

## **MINUTES**

### **MONTANA SENATE 52nd LEGISLATURE - REGULAR SESSION COMMITTEE ON BUSINESS & INDUSTRY**

**Call to Order:** By Chairman J.D. Lynch, on February 5, 1991, at 10:00 a.m.

#### **ROLL CALL**

##### **Members Present:**

J.D. Lynch, Chairman (D)  
John Jr. Kennedy, Vice Chairman (D)  
Betty Bruski (D)  
Eve Franklin (D)  
Delwyn Gage (R)  
Thomas Hager (R)  
Jerry Noble (R)  
Gene Thayer (R)  
Bob Williams (D)

**Members Excused:** None

**Staff Present:** Bart Campbell (Legislative Council).

**Please Note:** These are summary minutes. Testimony and discussion are paraphrased and condensed.

**Announcements/Discussion:** None

#### **HEARING ON SENATE BILL 223**

##### **Presentation and Opening Statement by Sponsor:**

Senator Mike Halligan, sponsor of the bill, stated that there are experts at the hearing ready to testify on this bill and he would leave the explaining of it to them.

##### **Proponents' Testimony:**

Representative Jerry Driscoll, house district 92, spoke in favor of the bill. He is mainly concerned about page 4 of the bill sub 3, lines 8 through 14. This section talks about fair market value when you have a sheriff's sale on a foreclosure. This entire bill, page one, on the Washington-Idaho carpenters trust and the galleria, the laborers pension fund was also involved in that loan. They have been in court for seven years, and they still haven't had anything settled. He asked that the committee adopt section 3 on page 4.

George Bennett, representing Montana bankers association,

spoke in favor of the bill. We are talking about judicial foreclosure of loans where you have gone through a court preceeding, the court has entered a judgement against all the interested parties in the real property. The real property is then sold by sheriff's sale. A sheriff's sale is a public sale, it's done after advertising and hopefully there will be a large number of independent bidders at that sale. What happened in the galleria case essentially was that the Montana supreme court put a hurdle for lenders in obtaining judgements with respect to commercial properties and the law through the galleria case. This bill addresses the market value problem, it addresses the one action rule, and it addresses some lien priority problems. This bill would provide that where you have a foreclosure sale (sheriff's sale) that the sale proceeds in the absence of fraud represent the value of that property at that time and for the purposes of determining the deficiency that can be granted to the lender. We are talking about all lenders, federal lenders, state lenders, private lenders, we're not just talking about the bankers, we are talking about everyone. It is critical to our economy to have a free flow of credit. People with money who lend to people who want to do things is what makes our economy go. If you clog the creditor's right process the way the galleria case has, you're ideally affecting the Montana economy. This is a critical bill to the lending industry and particularly the banks. The galleria problem is going to clog the system and cause a serious problem with credit availability.

Dave Hansen, with first interstate bank in Missoula, spoke in favor of the bill. He stated that this has had an impact on the banking industry. It has severely restricted commercial real estate, because they now require more of a down payment. Perhaps up to 40% down which makes most commercial projects unbuyable. Projects that are needed are not being completed at this point in time. The foreclosure process will continue to be more expensive, they need more appraisals and the consumer ends up paying for it also. He believes that we have a real serious problem from a commercial real estate stand point.

Tom Welch, president of the pioneer federal savings and loan, spoke in favor of the bill. Pioneer federal is a small lender; however, 85% of the dollars that they have on deposit are loaned back out right now in Montana. Every single one of those loans are made in Montana. Bills such as this clear up hurdles to pioneer federal that continues to make loans in Montana. It is becoming more and more difficult to find good loans, but then when you run into hurdles such as galleria it makes it very difficult for them when they are weighing the options to put their money to work in Montana. SB 223 will clear up one of those hurdles.

John Seeberger, with first interstate bank of Montana, spoke in favor of the bill (See Exhibit 1).

Larry Banister, from westmark construction, spoke as a beneficiary of this bill. His company builds commercial real estate projects for clients mostly in the state of Montana. The single most important factor in a construction project is if the owner has financing. Without that financing the project doesn't

what it is.

Michael Sherwood, appearing on behalf of MTLA, stated that he doesn't believe that SB 223 will cure all the evils nor will it justify unfairness, but it in all likelihood is more fair under the current situation of galleria. He does not oppose SB 223 based on the substance of the bill, but he does have some concerns on page 4 regarding the remedies available to someone who has been a victim of fraud. Specifically the bill gives, then it takes it away. He offered some proposed amendments (See Exhibit 3).

