

BIDDING AT SHERIFF SALES

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September, 2001[©]

This article is intended to give a brief overview of the bidding process for judicial sales in the State of Illinois. It is important to recognize that there are several different scenarios that can come about during the foreclosure process in relation to bidding. One scenario is where there is only a first mortgage. The second would be where the first mortgagee is foreclosing with junior lienholders. The third would involve bidding as the junior lienholder at its own sale and finally, the junior lienholder bidding at the first mortgage holder's sale. This paper will try to explain how to handle each of these situations.

The first topic that needs to be discussed is bidding where your client is the first and only mortgagee of the property. As a backdrop to all bidding issues, the United States Supreme Court in the case of BFP v. Resolution Trust Corporation, 114 S.Ct. 1757 (1994) described what was considered, in the context of the bankruptcy court, as a reasonable equivalent for value. The court indicated that it felt, and is now the law of the land, that the amount bid at the time of the sale is reasonably equivalent value and equates same with "fair market value". Therefore, to the extent that we had previous law dealing with a 70% fair market value in bankruptcy court or a case by case basis, the decision has been issued and the BFP case provides that the amount that is bid at the sale is the amount that the value of the property is worth for purposes of bankruptcy code, and presumably for purposes of state court action.

The only issue that a client has with regard to bidding where it has the first and only mortgage on the property is whether or not they are going to bid any type of deficiency. Please keep in mind that to the extent that there has been a Chapter 7 bankruptcy discharge, or the debtors were served by publication, the action can only be in rem. The deficiency judgment will not amount to much of anything. The question of whether or not to go for the deficiency may be a strategic one based on the provisions of the statute.

The Illinois statutes provide that the debtors shall have an additional period of redemption where there is a deficiency bid. That additional period of redemption is for thirty days after the date the sale is confirmed and the redemption amount will be the amount that was bid at the sale plus any additional costs or expenses incurred post sale (see 735 ILCS 5/15-1604). Therefore, if a client does not wish to have the additional thirty day period of redemption, the client should seriously consider

making a full debt bid. On the other hand, because of certain constraints with Fannie Mae and VA/FHA loans, there may very well be a deficiency judgment that issues.

One particular problem that we have had in the Circuit Court of Cook County (doesn't everyone?) deals with deficiency judgments. If a judgment is relatively small, the judges do not question same. However, I have had some judges request appraisals or broker price opinions where we have had extremely large deficiency balances. This further delays the confirmation process and of course, delays the additional period of redemption. Please keep this in mind when discussing the bid by a client in anticipation of the sale.

The second scenario that presents itself is where you represent the senior lienholder and there are junior lienholders existing against the property. If you have properly named and served these junior lienholders, they will be extinguished through the foreclosure procedure. Therefore, the amounts that are due and owing to those junior lienholders are irrelevant to your client's bid process. The only comment that we would want to make on this particular matter is that occasionally you will find that you did not name the appropriate junior lienholders in the foreclosure action.

There are two cases that have been cited routinely for the fact that the only right of the junior lienholder is a right of redemption and that you should be able to extinguish their lien interest. The first case was Baldi v. Chicago Title and Trust, 1130 Ill.App.3d 29 (1983). The problem with Baldi is that the decision was before the IMFL changes that occurred in 1987. Title companies are not willing to rely on Baldi. The second case and the one that should be cited is Orloff v. Patak 224 Ill.App.3d 638 (3rd Dist. 1992). This case has not been cited or overturned and appears to uphold the reasoning that was set forth in Baldi. In the Orloff case, a junior lienholder was omitted from the foreclosure proceeding and the court felt that the junior lienholder's interest would have been in redemption only. Title companies feel these two cases are on less than firm ground, however, they may be a bullet in your arsenal in the event that you need to use them in the future.

The bidding that is held in this particular situation is exactly the same as the bidding as described where there is only one mortgage on the property.

We now tread into the realm of second mortgage bidding which holds innumerable problems and pitfalls for the client. The significant issues that need to be dealt with herein concern what action is taken by the second mortgagee in the first mortgage holder's foreclosure action. All too often we find that clients do not receive documents from process servicing or are not aware that there is a

pending foreclosure action by the first mortgage holder. By the time the file reaches the attorney's office, matters could very well have gone past the point of judgment and may actually be just prior to the sale date. Therefore, it is necessary for us to break down different scenarios in this regard.

