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Deficiency Judgment Relief in Montana Foreclosures

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COMMENTS

DEFICIENCY JUDGMENT RELIEF IN MONTANA FORECLOSURES

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I. INTRODUCTION

Generally, in the United States strict foreclosure, in which a debtor loses all equity in the realty and title vests immediately in the creditor, has been replaced with foreclosure by power of sale and judicial procedure. These newer forms of foreclosure carry with them, respectively, anti-deficiency provisions and rights of possession and redemption.[1] These changes reflect an important public policy underlying mortgage foreclosure law: the protection of debtors from unreasonable losses.[2] In Montana, foreclosure law has become somewhat unsettled in recent years because of Montana Supreme Court decisions that appear to unduly favor debtors over creditors. However, careful examination of the relevant statutes and judicial opinions shows that neither the Montana Legislature nor Montana courts favor debtors over creditors in mortgage foreclosure. In fact, recent Montana Supreme Court opinions evidence an intricate balancing of creditors' and debtors' rights and, if anything, show a slight favoritism of creditors over debtors.

A case in point is *Trustees of the Washington-Idaho-Montana Carpenters-Employers Retirement Trust Fund v. Galleria Partnership*[3] [*Galleria I* and *Galleria II*]. The *Galleria I* case represents the first time that the Montana Supreme Court invalidated a foreclosure sale price on inadequacy of price grounds and instructed the district court on remand to credit the debtors with the

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1. Steven Wechsler, *Through the Looking Glass: Foreclosure by Sale as* De Facto *Strict Foreclosure—An Empirical Study of Mortgage Foreclosure and Subsequent Resale*, 70 CORNELL L. REV. 850, 858 (1985).

2. David J. Dietrich, *The Montana Judicial and Non-Judicial Foreclosure Sale: Analysis and Suggestions for Reform*, 49 MONT. L. REV. 285, 331 (1988).

3. 239 Mont. 250, 780 P.2d 608 (1989) [hereinafter *Galleria I*], *remanded and appealed*, Trustees of the Washington-Idaho-Montana Carpenters-Employers Retirement Trust Fund v. Galleria Partnership, ___ Mont. ___, 819 P.2d 158 (1991) [hereinafter *Galleria II*].

fair market value of the debtors' property. Nevertheless, the facts of *Galleria I* and *Galleria II* show that ultimately the Montana Supreme Court granted the debtors a Pyrrhic victory.

After describing the factual background of *Trustees of the Washington-Idaho-Montana Carpenters-Employers Retirement Trust Fund v. Galleria Partnership*, this comment will present the two major holdings of the majority opinion, followed by the position taken in the dissenting opinion. The comment will then analyze the opinion by discussing a prior decision leading up to the *Galleria I* appeal and a later decision which shows a judicial trend toward disallowing such appeals. Next this comment will describe the additional background of the second appeal of *Trustees of the Washington-Idaho-Montana Carpenters-Employers Retirement Trust Fund v. Galleria Partnership*. After presenting the holding, the comment will analyze the *Galleria II* opinion regarding the fair market value issue. The comment will then describe the future of fair market value credits in Montana foreclosures. After presenting several suggestions for statutory reform, the comment concludes by predicting that the Montana Supreme Court will uphold *Galleria I* and *Galleria II*, but with some limitations.

II. *GALLERIA I*

A. Background

Under longstanding Montana mortgage laws, foreclosure can be accomplished by two methods: a power of sale[4] or judicial procedure.[5] Montana allows lenders to foreclose instruments securing real property through judicial procedure by providing for a sheriff's sale followed by a docketing of a deficiency judgment.[6] The deficiency judgment represents the difference between the amount bid at the sheriff's sale, less plaintiff's costs and attorneys' fees, and the full amount of the defendant's obligation.[7] Foreclosure by judicial procedure benefits debtors by allowing them to retain possession of their property for one year, if the property is used for residential purposes.[8] Additionally, foreclosure by judicial procedure provides the debtor with a one-year right to redeem the property

4. A power of sale allows the lender to sell the real property to a third party under the terms of the security instrument, but no additional money is sought from the borrower even if the sale price fails to meet the original obligation. *See* MONT. CODE ANN. § 71-1-223 to -225 (1991).

5. MONT. CODE ANN. § 71-1-222 (1991).

6. MONT. CODE ANN. § 71-1-222(2) (1991).

7. MONT. CODE ANN. § 71-1-222(2) (1991).

8. MONT. CODE ANN. § 25-13-821 (1991).

from the purchaser at foreclosure for the amount bid plus certain costs and interest.[9]

The Great Depression led many states, including Montana, to pass legislation limiting deficiency judgments in mortgage foreclosures. After the passage of an anti-deficiency statute by the Montana Legislature in 1935,[10] Montana lenders found themselves unable to obtain deficiency judgments following purchase-money mortgage foreclosures. Furthermore, as noted above, they were also unable to possess the foreclosed property for the statutory one-year redemption period. Desiring to dispose of these foreclosed properties more quickly, lenders proposed the Small Tract Financing Act to the Montana Legislature. The purpose of the Small Tract Financing Act of 1963 (the Act) was to promote the lending and banking industry by encouraging the use of deeds of trust, also called trust indentures. Under the Act, trust indentures would take away borrowers' rights of possession and redemption.[11] The lending and banking industry wished to void debtors' rights of possession and redemption because those rights caused lenders' funds to be tied up during the statutory redemption period.[12] In what many call the "quid pro quo" which led to the passage of the Act, the lending and banking industry agreed to release their right to the deficiency judgment for all foreclosures of trust indentures.[13] Thereafter, under the Act, lenders had no right to deficiency judgments and borrowers had no rights to possession or redemption.

The plain language of the Small Tract Financing Act itself seemed to provide lenders with not one but two options.[14] First, lenders could foreclose deeds of trust by a power of sale with no related right of possession, right of redemption, or deficiency judgment.[15] And second, lenders could foreclose deeds of trust by a traditional judicial procedure method, as found in the mortgage statutes, providing for the right of possession, right of redemption, and deficiency judgment.[16]

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9. MONT. CODE ANN. § 25-13-802 (1991).

10. MONT. CODE ANN. § 71-1-232 (1991).

11. *Galleria I*, 239 Mont. 250, 256-57, 780 P.2d 608, 612.

12. *Id.*

13. First State Bank of Forsyth v. Chunkapura, 226 Mont. 54, 57, 734 P.2d 1203, 1205 (1987), *cited with approval in Galleria I*, 239 Mont. 250, 257, 780 P.2d 608, 612.

14. MONT. CODE ANN. § 71-1-304(3) (1991).

15. MONT. CODE ANN. § 71-1-304(2) (1991) (power of sale conferred); MONT. CODE ANN. § 71-1-319 (1991) (bidder takes possession on the 10th day following sale); MONT. CODE ANN. § 71-1-228 (1991) (right of redemption not to apply to trust indentures under the Small Tract Financing Act); MONT. CODE ANN. § 71-1-317 (1991) (anti-deficiency statute).

16. This was the relief requested by plaintiff First State Bank of Forsyth in *Chunkapura*, 226 Mont. 54, 59, 734 P.2d 1203, 1206. *See also* MONT. CODE ANN. § 71-1-

Although lenders usually prefer to foreclose under the Act to gain immediate possession of the property,[17] lenders often desire the deficiency judgment gained by judicial foreclosure when prices in the real estate market fall[18] or when the debtor has significant assets subject to a deficiency judgment. In a rising real estate market the lender may prefer to foreclose under the Act to gain immediate possession. In a falling market the lender may prefer to foreclose under the mortgage statutes in order to obtain a deficiency judgment for the difference between what it could get on the market and the full amount of the obligation.

The problem which confronts many courts is that even in a falling real estate market there is a fine line between making a suitably low bid and "economic overreaching."[19] The lender's bid might take unfair advantage of the depressed market. In such cases, the deficiency judgment constitutes a "double recovery," because the lender acquires both the property and a sizeable deficiency judgment as well.[20] In addition, when the occasional debtor has significant assets available to cover a deficiency judgment, lenders frequently prefer to foreclose under mortgage statutes. This option allows the lender to make a low bid at the foreclosure sale and obtain a large deficiency judgment. This too can be characterized as a "double recovery."

B. Facts and Procedure

In 1982, sixteen Great Falls residents formed the Galleria Partnership (the Partnership) to purchase a warehouse which the previous owner had remodeled to house numerous businesses.[21] Together, the partners made a cash down payment of $800,000 on the property.[22] On March 17, 1982, these individuals executed a

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222(2) (1991) (deficiency statute); MONT. CODE ANN. § 25-13-821 (1991) (possession statute); MONT. CODE ANN. § 25-13-801 (1991) (redemption statute).

17. *See Chunkapura*, 226 Mont. 54, 58, 734 P.2d 1203, 1205 ("[T]he use of trust deeds for security purposes has become nearly exclusive in this state.").

18. *Id.* at 63, 734 P.2d at 1208.

19. "Economic overreaching" is the term used by the Ninth Circuit Court in United States v. MacKenzie, 510 F.2d 39, 41-42 (9th Cir. 1975), to describe "artificially low bids" made by creditors at foreclosure sales.

20. By waiting until the property recovers its value, the lender can theoretically recover both the full value of the property and the full value of the property again in the form of a deficiency judgment. "Double recovery" is a term used by the Ninth Circuit in *MacKenzie*, 510 F.2d at 42 (9th Cir. 1975), to describe the "artificially large deficiencies" which result when creditors make "artificially low bids" at foreclosure sales; *see also* GRANT S. NELSON AND DALE A. WHITMAN, REAL ESTATE FINANCE LAW § 8.3, at 604 (2d ed. 1985).

21. *Galleria I*, 239 Mont. 250, 253, 780 P.2d 608, 610.

22. Appellant's Initial Brief at 10, *Galleria I*, 239 Mont. 250, 780 P.2d 608 (1989) (No. 89-029).

$1,200,000 promissory note to the Trustees of the Washington-Idaho-Montana Carpenters-Employers Retirement Trust Fund (Retirement Trust).[23] That same day, ten of the individuals and three others executed a trust indenture and security agreement to secure the $1,200,000 loan, with interest, under the promissory note.[24]

In 1981, the warehouse had been appraised at $1,950,000.[25] The Partnership used this appraisal to justify their request for the $1,200,000 loan from the Retirement Trust.[26] In 1985, after the Partnership defaulted on its monthly payments and after the Retirement Trust filed a complaint, the Retirement Trust obtained a second appraisal of $1,100,000.[27]

On April 12, 1985, the Retirement Trust filed a complaint in District Court, Eighth Judicial District, Cascade County, to foreclose the trust indenture securing Galleria's 1982 loan in the amount of $1,200,000.[28] On October 29, 1987, the district court granted summary judgment to the Retirement Trust and ordered a sheriff's foreclosure sale, which took place on December 8, 1987.[29] At this foreclosure sale, the sole bidder was the Retirement Trust.[30] The Retirement Trust purchased the property for $565,000.[31] The district court entered a deficiency judgment against Galleria by subtracting the Retirement Trust's bid of $565,000 from the principal and interest owing on the $1.2 million loan and the costs of the sale.[32]

The district court's final judgment for plaintiff Retirement Trust was $1,505,368.35.[33] Of that total amount, $1,308,193.35 represented the deficiency judgment (plus the interest on the obligation which accrued after default), and $197,175.00 was for costs and attorneys' fees.[34] From that final judgment the defendant Galleria appealed to the Montana Supreme Court.

