Denver Law Review

Volume 27 | Issue 12 Article 6

June 2021

Deficiency Judgments - A Need for Revision

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DEFICIENCY JUDGMENTS—A NEED FOR REVISION

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Since the field of deficiency judgments is so closely allied with the broader field of chattel mortgages, any consideration of the problems arising under the former must be linked to the two lines of judicial authority concerning the effect of a chattel mortgage upon the title of the mortgaged properties. The real problems arising under deficiency judgments all seem to hinge upon the determination of which party holds legal title to the property.

In Colorado, and some other states, the mortgage is seemingly considered to be a conditional sale which allows the title to remain in the mortgagee.[1] Other jurisdictions view the mortgage as only a lien, with the title passing to the mortgagor until his default and foreclosure. In Colorado, the fact that title is considered to rest exclusively in the mortgagee enables him to repossess under the terms of the mortgage and offer the mortgaged security for sale without recourse to the courts. This "bypassing" of our courts presents the problem of whether or not the price received by the mortgagee at the sale of the mortgaged security was a fair and equitable one, for, in Colorado, the mortgagee is entitled to credit the proceeds of the sale to the balance owed him by the mortgagor and then sue for the deficiency.[2] Unless the mortgagor can show bad faith in the conduct of the sale, the sale price of the retaken property will stand as the credit to which he is entitled.[3]

Under the "equitable" rule, which prevails in other jurisdictions, the title to the property is in the mortgagor, and the only way in which the mortgagee can repossess and sell the security is to go into court and ask for a foreclosure of his lien. This brings the sale within the purview of the court and affords an opportunity for setting standards both as to the conduct of the sale and the determination of the fair value of the mortgaged security. It enables the court, for instance, to determine before sale what constitutes a fair price for the property. In Colorado, there can be no such standards since the court is seldom aware of the sale until it has already taken place. Due to the difficulty of obtaining accurate information as to reasonable price of a chattel when repossessed, the court must content itself with stating that mere inadequacy of the price obtained will not invalidate the sale. Neither do the courts seem particularly concerned when it can be shown that the chattel brought only a fraction of its true market value. It is true that in the case of automobiles the court may require that the mortgagor be given credit for the NADA[4] "blue

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[1] HELLERSTEIN, Chattel Mortgages In Colorado 1 (1935).

[2] *Id*, at 37.

[3] Ramstetter v. McGinnis, 100 Colo. 494, 68 P. 2d 454 (1937).

[4] National Automobile Dealers Association.

book" value. However, those familiar with the NADA handbook know that it seldom correctly reflects the actual market value in any given locality.

There also seems to be little objection in this state to the sale of the mortgaged security to wholesale dealers in the property. Some jurisdictions, adopting a more realistic view of such practices, held otherwise.[5] It would seem that even in Colorado this might be attacked on the ground that the mortgagee is obliged to obtain the most reasonable value under the circumstances and must do nothing to interfere with the obtaining of the highest possible bid for the benefit of the mortgagor.[6]

Probably the most harsh aspect of the chattel mortgage statute as it applies to deficiency judgments is the practice of allowing the "insecure" mortgagee to repossess the security almost at will. The rule in Colorado seems to be that the mortgagee has the right to determine for himself whether he is unsafe in his security, subject to the rather vague limitation that his judgment must be exercised in "good faith and upon reasonable grounds."[7] The injustices of this rule are readily seen when it is pointed out that under the so-called "insecurity clause"[8] the seller-mortgagee might well exact a large down payment as well as a mortgage note from the mortgagor and then, within twenty-four hours, repossess and sell the security. Again, the mortgagor would be compelled to accept the amount obtained from the sale of the security as a credit against the total of the note and might conceivably have to pay a deficiency judgment even though he had had the use of the property for only one day! In short, the mortgagor is completely at the mercy of the mortgagee. And all because of our insistence upon following an antiquated interpretation of the effect of a chattel mortgage!

Application of Equitable Rule

While it is to be admitted that the problem of preventing people from buying what they cannot afford defies present solution, many strides have been made in other states in an effort to reduce the adverse effects of repossession, re-sale, and deficiency awards on persons of reduced means. These jurisdictions follow the "equitable" view that the mortgage is only a lien; title remaining in the mortgagor until foreclosure. It might seem at first blush that we have strayed far afield from the specific subject of deficiency judgments; however, extensive research seems to indicate that the source of most injustices perpetrated upon the debtor-mortgagor is in the interpretation in various jurisdictions of the effect a mortgage has on ownership of the mortgaged security. For in those states where it is considered that the mortgagee has legal title to the property, there seem to be fewer legal obstacles to the mortagee's retaking his own property, and selling it at his own pleasure.

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[5] Universal Credit Co. v. Uhri, 101 S. W. 2d 501 (Mo. App., 1937).
[6] Colorado Nat'l Bank of Denver v. Navins, 82 Colo. 130, 257 P. 357 (1927).
[7] Thomas v. Beirne, 94 Colo. 429, 30 P. 2d 863 (1934).
[8] Hellerstein, *op. cit., supra,* at 39.

