

UNITED STATE BANKRUPTCY COURT
EASTERN DISTRICT OF TENNESSEE
Southern Division

In re

DONALD LOUIS WAMP, JR.

Debtor

Bankruptcy Case
No. 94-11482

**UNION PLANTERS BANK OF
CHATTANOOGA**

Plaintiff

v.

Adversary Proceeding
No. 95-1046

**DONALD LOUIS WAMP, JR., &
CAROL O'DELL**

Defendants

MEMORANDUM

APPEARANCES:

Everett L. Hixson, Jr., & J. Christopher Hall, Shumacker & Thompson,
Chattanooga, Tennessee, Attorneys for Union Planters Bank

Thomas E. Ray, Ray & Sibley, Chattanooga, Tennessee, Attorneys for Carol
O'Dell

R. Thomas Stinnett, United States Bankruptcy Judge

Union Planters Bank began this adversary proceeding by filing a complaint for declaratory judgment against two defendants. One defendant, Donald Louis Wamp, Jr., has a Chapter 13 bankruptcy case pending in this court. Union Planters had a mortgage on a house and lot owned by Mr. and Mrs. Wamp. Union Planters bought the house and lot at the foreclosure of its mortgage. The other defendant, Carol A. O'Dell (Ms. O'Dell), then purchased the house from Union Planters.

Ms. O'Dell filed a motion to dismiss for lack of subject matter jurisdiction. The court denied the motion because it was not accompanied by a brief. See Local Bankr. Rule 9(c). Ms. O'Dell has filed another motion to dismiss for lack of subject matter jurisdiction. The new motion asks the court to dismiss or to set aside the order denying the earlier motion to dismiss and rule on its merits. The new motion also asks the court to abstain if dismissal is not required. 28 U.S.C. § 1334(c). The court will set aside the order denying the earlier motion to dismiss and will deal with both motions as one. The court reaches the conclusion that the pleadings fail to sufficiently allege subject matter jurisdiction.

The complaint makes the following allegations. Mr. Wamp and his wife executed a promissory note to Union Planters and secured the debt by a deed of trust on a house and lot in Lookout Mountain, Tennessee. Mr. Wamp defaulted in payments and Union Planters foreclosed. Union Planters bought the property at foreclosure. Its bid was set off against the debt, and Union Planters filed a deficiency claim in Mr. Wamp's Chapter 13 case for \$14,874.86. Union Planters agreed to sell the property to Ms. O'Dell for \$97,200. The contract with Ms. O'Dell provided that she bought the property "as is" except for Union Planters' agreement to repair the upstairs plumbing. A title search revealed a federal tax lien on the property. The IRS's right to redeem purportedly prevented Ms. O'Dell from getting

permanent financing. Union Planters agreed to lend Ms. O'Dell the purchase money until the redemption period ended, but after that Ms. O'Dell was supposed to get permanent financing elsewhere. Ms. O'Dell executed a promissory note to Union Planters secured by a deed of trust on the property. Ms. O'Dell took possession of the property. Immediately before her note to Union Planters became due, Ms. O'Dell began complaining about the condition of all the plumbing. According to the complaint, she demanded that the sale be rescinded or that Union Planters replace the entire plumbing system. It is alleged any such problems with the property are the result of Mr. Wamp's ownership and possession, and the deed of trust makes him liable to Union Planters for the cost of repairs it is required to make.

The complaint seeks a declaratory judgment that Union Planters' contract with Ms. O'Dell does not require it to repair any problems other than the upstairs plumbing. In the alternative, the complaint demands that Union Planters be allowed to add to its claim in Mr. Wamp's Chapter 13 case the cost of any repairs it is required to make. Mr. Wamp has not filed a response to Union Planters' complaint, but Union Planters has not requested judgment by default. FED. R. BANKR. P. 7055; FED. R. CIV. P. 55.

