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Uniform Commercial Code - Article III - Article IX - Status of Personal Property Used as Collateral - Deficiency Judgment Act

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Recent Decisions

UNIFORM COMMERCIAL CODE — ARTICLE III — ARTICLE IX — STATUS OF PERSONAL PROPERTY USED AS COLLATERAL — DEFICIENCY JUDGMENT ACT — The Supreme Court of Pennsylvania split on the question of when the Deficiency Judgment Act places a debtor's personal property offered as collateral beyond the reach of a judgment creditor when the agreement between the parties can be interpreted under either Article III or Article IX of the Uniform Commercial Code.

Horbal v. Moxham Nat'l Bank, 697 A.2d 577 (Pa. 1997).

The Deficiency Judgment Act requires a judgment creditor to follow certain procedures to apply the debtor's personal assets to an outstanding loan upon the debtor's default.¹ Whether the asset in question is considered a "personal" asset at the time a judgment creditor forecloses on the loan determines whether the creditor must follow the Deficiency Judgment Act to secure the asset.² Once the status of the asset has been determined, the court must analyze the parties' intended classification of the asset pledged against the value of the loan.³

In *Horbal*, the plaintiffs argued that the judgment creditor erroneously applied the asset against their defaulted loan.⁴ The plaintiffs contended that the asset was, at the time of foreclosure, a personal asset.⁵ By virtue of this argument, plaintiffs requested the payment of the value of the asset, interest earned and fees

1. 42 PA. CONS. STAT. ANN. § 8103 (West 1998).

2. *Id.*

3. *Id.*

4. *Horbal v. Moxham National Bank*, 697 A.2d 577 (Pa. 1997).

5. *Horbal*, 697 A.2d at 578.

associated with obtaining their judgment.⁶

On February 4, 1988, Moxham National Bank ("Moxham") agreed to lend \$120,000 to John Horbal, Anthony Horbal and Elaine Adams ("debtors," "assignors," or "Horbals"). The loan was partially secured by a mortgage on the debtors' interest in a parcel of real estate located at 502 Main Street in Johnstown, Pennsylvania.⁷ Moxham properly recorded the mortgage on February 11, 1988.⁸ The Horbals also pledged a \$25,000 Certificate of Deposit ("CD") as additional security for the loan.⁹ This loan transaction was completed on February 18, 1988.¹⁰ The pledge of the CD was necessary because the value of the real property at 502 Main Street was insufficient to fully secure the loan.¹¹

The assignment granted Moxham a full power of attorney authorizing Moxham "to ask, demand, collect, receive, receipt for, sue for, compound and give acquittance for any and all amounts which may be due or become due and payable under the Account."¹² Moxham essentially gained the legal right to make demands on all or part of the account without notice to, or agreement of, the assignors.¹³ Once the assignors paid the loan in full, or if the parties otherwise agreed, Moxham would release its claim on the pledged CD.¹⁴ If, however, the Horbals failed to pay the balance of the loan prior to maturity, or if they violated any rule or requirement of the loan provisions, Moxham could, at its discretion, withdraw any or all of the existing value of the account.¹⁵

6. *Id.* at 579.

7. *Id.* Plaintiffs were co-partners in Potomac Associates II which owned the subject property.

8. *Id.*

9. *Id.*

10. *Horbal*, 697 A2d. at 579. The Assignment of Security provided:

The undersigned, Anthony Horbal and John Horbal (Assignors), for and in consideration of good and valuable consideration in hand paid, the receipt and sufficiency of all of which is hereby acknowledged, does hereby ASSIGN, TRANSFER and PLEDGE to the Moxham National Bank . . . (hereinafter called Bank) all of Assignors' right, title and interest, on Certificate of Deposit Number 2005581, in the principal amount of Twenty Five thousand and 00/100 Dollars (\$25,000) . . . (all of which is hereinafter called the "Account").

Id. at 579.

11. *Id.*

12. *Id.*

13. *Id.*

14. *Horbal*, 697 A2d. at 579.

15. *Id.*

In 1989, the Horbals defaulted on the loan¹⁶ and Moxham initiated foreclosure proceedings against the property.¹⁷ On October 24, 1989, the common pleas court entered a default judgment in favor of Moxham.¹⁸ The court also executed a Writ of Execution upon the real property that was the subject of the loan.¹⁹ Moxham subsequently purchased the property for \$666.40 at a sheriff's sale held on December 14, 1990.²⁰

The sheriff delivered the deed to Moxham on January 21, 1991.²¹ Moxham resold the property for \$26,437 and applied the CD to the unpaid balance of the loan — \$116,000.²² The amount of the liquidated CD consisted of \$25,000 in principal and \$1,437 in accrued interest.²³ Moxham filed no petition for judicial determination of the fair market value of the real property.²⁴

John and Anthony Horbal subsequently assigned their legal rights in the liquidation of the CD to Highland Financial, Ltd. and James P. Walsh (collectively "plaintiffs").²⁵ The plaintiffs notified Moxham, on November 21, 1991, of this assignment.²⁶ The plaintiffs requested that Moxham turn over the proceeds realized from the liquidation of the CD, but Moxham refused.²⁷

Plaintiffs then filed a complaint against Moxham, asserting that it did not comply with the guidelines set forth in the Deficiency Judgment Act.²⁸ The plaintiffs claimed treble damages against Moxham, alleging that Moxham received a "usurious" rate of interest when it applied the CD to the outstanding balance of the loan.²⁹ The plaintiffs also requested that the court award them

16. *Id.* at 580.

