the time of the sale. If there are two or more debtors or seizing creditors and these parties cannot agree as to which should act as or appoint an appraiser, and in any case where an appraisal is required prior to the judicial sale and

less expensive than ordinary proceedings with the concomitant waves of discovery, depositions, and motion practice. In 2001, however, the Louisiana Legislature amended the Code of Civil Procedure to allow the creditor in an ordinary proceeding (which results in a personal judgment) to sell the property without appraisal.<sup>54</sup> To date, there has been no reported case interpreting this statutory change. It remains to be seen whether a creditor who obtains a judgment by ordinary process and then seeks a judicial sale without appraisal will be held to have waived the right to a deficiency judgment or will be held to be entitled to seek the deficiency.<sup>55</sup>

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which is not otherwise provided for in this Section, on the ex parte application of the sheriff or of any interested party, the court shall designate the party to act as or appoint the appraiser.

Thus, it is apparent that prior to any judicial sale with appraisal, the creditor must incur the costs of employing an appraiser to give an appraisal of the seized property. In addition, even if the debtor does not appoint an appraiser, the sheriff must appoint one for the debtor (*id.* § 13:4363–13:4364), and if the creditor's and debtor's appraisals differ by more than \$250,000, a third appraiser is appointed (*id.* § 13:4365). The costs of these appointed appraisers are incorporated into the cost of conducting the sale and debited from the amount realized after disposition of the property.

54. 2001 La. Acts No. 588 (effective Aug. 15, 2001). The Act amended Code of Civil Procedure article 2332, which provides, in pertinent part, as follows (additions are italicized):

The property seized must be appraised according to law prior to the sale. However *when the property seized is subject to a mortgage, security agreement, or other document creating a privilege in which the debtor has waived the right to appraisal and the judgment recites that the right of the judgment creditor to enforce the judgment is limited to the collateral or security for the amount of such judgment, there shall be no requirement that the property seized be appraised prior to the sale.*

55. The argument in favor of excluding a deficiency judgment following a sale without appraisal in ordinary proceedings is that the text of the Deficiency Judgment Act does not distinguish between executory and ordinary proceedings. It states:

Unless otherwise provided by law, if a mortgagee or other creditor takes advantage of a waiver of appraisal of his property, movable, immovable, or both, by a debtor, and the proceeds *of the judicial sale* thereof are insufficient to satisfy the debt for which the property was sold, the debt nevertheless shall stand fully satisfied and discharged insofar as it constitutes a personal obligation of the debtor . . . .

LA. REV. STAT. ANN. § 13:4106(A) (emphasis added).

*Cf.* Guar. Bank of Mamou v. Cmty. Rice Mill, Inc., 502 So. 2d 1067, 1070 (La. 1987) (involving a deficiency claim against sureties rather than the debtor). The *Guaranty Bank of Mamou* case is discussed further in *infra* note 57.



## V. THE ORIGINS OF LOUISIANA'S DEFICIENCY JUDGMENT ACT AND ITS RELATIONSHIP TO EXECUTORY PROCESS

An understanding of the technical rules governing executory process is critical, because although the Louisiana Deficiency Judgment Act predated the procedural rules on executory process,<sup>56</sup> Louisiana courts have traditionally linked the two concepts.<sup>57</sup>

The Deficiency Judgment Act originated in Act No. 28 of 1934 and was amended in 1952,<sup>58</sup> in 1960,<sup>59</sup> and again in the late 1980s.<sup>60</sup> Although there appears to be no extant legislative history explaining the purpose of the Act, it arose during the heights of the Great Depression and obviously was designed to prevent a creditor

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56. The Louisiana Deficiency Judgment Act arose in the 1930s; however, Louisiana's rules concerning executory process date back to the 1800s. See Henry McMahon, *The Historical Development of Executory Procedure in Louisiana*, 32 TUL. L. REV. 555, 567 (1958). As early as 1825, decisions noted the importance of authentic acts if property was to be taken without citation and service of process. See *Nichol v. De Ende*, 3 Mart.(n.s.) 310, 1825 WL 1283, at \*2 (La. 1825):

It does seem somewhat hard to seize and sell a man's property without calling him in judgment, and that the sheriff's levy should be the first notice to him that he has failed to comply with his contract. But such is the legal effect of a mortgage contract, and he ought to have considered the consequence before he bound himself with such solemnity. Besides a man is not supposed to be absent from or inattentive to his property; and if any irregularity or illegality take place in this extraordinary mode of immediate execution, the order of the judge, on proper application, would be suspended; or in all events a defendant in execution could bring his cause before the tribunals of the state so as to have his rights investigated, as in ordinary suits.

57. See, e.g., *Guar. Bank of Mamou*, 502 So. 2d at 1070: "The [Deficiency Judgment Act] is located in Chapter 21 of Title 13 of the Revised Statutes entitled 'Executory Process.' Although it does not expressly limit its provisions to executory proceedings, a close reading of its provisions reveals its intent to apply to situations in which executory proceedings are used." This case, however, did not involve a deficiency judgment claim against the debtor, but rather against sureties, and the case arose prior to the 2001 amendment of Code of Civil Procedure article 2332 allowing sales without appraisals in ordinary proceedings. Thus, it remains to be seen whether courts today will treat the language of this case as merely *dicta*. When the Deficiency Judgment Act was passed, the Revised Statutes had not been created (they did not come into existence until 1950), and the placement of the Deficiency Judgment Act in the same section of the Revised Statutes dealing with deficiency judgments was a result of the Louisiana Law Institute's actions, not an explicit legislative linking of executory process and deficiency judgments. On the other hand, at the time the Deficiency Judgment Act was created, there was no mechanism to foreclose without appraisal by ordinary process.

58. 1952 La. Acts No. 20.

59. 1960 La. Acts No. 32.

60. 1989 La. Acts No. 137.

from foreclosing on a debtor's collateral, buying the collateral at the sheriff's sale, attributing nothing from the bid price towards the debt, and then pursuing the debtor for the remaining outstanding debt, allowing the creditor to obtain a windfall by attempting to collect the entire debt and keep all the collateral if the creditor was the successful bidder at the sheriff's sale.<sup>61</sup>

The Deficiency Judgment Act contains express language that prohibits parties from circumventing it. The statute proclaims that it "declares a public policy and the provisions thereof can not, and shall not be waived by a debtor."<sup>62</sup> Although the text of the Louisiana Deficiency Judgment Act refers only to sales by judicial process without appraisal,<sup>63</sup> shortly after the Deficiency Judgment Act was adopted, Louisiana courts began holding that any non-judicial sale also bars a deficiency judgment.<sup>64</sup>

The strong link between executory process and deficiency judgments is understandable. That is because in executory process a creditor may choose to collect only from the collateral (by foreclosing without appraisal), or may collect first from the collateral by a judicial sale with appraisal and then seek to obtain the balance due from the debtor (the "deficiency judgment"). The combination between the strong public policy represented by the Deficiency Judgment Act and the fact that executory process results in an immediate judgment without citation or service of process led to a series of cases holding that it was not only a lack of appraisal that would bar a deficiency in executory proceedings,

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61. As the Louisiana Supreme Court has noted, "Unquestionably this act was enacted for the benefit and protection of the mortgage debtor . . . ." *Southland Inv. Co. v. Motor Sales Co.*, 5 So. 2d 324, 326 (La. 1941).

62. LA. REV. STAT. ANN. § 13:4107 (2006). The Act, however, only applies "to mortgages, contracts, debts or other obligations made, or arising on or after August 1, 1934." *Id.*

63. The pertinent language of the act is quoted in full at *supra* note 55.

64. The preeminent case is *Home Finance Service v. Walmsley*, 176 So. 415 (La. App. 2d Cir. 1937), decided shortly after the enactment of the Deficiency Judgment Act. *Walmsley* held that a non-judicial sale bars a deficiency:

While the statute under consideration refers particularly to judicial sales without appraisement, we are of the opinion that the statement of the public policy therein is sufficiently broad to disclose that it was the intention of the lawmakers to place a stamp of disapproval on any practice whereby encumbered property is sold without judicial appraisement, and to sanction the type of agreement, such as the one before us, would be to allow the employment of a device calculated to defeat the underlying purposes which prompted the passage of the law.

*Id.* at 417.

but also that any “fundamental”<sup>65</sup> defect in the executory proceedings would bar a deficiency even if there was an appraisal.

Therefore, creditors who invoked executory process used to proceed at their peril, even if they sought to foreclose with appraisal. Debtors’ counsel understandably would refuse to raise defenses at the time of the executory process foreclosure because, if defenses were raised at this stage, the creditor had the option of converting the executory process suit into an ordinary process suit or to amend and correct the deficiencies.<sup>66</sup> Debtors’ counsel realized that as long as the “fundamental defect” rule continued, there was no advantage to raising a potential defect during the executory proceedings. It made much more sense for debtors to wait until after the foreclosure sale when the creditor either converted the executory proceedings into an ordinary process suit to obtain the deficiency judgment or filed a separate suit for the deficiency judgment. Then and only then would many debtors point out the alleged “fundamental” defect. If the debtors were wrong and no “fundamental” defect was found, the debtors were no worse off than if they had raised the issue during the executory proceedings—they would be liable for the deficiency. On the other hand, the deficiency judgment would be barred if debtors were able to convince a court that the now-completed executory proceeding contained a fundamental defect.<sup>67</sup> Further, the jurisprudential rules on “fundamental” defects were so strong that if the creditor was the successful bidder on the property at the sheriff’s sale, the defect could be raised to invalidate the creditor’s purchase of the collateral at the sheriff’s sale.<sup>68</sup>

A spiraling round of jurisprudence and inter-related statutes developed in which courts would hold certain items were defects,<sup>69</sup> the legislature would amend or create statutes to allow executory process and a deficiency judgment despite this defect, and then courts would discover other substantial defects that would bar a deficiency. Many of these matters arose in trial court (not appellate) decisions, but the impact of changes in legislation was

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65. *Reed v. Meaux*, 292 So. 2d 557 (La. 1973); *Cent. Credit Union v. Montgomery*, 207 So. 2d 762 (La. 1968); Samuel Blaize, *Civil Procedure—Deficiency Judgment After Invalid Executory Process*, 29 LA. L. REV. 405 (1969).

66. LA. CODE CIV. PROC. art. 2644 (2009). *See also* *First Guar. Bank of Hammond v. Baton Rouge Petroleum Ctr., Inc.*, 529 So. 2d 834, 843 (La. 1987); *Dixie Sav. & Loan Ass’n v. Walter*, 557 So. 2d 1044 (La. App. 4th Cir. 1990) (where the creditor was allowed to amend its petition and add authentic evidence to correct deficiencies in executory process petition).

67. *See* the cases cited and accompanying text at *supra* notes 65–66.

68. *See Doherty v. Randazzo*, 128 So. 2d 669 (La. App. 4th Cir. 1961).

69. *See* discussion in *infra* notes 71, 73, and 75–77.

clear; they were intended to make executory process less technical. Examples of potential “fundamental defects” cured by legislation or later jurisprudence include: discrepancies between the amount of attorney’s fees on the note and the mortgage;<sup>70</sup> discrepancies between the description of the note in the mortgage and the note itself;<sup>71</sup> discrepancies between the interest rate on the note and the mortgage;<sup>72</sup> discrepancies between the language of the petition’s description of the note and the note itself;<sup>73</sup> the lack of a note paraphrased for identification with the mortgage;<sup>74</sup> documents that were not in authentic form;<sup>75</sup> petitions that were not properly verified;<sup>76</sup> and other technical formalities.<sup>77</sup>

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70. See LA. CODE CIV. PROC. ANN. art. 2635(B) (2002), as amended by 1981 La. Acts No. 210, §1.

71. See *id.* The language of the opening paragraph previously read: “The plaintiff shall submit with his petition the authentic evidence necessary to prove his right to use executory process to enforce the mortgage or privilege. These exhibits shall include authentic evidence of: . . . .”

The Act changed this opening paragraph to read: “In order for a plaintiff to prove his right to use executory process to enforce the mortgage, security agreement, or privilege, *it is necessary only* for the plaintiff to submit with his petition authentic evidence of: . . . .” *Id.* (emphasis added). See also *Myrtle Grove Packing Co. v. Mones*, 76 So. 2d 305 (La. 1954) (holding that this type of discrepancy prevented a deficiency judgment).

72. See LA. CODE CIV. PROC. ANN. art. 2635(B) (2002), as amended by 1989 Acts 137, § 18. See also *supra* note 71.

73. *Margolis v. Allen Mortgage & Loan Corp.*, 268 So. 2d 714 (La. App. 4th Cir. 1972).

74. See 1992 La. Acts No. 1132.

75. *League Cent. Credit Union v. Montgomery*, 207 So. 2d 762 (La. 1968); *Wash. Bank & Trust Co. v. Hodge*, 495 So. 2d 953 (La. App. 1st Cir. 1986) (clerk of court’s certificate found inadequate); *Chrysler Credit Corp. v. Walker*, 488 So. 2d 209 (La. App. 4th Cir. 1986). *But see* LA. REV. STAT. ANN. § 13:3733 (2006), as amended by 1987 La. Acts No. 478, § 1; LA. REV. STAT. ANN. § 13:4102(D) (2006), as amended by 1987 La. Acts No. 855. Finally, note the change in the language of LA. CODE CIV. PROC. ANN. art. 2635 (2002), as amended by 1989 Acts No. 137, § 18, to change the requirements that everything be in authentic form to requiring that only certain specified documents be in authentic form.

76. *Bank of Coushatta v. King*, 522 So. 2d 1328 (La. App. 2d Cir. 1988) (affidavit merely adopting allegations in petition without any additional information regarding breach or entitlement to executory process not properly verified). The Louisiana Supreme Court granted writs, 531 So. 2d 463 (La. 1988), the decision was set aside, and the supreme court reversed and remanded in light of *First Guaranty Bank v. Baton Rouge Petroleum Center, Inc.*, 529 So. 2d 834 (La. 1988) (on rehearing).

77. See *Pelican Homestead & Sav. Ass’n v. Winston*, 517 So. 2d 1220 (La. App. 4th Cir. 1987) (failure to attach procuracy was defect providing defense to deficiency judgment action); *Int’l Harvester Credit Corp. v. Majors*, 467 So. 2d 1251 (La. App. 2d Cir. 1985) (failure to appraise with minuteness all six

The "fundamental defect" line of jurisprudence seemed to come to an abrupt halt when the Louisiana Supreme Court decided *Baton Rouge Petroleum*,<sup>78</sup> which, overruling a prior decision of the Supreme Court,<sup>79</sup> held that a debtor in executory proceedings must raise all defenses during the executory proceeding itself.<sup>80</sup> Failure of debtors to raise defenses in the executory proceeding prevented them from raising those defenses in any subsequent action to collect on a deficiency judgment. The *Baton Rouge Petroleum* holding has sometimes been referred to as the "raise it or waive it" rule, for if the defense is not raised in the executory process suit, it is waived for the purposes of defending against a deficiency judgment.<sup>81</sup> Thus, *Baton Rouge Petroleum* presented creditors with protection against debtors who could have raised defenses but failed to do so in the executory proceedings.

The defect that existed in *Baton Rouge Petroleum* was not insignificant. The creditor had failed to attach to the executory process petition proper evidence of the corporate authority of the debtor to execute the mortgage, although a resolution had been passed and had been recorded in the mortgage records.<sup>82</sup> Normally, this kind of defect would have been caught by a judge in examining the executory process papers, but apparently it was

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parcels of land encumbered by mortgage fundamental defect); *Chrysler Credit Corp. v. Stout*, 404 So. 2d 304 (La. App. 3d Cir. 1981) (failure to sufficiently allege default entitling creditor to executory process).

78. *Baton Rouge Petroleum*, 529 So. 2d 834.

79. *Baton Rouge Petroleum* expressly overruled *League Central Credit Union v. Montgomery*, 207 So. 2d 762 (1968).

80. 529 So. 2d at 844.

81. As *Baton Rouge Petroleum* explained:

If the debtor diligently and successfully asserts such a defense in the executory proceeding, he usually cannot defeat the creditors rights. The creditor is expressly authorized to convert the executory proceeding into an ordinary proceeding wherein he may obtain a judgment for the full amount due and enforce his mortgage on the property. On the other hand, in *League Central*, the debtor who neglects to raise an authentic evidence defense in the executory proceeding may use it in the deficiency action to completely defeat the creditor's right to the balance of the debt due. There does not appear to be any reason in law or logic that the diligent debtor should be penalized for exercising the defenses in the manner specifically provided by law, *i.e.*, by appeal or injunction. Moreover, the legislative history of the Deficiency Judgment Act indicates no intention to include within its safeguards a defense based upon improper authentic evidence filed in the executory proceeding.

*Id.* at 843 (citations omitted).

82. *See id.* at 835.

not.<sup>83</sup> Nonetheless, because the supreme court deemed that this defect was obvious on the face of the pleadings and could be easily ascertained by the debtor and raised as a defense to halt the executory proceedings, the debtor lost the right to raise the defense when the creditor sought to obtain a deficiency judgment.

The holding of *Baton Rouge Petroleum*, however, was based upon the explicit assumption that although there were apparent defects in the executory proceedings, the appraisal was valid.<sup>84</sup> This qualification left an opening for a new round of challenges on deficiency judgments. Cases developed where debtors claimed that, although the executory proceedings were valid, the appraisal was improper, and because the appraisal was improper, the deficiency judgment remedy was barred.

In a series of cases spanning more than a decade, courts explored the parameters of these improper appraisal claims. The

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83. It is beyond the scope of this Article to consider due process issues; however, it should be noted that executory proceedings result in a pre-judgment seizure through state action and therefore must comply with U.S. Constitutional due process principles. The Louisiana Supreme Court has held that executory proceedings are constitutional. *See Buckner v. Carmack*, 272 So. 2d 326 (La. 1973). *Buckner*, however, was decided under the rules that *Baton Rouge Petroleum* overturned—namely, that any substantial or fundamental defect in executory proceedings would bar a deficiency. Further, after *Buckner* the U.S. Supreme Court decided *Mitchell v. W.T. Grant, Co.*, 416 U.S. 600 (1974), a case involving Louisiana sequestration procedures. *Mitchell* emphasized that a key fact which allows pre-judgment seizures to be valid is the existence of a neutral judicial official who evaluates the evidence presented: “Moreover, in the parish where this case arose, the requisite showing must be made to a judge, and judicial authorization obtained. *Mitchell* was not at the unsupervised mercy of the creditor and court functionaries. The Louisiana law provides for judicial control of the process from beginning to end.” *Id.* at 616 (emphasis added).

This language echoes the admonition in *Fuentes v. Shevin*, 407 U.S. 67 (1972), that “[t]he minimal deterrent effect of a bond requirement is, in a practical sense, no substitute for an informed evaluation by a neutral official.” *Id.* at 83 (emphasis added).

Thus, one unanswered question that might arise from a broad reading of *Baton Rouge Petroleum* excusing a creditor from arguably defective executory process pleadings is whether Louisiana law today accords with due process when a court routinely fails to notice missing documents that statutes mandate be attached to the petition and presented to the court in order to obtain a judgment in the executory proceedings.

84. In *Baton Rouge Petroleum*, the court explained:

Although [the Deficiency Judgment Act] policy is broad and strong, there is nothing in its history or expressions that indicates an intention to bar a creditor who fully complies with appraisal requirements from obtaining a deficiency judgment simply because of a lack of authentic evidence in the executory proceeding.

529 So. 2d at 844 (emphasis added).

courts rejected claims that the appraisals were too low,<sup>85</sup> that the appraiser was unqualified,<sup>86</sup> that there was a "windshield" appraisal (a situation where the appraiser never exited the car to look inside the building),<sup>87</sup> or that the property was appraised as a combination of tracts rather than as individual tracts.<sup>88</sup>

The general rationale of these cases is that, unless the debtor can show significant damage because of the purported improper appraisal, the debtor cannot rely on an allegation of an improper appraisal to bar the creditor's subsequent pursuit of a deficiency judgment.<sup>89</sup> In practice, this test is almost impossible to meet because, under Louisiana rules, both the creditor and the debtor have a right to appoint an appraiser.<sup>90</sup> Once a foreclosure judgment is rendered, the sheriff notifies the parties of their need to appoint

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85. See, e.g., *Whitney Nat'l Bank v. Clark*, 627 So. 2d 705, 707 (La. App. 4th Cir. 1993) (where the court granted creditor's summary judgment in deficiency, despite debtor's allegation that, among other things, appraisal was too low; the court noting that whether "the property's value was higher at an earlier time does not create a factual issue as to its value at the time of the seizure and sale"); *Whitney Nat'l Bank v. F.W.F., Inc.*, 635 So. 2d 361 (La. App. 4th Cir. 1994) (decided a few months later, where debtor's allegation that failure to appraise movables with minuteness resulted in an allegedly too low appraisal was found insufficient to bar deficiency judgment).

86. See *Am. Bank & Trust Co. v. Price*, 688 So. 2d 536 (La. App. 2d Cir. 1996). On rehearing, the Court adopted the dissenting opinion and found that a deficiency was not barred even though the appraiser was actually a loan officer for the foreclosing Bank who was not formally trained as an appraiser. *Id.* at 552.