The first scenario that is the easiest to discuss is where the first mortgage has filed its foreclosure action, summons has been served and timely transmitted to the attorney for the second mortgage holder. This all occurs prior to the entry of the Judgment of Foreclosure and Order of Sale. The second mortgage holder's attorney then files his/her Appearance and Answer in the foreclosure action and the judgment date approaches. The attorney appears at the judgment date or within thirty days of the entry of the judgment, present its proofs to the court that it wishes to protect its interest and that it wants the court to determine that his client has a good and valid second lien on the property subject only to the first lien, and provides the amounts that are due and owing.

The Judgment of Foreclosure and Sale will then reflect that the second mortgage holder has proved up its second lien interest and that it is a valid mortgage subject to that of the first mortgage holder. This is what we commonly refer to as the prove up of the second lien interest.

Why is the prove up necessary? The prove up is necessary due to the bidding process that will occur. The first mortgage holder will be bidding part, or all of its balance due. The first mortgage holder need not come in with any funds at the time of the sale since it is "deficit bidding" its balance. The second mortgage holder would also like to deficit bid but can only do so to the extent of the amount that the court has determined to be due and owing to the second mortgage holder. So, let us take the example that the first mortgage holder is owed \$100,000.00 and the second mortgage holder is owed \$50,000.00. The total debt on the property would be equal to \$150,000.00. The first mortgage holder, if it were the only lienholder on the property, could bid up to \$100,000.00 and not have to pay any money at the time of the sale by deficit bidding.

In this scenario, where the second mortgage holder has proved up its \$50,000.00 lien, the first mortgage holder would bid \$100,000.00 and the second mortgage holder could bid up to \$150,000.00. That is, the \$100,000.00 owed by the first plus the \$50,000.00 that it has proved up in its lien interest for a total of \$150,000.00. The question is then how much money will need to be paid by the second mortgage holder at the time of the sale? Clearly, the second mortgage holder must pay the amount that the first mortgage holder bid at the time of the sale which would be the \$100,000.00 figure. The second mortgage holder, by virtue of having proved up its lien interest, can deficit bid its \$50,000.00 figure to the extent that it would bid \$150,000.00. Therefore, we have seen

that it is imperative that the second mortgage holder prove up its lien interest in the Judgment of Foreclosure and Sale so as to be able to deficit bid its balance. It has to outbid and has to pay the amount due and owing to the first lienholder.

Let us change the scenario that was just referenced above to make the facts such that the second lienholder did not prove up its lien interest. This can happen wherein papers are “found” just prior to the date of the sale and there is no time to go to court to prove up the lien interest or the court will not allow the prove up for a variety of reasons to be discussed below. In this scenario, the second mortgage holder is not allowed to deficit bid and would be required to come in with all cash for the total amount that the second mortgage holder would be bidding. In our scenario above, if we determined that the bid would be \$150,000.00, this second mortgage holder would have to come in to court with the sum of \$150,000.00 for its bid since there is no record in the court file that the second mortgage holder is due and owing any funds whatsoever. This is fraught with danger and the best practice that we can suggest to our clients is to bid \$1.00 over the first mortgage holder’s bid. It is clear that the second mortgage holder would have to pay that sum to begin with, therefore by bidding \$1.00 over, it is not putting the second mortgage holder at any substantial increased risk.

The issue is whether or not there are going to be third party bidders who outbid that second mortgagee’s bid and what action should the second mortgagee take to protect its balance and what ramifications does that have vis-a-vis the borrowers?

The issue we are faced with is what really happens to the surplus funds? If we were to look at the Report of Sale that would be issued, it would show that an amount was bid over and above the first mortgage holder’s balance. Let us take the example that \$125,000.00 was bid on the sale where the first was \$100,000.00. What happens to that \$25,000.00? Clearly, the second mortgagee would prepare a motion and be running into court asking the court to find that it has a lien interest up to the extent of \$50,000.00 and that the second mortgage holder is entitled to a refund of the \$25,000.00. In many instances, this motion would be granted and the funds disbursed to the second mortgage holder. However, notice has to be given to the borrower and it could be that the borrower also will be running into court asking that those funds be disbursed to him or her.