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23. *Galleria I*, at 253, 780 P.2d at 609.
24. *Id.* at 253, 780 P.2d at 610.
25. *Id.*
26. *Id.* at 263, 780 P.2d at 616.
27. *Id.* at 255, 780 P.2d at 611.
28. *Id.*
29. *Id.* at 256, 780 P.2d at 611.
30. *Id.*
31. *Id.*
32. *Id.*
33. *Id.* at 252, 780 P.2d at 609.
34. *Id.*

C. The Holdings

1. A Deficiency Judgment is Permissible under the Small Tract Financing Act of 1963

The first issue the Montana Supreme Court addressed was whether a trust indenture executed in conformity with the Small Tract Financing Act of 1963[35] and foreclosed by judicial proceedings could be the basis for a deficiency judgment.[36] The court had interpreted the pertinent statutes of the Act just two months before the filing of the Retirement Trust's initial complaint in *First State Bank of Forsyth v. Chunkapura*.[37]

In *Chunkapura*, the court held that it would not allow deficiency judgments under the Act because "advertisement and sale"[38] (which the Act does not define) applied to judicial procedure foreclosures.[39] The court defined judicial foreclosures as having an advertisement and sale procedure because the plaintiff advertises the sheriff's sale in the legal section of a newspaper of general circulation.[40] On rehearing, the court modified this holding to apply only to foreclosures where the real property involved was an occupied, single-family residential dwelling.[41] The court stated explicitly that under the Act commercial borrowers would indeed be liable for deficiency judgments upon judicial foreclosure of their trust indentures.[42] The court justified its position by stating that the purpose of the Act was to effect a *quid pro quo* between borrowers and the lending and banking industry so that the borrowers

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35. MONT. CODE ANN. § 71-1-317 (1991). This section provides that:

> When a trust indenture executed in conformity with this part is foreclosed by advertisement and sale, no other or further action, suit, or proceedings shall be taken or judgment entered for any deficiency against the grantor or his surety, guarantor, or successor in interest, if any, on the note, bond or other obligation secured by the trust indenture or against any other person obligated on such note, bond, or other obligation.

But the Act also provides that:

> A trust indenture executed in conformity with this part may be foreclosed by *advertisement and sale* in the manner provided in this part or, at the option of the beneficiary, by judicial procedure as provided by law for the foreclosure of mortgages on real property. The power of sale may be exercised by the trustee without express provision in the trust indenture.

MONT. CODE ANN. § 71-1-304(3) (1991) (emphasis added).

36. *Galleria I*, at 256-58, 780 P.2d at 611-13.

37. 226 Mont. 54, 734 P.2d 1203 (1987).

38. MONT. CODE ANN. § 71-1-317 (1991). This provision denies all deficiency judgments when the trust indenture is foreclosed by "advertisement and sale."

39. *Chunkapura*, at 63, 734 P.2d at 1208.

40. *Id.*

41. *Id.* at 67, 734 P.2d at 1211.

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

would give up the right to possess their real property and the one-year period of redemption in return for the lenders giving up their right to a deficiency judgment.[43] The *Chunkapura* court ruled that since the legislature intended the Act to benefit homeowners and small business expansions of not more than three acres, its anti-deficiency provision should not benefit commercial borrowers.[44]

In *Galleria I* the Montana Supreme Court confronted a commercial borrower who stood in a position similar to the debtors in *Chunkapura*.[45] Although the Galleria Partnership argued that it intended its loan for a business expansion, the court was unpersuaded.[46] The court affirmed the modified *Chunkapura* decision and held that the Small Tract Financing Act allows deficiency judgments when lenders foreclose the trust indentures of commercial borrowers by judicial procedure.[47]

2. Sitting as a Court of Equity, the District Court May Take Evidence of the Fair Market Value of the Real Property to Determine the Deficiency Judgment

The second major issue which the Montana Supreme Court addressed in *Galleria I* was whether the amount of the deficiency judgment was fair.[48] The court asserted that a foreclosure action is an action in equity, which allows the court to "determine any other equities existing between the parties connected with the main subject of the suit, and grant all relief necessary to the entire adjustment of the subject."[49] The court held that the district court, acting as a court of equity, had the authority to hear the evidence of both parties regarding the fair market value of the real property, and if that value were significantly higher than the $565,000 bid by the Retirement Trust at the sheriff's sale, to use the higher fair market value as the basis for determining any deficiency judgment.[50] In arriving at its holding, the court emphasized again that the property had been valued at $1,950,000 in 1981 and at $1,100,000 in 1985, but purchased for $565,000 in 1987.[51] The court remanded the action to the district court for determination of the

43. *Id.* at 66, 734 P.2d at 1210.
44. *Id.* at 66-67, 734 P.2d at 1210.
45. *Galleria I*, 239 Mont. 250, 258, 780 P.2d 608, 613.
46. *Id.* at 257, 780 P.2d at 612.
47. *Id.* at 257-58, 780 P.2d at 612-13.
48. *Id.* at 263, 780 P.2d at 616.
49. Tiffany v. Uhde, 123 Mont. 507, 512-13, 216 P.2d 375, 378 (1950), *cited with approval in Galleria I*, 239 Mont. 250, 265, 780 P.2d 608, 617.
50. *Galleria I*, at 265, 780 P.2d at 617.
51. *Id.* at 263-64, 780 P.2d at 616.

fair market value of the property.[52] The court thus attempted to prevent the possibility of double recovery by the Retirement Trust, which wanted both the property, last valued at more than $1,000,000, and a deficiency judgment for $1,308,193.35, all in compensation for the Partnership's default on a $1,200,000 obligation.[53]

D. The Dissent

Justice McDonough's dissenting opinion focused upon the remand to the district court for fair market value determination. The dissent based its objections upon statutory and procedural matters. The dissent first argued that there was no statutory basis for a fair market value determination of deficiency judgments. On that basis alone Justice McDonough would have held that the deficiency judgment of $1,308,193.35 was proper.[54] Furthermore, the dissent reasoned that because the defendant Galleria never questioned the propriety of the actual amount of the deficiency judgment, either in the lower court proceedings or in its appeal, the court should never have addressed that issue at all.[55]

E. Analysis

This analysis of *Galleria I* first explores the court's authority to require a fair market valuation credit upon remand. Next the analysis focuses upon how the court initially found the price inadequacy. Finally, this analysis notes a shift in the prevailing supreme court winds and what that means for the future of fair market valuation credit in Montana foreclosures.

1. Deficiency Judgments Permissible

Deficiency judgments are not available to lenders foreclosing under the Small Tract Financing Act for occupied, single-family residential property.[56] The *Galleria I* court builds its analysis upon *Chunkapura*. In *Chunkapura*, the debtors had executed a deed of trust on October 20, 1980 to secure a $17,000 promissory note allowing them to purchase the lot for their family home in Forsyth, Montana.[57] The Chunkapuras made approximately $11,999.20 in

52. *Id.*
53. *Id.* at 264, 780 P.2d at 616.
54. *Galleria I*, at 270, 780 P.2d at 620 (McDonough, J., dissenting).
55. *Id.*
56. *Chunkapura*, 226 Mont. 54, 67, 734 P.2d 1203, 1211.
57. *Id.* at 55, 734 P.2d at 1203.

payments of principal and interest before they defaulted in 1985.[58] The plaintiff, First State Bank of Forsyth, filed for a foreclosure action under judicial procedure, requesting both a sale and a deficiency judgment.[59] At the sheriff's sale, the Bank, the sole bidder, bid $10,000.[60] After the sheriff's fees and attorneys' fees were deducted, the Bank requested the district court to docket a deficiency judgment of $8,556.93.[61]

The Chunkapuras fought the deficiency judgment on two grounds. First, they argued that Montana Code Annotated section 71-1-305 prohibits deficiency judgments as inconsistent with the purposes of the Act.[62] They argued that the purpose of the Act was to encourage the lending and banking industry by taking away borrowers' rights to possession and redemption after foreclosure, and that, in return, lenders had to give up their rights to deficiency judgments.[63] Second, the Chunkapuras argued that Montana Code Annotated section 71-1-317, which states that no deficiency judgment can be allowed when the property is sold by advertisement and sale, applies not only to power of sale but judicial procedure as well, because even under judicial procedure there is advertisement and sale.[64]

The Montana Supreme Court accepted the Chunkapuras' arguments and held that Montana Code Annotated section 71-1-317 prohibited any deficiency judgment under the Act.[65] The court stated that while the Act appears to permit judicial foreclosure, it does not also provide for the rights of possession, redemption, and deficiency.[66] Further, the court stated that to allow a deficiency would be inconsistent with the legislative intent of the Act.[67] To arrive at this holding, the Montana Supreme Court strained to find some ambiguity in the Act which would allow the court to forbid a deficiency judgment against the Chunkapuras.[68]

The *Chunkapura* opinion is best understood by looking at the equities. The Chunkapuras were going to lose their property valued at perhaps $17,000, approximately $11,999.20 in payments of

58. *Id.* at 55, 734 P.2d at 1204.
59. *Id.*
60. *Id.*
61. *Id.*
62. *Id.* at 59, 734 P.2d at 1206.
63. *Id.*
64. *Id.*
65. *Chunkapura*, 226 Mont. 54, 63, 734 P.2d 1203, 1208.
66. *Id.* at 60, 734 P.2d at 1206.
67. *Id.* at 63, 734 P.2d at 1208.
68. Kathleen M. Magone, *First State Bank v. Chunkapura: New Limitations on Trust Indentures*, 49 MONT. L. REV. 181, 196 (1988).

principal and interest,[69] $8,556.93 in a deficiency judgment,[70] and attorneys' fees. After the *Chunkapura* rehearing, however, the court narrowed its holding to apply only to occupied, single-family residential property.[71] The court made it clear that the "quid pro quo" which "secured passage of the Act" was not intended by the legislature to benefit commercial borrowers, although the court cited no authority for that assertion beyond the personal knowledge of the justices.[72]

In *Galleria I*, the Montana Supreme Court reviewed and approved the *Chunkapura* decision as it applied to a commercial borrower.[73] The court again noted that there is no provision under the Act for any right to possess or redeem either for residential or commercial borrowers,[74] but that deficiency judgments could be docketed against commercial borrowers.[75] The court appealed to the legislature for attention to the matter, but noted that two legislative sessions had passed since the court's previous request for statutory revision in *Chunkapura*.[76]

2. *Fair Market Valuations Permissible*

Faced now with a commercial borrower against whom a catastrophic deficiency judgment might be docketed, the *Galleria I* court invoked its equity power to require a fair adjustment of the equities between the parties. On remand, the court ordered the district court to determine the fair market value of the property before docketing a deficiency judgment. To come to this decision, the court relied upon three sources of authority: the statutes of other western states which require fair market valuations; a 1975 Ninth Circuit opinion which applied a fair market valuation statute; and Montana Code Annotated section 3-2-204(5), which allows the Montana Supreme Court to sit as a court of equity and gives the court broad powers to make adjustments between the parties.

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69. *Chunkapura*, at 55, 734 P.2d at 1204.

70. *Id.*

71. *Id.* at 76, 734 P.2d at 1211.

