

# Wisconsin Supreme Court Addresses Guarantor Liability after Waiver of Deficiency

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## 1. Synopsis: Waive the deficiency in Wisconsin, when you have a guarantor on the hook.

On July 9, 2010, the Wisconsin Supreme Court held that a mortgagee who elects to foreclose a mortgage using a shortened redemption period does not forfeit the right to obtain a judgment against a guarantor of the underlying mortgage debt. In *Bank Mutual v. S.J. Boyer Construction, Inc.*,<sup>1</sup> the court concluded that guarantors of payment are not members of the class of persons against whom a mortgagee must waive a deficiency judgment when electing the shortened redemption period under Section 846.103(2) of the Wisconsin Statutes<sup>2</sup>, because guarantors are not “personally liable for the debt secured by the mortgage [being foreclosed].”<sup>3</sup>

The court concluded that the phrase “personally liable for the debt” in the deficiency statute is a term of art that must be given its legal meaning. The court consequently held that the phrasing of the deficiency statute distinguishes the personal liability of a mortgage loan borrower from the liability of a guarantor of the mortgage loan, because the guarantor’s liability arises not from the mortgage debt but from a separate contractual obligation—the guaranty.<sup>4</sup> The court’s clarification of Wisconsin’s deficiency

statute therefore allows lenders to take advantage of the shortened redemption period with respect to Wisconsin mortgagors without losing the right to pursue guarantors of the mortgage debt.

## 2. Factual and Procedure Background of Boyer Construction.

The background facts in *Boyer Construction* are straight forward. In February 2000, Steven and Marcy Boyer (the Boyers) executed a Continuing Guaranty (Unlimited) to First Northern Savings Bank (n/k/a Bank Mutual) (the Bank). The Boyers’ guaranty was joint and several, and was an unlimited guaranty of payment and not of collection. Between 2003 and 2005, the Boyers’ company, S.J. Boyer Construction, Inc. (Boyer Construction), executed several business notes to the Bank, totaling approximately \$1.4 million. The notes were made in connection with business loans from the Bank to Boyer Construction. The loans were secured by several mortgages against properties owned by Boyer Construction.

Boyer Construction ultimately defaulted on the notes, and the Bank initiated a lawsuit to recover against Boyer Construction and the Boyers in February 2007. The bank’s complaint included five counts of foreclosure with respect to the properties secured by Boyer Construction’s mortgages and a separate claim directly against the Boyers on their guaranty. For each foreclosure claim, the Bank waived any claim for deficiency judgment against

Boyer Construction under section 846.103(2).

Section 846.103(2) permits a shortened redemption period of three months with respect to most commercial properties, provided the mortgagee waives its right to claim a deficiency against the mortgagor. Section 846.103(2) states in pertinent part that:

[i]f the mortgagor of real property other than a one- to 4-family residence that is owner-occupied... a farm, a church or a tax-exempt nonprofit charitable organization has agreed in writing at the time of execution of the mortgage to the provisions of this section, the plaintiff in a foreclosure action of a mortgage,... , may elect by express allegation in the complaint to waive judgment for any deficiency... *against every party who is personally liable for the debt secured by the mortgage...* When the plaintiff so elects, judgment shall be entered as provided in [chapter 846], *except that no judgment for deficiency may be ordered nor separately rendered against any party who is personally liable for the debt secured by the mortgage* and the sale of the mortgaged premises shall be made upon the expiration of 3 months from the date when [the foreclosure] judgment is entered.<sup>5</sup>

<sup>1</sup> 2010 WI 74.

<sup>2</sup> Textual references to the Wisconsin Statutes are hereafter indicated as “chapter xxx” or “section xxx.xx,” without the designation “of the Wisconsin Statutes.”

<sup>3</sup> Wis. Stat. § 846.103(2).

<sup>4</sup> Boyer Constr., 2010 WI 74, ¶ 3.

<sup>5</sup> Id. ¶ 30 (quoting Wis. Stat. § 846.103(2)) (emphasis added).