87. *Id.* The court rejected the claim that an appraisal was defective even though the appraiser never entered the house he was appraising.

88. *Williams v. Perkins-Siegen P'ship*, 649 So. 2d 367 (La. 1995) (on rehearing) (reversing a trial court finding that deficiency was barred where creditor appraised as a group three parcels subject to a mortgage rather than appraising each parcel independently). See also *Commercial Nat'l Bank v. Succession of Rogers*, 628 So. 2d 33 (La. App. 2d Cir. 1993).

89. *Am. Bank & Trust Co.*, 688 So. 2d at 543 (reversed on rehearing adopting dissent) ("[S]he who asserts the lack of qualifications of the appraisers bears a burden of proof which the case law has consistently said to be *heavy or substantial burden*. A debtor's mere supposition or argument that the appraisal is or was unfairly or unjustly prejudicial to the debtor . . . without some evidence to establish that fact, will not be deemed to satisfy the substantial burden of proof and rebut the presumption that the sale was conducted as the law directs.") (citations omitted). See also *Whitney Nat'l Bank*, 635 So. 2d at 365 ("When there has been substantial compliance with [the executory process procedures], i.e. no deviations shown to be or obviously prejudicial to a material degree, then there is at least a very strong presumption, perhaps even a conclusive presumption, that the results of the appraisal process are correct. It is thus very difficult, it if is possible at all, for the debtor to defeat a claim for deficiency judgment simply by arguing that the appraisal amount used in the executory process judicial sale was wrong . . .").

90. LA. REV. STAT. ANN. § 13:4363 (1982).

an appraiser.<sup>91</sup> If one (or both) does not timely appoint an appraiser, the sheriff appoints one for them.<sup>92</sup> If both appoint an appraiser and the appraisals differ by less than \$250,000, the appraisal for the purposes of the foreclosure proceedings becomes the average of the two.<sup>93</sup> Only in the event that the difference in appraisals is more than \$250,000 is a third appraiser appointed;<sup>94</sup> in that instance, the third appraiser is appointed by the sheriff and that third appraisal becomes the value for the foreclosure sale.<sup>95</sup> In this situation, the minimum bid is two-thirds of the value reflected by the third appraisal.

As the cases show, as a practical matter a debtor who fails to appoint an appraiser under the statute bears a difficult burden of proving prejudice. The implication from the jurisprudence appears to be that if the debtors had appointed their own appraisers, those appraisals would have shown the "true value" of the property and thus the ultimate number used as the basis for the two-thirds rule would be higher.<sup>96</sup> The underlying assumption of these cases (often

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91. Louisiana Revised States section 13:4363 states that within seven days, exclusive of holidays, before the sale of seized property, the sheriff shall serve written notice on the debtor and on the seizing creditor, in the manner provided for the service of a citation, directing each to name an appraiser to value the property and to notify the sheriff of his appointment prior to the time stated in the notice, which shall be at least four days, exclusive of holidays, prior to the time of the sale. The appraisal of the debtor and seizing creditor shall be made and delivered to the sheriff at least two days, exclusive of holidays, prior to the time of the sale.

92. LA. REV. STAT. ANN. § 13:4364 (1986).

93. Louisiana Revised States section 13:4365(B) states that if appraisers cannot agree, and (1) the difference in value between the two appraisals does not exceed two hundred and fifty thousand dollars, and (2) the value assigned by the lower of the two appraisers is at least ninety percent of the value assigned by the higher of the two appraisers, then the sheriff shall average the two figures and use the average as the appraised value for purposes of determining the opening bid. In those cases where the two appraisers do not agree and the values are not within the averaging limits, then the sheriff shall appoint a third appraiser, who shall also be sworn, and whose decision shall be final.

94. LA. REV. STAT. ANN. § 13:4365 (1987).

95. *Id.*

96. *See, e.g.,* Whitney Nat'l Bank v. F.W.F., Inc., 635 So. 2d 361 (La. App. 4th Cir.), *writ denied*, 642 So. 2d 1301 (La.), *reconsideration denied*, 644 So. 2d 1045 (La. 1994). As the fourth circuit stated:

However, when the debtor has been served with the notice of seizure and notice to appoint appraiser, and fails to appoint an appraiser, and also fails to object to the lack of "minuteness" of the appraisals at any time prior to the judicial sale of the collateral property, all as in the present case, the debtor may not complain of the lack of "minuteness" in the appraisals as a defense to a later deficiency judgment action. A fully notified debtor who never raises any objection to the appraisals in time



implicit) is that the buyer at the sheriff's sale is either the foreclosing creditor or someone who buys the property for only two-thirds of the appraised value. If there had been spirited bidding for the property so that the price paid at the judicial sale was higher than two-thirds and might even approach what the debtor believes to be the "true" fair market value, the debtor likely would not complain.

Perhaps the most basic cause of a debtor's complaint of an improper appraisal stems from two sources. First, the debtor usually cannot afford to bid on the property or, if so, is not the successful bidder. Thus, the debtor loses ownership of the property and still owes a deficiency judgment. Second, given the fact that most debtors are not the successful bidders at sheriffs' sales, the debtor may believe either (1) that the appraisal was too low and therefore two-thirds of the appraisal left a larger deficiency than was necessary, or (2) that the creditor received a windfall by both buying the property for two-thirds of the appraised value and collecting the deficiency on the difference.

While *Baton Rouge Petroleum* supposedly suppressed the "fundamental defect" rule outside of the appraisal area, the language of "fundamental defect" or similar terminology continues to be used by some courts, particularly when the allegation is that the appraisal is so defective as to bar the deficiency judgment.<sup>97</sup> Of course, even if the appraisal is valid, the creditor still bears the burden of proof about the amount of the deficiency judgment.<sup>98</sup>

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for any lack of "minuteness" to be cured, i.e. prior to the judicial sale of the collateral property, has waived the "minuteness" requirement.  
*Id.* at 363.

97. See, e.g., *First Fed. Sav. & Loan Ass'n of New Iberia v. Moss*, 616 So. 2d 648, 651 (La. 1993) ("[W]e decide that such an *in globo* sale [of separately mortgaged properties] is unauthorized and that, under the circumstances of this case, the unauthorized sale constitutes a *fundamental defect* in the executory proceeding, precluding the seizing creditor from obtaining a deficiency judgment."); *Ray v. Varwig*, 641 So. 2d 711 (La. App. 3d Cir. 1994), *writ denied*, 648 So. 2d 1336 (La. 1995); *Citicorp Acceptance Co., Inc. v. Roussell*, 601 So. 2d 350 (La. App. 1st Cir.), *writ denied*, 608 So. 2d 177 (La. 1992); *Bank of LaPlace v. Millet*, 545 So. 2d 646 (La. App. 5th Cir.), *writ denied*, 550 So. 2d 630 (La. 1989). See also *Bank of Commerce & Trust Co. v. Landry*, 610 So. 2d 927, 931 (La. App. 1st Cir. 1992) (using the phrase "prejudicial defect"); *Samco Mortgage Corp. v. Armstrong*, 579 So. 2d 521, 524 (La. App. 4th Cir. 1991) (using the phrase "nonprejudicial technicality").

98. In *Security Homestead Federal Savings Corp. v. Ullo*, 589 So. 2d 5, 7-8 (La. App. 5th Cir. 1991), a mortgage creditor sought summary judgment in pursuit of deficiency, but offered no supporting evidence. The appellate court, in holding for the debtor, noted that *Baton Rouge Petroleum* does not relieve a creditor of his burden of proof in the case for a deficiency action. The law requires that a creditor prove that a deficiency amount remains due on the debt

Even though *Baton Rouge Petroleum's* “raise it or waive it” rule and the post-*Baton Rouge Petroleum* appraisal cases seem to put more burdens on the debtor to avoid the deficiency judgment, foreclosing creditors nonetheless may wish to carefully consider all of the procedural niceties required by Louisiana procedural statutes before seeking a deficiency.<sup>99</sup>

## VI. THE LOUISIANA DEFICIENCY JUDGMENT ACT IS A PROCEDURAL RULE

The Louisiana Deficiency Judgment Act is a purely procedural statute. The Act outlines specific procedural hurdles that a creditor must follow in the process of foreclosing on collateral and obtaining the proceeds to be applied to a debtor's outstanding obligation. For example, unless a specific exemption from the statute applies, a creditor is forbidden from pursuing a deficiency unless there is a judicial sale of the collateral.<sup>100</sup> The judicial sale must be made with appraisal,<sup>101</sup> and the collateral must be sold for at least two-thirds of its appraised value at the first sale.<sup>102</sup> Even if the sale brings full fair market value, any other form of sale (whether it is a private sale or a judicial sale without appraisal) that does not comport with these requirements bars the creditor from collecting any deficiency from the debtor<sup>103</sup> unless a specific statutory exemption applies.

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after distribution of the proceeds of the judicial sale and that the property was sold under executory procedure after appraisal in accordance with Louisiana Code of Civil Procedure 2723.

99. See, e.g., *Fed. Sav. & Loan Ins. Corp. v. Tri-Parish Ventures, Ltd.*, 881 F.2d 181, 184 (5th Cir. 1989), holding that a failure to strictly follow Louisiana's procedural statutes may bar a deficiency even after the *Baton Rouge Petroleum* decision. The Fifth Circuit noted that *Baton Rouge Petroleum* contains

phrases, admittedly in dicta, which emphasize that sale with appraisal is a prerequisite to a deficiency judgment. While the opinion does not mandate expressly that the debtor be given notice of the appraisal and an opportunity to participate, the failure to accord same deprives the debtor of the protection ‘against an unjust sacrifice’ of his property. The debtor must have the right, not merely the privilege, to participate in the appraisal of the property; actual notice of the seizure is not enough.

100. LA. REV. STAT. ANN. § 13:4106 (1989).

101. *Id.*; LA. CODE CIV. PROC. art. 2771 (2009).

102. LA. REV. STAT. ANN. § 13:4106. If there are superior liens or encumbrances, however, the minimum bid is the greater of two-thirds of the appraised value or the amount of superior liens and encumbrances. See LA. CODE CIV. PROC. ANN. arts. 2336 (2001), 2337 (1989).

103. LA. CODE CIV. PROC. ANN. arts. 2336 (2001), 2724(B) (1992).

At base, the Louisiana Deficiency Judgment Act reflects an implicit assumption that a judicial sale will not necessarily bring a fair market price for the property being sold, for if a fair market price always could be obtained through a judicial sale, there would be no need to have a rule requiring an appraisal or the minimum two-thirds bid rule.

The purely procedural nature of the Deficiency Judgment Act can be illustrated by the following examples.

*Example A:* A creditor is owed \$300,000; the security for the debt is a \$90,000 first mortgage on a tract of land worth \$90,000. The creditor, wanting to proceed quickly and expeditiously, privately sells the property with the debtor's consent for \$90,000 and decides, *after* the sale, to credit the debtor with the full value received and to attempt to collect a deficiency for the remaining \$210,000.<sup>104</sup> Although the creditor has given debtor the benefit of the full value of the sale, the creditor is nonetheless prevented from collecting anything further because of the Deficiency Judgment Act.<sup>105</sup>

*Example B:* As in Example A, a creditor is owed \$300,000, and the security for the debt is a \$90,000 first mortgage on a tract of land worth \$90,000. This time, however, the creditor proceeds by judicial process, not by a private sale, but the creditor takes advantage of a waiver of appraisal clause in the mortgage and has the property sold at the sheriff's sale without appraisal; the property brings \$90,000. After the sheriff's sale, the creditor decides to credit the debtor with the full value received and then seeks to collect a deficiency only for the remaining \$210,000. As in Example A, the debtor has received full value for the property and the maximum credit towards the debtor's outstanding obligation, yet, the creditor again is prohibited from obtaining a deficiency judgment because the judicial sale was without appraisal.<sup>106</sup> The Deficiency Judgment Act does not consider whether the debtor has received full value for the property but only whether the proper procedure was followed.

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104. The amount still owing would be \$300,000 - \$90,000 = \$210,000.

105. A creditor may invoke a private sale and obtain a deficiency if the creditor complies with the special provisions of the Deficiency Judgment Act, which require an agreement between creditor and debtor post-default but pre-sale. See LA. REV. STAT. ANN. §§ 13:4108.1, 4108.2, as discussed in further detail in Section X of this Paper.

106. LA. CODE CIV. PROC. ANN. art. 2771 (1989); LA. REV. STAT. ANN. § 13:4106.

*Example C:* A creditor is owed \$300,000; the security for the debt is a \$300,000 first mortgage on a tract of land worth \$300,000. The creditor invokes an executory proceeding with appraisal; the property sells for two-thirds of its appraised value<sup>107</sup> (\$200,000) at the first sale. In this instance, the creditor would be entitled to keep the \$200,000 in sales' proceeds and still pursue the debtor personally<sup>108</sup> for a deficiency of a \$100,000.<sup>109</sup> In this instance the creditor would be entitled to be made whole.<sup>110</sup>

*Comments on Examples A, B, and C:* In practice, there is seldom serious adverse bidding at judicial sales, and experienced practitioners will attest that, in a majority of cases, the foreclosing creditor becomes the successful purchaser by merely bidding the statutorily required minimum amount. With this in mind, consider that if the foreclosing creditor in Example C was the successful bidder (for \$200,000) and became owner of the property, the creditor would own the property (which had been appraised at \$300,000) and still be able to pursue the debtor for a \$100,000 deficiency (the difference between the \$300,000 debt and the \$200,000 minimum bid). Thus, the creditor would in fact be able to

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107. For this example and the succeeding examples, it is assumed that the appraised value is equal to the fair market value of the property. This assumption is only for the purposes of the examples. It is often the case that an appraisal submitted at a foreclosure sale may differ from the "fair market value" (realizing, of course, that "fair market value" is only an estimate). For cases defining "fair market value," see *Shopf v. Marina Del Ray P'ship*, 549 So. 2d 833 (La. 1989) (in the dissolution of partnership, the court stated that "[f]air market value is defined generally as the price that a willing buyer would pay to a willing seller for a certain piece of property in an arm's length transaction, neither being under any compulsion to buy or sell and both having reasonable knowledge of the relevant facts"). See BLACK'S LAW DICTIONARY 537 (5th ed. 1979). See, e.g., *Joiner v. Abercrombie*, 968 So. 2d 1184, 1186 (La. App. 2d Cir. 2007) (context of lesion); *McConnico v. Red Oak Timber Co.*, 847 So. 2d 191, 198 (La. App. 2d Cir. 2003). For authority questioning whether foreclosure appraisals actually approach fair market value, see Melissa B. Jacoby, *Home Ownership Risk Beyond A Subprime Crisis: The Role Of Delinquency Management*, 76 *FORDHAM L. REV.* 2261, 2881 n.105 (2008).

108. The debtor's personal liability would be obtained when the creditor either converted the executory proceeding to an ordinary one or filed a separate suit for a deficiency judgment. See LA. CODE CIV. PROC. art. 2644 (1960).

109. The \$300,000 debt minus the \$200,000 received at the judicial sale.

110. On the other hand, assume the same facts as in Example C but the judicial sale was held *without* appraisal with the foreclosing creditor as the successful bidder. Now, although the creditor bid only costs and could not get a deficiency judgment, the creditor nonetheless has obtained ownership of \$300,000 in collateral, the exact amount of the debt.

collect \$400,000 (the creditor would have \$100,000 deficiency plus property worth \$300,000 that it had bought for \$200,000).<sup>111</sup>

Contrast this to the situation in Examples A and B. In both of these examples, if the creditor had been the only bidder on the \$90,000 piece of property, the creditor receives no windfall (because the creditor purchased the property for its exact value) and would actually have a deficit because the foreclosure without appraisal barred pursuit of the any portion of the debt remaining after the sales.

As these examples illustrate, the Deficiency Judgment Act does not consider whether the winning bid reflected the true value of the property or the "fairness" of the result. In Examples A and B, the creditor has acted fairly when judged objectively—the creditor has given the debtor the full value of the mortgaged property; yet, because the creditor has failed to follow the procedural requirements of the Deficiency Judgment Act, the debtor is relieved of all further liability and the creditor is barred from pursuing the remaining \$210,000 that is owed by the debtor. In contrast, under Example C, the creditor receives a windfall by owning (after the judicial sale) property worth \$300,000 and still maintains the right to sue the debtor for an additional \$100,000. By following the Deficiency Judgment Act strictly and by being the only bidder at the sheriff's sale, the creditor in Example C has used the law to collect more than the debtor owed. This result is allowed by Louisiana law.

These comments are not intended to be a critique of the Deficiency Judgment Act; the Act serves a salutary purpose of forcing creditors, who control the collection process, to use judicial procedures that are clearly set forth in statutes. In other words, the Deficiency Judgment Act puts the onus on the creditor to act in a procedurally proper manner and gives courts a "bright line" rule by

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111. Note that the foreclosing creditor does not have to pay cash equaling the amount of its own outstanding unpaid obligation if the creditor is the winning bidder. The creditor uses the amount of its judgment as a credit to pay for the item. The creditor, however, still must pay costs and sheriff's commissions; further, the foreclosure sale does not extinguish any superior mortgages or privileges that prime the foreclosing creditor's interests in the collateral. *See Casey v. Nat'l Info. Serv., Inc.*, 90 So. 2d 710, 716-17 (La. App. 1st Cir. 2005) ("Where the seizing creditor submits the highest bid for the property, if the amount of his accepted bid is the amount of his security interest plus costs, he will simply pay the amount of costs to the sheriff. If the seizing creditor bid the property in this manner, he would obtain it free and clear of all inferior encumbrances."); *Capital Sav. Ass'n v. Runnels*, 361 So. 2d 458 (La. App. 1st Cir. 1978). *See also* LA. CODE CIV. PROC. ANN. art. 2374 (1989) (stating that the purchaser "shall pay to the sheriff only that portion of the sale price which exceeds the amount of the superior security interest . . .").

which to judge the creditor's actions. "Bright line" rules have the advantage of predictability and ease of enforcement, and are often used by legislatures even though they may lead to results that, at the extremes, may seem less than equitable.<sup>112</sup>

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112. Louisiana has never had the law versus equity distinction of common law. *See, e.g.*, *Dupuis v. Becnel Co.*, 535 So. 2d 375, 377 (La. 1988); *Babineaux v. Pernie-Bailey Drilling Co.*, 262 So. 2d 328, 335 n.5 (La. 1972) (noting the distinction of federal practice from Louisiana practice is due to the lack of such a distinction in a civilian jurisdiction). Equity in Louisiana is a last resort only if there is no positive law applicable. Louisiana Civil Code article 1 states that the "sources of law are legislation and custom." Article 4 provides that where "no rule . . . can be derived from legislation or custom, the court is bound to proceed according to equity." LA. CIV. CODE art. 4 (2009). Moreover, comment (b) to Louisiana Civil Code article 1 expressly categorizes equity as merely a "persuasive or secondary source of law" in comparison to legislation and custom.

For example, in Louisiana, a "bright line" rule exists in real estate sales that looks to the date the sale document is filed in the public records, not the knowledge of the parties. If X buys land from a seller on January 1st but does not record the act of sale until January 3rd, and if Y buys the same land from the seller on January 2nd and records the act on that day, knowing that X has already signed the January 1st act of sale, Y will be seen as owner and will trump X's rights. The fact that Y knows of X's sale, and the fact that it seems inequitable that Y should be able to own the property to the detriment of X merely because Y beat X in the race to the courthouse will not stop Y from being recognized as owner. This rule is clear in Louisiana. *See* LA. CIV. CODE art. 3338, stating in pertinent part:

The rights and obligations established or created by the following written instruments are without effect as to a third person unless the instrument is registered by recording it in the appropriate mortgage or conveyance records pursuant to the provisions of this Title:

(1) An instrument that transfers an immovable or establishes a real right in or over an immovable.

Thus, X's rights are not effective as to Y because his document was not recorded when Y made and recorded his agreement. Other states may reach a contrary result. For instance, see New York's rule regarding recordation of conveyances, which states, in pertinent part:

A conveyance of real property . . . may be recorded in the office of the clerk of the county where such real property is situated . . . Every such conveyance not so recorded is void as against any person who subsequently purchases or acquires by exchange or contracts to purchase or acquire by exchange, the same real property or any portion thereof, . . . *in good faith* and for a valuable consideration, from the same vendor.

N.Y. REAL PROP. LAW § 291 (McKinney 2006) (emphasis added).

