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LEGISLATION

The Pennsylvania Mortgage Deficiency Judgment Act of 1937

The problem of relief of mortgage-debtors during the financial crisis which began in 1929 hardly need be reviewed. In order to point out the problem involved in a consideration of the new Pennsylvania Act,¹ it is sufficient to note that an emergency existed which caused a nearly complete absence of a market for real estate. The resulting series of purchases by mortgagees, for nominal bids sufficient to cover costs, of lands worth thousands of dollars in normal times impressed the legislatures of more than half of the states with the necessity of statutory relief of mortgagor-debtors,² with the result that at least twenty states passed remedial laws in 1933.

1. Pa. Laws 1937, no. 561. "An Act—To protect the obligors or guarantors of bonds and mortgages, and owners of property affected thereby, and others indirectly liable for the payment thereof, by prohibiting, for certain periods, the foreclosure sale of mortgaged property at less than its fair market value; and prescribing the method of fixing the fair market value of said property."

2. A classification of the statutes follows. *Moratory*: ARIZ. REV. CODE (Courtright, Supp. 1936) § 2337a-g; CAL. CODES AND GEN. LAWS (Deering, Supp. 1935) tit. 376a; ILL. REV. STAT. (Cahill, 1933) c. 95, §§ 30-36; Iowa Laws 1933, c. 179, 182, *id.* 1935, c. 110, 115,

Of course, even in the absence of such legislation the hard-pressed mortgage debtor is not entirely without relief. Thus equity courts, while asserting that inadequacy of the price obtained upon the foreclosure and sale of land is not alone sufficient ground for setting aside a sale,³ nevertheless do give such relief when it is found that the price obtained was *grossly* inadequate.⁴ But this remedy is of little practical value, for, when the same price is bid at successive sales, the chancellor, if not obliged⁵ to confirm it, ordinarily would do so on the ground of the futility of further sales.

Thus, legislation was necessary to remedy the emergency situation, and Pennsylvania's solution was the Mortgage Deficiency Judgment Act of 1934,⁶ which by its own terms was to expire at the end of one year. Subsequently, the 1935 Act⁷ was avowedly passed as a continuation of the 1934 Act, and contained further restrictions upon the rights of the foreclosing mortgagee.⁸ Both acts were declared unconstitutional as applied to mortgages executed prior to the effective date of the Act.⁹

Unlike its predecessors the 1937 Act is not limited in duration, but is a permanent measure. The legislature has apparently abandoned any intention of bringing the Act within the category of moratory legislation, probably as a result of the court's statement in the *Winowich* case that legislation will not be upheld, as being moratory in nature, simply because it shares with moratory

116, *id.* 1937, c. 78-83; KAN. STAT. ANN. (Corrick, 1935) c. 67, art. 3a; Mont. Laws 1933, c. 116; N. H. Laws 1933, c. 161; N. D. Laws 1933, c. 155-158; OHIO CODE ANN. (Baldwin's Throckmorton, 1934) § 11,588; Okla. Laws 1933, c. 16; S. D. Laws 1933, c. 135, 137; Tex. Laws 1933, c. 17, 59, 92, 102, 105; Vt. Laws 1933, no. 30.

Upset price: Ga. Laws 1935, part I, tit. VII, no. 412; N. C. CODE ANN. (Michie, 1935) § 2593b-f.

Deficiency judgment (credit on): Idaho Laws 1933, c. 150, *id.* 1937, c. 31; N. J. Laws 1933, c. 82; N. Y. CIV. PRAC. CODE (Cahill, Supp. 1936) § 1083a; S. C. CODE (Supp. 1934) § 9501.

Combination (upset price and deficiency judgment): Ark. Acts 1933, no. 21, p. 47, *id.* 1935, no. 49, p. 116; MICH. COMP. LAWS (Mason, Supp. 1936) §§ 14,444-1 to 14,444-10; MINN. STAT. (Mason, Supp. 1936) §§ 9655-1 to 9655-4; NEB. COMP. STAT. (Kyle, Supp. 1935) art. 20-1531, 20-21, 159; PA. STAT. ANN. (Purdon, Supp. 1936) tit. 21, §§ 808-820; Wis. Laws 1933, c. 11, 13, 15, 125.

3. Glenn v. Miller, 186 Iowa 1187, 173 N. W. 135 (1919); Federal Title & Mtge. Guar. Co. v. Lowenstein, 113 N. J. Eq. 200, 166 Atl. 538 (1933); Lamb v. Kelley, 97 W. Va. 409, 125 S. E. 102 (1924).