72. The court never cites its specific source (beyond the statement of intent within the Act itself) for the legislative intent supporting the "quid pro quo." The court simply states that "[t]he history of the legislative adoption of that Act [is] not unknown to some members of this Court . . . ." *Id.* at 56, 734 P.2d at 1204. It should be noted that one of the majority in *Chunkapura*, Chief Justice Jean A. Turnage, was a member of the Montana House of Representatives when the Small Tract Financing Act was passed in 1963.

73. *Galleria I*, 239 Mont. 250, 256-58, 780 P.2d 608, 611-13.

74. The court states that "[t]he Small Tract Financing Act . . . makes no provision for any right of redemption . . . ." *Id.* at 256, 780 P.2d at 611-12.

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

76. *Id.*

First, the court reviewed the statutes of other western jurisdictions such as California, Washington, Arizona, Utah, Idaho, Oregon, and Alaska for their persuasive authority.[77] All of these western states except Alaska require some type of fair market valuation as a basis for determining deficiency judgments.[78] In addition, South Dakota and North Dakota also provide for fair market valuations by statute.[79]

Second, the court drew upon the Ninth Circuit Court of Appeal's characterization of deficiency judgments as being unjust when not based upon fair market value.[80] In *United States v. MacKenzie*, the lower court had refused to follow a Nevada law which calculates fair market value into the deficiency judgment.[81] The Court of Appeals reversed.[82] The court stated that "depriving the [plaintiff] of potential 'double recoveries' created by artificially large deficiencies that [plaintiff] has caused takes away nothing to which [plaintiff] is entitled."[83] The *McKenzie* opinion argued that mortgagee bids at foreclosure sales should be based upon fair market value. Furthermore, "economic overreaching" best describes what happens when the foreclosing lender makes a low bid at foreclosure sale.[84] Thus the *Galleria I* court drew upon the persuasive power of the Ninth Circuit Court of Appeal's strong condemnation of double recoveries and economic overreaching by lenders.

Third, the Montana Supreme Court sought a solution to the problem through its powers of equity. Legal scholars and courts have traditionally understood foreclosure actions to be actions in equity.[85] In *Galleria I*, the Montana Supreme Court invoked its equity power as provided by Montana statute.[86] From this statute,

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77. *Id.* at 264, 780 P.2d at 616.

78. *Id.*

79. *Id.*

80. United States v. MacKenzie, 510 F.2d 39, 41 (9th Cir. 1975), *cited with approval in Galleria I*, 239 Mont. 250, 264-65, 780 P.2d 608, 617.

81. 510 F.2d 39, 40 (9th Cir. 1975).

82. *Id.* at 43.

83. *Id.* at 42.

84. *Id.*

85. As early as 1904, the Montana Supreme Court asserted its equitable power to overturn a grossly inadequate foreclosure sale price in Burton v. Kipp, 30 Mont. 275, 286, 76 P. 563, 565 (1904) (dictum) (reciting with approval the mere inadequacy of price plus additional circumstances exception). *See generally* Dietrich, *supra* note 2, at 318.

86. MONT. CODE ANN. § 3-2-204(5). This statute provides:

> [i]n equity cases and in matters and proceedings of an equitable nature, the supreme court shall review all questions of fact arising upon the evidence presented in the record, whether the same be presented by specifications of particulars in which the evidence is alleged to be insufficient or not, and determine the same, as well as questions of law, unless for good cause a new trial or the taking of further evidence in the court below be ordered. Nothing herein shall be construed to

the court justified its review of the facts in *Galleria I*.[87] The equitable power provided by this statute allowed the court on appeal to readjust the equities between the parties without a specific allegation of error. By invoking the persuasive authority of other western states and the Ninth Circuit Court of Appeals, the Montana Supreme Court showed the need for using fair market valuation to calculate the deficiency judgment. By invoking the mandatory authority of Montana statutory law in equitable proceedings, the Montana Supreme Court justified its use of the equity power to satisfy that need.

The dissent's argument that there is no specific statutory authority for using fair market valuation in foreclosure sales is thus immaterial to the Montana Supreme Court when sitting in equity.[88] Because of the broad equity powers of adjustment granted to the court by Montana Code Annotated section 3-2-204(5), the dissent's objection that the defendants never raised the issue of fair market value in the district court is simply irrelevant to the court when sitting in equity. But the dissent's argument that the defendants could have asked the district court to set aside the deficiency and order the property appraised should not be ignored, because it probably represents the safest way for borrowers to assert their rights in foreclosure sales.

3. *The Finding of Price Inadequacy*

When the Montana Supreme Court remanded *Galleria I* to the district court for determination of fair market value, it did so on the equitable theory that the price bid in by the mortgagee at the sheriff's sale was inadequate.[89] The court was not clear about why the price was inadequate. The opinion hints at two possibilities. First, the court notes that the mortgagee's bid on the real property was "approximately 30% of [the property's] original appraised value [and was] the basis for what must [have been] a cat-

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abridge in any manners the powers of the supreme court in other cases.

87. 239 Mont. 250, 265, 780 P.2d 608, 617.

88. *See* Robert M. Washburn, *The Judicial and Legislative Response to Price Inadequacy in Mortgage Foreclosure Sales*, 53 S. CAL. L. REV. 843, 855-56 (1980):

> Even when the mortgagee exercises a power of sale in a mortgage or deed of trust, equity has jurisdiction to grant relief upon petition by an injured party. Courts of equity also have extensive inherent power in supervising judicial sales and wide discretion in the exercise of that power. This discretion extends to grant or denial of a deficiency judgment, to confirmation of the sale, and to vacating a confirmed sale.

89. *Galleria I*, 239 Mont. at 265, 780 P.2d at 617.

astrophic deficiency judgment for the Partners."[90] Second, the court stated that "Had the *sole bid* at the sheriff's sale for the property here been for $100 or $1,000, undoubtedly we would be moved by equity to inquire as to its fairness. The actual bid of $565,000.00 is only a matter of degree."[91] It is unclear whether the court found the $565,000 bid inadequate because it was 30 percent of the mortgagor's original purchase price or perhaps because the *sole bidder*—the mortgagee—had made a relatively low bid.

The general rule in mortgage foreclosure is that any price bid in at the foreclosure sale is adequate.[92] There are, however, two fundamental equitable exceptions to this general rule in inadequacy of price cases.[93] These exceptions are not mutually exclusive; both may operate at the same time. The first exception is the gross inadequacy of price exception, accepted in a minority of states.[94] Montana has not adopted this rule.[95] The second fundamental equitable exception in inadequacy of price cases is the mere inadequacy of price with additional circumstances exception, which is

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90. *Id.* at 264, 780 P.2d at 616.

91. *Id.* at 265, 780 P.2d at 617 (emphasis added).

92. Speers Sand & Clay Works, Inc. v. American Trust Co., 52 F.2d 831, 835 (4th Cir. 1931), *cert. denied*, 286 U.S. 548 (1932). *Contra* Wood v. Parker, 63 N.C. 373 (1869). *See* Washburn, *supra* note 88, at 859.

93. *See generally* Charles C. Marvel, Annotation, *Inadequacy of Price as Basis for Setting Aside Execution or Sheriff's Sale—Modern Cases*, 5 A.L.R.4th 794 §§ 3-4 at 800-11 (1981).

94. Ballentyne v. Smith, 205 U.S. 285, 291 (1907); Graffam v. Burgess, 117 U.S. 180, 191-92 (1886) (reciting general rule and gross inadequacy exception with approval); United States v. Wells, 403 F.2d 596 (5th Cir. 1968); Madison v. Ware, 171 So.2d 117 (Ala. 1965); George v. Cone, 91 S.W. 557, 558 (Ark. 1905); Girard Trust Bank v. Castle Apart's, Inc., 379 A.2d 1144 (Del. 1977) (dictum); Van Senden v. O'Brien, 58 F.2d 689 (App. D.C. 1932), *cert. denied*, 287 U.S. 608 (1932); Maule Indus. v. Seminole Rock & Sand Co., 91 So. 2d 307, 311 (Fla. 1956); Williams v. Regent Motel Corp., 223 S.E.2d 225 (Ga. 1976); Hoge v. Kane, 670 P.2d 36 (Haw. Ct. App. 1983); Butler v. Slattery, 237 N.W. 232 (Iowa 1931) (dictum); Straus v. Anderson, 9 N.E.2d 205, 208 (Ill. 1937); Branck v. Foust, 30 N.E. 631 (Ind. 1892) (dictum); Wyandotte State Bank v. Murray, 114 P. 847, 849 (Kan. 1911); McCartney v. Frost, 386 A.2d 784 (Md. 1978) (dictum); Michigan Trust Co. v. Cody, 249 N.W. 844, 845 (Mich. 1933); Industries Sales Corp. v. Reliance Mfg. Co., 138 So.2d 484 (Miss. 1962); Brookshire v. Powell, 335 S.W.2d 176 (Mo. 1960); Nebraska Fed. Sav. and Loan Ass'n v. Patterson, 321 N.W.2d 71 (Neb. 1982); Hackettstown Nat'l Bank v. Smith, 6 A.2d 485, 486 (N.J. 1938); Southold Sav. Bank v. Gilligan, 350 N.Y.S.2d 303, 305 (1973); Certain-Teed Prod. Corp. v. Sanders, 141 S.E.2d 329, 337 (N.C. 1965); Commissioners of Land Office v. Harrower, 29 P.2d 123, 127 (Okla. 1934); Thompson v. Thompson, 378 P.2d 281 (Or. 1963); Capozzi v. Antonoplos, 201 A.2d 420 (Pa. 1964); Anderson v. Anderson, 266 A.2d 56 (R.I. 1970); Howell v. Gibson, 37 S.E.2d 271, 274-75 (S.C. 1946); Watson v. United Am. Bank in Knoxville, 588 S.W.2d 877 (Tenn. App. 1979); Greater Southwest Office Park, Ltd. v. Texas Commerce Bank Nat'l Ass'n, 786 S.W.2d 386 (Tex. 1990); Sensenbrenner v. Keppler, 130 N.W.2d 177 (Wis. 1964).