17. *Id.*

18. *Id.*

19. *Horbal*, 697 A.2d at 580. A "writ of execution" renders the judgment or decree of a court enforceable. Formal, written command of a court directing a sheriff or other official to enforce a judgment through process of execution. BLACK'S LAW DICTIONARY 1109 (6th ed. 1990).

20. *Horbal*, 697 A.2d at 580.

21. *Id.*

22. *Id.*

23. *Id.*

24. *Horbal*, 697 A.2d at 580. The Deficiency Judgment Act requires that this filing occur within a six-month time period subsequent to the sale of the property which is the subject of a foreclosure. 42 PA. CONS. STAT. ANN. § 8103 (West 1998).

25. *Horbal*, 697 A.2d at 580.

26. *Id.*

27. *Id.*

28. *Id.*

29. *Id.*

[A] person who has paid a rate of interest for a loan or use of money at a rate in

litigation fees.³⁰ The plaintiffs and Moxham filed cross-motions for summary judgment.³¹ The trial court granted Moxham's motion on June 22, 1993.³²

The trial court found that the Deficiency Judgment Act did not apply because the CD was not, at the time of foreclosure, a "personal" asset.³³ The court's rationale for this decision was based on its finding that the CD agreement was independent of the mortgage agreement.³⁴ The trial court found that when the Horbals defaulted on the mortgage, the CD became the property of Moxham; thus, the CD could not have been the personal property of the Horbals at the time of the sheriff's sale.³⁵ Therefore, the court found no reason to invoke the Deficiency Judgment Act.³⁶ Moxham, thus, it could apply the balance of the CD to the loan, at any time after the mortgage assumed default status.³⁷ By ruling the Act inapplicable to the foreclosure proceedings, the trial court concluded that plaintiff's request for payment of interest on the CD and attorney's fees were no longer valid.³⁸

John Horbal, Anthony Horbal, Highland Financial, and James P. Walsh (collectively "appellants") appealed to the Superior Court of Pennsylvania, but Moxham again prevailed.³⁹ After granting allocatur, the Supreme Court of Pennsylvania deadlocked.⁴⁰ By failing to form a majority, the supreme court affirmed the decision of the superior court.⁴¹

Application of the Deficiency Judgment Act is appropriate when

excess of that provided for by this act or otherwise by law or has paid charges prohibited or in excess of those allowed by this act or otherwise by law may recover triple the amount of such excess interest or charges in a suit at law against the person who has collected such excess interest or charges.

41 PA. CONS. STAT. ANN. § 502 (West 1998).

30. *Horbal*, 697 A.2d at 580. "[If] a borrower or debtor, including but not limited to a residential mortgage debtor, prevails in an action under this act, he shall recover the aggregate amount of costs and expenses determined by the court to have been reasonably incurred on his behalf in connection with the prosecution of such action, together with a reasonable amount of attorney's fee." 41 PA. CONS. STAT. ANN. § 503(a) (West 1998).

31. *Horbal*, 697A.2d at 580.

32. *Id.*

33. *Id.*

34. *Id.*

35. *Id.*

36. *Horbal*, 697 A.2d at 580.

37. *Id.*

38. *Id.*

39. *Id.*

40. *Id.* at 581.

41. *Horbal*, 697 A.2d at 581.

the real property of a mortgagor is sold as the result of foreclosure and the judgment creditor receives less than the amount of the judgment, plus interest and costs.⁴² The judgment against the debtor, under the Deficiency Judgment Act, is reduced by the fair market value ("FMV") of the property purchased by the judgment creditor at foreclosure, rather than by the foreclosure sale price.⁴³ The FMV is the price yielded under the depressed conditions of the foreclosure sale⁴⁴ — the fair and just value of the property.⁴⁵ The legislature designed the Act to eliminate a debtor's continuing personal liability after the creditor has acquired the debtor's real property and its value (as determined by its subsequent sales price) is sufficient to satisfy the amount remaining on the original debt.⁴⁶

The Act comes into play when real property of a debtor only partially discharges the debt, such as when the property is sold for less than the total of the original loan, plus associated costs and expenses.⁴⁷ The Deficiency Judgment Act, however, requires that the creditor formally request the court to ascertain the FMV of the real property within six months after its sale.⁴⁸ If the creditor fails to make a timely request for determination of the FMV, any or all parties liable for the debt (or any other party claiming a legal interest in the property) may petition the court to void the alleged deficiency remaining due to the expiration of the statute of limitations.⁴⁹ If the court grants the debtor's petition, the judgment

42. *Id.*

Whenever any real property is sold, directly or indirectly, to the judgment creditor in execution proceedings and the price for which such property has been sold is not sufficient to satisfy the amount of the judgment, interest and costs and the judgment creditor seeks to collect the balance due on said judgment, interests and costs, the judgment creditor shall petition the court having jurisdiction to fix the fair market value of the real property sold. The petition shall be filed as a supplementary proceeding in the matter in which the judgment was entered.