Boyer Construction and Steven Boyer answered the Bank's complaint, admitting most of the allegations but denying Steven's liability under the guaranty. Marcy Boyer did not answer the complaint. The Bank moved for summary judgment against Steven and Boyer Construction, and for default judgment against Marcy. The circuit court granted both motions and ultimately entered judgments against the Boyers personally in an amount in excess of \$1.4 million. The circuit court also entered foreclosure judgments on the properties owned by Boyer Construction, ordering that the properties be sold. The court acknowledged the Bank's waiver of a deficiency claim against Boyer Construction.<sup>6</sup>

Because of the shortened redemption period under section 846.103(2), three months after entry of the foreclosure judgments, the mortgaged properties were sold at a sheriff's sale. The Bank then moved to confirm the sheriff's sale. Boyer Construction and Steven Boyer objected to confirmation on the basis that the sale violated section 846.103(2), because the Bank elected the shortened redemption period afforded by the statute but did not waive its right to a deficiency against the Boyers on their guaranty. Marcy Boyer then moved the court to re-open her default judgment and objected to entry of judgment against her on the guaranty for the same reason given in Steven's objection to confirmation.

The circuit court denied the objections, concluding that the Boyers' guaranty was a contract separate from the business notes executed by Boyer Construction and therefore provided a basis for the Boyers' personal liability despite the language in section 846.103(2) conditioning a shortened redemption period on waiver of deficiency claims against

all parties "personally liable" for the mortgage debt.<sup>7</sup> Boyer Construction and the Boyers then appealed.

The Wisconsin Court of Appeals reversed the circuit court's decisions in a unanimous, published opinion.<sup>8</sup> The court looked to the text of section 846.103(2) and observed that nothing in the statutory language explicitly excluded guarantors from those "personally liable for the debt secured by the mortgage."<sup>9</sup>

The court of appeals then examined whether the Boyers' guaranty made them personally liable for the business notes executed by Boyer Construction. The court distinguished between absolute guaranties of payment and conditional guaranties of collection. The court noted that in the case of an absolute guaranty, a mortgagee may proceed directly against the guarantor without first proceeding against either the mortgagor or the mortgaged property. Conversely, in the case of a conditional guaranty, a mortgagee must exhaust all remedies against the principal debtor before proceeding against the guarantor. In other words, absolute guarantors are liable as principals.<sup>10</sup>

The court of appeals held that the Boyers' guaranty was an absolute guaranty of payment and not a conditional guaranty of collection. Accordingly, the Boyers were principally liable for the Boyer Construction business notes and the Bank's decision to shorten the redemption period applicable to its mortgage foreclosure action precluded

it from seeking a deficiency judgment against the Boyers on their guaranty. The court rejected the Bank's argument that the Boyers' guaranty liability was separate from the underlying mortgage debt. The court also rejected the Bank's argument that restricting its right to deficiency was inappropriate in this instance because the Bank could have proceeded separately and directly against the Boyers without foreclosing the Boyer Construction mortgages. The Bank then petitioned the Wisconsin Supreme Court for review, which the court granted in August 2009.

### **3. The Wisconsin Supreme Court's Review: The majority finds ambiguity in the haystack of plain language.**

The Wisconsin Supreme Court acknowledged its responsibility to interpret section 846.103(2)—and specifically, the statutory phrase "personally liable for the debt secured by the mortgage"—to place the deficiency statute in its proper context and clarify the manifest purpose of the statute.<sup>11</sup> Accordingly, the court characterized its interpretive role with respect to the language of section 846.103(2) as confined by the context of Wisconsin's foreclosure statute as a whole.<sup>12</sup>

The court noted that Wisconsin's foreclosure statute (chapter 846) establishes a comprehensive scheme of foreclosure, including the substantive and procedural requirements for obtaining a deficiency judgment for the unpaid portion of a mortgage debt after a sheriff's sale. The court acknowledged chapter 846's two-step foreclosure procedure, beginning with a judgment of foreclosure and sheriff's sale of a mortgaged property and concluding with confirmation

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<sup>6</sup> Id. ¶ 9.

