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## The Last Word

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DEFICIENCY JUDGMENTS IN PENNSYLVANIA:  
THE LAST WORD

HARRIS OMINSKY

I welcome this invitation by the editors of the *Villanova Law Review* to respond to Professor Sirico's Reply to my article. For one thing, our exchange of ideas will undoubtedly advance the inquiry into mortgage remedies and help focus on typical areas of agreement and disagreement. For another, I have been waiting over thirty years for an opportunity to respond publicly to law professors' comments on my papers—without fear of affecting my grade. My comments may be summarized as follows:

First, the Reply does not seem to disagree that there are inherent flaws built into the present Pennsylvania deficiency judgment laws.<sup>1</sup> Second, with one exception, the Reply agrees with my recommended strategies for practicing lawyers. Third, the Reply agrees with my conclusion that the recent *First Pennsylvania Bank* decision on deficiency judgments cannot be relied upon as precedent, but disagrees with my interpretation of that decision. Fourth, the Reply agrees that some reform is needed, but would limit it to sophisticated commercial transactions involving mixed collateral.

## I. FLAWS IN THE ACT

The Reply does not seem to disagree that there are inherent flaws built into the present Pennsylvania deficiency judgment laws. This section will review just four of these flaws:

(1) When there is a foreclosure on a blanket mortgage and there is no bidding at the sheriff's sale, the results differ depending on whether the mortgaged properties happen to be in one county or more than one county.<sup>2</sup> Since the properties in the same county may be sold in one sale, the Deficiency Judgment Act is not applicable. However, because this cannot be done when the properties are in different counties, the lender can proceed only after compliance with the Act. Therefore, there is a different result if the mortgaged properties are sold a day apart instead of

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1. I outlined these flaws in *Deficiency Judgments in Pennsylvania—The Lender's Gauntlet Revisited*, *supra*, text accompanying notes 59-63. This article will be referred to in footnotes below as the *Article* and Professor Sirico's Reply as the *Reply*.

2. *Article*, notes 36 & 63 and accompanying text.

minutes apart.<sup>3</sup>

(2) When the lender avoids a blanket mortgage and structures a transaction so that there are separate mortgages and notes, instead of one blanket mortgage and note for the aggregate loan, he avoids the applicability of the Act.<sup>4</sup> Professor Sirico acknowledges this result, and even suggests this strategy as a reason that the courts or legislators do not have to change the law.<sup>5</sup>

(3) When a loan is collateralized by both real estate and personal property, such as with a restaurant or hotel, the lender obtains a different result depending on the order in which he proceeds against the collateral. It presents the lender with what I have described as "The Pennsylvania Dilemma."<sup>6</sup> If he proceeds against business equipment and pots and pans first, the Uniform Commercial Code is applicable and no deficiency judgment proceedings are required.<sup>7</sup> If he proceeds first against the real estate, he must comply with the Act before proceeding against the personal property.

(4) A foreclosing lender who, after completing foreclosure, has a right to a personal judgment against a borrower may be barred from this judgment if the lender is delayed from proceeding on the judgment past the six-month deficiency judgment deadline.<sup>8</sup> Therefore, if the borrower is able, either by empty strategies or legal defenses, to delay a personal judgment, he will succeed in protecting all his property except for this first property deeded to the lender at the sheriff's sale. In addition, he will succeed in protecting all of his friends and associates who have guaranteed that debt. Although the Reply recognizes that this predicament could occur, the Reply suggests that it may not happen frequently enough to worry about. The Reply reaches this conclusion on the assumption that lawyers will follow my recommended strategy of obtaining a personal judgment against a debtor before completing an *in rem* foreclosure action.<sup>9</sup>

That assumes all lawyers either know about this rather arcane problem, or will find out about it when they read this article. Unfortunately, the case books are strewn with cases involving lawyers, who for one reason or another, do not obtain a personal

