COURT OF APPEALS
DECISION
DATED AND FILED

December 17, 2009

David R. Schanker
Clerk of Court of Appeals

Appeal No. 2008AP2 **Cir. Ct. No. 2003CV230**

STATE OF WISCONSIN **IN COURT OF APPEALS**
DISTRICT II

FEDERAL NATIONAL MORTGAGE ASSOCIATION,

PLAINTIFF-THIRD-PARTY PLAINTIFF-RESPONDENT,

V.

SCOTT T. LEWIS AND APRIL D. LEWIS,

DEFENDANTS,

FIRST MIDWEST BANK,

DEFENDANT-RESPONDENT,

ILLINOIS PROCESS SERVERS, INC. AND ABC INSURANCE COMPANY,

THIRD-PARTY DEFENDANTS,

DANIEL L. PARISE AND HELEN M. PARISE,

THIRD-PARTY DEFENDANTS-APPELLANTS.

APPEAL from a judgment of the circuit court for Walworth County: ROBERT J. KENNEDY, Judge. *Reversed and cause remanded for further proceedings*.

Before Vergeront, Lundsten and Storck, JJ.[1]

¶1 PER CURIAM. Appellants Daniel Parise and Helen Parise purchased a home after a foreclosure sale. They appeal the circuit court's order establishing the right of First Midwest Bank (Midwest) to acquire the property from them. Midwest was a second mortgage holder who was not joined as a party at the time of the foreclosure sale to the first mortgage holder, Federal National Mortgage Association (Federal). For the reasons that follow, we conclude that the circuit court erroneously exercised its discretion when fashioning the terms on which Midwest has the right to acquire the property from the Parises. Accordingly, we reverse and remand for further proceedings consistent with this opinion.

BACKGROUND

¶2 This case started as a simple foreclosure action. Federal, as the first mortgage holder, commenced this foreclosure action in March of 2003. The foreclosure summons and complaint named owners of the residence and a second mortgage holder, Midwest. Federal retained Illinois Process Service, Inc., to serve the summons and complaint on Midwest, but, unknown to Federal, its process server failed to properly serve Midwest.

[1] Circuit Court Judge John R. Storck is sitting by special assignment pursuant to the Judicial Exchange Program.

¶3 In May of 2003, Federal was granted by default a non-deficiency foreclosure judgment with a six-month redemption period. In November of 2003, the property was sold at sheriff's sale to Federal for $206,236.82, the amount of its judgment. The sheriff's sale was confirmed, and a sheriff's deed was given to Federal. Federal listed the home with a realtor and, on May 11, 2004, the Parises purchased the home for $166,000.00. As a result, Federal incurred a loss of approximately $40,000.

¶4 About eight months later, Midwest filed a motion to reopen the default judgment of foreclosure. Midwest was not properly served and, for that reason, the circuit court reopened the judgment and vacated it. Later, Federal joined the process server and the Parises as third-party defendants. Federal sought damages for the improper service against the process server. The Parises counterclaimed against Federal for damages.

¶5 On November 5, 2007, about four years after the sheriff's sale and about three and a half years after the purchase by the Parises, a trial to the court was held. All parties had the opportunity to put on evidence of the value of the property at the time of the sheriff's sale and at the time of trial, but only the Parises presented such evidence in the form of opinion evidence from Mr. Parise.

¶6 The circuit court held that Midwest was entitled to equitable subrogation of the mortgage. The circuit court wrote that Midwest "may redeem by paying the sum of Two Hundred Six Thousand Two Hundred Thirty-seven and 82/100 ($206,237.82) Dollars, at which time the first mortgage lien is revived, and the junior lienholder (FIRST MIDWEST) becomes subrogated thereto." The court ruled that, if Midwest paid the clerk of courts that sum, Midwest would be entitled to a sheriff's deed or a court deed to the property.

¶7 The circuit court also concluded that, if Midwest opted to "redeem" the property, the Parises were entitled to damages against Federal. The court calculated the damages by adding the purchase price ($166,000), the out-of-pocket improvement expenses paid by the Parises ($44,000), and real estate taxes for 2004 through 2006 ($8,730.13), for a total amount of $218,730.13.