It is the "in good faith" language that is critical, and could resort in a court looking to equitable considerations to grant the property to the previously contracted, but unrecorded, sale. *See* *Miles v. De Sapio*, 96 A.D.2d 970, 971 (N.Y. App. Div. 1983):

Where there are conflicting claims between a prior unrecorded deed and a subsequent purchaser, if the purchaser "has knowledge of any fact, sufficient to put him on inquiry as to the existence of some right or

VII. CALCULATING THE MINIMUM BID AT THE FIRST SALE<sup>113</sup>

Although the text of the Deficiency Judgment Act concerns the appraisal requirement,<sup>114</sup> other statutes must be considered to obtain an understanding of how the appraisal rules intersect with calculating the payment of the winning bid.<sup>115</sup>

When encumbered property is sold, a creditor who intends to pursue a deficiency judgment must sell the property with appraisal for the greater of two-thirds of its appraised value or the amount of superior liens and encumbrances.<sup>116</sup> The reason that the amounts of superior liens and encumbrances must be considered is that a sheriff's sale extinguishes only rights inferior to those of the foreclosing creditor.<sup>117</sup>

The sheriff's sale does not extinguish superior security interests or rights.<sup>118</sup> A purchaser at a sheriff's sale buys the property "subject to"<sup>119</sup> superior liens and encumbrances, which means that these liens and encumbrances continue to affect the property although the purchaser has no personal liability for these debts.<sup>120</sup> Thus, immediately after a foreclosure sale, holders of superior liens and encumbrances can immediately begin their own foreclosure proceedings if they so choose.<sup>121</sup>

The interrelationship between the two-thirds rule and the superior lien encumbrance rule may create situations where a creditor may not wish to bid at the first sale if no one else is bidding. The next three examples are based on the following hypothetical situation. Creditor A holds a \$300,000 first mortgage on property, while Creditor B holds a \$100,000 second mortgage

title in conflict with that he is about to purchase, he is presumed either to have made the inquiry, and ascertained the extent of such prior right, or to have been guilty of a degree of negligence equally fatal to his claim, to be considered as a bona fide purchaser.

113. This section deals with the first judicial sale; the issue of what happens if there are no successful bidders at the first judicial sale and a second sale is held is dealt with in Section IX of this Article.

114. LA. REV. STAT. ANN. § 13:4106 (1989).

115. LA. CODE CIV. PROC. arts. 2331-2343, 2721-2725 (2009).

116. LA. CODE CIV. PROC. arts. 2771, 2337 (1989).

117. LA. CODE CIV. PROC. art. 2375 (1960).

118. See LA. CODE CIV. PROC. art. 2374 (1989) (stating that a purchaser at a sheriff's sale buys subject to the rights of superior creditors).

119. *Id.*

120. See *id.* (stating that a purchaser buys subject to superior mortgage rights); LA. CODE CIV. PROC. art. 2375 (1960) (stating that the purchaser is liable for nothing beyond the purchase price). See also *Thompson v. Levy*, 23 So. 913 (La. 1898).

121. LA. CODE CIV. PROC. art. 2378 (1989).

on the same tract.<sup>122</sup> These examples assume that B forecloses and A does not intervene in the foreclosure proceedings;<sup>123</sup> therefore, the property will be purchased subject to A's mortgage. Under this situation, and as these examples demonstrate, the minimum bid<sup>124</sup> at B's foreclosure sale will depend upon the amount of the appraisal at B's foreclosure sale.

*Example D:* If the property appraises for \$90,000, the minimum bid is \$300,000,<sup>125</sup> the amount necessary to satisfy Creditor A's superior mortgage.

*Example E:* If the property appraises for \$600,000, the minimum bid is \$400,000, which is two-thirds of the appraisal amount. This is because two-thirds of the appraised value exceeds the amount of Creditor A's mortgage.

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122. The assumption in this situation is that the face amount of each mortgage equals the sum owing on each mortgage at the time of foreclosure. Of course, in most situations the face amount of the mortgage differs from the payoff amount at the time of foreclosure, because usually the borrower has made some payments on the mortgage which have been applied against the principal balance.

123. Creditor A does not have to be involved in Creditor B's foreclosure or even be given notice of it, for the judicial sale will be "subject to" Creditor's A superior mortgage. LA. CODE CIV. PROC. art. 2374 (1989). Of course, Creditor A could choose to intervene into the executory proceedings. *Id.* arts. 1092 (1962), 2643 (1989). If Creditor A does intervene, then the sheriff's sale will extinguish Creditor's A mortgage (*id.* arts. 2376, 2337 (1989)), and because under these examples there are no superior liens extant other than Creditor A, the minimum bid with Creditor A's intervention will then become only two-thirds of the appraised value.

124. In all of these examples, the amount of sheriff's commissions is not taken into account. The minimum bid must always be enough to pay commissions. *See* LA. CODE CIV. PROC. art. 2337, noting that unless "the price offered by the highest bidder at the first or subsequent offering is not sufficient to discharge the costs of the sale . . . the property shall not be sold." Under Louisiana Revised Statutes section 33:1428(7)(a), commissions are set on the ultimate sales price as the amount that the winning creditor receives—6% of the price of adjudication on movables and 3% of the price of adjudication on immovables. Under this statute, "'the price of adjudication' shall mean the amount of the successful bid price at the sale conducted by the sheriff."

125. The minimum bid must always include costs, and costs are paid first out of the sales proceeds. *See* LA. CODE CIV. PROC. art. 2372, regarding distribution of proceeds of sale, "[a]fter deducting the costs" the sheriff shall pay mortgage holders. In none of the examples that follow, however, have the authors included costs in the calculations, because the purpose of the illustrations is not to have a precise calculation of all aspects of a sale but rather to illuminate particular issues relating to minimum bids and proceeds distributions to creditors and debtors.



*Example F:* If the property appraises for \$1.2 million, the minimum bid is \$800,000, two-thirds of the appraisal amount, for the same reasons as in Example E.

In both Examples E and F, although there is plenty of equity in the property, Creditor B (who has only a \$100,000 mortgage and who is conducting the foreclosure proceedings into which Creditor A has not intervened)<sup>126</sup> may not be anxious to make the minimum bid because to do so would require, in essence, payment of cash to the debtor. To understand this factor, however, one must explore the distinction between the minimum bid and the amount that the creditor actually pays.

#### VIII. WHAT A FORECLOSING CREDITOR MUST PAY IN A WINNING BID AND HOW THIS RELATES TO THE MINIMUM BID AT THE FIRST SALE AND THE DISTRIBUTION OF PROCEEDS OF THE SALE

The two-thirds minimum bid requirement of the Deficiency Judgment Act is a separate and distinct rule from what the foreclosing creditor must actually pay at the sheriff's sale when the foreclosing creditor is the successful bidder and when there are superior liens and encumbrances.

While the combination of the Code of Civil Procedure and Deficiency Judgment Act requires that there be a minimum bid at the sheriff's sale equal to the greater of the superior liens and encumbrances or two-thirds of the appraised value,<sup>127</sup> the amount that the foreclosing creditor must pay as a successful bidder is calculated on an entirely different basis. The best way to explain this is to use another series of examples. Under these examples, Creditor L holds a \$100,000 first mortgage on property and Creditor M holds a \$300,000 second mortgage on the same tract.<sup>128</sup> Creditor M is the foreclosing creditor in a suit in which Creditor L has not intervened.

*Example G:* If the property appraises for \$120,000, the minimum bid is \$100,000. This is because two-thirds of the \$120,000

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126. Creditor A always has the right to intervene into the proceedings. See LA. CODE CIV. PROC. arts. 1092 (1962), 2643 (1989).

127. See the discussion in *supra* Section VII.

128. The assumption in this situation is that the face amount of each mortgage equals the sum owing on each mortgage at the time of foreclosure. Of course, in most situations the face amount of the mortgage differs from the pay-off amount at the time of foreclosure, because usually the borrower has made some payments on the mortgage that have been applied against the principal balance.

appraisal is \$80,000, but the minimum bid must be enough to cover Creditor L's \$100,000 first mortgage.<sup>129</sup>

*Comments on Example G:* If Creditor M, the foreclosing creditor, is the only bidder at the sale, Creditor M must pay the costs of the sale,<sup>130</sup> but Creditor M does not pay any additional sums. This is because Creditor M is given a credit against its \$300,000 second mortgage.<sup>131</sup> No monies go to Creditor L, because Creditor L has not intervened. While Creditor M's second mortgage is extinguished by the sheriff's sale,<sup>132</sup> Creditor L's mortgage is unaffected by the sheriff's sale (the property is sold "subject to" L's mortgage<sup>133</sup>). Thus, at the conclusion of the sheriff's sale, while the minimum bid is \$100,000, when Creditor M is the successful bidder, M pays only costs.

On the other hand, had a third-party come to bid at the sale,<sup>134</sup> and had Creditor M allowed the sale to go through for only the \$100,000 bid by the third party,<sup>135</sup> then the third party would pay

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129. See LA. CODE CIV. PROC. art. 2337 (2009) ("If the price offered by the highest bidder at the first or subsequent offering is not sufficient to discharge the costs of the sale and the security interests, mortgages, liens, and privileges superior to that of the seizing creditor, the property shall not be sold.").

130. See *id.* art. 2337 cmt. ("Although the source article makes no reference to the 'costs of the sale,' it would appear that the bid has to be sufficient to pay whatever costs are incurred over and above those advanced by the seizing creditor. The reason for this is that the claim of a superior mortgage holder cannot be reduced.").

131. See *id.* art. 2374 ("If there is a security interest, mortgage, lien, or privilege on the property superior to that of the seizing creditor, the purchaser shall pay to the sheriff only that portion of the sale price which exceeds the amount of the superior security interest, mortgage, lien, or privilege."). See also *Casey v. Nat'l Info. Serv. Inc.*, 906 So. 2d 710, 716–17 (La. App. 1st Cir. 2005).

132. See LA. CODE CIV. PROC. art. 2376 ("The sheriff sale give the purchaser a release from the security interest, mortgage, lien, or privilege of the seizing creditor . . .").

133. See *id.* art. 2372.

134. The requirements of a third party coming to a sheriff sale and submitting a bid are different than for the foreclosing creditor.

Where terms of the sale are not fixed in the order of sale, the seizing creditor may fix the "portion of the purchase price to be paid at the moment of adjudication. In default of such instruction, the officer may fix the amount, which in no case shall be less than ten per cent." This portion must be stated in the advertisement. LA. REV. STAT. ANN. § 13:4359 (2006). Additionally, the full payment take place "at the moment of the adjudication." The property must be re-advertised under this provision if the purchaser fails to pay the full price at adjudication, if so ordered, or to make full payment thirty days if allowed by section 13:4359. *Id.* § 13:4360.

135. This situation is unlikely to occur in the real world and is used only for illustrative purposes. This situation is unlikely because, if the property is appraised for \$120,000, Creditor L undoubtedly would have bid up to almost the

\$100,000 to the sheriff. The sheriff would then distribute the \$100,000<sup>136</sup> to Creditor M.

Regardless of whether Creditor M or a third party was the successful bidder in this situation, however, Creditor M must apply the \$100,000 to its loan and can now seek to sue the borrower for a deficiency judgment of \$200,000.<sup>137</sup>

*Example H:* If the property appraises for \$300,000, the minimum bid is now \$200,000. This is because \$200,000 is two-thirds of the appraised value and also is greater than Creditor L's \$100,000 first mortgage.

*Comments on Example H:* If Creditor M, the foreclosing creditor, is the only bidder at the sale, Creditor M must pay the costs of the sale,<sup>138</sup> but Creditor M does not pay any additional sums. This is because, as in Example G, Creditor M is given a credit against its \$300,000 second mortgage.<sup>139</sup> No monies go to Creditor L because Creditor L has not intervened. The deficiency that Creditor M can now seek against the borrower is \$100,000.<sup>140</sup>

If a third party is the successful bidder for \$200,000,<sup>141</sup> the third party must pay \$200,000 in cash to the Sheriff, who then distributes the funds to Creditor M.<sup>142</sup>

*Additional Comments on Examples G and H:* As can be seen from Examples G and H, the foreclosing creditor can use the monies it is owed under the mortgage as a "credit" against the purchase price and pay only the costs of sale while preserving a

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full appraised value before letting the third party bidder "win" the bid, for the higher the number at the sheriff's sale, the more money will flow from the third party to Creditor L.

136. As noted in *supra* note 125, these examples do not take into account the costs of the sale, which would otherwise have to be included in the calculation of the proceeds distribution.

137. The loan was \$300,000; the deficiency is \$200,000 after applying the \$100,000 from the sheriff's sale.

138. See LA. CODE CIV. PROC. art. 2337 (2009).

139. See *id.* art. 2374. See also *Casey v. Nat'l Info. Serv., Inc.*, 906 So. 2d 710, 716-17 (La. App. 1st Cir. 2005).

140. The loan was \$300,000; the deficiency is \$100,000 after applying the \$200,000 from the sheriff's sale.

141. As in Example G, however, it is unlikely that Creditor M will allow a third party to be the sole bidder at \$200,000. It is more likely that Creditor M would bid the property up to or near \$300,000, which is both the appraised value of the property as well as the pay-off on Creditor M's mortgage.

142. As noted *supra* note 125, these examples do not take into account the costs of the sale, which would otherwise have to be included in the calculation of the proceeds distribution.

deficiency against the borrower. At the same time, Creditor L's first mortgage is unaffected because Creditor L has not intervened in the proceedings. Thus, if the day after the sheriff's sale the borrower defaults on its loan with Creditor L, that creditor may immediately begin foreclosure proceedings under its mortgage; the current owner of the property after the sheriff's sale (whether Creditor M or a third party) will find that it will now lose the property unless it becomes the successful bidder at Creditor L's sheriff's sale.

Another series of examples will be useful in looking at what happens if there is a mortgage inferior to that of the foreclosing creditor.

#### *A. Examples Involving a Mortgage Inferior to that of the Foreclosing Creditor*

Under these next series of examples, the facts are the same as in Examples G and H—Creditor L holds a \$100,000 first mortgage on property and Creditor M holds a \$300,000 second mortgage on the same tract. Now, however, there is an additional creditor, Creditor O, who holds a \$75,000 third mortgage on the same tract.<sup>143</sup> In these series of examples, Creditor M is the foreclosing creditor, while third mortgage Creditor O has intervened into the foreclosure proceedings,<sup>144</sup> but first mortgage Creditor L has not.

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143. As in the previous hypotheticals, the assumption is that the face amount of each mortgage equals the sum owing on each mortgage at the time of foreclosure.

144. Creditor O need not intervene to be entitled to the rights discussed in Examples I and J because the Sheriff must distribute proceeds that exceed the foreclosing creditor's mortgage to inferior secured creditors and then, if any remains, to the owner of the property. See LA. CODE CIV. PROC. art. 2373 (2009). In any event, however, unlike first mortgage Creditor L (who gets no notice of second mortgage Creditor M's foreclosure proceedings because Creditor L's mortgage is unaffected), third mortgage Creditor O must get notice of the foreclosure sale. The notice to Creditor O is required under the procedural due process rules set forth in *Mennonite Board of Missions v. Adams*, 462 U.S. 791 (1983), which requires notice to those whose property rights (including mortgages and security interests) may be affected by a foreclosure sale. The due process issues relating to foreclosures are beyond the scope of this Article, but the key cases include: *Jones v. Flowers*, 547 U.S. 220 (2006); *Davis Oil Co. v. Mills*, 873 F.2d 774 (5th Cir. 1989); *Small Engine Shop v. Cascio*, 878 F.2d 883 (5th Cir. 1989); *Magee v. Amiss*, 502 So. 2d 568 (La. 1987).

*Example I:* If the property appraises for \$240,000,<sup>145</sup> the minimum bid is now \$160,000. This is because the \$160,000 two-thirds amount is greater than Creditor L's \$100,000 first mortgage.

*Comment on Example I:* If Creditor M, the foreclosing creditor, is the only bidder at the sale, Creditor M must pay the costs of the sale<sup>146</sup> but no other cash, because Creditor M is given a credit against its \$300,000 second mortgage. No money is distributed to third mortgage Creditor O, because the sale's proceeds are not sufficient to pay off the mortgage of foreclosing Creditor M, and no money is distributed to first mortgage Creditor L, because L has not filed an intervention in the proceedings and its mortgage is unaffected by the foreclosure sale.

Following the sheriff's sale, second mortgage Creditor M may pursue the debtor for a deficiency of \$60,000 (the difference between the minimum bid of \$240,000 and the payoff of the \$300,000 mortgage held by Creditor M); third mortgage Creditor O may pursue the debtor for a deficiency of \$75,000 (because no sales proceeds were attributable to Creditor O's mortgage); and first mortgage Creditor L is completely unaffected.

If a third party had been the successful bidder at this sale and had bid \$240,000, the third party would have paid the sheriff \$240,000,<sup>147</sup> from which the sheriff would distribute \$240,000 to Creditor M and nothing to Creditors O or L. Creditor O gets nothing because all the \$240,000 went to Creditor M. Creditor L gets nothing because it has not intervened in the sale; however, because the sale did not affect Creditor L's mortgage, Creditor L may begin its own foreclosure proceedings if the debtor defaults in its obligations to Creditor L.

*Example J:* If the property appraises for \$600,000, the minimum bid is now \$400,000. This is because that \$400,000 is two-thirds of the appraised value and is greater than Creditor L's \$100,000 first mortgage.

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145. In this example, the property is encumbered for \$475,000, but is worth at the time of foreclosure only \$240,000. The situation, however, is not unrealistic. Many properties following the devastation wrought by Hurricanes Katrina, Rita, Ike, and Gustav were worth far less following the storms than they were prior to the storms. The Louisiana Supreme Court has noted "the inadequacy of words to describe the total devastation of property, community and social structures which are the after-effects of these historic storms." *State v. All Prop. & Cas. Ins. Carriers*, 937 So. 2d 313, 326 (La. 2006).

146. LA. CODE CIV. PROC. art. 2337 (2009).

147. As noted *supra* note 125, these examples do not take into account the costs of the sale, which would otherwise have to be included in the calculation of the proceeds distribution.

*Comments on Example J:* If Creditor M, the foreclosing creditor, is the only bidder at the sale, Creditor M must pay the sheriff \$100,000 in cash.<sup>148</sup> This is because, while Creditor M is given a credit against its \$300,000 second mortgage,<sup>149</sup> the minimum bid now exceeds its mortgage, and it must pay the sheriff \$100,000 (the difference between the \$300,000 second mortgage which Creditor M holds and the minimum bid of \$400,000).

The sheriff does not distribute any of the \$100,000 in cash to the first mortgage holder Creditor L, because Creditor L has not intervened and its mortgage is unaffected by the sale. The sheriff instead distributes \$75,000 to third mortgage Creditor O, whose mortgage is being extinguished in the sheriff's sale.<sup>150</sup> This \$75,000 fully pays off Creditor O's mortgage. The remaining \$25,000 of the \$100,000 in cash goes to the owner of the property, not to Creditor L (because L has not filed an intervention in the suit).

If a third party had been the successful bidder at this sale and had bid \$400,000, the third party would have paid the sheriff \$400,000,<sup>151</sup> from which the sheriff would distribute \$300,000 to Creditor M, \$75,000 to Creditor O, and \$25,000 to the owner of the property.

Whether the successful bidder is second mortgage Creditor M or a third party, neither Creditor M nor Creditor O is entitled to seek a deficiency judgment, because their secured debts have been fully satisfied by the sale.

### *B. Foreclosure Sales Involving a Third Party Possessor*

The distribution of sheriff sale proceeds must take into account the rights of third party possessors who have filed an intervention<sup>152</sup> in the proceedings. Third party possessors in Louisiana are owners of property who are not personally liable to the foreclosing creditor.<sup>153</sup> In other words, third party possessors

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148. As in other hypothetical examples, the costs of the sale are not included in these calculations.

149. See LA. CODE CIV. PROC. art. 2374. See also *Casey v. Nat'l Info. Serv., Inc.*, 906 So. 2d 710, 716–17 (La. App. 1st Cir. 2005).

150. See LA. CODE CIV. PROC. arts. 2373, 2376.

151. As noted *supra* note 125, these examples do not take into account the costs of the sale, which would otherwise have to be included in the calculation of the proceeds distributions.

152. LA. CODE CIV. PROC. arts. 1092, 2643, 2703.

153. Code of Civil Procedure article 3343 provides that the definition of “third party” is, among other things, a person “who is not a party to or personally bound by an instrument.” *Id.* art. 3343. The article goes on to note that a “person who by contract assumes an obligation . . . is not a third person with respect to the obligation or right or to the instrument creating or

are those who purchased property “subject to” a preexisting mortgage.<sup>154</sup>

Third party possessors are entitled to claim the lesser of (1) the costs of improvements they have made to the property<sup>155</sup> or (2) the value of the enhancements.<sup>156</sup> The method of calculating the distribution is a “waterfall” distribution—that is, if there is cash available after paying the first level, it flows down to the second level; if there is still cash left after paying off levels one and two, it flows down to level three, and after that to level four. The levels are:

- First, cash from the sale equal to the unenhanced value of the property goes to the foreclosing creditor.
- Second, the third party possessor gets an amount equal to the lesser of (1) the costs of the enhancements or (2) the increase in value of the collateral resulting from the enhancement.
- Third, any remaining funds go to the foreclosing creditor until paid.
- Fourth, any remaining funds go to inferior creditors (in the order that their security interests rank) until they are paid in full, with any sums remaining after that to the third party possessor.

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establishing it.” *Id.* See also *id.* art. 2703, for the rights of Third Party Possessors in an executory proceeding.