3. See Article, notes 33-35.

4. Article, notes 37 & 64 and accompanying text.

5. Reply, text accompanying note 27.

6. Article, at 1145.

7. Article, notes 57, 58 & 62 and accompanying text.

8. Article, note 13.

9. Reply, text accompanying note 24.

judgment in time.<sup>10</sup>

## II. STRATEGIES FOR PRACTICING LAWYERS

With one exception, the Reply agrees with my recommended strategies for practicing lawyers. The Reply does not challenge my recommendation that the lender should avoid the Act by proceeding against the personal property first and real property second, when the collateral consists of both real estate and personal property. The Reply agrees with, and indeed recommends, avoiding blanket mortgages by the use of separate mortgages in order to avoid application of the Act.<sup>11</sup>

The one strategy presented in my article that was questioned in the Reply is the recommendation to foreclose on a junior mortgage when the lender holds more than one mortgage on the same property.<sup>12</sup> Even my article raises a question about whether this strategy works because of potential issues of subrogation and merger, which may be applicable to the senior mortgage.<sup>13</sup> However, Professor Sirico concludes that “[a] court should deduct the property’s full fair market value from the judgment on the debt secured by the second mortgage.”<sup>14</sup>

The hypothetical case which is criticized by Professor Sirico involves a property worth \$100,000 subject to a first mortgage of \$100,000 and a second mortgage of \$50,000, both of which are held by the same lender.<sup>15</sup> My article points out that upon foreclosure on the second mortgage the lender winds up with the property subject to the \$100,000 mortgage. Since the property is only worth \$100,000 and is subject to the first mortgage of \$100,000, the debtor has acquired a property with no net worth. Therefore, he should receive no credit toward the \$50,000 second mortgage under the provisions of the Act.<sup>16</sup> The result of a foreclosure on a junior lien should be the same whether the foreclosing lender holds the first mortgage at the time of the sale or whether it is held by someone else, either by assignment or otherwise. Deducting the “full fair market value” from the \$50,000 second mortgage debt seems to ignore the clear terms of the

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10. *See Article*, note 13.

11. *Reply*, note 27 and accompanying text.

12. *Article*, note 32 and preceding text.

13. *Article*, note 32.

14. *Reply*, text following note 26.

15. *Article*, text following note 29.

16. *Article*, text following note 31.

Act.<sup>17</sup>

### III. THE *FIRST PENNSYLVANIA BANK* CASE

The Reply agrees with my conclusion that the *First Pennsylvania Bank* decision on deficiency judgments cannot be relied upon as precedent, but disagrees with my interpretation of that decision.

The portion of the *First Pennsylvania Bank* case dealing with Pennsylvania deficiency judgments represented the view of only two Justices on the deficiency judgment issue,<sup>18</sup> was considered dictum by one Justice,<sup>19</sup> and has been "called into question" by the *Valley Trust Company* case.<sup>20</sup> I therefore concluded in my article that lenders must assume that the *First Pennsylvania Bank* case cannot be used as precedent.<sup>21</sup> Professor Sirico agrees with my conclusion.<sup>22</sup>

However, Professor Sirico quarrels with my reading of the opinion. I suggested, as does Professor Sirico, that since the *First Pennsylvania Bank* case dealt with separate mortgages, it was not clear whether the decision would have been the same if there had been one blanket mortgage.<sup>23</sup> I then concluded that the court's reasoning seems equally applicable to blanket mortgages and that, therefore, the Justices who wrote the opinion would have found that the Act did not apply to a blanket mortgage, any more than to separate mortgages.

Professor Sirico is troubled by this statement and comes to the opposite conclusion.<sup>24</sup> Perhaps he is misled by references in that case to "separate mortgages." If the case had involved separate mortgages with separate debts and separate notes applicable

17. Section 8103 provides: "After the hearing and determination. . . of the fair market value. . . the debtor. . . shall be released and discharged of such liability to the judgment creditor to the extent of the fair market value. . . less the amount of all prior liens, costs, taxes and municipal claims not discharged by the sale. . . ." 42 PA. CONS. STAT. ANN. § 8103(c) (Purdon 1982) (emphasis added).

