20090214

IN THE SUPREME COURT

STATE OF NORTH DAKOTA

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STATE OF NORTH DAKOTA

First International Bank & Trust, Appellant/Plaintiff, vs. D. Duane Peterson, MID AM Group, LLC, James R. Bullis, Kevin L. Christianson, Richard R. Jordahl, Douglas H. Peterson, Arlan H. Anderson, Greg Anderson, and Robert Green, Appellees/Defendants.	Supreme Court No. 20090214

BRIEF OF APPELLEES/DEFENDANTS ANDERSON, ANDERSON & GREEN

On Appeal from Judgment and Order of the District Court
East Central Judicial District
Cass County, North Dakota
Cass County Civil No. 09-07-C-04280
The Honorable Frank L. Racek

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STATEMENT OF THE ISSUES

[1] Is a personal guaranty extinguished when the lender purchases the underlying mortgaged property for the full amount of the underlying debt without establishing the fair market value or any deficiency as allowed by N.D.C.C. § 32-19-06.1?

STATEMENT OF THE FACTS

[2] In 2006, MID AM Group, LLC, ("MID AM") borrowed money from the Appellant, First International Bank ("FIB") to construct some 50 condominium units known as Village Homes at Harwood Groves (the "Property"). (App. 65-69.) FIB secured the loans with mortgages on the Property. (App. 86-96.) FIB also obtained guaranties from the above-named Appellees.[1] (App. 110-13, 140-49.)

[3] The guaranties signed by Appellees Anderson, Anderson & Green ("Anderson Defendants") contain the following language:

> 1. . . . no act or thing, except full payment and discharge of all indebtedness, shall in any way exonerate the undersigned.
>
> . . .
>
> 7. The undersigned waives any and all defenses claims and discharges of borrower or any other obligor, pertaining to indebtedness, except the defense of discharge by payment in full.

(See, e.g., App. 144-45.) (emphasis added).

[4] MID AM eventually defaulted on the loans with FIB. (App. 12-13.) In October 2007, FIB brought a foreclosure action against MID AM and other entities with

[1] FIB implies that Appellees Anderson, Anderson, and Green were paid to act as individual guarantors. FIB, however, presented no admissible first-hand knowledge to support this assertion. In fact, nobody paid them to act as personal guarantors. This fact, however, is irrelevant to the current appeal.

liens on the property. (App. 182.) On October 25, 2008, FIB obtained a judgment against MID AM in the amount of $6,591,770.19. (App. 182-83.)

[5] On April 23, 2008, there was a sheriff's sale of the Property. (App. 203.) One party bid $6,000,000 for the Property. (App. 183.)

[6] FIB was the winning bidder at the auction. It bid the then full amount of the indebtedness, $7,325,313.08, to purchase the Property. (App. 183.)

[7] The Sheriff's Report of Sale accurately recorded that there was no deficiency. (Docket #30, Ex. B.)

ARGUMENT

[8] The District Court properly ruled that FIB's purchase of the Property for the full amount of its debt extinguished any liability under the personal guaranties. This decision was based on the clear precedent of this Court regarding the extinguishment of guaranties following the purchase of the mortgaged property for the full amount of the underlying debt. The District Court also rejected FIB's belated waiver and estoppel arguments, which were brought after the Anderson Defendants prevailed on summary judgment and were dismissed from the case. The waiver and estoppel arguments fail to establish the necessary elements of the claims. The District Court's decision should be affirmed.

I. FIB's Purchase of the Property for the Full Amount of its Debt Extinguished the Personal Guaranties.

[9] FIB is barred from obtaining any payment from the personal guarantors because it accepted the Property in exchange for its debt. As this Court has held, a personal guaranty only exists to insure the payment of the underlying debt. First Federal Sav. & Loan Ass'n v. Scherle, 356 N.W.2d 894, 896 (N.D. 1984). When the debt is paid, the personal guaranty is extinguished. Id. The debt can be paid through a satisfaction of

judgment against the principal debtor or through a discharge by foreclosure of the mortgage. Id. When a bank voluntarily converts its debt into property by bidding the full amount of its debt at a sheriff's sale, any liability under a personal guaranty is extinguished. Id. The District Court's opinion correctly applied these principles of law to this case, and its decision should be affirmed.

