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GOOD NEWS FOR LENDERS: WISCONSIN SUPREME COURT STRENGTHENS LENDERS' REMEDIES AGAINST GUARANTORS

By Matthew P. Gerdisch of *Kohner, Mann & Kailas, S.C.*

The Wisconsin Supreme Court recently issued a decision that clarifies an important part of foreclosure law. The decision is advantageous for lenders that seek not only to foreclose on real estate collateral, but also preserve their right to collect from guarantors.

Wisconsin law allows a lender to shorten the redemption period on a foreclosure of commercial real estate¹ from six (6) months to three (3) months if the borrower agreed in writing (usually by way of a clause in the mortgage) to the provisions of Section 846.103(2) of the Wisconsin Statutes. In order to utilize the shortened redemption period, however, the statute requires the mortgagee (the lender) to elect in the lender's foreclosure Complaint to waive judgment for any deficiency against "every party who is personally liable for the debt secured by the mortgage." The borrower on the business note is a "party who is personally liable for the debt secured by the mortgage" and, by application of the statute, the borrower would be free of a deficiency judgment if the mortgagee (the lender) made the Section 846.103(2) election. But what about the guarantor of the business note? Is the guarantor "personally liable for the debts secured by the mortgage" and therefore free of the debt too? This was a question without a clear answer until very recently. Previously, the "safe" course of action to preserve the claim against the guarantor was to proceed under the longer six month redemption period and not waive the deficiency claim in the foreclosure action. However, the **Wisconsin Supreme Court** in a very recent decision, in *Bank Mutual v. S.J. Boyer Construction, Inc.* 2010 WI 74 (July 9, 2010), **ruled that the lender can elect the three month redemption period, waive the judgment for deficiency against the borrower, and still retain the right to obtain judgment against the guarantor for the full amount of the guaranteed debt.**



¹ Section 846.103(2) applies to real property other than a one-to-4 family residence that is owner-occupied at the commencement of the foreclosure action, a farm, a church or a tax-exempt nonprofit charitable organization.

In the Boyer case, Bank Mutual sued the borrower (S.J. Boyer Construction, Inc.) for foreclosure on five business notes secured by mortgages on five properties. The Complaint also included a separate claim for relief against two guarantors (Steven Boyer and Marcy Boyer) on an unlimited Continuing Guaranty of all debts and obligations of the borrower to the bank. The foreclosure Complaint stated that the bank waived any deficiency claims against the borrower. The amount due the bank exceeded \$1.4 million. The bank obtained summary judgment and after the three month shortened redemption period expired, the properties were sold at Sheriff's Sale. The bank was the only bidder and purchased the properties for \$1,180,000.00. The borrower and the guarantors objected to confirmation of the sales and sought relief from the judgment because the bank elected the shortened redemption period but the judgment did not waive deficiency judgment against the guarantors. The trial court overruled the objections and denied the request for relief from the judgment finding, in part, that the guaranty was a contract separate from the business notes and provided an independent basis for the guarantors to be liable to the bank, in spite of the language of Section 846.103(2) requiring waiver of deficiency against parties "personally liable" for the debts. The borrower and the guarantors appealed the trial court's decision to the appellate court.

The appellate court, in a unanimous decision, overruled the trial court. The appellate court found that the guaranty was a guaranty of payment and that the guarantors were personally liable for the debts secured by the mortgage. As a result, the appellate court ruled that Bank Mutual could not reap the benefit of the shorter redemption period and obtain judgment for deficiency against the guarantors. Bank Mutual appealed the appellate court decision to the Wisconsin Supreme Court.

The Wisconsin Supreme Court, in a majority decision (two justices dissented and one did not participate in the decision) reviewed, among other things, the statutory lineage of the present foreclosure statute and found that the phrase "personally liable for the debt secured by the mortgage" is a legal term of art that does not include a guarantor. The Court explained that the



borrower was "personally liable for the debt secured by the mortgages" because it signed the business notes that evidenced the debt secured by the mortgages. By contrast, the guarantors did not sign the notes secured by the mortgages; instead, the guarantors were "personally liable" on their contract of guaranty. The Court explained that when "a guarantor's liability arises from a completely separate contract of guaranty, the guarantor is not personally liable for the debt secured by the mortgage, and, in such a case, neither a guaranty of payment nor a guaranty of collection comes within the scope of the redemption statute." The Court concluded

"that a mortgagee who forecloses under the shortened redemption period of Section 846.103(2) does not forfeit the right to obtain a judgment against the guarantor of payment even though [the mortgagee] must waive its right to collect any deficiency from the [borrower]". The question is now answered and under Wisconsin law a lender can elect the shortened redemption period (and waive judgment for any deficiency against the borrower or co-signer of the note) but the lender does not waive the lender's right to seek full payment from the guarantor of all guaranteed obligations.