154. Code of Civil Procedure article 2703 refers to a Third Party Possessor as a “person who has acquired the property subject to the mortgage or privilege thereon and who has not assumed the payment of the indebtedness secured thereby.” *Id.* art. 2703. Third party possessor status can also result if a purchaser buys property by a “cash sale” in which the seller has failed to mention or disclose existing mortgages and encumbrances. In such an instance, the seller has breached its warranty of title to the buyer. LA. CIV. CODE art. 2475 (2009). But the mortgages remain extant on the property. LA. CODE CIV. PROC. art. 2701. The buyer has no personal liability to the holders of the mortgages. LA. CIV. CODE art. 3315.

155. The improvements could also have been made by a predecessor in title to the third party possessor provided that the predecessor in title also was a third party possessor. This is because the sale transfers all benefits of the property to the vendee, and a third party possessor can “assert any claim which he has to the enhanced value of the property due to improvements placed on the property . . . by any prior third possessor through whom he claims ownership of the property.” See LA. CODE CIV. PROC. art. 2703. In fact, a party need not be a vendee to claim the benefits of the third party possessor. For example, a mortgagee of a third party possessor may step into the mortgagor-third party possessor’s shoes to receive the benefits. See *Citizens’ Bank of La. v. Miller*, 412 So. 516 (La. 1893).

156. *Glass v. Ives*, 126 So. 69, 71 (La. 1930). See also LA. CIV. CODE art. 3318.

This process can be illustrated by the following examples. Under these examples, as in Examples I and J, Creditor L holds a \$100,000 first mortgage on the property, Creditor M holds a \$300,000 second mortgage on the same tract, and Creditor O holds a \$75,000 third mortgage on the same tract.<sup>157</sup> Creditor M is the foreclosing creditor in a suit into which third mortgage Creditor O has intervened<sup>158</sup> but first mortgage Creditor L has not.

Unlike Examples I and J, however, Seller X, a homeowner, was the debtor on the mortgages held by Creditors L and M on X's home, but Seller X has sold the property to Buyer Y by a sale subject to the mortgages held by Creditors L, M, and O.

*Example K:* If the property appraises at Creditor M's foreclosure sale for \$525,000, Creditor M might think that it will ultimately be entitled to full compensation from the proceeds of the sale of the property, for it has a \$300,000 second mortgage, Creditor L has a \$100,000 first mortgage. The minimum bid at the foreclosure sale will be \$350,000 (two-thirds of \$525,000), which is more than sufficient to pay off Creditor M's \$300,000 mortgage. Creditor M, however, has failed to account for the possibility that Buyer Y may assert her third party possessor rights.

*Comments on Example K:* If Buyer Y wishes to invoke her third party possessor rights, then Buyer Y will need to both seek a separate appraisal<sup>159</sup> and introduce proof of the costs of the improvements made. Buyer Y needs a separate appraisal because the only appraisal the foreclosing creditor requires for a deficiency judgment relates to the value of the property at the time of

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157. As in the previous hypotheticals, the assumption is that the face amount of each mortgage equals the sum owing on each mortgage at the time of foreclosure.

158. Creditor O need not intervene to be entitled to the rights discussed in Examples I and J, because the Sheriff must distribute proceeds that exceed the foreclosing creditor's mortgage to inferior secured creditors and then, if any remains, to the owner of the property. LA. CODE CIV. PROC. art. 2373. In any event, however, unlike first mortgage Creditor L who gets no notice of second mortgage Creditor M's foreclosure proceedings because Creditor L's mortgage is unaffected, third mortgage Creditor O must get notice of the foreclosure sale. The notice to Creditor O is required under the procedural due process rules set forth in *Menonite Bd. of Missions v. Adams*, 462 U.S. 791 (1983), which requires notice to those whose property rights (including mortgages and security interests) may be affected by a foreclosure sale. The due process issues relating to foreclosures is beyond the scope of this paper, but the key cases include: *Jones v. Flowers*, 547 U.S. 220 (2006); *Davis Oil Co. v. Mills*, 873 F.2d 774 (5th Cir. 1989); *Small Engine Shop v. Cascio*, 878 F.2d 883 (5th Cir. 1989); *Magee v. Amiss*, 502 So. 2d 568 (La. 1987).

159. LA. CODE CIV. PROC. art. 1092. *See also Glass*, 126 So. 69.



foreclosure, but the third party possessor is entitled to collect the lesser of the cost of the improvements made or the enhancements to value caused by the improvements; the only way an enhancement to value can be shown is by having an appraisal of the property made that *excludes* the improvements erected by the third party possessor.<sup>160</sup> Thus, Buyer Y will need to assert her third party possessor rights and introduce an appraisal, in ample time prior to the judicial sale,<sup>161</sup> to demonstrate the enhanced value. Likewise, Buyer Y will need to be able to prove the cost of the improvements.

Assume Buyer Y demonstrates that the costs of the improvements were \$125,000, and Buyer Y's appraisal shows that, without the enhancements, the property would be worth only \$250,000.<sup>162</sup> Now the distribution of the proceeds would be as follows:

- First, the unenhanced value of the property (\$250,000) to foreclosing Creditor M. That leaves \$100,000 of the \$350,000 minimum bid price to be distributed,<sup>163</sup> but this money does not go Creditor M at this point.
- Second, the third party possessor gets any excess, but only equal to the lesser of costs or enhancements. In this case the costs were \$125,000 and the enhancement was \$275,000 (\$525,000 appraised value with enhancements minus \$250,000 appraised value without enhancements). Buyer Y, as a third party possessor, is entitled to claim only the lesser of the costs or the enhancement; the lesser number is

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160. See *Glass*, 126 So. 69.

161. Code of Civil Procedure article 1092 states that a third person claiming "ownership or, or a mortgage or privilege on, property seized" may intervene. LA. CODE CIV. PROC. art. 1092. If ownership is claimed, the intervention must be filed at any time prior to the judicial sale, and the court is allowed to enjoin the sale until the third person's ownership claims are resolved. If the third person claims a mortgage or privilege, it may intervene at any time prior to the sheriff's distribution of proceeds of the sale of the property.

162. This example is not farfetched. The test of "enhancements" is made by comparing *at the time of foreclosure* the value of the property with and without the enhancements. The court in *Glass*, 126 So. at 70, considered what the value of the property was at the time of the suit: "The evidence shows that the property is worth now only about \$6,000 . . ." On the other hand, the test of the *cost* of enhancement looks to the actual out-of-pocket costs of the third party possessor, regardless of when these costs were incurred. Thus, it is possible that although the property is worth \$525,000 today, at the time the enhancements were made fifteen years ago, the cost to make these enhancements was only \$125,000. Today, it might cost two or three times that amount to make those same enhancements, but the test of "costs" for third party possessors does not look to the present value of these sums or worth of the costs as measured by inflation (or deflation) but rather to the actual out-of-pocket costs.

163. The minimum bid was \$350,000;  $350,000 - 250,000 = 100,000$ .

\$125,000, but there is only \$100,000 of the bid price to be distributed, so Buyer Y gets the entire \$100,000.

- Third, any excess to the foreclosing creditor until paid. There is no excess from the bid price. Therefore, Creditor M gets nothing and Creditor O gets nothing.
- Fourth, any excess to inferior creditors (in the order of their security interests) until they are paid in full and then to the third party possess. There is no excess here either.

Note in this example that if Buyer Y had not claimed third party possessor rights, foreclosing Creditor M would have received the entire \$300,000 from the \$350,000 minimum bid, and third mortgage Creditor O would have received the remaining \$50,000 of funds. When Buyer Y intervenes to claim third party possessor status, however, the distributions change. Foreclosing Creditor M gets only \$250,000, third mortgage Creditor O gets nothing, and both Creditor M and Creditor O are left to pursue Buyer Y for the remaining deficiencies. Neither Creditor M nor Creditor O have a security interest in the \$100,000 Buyer Y received from the sale as third party possessor, because the only rights that Creditors M and O had were as secured creditors of Seller X and Seller X's property; they had no personal claim against Buyer Y.

In Example K, Creditor L's first mortgage is unaffected by the foreclosure sale because it has not intervened into the proceedings; therefore, it can begin its own foreclosure suit the very next day if the Seller Y is in default on the mortgage to Creditor L.

### *C. Foreclosure Sales Involving a Third Party Possessor Who Has Granted a Mortgage to a Creditor*

The rights of third party possessors can be affected by those mortgage creditors as to which the third party has personal liability. To put this another way, an owner may be a third party to the foreclosing creditor but may not be a third party to other mortgage creditors. Example L illustrates this situation.

As in Example K, Creditor L holds a \$100,000 first mortgage on property, Creditor M holds a \$300,000 second mortgage on the same tract and is the foreclosing creditor, both of which have been granted by Seller X.

Unlike Example K, Creditor O is not the holder of a third mortgage granted by Seller X. There is no Creditor O in Example L.

As in Example K, Seller X has sold the property to Buyer Y subject to L and M's mortgage. After the sale, however, Buyer Y borrows \$190,000 from Creditor O2 and grants Creditor O2 a mortgage on the property to secure the loan. Buyer Y now uses the \$190,000 to construct a home on the property.

*Example L:* At the time of foreclosure, the property appraises for \$525,000, Buyer Y intervenes to claim third party possessor status, and Buyer Y demonstrates that while the costs of the enhancements were \$190,000, the value of the property without the enhancements was \$250,000 (as in Example K).

*Comments on Example L:* The minimum bid at this sale would be \$350,000 (two-thirds of \$525,000), which is greater than Creditor L's first mortgage (and Creditor L has not intervened into the sale). Under this example, the distribution of the sales proceeds would be as follows:

- First, the unenhanced value of the property (\$250,000) to foreclosing Creditor M. That leaves \$100,000 of the bid price to be distributed.<sup>164</sup>
- Second, any excess to the lesser of costs or enhancements to the third party possessor. In this case the costs were \$190,000 and the enhancement was \$275,000 (\$525,000 appraisal value with enhancements minus \$250,000 appraisal value without enhancements). Buyer Y, as a third party possessor, is entitled to claim only the lesser of the costs or the enhancement; the lesser number is \$190,000, but there is only \$100,000 of the \$350,000 minimum bid price to be distributed, so Buyer Y gets the entire \$100,000.
- Unlike Example, K, however, while Buyer Y is a third party possessor to foreclosing Creditor M, Buyer Y is personally liable on the mortgage to third mortgage Creditor O2, so Buyer Y by definition is not a third party possessor as to Creditor O2 (because if an owner is personally liable to the mortgage creditor, the owner cannot be a third party possessor<sup>165</sup>). An attribute of Creditor O2's mortgage (which secures Buyer Y's personal obligations to Creditor O2) is that Creditor O2 can "step into the shoes" of Buyer Y and claim Buyer Y's third party possessor status as against foreclosing Creditor M and thus take the money that otherwise would have gone to Buyer Y at this point.<sup>166</sup> Therefore, the \$100,000 goes to Creditor O2. At

164. The minimum bid was \$350,000;  $350,000 - 250,000 = 100,000$ .

165. See LA. CIV. CODE art. 3343 (2009).

166. This was the express holding of *Citizens' Bank of Louisiana. v. Miller*, 12 So. 516, 517 (1893), where the court stated:

Therefore the Excelsior Planting & Manufacturing Company was held to be a third possessor, entitled to the benefits of the provisions of Article 3407 of the Civil Code. But, as between the Excelsior Planting & Manufacturing Company and J. K. Ober *et al.*, the former was not a third possessor. As to them the company or corporation was the original mortgage debtor, and, as such, owed Ober *et al.* the amount due for the

this point, Creditor M is still owed \$50,000<sup>167</sup> and Creditor O2 is owed \$90,000<sup>168</sup>

- Third, any excess to the foreclosing creditor until paid. There is no excess, so Creditors M and O2 get nothing further.
- Fourth, any excess to inferior creditors (in the order of their security interests) until they are paid in full and then to the third party possessor. There is no excess here.

Note that in this Example L, third mortgage Creditor O2 gets \$100,000 by asserting the third party possessor right of its mortgagor. Creditor O2 could arguably have done this on its own even if Buyer Y had not intervened.<sup>169</sup> Had third party possessor status not been claimed at all, however, foreclosing Creditor M would have received the payoff of its mortgage (\$300,000) from the minimum bid of \$350,000, and Creditor O2 would have received only the remaining \$50,000. Thus, when Creditor O2 asserts Buyer Y's third party possessor status, Creditor O2 gets more money and Creditor M gets less.

Of course, as in Example K, Creditor L's mortgage is unaffected by the foreclosure sale.

## IX. ISSUES INVOLVING A SECOND JUDICIAL SALE

Prior to 1995, there apparently were some creditors who made a habit of filing executory process suits with appraisal but who did not bid at all in the first sale. If there were no other bids, the property

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enhanced value of the plantation on account of the improvements. There is no argument necessary to show that the mortgagee cannot have his debt diminished on account of improvements placed on the mortgaged property. Whatever improvements are placed thereon necessarily fall under the operation of the mortgage, and the mortgage creditor is entitled to the benefit of the enhanced value of the property and this enhanced value can in no way be separated from the mortgaged property between mortgagor and mortgagee, so as to become what counsel for Sells & Co. denominated an "incorporeal right," and therefore incapable of being subjected to the mortgage of Ober *et al.* The plantation, with its prospective value, from whatever source, was subject to the mortgage of J. K. Ober *et al.* The proceeds of the sale represent the property in its entirety, and there is no means of separating the enhanced value from it.

167. Creditor M has already collected \$250,000 of its \$300,000 mortgage.

168. Creditor O2 has just collected \$100,000 of its \$190,000 mortgage.

169. While the *Citizens' Bank* case does not directly stand for this proposition, it is clear from the holding that a mortgagor, who is a third party possessor, necessarily encumbers all of their rights as third party possessors on the collateral property. In the event of default, the mortgagee is entitled to the benefits that inure to the encumbered property, which necessarily includes the rights of third party possessors.

could not be sold at the first sale and a second sale under the Code of Civil Procedure was required. At the second sale, there was no requirement that the minimum bid be two-thirds of the appraised value (as there was at the first sale), although the minimum bid had to exceed superior mortgages or encumbrances.<sup>170</sup>

This led to a situation where, prior to 1995, creditors who did not bid at the first sale (when there was no other adverse bids) and who routinely allowed the property to be sold at the second sale could receive a huge windfall when there were no superior mortgages. This is because the minimum bid at the second sale was merely costs. In that event, there would be nothing to attribute to the mortgagor's debt. The creditor would receive the property (for merely costs) by being the successful bidder at the second sale, and the creditor would be entitled to pursue the debtor for the entire amount of the debt as a deficiency.

To prevent creditors, as a matter of course, from foreclosing on property, refusing to bid at the first sale, and then buying property at a second sale for costs, thereby obtaining a vast windfall that the Deficiency Judgment Act was designed to prevent, the Code of Civil Procedure was amended in 1995.<sup>171</sup> Rather than setting a new two-thirds rule for the amount of the bid at the second sale, the amendment created a requirement that the creditor reduce the debt by "the greater of either one-half of the appraised value, less superior security interests, mortgages, liens, and privileges, or the amount by which the price bid exceeds superior security interests, mortgages, liens, and privileges."<sup>172</sup> This rule combines the procedural approach of the Deficiency Judgment Act (mandating that the debt be reduced by a certain amount, regardless of the bid price) with a substantive recognition that the minimum bid at the second sale might in fact approach or exceed the fair market value of the property. This can be illustrated by the following examples.

In these examples, Creditor Q is owed \$100,000.00 and is secured by a \$100,000 first mortgage on the property, but Creditor Q does not intervene in the executory proceedings brought by Creditor R, which is owed \$300,000 and is secured by a \$300,000 second mortgage.

*Example M:*<sup>173</sup> The property appraises for \$600,000, but no one bids the minimum two-thirds (\$400,000) of appraised value at

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170. LA. CODE CIV. PROC. art. 2337 (2009).

171. 1995 La. Acts No. 1023.

172. LA. CODE CIV. PROC. art. 2336.

173. See also Michael H. Rubin, *Ruminations on Security Devices*, 56 LA. L. REV. 641, 647-50 (1996).

the first sale.<sup>174</sup> At the second sale, the minimum bid is \$100,000.00, the amount of Creditor Q's first mortgage claim.<sup>175</sup>

*Comments on Example M:* If Creditor R purchases the property for the \$100,000.00 bid price, it pays nothing to the sheriff<sup>176</sup> because the bid price is less than its \$300,000 mortgage. Because the bid equaled the amount owed to first mortgage Creditor Q, Creditor R must reduce the debtor's obligation by \$200,000, which is "one-half of the appraised value"<sup>177</sup> ( $\$600,000 \div 2 = \$300,000$ ) minus "superior security interests, mortgages, liens, and privileges"<sup>178</sup> (\$100,000). Therefore, after the second sale at which foreclosing Creditor R bids \$100,000 on a \$600,000 tract of land securing a \$300,000 debt, the debt is reduced by \$200,000. Therefore, Creditor R, who now has property worth \$600,000 for which it has paid only costs, can pursue the debtor for a \$100,000 deficiency.<sup>179</sup> The property is still secured by Creditor Q's \$100,000 first mortgage, but foreclosing Creditor R has achieved a potential windfall.<sup>180</sup>

Of course, Creditor Q's mortgage remains unaffected by the judicial sale.

*Example N:* The facts are the same as in Example M, but this time the property appraises for \$300,000. Now the minimum bid is

174. The minimum bid is two-thirds of \$600,000, the appraised value of the property. LA. CODE CIV. PROC. art. 2336. Since \$400,000 (two-thirds of \$600,000) exceeds Creditor Q's \$100,000 mortgage, the minimum bid is \$400,000. *Id.* arts. 2336, 2337.

175. LA. CODE CIV. PROC. art. 2337, stating that if "the price offered by the highest bidder at the . . . subsequent offering is not sufficient to discharge the costs of the sale and the security interests, mortgages, liens, and privileges superior to that of the seizing creditor, the property shall not be sold."

176. As in the other examples, costs of the sale are not taken into account for ease of understanding. In actuality, however, Creditor R would have to pay the costs of suit and the sheriff's commissions. *Id.* art. 2373.

177. *Id.* art. 2336.

178. *Id.*

179.  $\$600,000/2 = \$300,000 - \$100,000$  bid (which does not exceed the amount of Creditor Q's superior mortgage) = \$200,000.

180. The windfall is that the net value of the property is \$500,000 (\$600,000 appraised value minus Creditor Q's \$100,000 first mortgage) plus the ability to sue the debtor for a \$100,000 deficiency. This windfall in fact is greater than if foreclosing Creditor R had bid two-thirds at the first sale. This is because if Creditor R had bid two-thirds at the first sale, that amount (\$400,000) would have been greater than the debt owed to Creditor R. There would be no deficiency judgment at all, in contrast to the second sale situation where Creditor R both acquires the property (which has \$500,000 in equity) and can pursue the debtor for a \$100,000 deficiency.

\$200,000 (two-thirds of the appraised value, and this two-thirds number is greater than Creditor Q's first mortgage). There are no bids at the first sale and a second sale is held. At the second sale other bidders show up and actually make bids. Now, rather than purchase the property for the \$100,000 minimum bid (as in Example M), foreclosing Creditor R gets the property, but only by bidding \$275,000.

*Comments to Example N:* In this case Creditor R must reduce the debt owed by "the greater of either one-half of the appraised value, less superior security interests, mortgages, liens, and privileges, or the amount by which the price bid exceeds superior security interests, mortgages, liens, and privileges."<sup>181</sup> Since one-half of the appraised value is \$150,000, and since \$175,000 is the amount that the bid exceeds first mortgage Creditor Q's superior \$100,000 mortgage, the deficiency that Creditor R can seek is limited to \$125,000. (\$300,000 - \$175,000). Again, however, Creditor R, by being the successful bidder, receives a windfall by owning property that has equity and is still able to sue the debtor for a deficiency.<sup>182</sup>

As in Example M, Creditor Q's mortgage remains unaffected by the judicial sale.

*Additional Comments on Examples M and N:* Examples M and N demonstrate that even at the second sale, it is possible that a foreclosing creditor who is the successful bidder might receive a windfall by (1) being able to collect a deficiency judgment and (2) receiving more than what was owed by the debtor when the property is later sold by the creditor at an amount equal to or in excess of the appraised value given prior to the first sheriff's sale (at which the property was *not* sold). The windfall results from the assumption that the property can later be sold for at least its appraised value and that the deficiency in fact can be collected.

The fact that it is theoretically possible for the foreclosing creditor to receive a windfall, however, does not mean that the Deficiency Judgment Act and the Code of Civil Procedure do not perform useful functions. Even assuming that the appraised value of the property is entirely accurate and truly reflects the fair market

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181. LA. CODE CIV. PROC. art. 2336.