42 PA. CONS. STAT. ANN. § 8103(a) (West 1998).

43. *First Nat'l Consumer Discount Co. v. Fetherman*, 527 A.2d 100, 105 (Pa. 1987).

44. *Fetherman*, 527 A.2d at 105.

45. *Id.*

46. *Philip Green & Son, Inc. v. Kimwyd, Inc.*, 189 A.2d 231, 232-33 (Pa. 1963).

47. *Fetherman*, 527 A. 2d at 104.

48. 42 PA. CONS. STAT. ANN. § 8103(a) (West 1998). *See text accompanying note 43.*

49. *Horbal*, 697 A.2d at 581.

If the judgment creditor shall fail to present a petition to fix the fair market value of the real property sold within the time after the sale of such real property as provided by section 5522 (relating to the six-month limitation), the debtor, obligor, guarantor or any other person liable directly or indirectly to the judgment creditor for the payment of the debt, or any person interested in any real estate which would, except for the provisions of this section, be bound by the judgment, may file a petition, as a supplementary petition in the matter in which the judgment was entered, in the court

is designated as satisfied and all parties are freed from any obligations arising after the date of sale.⁵⁰

The Act does not affect any contractual rights and duties between mortgagor and mortgagee — it only sets the foundation for the process of foreclosure and identifies the debtor's property that may be taken by foreclosure.⁵¹ The Horbals and Moxham signed an agreement stipulating that Moxham had a full power of attorney over the CD, which expressly granted Moxham the authority to withdraw all or part of the value of the CD without notice to the Horbals.⁵²

It is the direct application of the Act that was the basis for the *Moxham* case. Whether the bank had the right to apply the Horbal's CD to the mortgage without following the procedures of the Deficiency Judgment Act was the crux of this case. In a split decision, the Supreme Court of Pennsylvania upheld the decision of the Superior Court in favor of Moxham National Bank.⁵³ This meant that Moxham retained all of the Horbals' rights to the CD when they made the original assignment.⁵⁴ The court stated that Moxham had the discretion to liquidate the CD and apply the funds to the unpaid balance prior or subsequent to the sheriff's sale based on the express provisions of the assignment.⁵⁵ The parties did not dispute whether the CD could have been applied to the outstanding mortgage prior to the sheriff's sale.⁵⁶ They agreed that once the loan assumed default status, compliance with the Act was not necessary to liquidate the CD and that the Act applied after the sale for the outstanding balance of the mortgage.⁵⁷

The Deficiency Judgment Act is applicable when real property is sold to a judgment creditor for less than the amount of the loan in

having jurisdiction, setting forth the fact of the sale, and that no petition has been filed within the time limited by statute after the sale to fix the fair market value of the property sold, whereupon the court, after notice as prescribed by the general rule, and being satisfied of such facts, shall direct the clerk to mark the payment satisfied, released and discharged.

42 PA. CONS. STAT. ANN. § 8103(d) (West 1998).

50. 42 PA. CONS. STAT. ANN. § 8103(d) (West 1998). See text accompanying note 49.

51. Commercial Bldg. Ass'n v. Steen, 24 Pa. D. & C. 575 (1935).

52. *Horbal*, 697 A.2d at 579.

53. *Id.* at 578. Justice Castille, filed an Opinion in Support of Affirmance in which Chief Justice Flaherty and Justice Zappala joined. Justice Newman filed an Opinion in Support of Reversal in which Justices Cappy and Nigro joined. *Id.* at 584.

54. *Horbal*, 697 A.2d at 583.

55. *Id.*

56. *Id.*

57. *Id.* at 581.

default,⁵⁸ including interest and costs.⁵⁹ In *First Nat'l Consumer Discount Co. v. Fetherman*, judgment debtors requested the common pleas court to enter the creditor's claim as satisfied and award the debtors liquidated damages when the debtors' property was sold at a sheriff's sale.⁶⁰ The trial court found in favor of the debtors and the creditor appealed.⁶¹ The superior court affirmed in part and reversed in part and the debtors appealed.⁶² The supreme court made two rulings.⁶³ First, a judgment creditor must petition the court for determination of the FMV of the property within six months after the foreclosure sale of the property.⁶⁴ If the creditor fails to do so, the court will deem the obligation of the debtor fulfilled.⁶⁵ Also, the court ruled that when it deems the obligation fulfilled by the debtor, but the creditor does not recognize the court's ruling within thirty days after notification, the debtor is entitled to an award of liquidated damages.⁶⁶

The debtors obtained a mortgage for \$31,416.00 on two unrelated sections of real property.⁶⁷ When the debtors defaulted on the loan, the creditor submitted a complaint in mortgage foreclosure to the Common Pleas Court of Bucks County.⁶⁸ The court entered a judgment for \$27,600.00 in favor of the creditor.⁶⁹ Shortly thereafter, the creditor successfully bid \$28,500 for one of the pieces of the debtors' property at a sheriff's sale.⁷⁰ After outstanding bills, expenses associated with the property, and fees associated with the sheriff's sales were paid, the remaining \$26,912.24 went to the creditor.⁷¹ Twenty-one months later, the debtors requested that the creditor report the debtors' obligation as fulfilled.⁷² Creditor's counsel informed the debtors that the obligation would be designated as fulfilled and that the creditor would make this report

58. *First Nat'l Consumer Discount Co. v. Fetherman*, 527 A.2d 100, 104-05 (Pa. 1987).