States following the so-called "equitable" rule recognize merely a lien by the mortgagee in the security and logically require that the repossession and sale be conducted under the watchful eye of both the court and the defaulting mortgagor. Louisiana, which follows the latter rule, provides, in all foreclosure actions, for the appointment of three appraisers. One of the appraisers is selected by the mortgagor, and the other two are chosen by the district judge having jurisdiction over the property. They are required to make a personal examination of the property that is appraised and by formal, authentic act, before a notary or clerk of court, an inventory is prepared setting forth the reasonable value of such chattels. In all cases, the appraisers appointed are disinterested parties and at least fairly familiar with the property they are called upon to appraise.[9] The Attorney General of Louisiana, in passing on the situation which arises when the mortgagee waives appraisement and proceeds with the sale, has stated the rule to be that, where a mortgagee or other creditor takes advantage of a waiver of the right of appraisement, the sale discharges the debt and the creditor thereafter has no right to proceed against the debtor or his other property for any remaining deficiency.[10] In the case of *Home Finance Service v. Walmsley*,[11] the Louisiana Appellate Court stated that a creditor who had disposed of the debtor's pledged automobile without appraisement and credited the proceeds on the debtor's note could not thereafter maintain suit for recovery of the remaining deficiency. The rule in Louisiana permits the security to be valued at close to "market value" and does not indulge in vague references to "reasonable value under the circumstances," a phrase finding common usage in our Colorado courts.

IOWA RULE

Although the rule which obtains in the Iowa courts does not provide as much protection to the debtor, it still seems infinitely superior to the rule in Colorado. Thus, under the Iowa Code, which adheres to the theory that only a lien is created in the mortgagee, it is held that personal property which is levied upon and advertised for sale on execution must be appraised before sale by two disinterested members of the community, one of whom shall be chosen by the execution debtor and the other by the creditor. If no agreement can be reached in the selection, the levying officer may select the appraisers. The appraisers shall then return a just appraisement if they can agree; if they cannot agree, they shall choose another disinterested citizen and with his assistance shall complete the appraisal. When offered for sale, the property shall not be sold upon the first offer for less than two-thirds of said valu-

[9] La. Acts 1934, No. 28.
[10] Opinions of Attorney General 1934-1936, p. 633.
[11] 176 So. 415 (La. App., 1937).

ation. If offered for three successive days at the same place and hour of day as advertised and no bid is received equal to two-thirds of the appraised value thereof, it can be sold for one half of said valuation. Only when the above conditions have been met and a deficiency still exists after the sale of the property may the judgment holder order out another execution for the balance remaining.

True, it may be argued that the provision for the sale of the mortgaged chattel at anywhere from one-half to two-thirds of its appraised value actually allows the buyer an opportunity to purchase the article for two-thirds and no more. However, the sale is still conducted under the careful scrutiny of the court and providing the sale is not one to which only dealers in the commodity familiar with the two-thirds provision are invited, the mortgagor still has a fighting chance to obtain a bid from a private individual for full market value. Thus, although "market value" for the mortgaged security is not a certainty, at least the sale is conducted on a fair and reasonable basis and under the supervision of the court. It will also be noted that provision is made for advertising the date and place of sale, a provision omitted from the Colorado rule. The entire procedure eliminates the possibility of collusion between mortgagee and purchaser which exists in Colorado, and the mortgagor is at least assured that he will not be subjected to an unreasonable deficiency judgment merely because of a grossly inadequate sale price.

Need For Revision in Colorado

After having viewed the procedure followed in Louisiana and Iowa, two of many states with similar rules, it should be apparent that our Colorado rule is sadly in need of revision. Certainly it cannot be denied that a real problem exists in the instance of the man of moderate means who purchases an automobile, makes a down payment of several hundred dollars, signs a note with an exorbitant interest rate, then defaults after one or two payments, has his chattel repossessed and sold for a sum considerably less than the original purchase price. He then finds himself legally obligated to pay a deficiency judgment that in effect charges him an utterly fantastic sum for the use of the car for only a short time. The Denver Legal Aid Society is constantly confronted with similar problems, most of which with the same unfortunate results. The injustice does not end there. Too often, it happens that the person who purchases the mortgaged security at the sale is the original seller who, after purchasing the automobile at a ridiculously low figure, manages somewhat miraculously to sell it again at a substantial profit. Thousands of dollars are often made from the sale of one automobile through this same procedure.

It must be noted that the primary stumbling block in Colorado to an effective handling of deficiency judgments is our adherence to the outmoded legal fiction that in cases of sale with a chattel

mortgage note, the title remains in the mortgagee. As long as we continue to operate under this rule, the means of regulating the repossession and sale of a mortgaged chattel will not be adequate to effect any great reduction in the number of debtors who are forced into a lifetime of debt and economic hardship because of a deflated sale price of the mortgaged chattel and the consequent grossly exaggerated deficiency remaining. However, because of the tremendous political power of those interested in retaining our present system, it is doubtful that any legislative remedy can be obtained at this time. It may well be that the answer lies in making the courts aware of all the facts in these problems which have only infrequently been brought before them. If our courts could be convinced that the man who purchases an automobile or refrigerator, defaults after a few payments and returns the article in substantially the same condition he originally purchased it, should be allowed a credit for the original sale price minus reasonable depreciation, the deficiency judgment then allowed would be no more than the debtor deserves for his default, and our problem would be on its way to solution.

BEYOND INSTITUTES, WHAT?—A PROGRAM FOR TOPICAL LUNCHEONS

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Together with many other lawyers, I have learned a great deal from the institutes which have been conducted by the Colorado and Denver Bar Associations. Such institutes probably offer the best means of imparting general information quickly and efficiently. I have been conscious, however, both as a spectator and as a participant in panel discussions, that many of the listeners leave the institutes with unanswered questions. Often these questions relate not merely to isolated or unique transactions, but rather they involve problems which recur over and over again. The experience of other lawyers in dealing with these particular problems would be most helpful if that experience could be shared.

I have a most profound respect for the aggregate knowledge residing in a group of lawyers on any problem that can be conceived. It is unfortunate that there has been almost no systematic way in which such joint knowledge could be shared. Time and time again lawyers who specialize in particular fields, and who are participating in institutes, find that there are members of the audience who know much more about a particular topic than the so-called expert. In the conduct of an institute, that specialized knowledge in the audience ordinarily cannot be made available to the group. In order to cover the ground, an institute cannot make