According to Union Planters, its dispute with Ms. O'Dell comes within the bankruptcy jurisdiction of the federal courts because the outcome will determine the amount of its claim in the Chapter 13 case. 28 U.S.C. § 1334(b) & § 157(a), (b). Union Planters bases this assertion on the theory that it has the right to add the cost of repairs to its claim in Mr. Wamp's Chapter 13 case.

The motion of Ms. O'Dell asserts that Union Planters' claim is limited to the amount of the filed deficiency claim (about \$15,000). She contends that allowing Union

Planters to collect the cost of repairs would amount to setting aside the foreclosure sale and reducing Union Planters' bid.

When a mortgagee buys the property by bidding at a foreclosure sale, the mortgagee credits the amount of the bid against the debt owed by the mortgagor. The following examples may help explain the legal issues. To keep the examples simple, the court will ignore foreclosure costs and interest accruing after foreclosure.

The mortgage debt is \$100,000. The mortgagee buys the property at the foreclosure sale by bidding \$75,000. This is credited against the \$100,000 debt, leaving a deficiency of \$25,000 owed by the mortgagor. If the mortgagee resells the property for only \$65,000, will it be entitled to add \$10,000 to the deficiency claim against the mortgagor? No, the mortgagor will still owe a deficiency of \$25,000.

Suppose the mortgagee made \$5,000 in repairs after it bought the property at foreclosure for \$75,000. The mortgagee then resells the property for \$78,000. The effect is the same as if the mortgagee simply resold the property for \$73,000 without making any repairs. If that had happened, the mortgagee could not increase the deficiency by adding the \$2,000 difference between its bid (\$75,000) and the resale price (\$73,000). Union Planters contends, however, that the mortgagee in this example should be allowed to increase the deficiency by \$2,000 since it did make the repairs after foreclosure.

Union Planters actually takes the argument another step. Suppose the mortgagee resold the property for \$78,000 without making any repairs, but as a result of warranties it made in the sale contract, it pays \$5,000 for repairs after the sale. The

mortgagee probably could have avoided the cost by not making any warranties, though that may have reduced the price. The mortgagee may not incur the repair costs until long after the foreclosure. Nevertheless, Union Planters proposes a rule that the mortgagee could add at least part of the repair costs to the deficiency.

The court does not agree. The mortgagee may have the right to recover from the mortgagor for injuries to the property. This right exists, however, as a means for the mortgagee to protect the value of the property *as security for the debt*. Suppose the debtor, before foreclosure, caused damages to the property that reduced its value by \$40,000. The foreclosure price, however, leaves a deficiency of only \$10,000. The \$10,000 deficiency is the maximum amount of harm to the mortgagee since its interest in the property existed only to secure the debt. The mortgagee cannot recover more than the deficiency after foreclosure.

The reasoning of the Tennessee Supreme Court supports this result. A mortgagee can hold the mortgagor liable for injuries to the property only to the extent they reduce the property's value to less than the secured debt. *Lieberman, Loveman & Kohn v. Knight*, 153 Tenn. 268, 283 S.W. 450 (1925). Some courts, following a different rule, require the mortgagor to maintain a debt-to-value ratio or a margin of security. *Finley v. Chain*, 176 Ind.App. 66, 374 N.E.2d 67 (1978). Under either rule, however, the mortgagee's right to recover damages *after foreclosure* is limited to the amount of the deficiency:

When the waste is assessed in a foreclosure action or after foreclosure, so that the debtor-creditor relationship no longer exists, it is unnecessary to give the mortgagee the benefit of any margin of security; in such a case, the recovery is limited to the deficiency or the unpaid debt, even if the loss of value of the real estate is much greater. *Finley v. Chain*, 176 Ind.App. 66, 374 N.E.2d 67 (1978);

Leipziger, *The Mortgagee's Remedies for Waste*,
64 Calif.L.Rev. 1086, 1098-1099 (1976).

Restatement (Third) of the Law of Property-Security (Mortgages) § 4.6, Tentative Draft No. 3 (1994).¹ See *Prudential Insurance Co. v. Spencer's Kenosha Bowl, Inc.*, 404 N.W.2d 109 (Wis. 1987); *Edelman v. Poe*, 103 So.2d 33 (Ala. 1958).