[10] These longstanding principles were set forth by this Court in 1984 in a case remarkably similar to the instant action. In Scherle, First Federal loaned East Plaza Development $1.42 million, obtained a real estate mortgage as collateral, and also obtained four personal guaranties. Id. at 895. When East Plaza Development defaulted on the loan, First Federal served the personal guarantors with a lawsuit, just as FIB did here. Id. While the lawsuit against the personal guarantors was pending, First Federal obtained a judgment of foreclosure on the real estate mortgage and then bid in the full amount of its judgment to purchase the real estate at the sheriff's sale. Id. Again, that is precisely what FIB did here.

[11] In the following passage from the opinion, this Court explained why the bank's purchase of the real estate extinguished the personal guaranties:

> In this case First Federal satisfied its mortgage by purchasing the mortgaged property for the amount of the underlying debt, which had been reduced to a foreclosure judgment. Thus, First Federal voluntarily converted the debt into property by taking the mortgaged property in satisfaction of the debt. As a result, the primary debt which the defendants guaranteed to pay was discharged. Because one cannot guarantee payment on a nonexistent debt, the defendants' individual guarantees were extinguished when First Federal purchased the property for the judgment amount.

Id. at 896 (emphasis added).

[12] FIB also chose to satisfy its mortgage by taking the Property for the full amount of the underlying debt. As in Scherle, all of the individual guaranties here are thus extinguished.

[13] The legal principles set forth in Scherle were reaffirmed by this Court sixteen years later in Principal Residential Mortgage, Inc. v. Nash, 2000 ND 21, 606 N.W.2d 120. In Nash, Principal Residential Mortgage ("Principal") held a mortgage and brought a foreclosure action. Principal bid in the full amount of the debt, plus attorneys' fees. Accordingly, as attorneys' fees, however, could not properly be recovered under N.D.C.C. § 28-26-04, Principal had actually bid in an amount in excess of the recoverable debt and thus created a surplus.

[14] Nash, the debtor, sought to recover that surplus. Principal contended that its "credit bid" was somehow legally different than a new or "green money" bid. Thus, Principal argued, no real surplus had been created and no amount was payable to Nash. This Court flatly disagreed. This Court explained that Principal's argument would render the sheriff's sale a "sham." Id. at ¶ 23. That is because the amount paid directly impacts statutory redemption rights. Id. at ¶¶ 22-23. Accordingly, a credit bid is just like receiving a bid from a third party, and the credit bid can create a surplus to be paid back to the debtor. Id. at ¶ 24. Thus, Principal's bid both extinguished the underlying debt and created a surplus. Id. at ¶¶ 22-23. This Court's holdings, as follows, are emphatic regarding the nature of a credit bid:

> PRM cites no authority for its novel assertion that a judgment creditor's "credit bid" is different from any other bid at a sheriff's sale and cannot result in a surplus. The amount of the creditor's bid has significant legal ramifications, particularly upon redemption rights. See N.D.C.C. § 28-24-02 (redemptioner may redeem by paying the purchase price plus costs and interest). If amounts not collectable through foreclosure proceedings were included in the bid of the judgment creditor and the debtor were forced to pay the bid amount to redeem, redemption rights which exist for

> the benefit of the mortgagor would be compromised. First State Bank of New Rockford v. Anderson, 452 N.W.2d 90, 92 (N.D. 1990).
>
> . . .
>
> PRM's suggestion the amount of its bid is inconsequential and can never result in a surplus would render the sheriff's sale a sham. Section 28-23-07, N.D.C.C., provides that "[a]ll sales of property under execution must be made at public auction to the highest bidder." When a creditor bids at a sheriff's sale, its bid is on the same footing as other bids. The creditor's bid is an offer to pay the specified amount for the property. If the creditor bids more than it is allowed to recover under the foreclosure judgment and sale provisions, there is a surplus. If there is no "real money" in the court's hands, the court can surely order the judgment creditor to tender the amount of its bid which exceeds the amount the creditor is entitled to recover from the proceeds of the sale.