¶8 Finally, if Midwest opted to redeem, the circuit court established for the Parises an "ultimate equity of redemption," that is, an amount the Parises could pay to Midwest to retain their property. The amount was set at $301,224.89 and was comprised of the amount the court determined Midwest would have paid to purchase the property, $206,236.82,[2] and the amount of Midwest's mortgage plus accrued interest, attorney fees, and costs of prosecuting and defending the action up to November of 2007, $94,988.07.

¶9 Under the court's ruling, Midwest was required to exercise its "right of redemption" on February 20, 2008. If Midwest chose to do so, the Parises, in turn, could "redeem" the property from Midwest by paying it $301,224.89 on that same date.

DISCUSSION

¶10 In fashioning equitable relief for Midwest, the circuit court relied on ***Buchner v. Gether Trust***, 241 Wis. 148, 5 N.W.2d 806 (1942). We agree that

[2] In setting the amount Midwest would have to pay to purchase the property, the court wrote that Midwest "may redeem by paying" $206,237.82, one dollar more than paid at the sheriff's sale by Federal. When the judgment was prepared, this amount appears in paragraphs 6 and 7 of the conclusions of law. In an apparent oversight, the judgment uses *$206,236.82* in computing the $301,224.89 figure the Parises would have to pay to Midwest to retain the property.

Buchner provides the framework for a resolution of this case, but we conclude that the circuit court erroneously exercised its discretion in applying ***Buchner*** to the facts of this case.

¶11 A court of equity has the power to fashion a remedy to meet the needs of a particular case. *See* ***Prince v. Bryant***, 87 Wis. 2d 662, 674, 275 N.W.2d 676 (1979). We therefore apply an erroneous exercise of discretion standard in reviewing decisions made in equity by the circuit court. ***Lueck's Home Improvement, Inc. v. Seal Tite Nat'l, Inc.***, 142 Wis. 2d 843, 847, 419 N.W.2d 340 (Ct. App. 1987). We will uphold the circuit court's decision if we find that the court examined the relevant facts, applied a proper standard of law, and, using a demonstrated rational process, reached a reasonable conclusion. ***McCleary v. State***, 49 Wis. 2d 263, 277-78, 182 N.W.2d 512 (1971).

¶12 The Parises contend that the circuit court failed to fashion an appropriate equitable remedy because, if Midwest elects to "redeem," the Parises, who are innocent, will be put in a worse position and Midwest will be put in a better position. The Parises' argument contains the implicit assumption that, at the time of the sheriff's sale, Midwest, as holder of a second mortgage, could not have benefitted from notice because the property was worth no more, and likely much less, than the first mortgage held by Federal. Thus, there would have been insufficient equity in the property to apply any funds toward the second mortgage held by Midwest.

¶13 Although we do not agree with all of the particulars of the Parises' arguments, we do agree that the relief ordered by the circuit court must be vacated because it inequitably harms the Parises and potentially provides an unfair

windfall to Midwest. We begin with a discussion of the case that all of the parties agree provides guidance, ***Buchner***.

¶14 In ***Buchner***, the plaintiffs purchased property as a result of a mortgage foreclosure proceeding. A junior judgment lienholder, Gether Trust, was named as a party in the mortgage foreclosure, but was not served. ***Buchner***, 241 Wis. at 150. The ***Buchner*** court rejected the Trust's argument that a foreclosure proceeding resulted in complete destruction of the first mortgage as a lien, thereby promoting the junior lien to a first lien and leaving title in the property subject to the lien of the Trust. The court explained that, when a subordinate lienholder has been deprived of the opportunity to participate in foreclosure proceedings, that lienholder retains the same rights he or she would have had, *but no more*:

> [W]here a senior mortgage has been foreclosed without making the claimant of a subordinate lien a party, the proceedings are not null and void but leave the holder of the subordinate lien with the same rights that he would have had, had he been made party to the foreclosure proceedings. This implies that his rights are not improved, or the rank of his judgment lien advanced. The rights of the subordinate lien claimant duly served with process in the foreclosure of a senior mortgage are to pay the mortgage or to redeem the property. These rights are unimpaired and unchanged by the defective foreclosure.... [T]he junior lien claimant may bring an action to redeem provided he does not lose his rights by laches.... [W]e discover no case holding that the rights of the junior claimant are improved or increased by the defect in the foreclosure proceedings. In accordance with quite elementary principles of justice, his position is preserved and *equity will not permit that he suffer any disadvantage from the failure to include him as a party. [At the same time, it] would be utterly unfair to do more than this.*