There is another reason for not allowing Union Planters to increase the deficiency claim by adding the cost of repairs made after foreclosure. A mortgagee that bids too much at foreclosure cannot undo the bid and reduce the price to cover the cost of the repairs, unless it can prove a ground, such as fraud by the mortgagor, for setting aside the foreclosure sale. In *Duke v. Daniels* the mortgagors argued that the sale price at foreclosure was too low. The mortgagors disputed the mortgagee's testimony that the need for repairs made the price low. The trial court put the burden on the mortgagee to prove the cost of repairs. The Court of Appeals reversed, saying:

The Chancellor faulted the plaintiff for not proving his assertion made that it would cost \$10,000.00 to repair the property. This assertion was made when plaintiff explained why he bid the property at \$8,000.00. Again, this burden was not on the plaintiff nor was there any burden to take into consideration "enhanced values." *The public sale price took all that into consideration.*

Duke v. Daniels, 660 S.W.2d 793, 795 (Tenn. App. 1983) (Emphasis added by the court.)

In *Stout v. Fuqua*, the mortgage applied to three tracts of land. The mortgagee foreclosed on one tract. He bought the tract at the foreclosure sale by bidding more than the

¹Available on Westlaw.

balance due on the secured debt. The mortgagee then held a second foreclosure sale of the same tract plus another of the mortgaged tracts. At the second foreclosure sale, the mortgagee supposedly bought both tracts for a bid that was less than the balance due on the secured debt. The court of appeals held the mortgagee bound by his bid at the first foreclosure sale and set aside the second. *Stout v. Fuqua*, 20 Tenn.App. 608, 103 S.W.2d 28 (1937). See also *Holt v. Citizens Central Bank*, 688 S.W.2d 414 (Tenn. 1984).

Thus, a mortgagee is bound by the amount of its bid at a foreclosure sale unless it can show a ground, such as fraud by the mortgagor, for setting the sale aside. Union Planters has not alleged a ground for setting aside the foreclosure sale, but it wants to accomplish the same thing by adding the cost of repairs to its claim against Mr. Wamp. That is not allowed under the rule expressed by *Stout v. Fuqua* and *Duke v. Daniels*.

The pleadings do not show any way for Union Planters to collect more from Mr. Wamp than the deficiency (about \$15,000) that was established by Union Planters' bid at the foreclosure. It follows that the outcome of the dispute between Union Planters and Ms. O'Dell will not affect Union Planters' claim in Mr. Wamp's bankruptcy case. The Sixth Circuit has adopted a broad view of bankruptcy jurisdiction, but in this situation the court does not have jurisdiction. See *Michigan Employment Security Commission v. Wolverine Radio Co. (In re Wolverine Radio Co.)*, 930 F.2d 1132 (6th Cir. 1991); *Ameritrust Co. v. Opti-Gage, Inc. (In re Opti-Gage, Inc.)*, 128 B.R. 189 (Bankr. S. D. Ohio 1991); *In re S. F. Cambridge Associates*, 135 B.R. 529 (Bankr. E. D. Tenn. 1991).

The court will allow Union Planters ten (10) days to amend its complaint. If no amendment is filed, the court will dismiss for lack of subject matter jurisdiction.

This Memorandum constitutes findings of fact and conclusions of law as required by FED. R. BANKR. P. 7052.

BY THE COURT

R. THOMAS STINNETT
UNITED STATES BANKRUPTCY JUDGE

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ORDER

In accordance with the court's Memorandum entered this date,

It is ORDERED that Union Planters Bank of Chattanooga is allowed ten (10) days from the date of entry of this order within which to amend its complaint. If the complaint is not amended within the time allowed, the complaint will be dismissed for lack of subject matter jurisdiction.

ENTER:

BY THE COURT

R. THOMAS STINNETT
U.S. BANKRUPTCY JUDGE

[entered August 21, 1995]