95. *See* Fox v. Curry, 96 Mont. 212, 220, 29 P.2d 663, 665 (1934) (quoting Burton v. Kipp, 30 Mont. 275, 286, 76 P. 563, 565 (1904)).

accepted in a majority of states.[96] Montana impliedly adopted this exception in dicta in *Burton v. Kipp*, although it mislabelled the exception as the gross inadequacy of price exception.[97]

Under the gross inadequacy of price exception, a court may hold that when a price bid in at a foreclosure sale results in "fundamentally unfair economic harm" to the mortgagor, the mortgagor should receive deficiency relief.[98] Although it is not strictly necessary, some courts have found that gross inadequacy of price "constitutes evidence of fraud, raises a presumption of fraud, unfairness, or mistake, or constitutes constructive fraud."[99] A bid of sixty percent of property value is usually the uppermost limit of the gross inadequacy exception.[100] But, typically, courts hold prices below forty percent of value to be grossly inadequate.[101] In *Galleria I*, the court found that a bid of 30 percent of original appraised value (not the value as of the sheriff's sale) fell within the

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96. Graffam v. Burgess, 117 U.S. 180 (1886); Schroeder v. Young, 161 U.S. 334 (1896); Savers Fed. Sav. & Loan Ass'n v. Reetz, 888 F.2d 1497 (5th Cir. 1989); Gottlieb v. McArdle, 580 F. Supp. 1523 (E.D. Mich. 1984); In re Worcester, 28 B.R. 910 (Bankr. Cal. 1983); Mason v. Wilson, 568 P.2d 1153 (Ariz. 1977); Wade v. Deniston, 21 S.W.2d 424 (Ark. 1929); Lopez v. Bell, 24 Cal. Rptr. 626 (Cal. App. 1962); Reed v. Westland Indus. Bank, 484 P.2d 1247 (Colo. 1971); Edward A. Lashins, Inc. v. Baumann, 201 So. 2d 495 (Fl. 1967), *cert. denied*, 210 S.2d 221 (Fla. 1967); Wilson v. Citizens Bank, Peach County, 238 S.E.2d 754 (Ga. App. 1977); Elliott & Healy v. Wirth, 198 P. 757 (Idaho 1921); Block v. Hooper, 149 N.E. 21 (Ill. 1925); Fletcher v. McGill, 10 N.E. 651 (Ind. 1887); Johnson v. Funk, 297 P. 670 (Kan. 1931); Kitchen, Whitt & Co. v. Fannin, 115 S.W.2d 325 (Ky. 1938); Estate of Spears v. Spears, 101 N.W.2d 332 (Mich. 1960); Guidarelli v. Lazaretti, 233 N.W.2d 890 (Minn. 1975) (dictum); Morgan v. Linham, 86 So. 2d 473 (Miss. 1956); Robert R. Wisdom Oil Co. v. Gatewood, 682 S.W.2d 882 (Mo. App. 1984); Fox v. Curry, 96 Mont. 212, 220, 29 P.2d 663, 665 (1934); Golden v. Tomiyasu, 387 P.2d 989 (Nev. 1963); J.E. Linde Paper Co. v. Gebert, 105 A. 447 (N.J. 1918); Armstrong v. Csurilla, 817 P.2d 1221 (N.M. 1991) (recognizing both exceptions); Mauer v. Butler, 389 N.Y.S.2d 483 (1976); Swindell v. Overton, 314 S.E.2d 512 (N.C. 1984); Warren v. Stinson, 70 N.W. 279 (N.D. 1896); United Oklahoma Bank v. Moss, 793 P.2d 1359 (Okla. 1990) (recognizing both exceptions); Wagener v. Yetter, 124 A. 487 (Pa. 1924); Anderson v. Anderson, 266 A.2d 56 (R.I. 1970); Peoples Fed. Sav. and Loan Ass'n v. Graham, 352 S.E.2d 511 (S.C. 1987); Kinkaid v. Rossa, 141 N.W. 969 (S.D. 1913); Pentad Joint Venture v. First Nat'l Bank of La Grange, 797 S.W.2d 92 (Tex. App. 1990); Watson v. United Am. Bank in Knoxville, 588 S.W.2d 877 (Tenn. App. 1979); Pender v. Dowse, 265 P.2d 644 (Utah 1954); Lovejoy v. Americus, 191 P. 790 (Wash. 1920).

97. Burton v. Kipp, 30 Mont. 275, 286, 76 P. 563, 565 (1904).

98. Washburn, *supra* note 88, at 863.

99. *Id.*; *see* American Trading & Prod. Corp. v. Connor, 109 F.2d 871, 873 (4th Cir. 1940) (raising presumption of fraud, unfairness, or mistake); Kenly v. Huntingdon Bldg. Ass'n, 170 A. 526, 528 (Md. 1934) (Digges, J., concurring) (dictum) (constituting evidence of fraud); Butler v. Daum, 226 A.2d 261, 263-64 (Md. 1967) (constituting constructive fraud).

100. Washburn, *supra* note 88, at 865; *but see* Gumz v. Chickering, 121 N.W.2d 279, 285 (Wis. 1963) (finding 87% to be a gross inadequacy).

101. Washburn, *supra* note 88, at 866; *but see* Washburn, *supra* note 88, at 869-70 (in the Fourth Circuit and in Delaware, the courts use 50% of value as the cutoff for gross inadequacy).

gross inadequacy of price exception,[102] and remanded the case for a fair market value credit.[103] According to case law and statutes from other jurisdictions, however, the more correct comparison of bid price to value would define value as of the date of the sheriff's sale.[104] The record in *Galleria I* shows that the full appraisal (the Stevens 1985 appraisal) closest to the date of the sheriff's sale (December, 1987) was for $1,100,000.[105] Assuming that the court accepted the $1,100,000 valuation, which the Retirement Trust had initiated but disclaimed as too high,[106] the correct comparison would then yield a bid-to-value percentage of 51 percent. It is unclear if the Montana Supreme Court found that a 50 percent-of-value bid fell within the gross inadequacy of price exception. Perhaps the *Galleria I* court thought it had no reliable evidence as to value other than original appraisal value ($1,950,000), verified as it was in the market by the original purchase price ($2,000,000).

While the Montana Supreme Court may have found that the gross inadequacy exception applied to the facts of *Galleria I*, the court might alternatively have found that the price was merely inadequate but coupled with additional circumstances, thus qualifying for the other exception. There are many possible additional circumstances used by courts to justify their refusal to confirm sale prices. Among them are missed sale dates by mortgagor and other minor misunderstandings between creditors and debtors regarding the sale, improper "motive or position of the sale purchaser," and the "status, disability, or business naivete of the debtor."[107] Other possible circumstances justifying vacating a sale include a substantial advanced bid made by a third party after the sale,[108] sale at a substantially higher price by the purchaser to a third party[109] or any other circumstances indicative of unfairness or irregularity.[110]

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102. *Galleria I*, 239 Mont. at 264, 780 P.2d at 616.

103. *Id.* at 265, 780 P.2d at 617.

104. Washburn, *supra* note 88, at 859.

105. *Galleria I*, 239 Mont. at 255, 780 P.2d at 611; *see* Respondent and Cross-Appellants' Responsive Brief and Brief in Support of Cross-Appeal at 26, *Galleria II*, ___ Mont. ___, 819 P.2d 158 (1991) (No. 90-404) [hereinafter Respondent's Brief].

106. *Galleria I*, 239 Mont. at 255, 780 P.2d at 611; *see also* Respondent's Brief at 39, *Galleria II* (No. 90-404).

107. Washburn, *supra* note 88, at 862.

108. Blackburn v. Selma R.R., 3 Fed. Rptr. 689, 694 (1880); *see* Washburn, *supra* note 88, at 867-68.

109. Unruh v. Streight, 615 P.2d 247 (Nev. 1980); Wachovia Realty Invs. v. Housing, Inc., 232 S.E.2d 667 (N.C. 1977); *see* Washburn, *supra* note 88, at 868.

110. Washburn, *supra* note 88, at 868. *See* Fletcher v. McGill, 10 N.E. 651, 654 (Ind. 1887), *reh'g denied* 11 N.E. 779 (Ind. 1887) (recognizing rule based on purchaser's unfairness to owner); Branck v. Foust, 30 N.E. 631, 633 (Ind. 1892) (requiring only slight unfairness when great inadequacy of price exists); *see also* Charles C. Marvel, Annotation, *Inade-*

Conceptually, fraud, misconduct, accident, mistake, unfairness and surprise fall under the ambit of the mere inadequacy of price with additional circumstances exception.[111] According to one leading case, *Graffam v. Burgess*,[112] only "slight circumstances" are required when there is a "great inadequacy" of price.[113] Additional circumstances also may include a lack of competitive bidding, especially where the mortgagee is the sole bidder.[114] Another circumstance might be a collapsed real estate market resulting in a lack of competitive bidding.[115] Often when the national or local economy depresses land prices to the point that land is almost worthless, only the mortgagee will bid at the foreclosure sale.

In *Galleria I* the Montana Supreme Court was silent as to which circumstance might have prompted the court to find the price inadequacy; indeed, the court was silent even as to which exception it relied upon in finding the price inadequacy. However, the Montana Supreme Court could have relied upon several additional circumstances to justify a mere inadequacy with additional circumstances exception. The court might have been troubled by the apparent eagerness with which the mortgagee accelerated the loan, perhaps falling under the category of "improper motive of sale purchaser."[116] Another additional circumstance might have

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quacy of Price as Basis for Setting Aside Execution or Sheriff's Sale—Modern Cases, 5 A.L.R.4th 794 § 4 at 802-09 (1981).

111. Some courts, however, deem these factors to constitute constructive gross inadequacy. *See infra* text accompanying note 123.

112. 117 U.S. 180 (1886).

113. *Id.* at 192.

114. *See* Bechtel v. Rocke, 5 N.E.2d 872, 874 (Ill. 1937) (where a second bidder, disqualified during the first sale, was allowed to purchase property on resale); Busey v. Perkins, 178 A. 254, 256 (Md. 1935) (dictum); Campbell v. Gardner, 11 N.J. Eq. 423, 429-30 (1857); *see also* Washburn, *supra* note 88, at 888 ("Several courts have held that the sole additional circumstance of mortgagee purchase is sufficient to set aside a sale where the sale price is merely inadequate.").

115. Brand v. Woolson, 180 A. 293 (Conn. 1935); Detroit Trust Co. v. Hart, 269 N.W. 598 (Mich. 1936); Federal Title and Mortgage Guar. Co. v. Lowenstein, 166 A. 538 (N.J. 1933); Young v. Weber, 175 A. 273 (N.J. 1934); Better Plan Bldg. & Loan Ass'n v. Holden, 169 A. 289 (N.J. 1933); Teachers' Retirement Fund Ass'n v. Pirie, 46 P.2d 105 (Or. 1935); National Bank of Washington v. Equity Investors, 506 P.2d 20 (Wash. 1973); John Davis Estate, Inc. v. Rochelle, 42 P.2d 788 (Wash. 1935); Suring State Bank v. Giese, 246 N.W. 556 (Wis. 1933); *but see* Kremer v. Rule, 257 N.W. 166 (Wis. 1934); *see also* Washburn, *supra* note 88, at 875-83; *but see* 2 JAMES C. BONBRIGHT, VALUATION OF PROPERTY 845 (1st ed. 1937) ("The *real* holding in [*Suring*], and it may be a very just holding, is that in an economic depression such as the present one, the law will compel mortgagees to share a larger burden of the common misfortune than would be required by observance of the traditional rules." (emphasis in original)).

116. Washburn, *supra* note 88, at 862; *id.* at 852 ("During periods of local or national credit stringency, the effect on borrowers is virtually the same as during the Depression. Default rates can rise to critical proportions; *mortgagees have economic incentives that en-*

been the "status, disability, or business naivete"[117] of some of the Galleria Partners, a number of whom had a partnership interest of less than 2 percent[118] and yet were encouraged by the former owner of the Galleria into entering into a $1.2 million loan with joint and several liability.[119] Similarly, another additional circumstance might have been the status, disability, or business naivete of some of the partners who, as senior citizens, lacked any future earning power and who had invested a significant portion of their retirement savings in the Partnership.[120] Other possible circumstances are that the mortgagee was the sole bidder at the foreclosure sale[121] and that the deteriorating Great Falls economy at the time of the sale[122] in 1987 further restrained competitive bidding.