4. Gross inadequacy of price may be defined as a sale price so far below the price that the land would actually bring under normal conditions that it shocks the conscience of the court. Henderson v. Henderson, 266 Ky. 319, 98 S. W. (2d) 904 (1936).

5. See Kremer v. Rule, 216 Wis. 331, 257 N. W. 166 (1934) (same price, lower than upset price, bid by mortgagee at three successive sales, but lower court refused to confirm. Held, sale confirmed). But note that this was conditioned on plaintiffs' judgment for deficiency being marked satisfied because of their express voluntary waiver.

6. PA. STAT. ANN. (Purdon, Supp. 1936) tit. 21, § 806, Note (1935) 84 U. OF PA. L. REV. 223.

7. PA. STAT. ANN. (Purdon, Supp. 1936) tit. 21, §§ 808-820.

8. A provision was added to this act which required the mortgagee to proceed first against the mortgaged property before going against other real property held by the mortgagor, or any property of the co-obligor.

9. The 1934 Act was declared unconstitutional in Beaver County B. & L. Ass'n v. Winowich, 323 Pa. 483, 187 Atl. 481 (1936), 85 U. OF PA. L. REV. 114. The Superior Court, following that decision, declared the 1935 Act unconstitutional in Shallcross v. North Branch-Sedgwick B. & L. Ass'n, 123 Pa. Super. 593, 187 Atl. 819 (1936), 85 U. OF PA. L. REV. 321 (1937). Of course there is no problem in connection with mortgages subsequently executed, for it is a firmly established principle of constitutional law that laws in existence at the time of making a contract become a part thereof and are determinative of the contractual rights of the parties. McCracken v. Hayward, 2 How. 608, 613 (U. S. 1844); Edwards v. Kearzey, 96 U. S. 595, 607 (1877); W. B. Worthen Co. v. Kavanaugh, 295 U. S. 56, 60 (1935).

legislation the element of limited duration. "The real test" (of moratory legislation) said the court, "is not the duration of the act, but whether the result which it brings about in a given case is permanent or temporary."¹⁰

The new Act introduces alternative terms providing that the mortgagee shall either release the mortgagor, and all who are secondarily liable, from any personal deficiency judgment, or petition the court to fix the fair market value¹¹ of the property, which must not exceed the amount of the debt, interest, costs, taxes and municipal claims. If the property does not bring the fair market value at the first sale, the court must postpone the sale for six months. At that time if a price equal to the determined fair market value is not obtained, then the court must defer the sale for another six months. But if a price equal to the fair market value is not then procured, the court may delay the sale for further periods up to a year in the aggregate. At the end of the two year period the property is sold, whether or not the "fair market value" can be obtained, and a deficiency judgment for the difference between the sale price and the amount of the obligation can then be obtained. It is doubtful that this election feature is sufficiently different from the comparable provision in the old acts to escape the imputation of unconstitutionality. It is probable that the theory underlying the phrasing of this provision in the alternative was that by allowing the mortgagee to proceed toward enforcement by an election of sale without a personal judgment or delayed sale with a personal judgment, the procedure only was varied, and no substantive right impaired. In any event this election feature may prove to be unfortunate, for the court in considering provisions of a somewhat similar nature in the 1934 Act was not impressed by an alternative which left no choice:

"Defendants argue that plaintiff cannot question the constitutionality of the provision of the act that the fair market value is to be allowed as a credit, because plaintiff's judgment was not actually subjected to such reduction; plaintiff having allowed a period of six months to elapse without petitioning the court to fix the fair value, the judgment was marked satisfied in accordance with another provision of the act. It is claimed, therefore, that it is only of the latter that plaintiff can complain, but that such provision is merely equivalent to a statute of limitations and as such is constitutional. This contention is specious, for it overlooks the fact that plaintiff could not prevent the time limitation from obliterating its judgment except by submitting to the unconstitutional alternative of petitioning for the fixing of a reduced deficiency indebtedness. The penalty for refusing to accept a partial loss of a contractual right was thus the deprivation of the right altogether."¹²

The court stated in the *Winowich* case that there was not a mere delay in remedy, but an impairment of a right when the net result was that the mortgagee had to be content with a smaller personal judgment than he otherwise would have obtained.¹³ Such was the situation under the old acts, where the mortgagee

10. *Beaver County B. & L. Ass'n v. Winowich*, 323 Pa. 483, 509, 187 Atl. 481, 493 (1936). Accord: *Vanderbilt v. Brunton Piano Co.*, 111 N. J. L. 596, 603, 169 Atl. 177, 180 (1933), in which the court said of a similar statute: "The statute does not grant a stay or delay and therefore does not deal with the question of a moratorium."