Id. at 152-53 (emphasis added; citations omitted). The court went on to say:

> Changes in the form of remedies do not affect substantive rights. It does not matter what label is put upon the

> attempt, whether by the purchaser at foreclosure sale or the holder of a junior lien, to arouse the conscience of a court of equity. Under the code, the facts are stated, and if in a substantive sense equitable rights are disclosed *the court will give such remedies as are appropriate to those rights*.

Id. at 153 (emphasis added). Thus, ***Buchner*** teaches that the remedy given a junior lienholder must be equitable under the circumstances.

¶15 Before moving on, we note that we will assume, without deciding, that the law requires that the property be offered to Midwest at some price. We acknowledge it might be argued that under ***Buchner*** a court may, if equity permits, simply extinguish the rights of a junior lienholder. But we do not address this question because the Parises do not present developed argument on it. Thus, we focus our attention on whether the price set by the circuit court was equitable.

¶16 We begin our analysis of the facts with a discussion of the value of the property at the time of the sheriff's sale. This amount is important because, if it was no more than the outstanding first mortgage, then there would have been insufficient equity in the property to cover any of the second mortgage held by Midwest. In that event, logic dictates that Midwest was not harmed by lack of notice. There are three reasons why we conclude that there is no dispute that the property's value was no more than the first mortgage amount.

¶17 First, at the sheriff's sale, a sale that by law must be advertised,[3] no one offered to pay more than the first mortgage amount.

[3] WIS. STAT. § 846.16(1) (2007-08). All further references to the Wisconsin Statutes are to the 2007-08 version unless otherwise noted.

¶18 Second, when later put up for sale with a realty firm, the property sold for substantially less than the first mortgage amount. There was a stipulation at the time of trial that: "After obtaining an appraisal on the property on May 11th, 2004, the Parises offered to purchase and did purchase the property from the plaintiff for $166,000." Mr. Parise testified at trial that the purchase was made through a realtor and that, at the time of the purchase, he was not aware that the property had been subject to a sheriff's sale. There is nothing indicating that this sale was anything but an arm's length transaction.

¶19 Third, none of the parties, including Midwest, presented evidence indicating that the property was worth more than the first mortgage amount at the time of the sheriff's sale. Cases such as ***Buchner*** put Midwest on notice that equity is a primary consideration in such matters. Thus, Midwest had an incentive to show that it was harmed by the lack of notice by presenting evidence that the value of the property exceeded the amount of the first mortgage. Midwest's failure to do so supports the view that the property's value did not exceed the first mortgage amount.

¶20 We conclude that the only reasonable inference from the record is that the value of the property at the time of the sheriff's sale was no more than the amount of the first mortgage. It follows that there is no reason to believe that Midwest would have benefitted from exercising any of the rights of a junior lienholder. Rather, the only reasonable inference is that, if Midwest had exercised its rights, it would have, as Federal did, added to its loss.

¶21 It is true that Midwest is an innocent party, but it is an innocent party that suffered no harm. This leads us to the problem with the circuit court's remedy. In an effort to treat Midwest fairly, the court determined that it would

permit Midwest to acquire the property for the amount it might have paid for the property if it had received notice, namely one dollar more than Federal's successful bid of $206,236.82. Presumably, Midwest will exercise this option only if the current value of the property is significantly higher than this purchase price, thus putting Midwest in a better position than if it had received notice in the first instance. This remedy runs afoul of ***Buchner***, which tells us that the junior lienholder's position should not be either improved or diminished.[4]

¶22 The remedy also fails to treat the Parises fairly. As the circuit court noted, the Parises are "faultless" in this matter. Like a typical home buyer, the Parises purchased a property listed with a realty company, paid what must be assumed was market value at the time, and proceeded to make improvements, both with their own labor and by paying for improvements. In the normal course, if they chose to do so, they could sell the property for its current fair market value. Thus, equitable treatment of the Parises would be to compensate them for their home at its fair market value. So far as we can discern, there is little reason to think that the amount the Parises will receive if Midwest decides to purchase their home would be equal to the home's current value.[5]