<sup>7</sup> See id. ¶ 12.

<sup>8</sup> Bank Mutual v. S.J. Boyer Constr., Inc., 2009 WI App 14, 316 Wis. 2d 266, 762 N.W.2d 826.

<sup>9</sup> Id. ¶ 12.

<sup>10</sup> See id. ¶ 13.

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<sup>11</sup> Boyer Constr., 2010 WI 74, ¶ 22.

<sup>12</sup> Id. ¶ 12.

of the sale, determination of any deficiency and entry of judgment for the deficiency.

The court also recognized that the foreclosure process under chapter 846 entails a redemption period, which in most commercial foreclosures runs for six months after the foreclosure judgment. Section 846.103(2), quoted above, permits a shortened redemption period of three months if the mortgagee waives its right to judgment for a deficiency “*against every party who is personally liable for the debt secured by the mortgage.*” (Emphasis added.) If the mortgagee elects to waive its right to a deficiency, the foreclosure judgment will be entered as provided under chapter 846, “*except that no judgment for deficiency may be ordered nor separately rendered against any party who is personally liable for the debt secured by the mortgage,*” and the sale of the mortgaged premises shall thereafter occur following expiration of three months from the date the foreclosure judgment is entered.<sup>13</sup>

The court acknowledged that the phrase “personally liable for the debt secured by the mortgage,” when read according to its common and ordinary meaning, does not clearly exclude guarantors. The court also acknowledged that reasonable people could read the statutory language to protect guarantors like the

Boyers. The court nonetheless concluded that the statutory phrase was a term of art that must be given its legal meaning. The court then embarked on an extensive, somewhat circuitous analysis of the statutory history underlying chapter 846 and the common law of foreclosure in Wisconsin and other jurisdictions to reach the conclusion that by using the phrase “personally liable for the debt” in section 846.103(2), the Wisconsin legislature intended to give effect to the specific legal meaning of the phrase and did not intend for the phrase to encompass parties who guarantee a mortgage debt through a contract separate from the note creating the mortgage debt.<sup>14</sup>

The court noted that within the context of foreclosure law, the statutory phrase has been used traditionally to distinguish the mortgagor’s liability on the mortgage note, which is personal in nature, from the mortgagor’s liability on the mortgage, which is limited to the property given to secure the mortgage note. Examining one of its earlier decisions, in which a bank was permitted to commence an action to collect the amount due on a note after having commenced an action to foreclose a mortgage securing the note,<sup>15</sup> the court stated that the purpose of the statutory phrase “personally liable for the debt secured by the mortgage” contained in section 846.04 is to unite in a single action both foreclosure of the mortgage and a personal claim against the mortgagor/maker of the mortgage note.<sup>16</sup>

The court concluded that while section 846.04 establishes the unity of action with respect to the mortgage being foreclosed and the underlying mortgage debt, the phrase “personally liable for the debt secured by the mortgage” contained both in section 846.04 and in section 846.103(2) must be interpreted

to distinguish only the mortgage borrower’s personal liability for the debt from its liability under the mortgage with respect to the property securing the debt. The court distinguished the mortgage borrower’s liability under chapter 846 from the liability of a guarantor of the mortgage debt, noting that judgment against a guarantor does not follow automatically from a judgment of foreclosure. A separate legal cause of action must be asserted against the guarantor, either outside of the foreclosure proceeding or concurrently with the foreclosure proceeding (as was the case with the Bank’s claim against the Boyers).<sup>17</sup>

The court then turned its analysis to the nature of a guarantor’s liability under common law principles. The court noted the long-recognized principle that a guarantor’s liability arises from a separate guaranty contract and not from the debt being guaranteed. In a carefully worded analysis, the court concluded that although guarantors of payment are personally liable under the terms of their guaranty contract, they are not directly liable for the underlying debt for which their guaranty was given.<sup>18</sup> The court held that this principle is codified in section 846.103(2) through the phrase “personally liable for the debt secured by the mortgage.”<sup>19</sup>

The court specifically rejected the Wisconsin Court of Appeals’ analysis of the Boyers’ primary liability as guarantors of payment and not of collection. As noted above, the court of appeals

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<sup>13</sup> See *id.* ¶ 30 (quoting Wis. Stat. § 846.103(2)) (emphasis added).