11. The previous act used the phrase "fair value", which the court criticized as indefinite since "fair value" in Pennsylvania means "fair market value", which can hardly be applied where there is no market as during the depression. This criticism applies only to emergency legislation, for only during an emergency is there no market.

12. *Beaver County B. & L. Ass'n v. Winowich*, 323 Pa. 483, 508, 187 Atl. 481, 492 (1936).

13. *Beaver County B. & L. Ass'n v. Winowich*, 323 Pa. 483, 493, 187 Atl. 481, 486 (1936), quoting from *The Planters' Bank of Miss. v. Sharp*, 6 How. 301, 327 (U. S. 1848): "One of the tests that a contract has been impaired is that its value has by legislation been diminished. It is not, by the constitution, to be impaired at all. This is not a question of degree or man-

was forced to accept a "fair value" as placed on the land by the court, the difference between this value and the sale price then being deducted from the deficiency judgment. Obviously, the mortgagee did suffer a permanent reduction in income whether it be denominated the impairment of a substantive right, as the court held, or merely an alteration in form of procedure. Undoubtedly the alternative provisions of the Act will be considered separately to determine whether either provision standing alone will pass the test of constitutionality. Accordingly, the validity of the provision for fixing the fair market value will not be considered as affected at all by the first alternative, on the ground that essentially there is no more than a choice between a definite impairment of the obligation of the contract¹⁴ and an alternative which may or may not be an impairment in itself.

To argue that the abolition of the deficiency judgment, considered independently, is not a definite impairment of the obligation of the contract is hardly tenable, for the right to a deficiency judgment is an inseparable coincident of the obligation of the mortgage. The abolition of the deficiency judgment was the very reason for holding the Arkansas statute unconstitutional,¹⁵ and that holding apparently is recognized even by the dissenting Justice in the *Winowich* case.¹⁶ Therefore the court, if it desire to be consistent, will hold this provision invalid.

The second alternative is the only remaining operative provision. The validity of the provision for compulsory postponement of the foreclosure sale for a period of possibly two years is questionable when considered in connection with the permanence of the Act. On the other hand, it may be argued that such a change constitutes a reasonable alteration of the remedy because the period is not so long that any true right of the mortgagee will be impaired. A statute suspending a similar foreclosure proceeding for six and one-half years was declared unconstitutional by the United States Supreme Court,¹⁷ but the Court upheld a statute providing for an extension of the redemption period not to exceed two years, and prohibiting any action for a deficiency judgment before the expiration of this period.¹⁸ In the latter case, however, emergency legislation was involved; further, the mortgagee's interest was protected since the income from the property was to be used for the payment of taxes, insurance, and on account of the mortgage indebtedness. The Court stated that in considering the question of reasonableness it was an important factor that in Minnesota mortgagees were, predominantly, not home owners or farmers, but corporations. The statute in that case was certainly more reasonable than the present Act which makes no provision for the protection of the mortgagee during the period of delay. In the *Winowich* case the court stated on the question of the reasonableness of the stay period that,

ner or cause, but of encroaching in any respect on its obligations, dispensing with any part of its force."

Id. at 506, 187 Atl. at 491. "The change wrought by the Pennsylvania Mortgage Deficiency Judgment Act is not merely of remedy but of substance. Whereas before its enactment the mortgagee after a sale on foreclosure had the important right to a judgment measured by the difference between the debt and the net proceeds realized from the sale, by the terms of the act this judgment is reduced by substituting the 'fair value' of the property for the price obtained at the sale as the amount of the credit to be allowed."

14. It hardly need be pointed out that since the court will not allow the amount of the deficiency judgment to be reduced by the amount of the "fair market value", it would not uphold a statute compelling the relinquishment of the entire right to a deficiency judgment. The provision operates to abolish the deficiency judgment, similarly to the statute struck down in *Adams v. Spillyards*, 187 Ark. 641, 61 S. W. (2d) 686 (1933), referred to in the *Winowich* case.

15. Ark. Acts 1933, no. 57, p. 158. The statute is set out in full in *Adams v. Spillyards*, cited *supra* note 14.

16. *Beaver County B. & L. Ass'n v. Winowich*, 323 Pa. 483, 521, 187 Atl. 921, 924 (1936).