59. *Id.* at 105.

60. *Id.* at 102.

61. *Id.*

62. *Id.* at 105.

63. *Fetherman*, 527 A.2d at 106.

64. *Id.* at 105.

65. *Id.*

66. *Id.* at 105-06.

67. *Id.* at 101-02.

68. *Fetherman*, 527 A.2d at 101-02.

69. *Id.* at 102.

70. *Id.*

71. *Id.*

72. *Id.*

to the court.⁷³ After some months, when debtors had not received any notice from the creditor, they requested the court to designate the obligation as fulfilled and to award them liquidated damages.⁷⁴

The trial court, in *Fetherman*, found in favor of the debtor, awarding \$13,800 in liquidated damages and designating the obligation fulfilled.⁷⁵ The creditor appealed and the ruling was affirmed by the superior court in favor of the debtors, but reversed on the issue of liquidated damages.⁷⁶ Debtors argued that the creditor did not follow the correct Deficiency Judgment Act procedure by failing to petition the court for a determination of the FMV of the property within six months of the sale of the property, as required by the Act.⁷⁷

Because the Act requires the judgment creditor to petition the court within six months for a determination of the property's FMV, and the creditor in this case did not do so, the court properly designated the judgment against the debtor as fulfilled and complete.⁷⁸ The court stated that it must follow the two steps to determine the remaining deficiency against the debtor when the debtor's property has been sold and the sale price is less than the amount of the outstanding debt.⁷⁹ The creditor must first petition the court to determine the FMV of the property within a six-month time frame.⁸⁰ The court further stated that if the creditor believes that the value it has received for the property is less than the amount of the outstanding loan, it should petition the court in accordance with the Deficiency Judgment Act.⁸¹ If the creditor does not petition the court within six months, an irrebuttable presumption arises that the debt is fulfilled.⁸²

There was no dispute in *Fetherman* as to whether the petition was filed within the six-month time frame. Both sides agreed that it was not filed. Thus, the supreme court held that the debt should be designated as fulfilled by the amount paid at the sheriff's sale, relieving the debtors of any further obligation to the creditor.

The court, in *Horbal*, also considered the status of the CD at the

73. *Fetherman*, 527 A.2d at 102.

74. *Id.*

75. *Id.*

76. *Id.*

77. *Id.* at 102.

78. *Fetherman*, 527 A.2d at 102-03.

79. *Id.* at 103.

80. *Id.* at 102-03; see also 41 PA. CONS. STAT. ANN. § 5522 (West 1998).

81. *Fetherman*, 527 A.2d at 104.

82. *Id.*

time of the sheriff's sale. The court stated that Moxham's interest in the CD could only be eliminated after the debt was satisfied.⁸³ Therefore, the creditor's right to cash in the CD was governed by the amount of its claim at the time the CD was cashed.⁸⁴ To analyze Moxham's claim against the CD, the supreme court reviewed provisions of the parties' Assignment of Deposit agreement under Article III (Commercial Paper) of the Uniform Commercial Code ("U.C.C.").⁸⁵ The U.C.C. classifies CDs as negotiable instruments.⁸⁶

The Supreme Court of Pennsylvania has ruled that a CD generally satisfies the definition of a "negotiable instrument" under the U.C.C.⁸⁷ *Gordon v. Fifth Avenue Bank* concerned a \$13,750 CD deposited in defendant's bank, the Fifth Avenue Bank of Pittsburgh, on which the bank refused payment.⁸⁸ Subsequent to the purchase of the CD, the plaintiff/debtor borrowed \$13,750 from the defendant, on a demand note.⁸⁹ When the plaintiff refused to pay the demand note, the defendant applied the CD (before its maturity) to the balance due on the note.⁹⁰ The trial court found that the note was not a negotiable instrument and that the defendant was a holder in due course.⁹¹ The plaintiff appealed to the superior court, which affirmed.⁹² The supreme court, however, reversed the lower courts' holdings.⁹³ The supreme court found that a CD is a negotiable instrument because it satisfies the following requirements: it is a written instrument, signed on behalf of a defendant (the maker), that contains an unconditional promise to pay the amount of the deposit plus the specified interest to the order of the named depositor at a fixed time.⁹⁴

83. *Horbal*, 697 A.2d at 583.

84. *Id.*

85. *Id.* at 582. "To be regarded as a negotiable instrument a writing must meet the following requirements: (1) be signed by the maker or the drawer; (2) contain an unconditional promise or order to pay a sum certain in money and no other promise, order, obligation or power given by the maker or drawer, except as authorized by this division; (3) be payable on demand or at a definite time; and (4) be payable to order or bearer." 13 PA. CONS. STAT. ANN. § 3104.