Because the Montana Supreme Court did not make explicit whether the Retirement Trust's bid fell within the gross inadequacy of price exception or the mere inadequacy with additional circumstances exception, it is difficult to evaluate the correctness of its approach or any future approach the court might take. The court may have felt no need to state its reasoning since the Retirement Trust's bid, at either 50 percent of current appraised value or 30 percent of original appraised value, fell within the gross inadequacy exception. The court may have relied upon the exception of mere inadequacy with additional circumstances because of the eagerness of the Retirement Trustee to accelerate the loan, the dete-

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courage foreclosure rather than forbearance.") (emphasis added); *Galleria I*, 239 Mont. at 255, 780 P.2d at 611 (regarding acceleration); *see* United States v. MacKenzie, 510 F.2d 39, 42 (9th Cir. 1975) ("Depriving the [mortgagee] of potential 'double recoveries' created by artificially large deficiencies that it has caused takes away nothing to which it is entitled."); *see also* NELSON AND WHITMAN, *supra* note 20, § 8.3, at 601 ("In times of depression, moreover, mortgaged property often sells for nominal amounts. The result is that the mortgagee can purchase at the sale for less than the mortgage debt, resell the property at fair market value and, in addition, attempt to realize on a deficiency judgment determined by the difference between the mortgage debt and the foreclosure sale price.").

117. Washburn, *supra* note 88, at 862; *see e.g.*, *Kloepping v. Stellmacher*, 21 N.J. Eq. 328, 329 (1871) (regarding a sale for 2.5% of value where the debtors refused to believe that their property could be sold for an eight dollar debt):

> But when such gross inadequacy is combined with fraud or mistake, or any other ground of relief, in equity it will incline the court strongly to afford such relief. The sale in this case is a great oppression on the complainants. They are ignorant, stupid, perverse, and poor. They lose by it all their property, and are ill-fitted to acquire more. They are such as this court should incline to protect, notwithstanding perverseness.

118. Appellant's Initial Brief at 6, *Galleria I*, 239 Mont. 250, 780 P.2d 608 (No. 89-029).

119. *Galleria I*, 239 Mont. at 254, 780 P.2d at 610 ("Each of the borrowers was told that the loan was nonrecourse.").

120. Appellant's Initial Brief at 6-7, *Galleria I* (No. 89-029).

121. *Galleria I*, 239 Mont. at 256, 780 P.2d at 611.

122. *Galleria II*, ___ Mont. at ___, 819 P.2d at 162.

riorating Great Falls economy, the fact that the mortgagee was the sole bidder, the business naivete of some of the smaller investors who participated jointly and severally with the larger investors, or the status of the senior citizens who had invested much of their retirement savings in the Partnership. Perhaps the best conclusion to draw is that when the court reviews the facts of a foreclosure case, all of the equitable matters together might lead the court to find price inadequacy, whereas no particular fact could by itself persuade the court to find inadequacy.

3. *The Future of Fair Market Value in Montana*

In the recent case of *Federal Savings and Loan Insurance Corporation v. Hamilton*,[123] the court refused to invoke its equity power to remand for fair market valuation. The court held that the defendants' evidence was insufficient to show that the deficiency judgment was unfair to the borrower.[124] The defendants, Darwin and Mary Hamilton, had borrowed $429,557 to develop a mobile home subdivision.[125] After making payments for three years, the defendants defaulted.[126] With two additional years of accrued interest, the total judgment came to $564,600.[127] *FSLIC v. Hamilton* is distinguishable from *Galleria I*, however, because plaintiff FSLIC, the only bidder at the foreclosure sale, bid $475,000 on the property, $45,443 more than the value of the underlying obligation.[128]

The Hamiltons argued that their property was worth more than $1 million because they had already sold 17 of 81 mobile home lots for $11,000 to $13,000.[129] Citing *Galleria I*, the defendants requested that the court remand their case to the district court to determine the fair market value of the property and recalculate the deficiency judgment.[130] The Montana Supreme Court upheld the deficiency judgment, however, and refused to remand on the grounds that a $475,000 bid on a property secured by a $429,557 obligation was not unfair on its face, and defendants had produced no evidence that the property was worth any more than the underlying obligation would indicate.[131]

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123. 241 Mont. 367, 317, 786 P.2d 1190, 1193 (1990) [hereinafter FSLIC v. Hamilton].
124. *Id.*
125. *Id.* at 369, 786 P.2d at 1192.
126. *Id.*
127. *Id.*
128. *Id.*
129. *Id.* at 370, 786 P.2d at 1192-93.
130. *Id.* at 370, 786 P.2d at 1193.
131. *Id.*

While distinguishing the *Galleria I* decision, in *FSLIC v. Hamilton* the Montana Supreme Court implicitly challenged the equitable powers basis of its *Galleria I* decision by stating in dicta that "[w]e acknowledge that an issue not presented to the district court will not be addressed on appeal."[132] The *Hamilton* court further challenged its *Galleria I* decision by restating the *Galleria I* dissenting argument that there is no statutory authority for a fair market value calculation of deficiency judgments.[133] Although the *Hamilton* court correctly found nothing wrong with the deficiency judgment on its face, the defendant's contention that the property was worth $1 million, as opposed to the $475,000 bid by the lender, seems close enough to the facts of *Galleria I* to have at least potentially warranted a similar remand for determination of fair market value. The *Hamilton* court's remand refusal should signal to practitioners that the court's attitude has shifted toward denial of fair market valuation credits.[134]

In dicta, the *Hamilton* court set forth the procedures it expected a defendant to follow in a lower court to qualify for a fair market value determination of deficiency judgment.[135] The supreme court thus essentially imposed a procedural limitation on *Galleria I*. Future defendants in foreclosure actions who believe that they face an unfair deficiency judgment and hope to receive judicial support for a fair market value determination should use Justice Weber's statements as their check list. First, the defendants should "petition the District Court [for a hearing] in regard to the adequacy of the sales price."[136] Second, the defendants should submit to the Montana Supreme Court "relevant evidence of fair market value on the date of sale."[137] Only then will the court take up the question of the propriety of the amount of the judgment. Although *FSLIC v. Hamilton* does not specify what proceedings must occur below, *Galleria I* indicates that perhaps a hearing in which both parties present expert appraisals of fair market value would be appropriate.[138]

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132. *Id.* (citing Wyman v. DuBray Land Realty, 231 Mont. 294, 299, 752 P.2d 196, 200 (1988)).

133. *Id.*

134. The *Galleria I* decision was authored by Justice John Sheehy who retired from the court in 1991. Justice Sheehy did not sit on the court at the time of the *FSLIC v. Hamilton* decision. It is interesting to note that Justice Fred Weber, who authored the 1990 *FSLIC v. Hamilton* decision, did not participate in the earlier *Galleria I* decision.

135. *Hamilton*, 241 Mont. at 371, 786 P.2d at 1193.

136. *Id.*

137. *Id.*

138. *Galleria I*, 239 Mont. 250, 265, 780 P.2d 608, 617.

III. *GALLERIA II*

A. Background

1. District Court Procedure

In a preliminary hearing on December 13, 1989, District Court Judge Leonard H. Langen outlined the procedures he expected counsel for the Retirement Trust and Galleria Partnership to use in the upcoming hearing to determine fair market value of the Galleria building.[139] Judge Langen expressed his expectation that each side would present two or three appraisers, each of whom would then be subject to cross-examination.[140] The district court expected the Retirement Trust to present its case first.[141] Although the court asked the Retirement Trust to present its evidence first, that fact did not determine which party had the burden of proof.[142] In approval of the district court decision and citing *FSLIC v. Hamilton*,[143] the Montana Supreme Court stated that the Galleria Partnership—and for that matter any mortgagor in a hearing to determine fair market value vis-à-vis a foreclosure sale—carried the burden of proof.[144]

Instead of receiving three to four hours of direct testimony from each appraiser, the district court and counsel for both parties agreed to have the appraisers submit their reports to the court and then appear for cross-examination.[145] The district court made explicit what it would be looking for on cross-examination.[146] First, it wanted an opportunity to determine generally "which [appraiser] knew what he [was] doing."[147] Second, the district court wished to know what "procedures [the appraiser] used and upon what [the appraiser] based his figures."[148] Finally, the court listed the three typical parts of the appraisal: "comparable sales, which [the appraisers] may have a difficulty in finding; the income to the prop-

139. Transcript of Hearing Held by Long Distance Telephone Conference Call on December 13, 1989 at 2-3 (Appendix to Respondents' Brief), *Galleria II* (No. 90-404) [hereinafter Transcript of Hearing].

140. *Id.* at 3.

141. *Id.*

142. *Galleria II*, ___ Mont. at ___, 819 P.2d at 163.

143. 241 Mont. 367, 786 P.2d 1190 (1990).

144. *Galleria II*, ___ Mont at ___, 819 P.2d at 163.

145. Transcript of Hearing at 7, *Galleria II* (No. 90-404). This procedural deviation may be responsible for some of the confusion in the district court and in the supreme court regarding the basis used by the appraisers for their appraisals.

146. *Id.*

147. *Id.*

148. *Id.*

erty; and then I guess, to some extent the replacement value."[149] There is no mention made in the record of this preliminary hearing regarding the *Galleria I* requirement that the effects of foreclosure should not reduce the fair market value of the property.[150]

The district court held the fair market value hearing on March 2, 1990, and the court rendered an oral judgment from the bench that "the fair market value of the foreclosed property at the time of the Sheriff's Foreclosure Sale on December 8, 1987, was $1,100,000."[151] The court rendered its judgment on June 15, 1990.[152] From this judgment the defendant Galleria Partnership appealed and the plaintiff Retirement Trust cross-appealed.

2. *Facts Related to the Appraisals*

On remand, the district court heard testimony from appraisers presented by the Retirement Trust and Galleria Partnership.[153] The Retirement Trust presented the testimony of one appraiser, William Ferro, who had performed two appraisals of the property in 1987-88, before the *Galleria I* court issued its instructions regarding valuation methods. This appraiser testified that these earlier appraisals were adequate for the district court's purposes in 1991. Galleria Partnership presented the testimony of one appraiser, Steven Hall, who had performed his appraisal in 1991. Galleria Partnership also submitted into evidence a 1985 appraisal, a critique of that appraisal, and relevant testimony from three other witnesses.

The Retirement Trust's appraiser, William Ferro of Great Falls, testified that the basis for his appraisal was "fair market value," which he defined as the "most probable price . . . for which the appraised property [would] sell in a competitive market under all conditions requisite to a fair sale with the buyer and seller each acting prudently, knowledgeably and for self-interest, and assuming that neither [party was] under undue stress."[154] Ferro testified that he had twice appraised the Galleria property.[155] Ferro submitted his first appraisal to the Retirement Trust on November 9,

149. *Id.*

150. *Galleria I*, 239 Mont. 250, 265, 780 P.2d 608, 617.

151. Memorandum Opinion of June 13, 1990 at 2 (Appendix to Appellants' Initial Brief), *Galleria II* (No. 90-404).

152. Final Judgment as to Plaintiffs and Defendants Galleria Partnership (Appendix to Appellants' Initial Brief), *Galleria II* (No. 90-404).

153. *Galleria II*, ___ Mont. at ___, 819 P.2d at 161.