Since the \$100,000 mortgage is a "prior lien," no credit may be given to the debtor towards the second mortgage because the amount must first be deducted from the fair market value of \$100,000 which is "received" by the lender. Any other interpretation would require the junior mortgage holder to give the same credit for an unencumbered property as for an encumbered one.

18. *Article*, text accompanying note 43.

19. *Article*, note 39.

20. *Article*, text preceding note 41.

21. *Article*, text following note 43.

22. *Reply*, text between notes 37 and 38.

23. *Article*, text following note 40.

24. *Reply*, text accompanying notes 32-36.

to each, I would agree that the foreclosure on one mortgage should not effect the others.<sup>25</sup> However, the *First Pennsylvania Bank* case involved a default on one debt of \$1,100,000 which was evidenced by one note in the same amount and secured by similar mortgages *in that amount* filed in five different counties.<sup>26</sup> Apparently, each mortgage was identical except for the metes and bounds descriptions.

Since the Act speaks of discharge of the “debt” being foreclosed upon, it would be difficult to argue in the *First Pennsylvania Bank* case that the foreclosing lender should avoid discharge on the theory that it foreclosed on separate debt. In fact, under similar factual circumstances in the *Valley Trust Company* case, the superior court held that the debt was discharged.<sup>27</sup> This whole dispute, in fact, bolsters my argument on the need for reform. The distinctions are fuzzy, the courts are sometimes confused, and a practicing lawyer and a law professor cannot agree on what the law is.

If the borrower is to have protection against a greedy lender, why should that protection rise or fall on the form of the loan documents? Should the borrower’s rights with multiple properties hang upon the thread of whether one mortgage or many mortgages are used, or whether the borrowed sum is broken down into smaller debts? And if there is only one debt, as in the *First Pennsylvania Bank* case, should it make a difference whether all of the property descriptions are included as an exhibit in each of the mortgages, or whether each of the separate mortgages contain only the description required for recording that mortgage in the applicable county?

#### IV. RECOMMENDED REFORM

The Reply agrees that some reform is needed, but would

25. Indeed, this is a suggested strategy adopted by the *Reply*. *Reply*, note 27.

26. *First Pennsylvania Bank v. Lancaster County Tax Claim Bureau*, 504 Pa. 179, 182, 470 A.2d 938, 939-40 (1983).

27. In that case there was also one bond and three separate mortgages in the face amount of the bond, as explained in the lower court opinion in *Valley Trust Company. In Re Defendant’s Petition to Strike or Open Judgment: Valley Trust Company v. Lipitsky*, No. 486, (Ct. Comm. Pl., Cumberland Co., Pa. 1981). The common pleas court stated: “On March 20, 1980, defendants gave their obligation to plaintiff bank in the amount of \$353,000. Separate mortgages were given to plaintiff bank, each in the amount of \$353,000, on properties situated in Lebanon, Dauphin and Cumberland Counties.” *Id.*

limit it to sophisticated commercial transactions involving mixed collateral.

Professor Sirico states that the “sophistication of the lenders and the dearth of cases in the area suggest that the Act does not set a trap for the unwary.”<sup>28</sup> Perhaps Professor Sirico’s own Reply helps prove my point about “traps”—even for the wary. As described above, we disagree about the strategy to be taken when the same lender holds more than one mortgage on a property. If we had a real case, one of us would have followed the “right” strategy; the other one would have fallen into the “trap.”

We also disagree about whether the *First Pennsylvania Bank* case involved the type of “separate” mortgages which could permit a lender to avoid the Act. If we were structuring a real mortgage loan, we may each have prepared different mortgage documentation. One of us may have fallen into the trap of exposing the lender to the gauntlet of the Act.