182. The windfall here is the \$200,000 net value of the property (\$300,000 appraised value minus \$100,000 first mortgage) plus the ability to sue the debtor for a \$125,000 deficiency. Thus, although foreclosing Creditor R is owed only \$300,000, it will be able to collect \$325,000, assuming the property can be sold for at least its appraised value and the deficiency can be collected.

value of the property,<sup>183</sup> the mere fact that a creditor has foreclosed usually means that the property will bring less when the creditor tries to market it, for it is likely that the public will believe that the creditor must dispose of the property quickly at “firesale” prices.<sup>184</sup> Thus, it may be unlikely that the creditor will realize the appraised value of the property. Further, because a deficiency seeks a personal judgment against the debtor, if the deficiency is uncollectible, either because the debtor simply does not have enough assets to satisfy the deficiency or because the debtor files for bankruptcy, the creditor’s action in invoking the second sale may not result in any actual windfall.

The theoretical fact that a creditor may be able to collect more than the debt (if the creditor is the successful bidder at a first or second sale, is able to realize the full appraised value of the property, and is able to collect the deficiency) merely emphasizes the practical fact that judicial sales may not result in a sale at a price equal to the fair market value of the property. Indeed, the entire function of the Deficiency Judgment Act in creating procedural hurdles requiring a reduction of the debt<sup>185</sup> may undermine the assumption set forth by the U.S. Supreme Court that foreclosure sales should be presumed to bring fair market value

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183. Of course, if the appraisal reflected the fair market value of the property, then the fact that a second sale occurs because of the lack of a two-thirds appraised value bid at the first sale only underscores the inadequacy of foreclosures to result in judicial sales that realize fair market value.

184. See, e.g., J.W. Elphinstone, *Foreclosure Fire Sale*, Aug. 29, 2007, WASH. POST, <http://washingtontimes.com/article/20070829/BUSINESS/108290014/1006> (last visited December 1, 2008). See also Bernard Condon, *Fire Sale*, FORBES, Apr. 7, 2008, <http://www.forbes.com/forbes/2008/0407/040.html> (“Last summer Wells Fargo was in a bind: A Rochester Hills, Mich. couple had taken out a \$465,000 mortgage they couldn’t pay back without selling their home. But no one was willing to pay such a high price. So the bank tried to recoup the debt in a foreclosure sale. Still no takers. In February, after watching prices in this Detroit suburb crater, the bank threw up its hands, selling the four-bedroom brick colonial for \$325,000.”).

Many creditors are not in the business of marketing property and have internal as well as regulatory needs to “get the property off their books” as fast as possible. To use as just one illustration, national banks are bound by Federal Regulations regarding property taken back or obtained via foreclosure. In an effort to increase capital, allowing the bank to transact business in compliance with regulations, the bank will write the loan value down to zero upon default. These same regulations specify that such national banks may only hold such property for a finite period of time. For more information, see 12 C.F.R. § 34.81 (2009) and following.

185. As outlined in Code of Civil Procedure art. 2336, the procedural hurdle at the first sale is the two-thirds appraised value requirement, and the procedural hurdle at the second sale is compliance with the debt reduction rules.



and the actual foreclosure sale amount should set the basis of the deficiency available.<sup>186</sup>

#### X. STATUTORY EXEMPTIONS FROM THE LOUISIANA DEFICIENCY JUDGMENT ACT

The Deficiency Judgment Act reflects a strong public policy that cannot be voluntarily waived even by knowledgeable and sophisticated parties.<sup>187</sup> Since the Act came into existence in the 1930s, however, statutory exemptions have been created.

These statutory exemptions from the prohibition against deficiency judgments (in the absence of a judicial sale with appraisal) can be grouped into five categories: (1) matters in which an appraisal is not required because the property is cash or cash equivalents;<sup>188</sup> (2) matters in which an appraisal is not required because the markets are fluid and transparent;<sup>189</sup> (3) actions taking place under federal bankruptcy law or the law of other states;<sup>190</sup> (4) matters where the parties voluntarily agree, after default, to the value of the collateral and the amount of the deficiency;<sup>191</sup> and (5)

186. In *BFP v. Resolution Trust Corp.*, 511 U.S. 531 (1994), the issue was whether under the Bankruptcy Act, 11 U.S.C. § 548 (2006), a property's fair market value should be used to ascertain whether the amount paid at a foreclosure sale equals the "reasonably equivalent value" of the property. In a five to four ruling, the Court held that the value paid at the foreclosure sale was determinative in the bankruptcy context, even if it might have brought less than the fair market value. *BFP*, 511 U.S. at 545. The Court stated:

For the reasons described, we decline to read the phrase "reasonably equivalent value" in § 548(a)(2) to mean, in its application to mortgage foreclosure sales, either "fair market value" or "fair foreclosure price" (whether calculated as a percentage of fair market value or otherwise). *We deem, as the law has always deemed, that a fair and proper price, or a "reasonably equivalent value," for foreclosed property, is the price in fact received at the foreclosure sale, so long as all the requirements of the State's foreclosure law have been complied with.*

*Id.* (emphasis added). There are many articles about *BFP*, including: Eric S. Palace, *In re BFP: Just a Band-Aid?—Looking for a Stable Solution that Balances Creditors' and Debtors' Rights Under Bankruptcy Code Section 548(A)(2)*, 15 ANN. REV. BANKING L. 359 (1996); Marie T. Reilly, *A Search for Reason in Reasonably Equivalent Value after BFP v. Resolution Trust Corp.*, 13 AM. BANKR. INST. L. REV. 261 (2005); Jessica L. Wasserstrom, *The Judicial Search for Objectivity in Valuation, Third Circuit Rules That Market Capitalization Is Preferred Method of Valuing Assets in the Fraudulent Transfer Context*, 26 AM. BANKR. INST. J. 58 (2007).

187. LA. REV. STAT. ANN. § 13:4107 (2006).

188. *Id.* § 13:4108(5).

189. *Id.* § 13:4108(1), (2).

190. *Id.* § 13:4108(3), (4).

191. *Id.* §§ 13:4108.1, 13:4108.2.

transactions falling within the scope of Louisiana's version of the Uniform Commercial Code.<sup>192</sup>

This Section examines the first four categories; the next section reviews U.C.C. issues.

### *A. Cash and Cash Equivalents*

When the asset consists of cash or the equivalent of cash, the legislature allows creditors to pursue a deficiency without proceeding by a judicial sale with appraisal.<sup>193</sup> This is entirely understandable, for there is no need to appraise the value of cash or cash equivalents, and the debtor will clearly receive the full credit for the collateral when it is sold if the collateral consists of cash or cash equivalents. Therefore, a creditor's offset of a certificate of deposit,<sup>194</sup> the creditor's receipt of a refund of insurance premiums,<sup>195</sup> or the creditor's collection of accounts receivable will not bar a deficiency.<sup>196</sup>

### *B. Transparent and Fluid Markets*

The second statutory exception to the Deficiency Judgment Act concerns national markets that are broad, transparent, and fluid. There can be little question that the value received for collateral disposed of on those national markets will be the fair market value of the property at the exact time the collateral is sold on those markets. There is no need for an appraisal if property is continually valued, readily accessible, and easily tradable on a broad-based market. Thus, sales of stock and commodities on national exchanges are statutorily exempt from the Deficiency Judgment Act,<sup>197</sup> but the statutory exemptions from the Deficiency Judgment Act do not include any market other than the NYSE, AMEX, NASDAQ, and the Chicago Commodity Exchange.<sup>198</sup>

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192. *Id.* § 13:4108.3.

193. *Id.* § 13:4108.

194. *Id.* § 13:4108(5)(b).

195. *Id.* § 13:4108(6). This statute overrules the holding of *Rushing v. Dairyland Ins. Co.*, 456 So. 2d 599 (La. 1984).

196. LA. REV. STAT. ANN. § 13:4108(5)(c).

197. *Id.* § 13:4108(1), (2) (regarding the sale of stocks, bonds, or options through the New York Stock Exchange, the American Stock Exchange, or the NASDAQ, and the sale of options on the Chicago Commodity Exchange).

198. *Id.* § 13:4108, providing in pertinent part:

Notwithstanding any other law to the contrary, including but not limited to La. R.S. 13:4106 and 4107, none of the following actions by a mortgagee or other creditor shall prohibit the mortgagee or other creditor from obtaining a deficiency judgment against any debtor,

At the time this statutory exemption was created,<sup>199</sup> the vast and fluid Internet marketing phenomena had not occurred. One might anticipate that, at some point in the future, the legislature may consider adding publicly recognized, broadly used, markets, including Internet-based markets (such as eBay<sup>200</sup>) to the list of statutory exemptions.<sup>201</sup>

### *C. Actions Taking Place Under Federal Bankruptcy Law or the Laws of Other States*

The third group of statutory exemptions from the Deficiency Judgment Act concerns creditors who proceed in bankruptcy court, because the Bankruptcy Code has erected its own set of protections for debtors and has a detailed system of judicial oversight.<sup>202</sup>

In addition, if a creditor has proceeded to foreclose on collateral located in another state and uses that state's procedures;<sup>203</sup> it is impossible for the creditor to comply with the

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guarantor, or surety, notwithstanding the fact that a sale of property or collateral may have occurred at a judicial sale without appraisal, at a public or private sale with or without appraisal, or at a judicial sale with a defective appraisal: (1) A sale through the New York Stock Exchange, the American Stock Exchange, or the NASDAQ, of any pledged stock, bonds, or options registered or traded on such exchanges. (2) A sale through the Chicago Commodity Exchange of any pledged options registered or traded on such exchange.

199. Revised Statutes section 13:4108 was enacted by 1986 La. Acts No. 489.

200. eBay, <http://www.ebay.com> (last visited Apr. 8, 2009). The authors are not suggesting that eBay is the only Internet market available or that it should be used; rather, the purpose of the observation is to note that it is possible national, fluid markets exist outside of the formalized structure of the national stock and commodity exchanges.

201. The number of eBay traders is huge. As of 2005, there are over 212 million eBay buyers and sellers, of which 128 million are in the USA, and more than 724,000 Americans report that eBay is their primary or secondary source of income, while another 1.5 million individuals report supplementing their income by selling on eBay. Updated eBay Statistics, Thebidfloor.com, [http://www.thebidfloor.com/ebay\\_statistics.htm#current\\_number\\_of\\_members](http://www.thebidfloor.com/ebay_statistics.htm#current_number_of_members) (last visited Apr. 8, 2009).

202. LA. REV. STAT. ANN. § 13:4108(3) (regarding the sale of collateral made pursuant to an order of a U.S. Bankruptcy Court or a U.S. District Court sitting in bankruptcy).

203. Revised Statutes section 13:4108(4) addresses collateral located outside of Louisiana where the creditor elects to use the foreign jurisdiction's procedures. *Id.* § 13:4108(4). This provision is a statutory recognition of the judicial rule originally announced in *Exchange National Bank of Chicago v. Spalitta*, 321 So. 2d 338, 343 (La. 1975), a case decided before section 13:4108 was enacted, holding that application of Louisiana's Deficiency Judgment Act was inapplicable in the context of sales in bankruptcy.

Louisiana Deficiency Judgment Act if the state does not have a mechanism to hold a judicial sale or for judicial sales with appraisal. The Deficiency Judgment Act does not penalize a creditor for utilizing a procedure that is valid in the state where the asset is located.<sup>204</sup>

#### D. Work-Out Agreements

Creditors and debtors have an economic incentive to avoid judicial foreclosures if they can reach a voluntary agreement to sell the collateral and set the amount of the deficiency. Creditors may prefer to avoid the delays inherent in judicial foreclosures,<sup>205</sup> while debtors may prefer not being burdened with the extra costs of judicial proceedings, which include court costs, sheriff's commissions, and legal fees for the creditor's counsel.<sup>206</sup>

The Louisiana Legislature has enacted two separate provisions permitting creditors and debtors to reach voluntary agreements concerning disposition of collateral and the collection of deficiency judgments. Louisiana Revised Statutes section 13:4108.1 controls commercial transactions and section 13:4108.2 controls consumer transactions, but both follow the same general principles.

Under Revised Statutes section 13:4108.1, the debtor and creditor must reach an agreement concerning the value of the collateral. The agreement can be reached only after the debt comes due or after the debtor is in default on the obligation, for Louisiana law prohibits a debtor from agreeing at the inception of a loan to transfer ownership of the collateral to the creditor if there is a default in the loan.<sup>207</sup> The statute uses "reasonably equivalent

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204. In this regard, the effect of Revised Statutes section 13:4108(4) is identical to the bankruptcy rule of *BFP v. Resolution Trust Corp.*, 511 U.S. 531 (1994): a non-Louisiana state procedure for foreclosure is deemed to bring a fair market value. See *supra* note 186.

205. Even with executory process, a judicial sale of immovable property cannot be set less than thirty days from the date of the judgment because of the statutory rules controlling advertisements for the sale, and it is not unusual for it take up to sixty days from the date of the filing of the executory suit and the judicial sale. See LA. REV. STAT. ANN. §§ 13:4341, 43:203.

206. It is not unusual for notes secured by mortgages to call for 25% attorney's fees. While courts maintain the ability to supervise, control and set the amount of such fees, fees can add a substantial amount to the debtor's obligations. See *Leenerts Farms, Inc. v. Rogers*, 421 So. 2d 216 (La. 1982). For example, in *Metro Reporters, Inc. v. Avery*, 665 So. 2d 547 (La. App. 5th Cir. 1995), a court reporting agency sued an attorney on an open account; the trial court awarded attorney's fees that were equal to 69% of the amount of the judgment awarded to the court reporters.

207. As the Louisiana Supreme Court stated in *Alcolea v. Smith*, 90 So. 769 (La. 1922):

value” to mean the agreed value of the collateral;<sup>208</sup> this phrase echoes the identical words used in the Bankruptcy Code.<sup>209</sup>

The agreement should be reached after default but prior to the disposition of the collateral, and preferably should be memorialized in writing.<sup>210</sup> In practice, the parties usually enter

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Since the edict of Constantine annulling and prohibiting what was known as the *lex commissoria* and the stipulation in the contract of pledge which it authorized, whereby, in default of payment by the pledgor, the thing pledged became the property of the pledgee without further action on his part, such stipulations have been prohibited in all countries where the civil law prevails, and the prohibition has long since become part of the common law, the commentators on both systems agreeing that they are *contra bonos mores* and oppressive; that they involve the abuse of the power of the strong over the weak, represent odious speculations by those who have money, at the expense of those who need it, and are unconscionable.

208. Revised Statutes sections 13:4108.1(B)(2) and 13:4108.2(B)(2) are similar. Under section 13:4108.1(B)(2), “‘Reasonably equivalent value’ means the value that the owner and the mortgagee or other creditor of the property being sold or otherwise disposed of agree to attribute to the property for the purposes of reducing the secured debt.” LA. REV. STAT. ANN. § 13:4108.1(B)(2). Under section 13:4108.2(B)(2), “‘Reasonably equivalent value’ means the value which the owner and the mortgagee or other creditor expressly agree to attribute to the property transferred as provided in Subsection A of this Section [which addresses reduction of the debtor’s outstanding obligation].” *Id.* § 13:4108.2(B)(2).

209. See 11 U.S.C. § 548(a)(2) (2006), which uses the term “reasonably equivalent value” in the context of fraudulent transfers. As noted in *In re Miller*:

In *BFP v. Resolution Trust Corp.*, the United States Supreme Court discussed the meaning of “reasonably equivalent value” as used in 11 U.S.C. § 548. The Court held that the price paid by a third-party purchaser at a foreclosure sale for real property was the reasonably equivalent value for that property as long as all applicable state laws were complied with. In *T.F. Stone Co. v. Harper*, the Fifth Circuit extended the reasoning in *BFP* to § 549(c). Thus, it applied the Supreme Court’s holding from a case involving a pre-bankruptcy petition mortgage foreclosure sale to a post-petition tax foreclosure sale.

454 F.3d 899, 901–02 (8th Cir. 2006) (citations omitted).

210. The exception provided under Revised Statutes section 13:4108.1 was discussed in *Echo, Inc. v. Power Equipment Distributors, Inc.*, 719 So. 2d 79 (La. App. 1st Cir. 1998). In *Echo*, a wholesaler sought a deficiency judgment on amounts owed under a terminated distributorship agreement after recouping unsold inventory and reselling the same to other distributors via a private sale. *Id.* at 83. The distributorship agreement contained merchandise buy-back provisions in the event of default. *Id.* Additionally, the wholesaler sent a letter to the distributor upon termination outlining buy-back prices for inventory that the wholesaler would credit to the distributor. *Id.* The distributor even assisted the wholesaler in loading the inventory on a truck for return to the wholesaler. *Id.* Despite this, the Court found that there was no evidence of the surrender of inventory being a partial *dation en paiement*; that the distributorship agreement was not part of a work-out agreement; and that there was no evidence of a

into a written contract setting value of the property, defining the debt, and describing that after the disposition of the collateral the debtor will be liable for a deficiency equal to the difference between (1) the debt, and (2) the greater of the agreed value of the property or the price the collateral brings at its disposition.

If the agreement is reached, then the creditor will be entitled to a deficiency, regardless of whether the disposition of the collateral is a public, private, or judicial sale. Further, under such an agreement, the parties can agree that the creditor may become the owner of the collateral.<sup>211</sup>

Louisiana Revised Statutes section 13:4108.2, concerning consumer transactions,<sup>212</sup> provides additional protections for debtors. The agreement must inform the debtor, “in laymen’s

voluntary agreement between the parties regarding the reasonable value that should be attributed to the assets, despite the distributor’s acquiescence to the surrender of inventory, so as to enable the creditor to use an exception to the deficiency judgment prohibition. *Id.* at 95.

Other courts have similarly held that the exceptions outlined under section 13:4108.1 were inapplicable where there was no evidence that the parties attempted to enter into a work-out or settled on a reasonably equivalent value to apply to the debt. *See* Citizens Sav. & Loan Ass’n v. Kinchen, 622 So. 2d 662, 665 (La. 1993); First Nat’l Bank of Houma v. Bailey, 583 So. 2d 559 (La. App. 3d Cir. 1991).

211. Sections 13:4108.1 and 13:4108.2 use different terminology to accomplish this purpose.

Section 13:4108.1 states that the exception to the Deficiency Judgment Act applies:

[W]hether or not the mortgagee or other creditor has foreclosed on all or any of the property and sold such property at a judicial, public, or private sale, with or without appraisal, regardless of the minimum bid, and whether or not the mortgagee or other creditor has acquired such property from any debtor, guarantor, or surety pursuant to a complete or partial giving in payment.

LA. REV. STAT. ANN. § 13:4108.1 (emphasis added). The reference to a “complete or partial giving in payment” is legislatively designed to obviate any claim that a *dation en paiement*, a giving in payment (LA. CIV. CODE art. 2655), must extinguish a debt completely. Thus, sections 13:4108.1 and 13:4108.2 explicitly allow a creditor to become owner of the collateral and still collect a deficiency as long as the other requirements of these acts are met.

Section 13:4108.2 notes that a deficiency may be obtained if the requirements of this section are met, even “if the mortgagee or other creditor *has acquired such property from the debtor. . .*” LA. REV. STAT. ANN. § 13:4108.2 (emphasis added).

212. LA. REV. STAT. ANN. § 13:4108.2, defining a “consumer transaction” as “any transaction entered into for personal, family, or household (noncommercial) purposes and particularly includes transactions that are secured by residential immovable property, but excluding secured transactions for consumer purposes that are subject to Chapter 9 of the Louisiana Commercial Laws.”

terms,"<sup>213</sup> of the right to obtain an appraisal. Under the agreement, the creditor must attribute at least 75% of the appraised value to the debt and the debtor must agree to remain liable for the deficiency. The agreement must inform the debtor that she is forfeiting the right to "judicial appraisal and sale." Of course, had there been a "judicial appraisal and sale," the debtor would have a right to appoint an appraiser,<sup>214</sup> but the minimum bid at the sheriff's sale would be only two-thirds of the appraised value, not three-quarters as under Revised Statutes section 13:4108.2, and the judicial sale costs and attorneys fees incurred in a law suit would be added.

Both sections 13:4108.1 and 4108.2 provide creditors and debtors with a mechanism to avoid the time and expense of judicial proceedings while at the same time permitting the parties to define the value of the property and the amount of the deficiency. If the debtor does not agree, the debtor can compel the creditor to invoke a judicial sale.

In no event, however, can the creditor repossess the property without the debtor's consent.<sup>215</sup>

#### XI. THE DEFICIENCY JUDGMENT ACT DOES NOT EXTINGUISH THE DEBT

If a creditor violates the Deficiency Judgment Act, the creditor can no longer pursue the debtor for any additional payments, even if the price brought at the sale does not equal the amount of the debt. This does not mean, however, that the entirety of the obligation is extinguished.

The Deficiency Judgment Act states that, if it is violated, "the debt nevertheless shall stand fully satisfied and discharged insofar as it constitutes a *personal obligation of the debtor*."<sup>216</sup> This language is deliberate and limited. The debt itself is not extinguished<sup>217</sup> as is made clear by the next section of the Act, which allows a creditor who has violated the Deficiency Judgment Act to sell other

213. *Id.* § 13:4108.2(D).

214. *Id.* § 13:4363.

