

## **Lender's Credit Bid of Entire Debt at Foreclosure Sale Results in Forfeiture of Rights to Additional Collateral**

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The Sixth Circuit Court of Appeals recently affirmed the decisions of the courts below and held in an unpublished opinion that a secured lender's credit bid at a Michigan foreclosure sale extinguished all of the Chapter 13 debtor's indebtedness to the lender, thereby precluding the lender from executing on a prepetition foreclosure judgment obtained against the debtor in Wisconsin. *State Bank of Florence v. Miller (In re Miller)*, 2013 WL 425342 (6th Cir. Feb. 5, 2013). The decision in *Miller* reminds lenders that foreclosure sales and credit bids in connection therewith require careful planning, especially where multiple parcels of property are at issue.

In *Miller*, the lender extended a loan to the debtor pursuant to a promissory note governed by Wisconsin law. As security for the loan, the debtor granted the lender a mortgage on certain real property in Wisconsin. The Michigan mortgage provided that it secured repayment under the promissory note, as well as any other obligations, debts and liabilities of the debtor to the lender. The lender also extended a second loan pursuant to a promissory note governed by Wisconsin law. The second promissory note was secured by the debtor's residence, as well as three parcels of land, all of which were located in Michigan.

After the debtor defaulted under the notes and mortgages by failing to make payments, the lender commenced a judicial foreclosure proceeding in Wisconsin state court, and shortly thereafter commenced a foreclosure by advertisement proceeding with respect to the Michigan property. The debtor, who at the time was a resident of Wisconsin, did not defend the Wisconsin foreclosure proceeding, nor did he contest the foreclosure by advertisement in Michigan. Approximately one month after the foreclosures were commenced, the debtor filed for relief under Chapter 13 in Wisconsin. However, the debtor voluntarily dismissed his bankruptcy case, sold his Michigan residence, and paid the proceeds to the lender. During that period, the lender obtained a foreclosure judgment in Wisconsin, and also recommenced its foreclosure by advertisement in Michigan with respect to the three parcels of land. At the sheriff's sale in Michigan, the lender credit bid the entire amount of the debt owed by the debtor to purchase the property.

Five days before the redemption period of one year was scheduled to expire with respect to the remaining Michigan property and before the Wisconsin foreclosure sale could occur, the debtor filed for relief under Chapter 13, this time in Michigan. Upon the filing of the bankruptcy, the redemption period for the Michigan property was extended for sixty days under section 108(b) of the Bankruptcy

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Code. When the debtor failed to redeem the Michigan property within this extended period of time, the redemption period expired and legal title to the Michigan property vested with the lender, which cancelled the promissory note secured by the Michigan property.

The lender next moved for relief from the automatic stay in the debtor's bankruptcy case in order to allow the lender to pursue the Wisconsin foreclosure judgment. However, the United States Bankruptcy Court for the Western District of Michigan determined that the lender's credit bid for the total amount of the debt satisfied the entire debt. *In re Miller*, 442 B.R. 621, 628-37 (Bankr. W.D. Mich. 2011). The bankruptcy court lifted the automatic stay only to allow the lender to, among other things, dismiss the Wisconsin action with prejudice and turnover the Wisconsin property to the debtor free and clear of any mortgages and claims. The lender appealed to the Sixth Circuit Bankruptcy Appellate Panel, but the BAP affirmed the bankruptcy court below. *State Bank of Florence v. Miller (In re Miller)*, 459 B.R. 657 (B.A.P. 6th Cir. 2011).

Thereafter, the lender appealed to the Sixth Circuit Court of Appeals. The lender first argued that because the debtor failed to object to the lender's proof of claim. However, the Sixth Circuit agreed with the courts below, and held that the lender forfeited this argument by failing to raise it below in a timely fashion and did so only on appeal. The Sixth Circuit emphasized that the debtor notified the lender of his objection to the lender's claim when he filed his amended Chapter 13 plan and cited case law in support of his objection.

The lender also argued on appeal that the bankruptcy court erroneously applied Michigan law to determine the effect of the lender's credit bid at the Michigan foreclosure sale by advertisement. According to the lender, because the promissory notes stated that they were governed by Wisconsin law, the bankruptcy court should have applied Wisconsin law. Therefore, the lender argued that the bankruptcy court erred in holding that the credit bid for the full amount of the debt extinguished a Wisconsin debt secured solely by Wisconsin real estate. Upon review of authority cited by the lender, the Sixth Circuit noted that the Wisconsin Court of Appeals has previously held that Wisconsin foreclosure proceedings are governed by Wisconsin law, regardless of the choice of law stated in a promissory note.

The Sixth Circuit also undertook a fairly comprehensive analysis of both Michigan and Wisconsin law, and concluded that regardless of which state's law should apply to the Michigan foreclosure, the lender's decision to bid the full amount of its debt at the Michigan foreclosure sale extinguished the entire debt. The Sixth Circuit further succinctly stated that "[t]he rule is clear in both jurisdictions that a purchaser who overbids at a sheriff's sale based on unilateral mistake must accept the consequences of that decision, unless the purchaser can show fraud or other improper inducement in the making [sic] the bid." Here, the lender never alleged any improper conduct or fraud by the debtor. Therefore, the Sixth Circuit agreed with the lower courts and held that the lender was precluded from executing on the Wisconsin foreclosure judgment to recover a debt that no longer exists.

The lender, not to be deterred, next argued that it was improper for the bankruptcy court to determine whether the entire debt was extinguished. Instead, the lender asserted that the bankruptcy court should have granted the lender relief from the automatic stay to allow the lender to attempt to set aside the Michigan foreclosure and to request the Wisconsin state court to determine the effects of the Michigan foreclosure on the Wisconsin foreclosure judgment. The Sixth Circuit disagreed. First, the Sixth Circuit reiterated that the lender must bear the burden of its own negligence. Second, the Sixth Circuit noted that even if the lender were permitted to present its arguments to the Wisconsin state court, the lender could not present any issue concerning judicial confirmation of the Michigan foreclosure sale because the Michigan proceeding was a foreclosure by advertisement, not a judicial

foreclosure. Accordingly, the Sixth Circuit determined that court confirmation of the sale was not relevant. Moreover, the Sixth Circuit recognized that Wisconsin courts, like Michigan courts, require a lender to face the consequences of its own mistake with respect to the purchase price at a foreclosure sale.

Finally, the Sixth Circuit discarded the lender's argument that the bankruptcy court violated its procedural and substantive due process rights.

Lenders should undertake a considerable amount of due diligence prior to any foreclosure sales to ensure that the any credit bid can be justified based on an appraisal and any other relevant information (e.g., brokers' opinions of value and environmental audits). Where lenders have multiple properties subject to mortgages in their favor and make a low ball bid, those lenders should be prepared to forfeit their rights to additional collateral and lose any deficiency claim against the mortgagor and any guarantors.

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