17. *W. B. Worthen Co. v. Kavanaugh*, 295 U. S. 56 (1935).

18. *Home B. & L. Ass'n v. Blaisdell*, 290 U. S. 398 (1934), involving Minnesota Mortgage Moratorium Law, MINN. STAT. ANN. (Mason, Supp. 1936) § 9633-1.

"There is an obvious difference between an act the purpose of which is the prescription of a *reasonable and safeguarded* stay, and one which attempts an illegal deprivation of the substantive rights of a creditor, even if its invalid operation is only for a temporary period."¹⁹

Since the court will not allow an unreasonable stay in a statute of limited duration, it follows that it certainly would be loath to allow such a stay in a statute of permanent duration. Moreover, under the Pennsylvania Act the delay will be encountered whether there is an emergency or the market is simply sub-normal.²⁰ Of course, in the latter situation, the possibility of a sale will depend upon whether the court exercises its discretion in fixing the "fair market value" at a figure which is reasonably apt to be bid.

Another feature of the Act which must receive the consideration of the court is the failure to limit its effect to the purchase of the property by the mortgagee himself. This is an unfortunate situation. There is no reason whatever for compelling the mortgagee to credit his debtor with a benefit which has accrued to a stranger as the result of general economic conditions. In *Vanderbilt v. Brunton Piano Co.*²¹ the New Jersey Supreme Court declared the first New Jersey statute unconstitutional, pointing out that the statute applied without distinction between a sale to a third party and a sale to the mortgagee, thus making the impairment of the obligation more obvious. In considering a subsequent statute of equally wide application the New Jersey court referred to the *Vanderbilt* case on this point and again rendered a decision unfavorable to the legislation.²² On the other hand, the United States Supreme Court upheld as valid a statute which was restricted to a purchase directly or indirectly by the mortgagee.²³ On this aspect of the question the Pennsylvania Supreme Court has expressed itself as follows:

"The facts in the present case do not call for a discussion of a further *obviously untenable* feature of the act—that apparently the mortgagee must

19. Italics added. *Beaver County B. & L. Ass'n v. Winowich*, 323 Pa. 483, 510, 187 Atl. 481, 493 (1936).

20. It seems that the effect of the Pennsylvania statute is to shift the burden of bad market conditions to the mortgagee. The mortgagors' debt is not paid; instead the mortgagee must take land and, at a time when there is no market, must pay for the land a price equivalent to what it is worth in normal times. The agreement by which money is loaned and security taken seems not to look toward the lender suffering the consequences of bad general economic conditions, but rather contemplates that the risk be on the borrower. Therefore, the purpose of the statute should be to effect an equitable adjustment of loss in a situation not contemplated—an emergency—and should be limited to emergencies, for otherwise the borrower is secured rather than the lender. On the equitable considerations involved in a justification of this and similar legislation see Farage, *The Mortgage Deficiency Judgment Acts and Their Constitutionality* (1937) 41 DICK. L. REV. 67; Stone, *Mortgage Moratoria* (1936) 11 WIS. L. REV. 203; Notes (1935) 9 TEMPLE L. Q. 227; (1936) 11 TEMPLE L. Q. 63; (1937) *id.* at 404; (1935) 84 U. OF PA. L. REV. 223; (1937) 24 VA. L. REV. 44. Compare the Proposed Uniform Real Estate Mortgage Act, which provides that after foreclosure the mortgagee may secure a deficiency judgment for the difference between the sale price and the amount of the debt upon showing that the property was sold for its fair market value at the time of the sale, but if sold for less the credit upon the deficiency judgment will be the difference between the sale price and the fair market value. If the sale price was greater than the fair market value, the deficiency judgment will be for an amount equal to the difference between the sale price and the amount of the debt. In any case the mortgagee may obtain a sale after a delay of 120 days. This act is appreciably less stringent than the Pennsylvania Act, and yet Article II limits the application of the former to mortgages executed after it shall have been passed. It seems a justifiable inference that the drafters of the Uniform Act recognized the serious constitutional questions involved in a wider application of a statute of this nature.

21. 111 N. J. L. 596, 169 Atl. 177 (1933).

22. *Sayre v. Duffy*, 13 N. J. Misc. 458, 179 Atl. 459 (Sup. Ct. 1935).

23. *Richmond Mtge. & Loan Corp. v. Wachovia Bank & Trust Co.*, 57 Sup. Ct. 338 (U. S. 1937), *aff'g* 210 N. C. 29, 185 S. E. 482 (1936), 85 U. OF PA. L. REV. 533 (1937).