The Wisconsin Supreme Court Rules That Guarantors Are Not Bound by Fair Value Determined at a Confirmed Foreclosure Sale

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The Wisconsin Supreme Court recently ruled that the mortgagor—but not the guarantor—is bound by the foreclosure court confirming a sheriff's sale for fair value. The author of this article explains the decision and why it caused mortgage lenders to shudder.

The Wisconsin Supreme Court recently issued a decision which caused Wisconsin mortgage lenders to shudder. In *Horizon Bank, N.A. v. Marshalls Point Retreat LLC*,[1] the court ruled that the mortgagor—but not the guarantor—is bound by the foreclosure court confirming a sheriff's sale for fair value. This is the case even if the mortgagor and the guarantor are both defendants in the same action, and the guarantor does not object to the court's determination that the sale was for fair value. Because foreclosures are governed by a statute and guaranties are contracts, the circuit court is free to separately consider the amount of credit to be applied to the guaranty in the same or a different proceeding. In the wake of *Marshalls Point*, mortgage lenders are scrambling for a solution to avoid having to litigate the fairness of the foreclosure sale price twice.

The Facts

Horizon Bank loaned $5 million to Marshalls Point Retreat LLC ("Marshalls Point"), secured by a mortgage on property located in Sister Bay, Wisconsin. Allen S. Musikantow, a member of Marshalls Point, signed a guaranty of payment of the loan. The guaranty provided that "federal law applicable to lender and to the extent not preempted by federal law, the laws of the State of Indiana" would govern the rights of Musikantow, who lived in Florida. In the foreclosure action, Marshalls Point and Musikantow stipulated to the entry of judgment against them by Horizon Bank in the amount of $4,045,555.55.

The parties also agreed in the stipulation that the amount paid to the bank from the proceeds of the sale of the property would be credited as payment on the judgment.[2] At the sheriff's sale, Horizon Bank credit bid

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$2,250,000 for the property. The bank moved the court to confirm the sale as being for "fair value" pursuant to Wisconsin Statutes Section 846.165. The bank also waived its deficiency claim against Marshalls Point (thereby reducing the redemption period),[3] and sought to have the bid amount credited towards the judgment against Musikantow.

At the confirmation hearing, Musikantow did not object to the confirmation of the sale, but sought language in the confirmation order that said confirmation would not have any collateral estoppel or *res judicata* effect against Musikantow, asserting that the property was worth more than $10 million. Musikantow further stated he had a witness in the courtroom prepared to testify to the higher value. However, the court adjourned the hearing, and the witness never testified.

At the adjourned hearing, Musikantow said that, although he could produce evidence of value, the evidence was unnecessary because the guaranty provided that federal and Indiana law governed. He also noted that Horizon Bank had commenced a federal lawsuit in Florida to domesticate the judgment against him. The circuit court confirmed the sale, entering an order finding that the $2.25 million price was a "fair and reasonable value for the property."[4] However, the court declined to rule on the amount of credit to be applied against the guaranty because, under the guaranty's governing law provision, the court said the Florida court would decide this issue. A second order to this effect was issued a month later, and the bank appealed. The court of appeals reversed, and Musikantow appealed to the Wisconsin Supreme Court.

The Wisconsin Supreme Court Decision

Justice Ann Walsh Bradley wrote the Wisconsin Supreme Court's opinion reversing the court of appeals. Justice Bradley reviewed the facts and concluded that, while Wisconsin Statutes Section 846.165 governs the procedure for confirming a sheriff's sale on foreclosed property, it only determines the fair value of the premises to be applied to the mortgage debt.[5] The plain language of the statute, said the court, "does not apply to a judgment obtained against a third-party guarantor."[6] The guarantor's liability arises not from the mortgage debt, but instead from a contract between the guarantor and the lender.[7]

Moreover, the question of fair value for the purposes of confirming a sheriff's sale under Wisconsin Statutes Section 846.165 is different from the question of a credit a guarantor receives when the foreclosed property is conveyed by a sheriff's sale. "Fair value," for the purposes of a sheriff's sale, is a value which will not "shock the conscience."[8] By contrast, the amount of a credit due to a guarantor is governed by the contract between the guarantor and the lender.[9] Consequently, relying upon *Crown Life Insurance. Co. v. LaBonte*[10] (where the guarantor was sued for the remaining unpaid amount after the subject mortgage was foreclosed and the property sold), the court held that the actions on the mortgage debt and the guaranty can proceed on separate tracks, either in the same or separate actions. Additionally, decisions regarding proper credit to be applied to the mortgage debt and to the guaranty obligation may be rendered at the same or different times.[11] Because foreclosures are equitable proceedings, in "the circuit court's discretion it could

be fair to speedily confirm the sale when there will be no deficiency judgment against the mortgagor, while leaving the determination of the credit toward the guaranty for another day," as the circuit court did here.[12] The circuit court properly exercised its discretion in decoupling these issues.[13]