Questions From Committee Members:

Senator Thayer asked if this bill affected residential property in any way.

George Bennett replied that this bill would address only commercial properties.

Senator Hager stated that George Bennett had stated that he has done only four foreclosures and that there was many bidders, he asked if they were done recently.

George Bennett replied that the last one that he did was out on airport road in Helena. It was commercial property, and there were four or five bidders.

Senator Hager asked if the foreclosures were done in a suppressed real estate situation.

George Bennett replied no, probably not.

Jim Benn replied that in regards to the sale process, a person has to advertise it, you have to publish it in the newspaper. If you get called from interested folks about how much the property is, where it is located, etc. It is not unusual in a depressed market that the debt due on the property is in excess of its value. That results in very little interest, nobody showing up to view the property. They have conducted foreclosure sales, were property was being sold that was less than the market value of the property.

Senator Lynch asked on this cash only sale, is that how this is conducted.

Jim Benn replied that there is a cash requirement. If a third party comes to the sale, they have to pay cash. If they're an interested and qualified party they can go to the lender in advance and put in a bid. They can probably make a deal.

Senator Lynch asked that Jim Benn explain sheriff's sale to him. How long does a person get notice that it's going to come up.

Jim Benn replied that it is published three times in the newspaper in the county.

Senator Lynch stated that the 20 days on page 4 sounds terribly short to him.

Jim Benn commented that his concern with the sale process is that the bid be certain so that the lender and the debtor know where they are in the foreclosure process. If three years later, the borrower discovers that there was in fact fraud, he doesn't want the borrower disabled from bringing suit.

Senator Williams asked if a person could redeem their property within a years time.

Jim Benn replied yes.

Closing by Sponsor:

Senator Halligan closed by saying this bill carves out problems, which are the delays, the uncertainty, and the issues heard today that cause all of the excess expense. The purpose is to deal with the balance. With respect to the amendments, he thinks that Mike Sherwood has some good points. We will work with Mr. Sherwood on the amendments on the statutes of limitations.

ADJOURNMENT

Adjournment At: 11:10 a.m.



J.D. LYNCH, Chairman



DARA ANDERSON, Secretary

JDL/dia

## BUSINESS & INDUSTRY

FEB 5, 1991.

# VISITORS' REGISTER

[illegible]

(Please leave prepared statement with Secretary)

ROLL CALL

Business & Industry COMMITTEE

DATE 2/5/91

LEGISLATIVE SESSION

NAME	PRESENT	ABSENT	EXCUSED
Senator Bruski	X		
Senator Franklin	X		
Senator Gage	X		
Senator Hager	X		
Senator Noble	X		
Senator Thayer	X		
Senator Williams	X		
Senator Kennedy	X		
Senator' Lynch	X		

Each day attach to minutes.

TESTIMONY OF JOHN SEEBERGER  
FIRST INTERSTATE BANK OF MONTANA, N.A.  
GREAT FALLS OFFICE  
SUPPORTING SENATE BILL 223, FEBRUARY 5, 1991

Our bank is the trustee for an industrial revenue bond issue that financed the construction of a motel in Glendive, Montana. The bonds were sold to a variety of purchasers ranging from some very elder retired individuals to a bank pension fund. The bonds were sold in increments of \$5,000 and many of the bondholders hold just one bond. As you might guess most of these small bondholders are rather unsophisticated investors and frankly cannot stand to absorb much of a loss on their investment.

In May 1989 the bonds were in default and we sent the debtor a notice of default, accelerated the bonds and began negotiations with the debtor to try and seek the debtor's cooperation in voluntarily turning the property over to us so we could liquidate it in an effort to recover as much as possible for the bondholders. By August 1989 it became evident that negotiations with the debtor were not going to resolve the problem and we were going to have to resort to foreclosure. In September foreclosure proceedings were started and we anticipated that within a relatively short period of time we would have a sheriff's sale and could move forward with finding a purchaser for the property, expecting that if the sale of the property was not sufficient to satisfy the debt that we would obtain a deficiency judgement against the debtor and try to collect through the liquidation of other assets the debtor might have. During this same period of time the Montana Supreme Court issued their "Galleria decision" changing this whole scenario. The "Galleria decision" in essence held that the fair market value of property subject to foreclosure is the intrinsic value of the real property with its improvements at the time of sale under judicial foreclosure without consideration of the impact of the foreclosure proceedings on the fair market value and that the method of

determining the fair market value to be used as the basis for determination of a deficiency judgement is in the discretion of the District Court. Prior to that decision, the fair market value for purposes of obtaining a deficiency judgement was the value realized by the sale of the property.