Members Equity Credit Union v. Duefel 692 N.E.2d 865 (3rd Dist. 1998) discussed the issue as to what happens when there is a surplus fund. In that case, the issue was whether or not the court erred in ordering the surplus resulting from the foreclosure of a junior mortgage be applied to the payment of a senior mortgage which was not part of the foreclosure process. The court cited and

distinguished Kankakee Federal Savings and Loan v. Mueller 134 Ill.App.3d 943 (1985) for the proposition that the successful bidder at the first's sale could then take the surplus and apply it to the junior mortgage that was held on the property. This was due to the fact that the successful bidder at the sale was the senior lienholder and a defendant in the case. The facts of Members Equity are reversed, and the court held that the buyer at a Judicial Sale takes the property subject to any outstanding debts which may encumber the property subsequent to the sale and therefore felt that the trial court abused its discretion in ordering the surplus funds to be applied to the first mortgage and held that the surplus funds should move to the borrower instead. The law is not as clear as we would like it to be with respect to asking the court to turn over those surplus funds to the junior lienholder. The court in the case specifically did not condone the action of the junior lienholder in failing to Appear and Answer the complaint, but did allow those funds to be distributed. The practioner representing a junior lienholder should carefully review the judgment as entered by the senior lienholder. What provision is made in the judgment with respect to a distribution of surplus proceeds? The statutory procedure is found at 735 ILCS 5/15-1512. A judgment entered should reflect the language of paragraph D allowing the funds to be held until further order of court. It is necessary to review the language of the judgment entered. It seems clear that in order to protect your interest as a junior lienholder, the minimum pleadings should be filed asserting a right to the surplus funds. It is also important that the client understands that timely transmission of pleadings and procedures to the attorneys are absolutely a requirement.

One of the issues that we have encountered over the years is coming in to court between the time that the judgment has been entered and prior to the day of the sale to prove up the junior lienholder's interest. In past years, practices have been lenient by the courts allowing the motion by the junior lienholder to amend the judgment in terms of lien priority and to allow their prove up interest. Recently, many Illinois courts are stricter with respect to this matter, and require a 2-1401 petition to vacate the default against a junior lienholder to allow the prove up where filed more than 30 days after judgment. A 2-1401 petition must meet certain necessary requirements in order to be presented to the court and for that petition to be granted. I would commend to your reading the distinction between a motion within thirty days and a 2-1401 petition in Bank and Trust Company v. Line Pilot Bungee, Inc. 323 Ill.App.3d 412 (5th Dist. 2001).

Therefore, it is important to know early on as to a client's intentions concerning this particular problem. If we know early on, the motion to vacate would be relatively routine within the thirty day period after judgment. However, if the client delays its decision beyond this 30 day period, it becomes much more onerous and much more treacherous with respect to handling the matter.

There are a few ancillary issues that need to be addressed that concern whether or not a third lienholder can prime a second lienholder in terms of prove up and bidding at the time of the foreclosure sale, and the effect of transfer of title to a bonafide purchaser for value?

It is clear that a junior lienholder can not extinguish the rights of a senior lienholder. Heritage Federal Credit Union v. Giampa 622 N.E.2d 48 (1993) clearly set forth the current status of the Illinois law that a suit to foreclose a junior mortgage can only cut off rights of interest subsequent to the interest that is being foreclosed. Therefore, it is imperative to review title when viewing the foreclosure action to ascertain that the proper parties have been named and what will be the state of title upon completion of the foreclosure action.

Distinguished from Giampa is Mid-America Federal Savings and Loan Association v. Liberty Bank 204 Ill.App.3d 995 (1990) which involved a situation where the third lienholder was able to prime the second lienholder due to the default of the second lienholder. The court held that the third lienholder had taken all action necessary to prove up its lien interest, that the second lienholder had failed to Appear or Answer or otherwise plead and therefore, pursuant to the terms of the judgment, the proceeds of the sale were to be distributed first to the first mortgage holder and then second to the third lienholder. This also brings up the point that it is imperative that the second lienholder review the Judgment of Foreclosure and Order of Sale with respect to the distribution of sale proceeds in the event of any type of surplus. For a discussion of this issue, see World Savings and Loan Association v. Amerus Bank 317 Ill.App.3d 772 (1st Dist. 2000).

One final note that is interesting concerns whether or not a borrower could purchase property back at a foreclosure sale and extinguish a junior lien interest. The case of BCGS, L.L.C. v. Jaster 299 Ill.App.3d 208 (2nd Dist. 1998) is of interest in this matter as well as referring to Restatement of the Law of Mortgages, Section 4.9. This poses some interesting reading for those attorneys who might be representing borrowers as well as junior lienholders who did not bid at the time of the foreclosure action.

The above was meant to be a general discussion as to bidding and we would commend the cases to you for reading as well as discussion with other counsel on this particular matter.