215. See discussion of Louisiana's prohibition against self-help, *supra* notes 19 and 28.

216. LA. REV. STAT. ANN. § 13:4106(A) (emphasis added).

217. Some courts have stated in dicta that a violation of the Act results in an extinction of the debt, but this dicta cannot be squared with the express language of Louisiana Revised Statutes section 13:4106(B). For a case with this dicta, see *Farmerville Bank v. Scheen*, 76 So. 2d 581, 584-85 (La. App. 2d Cir. 1955) ("By virtue of such procedure under said statute, Holmes, the principal debtor, was released and discharged and, in fact, the debt itself discharged.").

collateral on which it has a security interest.<sup>218</sup> If the debt itself had been extinguished, the accessory obligation constituting the security interest would have become unenforceable.<sup>219</sup>

Therefore, if a mortgage affects two tracts in two different parishes and if a creditor forecloses on the first tract without appraisal, the creditor cannot pursue the debtor for the deficiency but can foreclose on the second tract and obtain a privilege on the proceeds of the sale<sup>220</sup> up to the value of the remaining deficiency. Of course, if the sale of the second tract does not satisfy the deficiency, the creditor cannot pursue the debtor for any additional monies.

## XII. SURETIES, GUARANTORS, AND THE LOUISIANA DEFICIENCY JUDGMENT ACT<sup>221</sup>

The text of the key provision of the Deficiency Judgment Act, Louisiana Revised Statutes section 13:4016, refers to the “debtor,” not to any sureties. On the other hand, in a voluntary work-out situation under section 13:4108.1 (the section dealing with commercial and not consumer debt), a surety cannot claim

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218. LA. REV. STAT. ANN. § 13:4106(B) (“If a mortgage or pledge affects two or more properties, movable, immovable, or both, the judicial sale of any property so affected without appraisal shall not prevent the enforcement of the mortgage or pledge *in rem* against any other property affected thereby.”). See *Bankers Trust of La. v. Smith*, 629 So. 2d 525 (La. App. 5th Cir. 1993) (allowing an *in rem* judgment against property via Louisiana Revised Statutes section 13:4106(B)).

219. Louisiana Civil Code article 1913 defines “accessory contract” as one made to provide security for the performance of an obligation. The obligation being secured is the principal obligation. For suretyship, extinction of the principal obligation extinguishes the suretyship. LA. CIV. CODE art. 3059 (2009). On the other hand, while a Louisiana mortgage is accessory to a principal obligation, the Civil Code permits parties to create a mortgage which secures a non-recourse obligation. See *id.* arts. 3282, 3297.

220. Louisiana Civil Code article 3279 expressly grants the mortgagee “upon failure of the obligor to perform the obligation that the mortgage secures, the right to cause the property to be seized and sold . . . and to have the proceeds applied toward the satisfaction of the obligation in preference to claims of others.” LA. CIV. CODE art. 3279.

221. For the Louisiana Civil Code articles on suretyship, see LA. CIV. CODE art. 3035–3070. Louisiana jurisprudence uses the terms “surety” and guarantor” interchangeably. See, e.g., *Aiavolasiti v. Versailles Gardens Dev. Co.*, 371 So. 2d 755 (La. 1979); *Fleet Fuel, Inc. v. Mynex, Inc.*, 924 So. 2d 480 (La. App. 2d Cir.), *writ denied*, 930 So. 2d 977 (La. 2006).

The form of suretyship contract routinely used by creditors is often entitled a “Continuing Guarantee.” See, e.g., *First Bank & Trust v. N & S Specialties, Inc.*, 947 So. 2d 205 (La. App. 5th Cir. 2007); *City of Minden v. Ray*, 914 So. 2d 1195 (La. App. 2d Cir. 2005); *Kinkle v. R.D.C., L.L.C.*, 889 So. 2d 405 (La. App. 3d Cir. 2004).



protection under the Deficiency Judgment Act if the debtor and creditor otherwise comply with this statute.<sup>222</sup> While identical language is not used in Revised Statutes section 13:4108.2 (the consumer debt provision), it appears that the result should be the same—if the creditor can collect from a consumer debtor as an exception to the Deficiency Judgment Act, there is no reason why the surety should be able to use the Deficiency Judgment Act when the debtor cannot.<sup>223</sup>

A more difficult question, however, is what happens to a surety if the creditor's violation of the Deficiency Judgment Act bars a claim against the debtor. In the almost twenty decisions<sup>224</sup> that discuss (either directly or tangentially) a surety's liability under the Deficiency Judgment Act since the Act was created almost eight decades ago, two conflicting lines of analysis have emerged.

#### A. *The Louisiana Supreme Court Decision in Southland*

The earliest decision is the Louisiana Supreme Court's opinion in *Southland Investment v. Motor Sales Co.*,<sup>225</sup> which was rendered in 1941, eight years after the Deficiency Judgment Act was

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222. LA. REV. STAT. ANN. § 13:4108.1(A) (2006) (“[T]he mortgagee or other creditor may collect from or pursue any debtor, guarantor, or surety for a deficiency judgment on the secured obligation . . .”).

223. This discussion concerns only the rights of the surety under Louisiana Revised Statutes section 13:4108.2. It is not intended to be a comprehensive discussion of all rights of a surety under other statutory provisions, including the rights of a surety to obtain a release under certain circumstances if, without the surety's consent, there is an impairment of subrogation rights. LA. CIV. CODE art. 3062. For an overview of Louisiana suretyship law, see Michael H. Rubin, *Ruminations on Suretyship*, 57 LA. L. REV. 565 (1997).

224. *Meadow Brook Nat'l Bank v. Massengill*, 427 F.2d 1055 (5th Cir. 1970); *Bowl-Opp, Inc. v. Larson*, 334 F. Supp. 222 (E.D. La. 1971); *Howard Trucking Co., Inc. v. Stassi*, 485 So. 2d 915 (La. 1986); *Southland Inv. Co., Inc. v. Motor Sales Co.*, 5 So. 2d 324 (La. 1941); *Univ. Prop. Corp. v. Fidelity Nat'l Bank of Baton Rouge*, 500 So. 2d 888 (La. App. 1st Cir. 1986); *Gulf Nat'l Bank at Lake Charles v. Ryan*, 432 So. 2d 1122 (La. App. 3d Cir. 1983); *Domingues Motors, Inc. v. Lalonde*, 417 So. 2d 900 (La. App. 3d Cir. 1982); *Gen. Motors Acceptance Corp. v. Smith*, 399 So. 2d 1285 (La. App. 4th Cir. 1981); *Ford Motor Credit Co. v. Soileau*, 323 So. 2d 221 (La. App. 3d Cir. 1975); *Commercial Credit Equip. Corp. v. Larry Parrott of Gueydan, Inc.*, 212 So. 2d 860 (La. App. 3d Cir. 1968); *C.I.T. Corp. v. Rosenstock*, 205 So. 2d 81 (La. App. 4th Cir. 1967); *Pioneer Bank & Trust Co. v. Foggin*, 177 So. 2d 131 (La. App. 2d Cir. 1965); *Gumina v. Dupas*, 178 So. 2d 291 (La. App. 4th Cir. 1965); *Wilson v. Brian*, 81 So. 2d 142 (La. App. 2d Cir. 1955); *Farmerville Bank v. Sheen*, 76 So. 2d 581 (La. App. 2d Cir. 1955); *Simmons v. Clark*, 64 So. 2d 520 (La. App. 1st Cir. 1953); *Guinn v. Houston Fire & Cas. Ins. Co.*, 32 So. 2d 613 (La. App. 1st Cir. 1947).

225. *Southland*, 5 So. 2d 324.

enacted. A partnership sold new and used cars; the plaintiff provided liquidity to the partnership by buying the negotiable notes executed by Enterprises' customers for car purchases. Each note was secured by a chattel mortgage on the purchased car,<sup>226</sup> and the two partners endorsed each note so that they were liable to Southland if the original car purchaser defaulted.<sup>227</sup> When the

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226. Prior to Louisiana's adoption of its version of Article 9 of the U.C.C. in 1990 (LA. REV. STAT. ANN. § 10:9-101 (2002) and following), Louisiana statutes permitted a lender to obtain a security interest on tangible movable property through a chattel mortgage. See former LA. REV. STAT. ANN. § 9:5351, repealed by Acts 2001, No. 128, § 18, effective July 1, 2001. For a discussion of the chattel mortgage law, see Andrew A. Braun, *Executory Process and Self-Help Remedies Under U.C.C. Article 9*, 38 LA. B.J. 315 (1991); Michael H. Rubin, *Security Devices*, 49 LA. L. REV. 495 (1988); James A. Stuckey, *Louisiana's Non-Uniform Variations in U.C.C. Chapter 9*, 62 LA. L. REV. 793, 876 (2002).

227. *Southland*, 5 So. 2d at 324-25:

For cause of action the plaintiff alleged that the Motor Sales Company is a commercial partnership composed of L. M. Stevens and his wife and is engaged in the business of selling new and used automobiles in Haynesville; that it (plaintiff) purchased notes given the defendants as part payment of the purchase price of automobiles during the years 1936, 1937, and 1938, which notes, secured by chattel mortgage and vendor's lien on the cars purchased, were endorsed by the defendants; that some 58 persons whose notes were so acquired by the plaintiff defaulted in their payments; that the plaintiff, pursuant to an agreement had with the defendants, repossessed these respective automobiles, 34 (listed and described in a statement made a part of the record and marked Exhibit A) being sold at private sale and the proceeds thereof (after deduction of the costs incidental to the sale) applied toward the liquidation of the obligation on the respective unpaid notes, the aggregate amount remaining due thereon being \$3,617.50; and that the remaining 24 automobiles (listed and described in a statement made a part of the record and marked Exhibit B) are still in the possession of the plaintiff, the balance due thereon being \$4,206.93.

...  
The facts of this case, as revealed by the record, show that the defendant Motor Sales Company, a company engaged in the business of buying and selling new and second-hand automobiles, entered into an agreement with the Southland Investment Company, Inc., whereby the sales consummated by the defendant company were refinanced by the investment company's purchase of the notes given to the defendant company in part payment of the automobiles purchased from them. Under this agreement the plaintiff was to reserve a portion of the amount paid for the notes in order that a fund might be accumulated to offset any loss the plaintiff might incur through these transactions. The plaintiff was charged with the duty of repossessing any cars upon which the installments were not paid and of turning them over to the defendant company within 90 days. It was understood that the defendants' liability, irrespective of the unconditional endorsement on

partnership could not pay the debt, the partners agreed to a private sale of the vehicles by the plaintiff.

The Louisiana Supreme Court rejected the partners' attempt to use the Deficiency Judgment Act as a bar when, after the private sales did not bring sufficient sums to pay off the debt, Southland attempted to collect the balance from the sureties.<sup>228</sup> The court's analysis is short and begins with the statement that the Deficiency Judgment Act is for the protection of the mortgage debtor<sup>229</sup> (and, by implication, not sureties or endorsers).<sup>230</sup> The court found that the cars were sold "at private sale for the best price obtainable with the consent and acquiescence of the defendants, for the best interest of all parties concerned,"<sup>231</sup> and that, under these circumstances, the endorsers were liable.

*Southland* was decided under the former Negotiable Instruments Law (the "NIL"), the forerunner of articles 3 and 4 of the U.C.C.<sup>232</sup> The result of *Southland* is an implicit recognition that

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the back of the notes, would only begin when these repossessed cars were so turned over to them.

228. *Id.* Under Louisiana law, if the U.C.C. does not provide specific rules for endorsers, Louisiana suretyship law controls. See Rubin, *Ruminations on Suretyship*, *supra* note 223. The same general rule applied under the forerunner of the U.C.C. which was in effect in Louisiana at the time the *Southland* case was decided. See discussion *infra* note 232.

229. *Southland*, 5 So. 2d at 326. The court stated:

*Unquestionably [the Deficiency Judgment Act] was enacted for the benefit and protection of the mortgage debtor and, ordinarily, under the express provisions of Act No. 64 of 1904 (known as the Negotiable Instruments Act) "A person secondarily liable on the instrument is discharged . . . [b]y any act which discharges the instrument." Section 120. According to the record as made up in this case, however, the cars listed and described in Exhibit A were repossessed and sold by the plaintiff at private sale for the best price obtainable with the consent and acquiescence of the defendants, for the best interest of all parties concerned. Under these circumstances we are of the opinion that the defendant is liable to the plaintiff for any amount remaining unpaid on the notes defendant transferred to it under the transactions listed in Exhibit A, which, as shown by the record, is \$3,617.50.*

*Id.* (emphasis added).

230. The court does not characterize the endorsers as sureties, although there is language in the opinion indicating that they may have been bound with the makers of notes *in solido*, but it also recognizes that endorsers are only bound "secondarily." *Id.* at 325-26.

231. *Id.*

232. The Negotiable Instruments Law was originally enacted under 1904 La. Acts No. 64 and was later codified as Louisiana Revised Statutes sections 7:1 and following. However, in 1974 the NIL statutes were repealed. This legislation was eventually superseded by Louisiana's adoption of its version of Articles 3 and 4 of the U.C.C. at Revised Statutes sections 10:3-101 and

the Deficiency Judgment Act does not extinguish the debt but merely extinguishes the personal obligation of the primary obligor. This implicit recognition occurs because, under the NIL, the discharge of the maker discharges the endorsers. Because *Southland* held that the endorsers could not take advantage of the Deficiency Judgment Act's bar against the maker, it was recognizing that the debt was not extinguished and that the maker was not "discharged" in the sense of canceling the debt; rather, there was simply an inability to collect from the maker personally without extinguishing the debt. This is akin to the rule that the natural obligation to pay a debt remains even if the debtor has a personal defense, such as minority.<sup>233</sup>

*Southland's* holding and rationale would seem to create an insurmountable barrier to sureties and endorsers who seek to use the Deficiency Judgment Act to bar claims against them even though the debtor can claim the benefit of the Act. This is because *Southland* expressly pointed out that the Deficiency Judgment Act's purpose is to protect the debtor who owns the encumbered property; by implication, the Act does not protect those who may be liable on the debt but who are not owners of the collateral.

*Southland*, however, has not created a single line of uniform jurisprudence. One line of cases follows the reasoning in *Southland*.<sup>234</sup> These opinions reflect an understanding that, because the Deficiency Judgment Act's purpose is to protect debtors and owners, sureties and endorsers are not entitled to notice of the foreclosure sale and are not entitled to appoint an appraiser.<sup>235</sup>

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following and at sections 10:4-101 and following, respectively. Such provisions were extensively reworked by 1992 La. Acts No. 1133.

233. See LA. CIV. CODE art. 1762 (2009).

234. See *Univ. Prop. Corp. v. Fid. Nat'l Bank of Baton Rouge*, 500 So. 2d 888 (La. App. 1st Cir. 1986), writ denied, 501 So. 2d 762 (La. 1987) (using *Southland* to support a "balancing" test to determine whether a disposition of the collateral without appraisal should bar a deficiency judgment against either the debtor or the surety). The facts in *University Properties*, however, arose prior to the Deficiency Judgment Act amendments allowing voluntary work-outs, and the court held that these amendments were not retroactive. See also *Farmerville Bank v. Scheen*, 76 So. 2d 581 (La. App. 2d Cir. 1955) (relying on *Southland*, held that the Deficiency Judgment Act was not available as a defense to a surety who had agreed to a private sale of a car on which the creditor held a security interest and who, prior to the sale, also agreed in writing to be liable for the deficiency).

235. See *Gumina v. Dupas*, 178 So. 2d 291 (La. App. 4th Cir.), writ denied, 179 So. 2d 430 (La. 1965). A son apparently endorsed a mortgage note his parents had executed for the purchase of property. While the court referred to the son as a solidary obligor, it appears that the court found that he became bound by endorsing the note. The court states that he "intervened" into the

These cases hold that sureties and endorsers cannot claim the protection of the Act<sup>236</sup> even if the creditor sells the collateral without appraisal.<sup>237</sup>

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mortgage, but a mortgage is an *in rem* accessory obligation that secures a principal obligation. See LA. CIV. CODE art. 3282. The mortgage is not itself a personal principal obligation.

A foreclosure suit occurred which resulted in a deficiency. The sale was allegedly conducted with appraisal; thus, the creditor had not violated the Deficiency Judgment Act as to the debtor. The endorser-son filed bankruptcy and obtained a discharge; the creditor subsequently pursued and was awarded a default judgment against the son. The court found that the bankruptcy discharge defense had been waived. On the issue of whether the son was entitled to notice of the judicial sale or a right to appoint an appraiser, the court rejected that claim, relying on *Southland* for the proposition that it was the for debtor-owner that the Deficiency Judgment Act exists, not an endorser or surety. *Gumina*, 178 So. 2d at 295-96.

*Gumina's* result is in accord with the later due process holding in *Mennonite v. Adams*, 462 U.S. 791 (1983), that those entitled to notice of a foreclosure sale are those whose property interests (such as an ownership in or a mortgage on the property bearing sold) are affected by the judicial sale. For more on *Mennonite*, see Michael H. Rubin & Marshall Grodner, *Recent Developments, Security Devices*, 53 LA. L. REV. 969 (1993). See also *supra* notes 144 and 158. *Accord* Sec. Nat'l Trust v. Moore, 639 So. 2d 373 (La. App. 2d Cir. 1994). Cf. *Pioneer Bank & Trust Co. v. Foggin*, 177 So. 2d 131 (La. App. 2d Cir.), writ denied, 179 So. 2d 18 (La. 1965) (involving removal of collateral from the state and a surety's ineffectual attempt to be released because of alleged impairment of subrogation).

236. See *Meadow Brook Nat'l Bank v. Massengill*, 427 F.2d 1055 (5th Cir. 1970); *Gulf Nat'l Bank at Lake Charles v. Ryan*, 432 So. 2d 1122 (La. App. 3d Cir. 1983); *Ford Motor Credit Co. v. Soileau*, 323 So. 2d 221 (La. App. 3d Cir. 1975).

237. See *Commercial Credit Equip. Corp. v. Larry Parrott of Gueydan, Inc.*, 212 So. 2d 860 (La. App. 3d Cir. 1968). This was another financing case whose facts were similar *Southland*. Commercial Credit bought secured commercial paper from the defendant representing equipment sales to third parties, and the defendant had a written agreement to "repurchase" the secured equipment if the third party defaulted on the note. Commercial Credit sold the equipment at a private sale. In its initial opinion, without citing *Southland*, the *Commercial Credit* court found that the defendant (who was similar to that of a surety, although its obligation was to repurchase the equipment and not to directly pay the debt of the third person) could not take advantage of the Deficiency Judgment Act. After holding initially that the Deficiency Judgment Act applied, the *Commercial Credit* court granted a rehearing on the Act and on the applicability of *Southland* and reaffirmed its earlier ruling, stating:

Rehearing was granted in the instant case for the reason that some members of this Court were of the opinion that the Limited Liability Plan Agreement as set forth in the original opinion herein violated LSA-R.S. 13:4106 et seq., commonly referred to as the Deficiency Judgment Act, for the reason that the property repossessed by plaintiff was sold at private sale without benefit of appraisalment. After due

A divergent line of jurisprudence has developed, however; these cases purport to distinguish *Southland* and hold that sureties have been released when the debtor can claim the benefits of the Deficiency Judgment Act.

*B. The Cases that Distinguish Southland and Allow a Surety to Raise the Deficiency Judgment Act Defense*

A line of cases distinguishing *Southland* has developed; the key opinions are *Simmons*,<sup>238</sup> *C.I.T.*,<sup>239</sup> and *Bowl-Opp*.<sup>240</sup> When one examines each of these cases, however, it is questionable how firm a foundation they provide to sureties who claim that the Deficiency Judgment Act protects them.

*Simmons* barred a deficiency judgment against a pledgee following a judicial sale without appraisal. Mr. and Mrs. Holmes had executed a note secured by a mortgage on their property as a loan made by Simmons; the Clarks had pledged their own note, secured by a mortgage, to secure the Holmes' obligations.<sup>241</sup>

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consideration of the matter we hereby reinstate our original decree. In the case of *Southland Investment Co. v. Motor Sales Co.*, 198 La .1028, 5 So.2d 324, the Supreme Court of this State held that the deficiency judgment statute was enacted for the benefit and protection of the mortgage debtor *and nowhere does the statute refer to or mention public policy towards or relief for parties secondarily or otherwise obligated for the indebtedness, such as an endorser. The Court also held that the provisions of the statute pronouncing the principle of the public policy were inapplicable to the case of an endorser whose rights and remedies are prescribed and governed by other applicable laws, particularly the articles of the Code pertaining to suretyship.* The *Southland Investment Company* case, *supra*, was cited with approval in *Farmerville Bank v. Scheen*, 76 So.2d 581 (La.App. 2 Cir. 1954), and in *Gumina v. Dupas*, 178 So.2d 291 (La.App. 4 Cir. 1965). For the reasons set forth in the above cited cases, it is our opinion that the Deficiency Judgment Act does not apply to the instant case.

212 So. 2d at 864 (emphasis added).

238. *Simmons v. Clark*, 64 So. 2d 520 (La. App. 1st Cir. 1953).

239. *C.I.T. Corp. v. Rosenstock*, 205 So. 2d 81 (La. App. 4th Cir. 1967).

240. *Bowl-Opp, Inc. v. Larson*, 334 F. Supp. 222 (E.D. La. 1971).