86. *Horbal*, 697 A.2d at 582. Certificates of deposit are recognized as negotiable instruments. 13 PA. CONS. STAT. ANN. § 3104(b)(3).

87. *Gordon v. Fifth Ave. Bank of Pittsburgh*, 162 A. 825, 826 (Pa. 1932).

88. *Id.*

89. *Id.*

90. *Id.*

91. *Id.*

92. *Gordon*, 162 A. at 826.

93. *Id.* at 827.

94. *Id.* at 826.

The *Horbal* court applied the standards set by the 1979 version of the U.C.C., 13 Pa. Cons. Stat. section 3119(b) (rather than the 1992 version), because this version governed at the time the events took place.⁹⁵ This section provided that an independent agreement between the parties does not alter the negotiability of the CD.⁹⁶ When one party transfers a negotiable instrument to another, the transfer of the instrument vests the transferee with the same rights that the transferor had in the instrument.⁹⁷ If the instrument is accepted in "good faith" and the document has a designated value, the transferee becomes a "holder in due course."⁹⁸ As a holder in due course, the transferee may transfer or negotiate the instrument and, except as otherwise provided in section 3603 (relating to payment or satisfaction), discharge or enforce payment in its own name.⁹⁹ A holder in due course takes the instrument free from "all claims to it on the part of any person."¹⁰⁰

The parties in *Horbal* stipulated that the CD met the requirements of a negotiable instrument.¹⁰¹ By virtue of its negotiability, the CD remained independent of any prior agreements between the parties, which meant that Moxham's rights to the CD came to fruition at the same time, and were identical to the debtor's rights at the CD's inception.¹⁰² Moxham was a holder in due course of the CD, the supreme court held, which gave Moxham the absolute right to enforce payment in its own name upon default.¹⁰³ Moxham's absolute right to the CD upon the debtors' default, as a holder in due course, meant that the CD could no longer be classified as the Horbals' "personal" asset when they defaulted on the loan because the CD was used as collateral for the loan.¹⁰⁴ The legislature designed the Deficiency Judgment Act to shield the personal assets of debtors — determining the status of a debtor's assets is the key to whether the Act applies.¹⁰⁵ The court further held, on the date of the sale of the debtors' property, the CD was not classified as personal property, indicating that the Act

95. *Horbal v. Moxham Nat'l Bank*, 697 A.2d 577, 582 (Pa. 1997).

96. *Id.* at 582. *See also* 13 PA. CONS. STAT. ANN. § 3119(b) (West 1998).

97. *Id.* at 582. *See also* 13 PA. CONS. STAT. ANN. § 3201(a) (West 1998).

98. *Id.* at 582. *See also* 13 PA. CONS. STAT. ANN. § 3302(a) (West 1998).

99. *Id.* at 582. *See also* 13 PA. CONS. STAT. ANN. § 3301 (West 1998).

100. *Horbal*, 697 A.2d at 582. *See also* 13 PA. CONS. STAT. ANN. §3305(1) (West 1998).

101. *Id.* at 582.

102. *Id.*

103. *Id.* at 582-83.

104. *Id.* at 583.

105. *Horbal*, 697 A.2d at 583.

did not apply to the CD.¹⁰⁶ Because the Act did not apply, Moxham had the option of liquidating the CD and applying the proceeds to the existing debt created by the Horbals' default on the loan.¹⁰⁷

Justice Castille supported the superior court's position that the Act offers the creditor a level of security by allowing the collection of items pledged as collateral when a debtor defaults.¹⁰⁸ The assignment between the parties acts as an exchange of obligations and ultimately equalizes their respective rights.¹⁰⁹ The superior court made a distinction between a legal and an equitable assignment, a differentiation based on how much authority and control the assignee maintains.¹¹⁰ A "legal assignment" offers total authority to the assignee equal to the complete interest, granting the assignee total authority to manage the property as though it were his own.¹¹¹ An "equitable assignment" grants the assignee merely a present interest in the assignment.¹¹² The distinction between the two types of assignments lies in whether the assignee could feasibly fulfill the requirements of the assignment when the assignee does not have the authority to do so.¹¹³ For either assignment to be valid, both parties must have intended to enter into the assignment.¹¹⁴

It must be noted, however, that the assignee's authority over the assignment will not eclipse that of the assignor, as held in *Himes v. Cameron County*.¹¹⁵ In *Himes*, the parties entered into a valid contract that assigned the right to construction project progress payments.¹¹⁶ Payment was to be made incrementally, with a percentage of each payment retained by the assignor until the project was completed.¹¹⁷ The court examined whether funds were to be paid to the assignee directly and, if so, what rights the assignor had to retain its fixed percentage of the funds, as stated in the assignment.¹¹⁸ The Supreme Court of Pennsylvania held that the assignee did not have any greater right to the funds than the

106. *Id.*

107. *Id.*

108. *Id.*

109. *In re Purman's Estate*, 56 A.2d 86, 88 (Pa. 1948).

110. *Id.*

111. *Id.*

112. *Id.*

113. *Id.*

114. *Purman*, 56 A.2d at 88.