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[4] In addition to the right to purchase the property, a junior lienholder properly served in the proceeding to foreclose the senior mortgage also has the right to pay the senior mortgage and become subrogated to the rights of the senior mortgagee. ***Buchner v. Gether Trust***, 241 Wis. 148, 152, 5 N.W.2d 806 (1942). This is now codified at WIS. STAT. § 846.15. Had Midwest paid off Federal's mortgage of $206,236.82, it would then have been owed that amount plus its own lien—apparently approximately $45,000—but, as we have explained, the sheriff's sale would not have generated more than $206,236.82. The circuit court's order being appealed granted Midwest the right to purchase the property, not the right to pay off Federal's mortgage and be subrogated to Federal's rights. That makes sense given that Federal had purchased the property and sold it to a third party. No party contends that the court should have considered the subrogation option on the facts of this case.

[5] We observe that, if Midwest opts to "redeem" the property, the order permits the Parises to retain their home by paying Midwest $301,224.89. But, once again, this amount bears (continued)

¶23 In light of the circumstances, especially the fact that Midwest was not harmed by lack of notice, we conclude that the only reasonable remedy that gives Midwest back its lost opportunity is to permit Midwest to acquire the property at its current fair market value. We acknowledge that the Parises' attorney gave the circuit court little to work with. The record discloses that the attorney did not name any experts by a deadline and that Midwest moved to exclude expert testimony, but we do not know what would have happened had the Parises' attorney attempted to put on an expert regarding current fair market value. What did happen is that the attorney presented only the opinion of Mr. Parise. Still, with so much at stake for the Parises, we conclude that the circuit court should have either credited Mr. Parise's testimony regarding current value or directed the parties to provide reliable current fair market value information before issuing an order.

¶24 Accordingly, on remand, if Midwest remains interested in exercising its right to purchase the property, the circuit court should hold an evidentiary hearing to determine the current fair market value of the property and then permit Midwest to acquire the property by paying that amount to the Parises. We are mindful that Midwest may not be interested in paying the current fair market value of the property because, if that amount is correctly determined, Midwest gains nothing—the amount it would pay would be equal to the value of the asset it

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no relation to the market value of the home or, for that matter, the amount the Parises have invested in it. Rather, this amount is comprised of the redemption amount ($206,236.82) and the amount of Midwest's second mortgage, plus interest and other expenses incurred by Midwest ($94,988.07). We see no equitable basis for requiring the Parises to pay expenses incurred by Midwest since the Parises had no responsibility for Midwest not having been notified of the foreclosure. And, as we have already explained, had Midwest been notified, the evidence is that its mortgage would not have been satisfied, given the amount of the first mortgage and the value of the property.

acquires. But that is precisely the point. This remedy returns Midwest to the position it would have been in had it received proper notice, a position in which it had no prospect of gaining an advantage by exercising its options.

¶25 As noted above, the Parises counterclaimed against Federal for damages. It is unclear to us whether the $12,492.31 the court's order requires Federal to pay the Parises in addition to $206,237.82 (which Federal would receive from Midwest) is based on Federal's liability on the counterclaim or on the court's assessment of the equities among the three parties. In either case, it is unnecessary for us to address this aspect of the court's decision. Federal will not be required to pay this amount, or any amount, in order for Midwest to have the option of purchasing the property for its fair market value. Nothing in our opinion precludes the Parises from pursuing their counterclaim.[6]

CONCLUSION

¶26 For the above reasons, we remand to the circuit court for further proceedings consistent with this opinion.

[6] The Parises argue that the circuit court order is improper because it "undermine[s] the warranty deed" that Federal gave to the Parises. Federal responds that it gave the Parises a "special warranty deed," not a warranty deed, and, thus, Federal has no liability for any damages to the Parises that arise from Midwest's lien. As we understand the Parises' argument, it relates to their counterclaim and is premised on the court's order that we are reversing. Therefore, we do not address it.

The Parises also argue that Wells Fargo Bank is a necessary party. We do not address this issue because it was not raised before the circuit court.

By the Court.—Judgment reversed and cause remanded for further proceedings.

This opinion will not be published. *See* WIS. STAT. RULE 809.23(1)(b)5.