241. Under the Civil Code pledge provisions that were applicable to this transaction at the time, one could pledge a note to secure the obligations of another. LA. CIV. CODE art. 3158 (2009). Today, of course, that type of security interest is covered by U.C.C. article 9. LA. REV. STAT. ANN. § 10:9-101 (2002) and following. The pledge of a secured note to secure a principal obligation is the basis of the Louisiana collateral mortgage. For more on collateral mortgages, see Max Nathan & Anthony Dunbar, *The Collateral Mortgage: Logic & Experience*, 49 LA. L. REV. 39 (1988); Max Nathan & H. Gayle Marshall, *Forum Juridicum*, 36 LA. L. REV. 973 (1976); Max Nathan & H. Gayle

Simmons foreclosed on the Holmes' property without appraisal and then sought a deficiency against the Clarks. In barring the deficiency against the Clarks, the court relied on provisions of the suretyship articles of the Civil Code, even though there was no language in the case to indicate that the Clarks were sureties. Louisiana law has long held that a pledge (which is a physical transfer of an asset to a creditor, with the creditor having the right to hold it until paid or sell it upon default and get a privilege on the proceeds of the sale)<sup>242</sup> is completely separate from suretyship, which is a personal obligation where someone undertakes to pay the debtors of another.<sup>243</sup> Pledge is a "real right" under Louisiana law and suretyship is a "personal right."<sup>244</sup> To the extent that the

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Marshall, *The Collateral Mortgage*, 33 LA. L. REV. 497 (1973); Michael Rubin & R. Marshall Grodner, *Recent Developments, Security Devices*, 53 LA. L. REV. 969 (1993); Michael Rubin, David Willenzik & Marie Moore, *Is the Collateral Mortgage Obsolete*, 41 LA. B.J. 529 (1994); David Willenzik, *Future Advance Priority Rights of Louisiana Collateral Mortgages: Legislative Revisions, New Rules, and a Modern Alternative*, 55 LA. L. REV. 1 (1994).

242. See LA. CIV. CODE art. 3133 (defining pledge); *id.* arts. 3164, 3165 (regarding rights under Pawn upon default); *id.* art. 3179 (regarding rights under antichresis upon default). A key Supreme Court decision on the pledge of notes to secure the obligations of another is *Succession of Picard*, 115 So. 2d 817 (La. 1959).

243. For example, in *Kaplan v. University Lake Corp.*, the court held that one who assumes a pledged note secured by a mortgage does not assume personal liability on the underlying principal obligation that the pledged note secures. 381 So. 2d 385, 391 (La. 1980). The court stated:

In this instance the obligation assumed by GSA was clear and specific. GSA assumed only mortgages, liens and judgments extant (outstanding and enforceable) against the property it purchased, on the date of its acquisition. GSA did not undertake to assume any personal obligation of its vendor or any other antecedent owner of the property in question. GSA neither endorsed the hand note nor expressly agreed to pay it. The record is devoid of an express written instrument binding GSA to pay the personal obligation of the maker of the hand note involved herein. It follows that GSA may not be held liable for such personal liability. La. C.C. Article 2278(3).

*Id.*

244. The Louisiana Civil Code makes clear that suretyship is a personal right while pledge is a real right. Civil Code article 3035 defines suretyship as a contract "by which a *person binds himself* to a creditor to fulfill the obligation of another," while article 3133 defines pledge as a contract where "one debtor *gives something* to his creditor as security for his debt." LA. CIV. CODE art. 3133 (emphasis added). See also Thomas A. Harrell, *Security Devices*, 45 LA. L. REV. 559, 559 (1984) ("All mortgages and pledges are by their nature "*in rem*," if by that one means that no other responsibility for satisfaction of the principal obligation rests upon the mortgagor or pledgor by virtue of his contract and that each creates a real right over the property to have it sold and the proceeds applied to satisfy the obligation it secures."). Louisiana law is in accord with the

*Simmons'* analysis depends upon application of suretyship articles, the language is *dicta*, for there was no suretyship.<sup>245</sup> In opinions after *Simmons*, the Louisiana Supreme Court has rejected the argument that one who pledges a note secured by a mortgage undertakes personal liability on the principal obligation the pledge secures.<sup>246</sup> Moreover, later decisions have rejected *Simmons'* argument that sureties are entitled to claim an impairment of their rights of subrogation if a sale of the debtor's property occurs without notice to the sureties.<sup>247</sup>

In *C.I.T.*,<sup>248</sup> an endorser of notes secured by a chattel mortgage claimed that the Deficiency Judgment Act protected him following a judicial sale *with* appraisal because he was not a party to the prior executory proceedings and because the sale denied him his subrogation rights against the debtor. There was no question that the sale was with appraisal<sup>249</sup> and that the *debtor* could not claim Deficiency Judgment Act protection; nevertheless, the court found

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French rules at the time the Civil Code was adopted. For example, see Planiol, who cautioned that:

One should avoid confusing suretyship with the following-contracts: The contract of "porte-fort" which gives rise to a principal obligation. The "porte-fort" who stands as security for another, resembles the surety in that he is not bound unless the third party does not satisfy the creditor; but he never becomes an accessory debtor of another. In effect, as long as the third person whom he has guaranteed is not bound, he remains the sole debtor; as soon as the third party obligates himself, the guarantor is freed.

2 Marcel Planiol, *TRAITÉ ÉLÉMENTAIRE DE DROIT CIVIL* No. 2325 (La. State Law Inst. trans., 1959).

245. For a similar case in which the court used a combination of the suretyship articles and the Deficiency Judgment Act to bar a claim against a pledgor, see *Wilson v. Brian*, 81 So. 2d 142 (La. App. 2d Cir. 1955). That opinion suffers from the same analytical problems that infect *Simmons*. Moreover, *Wilson* was decided six months after *Farmerville Bank v. Scheen*, 76 So. 2d 581 (La. App. 2d Cir. 1955), which found that an actual surety was liable; yet *Wilson* did not cite *Farmerville*. Further, while *Wilson* cited *Southland*, it did not explain why the result or analysis should be different in *Wilson* than was mandated by the Supreme Court in *Southland*. *Wilson*, 81 So. 2d at 144.

246. *Kaplan*, 381 So. 2d 385. In addition, if what a third party has been pledged is a collateral mortgage package, the Louisiana Supreme Court has held that a collateral mortgage package is an *in rem* obligation that creates no personal liability for the pledgor. *Diamond Servs. Corp. v. Benoit*, 780 So. 2d 367 (La. 2001). For more references on collateral mortgages, *supra* note 241.

247. *Sec. Nat'l Trust v. Moore*, 639 So. 2d 373 (La. App. 2d Cir. 1994).

248. *C.I.T. Corp. v. Rosenstock*, 205 So. 2d 81 (La. App. 4th Cir. 1967).

249. Following the foreclosure, the creditor had converted the executory suit against the borrower into an ordinary proceeding for a deficiency. *C.I.T.*, 205 So. 2d at 82-83.



that the Deficiency Judgment Act did bar the creditor's claim against the endorser because of the suretyship articles of the Civil Code as they existed at the time. *C.I.T.*, however, did not cite *Southland*. Later courts have recognized that *C.I.T.*'s holding has been abrogated, at least insofar as it held that a surety's lack of notice of executory proceedings gives the surety any rights to complain about impairment of subrogation or any other matter.<sup>250</sup>

*Bowl-Opp*<sup>251</sup> held that the Deficiency Judgment Act could be used as a bar by endorsers following a public auction without appraisal; the auction was authorized by a bankruptcy court order. *Bowl-Opp* distinguished *Southland* and its progeny reasoning that in those cases, unlike in *Bowl-Opp*, there was an agreement between the creditor and surety about the sale of the collateral. The *Bowl-Opp* court chose to rely upon the *C.I.T.* and *Simmons* cases for the proposition that when a surety is "not a party to any agreement between the maker primarily liable and the holder of the note relative to repossession or sale of the mortgaged," the surety can use the Deficiency Judgment Act. *Bowl-Opp* does not discuss the underlying rationale of *Southland* (that the Act protects only debtor-owners), does not address the fact that the Louisiana Revised Statutes section 13:4016 (the operative section of the Deficiency Judgment Act) contains no language concerning sureties, and does not explain why the surety's knowledge and agreement to the sale of collateral is pertinent at all when,<sup>252</sup> the Act operates as a bar to a deficiency against the debtor regardless of the debtor's intent or knowledge. Moreover, the underlying basis of *Bowl-Opp*—that the Deficiency Judgment Act applies to a sale ordered by a bankruptcy court—has been legislatively overruled.<sup>253</sup>

As can be seen, there are logical problems within *Simmons*, *C.I.T.*, and *Bowl-Opp*; yet, later cases have relied on them to bar claims against sureties. These later decisions find persuasive the

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250. See *Sec. Nat'l Trust*, 639 So. 2d at 376 ("[A]n executory proceeding and judicial sale of mortgaged property, after due notice to and appraisal by the owners of the property, does not 'unjustly impair' the collateral nor discharge an accommodation party not served or named as a defendant therein.").

251. See *Bowl-Opp, Inc. v. Larson*, 334 F. Supp. 222 (E.D. La. 1971).

252. It must be remembered that when *Bowl-Opp* was decided, the "work-out" provisions of Louisiana Revised Statutes sections 13:4108.1 and 13:4108.2 had not yet been enacted, allowing a creditor and debtor to agree to a deficiency following a sale without appraisal.

253. See LA. REV. STAT. ANN. § 13:4108(3) (2006), enacted by 1986 La. Acts No. 489, §2 and 1989 La. Acts No. 137, § 8 (effective Sept. 1, 1989) (stating that a deficiency judgment is not barred by a "sale pursuant to an order of a United States Bankruptcy Court, or of a United States District Court sitting in bankruptcy").

argument that it is unfair to allow the debtor to have a Deficiency Judgment Act defense while depriving that defense to the surety.<sup>254</sup>

There is one case from the Louisiana Supreme Court that appears to follow the jurisprudential line that diverges from *Southland*. In *Howard Trucking*<sup>255</sup> the supreme court found, without discussing the matter in depth, that sureties who were shareholders of the borrower under a lease could raise a Deficiency Judgment Act claim. *Howard Trucking*, however, did not cite *Southland*, and its decision turned on a lease analysis that was legislatively overruled by the enactment of the Lease of Movable law.<sup>256</sup> Thus, it may be questionable whether *Howard Trucking* remains viable today.

### C. What Should the Rule Be?

The authors assert that substantial deference should be given *Southland*, which was the earliest Louisiana Supreme Court case on the issue and the one decided closest in time to the enactment of the Deficiency Judgment Act. *Southland's* main point was that the Deficiency Judgment Act exists to protect the debtor-owner of property, not sureties. On the other hand, later cases have seized on *Southland's* emphasis on the agreement of the surety to the sale to support a practice of allowing sureties to use a Deficiency Judgment Act defense when there was no such agreement. It is difficult to find a statutory basis for a result which protects only those sureties who do not consent to sales that would otherwise trigger the Deficiency Judgment Act.

The contrasting lines of cases have deeper problems, however, for they depend either upon a bright-line public policy application of the Deficiency Judgment Act to all sureties (a purported "bright-line" not explicitly found in the Act or in *Southland*) or upon equitable theories that a creditor should not be able to collect from the surety when it cannot collect from the debtor (under the rationale that this would allow the creditor to do indirectly what it cannot do directly—that is, sell collateral without appraisal and then collect a deficiency from someone).

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254. See *Domingues Motors, Inc. v. Lalonde*, 417 So. 2d 900 (La. App. 3d Cir. 1982); *Gen. Motors Acceptance Corp. v. Smith*, 399 So. 2d 1285 (La. App. 4th Cir. 1981).

255. See *Howard Trucking Co., Inc. v. Stassi*, 485 So. 2d 915 (La.), cert. denied, 479 U.S. 948 (1986).

256. *Howard Trucking* re-characterized a lease as a sale, despite the parties' stated intent. The Lease of Movable Act requires that courts honor as leases documents the parties intend to be leases. LA. REV. STAT. ANN. § 9:3301 (1997) and following.

What these cases do not discuss, however, is that the essence of suretyship is that a surety may have to pay a creditor even if the surety cannot collect from the debtor. Sureties have never been able to assert certain personal defenses of the principal obligor,<sup>257</sup> and it seems clear that the bar that the Deficiency Judgment Act raises is just such a personal defense; the Deficiency Judgment Act does not extinguish the debt but merely prevents a personal claim against the debtor-owner.<sup>258</sup>

It is submitted that a court could validly balance interests of the creditor and the surety by allowing the creditor to pursue the surety for a deficiency after giving credit for the value of the collateral at the time of either the non-judicial foreclosure or a judicial foreclosure without appraisal, and in either case the creditor must bear the burden of demonstrating the value of the collateral at the time of the creditor's realization on it. This is the same type of burden that a creditor bears under the U.C.C. It is also fair to the surety who understands that when the suretyship is undertaken, if the debtor does not pay and cannot pay, the surety must pay.

It is also submitted that it is possible that courts may draw a distinction between legal and commercial sureties on one hand and

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257. LA. CIV. CODE art. 3046 (2009) (The surety may assert against the creditor any defense to the principal obligation that the principal obligor could assert except lack of capacity or discharge in bankruptcy of the principal obligor.). Official Law Institute comment (a) states that the article reproduces the substance of Louisiana Civil Code article 3060 (1870) and the second sentence to Louisiana Civil Code article 3036 (1870).

LA. CIV. CODE art. 3060 (1870) ("The surety may oppose to the creditor all the exceptions belonging to the principal debtor, and which are inherent to the debt; but he cannot oppose exceptions which are personal to the debtor.").

LA. CIV. CODE art. 3036 (1870) ("A man may, however, become surety for an obligation of which the principal debtor might get a discharge by an exception merely personal to him; such as that of being a minor, or a married woman.").

258. See discussion regarding LA. REV. STAT. ANN. 13:4106(B) at *supra* notes 217 and 218. For example, a surety is always liable even if the surety cannot collect through subrogation against the debtor or through reimbursement. Illustrations of this include situations when the debtor becomes a bankrupt or when one becomes the surety of a minor; in either case, the surety cannot assert that defense against the creditor and must pay the debt to the full extent of the suretyship agreement. LA. CIV. CODE art. 3046 (2009). The fact that in both cases (bankruptcy and minority) the debtor has a defense to the personal obligation does not relieve the surety of his or her obligation to the creditor. Second, even if the surety is not fully liable, and assuming that the courts try to broadly read the public policy statement in the Deficiency Judgment Act (which applies only to debtors) to extend the Act to sureties, it appears one could argue that the surety has only been impaired to the extent that the surety's rights of subrogation against the collateral have been impaired.

ordinary sureties on the other.<sup>259</sup> There are two reasons for this. First, the Deficiency Judgment Act itself draws a distinction between commercial and consumer transactions in the work-out provisions of Louisiana Revised Statutes sections 13:4108.1 and 13:4108.2. Second, under the Civil Code, ordinary and commercial sureties are subject to different rules.<sup>260</sup> This is because, under the suretyship articles, when an impairment of subrogation occurs without the sureties' prior consent, an ordinary surety is completely released while the commercial surety is released only to the extent of the impairment.<sup>261</sup>

The authors submit that the following rule is workable, defensible, and follows from the express language of the suretyship articles and the Deficiency Judgment Act:

1. Neither a debtor nor the debtor's sureties may waive the creditor's compliance with the Deficiency Judgment Act.
2. If the creditor forecloses in violation of the Deficiency Judgment Act, thereby barring a deficiency against the debtor:
  - a. The creditor may collect the deficiency from a commercial or legal surety, but only for the *lesser* of the difference between the debt owed at the point of the creditor's violation of the Deficiency Judgment Act and: (i) the value of the collateral at the time of the creditor's violation of the Deficiency Judgment Act or (ii) the amount of the security interest on the collateral at the time of the creditor's violation of the Deficiency Judgment Act. The creditor bears the burden of proof to show the value of the collateral at the time of the disposition of the property.<sup>262</sup>

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259. LA. CIV. CODE art. 3041 (noting that there "are three types of suretyship: commercial suretyship, legal suretyship, and ordinary suretyship;" articles 3042 to 3044 subsequently define each type of suretyship).

260. The definitions of commercial and ordinary sureties are found in Civil Code articles 3041 to 3044. Ordinary sureties (those who are neither commercial nor legal sureties) are entitled to an interpretation of their contract which is "strictly construed in favor of the surety." LA. CIV. CODE art. 3044.

261. *Id.* art. 3062.

262. The rationale here is that this rule is in accordance with Civil Code article 3062, which partially releases a commercial surety who has not consented in advance to an impairment of the surety's subrogation rights; the partial release under Civil Code article 3062 is the "extent the surety is prejudiced by the action of the creditor." It is submitted that the prejudice here equals difference between the value of the collateral at the time of the creditor's violation of the Deficiency Judgment Act and the debt owed at that point.

- b. The creditor may not collect any deficiency from an ordinary surety.<sup>263</sup>

There are three important things to note about this proposed rule. First, it is entirely consistent with the Deficiency Judgment Act and the Civil Code articles on suretyship. Second, this rule does not apply when the work-out provisions of Revised Statutes sections 13:4108.1 and 4108.2 are used, for in those instances the debtor is not released; this rule applies only if the debtor is completely released from personal liability by virtue of the Deficiency Judgment Act bar. Third, this rule focuses on the value of the collateral at the time of the creditor's action, not the face amount of the mortgage or the amount the property sold for at the private sale.

The following examples illustrate how the rule would work for commercial sureties.

*Example O:* A corporation has given a mortgage on land for \$100,000. A shareholder of the corporation is a surety for the corporation's obligations. The mortgaged property is sold by the creditor at a judicial sale without appraisal; the judicial sale brings \$45,000. At the time of the sale, the debtor's obligation to the creditor was \$100,000.

*Comment on Example O:* Under the Deficiency Judgment Act, the failure of the creditor to foreclose by judicial process with appraisal bars a deficiency against the debtor.

Concerning the surety, who in this context is a commercial surety,<sup>264</sup> and using the proposed rule, the surety is released to the extent of the difference between the value of the collateral at the time of the creditor's violation of the Deficiency Judgment Act and the debt owed at that point. The creditor bears the burden of proof that the property was worth only \$45,000 at the time of the sale. If the creditor meets its burden of proof, the surety is liable for only \$65,000 (the difference between the \$100,000 debt and the \$45,000 value of the property at the time of the judicial sale).

*Example P:* Assume the same facts as in Example O, but the creditor fails in its burden of proof in showing that the property was worth only \$45,000; the surety is able to show that, despite the \$45,000 paid at the sheriff's sale, fair market value of the property at that time was really \$60,000.

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263. This rule is consistent with the complete release that ordinary sureties are given under Civil Code article 3062, when the creditor impairs the subrogation rights of the ordinary surety without the ordinary surety's prior consent.

264. A surety for a corporate entity is a commercial surety. LA. CIV. CODE art. 3042.

*Comment on Example P:* Using the proposed rule, the surety's liability is only \$40,000 (the difference between the \$100,000 debt and the value of the collateral at the time of its sale).

*Example Q:* A partnership has given a mortgage on land for \$140,000. A partner of the entity is a surety for the partnership's obligations. The mortgaged property is sold by the creditor at a judicial sale without appraisal; the judicial sale brings \$80,000. At the time of the sale, the debtor's obligation to the creditor was \$300,000.

Under the Deficiency Judgment Act, the failure of the creditor to foreclose by judicial process with appraisal bars a deficiency against the debtor.

In its pursuit of the surety for a deficiency, the creditor attempts to show that the property was worth only \$80,000 at the time of the judicial sale (the amount of the price paid at the judicial sale), but the creditor cannot meet its burden of proof. The surety (who is a commercial surety<sup>265</sup>) is able to show that the fair market value of the property is actually \$200,000 at the time of the sale.

*Comment on Example Q:* Using the proposed rule, the surety is liable for \$160,000 (\$300,000 debt minus \$140,000 face amount of the mortgage). The reason is that no matter how much the fair market value of the property exceeded the face amount of the mortgage, all the creditor could have obtained at the judicial sale was the face amount of the mortgage (\$140,000).<sup>266</sup> Since the creditor never could have collected more than \$140,000 on its mortgage, it is this amount that determines the extent to which the surety's rights of subrogation are impaired, for the surety could not collect more from the mortgaged property under a mortgage foreclosure than the face amount of the mortgage.

### XIII. THE UNIFORM COMMERCIAL CODE'S APPROACH TO DEFICIENCY JUDGMENTS

Unlike the Louisiana Deficiency Judgment Act, Louisiana's version of U.C.C. Article 9<sup>267</sup> takes a different approach. Rather

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265. A surety for a partnership is a commercial surety. *Id.* art. 3042.

266. At the judicial sale, any amounts received in excess of the face amount of the mortgage goes to inferior secured creditors and then to the debtor. *See* Section VII, *supra*.

267. Louisiana's version of U.C.C. article 9 can be found at Revised Statutes sections 10:9-101 to 10:9-710. Louisiana statutes formerly used the term "Commercial Laws" rather than Uniform Commercial Code because, in a number of respects, Louisiana's version was not and is not identical to the

than being concerned with procedural requirements (was there a judicial sale, was it with appraisal, and was the appraisal valid), the U.C.C. instead looks at both the objective manifestations of the sale and its substantive results.