115. *Himes v. Cameron County Construction Corp.*, 444 A.2d 98 (Pa. 1982).

116. *Id.* at 99.

117. *Id.*

118. *Id.*

assignor and that as the work was completed, funds would be paid in conformity with the assignment contract agreed to by the parties.¹¹⁹

Courts apply the same principles to assignments as any other contractual arrangement when analyzing the rights of the assignor and assignee. In *Moxham*, the Supreme Court of Pennsylvania noted its earlier decision in *United States Nat'l Bank v. Campbell* as support for this principle.¹²⁰ *Campbell* concerned an agreement between the United States Mortgage and Realty Company and two insolvent Johnstown, Pennsylvania banks, the United States Trust Company of Johnstown and the United States Savings & Trust Company of Conemaugh.¹²¹ The agreement stated that United States Mortgage and Realty would receive a portion of funds paid (in this instance on a life insurance policy), to the two institutions (after deducting expenses) in return for contributions to the deficits of the insolvent institutions.¹²² The policy beneficiary, the United States Trust Company, was entitled to receive the proceeds of the policy.¹²³

When the United States National Bank demanded repayment of its contributions outside the confines of the assignment agreement, the Supreme Court of Pennsylvania ruled that these transactions violated the assignment and conflicted with the intent of the assignment.¹²⁴ The court held that expenses could be withheld from payments to the assignors prior to the assignee receiving its interest in the assignment.¹²⁵ The court reasoned that the intentions and standards set forth in the assignment were enforceable and applied to all parties to the assignment.¹²⁶

Justice Castille, in *Horbal v. Moxham*, examined the assignment provision that granted Moxham authority to liquidate the full or partial value of the CD without any written or oral communication to the debtors.¹²⁷ The CD would only be returned to the debtors if the parties agreed to this action independent of the assignment contract, or if the debtors completely paid their debt.¹²⁸ The court

119. *Id.* at 100.

120. *United States Nat'l Bank v. Campbell*, 47 A.2d 697 (Pa. 1946).

121. *Campbell*, 47 A.2d at 698-99.

122. *Id.* at 699.

123. *Id.*

124. *Id.* at 699-702.

125. *Id.* at 700.

126. *Campbell*, 47 A.2d at 701.

127. *Horbal v. Moxham National Bank*, 697 A.2d 577, 583 (Pa. 1997).

128. *Id.*

further stated that the Horbals and Moxham were free to modify any arrangements specified in the original assignment.¹²⁹ Justice Castille found that because the parties intended the CD to be collateral for the debt, the right to liquidate the CD shifted to Moxham when the Horbals defaulted on the loan.¹³⁰ Therefore, the CD was no longer the personal property of the debtors at the time of the sheriff's sale.¹³¹ Application of the Deficiency Judgment Act at the time of the sale of the real property would have been incorrect.¹³² Justice Castille would have affirmed the decision of the superior court to protect the creditor's interest in items pledged as collateral for loans on real property because that would offer the creditor a way to reduce its losses on defaulted loans.¹³³

The opinion in support of reversal, by Justice Newman, was based on the principle that the assignment of the CD and the payment of the loan were bound together for the purpose of paying the loan.¹³⁴ Further, Moxham could only liquidate the CD if there was an unpaid amount remaining on the debt.¹³⁵ Justice Newman noted that Moxham failed to petition the court for the FMV of the property within the six-month time frame of the sheriff's sale.¹³⁶ When this is not done, the judgment is deemed paid in full according to the Act.¹³⁷ Because there was no petition for the FMV of the real property within the time limits set forth in the Act, the Horbals were relieved of any further obligations on the debt to Moxham.¹³⁸

Justice Newman found that the Act established a method for a creditor to reduce its losses on a defaulted loan when real property is sold at an amount less than the value of the original loan.¹³⁹ Justice Newman, however, also recognized that the FMV is the value to be used to determine the difference between the unpaid balance of the loan and what the creditor may seek in judgment from the debtor.¹⁴⁰ Without a request for judicial determination of a

129. *Id.*

130. *Id.*

131. *Id.*

132. *Horbals*, 697 A.2d at 583.

133. *Id.*

134. *Id.* at 585-86.

135. *Id.* at 586.

136. *Id.*

137. *Horbals*, 697 A.2d at 586.

138. *Id.*

139. *Id.*

140. *Id.*

property's FMV within six months of the sale, the court presumes that the creditor has received full satisfaction and the debtor has no further obligation on the loan.¹⁴¹

Justice Newman's view is at odds with Justice Castille's due to their differing applications of statutory law to the facts of the case. Justice Castille based his interpretation on the negotiable instruments provisions of Article III of the U.C.C.¹⁴² Justice Newman, conversely, applied the secured transactions provisions of Article IX of the U.C.C.¹⁴³ Based on secured transactions law, Justice Newman stated that Moxham only received a security interest in the assignment and, therefore, was required to meet the guidelines set forth in the Act.¹⁴⁴ This security interest does not provide the same flexibility and authority to Moxham as Justice Castille's negotiable instruments analysis.¹⁴⁵