RESULT: The Supreme Court's decision will allow lenders to accelerate the foreclosure process making the three month redemption period election a readily available option even when the lender holds guaranties. Nevertheless the Boyer decision brings to mind a few "practice points."

In the first instance, a lender cannot make the Section 846.103(2) election to shorten the redemption period unless the mortgagor agreed in writing at the time of the execution of the mortgage to the provisions of Section 846.103(2). Likewise, Section 846.101 is a corresponding statute that allows for shortening the redemption period from 12 months to 6 months for other types of properties.² The best practice is for the lender to include within the terms of the mortgage the lender's right to make the election under both of the Wisconsin Statutes.

Second, lenders should keep in mind that if the lender makes the Section 846.103(2) shortened redemption period election, the statute states that the mortgagee (the lender) "consent[s] that the mortgagor, unless he or she abandons the property, may remain in possession of the mortgaged property and be entitled to all rents, issues and profits therefrom to the date of confirmation of the sale by the court." If the mortgaged property is generating rental income from tenant leases, and the lender makes the shortened redemption period election, the lender may be giving up the opportunity to collect rents during the shorten redemption period. There are unpublished court decisions, not binding on other courts, which have allowed a lender to elect the shortened redemption period but nonetheless assert a claim to the rents and profits where the lender also held, separate from the mortgage, an assignment of rents and leases agreement. However, such a claim to the rents and profits in such circumstances remains uncertain in Wisconsin foreclosure law and consequently a lender must keep in mind that by making the shortened redemption period election, the opportunity to collect the rents and profits during the redemption period may be lost.



Third, the *Boyer* case does not address a situation where a mortgage secures the guaranty. For example, suppose the owner of the borrower-business provides a personal guaranty of the business note and the owner also provides the lender a mortgage on the owner's home to secure the guaranty (instead of the business note). In that scenario it appears the guarantor is personally liable for the debt (the guaranty obligation) secured by the mortgage and an election by the lender of the shortened redemption period in the foreclosure of the owner's home might result in a court ruling that the lender must also waive judgment for deficiency against the guarantor.

Lastly, the *Boyer* decision also does not address the situation where a borrower waives by contract the right to be free from a deficiency judgment in the event of a shortened redemption period. For example, in a loan "work-out" situation, a forbearance agreement might include a provision whereby the borrower agrees that, in the event of a later foreclosure action, the redemption period will be shortened but that the lender shall have the right to obtain a deficiency judgment against the borrower. Do the provisions of Section 846.103(2) "trump" such an agreement and free the borrower of a judgment for deficiency despite the borrower's consent to deficiency liability? Or, is the forbearance agreement an enforceable waiver of the borrower's opportunity to be free of a deficiency judgment under the statute? These will be questions to be answered by other cases.

² Section 846.101 applies to real property that is a one-to-4 family residence that is owner occupied at the commencement of the foreclosure action, a farm, a church or tax-exempt nonprofit charitable organization and the foreclosure action is on a mortgage against real estate of 20 acres or less.

Lenders should give a cheer for the *S.J. Boyer Construction* decision. The decision clarifies lender's rights against guarantors and enhances alternatives in enforcing their foreclosure and guaranty rights. If you would like a copy of the *S.J. Boyer Construction* decision (but be warned it is 66 pages) or would like to discuss the impact of the decision on foreclosure strategies, please contact Matthew P. Gerdisch of our office.

If you have any questions relating to this article please contact the author, **Matthew Gerdisch**, at mgerdisch@kmksc.com or on (414) 962-5110. Mr. Gerdisch is the head of KMKSC's Banking and Bankruptcy department and is Board Certified—Business Bankruptcy Law and Creditors' Rights Law by the American Board of Certification.



About Kohner, Mann & Kailas, S.C.

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