Under Louisiana's version of the U.C.C., just as in the national version, a deficiency judgment is allowed as long as the collateral was disposed of in a "commercially reasonable" manner.<sup>268</sup> In both the national and Louisiana versions, the term "commercially reasonable" is deliberately not defined because the test is functional, not procedural, and depends upon the facts of each situation.

The late William D. Hawkland, former Chancellor of the LSU Law School, the pre-eminent expert in the U.C.C. during his lifetime, and a member of the U.C.C. Editorial Board, has written that that omission of a definition of "commercial reasonableness" was ". . . the result of design. The draftsman felt that it would be unwise to try to place finite limits on the overriding standard of fair play that was to circumscribe all dispositions by the secured party under Chapter 9."<sup>269</sup> He went on to state that commercial reasonableness "is a general standard, something akin to other supereminent provisions such as 'reasonable man,' 'reasonable time' and 'good faith' that are used throughout the Anglo-American legal system . . ."<sup>270</sup>

Rather than provide a definition, the U.C.C. and Louisiana's version provide three of the types of sales that could be considered commercially reasonable: when the property is sold in the ordinary

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U.C.C. In 2006, however, the Louisiana U.C.C. was amended by 2006 La. Acts No. 533, §1, and the provisions are now called the "Uniform Commercial Code." LA. REV. STAT. ANN. § 10:1-201 (2003).

268. Revised Statutes section 10:9-615 and U.C.C. section 9-615 both allow pursuit of a deficiency from the obligor where there is no surplus remaining after application of the proceeds of a sale of collateral to the debtor's outstanding obligation. *See* LA. REV. STAT. ANN. § 10:9-615; U.C.C. § 9-615 (1996). Both Revised Statutes section 10:9-625 and U.C.C. section 9-625 require compliance with the provisions of the chapter, including disposition in a commercially reasonable manner and reserve the power to judicial injunction from further collection efforts in the event of non-compliance. *See* LA. REV. STAT. ANN. § 10:9-625; U.C.C. § 9-625. *See also* LA. REV. STAT. ANN. § 10:9-610(b); U.C.C. § 9-610(b) ("Every aspect of a disposition of collateral, including the method, manner, time, place, and other items, must be commercially reasonable.")

269. William Hawkland, HAWKLAND'S HANDBOOK ON CHAPTER 9 LOUISIANA COMMERCIAL LAW (1990) (quoted with approval in *Ford Motor Credit Co. v. Melancon*, 677 So. 2d 145, 150 (La. App. 3d Cir. 1996)).

270. *Id.*

course of business; when the property is sold for the same price as would be obtainable in the ordinary course of business; or when the property is sold in a manner that is designed to achieve a fair price.<sup>271</sup>

Note that under the U.C.C., the fact that collateral is sold through judicial foreclosure or by a private sale is not determinative; likewise, whether an appraisal has been obtained prior to the sale also is not determinative.<sup>272</sup> Under the U.C.C., the question is not whether the creditor cleared procedural hurdles<sup>273</sup> but rather whether (1) the price obtained for the property was a fair one, regardless of the procedure, or whether (2) the sale was by a commercially reasonable practice regardless of the price obtained.

Despite this seemingly fluid and functional test, however, the U.C.C. contains a check on creditors. The U.C.C. presumes that every sale of secured collateral always results in satisfaction of the debt (that is, the presumption does not allow the creditor to collect a deficiency). The only way the creditor can overcome this presumption is to prove that the sale was conducted in a commercially reasonable manner.<sup>274</sup>

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271. See LA. REV. STAT. ANN. § 10:9-607(c); U.C.C. § 9-607(c). Both sections state that a creditor proceeds in a commercially reasonable when it:

- (1) undertakes to collect from or enforce an obligation of an account debtor or other person obligated on collateral, and;
- (2) is entitled to charge back uncollected collateral or otherwise to full or limited recourse against the debtor or a secondary obligor.

Both Revised Statutes section 10:9-627(b) and U.C.C. section 9-627(b) outline examples of transactions that are considered commercially reasonable. These include dispositions made:

- (1) in the usual manner on any recognized market;
- (2) at the price current in any recognized market at the time of the disposition; or
- (3) otherwise in conformity with reasonable commercial practices among dealers in the type of property that was the subject of the disposition.

As was stated in *Hall v. Owen County State Bank*, discussing Indiana's version of the U.C.C. and national U.C.C. jurisprudence: "Because the statutory definition of a commercially reasonable sale is vague, and because a judgment as to whether or not a sale was reasonable will generally depend upon the circumstances of each particular case, many courts have held this to be a question of fact." 370 N.E.2d 918, 929 (Ind. Ct. App. 1997).

272. Note that none of the provisions identified and excerpted in *supra* note 271 make mention of an appraisal as a requirement.

273. See Section VI regarding the requirements of the Deficiency Judgment Act.

274. See LA. REV. STAT. ANN. § 10:9-626(a)(2). If a creditor seeks a deficiency, the debtor or "secondary obligor" (which includes a surety) may object, and then "the secured party has the burden of establishing that the collection, enforcement, disposition, or acceptance was conducted in accordance with this Part." *Id.*



The Louisiana U.C.C. provides an alternative to the Louisiana Deficiency Judgment Act. Louisiana courts have recognized that even though there has not been a foreclosure with appraisal, a deficiency may be obtainable under the Louisiana U.C.C. for security interests perfected under that statute.<sup>275</sup> The U.C.C. allows for disposition of collateral by private sales,<sup>276</sup> by one or more contracts,<sup>277</sup> by sales as a unit or in parcels,<sup>278</sup> and by sales "at any time and place and on any terms."<sup>279</sup> The U.C.C. allows the parties to agree to the terms of notice that must be given.<sup>280</sup> The U.C.C. allows the parties to contract, within reason, on the parameters of commercial reasonability.<sup>281</sup>

Thus, a creditor whose collateral consists of both immovable property (which is always subject to the Deficiency Judgment Act) and a U.C.C. security interest on movables and other assets covered by the U.C.C.<sup>282</sup> may want to use two different procedures to convert the loan collateral into cash. The creditor may wish to proceed by executory process with appraisal under Louisiana's Deficiency Judgment Act to obtain a deficiency from the sale of the immovable, while, on the other hand, employing a private sale of the movables pursuant to the U.C.C. Of course, as expressly recognized by Louisiana's positive law and the U.C.C., the flexibility provided by the U.C.C. is conditioned on the disposition of the collateral being commercially reasonable.<sup>283</sup>

The question then, is what is a commercially reasonable sale?

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For transactions where the collateral consists of consumer goods, the creditor must provide certain statutorily mandated explanations before seeking a deficiency. *Id.* § 10:9-616(b).

275. *Ford Motor Credit Co. v. Melancon*, 77 So. 2d 145 (La. App. 3d Cir. 1996).

276. *See* LA. REV. STAT. ANN. § 10:9-610(b); U.C.C. § 9-610(b) (provided that the sale is commercially reasonable, private sales are expressly allowed).

277. LA. REV. STAT. ANN. § 10:9-610(b); U.C.C. § 9-610(b).

278. LA. REV. STAT. ANN. § 10:9-610(b); U.C.C. § 9-610(b).

279. LA. REV. STAT. ANN. § 10:9-610(b); U.C.C. § 9-610(b).

280. Revised Statutes section 10:9-611 and U.C.C. section 9-611 provide the general notification provisions for disposition of collateral; however, both Revised Statutes section 10:9-624(a) and U.C.C. section 9-624(a) provide that the debtor may waive that right by agreement.

281. Revised Statutes section 10:9-610 and U.C.C. section 9-610 allow parties to agree to the time, place, manner, and terms of disposition of collateral.

282. Revised Statutes section 10:9-109 sets forth the scope of Louisiana's U.C.C. concerning assets subject to a security interest.

283. *See* LA. REV. STAT. ANN. § 10:9-610(b) and U.C.C. § 9-610(b), both opening with the sentence: "Every aspect of a disposition of collateral, including the method, manner, time, place, and other terms, must be commercially reasonable. If commercially reasonable, a secured party may . . ." (emphasis added).

A brief examination of non-Louisiana case law arising under the U.C.C. may be instructive in outlining the parameters of a commercially reasonable sale. There are many treatises and surveys about commercially reasonable sales,<sup>284</sup> and this Article is not intended to duplicate these or to be a comprehensive review of this field. Rather, the purpose of this portion of the Article is to illustrate some of the common issues arising in the national jurisprudence. While Louisiana civilian courts generally do not look to common law jurisdictions for guidance on statutory terms, cases arising in other jurisdictions may provide persuasive authority in the context of a statute whose Louisiana provisions are identical to the national U.C.C. This approach is one that the Louisiana Supreme Court has used involving other statutes.<sup>285</sup>

### *A. Sales in Recognized Markets*

Just as the Deficiency Judgment Act contains an exception for sales conducted without appraisal through the New York Stock Exchange, American Stock Exchange, NASDAQ, and the Chicago Commodity Exchange,<sup>286</sup> cases from other jurisdictions have found that a commercially reasonable sale occurs when it is conducted in the usual manner and for the current price on a “recognized market.” National Uniform Commercial Code comment (4) to this provision notes that the term “recognized market” is “quite limited” and applies “only to markets in which there are standardized price quotations for property that is essentially

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284. See, e.g., WILLIAM HAWKLAND ET AL., HAWKLAND U.C.C. SERIES § 7-210:04 (2009); Gary Spivey, *Uniform Commercial Code: Burden of Proof as to Commercially Reasonable Disposition of Collateral*, 59 A.L.R. 3D 369 (1974); Richard Tinney, *What Is “Commercially Reasonable” Disposition of Collateral Required by U.C.C. § 9-504(3)*, 7 A.L.R. 4th 308 (1981).

285. See, e.g., *Giroir v. S. La. Med. Ctr., Div. of Hosps.*, 475 So. 2d 1040, 1042 (La. 1985) (“Because La. C.C.P. art. 1153 is based on Federal Rule of Civil Procedure 15(c), its doctrinal commentaries and judicial interpretations are strongly persuasive as to the meaning and application of the Louisiana article.”). See also *Indep. Fire Ins. Co. v. Sunbeam Corp.*, 755 So. 2d 226, 234 (La. 2000), which uses this principle and quotes with approval from *State v. Foret*, 628 So. 2d 1116, 1122–23 (La. 1993):

Since much of the Louisiana Code of Evidence is patterned after the Federal Rules of Evidence in an attempt to facilitate a “movement towards a uniform national law of evidence,” it seems appropriate for Louisiana Courts to, “especially where the language of the Louisiana Code is identical or virtually identical with that used . . . in the federal rules” utilize this “body of persuasive authority which may be instructive in interpreting the Louisiana Code.”

286. LA. REV. STAT. ANN. § 13:4108(1), (2) (2006).

fungible, such as stock exchanges.”<sup>287</sup> Courts around the country have had no difficulty in recognizing these markets.<sup>288</sup> If a sale has occurred on New York-based securities exchanges, courts have rejected debtors’ assertions that courts must inquire whether the market for a particular stock is “thin”; courts have noted that if the sale takes place in a recognized market, one need not look at whether trading for a particular stock is robust, for it is the national market itself, “not the popularity of the security,” that “assures a fair price through neutral market forces.”<sup>289</sup>

### *B. Other Aspects of a Commercially Reasonable Sale*

When a sale occurs outside of a nationally recognized market (such as the New York Stock Exchange), commentators have

287. See also *Fed. Dep. Ins. Corp. v. Blanton*, 918 F.2d 524, 529 (5th Cir. 1991) (“Courts treat the term ‘recognized market’ restrictively, but universally agree that securities markets properly fall within the exception.”).

288. See *Layne v. Bank One*, 395 F.3d 271, 279–80 (6th Cir. 2005):

The U.C.C. comments define a “recognized market” as “one in which the items sold are fungible and prices are not subject to individual negotiation. For example, the New York Stock Exchange is a recognized market.” U.C.C. § 9-610 cmt. 9. Sales on a recognized market are commercially reasonable “because the price on the recognized market represents the fair market value [of the collateral] from day to day.” *Nelson v. Monarch Inv. Plan of Henderson, Inc.*, 452 S.W.2d 375, 377 (Ky.1970); see also *FDIC v. Blanton*, 918 F.2d 524, 527-28 (5th Cir.1990) (“A recognized market assures a fair price through neutral market forces, and thus obviates the debtor’s need for protection through redemption, appraisal, or monitoring the sale.”). Therefore, where the collateral is sold in a recognized market, Kentucky courts have found the transaction to be commercially reasonable as a matter of law. *Bailey v. Navistar Fin. Corp.*, 709 S.W.2d 841, 842 (Ky.Ct.App.1986). Courts in other states have held similarly that a sale on a recognized market is per se commercially reasonable. See *Blanton*, 918 F.2d at 529 (noting that under Texas law, sale of collateral on a recognized market is commercially reasonable); *Suffield Bank v. LaRoche*, 752 F.Supp. 54, 59 (D.R.I.1990) (holding that the sale of pledged stock on the American Stock Exchange “ensured that its sale was commercially reasonable and beyond the scrutiny of this Court”). Moreover, the law provides that “[t]he fact that a greater amount could have been obtained by . . . disposition . . . at a different time or in a different method from that selected by the secured party is not of itself sufficient to preclude the secured party from establishing that the . . . disposition . . . was made in a commercially reasonable manner.” KY.REV.STAT. ANN. § 355.9-627(1).

289. *Fed. Dep. Ins. Corp.*, 918 F.2d at 528. The court here was discussing the notice requirement, but the statement is equally applicable to other aspects of a commercially reasonable sale.

observed that it is not any particular “aspect of the disposition”<sup>290</sup> that drives the battle over whether the sale was commercially reasonable; rather, the issue centers upon the price received.<sup>291</sup> Courts generally look to certain “aspects” or facets of the actual disposition of the collateral as a surrogate for finding a fair price. These criteria include: the manner of selling (timing of the sale, advertisement, location); the condition of the item (whether the creditor maintained the collateral); and the price itself.

A full explication of the jurisprudence outlining what is considered commercially reasonable is beyond the scope of this paper. Suffice it to observe that most courts appear to focus on: the manner that the creditor conducted the sale in relation to the market available for the collateral; notice and advertising of the sale; and the condition of the property.

### *C. Are Online Internet-Based Sales Commercially Reasonable?*

Whether the disposition of collateral through online Internet sales is commercially reasonable is a developing area.

At least two courts have found the use of online auction sites to be a commercially reasonable manner of selling collateral<sup>292</sup> and two other courts have found that online advertising of a proposed sale is commercially reasonable.<sup>293</sup> A law review article contends that online auction sites, such as eBay, should be recognized as commercially reasonable national markets and laments the failure of courts to recognize them as such.<sup>294</sup> Another law review article contends that eBay sales of repossessed automobiles should be

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290. JAMES WHITE & ROBERT SUMMERS, HANDBOOK ON THE UNIFORM COMMERCIAL CODE § 25-10, at 903 (5th ed. 2000).

291. *Id.* § 25-10, at 904.

292. CNH Capital Am., LLC v. Wilmot Farming Ventures, LLC, No. 07-0611, 2008 WL 2386166 (W.D. La. June 11, 2008). The court notes briefly that a sale is commercially reasonable if it is sold pursuant to the usual manner of a “recognized market” but does not further elaborate whether their analysis was conducted under safe-harbor (a), (b), or (c) of section 9-627. *See also* Union Nat’l Bank of Wichita v. Schmitz, 853 P.2d 1180 (Kan. Ct. App. 1993) (holding that a sale of a used automobile via an auto dealer-only, private auction netting only \$920 was commercially reasonable in spite of the fact that this procedure essentially barred the debtor from participating and increased the likelihood that the maximum amount that could be achieved from the sale was the wholesale price of the used car).

293. Gen. Elec. Capital Corp. v. Stelmach Const. Co., No. CIV.A. 00-2026-CM, 2001 WL 969052 (D. Kan. 8/15/01) (applying Kansas law); Fin. Fed. Credit, Inc. v. Boss Transp., Inc., 456 F. Supp. 2d 1367 (M.D. Ga. 2006).

294. See Michael Korybut, *Article 9’s Incorporation Strategy and Novel, New Markets For Collateral: A Theory Of Non-Adoption*, 55 BUFF. L. REV. 137 (2007).

held to meet the test of commercial reasonableness.<sup>295</sup> An on-line monograph on government sales notes that online auctioning is proving to be one of the most effective methods for state and federal agencies to dispose of surplus, seized, used, and lost items.<sup>296</sup> Factors in favor of finding that broad-based national online auction sites can be considered as appropriate national markets under the U.C.C. include (1) the wide audience for such markets, far broader than could be found in any single town or state where a public or private sale might be held; (2) the increased bidding activity through a wider group of interested parties;<sup>297</sup> (3) the efficiency of such online auctions in lower direct and indirect costs for sellers; and (4) and the speed by which such auctions can be conducted, reducing the time that the creditor must store the collateral and reducing the chance of deterioration in the collateral's value.<sup>298</sup>

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295. Richard H. Nowka, *eBay Auctions Of Repossessed Motor Vehicles—A Template for Commercial Reasonableness Under Revised Article 9*, 31 S. ILL. U. L.J. 281 (2007).

296. Korybut, *supra* note 294, at 152–53 (citing DAVID C. WYLD, IBM CTR. FOR THE BUS. OF GOV'T, GOVERNMENT GARAGE SALES: ONLINE AUCTIONS AS TOOLS FOR ASSET MANAGEMENT (Nov. 2004), <http://www.businessofgovernment.org/pdfs/WyldReport3.pdf>).

297. There are obvious differences between a national online auction on a well-recognized Internet site with a private auction conducted locally, and these differences seem to favor online auctions. For example, in *Walker v. McTague*, the sale of a business was held in sealed-bid auction, advertised only in the local newspaper. The court found this a commercially unreasonable sale, including but not limited to the fact that the creditor was the winning, and only, bidder. *Walker v. Mctague*, 737 N.E.2d 404 (Ind. Ct. App. 2000).

298. See *City Nat'l Bank of Fort Smith v. Unique Structures, Inc.*, 49 F.3d 1330 (8th Cir. 1995) (finding that the sale of twenty-seven mobile homes via a private, cash-only repossession sale was not commercially reasonable). The Court held that while a private cash sale with notice could be legitimate and reasonable, the bank did not sell the collateral in a timely fashion after it received possession. The collateral stood unprotected on a lot owned by the bank, and the mobile homes fell into disrepair, with fixtures missing, windows broken, and freeze damage incurred. The court attributed the disrepair to the bank, finding that they breached a duty to preserve the property once it gained possession, thus resulting in the depressed price brought by the collateral making the sale commercially unreasonable. *Id.*

See also *Ingersoll-Rand Fin. Corp. v. Miller Mining Co., Inc.*, 817 F.2d 1424 (9th Cir. 1987) (creditor's failure to inspect heavy machinery upon voluntary surrender, leaving it exposed to elements for twenty months, failing to make repairs and prepare for sale, and eventually selling the collateral for scrap was held to be not commercially reasonable).

Might a different result have occurred in both of these cases if the creditor had quickly advertised and conducted an online Internet auction on a web site appropriate for this type of collateral?

EBay is not the only national online auction site.<sup>299</sup> Bid4Assets.com specializes in tax-defaulted property, including sales by the U.S. Marshall Service and by counties. BKassets.com bills itself as “the only full service internet auctioneer dedicated to the sale of bankruptcy related assets” and asserts that bankruptcy trustees appoint it “through the United States Bankruptcy Court” to conduct authorized sales.

It is clear that courts are only beginning to grapple with the intersection between the Internet and U.C.C.’s requirement of a commercially reasonable sale. While no bright line test has yet emerged, it is possible that borrowers might prefer that lenders use online dispositions rather than local sales. Given the fact that the U.C.C. allows parties to contract about aspects of disposition of collateral, it can be anticipated that creditors may start to build into their security agreements clauses authorizing Internet disposition of collateral on defined web sites.

#### XIV. CONCLUSION

Whether creditors should be entitled to pursue deficiency judgments and how those creditors preserve their deficiency rights are not unique Louisiana problems but rather have been dealt with nationally in a variety of contexts.

Creditors attempting to preserve a deficiency judgment in Louisiana under the Deficiency Judgment Act will want to carefully comply with the procedural niceties required. Creditors attempting to preserve a deficiency judgment under Louisiana’s version of U.C.C. Article 9 may want to consider how other states have addressed this issue and may want to consider amending their security agreements to take advantage of advertising and selling collateral through Internet auction sites.

Debtors and sureties attempting to avoid a deficiency judgment may want to consider how to leverage the public policy that forms the backbone of the Deficiency Judgment Act and how to avoid the exceptions to the Act.

What is certain is that courts will continue to face deficiency judgment issues in a broad array of circumstances and that the legislature may consider additional statutory amendments or additions as the jurisprudence develops.

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299. For statistics on eBay usage, see *supra* note 201.