With this decision in hand the debtor's attorney argued that before we could proceed with our foreclosure a court hearing must be held to determine the amount of his client's potential liability for a deficiency judgement. We had to wait a little over four months, from October 1989 to February 6, 1990, to get a hearing in District Court in Glendive. At that hearing we presented an appraisal on the property of \$430,000. That appraisal had just been completed by an MAI certified appraiser that lived in Miles City, 80 miles from Glendive. At that same hearing the debtor presented an appraisal of \$964,000 done by a motel consultant from Virginia who was not a real estate appraiser but in actuality a CPA with a motel management background. As you can see there was a great deal of disparity between these two appraisals and this would certainly have an impact on the amount of the deficiency judgement we were trying to collect from the debtor given the fact that the outstanding balance of the bonds at that time was \$1.4 million. At that hearing there was a great deal of confusion between the two attorneys and the judge as to how they were suppose to proceed from that point so the judge agreed to reschedule another hearing so he and the attorneys could review the appraisals and sort the situation out. After several attempts to reschedule the hearing. we were finally successful in getting another hearing on September 4, 1990. This hearing again was held in Glendive. During the period of time between the February and September hearings the appraisers each revised their appraisal and revised them upward. Our appraiser at that hearing valued the property at \$650,000 and the debtor's appraiser revalued the property at \$1,460,000. During the period of time between the two hearings a court appointed receiver was operating the property and both



appraisers felt that the income on the property was up slightly and that would justify an increase in value. Looking at the two appraisals though you might wonder if the appraisers were looking at the same piece of property given the fact that they were \$900,000 apart in the valuation they were placing on it which certainly lends credence to the claim that appraising is not an exact science. I might point out that during testimony both appraisers testified that they would not stand behind the value they placed on the property for any longer than six months. After hearing the testimony the judge took the matter under advisement and on October 24, 1990, nearly a year from the date we started our foreclosure proceedings we finally had a ruling from the judge. In his ruling the judge indicated that he gave a great deal more credence to our appraiser's testimony concerning the economic conditions as they exist in Eastern Montana and felt that as a resident of Eastern Montana he had considerable appraisal experience in Montana but he was concerned by the conclusions our appraiser had come to regarding repairs and replacement and the discount he took into consideration because there was not a ready source of financing for that type of project. On the other hand he gave more credence to the debtor's appraisal which appraised the property without regard to the fact that a foreclosure sale was eminent. The judge did indicate, however, that he felt the debtor's appraiser used income figures that were overly optimistic. In the end, quoting from the judge's order "it appears to the court, based upon the wide variance of the appraisals presented, that determination of the fair market value of this property is less than precise" and the judge went on to determine that in his mind the property had a fair market value of \$900,000. Based upon that, our deficiency judgement would be approximately \$600,000. The difference between the \$1.4 million that was owing and the amount the judge determined to be the fair market value.

Let's stop and put things in perspective. The debtor became delinquent in May 1989 after four months of negotiation we

started a foreclosure proceeding that should have taken approximately four months to get to a sheriff's sale but instead took thirteen months to get a judge to render a decision, which has now cleared the way for us to proceed with our sheriff's sale so we can actually get title to the property and sell it. Keep in mind that after the sheriff's sale the debtor still has a one year right of redemption which means that for all practical purposes we will have to hold the property for a year after the sheriff's sale before we can sell it and transfer title.

This should give you a bit of a sense of what the "Galleria decision" has put us up against. We are already over a year into the foreclosure process, have spent over \$20,000 of the bondholders money in attorneys fees, and are stuck with a value on the property that appears to be a compromise between two appraisals that are miles apart. There is a good chance that when we are finally able to sell this property, which will be over a year from now, neither the judges value or the appraisers values are likely to be a valid reflection of what the property will ultimately sell for. Keep in mind that in their own testimony the appraisers both stated that they would not stand behind their appraisals for more than six months because of the changing dynamics in the real estate market and to put that into further prospective it has been over three months since the judge has rendered his decision and we still haven't been able to proceed with the sale and don't know when we will be able to because the debtor has now filed bankruptcy.