Id. (emphasis added).

[15] The holding in Nash is applicable here. Although FIB did not create a surplus, its bid was like the bid of any other party at the foreclosure sale. Once it bid in the full amount of the debt, the debt was extinguished. Had it bid a penny more, it would owe money to MID AM. As the District Court held, FIB cannot seek further recovery of a debt that has been discharged as a matter of law.

[16] As it did below, FIB attempts to rely on Bank of Kirkwood Plaza v. Mueller, 294 N.W.2d 640 (N.D. 1980) to argue that it can still proceed to collect on the personal guaranties even though the debt has been extinguished. However, as this Court carefully explained in Scherle, the Mueller case does not stand for that proposition, and the District Court properly rejected FIB's interpretation of Mueller.

[17] In the Mueller case, the bank proceeded under the Short-Term Mortgage Redemption Act ("STMRA") to foreclose on the property subject to its mortgage. Id. at 642. When parties have agreed to proceed under the STMRA, the lender cannot seek a deficiency judgment. N.D.C.C. § 32-19.1-07 (1995). The personal guarantors argued that North Dakota's anti-deficiency statutes required the bank to first proceed against the

property, and any recovery against the guarantors should be limited to the difference between the amount of the debt and the fair market value of the property. Mueller, 294 N.W.2d at 642. This Court held that North Dakota's anti-deficiency statutes do not apply to guarantors in that setting and, accordingly, the bank could file a separate action against the guarantors. Id. at 643.

[18] To be clear, the only issue decided in Mueller was one of procedure, i.e., "whether or not the North Dakota anti-deficiency statutes precluded the Bank from bringing separate actions on both the mortgage and the guarantees." Scherle, 356 N.W.2d at 896-97. The issue presented in Scherle four years later, i.e., whether a lender's purchase of property for the judgment amount extinguished a guaranty, was not presented and not decided in Mueller. Id. at 897.

[19] In Scherle, this Court went to great lengths to address and point out the limited nature of the holding in the Mueller case. This Court pointed out that Mueller only answered the procedural question of whether a separate action could be commenced. This Court went on to note that the remainder of its opinion in Mueller was "merely dicta, and is not, in any way, controlling upon later decisions." Id. The Mueller case "does not constitute precedent to support" the argument that a lender can continue an independent action against a personal guarantor after the lender has purchased the mortgaged property for the foreclosure judgment amount. Id. After Scherle and Nash, Mueller has no application to the present case.

[20] In that regard, FIB was entitled, procedurally, to commence this action along with its foreclosure action. Once it bid the full amount of its debt, however, that debt was discharged or extinguished just as if a third party bid that amount. Nash, 2000

ND 21, ¶¶ 22-23, 606 N.W.2d 120; Scherle, 356 N.W.2d at 896.[2] Scherle and Nash make it clear that a creditor cannot both take the property with a full credit bid and still pursue collection of the discharged debt. Accordingly, the District Court's decision in this case should be affirmed.

II. The Anderson Defendants Did Not and Could Not Waive the Defense of Discharge.

[21] FIB focuses on the language of the guaranties in an attempt to convince this Court that the District Court was wrong and to distinguish the holding in Scherle. However, the language of the guaranty agreements signed by the Anderson Defendants in fact supports the conclusion that their liability under the guaranties has been extinguished. While the agreements do contain broad provisions regarding waiver of most defenses, the defense of discharge is retained. Because the underlying debt was discharged by payment in full to FIB through the conversion of the debt into the Property, under the plain language of the guaranties, the liability has been extinguished.

[22] A guarantor's liability cannot be expanded beyond the plain language of the guaranty contract. Gen. Electric Credit Corp. v. Larson, 387 N.W.2d 734, 736 (N.D. 1986). A waiver of any of the guarantor's rights can only be accomplished "by the most unequivocal language in the guaranty agreement." Id. (discussing the guarantor's rights with respect to impairment of collateral). Any ambiguous or uncertain terms in a guaranty agreement will be construed against the drafter. Id.