The opinion in support of reversal also noted that the agreement between the Horbals and Moxham granted a security interest to Moxham in all debts incurred by the Horbals.¹⁴⁶ Therefore, classifying Moxham as a secured creditor would leave the Horbals some rights in the CD.¹⁴⁷ Justice Newman also found that an assignment gives the assignee a future claim equal to the secured loan amount and thus, places a condition on the assignment.¹⁴⁸ Although an assignment may appear complete on its face, it is only as good as the debt it is used to secure, as held in *Seip v. Laubach*.¹⁴⁹

In *Seip*, the defendant borrowed a sum of money from the plaintiffs and signed a note promising to repay the debt.¹⁵⁰ Sometime later, the defendant signed a note securing a debt to the Cement National Bank ("Bank") while the debt to the plaintiff remained unpaid.¹⁵¹ The defendant was the executor of his father's estate and offered to assign his interest in the estate to the Cement National Bank as additional security for the debt he owed to the

141. *Id.*

142. *Horbals*, 697 A.2d at 585, *see also* 13 PA. CONS. STAT. ANN. §§ 3101-22.

143. *Horbals*, 697 A.2d at 585, *see also* 13 PA. CONS. STAT. ANN. §§ 9101-14.

144. *Horbals*, 697 A.2d at 585.

145. *Id.* at 585-86.

146. *Id.* at 586.

147. *Id.*

148. *Id.* at 585.

149. *Seip v. Laubach*, 4 A.2d 149, 151 (Pa. 1939).

150. *Id.* at 149-50.

151. *Id.*

Bank.¹⁵² When the plaintiffs sued the Bank and the defendant for repayment on the note, the Bank responded that it held no assets of the defendant because any funds or future claims held by the Bank were merely collateral for defendant's loans.¹⁵³

The Supreme Court of Pennsylvania explored whether the plaintiffs could include the Bank in their claim on the note.¹⁵⁴ In its analysis, the court decided that the plaintiffs had no claim against the Bank or any of the defendant's rights to his father's estate held by the Bank.¹⁵⁵ The defendant's rights in his father's estate gave the Bank an additional way to reduce its loss if the defendant defaulted on the loan.¹⁵⁶ Thus, the court held that the defendant's assignment of his interest in his father's estate to the Bank only became effective if he failed to repay his loan.¹⁵⁷ The court interpreted this arrangement as a conditional assignment that, although it appeared facially effective, was legally enforceable only if the defendant defaulted on his Bank loan.¹⁵⁸ Thus, the assignment was conditional and acted only as security for an existing debt.¹⁵⁹

In addition to his application of secured transactions principles to the assignment, Justice Newman, in *Horbal*, also found that the court must review an assignment in light of the situation at the time of its creation.¹⁶⁰ In *Biddle v. Biddle*, the supreme court held that parole evidence may be admitted to determine the intent of the parties.¹⁶¹ The plaintiff, in *Biddle*, argued that the court should admit parole evidence regarding the classification of the plaintiff's assignment on a future claim to an estate securing a loan from defendants.¹⁶² The assignment appeared facially valid, but the plaintiff argued that he intended it only as security for the loan.¹⁶³ To determine whether the assignment was a security interest or absolute, the plaintiff requested that parole evidence be admitted to clarify the intention of the parties.¹⁶⁴ The court held that parole evidence is admissible to show the meaning of the parties when the

152. *Id.* at 150.

153. *Id.*

154. *Seip*, 4 A.2d at 150.

155. *Id.*

156. *Id.*

157. *Id.* at 151.

158. *Id.*

159. *Seip*, 4 A.2d at 151.

160. *Horbal v. Moxham Nat'l Bank*, 697 A.2d 577, 585-86 (Pa. 1997).

161. *Biddle v. Biddle*, 70 A.2d at 282 (Pa. 1950).

162. *Id.* at 282.

163. *Id.*

164. *Id.*

assignment was initiated.¹⁶⁵

The Horbals assigned their interest in the CD to Moxham National Bank, intending that the CD act only as a method to get the mortgage on the Johnstown property.¹⁶⁶ Justice Newman found that the assignment met the conditions of 13 PA. CONS. STAT. ANN. § 9203(a) and that when the assignment was initiated, Moxham had only a security interest in the CD.¹⁶⁷ Thus, because Moxham did not have an absolute assignment, it had to comply with the guidelines of the Deficiency Judgment Act to reach the CD.¹⁶⁸

Although Moxham, as the assignee, could have taken a part of the value of the CD between the time of default and the sheriff's sale, it had to return control of the CD to the Horbals, as assignors, when the debt ceased to exist.¹⁶⁹ By not requesting the court's determination of the FMV within the time provisions set forth in the Act, Moxham, by an irrebutable presumption, must accept the obligation of the Horbals as completed.¹⁷⁰ Because Moxham failed to abide by the guidelines of the Act, and it only had a security interest in the assignment, Justice Newman concluded that Moxham had no right to liquidate the CD.¹⁷¹ He further found that it should return any funds generated by this process to the original owners, the Horbals.¹⁷²

Justice Newman mentioned, however, that the conflicting opinions arose in this case because of Moxham's failure to follow the provisions of the Act.¹⁷³ If Moxham had petitioned the court and received a determination of FMV, the debt remaining on the mortgage would have been limited to the amount in excess of the FMV.¹⁷⁴ Thus, Justice Newman concluded, if liquidating the CD could have further reduced the resulting amount, Moxham would have had the right to do so.¹⁷⁵

Procedurally, both the concurring and dissenting opinions are

165. *Id.* at 282-83.