In addition, I suggest that there is a basic fallacy about concluding anything from the “dearth of cases” which is emphasized by the Professor. One cannot judge the number of times lawyers and lenders have had problems under the Act by merely counting reported judicial decisions. The delays, mistakes, costs, and missed deadlines under the Act are not always reflected in the law books. Frequently, lawyers who are precluded from proceeding under the Act will not even attempt to start a legal action. Furthermore, the reported cases do indicate massive confusion on deficiency judgments. Virtually every deficiency judgment case cited in my article<sup>29</sup> involves a lawyer (or client) who made a mistake in trying to obtain a deficiency judgment. Many of them are cases where confusion about the interpretation of the Act, or other circumstances caused attorneys to miss the crucial six month deficiency judgment deadline. They never got through the “gauntlet.”

Professor Sirico concludes that the Act imposes no unusually burdensome requirements. This comment may be viewed in several ways.

First, his Reply does not disagree with my description of the required procedural steps. Therefore, there is no dispute that with multiple properties the Pennsylvania mortgage lender will have to repeat the deficiency judgment procedure for each property the lender is forced to purchase at foreclosure, where the

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28. Reply at 1160.

29. Article, notes 10-13, 35 & 55.

properties are located in different counties or are sold at different times.<sup>30</sup> It is significant that an additional foreclosure under a debt cannot be started until the deficiency judgment procedure is completed on an earlier purchase. Therefore, where twenty-nine<sup>31</sup> or more parcels are covered by a blanket mortgage, it could theoretically take a lifetime for a lender to acquire all of its collateral.

One of Professor Sirico's arguments is that the lender may avoid all of this by using my suggestion that the loan be broken down into separate notes and mortgages at the time the loan is made. He labels this solution "simple."<sup>32</sup> However, he ignores the second part of my strategy, cross-collateralization of the separate mortgages, which may be necessary to give the lender comparable collateral to a blanket mortgage. This strategy is not a "simple" solution. With only five properties it would involve five separate mortgages on each property, or a total of twenty-five mortgages instead of one. With twenty-nine properties, it would involve 841 mortgages.

Another of Professor Sirico's arguments is that there is little practical value to deficiency judgments anyway. He says: "Whether increasing the size of the debt would result in a larger recovery in light of the debtor's financial plight is a separate question whose answer probably is almost always in the negative."<sup>33</sup> This is no comfort to the lender who may have other available remedies. He may be able to take over other collateral or obtain judgment against a substantial conglomerate that is maneuvering to insulate itself from a defaulted mortgage. Moreover, many loans are guaranteed or insured by major companies that could extricate themselves from their contracted liability if the lender failed to seek a deficiency judgment within the required six-month time frame.

The argument that deficiency judgments do not help in most cases is reminiscent of the story about the boy who drowned in a lake having an "average" depth of three feet.

#### CONCLUSION

As I suggested, the policy considerations underlying new leg-

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30. *Article*, text accompanying note 26.

31. *See* *Kitzmilller v. Cumberland Valley Sav. & Loan Ass'n*, 10 Pa. D. & C.3d 462 (Cumberland 1979).

32. *Reply*, text preceding note 27.

33. *Reply* at 1157.

islation should be different for residential properties than for other properties.<sup>34</sup> It is submitted that the deficiency judgment gauntlet need not extend to nonresidential properties. While, as suggested by Professor Sirico, there may be political and other reasons to protect certain classes of debtors,<sup>35</sup> these reasons should not prevent reform of an inequitable and outmoded system.

When lenders perceive unfair difficulties in enforcing their mortgage rights, borrowers will pay for this in the form of less favorable and more expensive mortgage terms.

In addition, one should keep in mind that the struggle between borrower and lender is not always a struggle between poor and rich, vulnerable and invulnerable, or right and wrong. In complex modern commercial loans involving multiple properties, the parties are sometimes of comparable economic strength and represented by equally competent counsel. Moreover, the lender may not be a "deep-pocketed" international insurance company or a national bank. It may be your retirement fund or your widowed Aunt Hilda who sold her husband's business and depends on the monthly mortgage check to pay for food.

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34. See *Article* at 1150.

35. See *Reply* at 1162 & notes 44-45.