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[2]While the only North Dakota cases on this issue have all been cited in this brief, other jurisdictions also follow this rule. Several other jurisdictions have also held that the lender's purchase of the mortgaged property at a sheriff's sale for the full amount of the debt extinguished the personal guaranties: see, e.g., State Bank of Young Am. v. Fabel, 530 N.W.2d 858, 862 (Minn. Ct. App. 1995); Muscle Shoals Nat'l Bank v. Hallmark, 399 So.2d 297, 298 (Ala. 1981); Provident Nat'l Bank v. Thunderbird Assocs., 364 So.2d 790, 798 (Fla. Ct. App. 1978).

[23] In this case, the guaranties retain the defense of discharge. The agreements state that "full payment and discharge of all indebtedness" will exonerate the guarantors. (App. 140.) The defense of discharge is also expressly retained at paragraph 7 of the agreement. (App. 141.) At the sheriff's sale, FIB bid in the full amount of the indebtedness. Since this credit bid is the same as a bid by a third party, FIB has received full payment, and the debt is discharged. See Nash, 2000 ND 21, ¶¶ 22-23, 606 N.W.2d 120; Scherle, 356 N.W.2d at 896. By the express terms of the guaranties, any liability of the Anderson Defendants has been exonerated.

III. A Lone Eighth Circuit Case Interpreting a Far Different Contract Under Minnesota Law Has No Bearing on this Case.

[24] FIB's next argument that the guaranties have not been extinguished is based on an Eighth Circuit case interpreting Minnesota contract law, not mortgage foreclosure law. FIB argues that in Henning v. Mainstreet Bank, 538 F.3d 975 (8th Cir. 2008) the court found that a credit bid at a sheriff's sale is not the same as an actual "green dollar" payment. First, this case is not based on North Dakota law. Because this Court has two North Dakota cases, Scherle and Nash, that directly address the issue of the effect of a credit bid, there is no need for the Court to look to a federal court interpreting the law of another state.

[25] Second, Henning does not deal with extinguishment of guarantor liability by purchasing the property for the full amount of the debt at a foreclosure sale. In Henning, the court was merely interpreting a term in a contract. 538 F.3d at 978. Under the contract, the guarantor gave the bank a mortgage on his personal residence as partial collateral for the loan. Id. at 977. The guaranty contained the following language regarding this mortgage:

> *Notwithstanding the foregoing*, the Lender hereby agrees that when $200,000 of the outstanding principal balance of the Amended and Restated Note has been *paid*, Lender upon written request from the Guarantor, will agree to release the Mortgage.

Id. (emphasis in original). The guarantor argued that the word "paid" in this contract meant the mortgage on his home should be released when the bank "received" $200,000 towards the debt from any source. Id. at 978. The court disagreed. Under both the Minnesota version of the UCC and the dictionary definition, "paid" meant that a payment had to be made by or on behalf of a party obligated to make the loan payment. Id.

[26] In Henning, the bank had exercised its lien rights in equipment owned by the debtor and in the debtor's accounts receivable. Id. At the foreclosure sale, the bank received $140,000 on the equipment, and the bank collected $56,000 from the debtor's accounts receivable. Id. Because these payments were not "made by or on behalf of" the debtor, none of the money was "paid" to the bank, so the bank did not have to release the mortgage on the guarantor's property. Id. at 979.

[27] In this case, the Court is not being called upon to interpret the meaning of the word "paid" under a dictionary definition or the UCC. Instead, the issue is the legal effect of FIB's decision to bid the full amount of its debt for property under North Dakota law. Under Scherle and Nash, FIB's decision to take the property in exchange for the debt extinguished any further liability on behalf of the guarantors.

IV. North Dakota Provides a Procedure to Lenders if They Believe the Value of the Mortgaged Commercial Property Fails to Meet the Amount of the Debt.

[28] Finally, FIB argues that it was left with no choice but to bid in the full amount of its judgment to purchase the Property. This assertion is incorrect. Under North Dakota law, there is a statutory procedure for a lender to pursue individual

guarantors if it believes that the value of the mortgaged commercial property is insufficient to cover the amount of the debt. See N.D.C.C. § 32-19-06.1 (providing the method for valuing commercial real property in foreclosure proceedings).