154. *Id.*

155. *Id.*

1987, one month before the foreclosure sale.[156] Ferro arrived at his first appraisal by comparing the market values of similar properties in Great Falls and "deduct[ing] the costs of clean-up, maintenance, and renovation, ranging from $100,000 for general clean-up and maintenance to $400,000 for major remodeling."[157] This appraisal valued the Galleria property between $256,000 and $325,000.[158]

One month after the foreclosure sale, Ferro prepared a second appraisal for the Retirement Trust's appeal to the State Tax Appeal Board. This January 1, 1988 appraisal valued the building at $266,500 using an income approach.[159] According to the September 22, 1989 order of the State Tax Appeal Board, however, the Retirement Trust eventually stipulated to an appraised value of $562,736.[160] The stipulated appraisal value thus approximated the Trustee's $565,000 bid at the December 8, 1987 foreclosure sale.

Steven Hall of Missoula testified for the Galleria Partnership "that the 'intrinsic' value of the Galleria property as of December 1987 was $1,595,000."[161] Hall testified that the basis of his appraisal was the "consideration of the replacement cost new of a property . . . allowing for the property's depreciation in the form of physical deterioration, its functional obsolescence, if any, its anticipated serviceable life and the general usefulness of the item involved."[162]

Galleria Partnership submitted into evidence a second appraisal prepared by Thomas Stevens of Missoula.[163] Commissioned by the Retirement Trust[164] and dated August, 1985, this appraisal valued the property at "$925,000 according to the income approach, $1,050,000 according to the cost approach, and $925,000 according to the market value approach."[165] "The 'final indication of value' was $1,100,000."[166] One of the Galleria partners, Allen Bloomgren, testified that "he had expected the appraisal to be about $1,500,000" and alleged that Stevens had performed his

156. *Id.*
157. *Id.*
158. *Id.*
159. *Id.*
160. *Id.*
161. *Id.*
162. *Id.* at ___, 819 P.2d at 162.
163. *Id.*
164. Appellants' Reply Brief and Brief in Response to Cross-Appeal at 12, *Galleria II*, ___ Mont. ___, 819 P.2d 158 (1991) (No. 90-404) [hereinafter Appellants' Reply Brief].
165. *Galleria II*, at ___, 819 P.2d at 162.
166. *Id.*

analysis improperly.[167] Stevens' appraisal did not, however, discount the effects of the foreclosure on the property because that requirement would not be handed down until the 1989 *Galleria I* opinion.[168]

Galleria Partnership also submitted into evidence a critique of the Stevens' appraisal that was prepared for the Retirement Trust[169] by Ben E. Stanton of Bozeman, and dated November 11, 1985, one month before the Retirement Trust bid at the foreclosure sale.[170] Using the income approach to valuation, the Stanton critique of the Stevens' appraisal valued the Galleria property at $565,000.[171] Stanton's critique contained the caveat that his valuation was based solely upon the data in the Stevens appraisal and did not in itself constitute an appraisal.[172] Like the Stevens appraisal, the Stanton critique did not take into account the effects of foreclosure upon the property.[173]

The Galleria Partnership then offered the testimony of Mick Miller, "a Great Falls insurance agent for the company carrying casualty insurance on the Galleria property," for the Retirement Trust.[174] Using as a basis the replacement cost minus depreciation, Miller explained why the Retirement Trust carried $1,950,000 in insurance on the Galleria building.[175]

Finally, the Galleria Partnership offered the testimony of its former building manager, Darryl Meyer, who managed the Galleria property before July, 1986.[176] Meyer testified to "the reluctance of prospective tenants to rent space in the building after the foreclosure proceeding was initiated" in April of 1985.[177]

B. The Holding: Fair Market Value

The Montana Supreme Court examined the issue of whether the "District Court abus[ed] its discretion in determining the value of the Galleria property"[178] and held that there was no abuse of discretion because the district court satisfied two criteria. First, the

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167. *Id.*
168. *Galleria I*, 239 Mont. 250, 265, 780 P.2d 608, 617.
169. Respondent's Brief at 7, *Galleria II* (No. 90-404).
170. *Galleria II*, at ___, 819 P.2d at 162.
171. *Id.*
172. *Id.*
173. Appellants' Reply Brief at 11-12, *Galleria II* (No. 90-404).
174. *Galleria II*, at ___, 819 P.2d at 162.
175. *Id.*
176. *Id.*
177. *Id.* at ___, 819 P.2d at 162-63.
178. *Id.* at ___, 819 P.2d at 163 (1991).

district court based the fair market value determination on "substantial, credible evidence," and, second, the district court did not reduce the fair market value by "the effect of judicial foreclosure proceedings on the property's value."[179] As to the latter proposition, the text of the *Galleria II* holding is slightly ambiguous and can be read in two ways. The opinion states: "We hold that the District Court relied on substantial, credible evidence in determining the fair market value of the Galleria property, without taking into consideration the effect of judicial foreclosure proceedings on the property's value."[180] Read literally, one might argue that the fair market value determination should be arrived at without taking into account the effect of foreclosure on the fair market value—by considering only the fair market value at the time of foreclosure sale. But a review of the text of the opinion reveals that the court intended exactly the opposite—that fair market value should be arrived at first by determining the fair market value and then adding to that amount any losses in value attributable to the effect of the foreclosure process.[181]

C. *Analysis of the Method Used to Determine Fair Market Value*

The Montana Supreme Court faced five sub-issues in evaluating the Galleria Partnership claims and the Retirement Trust's counterclaims regarding fair market value of the property. First, the parties argued that the district court should have based its decision on one of the appraisals advocated by the parties. Second, each party argued that the other party had used an incorrect definition of fair market value. Third, the parties argued in favor of different appraisal methods, the Retirement Trust relying on market value and income approaches and the Galleria Partnership relying on the replacement cost approach. Fourth, the parties were uncertain when their appraisals were supposed to have been prepared. Lastly, both parties held radically different views about

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179. *Id.* at ___, 819 P.2d at 165.

180. *Id.*

181. *See, e.g.*, Rainer Mortgage v. Silverwood Ltd., 209 Cal. Rptr. 294, 295 (1985) ("'[F]air value' means the *fair market value* of the property, undiminished by any of the disabilities that attend a judicial foreclosure sale.")(emphasis in original); *see also id.* at 300 ("[W]e have been unable to find a single case which construes the statutory phrase 'fair market value' to take into consideration the price-depressing effects of the foreclosure proceedings.").

For example, if the fair market value at the time of a foreclosure sale is $80,000, but there has been a $10,000 reduction in value due to foreclosure effects, the proper fair market value would be $90,000.

which valuation losses should have been attributed to the foreclosure process.

The first issue relating to the fair market value determination was whether the district court was bound to accept the appraisal of either of the parties.[182] Although the Retirement Trust had argued for the adoption of the Ferro appraisals and the Galleria Partnership had argued for the adoption of the Hall appraisal, the district court adopted neither.[183] Instead, the district court adopted the dollar amount—if not the appraisal itself—of Stevens' 1985 appraisal for $1,100,000.[184] The district court was reluctant to adopt the 1985 appraisal because the Montana Supreme Court had required on remand that December 8, 1987, the date of the sheriff's sale, be the date used for valuation,[185] and the Stevens appraisal was performed in 1985. Because setting a fair market value is a factual issue, the standard of review under M.R.Civ.P. 52(a) is "clearly erroneous."[186] Citing *Downing v. Grover*,[187] the court stated that a fact is not "clearly erroneous when based upon substantial credible evidence."[188]

Under the clearly erroneous standard of review, the Montana Supreme Court allows the district courts "broad discretion in valuation of real property."[189] As long as there is some support for the valuation in the record, the Montana Supreme Court will allow the district court valuation to stand.[190] In addition to allowing district courts to discount the appraisals advocated by the parties, the Montana Supreme Court acknowledged that it permits averaging the values of expert valuations.[191] The court also allowed the district court to disregard the Stanton critique of the Stevens ap-

182. *Galleria II*, at ___, 819 P.2d at 163.

183. *Accord*, Union Nat'l Bank v. Crump, 37 A.2d 733 (Pa. 1944) (holding that trial judges need not adopt any single expert opinion but may base fair market value on all the evidence).

184. Memorandum Opinion of June 13, 1990 at 5 (Appendix to Appellants' Initial Brief), *Galleria II* (No. 90-404) ("It is coincidental that the $1,100,000.00 figure which I arrived at on March 10, 1990, was the same figure which was submitted by an appraiser hired by the Trustees in 1985, after the Default Notice had been served, which appraisal the Trustees refused to accept.").

185. *Galleria I*, 239 Mont. 250, 265, 780 P.2d 608, 617.

186. *Galleria II*, ___ Mont. at ___, 819 P.2d at 163.

187. 237 Mont. 172, 178, 772 P.2d 850, 853 (1989).

188. *Galleria II*, at ___, 819 P.2d at 163.

189. *Id.*

190. *Id.*

191. *Id.*; *see also* Tahoe Highlander v. Westside Fed. Sav. & Loan Ass'n, 588 P.2d 1022 (Nev. 1979) (affirming district court's finding of fair market value of apartment complex).

praisal because it was "not based on an appraisal."[192]

Much of the difficulty the district court had in choosing the best appraisal relates to the next sub-issue, determining what meaning the appraisers should have given to the term "fair market value." The Montana Supreme Court reiterated the *Rainer Mortgage v. Silverwood Ltd.*[193] articulation of fair market value, as meaning the "underlying" or "intrinsic" value of a property.[194] Noting that "foreclosure sometimes depresses the value of property,"[195] the Montana Supreme Court stated that a determination of fair market value "necessarily excludes the circumstances of the foreclosure sale."[196] The Montana Supreme Court noted that "[f]ew of [the *Galleria II* appraisals had] relied purely on a fair market value analysis" as they should have done.[197]

In its remand instructions, the *Galleria I* court had stated that the district court should determine the fair market value by arriving at the "intrinsic value of the real property with its improvements at the time of sale under judicial foreclosure, without consideration of the impact of the foreclosure proceedings on the fair market value."[198] The *Galleria I* opinion relies upon both *Chunkapura* and *Rainer Mortgage v. Silverwood Ltd.* for its definition of fair market value.[199] This abstract definition of fair market value left the district court with little practical guidance in determining fair market value.[200] In *Galleria II*, the Montana

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192. *Galleria II*, at ___, 819 P.2d at 165. A full appraisal should consist of the comparable sales approach, the income approach, and the replacement cost approach, plus any other factors that might affect the fair market value of the property. *See, e.g.* Harris Ominsky, *Deficiency Judgments in Pennsylvania: The Lender's Gauntlet Revisited*, 30 VILL. L. REV. 1130, 1135 n.22 (1985):

> In determining this price, courts might consider the following factors: (1) recent sales of realty of comparable location and descriptions; (2) the uses to which the subject property is adapted and might reasonably be adapted; (3) the demand for the subject property and the demand for similarly situated realty; (4) income produced by the property; (5) all other elements that may affect the realty's actual value.

(Quoting Union Nat'l Bank v. Crump, 37 A.2d 733, 735 (Pa. 1944)).

193. 209 Cal. Rptr. 294 (1985).

194. *Galleria II*, ___ Mont. at ___, 819 P.2d at 164.

195. *Id.*

196. *Id.* (quoting Rainer Mortgage v. Silverwood Ltd., 209 Cal. Rptr. 294, 298 (1985)).

197. *Galleria II*, ___ Mont. at ___, 819 P.2d at 164.

