PUBLICATION

"Materially Less": The Foreclosure Deficiency Standard in Tennessee

September 03, 2013

Like many other states, Tennessee allows a creditor who has conducted a foreclosure sale of real property secured by a deed of trust or mortgage to recover "a deficiency judgment in an amount sufficient to satisfy fully the indebtedness." Tenn. Code Ann. § 35-5-118(a). In some cases, the debtor attempts to challenge an action for deficiency by claiming that the foreclosure sale price was insufficient. Practically, this issue will likely come up most often in the context of the creditor's summary judgment motion, where the debtor offers evidence, such as an affidavit or appraisal, of a market value higher than the sale price realized at the foreclosure sale. In those cases, the court must determine whether the evidence presented by the debtor presents an issue of material fact as to the creditor's right to a deficiency judgment based upon the price realized at the foreclosure sale. Thus, the question becomes: how close to the "fair market value" suggested by the debtor does the sale price have to be?

If the foreclosure occurred in Tennessee on or after September 1, 2010, we look first to the Tennessee Code:

(b) In all such actions, absent a showing of fraud, collusion, misconduct, or irregularity in the sale process, the deficiency judgment shall be for the total amount of indebtedness prior to the sale plus the costs of the foreclosure and sale, less the fair market value of the property at the time of the sale. The creditor shall be entitled to a rebuttable prima facie presumption that the sale price of the property is equal to the fair market value of the property at the time of the sale.

(c) To overcome the presumption set forth in subsection (b), the debtor must prove by a preponderance of the evidence that the property sold for an amount **materially less** than the fair market value of property at the time of the foreclosure sale. If the debtor overcomes the presumption, the deficiency shall be the total amount of the indebtedness prior to the sale plus the costs of the foreclosure and sale, less the fair market value of the property at the time of the sale as determined by the court.

Tenn. Code Ann. § 35-5-118(b)–(c) (emphasis added). Based on this statute, a debtor faced with a deficiency action will often argue that the sale price was "materially less" than the fair market value of the property at the time of the sale. But what exactly does "materially less" mean?

It is at least somewhat significant that the statute's enactment marked an obvious shift from the standard previously applied in Tennessee. Before the statute, a debtor could only overcome the presumption that the sale price represents the fair market value of the property by showing that the foreclosure sale price was "grossly inadequate" as compared to the fair market value. *See Lost Mountain Dev. Co. v. King*, No. M2004-02663-COA-R3-CV, 2006 WL 3740791, at *5 ("[T]he debtor is entitled to present evidence about the fair market value of the property at the time of the sale so as to attempt to overcome the presumption and prove that the sale price was grossly inadequate."). Thus, the current version of Tenn. Code Ann. § 35-5-118 changed the debtor's rebuttal standard from "grossly inadequate" to "materially less." But, what's the difference between "grossly in adequate" and "materially less"? How exactly did the statute change the standard?

Fortunately, Tennessee courts have already begun crafting answers to those questions. In *Greenbank v. Sterling Ventures, LLC*, the Court of Appeals of Tennessee examined the current version of the statute and provided a thorough analysis of its practical effect on the rebuttal standard. No. M2012-01312-COA-R3-CV, 2012 WL 6115015 (Tenn. Ct. App. Dec. 7, 2012). In interpreting the meaning of the phrase "materially less," the *Greenbank* Court looked to the legislative history of the statute. *Id.* at *8-9. Following an examination of comments made by various Representatives during discussion of the Bill, the Court concluded that:

[T]he Legislative intent in adopting the "materially less" standard was not to lessen the burden on the debtor so much as to negate the presumption that the sale price represents the fair market value. Rather, the term "materially less" still represents "a pretty substantial difference."

Id. at *9 (citations omitted). The Court noted further that "[i]t's a very difficult burden for the debtor to overcome . . . . You have to show a 'strong' difference, a 'material' difference." *Id.* (citations omitted).

In *Greenbank*, the debtor argued that the fair market value of the property at issue was between $735,000.00 and $750,000.00. The Court compared the highest value proposed by the debtor ($750,000.00) with the $667,400.00 price realized at the foreclosure sale, noting that the foreclosure sale price represented 89% of the highest fair market value proffered by the debtor. In determining whether a foreclosure sale price equaling 89% of the fair market value of the property was "materially less" than the fair market value. The Court examined the decision in *State of Franklin Bank v. Riggs*, the only other Tennessee case analyzing the statute. No. E2010-01505-COA-RV-CV, 2011 WL 5090888 (Tenn. Ct. App. Oct. 27, 2011). Noting that the *Riggs* Court found that "despite the [14%] difference between the foreclosure sale price and the appraised value, the property owners had not set forth a defense that 'at least had the potential of succeeding at trial,'" the *Greenbank* Court "infer[ed] that the *Riggs* Court concluded that a foreclosure sale price that was 14% below the appraised value did not meet the materially less standard in order to overcome the statutory presumption." *Greenbank*, 2012 WL 60115015 at *10 (citing *Riggs*, 2011 WL 5090888).

The *Greenbank* Court noted that its legislative history of the statute had shown that "the determination of 'materially less' is to be made on a case-by-case basis under the particular facts presented" and observed that "[s]ince the court will invariably be comparing the foreclosure sale price with the asserted fair market value of the property, it is axiomatic that a portion of the evidence presented will focus on the percentage difference between these two figures." *Id.* Though the Court declined to "establish a bright-line percentage, above or below which the statutory presumption is rebutted," it concluded, in light of the *Riggs* decision, that if a 14% difference did not constitute "materially less," it could not conclude, under the circumstances presented, that an 11% difference was materially less. *Id.*

Thus, in *Greenbank*, the Court found that by presenting evidence that the foreclosure sale price represented 89% of the fair market value of the property at the time of the sale, the debtor did not overcome the presumption that the foreclosure price was equal to the fair market value of the property. Accordingly, the Court found that summary judgment had been property awarded to the Bank. *Id.* at *11.

Though the *Greenbank* court declined to set out a "bright-line percentage, above or below which the statutory presumption is presented," the case law as it stands now certainly seems to establish that, in most circumstances, evidence that a sale price represents at least 86% of the fair market value proffered by the debtor will be insufficient to overcome the presumption that the foreclosure sale price is equal to the fair market value of the property at the time of the sale. Thus, barring extraordinary circumstances, if the foreclosure sale price is no more than 14% lower than the highest value offered by the debtor, the creditor has a good chance of winning summary judgment as to that issue. What we don't know is the position of the outer bounds. What if that number reaches 15%, 18%, or 25%? As it stands now, perhaps the absence of an outer threshold is a positive thing for creditors, who should have little difficulty making good faith arguments that even more significant differences are not "materially less" under the statute. Debtors, on the other hand, are unlikely to successfully challenge a creditor's summary judgment motion without evidence that the sale price was less than 86% of the fair market value.

In addition to the arguably significant 14% benchmark, there are a couple of things to keep in mind. First, though it is clear that the "materially less" standard remains a "significant burden" on the debtor, it is equally clear that the legislature intended the statute to lower the debtor's burden to some degree. Second, both *Greenbank* and *Riggs* were decided in the absence of any allegation of "fraud, collusion, misconduct, or irregularity in the sale process." Such allegations, sufficiently plead, will likely preclude the application of the presumption provided in the statute, significantly altering the analysis from that discussed in those cases. Consequently, debtors may be more inclined to include fraud allegations when challenging the sufficiency of a foreclosure sale price.