The court then turned to the stipulation between the parties. In the stipulation,[14] the court said Musikantow conceded that Horizon Bank's credit bid of $2.25 million constituted "fair value" for the property.[15] However, the court found that Musikantow never conceded this dollar amount was the amount of credit he was due in connection with the guaranty.[16] Although the stipulation mandated the amount of the winning bid be credited against the Musikantow judgment, the stipulation did not state it must be the *exclusive credit* to be so applied.[17] Rather than providing that the sheriff's sale proceeds be the sole credit to be applied to the Musikantow judgment, the court read the stipulation as providing a "floor" on the credit due, but not a "ceiling."[18] Responding to the dissent's assertion that such a reading would upset the parties' reasonable expectations, in what may prove to be an important footnote, the court suggested its "decision should serve to drive the banks and guarantors to write clearer stipulations that unambiguously reflect their intentions if they truly intend to resolve the full credit amount by stipulation."[19]

The Dissent

Justice Rebecca Grassl Bradley rendered a sharp dissent, raising several points. The dissent found the stipulation between the parties to be unambiguous: It compelled the circuit court to apply the sheriff's sale proceeds as the appropriate credit toward the judgment against Musikantow. Although Musikantow explicitly reserved his rights in the stipulation to litigate fair value prior to confirmation of the sheriff's sale, he failed to do so, thereby waiving those rights.[20] The stipulation included no provisions leaving the determination of the credit to be applied toward the guaranty "for another day," or providing that the sheriff's sale set a floor but not a ceiling on the credit due.[21] The stipulation in fact resolved all claims and defenses between the parties.[22] The only bases for a court to decline to enforce a stipulation are (1) where the stipulation was not formalized pursuant to Wisconsin Statutes Section 807.05, or (2) in a case of plain fraud, mistake or oppression. Neither applied here.[23]

The dissent also took issue with the majority's failure to recognize that, once the stipulation was signed and the order confirming the sale was entered, there was no reason to interpret the guaranty's choice of law provision which seemed to so bedevil the circuit court. The stipulation and order "superseded the guaranty not only on the issues of choice of law and venue but in its entirety, and the stipulation and order constituted the parties' exclusive agreement on the terms governing application of any credit toward the monetary judgment against Musikantow."[24] Additionally, stated the dissent, the majority failed to comprehend the purpose of Horizon's domestication action in the Florida federal district court. That proceeding was solely to enforce the Wisconsin court's judgment against Musikantow, and the district court lacked jurisdiction to resolve the credit issue.[25]

Finally, the dissent asserted, that the court's reliance on the *Crown* decision was misplaced. In *Crown*, the guarantor was sued in a sepa-

rate action commenced only after the foreclosure and the sheriff's sale, and not being a party to the foreclosure action, the guarantor had no opportunity to contest fair value.[26] The dissent pointed to the court of appeals decision of *McFarland State Bank v. Sherry*[27] as being more analogous. In *McFarland,* the mortgagor and the guarantor were sued in the same action and the bank successfully submitted a winning credit bid of $147,000. The bank asked the court to apply a lesser credit against the guarantor, citing *Crown.* Rejecting the bank's argument, the *McFarland* court ruled that, where the guarantor is party to the foreclosure proceedings, it did not make sense to "calculate [ ] a guarantor's liability based on a property value different than the price for which the property originally sold at a sheriff's sale."[28]

While *McFarland* did not control the case at bar, said the dissent, the stipulation and order did. Tying the sheriff's sale proceeds to the offset applied against the guarantor's liability as provided for in the stipulation and order, was consistent with *McFarland's* rationale that the determination of fair value controls as to both the mortgagor and guarantor where the mortgagor and guarantor are co-defendants, and the guarantor has the right to contest fair value before confirmation of the sale.[29] The dissent continued,