198. *Galleria I*, 239 Mont. 250, 265, 780 P.2d 608, 617 (citing First State Bank of Forsyth v. Chunkapura, 226 Mont. 54, 61, 734 P.2d 1203, 1207 (1987)).

199. *Chunkapura*, at 61, 734 P.2d at 1207 (relying on *Rainer*, 209 Cal. Rptr. at 298).

200. Appellants' Initial Brief at 7, *Galleria II* (No. 90-404) ("[P]residing Judge Langen specifically noted his obligation was to determine the 'intrinsic value' of the property pursuant to this Court's ruling and that he was not certain what that term meant, although he recognized it to be something other than a standard fair market value approach."); *id.* at 9 ("Ferro further testified he had never appraised the property on the basis of its intrinsic

Supreme Court acknowledged that "the method of valuation was left to the District Court."[201] The court did approve the district court's method of determining "intrinsic value," however, when it affirmed the Stevens appraisal.[202]

The court's definition of fair market value is probably the functional equivalent of the definitions used in most other jurisdictions. For example, the Wisconsin Supreme Court in *First Wisconsin National Bank of Oshkosh v. KSW Investments, Inc.*[203] defined fair value as the "price which a person willing and able to buy the property would reasonably pay for it, not for purposes of speculation, but for that use to which it has been or reasonably may be put."[204] The *KSW* court used "highest and best use"[205] as a gloss on the "use to which [the property] has been or reasonably may be put."[206] Both the Montana definition and the Wisconsin definition rely on hypothetical information. More important, both definitions strive to value the property without regard to the foreclosure process.

Not just the definition, but the overall method of the fair market value appraisal was in issue, however. Indeed, the Montana Supreme Court did not approve of any of the appraisal methods advocated by the parties. In reviewing the appraisals prepared by Ferro, Hall, and Stevens the supreme court concluded that, together, the parties had given the district court all of the information necessary to the fair market value determination.[207] Because the appraisals were so disparate, the Montana Supreme Court stated that the district court "was entitled to discount [all of] the appraisals."[208] The district court's ultimate valuation price did equal the Stevens valuation price. However, the district court stated that it had not relied upon the 1985 Stevens appraisal in making its valuation.[209]

The Montana Supreme Court singled out and approved of the Stevens appraisal as being the most thorough appraisal because it had considered all possible approaches—the income approach, the market approach, and the replacement cost approach—before it

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value, and in fact *did not even know* what 'the term intrinsic value as being applied to real estate in any way, shape or form' was.").

201. *Galleria II*, at ___, 819 P.2d at 165.
202. *Id.*
203. 238 N.W.2d 123 (Wis. 1976) [hereinafter *KSW*].
204. *Id.* at 128.
205. *Id.* at 126.
206. *Id.* at 128.
207. *Galleria II*, ___ Mont. at ___, 819 P.2d at 165.
208. *Id.*
209. *Id.*

came to a final valuation.[210] The court minimized the fact that Stevens prepared his appraisal two years before the foreclosure sale by stating that the earlier preparation date gave some assurance that the effects of foreclosure had not yet had an impact on the value of the property.[211]

The issue of the timing of the Stevens appraisal forced the Montana Supreme Court to decide when the parties' appraisals should have been performed. The court acknowledged the district court's right to rely upon an appraisal prepared two years before the foreclosure sale. The Supreme Court stated that:

> [h]aving been completed after the Trustees foreclosure action was filed, but two years before the foreclosure sale while the Galleria building was still occupied and maintained, the Stevens' appraisal may approximate most closely the value of the Galleria property at the time of the sheriff's sale, without taking into account the impact of the foreclosure proceedings.[212]

Although the appraisal should have arrived at the fair market value of the property as of the date of the sheriff's sale, the appraisal itself may have been performed years earlier. Appraisals prepared close to or before the mortgagee initiates foreclosure proceedings may be the most accurate in arriving at an intrinsic value of a property and may provide a useful comparison for appraisals which follow the initiation of foreclosure proceedings.

Finally, the court had to determine which impacts of foreclosure had diminished the property's intrinsic value. Losses of value attributable to foreclosure include, but are not limited to, losses of rental income,[213] mortgagee's failure to maintain and repair the property,[214] the value reduction due to redemption rights,[215] and the lack of an arm's-length transaction.[216] The Stevens appraisal consisted of an income approach, a replacement cost approach, and a comparable sales approach.[217] Ultimately, the Stevens appraisal settled on a dollar value slightly higher than any of the three indi-

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210. *Id.*

211. *Id.*

212. *Galleria II*, at ___, 819 P.2d at 165; *see also* Mellon Bank (East) Nat'l Ass'n v. Pennsylvania Restaurant of A.B.E., Inc., 528 A.2d 654, 655 (Pa. 1987) (accepting appraisal prepared three years before hearing for third party); First Wis. Nat'l Bank of Oshkosh v. KSW Inv., Inc., 238 N.W.2d 123, 126 & n.1 (Wis. 1976) (accepting appraisal prepared one year before foreclosure proceedings were initiated because the appraisal was based on the highest and best use of the property).

213. Appellants' Initial Brief at 29, *Galleria II* (No. 90-404).

214. *Id.*

215. *Rainer*, 209 Cal. Rptr. at 297-98.

216. Washburn, *supra* note 88, at 851.

217. *Galleria II*, at ___, 819 P.2d at 162.

vidual approaches.[218] The Stevens income approach may have been flawed, however, due to the impact of foreclosure proceedings. When the appraisal was prepared the property was already in foreclosure. Therefore, the property might not have been able to attract the number and quality of tenants it had attracted under normal circumstances.[219] One of Galleria Partnership's witnesses testified to the "reluctance of prospective tenants to rent space in the building after the foreclosure proceeding was initiated."[220] It is arguable that when the loss of tenants itself is the event that caused the foreclosure, as was the case in the Galleria building,[221] the accompanying loss of income should not be taken into account when determining fair market value because that loss can be attributed to the foreclosure process.

An additional, more difficult, question is whether an economic downturn in the national or local economy is an impact of foreclosure. According to the California Supreme Court, an economic downturn is an impact of foreclosure if the downturn results in a loss of a viable market for the property.[222] In *Rainer Mortgage v. Silverwood Ltd.*, the court discussed debtor protection as developed during the Depression, noting that:

> the Depression . . . severely reduced market values for real property. For many pieces of property there was no market at all. (citation omitted) Accordingly, giving the mortgagor a credit against the deficiency judgment for the greater of the sale price or the fair market value was often an empty protection.
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> . . . .
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> . . . The fair market value of the property was deemed an insufficient measure as circumstances might conspire to render valueless property which under normal conditions would have significant value. . . . The 'fair value' of foreclosed property is thus its intrinsic value.[223]

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218. *Id.* at ___, 819 P.2d at 163.

219. Appellants' Reply Brief at 10, *Galleria II* (No. 90-404). This is particularly true in the *Galleria* fact situation, where the underlying reason for the foreclosure itself was an extraordinary event affecting tenancy. The former owner of the Galleria, who had a financial interest in most of the tenants, lost his financial ability to maintain those tenants' businesses. The ensuing inability of those tenants to pay their rents, all at the same time, was the direct cause of the foreclosure. *See Galleria I*, 239 Mont. 250, 254, 780 P.2d 608, 610.

220. Appellants' Reply Brief at 10, *Galleria II* (No. 90-404).

221. *Galleria I*, at 254, 780 P.2d at 610.

222. *Rainer*, 209 Cal. Rptr. at 297-98; *accord*, Suring State Bank v. Giese, 246 N.W. 556, 557-58 (Wis. 1933); *cf.* REV. CODE WASH. ANN. § 61.12.060 (allowing court to "take judicial notice of economic conditions, and after a proper hearing fix a minimum or upset price to which the mortgaged premises must be bid or sold before confirmation of the sale.").

223. *Rainer*, 209 Cal. Rptr. at 297-98.

If a national or local downturn in the real estate market results in collapse of a market and a loss of competitive bidding at the foreclosure sale, then the economic downturn should not diminish the intrinsic value of the foreclosed property.[224]

D. Future Considerations

In the future, mortgagors should raise the inadequacy of a foreclosure sale price at the district court level. Although not strictly necessary in equitable foreclosure appeals, in *FSLIC v. Hamilton* the Montana Supreme Court expressed its desire to see the inadequacy proof presented in the district court. *Galleria II* tells us that mortgagors will bear the burden of proof. In the district court, the mortgagor must show that the fair market value of the property was, at the time of the sale, so much higher than the bid price that one of two equitable exceptions apply. Mortgagors must show that the price falls within either the gross inadequacy exception or the mere inadequacy coupled with additional circumstances exception. To meet this burden of proof, the mortgagor should use the *Rainer* definition of fair market value used in *Chunkapura* and *Galleria I* and *Galleria II*: "the intrinsic value of the real property with its improvements at the time of sale under judicial foreclosure, without consideration of the impact of the foreclosure proceedings on the fair market value."[225] The mortgagor also bears the burden of proving what losses in property value can be attributed to the foreclosure process.

In the future, a careful mortgagee, particularly the sole bidder at a foreclosure sale, should bid in an amount which will not fall within either the gross inadequacy exception or the mere inadequacy with additional circumstances exception. A full fair market value appraisal, based on the income, market, and replacement approaches and performed by an appraiser before the mortgagee initiates foreclosure proceedings, would provide some guidance in de-

224. *Suring*, 246 N.W. 556, 558 ("[E]conomic conditions are such as to preclude the element of competitive bidding, and to make ineffective the ordinary and usual manner of fixing the market value of the property."); *see also* Brand v. Woolson, 180 A. 293, 295 (Conn. 1935); Chemical Bank & Trust Co. v. Adam, 268 N.Y.S. 674, 677-78 (Sup. Ct. 1934); Federal Title & Mortgage Guar. Co. v. Lowenstein, 166 A. 538, 541 (N.J. 1933); Teachers' Retirement Fund Ass'n v. Pirie, 46 P.2d 105, 108 (Or. 1935); John Davis Estate, Inc. v. Rochelle, 42 P.2d 788, 789 (Wash. 1935); *but see* Weems v. McCloud, 619 F.2d 1081, 1091-92 (5th Cir. 1980) (dictum) ("It is no defense in Georgia if market values are depressed by general economic factors."); Kremer v. Rule, 257 N.W. 166, 169 (Wis. 1934) (dictum); *see generally* Sol Phillips Perlman, *Mortgage Deficiency Judgments During an Economic Depression*, 20 VA. L. REV. 771 (1934).

225. *Galleria II*, ___ Mont. at ___, 819 P.2d at 164.

termining a reasonable bid. The appraisal, whether performed before or after the initiation of foreclosure proceedings, should not diminish value by any current or projected effects of the foreclosure process.

District courts, when faced with similar valuation issues, should reconsider the process by which the parties present valuation testimony to the court. In *Galleria II*, the district court faced real difficulty when the plaintiff and defendant presented it with disparate fair market valuations, each based upon a different definition of fair market value.[226] Not only did the parties disagree on the definition of the basic term, they also disagreed significantly on the factual issue of the losses to the property associated with foreclosure. The latter issue was perhaps the crux of the *Galleria II* fair market value litigation. Since the ultimate goal is to arrive at appraisals for plaintiff and defendant that are truly comparable, these definitions and the list of foreclosure losses need to be determined early on, preferably even before the appraisers prepare their appraisals. A preliminary hearing or a pretrial conference might be an appropriate point to come to some agreement on these matters.