I would urge you to give careful consideration to Senate Bill 223 which addresses this issue and comes up with what I think is a good solution to the problem we are facing. Fair market value ought to be what property will sell for not what appraisers or judges think it might sell for. Let us also assume that creditors will conduct a fair sale. Senate Bill 223 is certainly a better alternative than the situation that I have just described to you.

TESTIMONY

SENATE BUSINESS & INDUSTRY

EXHIBIT NO. 2

DATE 2/5/91

BILL NO. SB 223

Submitted : February 5, 1991

Bill No. : SB 223

Testifying: Jock O. Anderson

From : Montana League of Savings Institutions

Position : Support

SB 223 if passed would nullify the recent Montana Supreme Court decision of Trustees of the Washington-Idaho-Montana Carpenters--Employees Retirement Trust Fund v. Galleria Partnership, 46 St. Rep. 1661 (1989). The key element of that case was to judicially impose an "impact price" mechanism into the foreclosure process.

In the exercise of our equity jurisdiction, therefore, we deem it proper to remand to the district court to determine the fair market value of the property at the time of the sheriff's sale. The fair market value is the intrinsic value of the real property with its improvements at the time of sale under judicial foreclosure, without consideration of the impact of the foreclosure proceedings on the fair market value. Chunkapura, 734 P.2d at 1207.

The method of determining fair market value we will leave to the district court, though it seems appropriate that each opposing party should be allowed to present the opinion of appraisers selected by them respectively.

When the fair market value of the property is determined by the district court, that figure will be the basis for the determination of a deficiency judgment if any.

The effect of SB 223 in nullifying Galleria would be to provide that the deficiency judgment would be determined by the bid at sheriff's sale which had always been the law prior to Galleria.

The basic rationale behind the Galleria decision is not misguided in intent: to try to insure that a lender does not buy the property at its foreclosure for an unfairly low price thus increasing the deficiency against the debtor. But that concern is already adequately addressed under Montana's redemption rights which award the debtor and all other lienholders the right to redeem the property for one full year. The debtor also has the right to assign these rights to a third party. Because of these redemption rights, it is difficult to envision a circumstance where a lender would have an incentive to bid less than what it fairly believed the property to be worth. If it bid too low, the property would be redeemed.

The harm in the Galleria decision is that "fair market value" as defined by the court is almost impossible to achieve in the circumstances of foreclosed property--either at the sheriff's sale or at a subsequent resale by the lender. Part of the reason for this is the existence of redemption rights. Purchasers don't pay "fair market value" for property that is not fully

transferable for one year. That problem is magnified when the property is the debtor's residence because under Montana's redemption laws the debtor has the right to live in the property during the year.

Thus the practical effect of Galleria will be, in almost all cases, to deprive the lender of full payment on its debt because a value will be attributed to the collateral which is higher than what can actually be obtained through sale. The bottom line is that Galleria increases the risk to the lender and therefore the cost of extending credit. While Galleria is a direct benefit to the small number of borrowers who default; it will tend to increase the cost of credit to the vast majority of borrowers who never default. Further, the increased risk of making loans will tend to cause available funds to be invested in low risk securities rather than loans.

It must be recognized that there are limits to the amount of risk that can be transferred from the borrower to the lender without jeopardizing the availability of credit. Montana already has redemption protections; it has the "one action" rule; and it has the Chunkapura limitation on deficiencies. Now it has imposed the "upset price." Any one of these borrower protections can be defended in isolation as a reasonable borrower protection

device. But Montana now has all of them and the cumulative result cannot reasonably be justified. Something has to give if we are to maintain an environment where funds are going to be available at a cost which will facilitate housing and economic development.

We urge your positive consideration of SB 223.

4480J

Michael Sherwood

MTLA

SENATE BUSINESS & INDUSTRY  
EXHIBIT NO. 3  
DATE 2/5/91  
BILL NO. SB 223

Opposing SB 223 and proposing an amendment:

Page 4, line 8:

After "Absent", strike: "proof by clear and convincing evidence of"

Page 4, lines 11 thru 14

After "purposes.", strike: "A" and all of lines 12 thru 14.

This bill allows a debtor the substantive remedies of "fraud or collusion", but takes them away through an extraordinary burden of proof and an oppressive statute of limitations for making such claims.