166. *Horbals*, at 579.

167. *Id.* at 586. An enforceable security interest is created when: (1) the collateral is in the possession of the secured party pursuant to an agreement or the debtor has signed a security agreement that contains a description of the collateral; (2) value has been given; and (3) the debtor has rights in the collateral. 13 PA. CONS. STAT. ANN. § 9203(a).

168. *Horbals*, 697 A.2d at 585-86.

169. *Id.* at 586.

170. *Id.*

171. *Id.*

172. *Id.*

173. *Horbals*, 697 A.2d at 586.

174. *Id.*

175. *Id.*

correct. The Deficiency Judgment Act clearly outlines the requirements for liquidating personal property of a debtor in default. The six-month time frame provided in the Act gives the creditor time to comply and determine how much more it is entitled to receive from the debtor after the sale takes place. If the creditor has not followed this process, the creditor, in effect, accepts whatever price it receives at the sale. Any further obligation by the debtor is relieved.

As an instrument intended to act as security for a loan, the CD meets the requirements of Article IX of the U.C.C., as Justice Newman found in his opinion in support of reversal. Under this analysis, the CD seems to be intended for security purposes only. After all, it is the intent of the parties that determines the true nature of an assignment.

Justice Newman also clearly notes that parole evidence (“use of the circumstances surrounding the execution of the assignment”) applies in situations such as *Horbal v. Moxham* to determine the intent of the parties regarding the assignment of property.¹⁷⁶ The intent of the parties in *Horbal*, therefore, determines the specific purpose of the CD’s assignment. Viewing the transaction independently, the CD acted as collateral for the Horbal’s Johnstown property. Thus, it appears that the CD falls within the confines of Article IX of the U.C.C.

A review of the facts and the wording of the assignment, however, suggests otherwise. In the assignment, the Horbals granted Moxham a full power of attorney and the right to withdraw all or part of the account without notice to or further consent by the Horbals.¹⁷⁷ If the parties had worded the assignment to provide that the Horbals only pledged the CD to secure the loan, Article IX would apply.

The assignment, however, acted as a contract between the parties that authorized Moxham to liquidate the CD upon default of the loan. The contract stated that the Horbals offered the CD to obtain the loan and if they failed to perform the terms of the assignment contract by repaying the loan, Moxham could liquidate the CD in lieu of receiving loan payments.¹⁷⁸

If the Horbals wanted to protect their interest in the CD, they could have negotiated different contract terms or paid the loan

176. *Id.*

177. *Id.* at 579.

178. *Horbal*, 697 A.2d at 579.

balance. Obviously, Moxham would not accept a contract that offered them no protection against default. In fact, the court may construe that type of arrangement as an illusory contract, as Justice Castille reasoned in support of affirmance.¹⁷⁹ The Horbals could receive the benefits of the real property without offering any recoverable consideration. The debtors could, essentially, deny payment on the loan balance and still recover the CD when they defaulted on the loan.

Policy should support what is in the best interests of business in this type of situation. On one hand, receiving collateral should protect lenders from defaulting debtors. On the other hand, policy should protect debtors from unauthorized claims against personal property. The Deficiency Judgment Act can protect both creditors and debtors when it applies. In this instance, the Horbals agreed to the conditions set forth in the assignment. It would have been unrealistic to assume that they could recover the full value of the CD after they defaulted on the loan.

Due to the split decision, there is clearly merit in both views on the application of the Act. In fact, the superior court did not reach a unanimous decision. By a narrow majority, the superior court chose not to apply the Act. The supreme court's split decision automatically affirmed the lower court's decision.

The definition of "personal property" and when an item becomes personal property are not clear. The legislature must provide a comprehensive definition of this term to avoid future controversies, such as that in *Horbal v. Moxham*. For the Act to apply, the property used as collateral, must be narrowly categorized as to its application. When the Deficiency Judgment Act is applicable, the law dictates the necessary process for a successful claim.

Specifying the exact process for loan repayment, collateral return, and/or collateral retention may also avoid this problem in default situations. This procedure is more akin to contract law than to secured transactions or negotiable instruments law. It is unreasonable to permit a defaulting debtor to utilize mortgaged real property without a penalty or allow recovery of personal property used as collateral for the loan. This scenario would shift all of the burden and risk to the creditor, which would not set an attractive or prudent standard for lending institutions. The Horbals should

179. *Id.* at 583. An "illusory" contract is "an expression cloaked in promissory terms, but which, upon closer examination, reveals that the promisor has not committed himself in any manner." BLACK'S LAW DICTIONARY 748 (6th ed. 1990).

have expected to lose their “deposit” when they failed to fulfill their commitment.

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