IV. SUGGESTIONS FOR REFORM

The foreclosure sale process as it exists in Montana today does little to assure a fair price for the debtor's property. The lack of commercial sales procedures, such as listing, advertising, and showing the property to potential purchasers, virtually guarantees an unfair price for the debtor's property.[227] The Uniform Land Transaction Act[228] recognizes this inadequacy and provides for commercial sale procedures in foreclosure sales.[229] Similar provisions might be considered by the Montana Legislature. The legislature also should pass legislation to disallow both the deficiency judgment and the statutory right to redemption when commercial indentures are foreclosed under the Small Tract Financing Act. In fact, the Montana Supreme Court has been asking the Montana Legislature to turn its attention to deficiency judgments under mortgage fore-

226. *Id.* at ___, 819 P.2d at 164 ("Few of [the appraisers] relied purely on a fair market value analysis.").

227. *See generally* George M. Platt, *Deficiency Judgments in Oregon Loans Secured by Land: Growing Disparity Among Functional Equivalents*, 23 WILLAMETTE L. REV. 37, 43 (1987) (noting three factors that reduce foreclosure prices: lack of arm's-length transaction, inadequate notice to potential bidders, and mortgagee's credit advantage in bidding).

228. The Uniform Land Transaction Act (ULTA) was drafted by the National Conference of Commissioners on Uniform State Laws in 1975 but has not been adopted by any state. *See* Washburn, *supra* note 88, at 936-38.

229. Washburn, *supra* note 88, at 937.

closure for several years.[230]

More importantly, the Montana Legislature should consider legislation that would provide a fair market value credit for mortgagors,[231] especially when the mortgagee is the purchaser. Perhaps this anti-deficiency relief could be coupled with anti-redemption relief for mortgagees. The Wisconsin fair market value credit statute, as quoted in *KSW*, might serve as a model for a Montana statute:

> Sec. 816.165(2), Stats., . . . provides:
> Application for confirmation of sale and for deficiency judgment: (2) In case the mortgaged premises sell for less than the amount due and to become due on the mortgage debt and costs of sale, there shall be no presumption that such premises sold for their fair value and no sale shall be confirmed and judgment for deficiency rendered, until the court is satisfied that the fair value of the premises sold has been credited on the mortgage debt, interest and costs.[232]

There is some empirical evidence to suggest that the right to redemption is a useless right, seldom, if ever, used by debtors.[233] It would probably be a fair exchange for debtors to give up some redemption rights in exchange for much-needed deficiency judgment relief.

At a bare minimum, debtors need to be able to elect between strict foreclosure and foreclosure by sale. After all, strict foreclosure was the starting point from which the courts created judicial

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230. *Chunkapura*, 226 Mont. 54, 64, 734 P.2d 1203, 1209 ("a subject which is deserving of the immediate attention of this legislature which is now sitting in session"); *see also Galleria I*, 239 Mont. 250, 257, 780 P.2d 608, 612 ("we recommended the attention of the legislature. . . [but] the legislature has met twice in regular session since *Chunkapura* and has undertaken no action regarding the subject").

231. The following states have statutes requiring a fair market value basis for deficiency judgments: ARIZ. REV. STAT. ANN. § 33-814(A) (1990); CAL. CIV. PROC. CODE § 580a (West 1992); *id.* § 726; GA. CODE ANN. § 44-14-161 (Michie 1991); IDAHO CODE §§ 6-108, 45-1512 (1991); MICH. COMP. LAWS ANN. §§ 27A.3170, .3280 (1991); NEB. REV. STAT. § 76-1013 (1991); NEV. REV. STAT. §§ 40-457, -459 (1991); N.J. STAT. ANN. § 2A:50-3 (West 1991); N.Y. REAL PROP. ACTS. LAW § 1371 (McKinney 1991); N.C. GEN. STAT. § 45-21.36 (1991); N.D. CENT. CODE § 32-19-06 (1991); OKLA. STAT. tit. 12, § 686 (1992); PA. STAT. ANN. tit. 12, §§ 2621.1, .6 (Purdon 1991); S.D. CODIFIED LAWS ANN. §§ 21-47-16, -48-14 (1991); UTAH CODE ANN. § 57-1-32 (1991); WASH. REV. CODE § 61.12.060 (1992); WIS. STAT. § 846.165 (1991). *See generally* Stefan A. Riesenfeld, *California Legislation Curbing Deficiency Judgments*, 48 CAL. L. REV. 705 (1960); Jon W. Backes, *Mortgages—North Dakota's Anti-Deficiency Statute Defined*, 65 N.D. L. REV. 127 (1989).

232. *KSW*, 238 N.W.2d 123, 125-26.

233. *Rainer*, 209 Cal. Rptr. 294, 299; *see* William O. Prather, *Foreclosure of the Security Interest*, 1957 U. ILL. L.R. 420, 452 (reporting studies showing that only 0.927% of foreclosed properties are redeemed, only 7% of deficiency judgments are realized, and in 99.3% of the public sales, the mortgagee is the lender).

sales and deficiency judgments with the hope of benefiting debtors. If mortgage reform cannot take a step forward, it might be preferable to allow debtors to choose to take the step backward into strict foreclosure.

Perhaps a true step forward can be found in a recent proposal to scrap the current foreclosure system in favor of one similar to the British system. The British courts have never allowed mortgagees to bid in at foreclosure sales.[234] Instead, a mortgagee must sell the property to a third party in order to realize a return of investment. As Professor Berger suggests, the mortgagee would probably sell the property at the highest possible price if some economic incentive to do so existed.[235] Allowing the mortgagee a percentage of the excess profit above all liens, fees and commissions might provide such an incentive. Professor Berger also suggests that the "percentage should range downward from perhaps 40% of amounts up to $25,000, to 25% of amounts over $100,000. For very large amounts, even a smaller percentage might be appropriate."[236] This method of foreclosure allies the interests of the mortgagor and the mortgagee. A high resale price rewards mortgagee with a profit on the sale and returns a greater share of mortgagor's equity than if the mortgagee made a low bid at a foreclosure sale.

Another recent scholarly proposal is to legislate mandatory resale reporting during the year following judicial confirmation of the foreclosure sale.[237] The mortgagee would submit a resale reporting form to both the mortgagor and the court, and would detail both the mortgagee's expenses and the mortgagee's profit on the sale. The mortgagee would then return all profit less expenses to the mortgagor. Professor Wechsler's proposal has the additional benefit of requiring a simple, out-of-court paper transaction. Professor Wechsler argues that "[r]equiring mortgagees to fill out a standardized reporting form would be a small price to pay to reduce the injustice of mortgagees retaining profits that belong to mortgagors."[238]

The message which the Montana courts have been trying to convey to the Montana Legislature is that deficiency judgment relief is needed in Montana. A review of the statutes, cases, and scholarship from other jurisdictions shows that there are solutions

234. Lawrence Berger, *Solving the Problem of Abusive Mortgage Foreclosure Sales*, 66 NEB. L. REV. 373, 379 (1987).

235. Berger, *supra* note 234, at 379-80.

236. Berger, *supra* note 234, at 380.

237. Wechsler, *supra* note 1, at 889-90.

238. Wechsler, *supra* note 1, at 890.

readily available to provide Montana's small businesses and commercial investors with the deficiency relief they need.

V. CONCLUSION

In *FSLIC v. Hamilton*, the Montana Supreme Court has taken a step away from its decision in *Galleria I*. Although *Chunkapura* is still firmly in place with respect to occupied, single-family residential property, the court's interpretation of the Small Tract Financing Act as applied to commercial property is not yet clear. But *FSLIC v. Hamilton* would indicate that the court will not look favorably upon any request for remand to recalculate a deficiency judgment based upon fair market value.

If the court remains hesitant to remand for fair market value calculations, commercial borrowers may find themselves unable to recover their equity in foreclosure actions. In addition, commercial borrowers may find that lenders are more likely to accelerate loans and institute foreclosure proceedings than they were previously. Eagerness to foreclose upon commercial deeds of trust may be the end result of the *Hamilton* and *Galleria II* courts' reluctance to remand for fair market value calculation of deficiency judgments. Defaulting commercial borrowers might prevent the inequity of a double recovery on the part of the lender by carefully documenting the fair market value of the property at the time of foreclosure sale and requesting that the lower court determine the equities between the parties in light of the fair market value. Using the *Galleria II* definition of "intrinsic value," the debtor should prove the value of the property at the time of the foreclosure sale, undiminished by the effects of foreclosure. In the future, creating such proof at the district court level may be required by the Montana Supreme Court before it will entertain arguments regarding fair market value.

Statutory anti-deficiency relief is available in other jurisdictions and should be made available to the small businesses and commercial investors of Montana. Not surprisingly, this idea is not popular with Montana lenders, who do not see themselves as making profits on mortgage foreclosures.[239] In truth, Montana lenders may not make a net profit on mortgage foreclosures.[240] But what

239. Hearings on S.B. 223 Before the Committee on Business and Industry, 52nd Leg., Reg. Sess. (Feb. 5, 1991) (testimony of Jock O. Anderson, Montana League of Savings Institutions).

240. *Cf.* Wechsler, *supra* note 1, at 853 n.19:

Local bankers and bank attorneys repeatedly expressed [the sentiment that mortgagees who purchase at foreclosure sales always suffer losses] . . . . These bank

needs to be understood is that even the occasional profit by a mortgagee visits an extreme hardship on an already distressed mortgagor. In discussing this issue, Professor Wechsler states that:

> Lenders probably will resist any change in the statutory process, arguing that overall, losses on foreclosures exceed gains and that, thus, they should be permitted to retain the occasional gain to offset greater losses. This argument is not convincing. First, while mortgagees may as a class sustain net losses on foreclosures, many mortgagees achieve net profits. More importantly, each mortgage transaction is independent of all others; a lender should not be allowed to make up a loss on one transaction by unfairly retaining a profit on a separate and unrelated transaction.
>
> Lenders might also argue that the interest rates they charge incorporate not only the anticipated losses, but the prospect of occasional profits, and that the cost of credit would rise if they were not allowed to retain those profits. The numbers and amounts of these profits probably are not large enough to significantly affect the lending practices of major institutions. Nevertheless, it is inappropriate to reduce interest rates generally, at the expense of a relatively small number of financially distressed homeowners. In this connection it is worth reemphasizing that the drafters of our foreclosure by sale statutes never intended lenders to receive these profits.[241]

Professor Wechsler's statements about New York homeowners aptly describe the plight of Montana's small business and commercial investors, many of whom are unsophisticated and unable to afford legal counsel at crucial stages of their business and real estate transactions. These small businesses and commercial investors contribute significantly to Montana's economy and deserve the protection of Montana's judiciary and legislature.

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officials and their counsel, who work with mortgage foreclosures and the management and resale of properties acquired in foreclosure, appear to sincerely believe that 'lenders always lose in foreclosures.' This may be because, when taken as a group, losses do outweigh gains. . . . Bankers usually reacted with surprise at evidence of profits from the resale of foreclosed property and characterized such profitable transactions as nonrecurring oddities.

241. Wechsler, *supra* note 1, at 886.