[29] N.D.C.C. § 32-19-06.1 states, in part, as follows:

> In an action involving the foreclosure of a mortgage on commercial real property, the plaintiff shall state in the pleading whether a deficiency judgment will be sought and if sought shall identify the parties claimed to be personally liable . . . . Within twenty days after the completion of the appraisal, the appraiser shall provide the plaintiff and file with the clerk of court a written report, including the fair market value of the property. . . . . At the time of the entry of the judgment, the court shall include in its findings of fact the fair market value of the property and the amount of any prior liens on the property. . . . . In addition to the appraisal, the court in its determination of the fair market value of the property may consider affidavits from the parties or other proof of paramount liens and other matters that may affect the value.

[30] If a creditor thinks that the ultimate value of the mortgaged property will not equal the amount of the debt, it may pursue others for the amount of the deficiency. To begin this process for commercial real property, the creditor must first obtain an appraisal of the property. Id. Then the creditor must mail this appraisal to all parties who may be personally liable for the debt. Id. Any party who disputes the appraisal may submit an affidavit to the court. Id. The court then determines the fair market value of the commercial real property through consideration of the appraisal, the affidavits submitted, and any "other matters that may affect the value." Id. The deficiency is then limited to the difference between the court-determined fair market value and the amount bid at the sheriff's sale. Id. The creditor may then pursue any parties who were personally liable. Id.

[31] The purpose of this statute is to allow for full recovery to a creditor, but not surplus recovery. By way of example, if the underlying property is worth $4 million and the debt is $5 million, the deficiency is limited to $1 million against "the parties claimed to be personally liable." In that regard, N.D.C.C. § 32-19-06.1 specifically applies to all parties that may be liable, not just mortgagors. See First State Bank of Cooperstown v. Ihringer, 217 N.W.2d 857, 862 (N.D. 1974) (interpreting the meaning of parties "personally liable" in a similar deficiency judgment statute).

[32] FIB generally argues that this process was unavailable to it because anti-deficiency statutes do not apply to guaranties. This argument is incorrect for two reasons. First, in the sense that the anti-deficiency statutes do not apply to personal guarantors, it just means that guarantors cannot use them as a defense. First Nat'l Bank & Trust Co. v. Anseth, 503 N.W.2d 568, 574 (N.D. 1993). For example, if a creditor decides to pursue the guarantors for the debt first, a guarantor cannot use the anti-deficiency statutes to force the creditor to foreclose the mortgage first. Id. The Anderson Defendants are not doing that here. FIB has already made its choice by foreclosing on the mortgage first.

[33] Second, N.D.C.C. § 32-19-06.1 was explicitly available to FIB before it chose to make its full credit bid at the sheriff's sale. As explained above, N.D.C.C. § 32-19-06.1 applies to all parties that may be liable for the debt, which includes individual guarantors. See Ihringer, 217 N.W.2d at 862 (interpreting the meaning of parties "personally liable" in a similar deficiency judgment statute). Thus, FIB had this process available to it, and it chose not to pursue this remedy. Instead, it made the decision to take the property in exchange for the debt. That business decision does not allow FIB to then pursue the guarantors.

V. FIB Fails to Establish the Elements of Estoppel or Waiver Through its March 2008 or February 2009 Letters.

[34] FIB also argues that the Anderson Defendants should be estopped from arguing that the guaranties are extinguished or that they have waived that right based on letters sent to them by FIB's counsel on March 25, 2008, and February 11, 2009. FIB's theory is that a failure to advise an opposing party of the law or possible legal consequences of its proposed course of action triggers estoppel and waiver.

[35] Two required elements for estoppel are that the defendant engaged in "conduct which amounts to a false representation or concealment of material facts" and the reliance by the plaintiff on that false representation or concealment. Blocker Drilling Canada, Ltd. v. Conrad, 354 N.W.2d 912, 920 (N.D. 1984). Silence regarding facts can provide the necessary conduct element for an estoppel claim, but the silence must be when the defendant has a duty to speak. Birch Publ'ns, Inc. v. RMZ of St. Cloud, Inc., 683 N.W.2d 869, 873 (Minn. Ct. App. 2004) (citations omitted).