> By ignoring *McFarland* and casting aside the Stipulation and Order, the majority, under the guise of equity, jettisons fundamental rules governing the interpretation of settlements and civil procedure that previously informed settlements of the sort reached by the parties in this case . . . This ruling is without precedent but now puts lenders, debtors and guarantors on notice that even a stipulated settlement, signed court order, and entered judgment will not bind a court to its terms and may be disregarded and rewritten by the circuit court.[30]

Conclusion

The *Marshalls Point* decision has roiled the Wisconsin mortgage lending industry. The court ruled that, even where a mortgagor and a guarantor are sued in the same action, and where both defendants stipulate to judgment of foreclosure, and the guarantor does not contest the fair value derived from a sheriff's sale before confirmation, the guarantor is free to argue that it is entitled to a greater credit against the guaranty—virtually guaranteeing further litigation.

In a footnote, the court suggested the outcome might be different if any stipulation between the parties is written clearly enough to provide that the credit to the mortgagor arising from the foreclosure sale is also the *sole and exclusive* credit due to the guarantor. Following *Marshalls Point,* one must ask why a guarantor would give up its potential right to a second bite at the apple by entering into such a stipulation—especially if the guarantor believes the foreclosed premises has greater value than that which might be derived by the lender's credit bid? Should the lender try to obtain such an agreement in the guaranty itself and would such an agreement be enforceable? Without knowing the answers, lenders may be well advised to revise their forms of guaranties, forbearance agreements, and reaffirmation agreements, and draft stipulations extremely carefully.

NOTES:

[1] *Horizon Bank, National Association v. Marshalls Point Retreat LLC*, 2018 WI 19, 380 Wis. 2d 60, 908 N.W.2d 797 (2018).

[2] The stipulation provided in paragraph 11:

> [t]he amount paid to [Bank] from the proceeds of said sale of the Premises, remaining after deduction by [Bank] of the

amount of interest, fees, costs, expenses, disbursements and other charges paid or incurred by [Bank] not included in the monetary judgment against [Musikantow] (set forth below) shall be credited by [Bank] as payment on said monetary judgment. *Id.* at ¶ 10.

[3]*See* Wis. Stat. § 846.103(2).

[4]*Marshalls Point*, 2018 WI 19, at ¶ 23.

[5]Wisconsin Statutes Section 846.165(2) provides:
In the 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.* (Emphasis added).

[6]*Marshalls Point,* 2018 WI 19, ¶ 34.

[7]*Id.* ¶ 35.

[8]*Id.* ¶ 38, quoting *Bank of New York v. Mills*, 2004 WI App 60, ¶ 18, 270 Wis. 2d 790, 678 N.W.2d 332 (Ct. App. 2004).

[9]*Id.* ¶ 37–39.

[10]*Crown Life Ins. Co. v. LaBonte*, 111 Wis. 2d 26, 330 N.W.2d 201, 36 U.C.C. Rep. Serv. 1232 (1983).

[11]*Id.* ¶¶ 42–43.

[12]*Id.* ¶ 44.

[13]*Id.* ¶ 58.

[14]*See* note 2.

[15]*Horizon Bank, National Association v. Marshalls Point Retreat LLC*, 2018 WI 19, ¶ 49, 380 Wis. 2d 60, 908 N.W.2d 797 (2018).

[16]*Id.* ¶ 55.

[17]*Id.* ¶ 50.

[18]*Id.* ¶¶ 53–54.

[19]*Id.* ¶ 53 n.10.

[20]*Id.* ¶ 87.

[21]*Id.* ¶ 94.

[22]*Id.* ¶ 82.

[23]*Id.* ¶ 81.

[24]*Id.* ¶ 84.

[25]*Id.* ¶ 85.

[26]*Id.* ¶¶ 89–90.

[27]*McFarland State Bank v. Sherry*, 2012 WI App 4, 338 Wis. 2d 462, 809 N.W.2d 58 (Ct. App. 2011).

[28]*Id.* ¶ 30.

[29]*Horizon Bank, National Association v. Marshalls Point Retreat LLC*, 2018 WI 19, ¶ 90, 380 Wis. 2d 60, 908 N.W.2d 797 (2018). The majority took issue with this, noting that *McFarland* did not interpret a stipulation like the one in *Marshalls Point.* Moreover, the majority said that *McFarland* "did not conclude that a guarantor's credit must always be equal to the circuit court's fair value determination at the confirmation sale. This is entirely consistent with our determination that the stipulation language in this case constitutes a floor not a ceiling for the credit amount." *Id.* ¶ 54 n.11.

[30]*Id.* ¶ 92.