[36] In this case, FIB fails to point to any facts suggesting that the Anderson Defendants misrepresented or concealed from FIB. FIB only alleges that the Anderson Defendants failed to advise FIB of the legal effect of its decision to make a full credit bid at the sheriff's sale. Essentially, FIB is arguing that attorneys for the Anderson Defendants and other Defendants had a duty to advise their adversaries of the potential legal consequences of their adversary's conduct during litigation. This argument, if correct, would turn the legal system on its head.

[37] An attorney's obligation is to his or her own client, not to the opposing party. In re Disciplining Action Against Britton, 484 N.W.2d 110, 111 (N.D. 1992); N.D.R. Prof. Conduct preamble. An attorney has a duty to diligently and competently represent the client and part of that duty involves not creating additional liability for the

client through giving legal representation to the opposing party. See N.D.R. Prof. Conduct 1.1; 2.1. If the defense attorneys had advised FIB not to bid in the full amount of its indebtedness, thereby increasing their clients' liability, their clients would have a claim for malpractice against their attorneys. Simply put, the failure to provide legal advice to an adversary does not constitute a "concealment of material facts" necessary to establish the first element for an estoppel claim.

[38] If that theory had merit, attorneys would suddenly be required to advise adverse parties of all manner of potential issues. For example, an attorney presumably would need to tell opposing counsel of language that may not be beneficial in a contract, or that certain evidence may not be admissible at trial absent further foundation. That is not the law.

[39] The estoppel argument also fails on the reliance element. FIB did not change its position based on the silence of the guarantors following the March 25, 2008, letter. FIB explained in its March letter that it intended to bid at the sheriff's sale the full amount of the principal and interest due and any other sums "so that there will be no remaining indebtedness . . . ." (App. 228.) Following the lack of response to this March letter, FIB still bid in the full amount of the indebtedness at the sheriff's sale. There was no change in FIB's position, so it cannot establish the necessary reliance element for estoppel.

[40] To establish waiver, FIB must prove that the Anderson Defendants voluntarily and intentionally relinquished a known right or privilege. Pfeifle v. Tanabe, 2000 ND 219, ¶ 18, 620 N.W.2d 167. "Waiver may be found from an unexplained delay in enforcing contractual rights or accepting performance different than called for by the contract." Id.

[41] FIB does not, and cannot, point to any act of the Anderson Defendants that waived their rights. The extinguishment of their guaranties did not occur until the date of the sheriff's sale when FIB bid in the full amount of its indebtedness to purchase the real estate. See Scherle, 356 N.W.2d at 896 (stating that a personal guaranty is extinguished when a lender purchases the mortgaged property for the judgment amount). At the time the Anderson Defendants received FIB's March 25, 2008, letter, the guaranties had not yet been extinguished, so they could not have waived that right. Certainly, following the sheriff's sale, the Anderson Defendants have done nothing to waive this legal principle of extinguishment. As the District Court accurately held, there was no requirement that any of the personal guarantors respond to this March 25 letter. (App. 256.)

[42] FIB also argues estoppel and waiver based on its February 11, 2009, letter where it informed all the parties to the case that it would be filing a motion for summary judgment. Because the Anderson Defendants had already been dismissed from the case on December 18, 2008, they had no duty or reason to respond to this letter. (App. 186.) Thus, the 2009 letter cannot establish estoppel or waiver as to the Anderson Defendants.

CONCLUSION

[43] When FIB chose to purchase the mortgaged property for the full amount of its debt, it took the property in exchange for its debt and thereby extinguished the personal guaranties. This result is dictated by clear North Dakota precedent and nothing in the language of the personal guaranties contradicts this result. The Anderson Defendants had no duty to inform FIB of the legal consequences of its actions, so there is no estoppel or waiver.

[44] Beyond that, one party in litigation cannot create a waiver by advertising to an opposing party its intentions and then claiming silence created a waiver. Again, the

Anderson Defendants had no duty to advise FIB as to their view of North Dakota law or the merits, or lack thereof, of a motion for summary judgment. The Anderson Defendants respectfully request that the District Court's decision be affirmed.

Dated: September 25, 2009

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