<sup>14</sup> See *id.* ¶ 39.

<sup>15</sup> *Farmers & Merchants Bank v. Matsen*, 219 Wis. 401, 263 N.W. 192 (1935) (cited in *Boyer Constr.*, 2010 WI 74, ¶ 42).

<sup>16</sup> *Boyer Constr.*, 2010 WI 74, ¶ 44. See also Wis. Stat. § 846.04, which is the statutory foundation for deficiency judgments generally in chapter 846. Section 846.04 permits a deficiency judgment within the foreclosure action only against parties “personally liable for the debt secured by the mortgage”—the same phrasing used in section 846.103(2).

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<sup>17</sup> See *Boyer Constr.*, 2010 WI 74, ¶ 51.

<sup>18</sup> See *id.* ¶¶ 53-54 (citing *Continental Bank & Trust Co. v. Akwa*, 58 Wis. 2d 376, 387, 206 N.W.2d 174 (1973) for the proposition that an action to enforce a guarantor’s liability must be in the form of a claim for damages based on breach of contract and not an action on the underlying guaranteed indebtedness).

<sup>19</sup> *Id.* ¶ 55.

characterized the Boyers as “personally liable for the debt secured by the mortgage” under section 846.103(2) because they were guarantors of payment and not of collection, and therefore primarily liable to the Bank for the Boyer Construction business notes.

The Wisconsin Supreme Court characterized the court of appeals’ reasoning as confusing the primary liability of a borrower with the primary liability of a guarantor. Boyer Construction was primarily liable for its business note obligations, and was therefore “personally liable for the debt secured by [its five] mortgage[s]” under section 846.103(2). By contrast, the court asserted that the Boyers were not personally or primarily liable for the Boyer Construction notes because the Boyers did not execute the notes. The Boyers executed a separate guaranty contract, and were therefore personally and primarily liable according to the terms of that contract. The court concluded that a guarantor’s liability arises under a completely separate contract. Accordingly, the guarantor cannot be “personally liable for the debt secured by the mortgage” as contemplated by section 846.103(2).<sup>20</sup>

The Boyers also argued that they were protected by section 846.103(2)’s mandate that “no judgment for deficiency may be ordered *nor separately rendered* against any party who is personally liable for the debt secured by the mortgage.” The court rejected the Boyers’ argument, asserting that the intent of the statutory language is procedural—namely, to mandate that a court may order a deficiency judgment within the confines of the original foreclosure judgment, but may not render the deficiency judgment until after the sheriff’s sale and its confirmation. Reading the language of section 846.103(2) (which addresses a shortened redemption

period) consistently with the language of section 846.04(1) (which addresses deficiency judgments generally), the court concluded that the phrase “separately rendered” in section 846.103(2) supports the procedural reality that a deficiency judgment must follow from a sheriff’s sale and its confirmation.<sup>21</sup>

The court ended its analysis by turning to the textually and contextually manifest purposes of section 846.103(2), ultimately concluding that by interpreting the phrase “personally liable for the debt secured by the mortgage” to exclude guarantors supports the purposes of section 846.103(2) and those of the Wisconsin foreclosure statute as a whole. The court asserted that section 846.103(2) serves two purposes: it expedites the foreclosure process by shortening the redemption period and it protects the rights of mortgagors who are relieved of personal liability as a consequence of the shortened redemption period. The court concluded that if the phrase “personally liable for the debt secured by the mortgage” were interpreted to protect both mortgagors and guarantors, the foreclosure process would be lengthened by fewer mortgagors electing the three-month redemption period and greater numbers of mortgagors would thereby be exposed to personal liability beyond the property securing their mortgage debt.<sup>22</sup> The court also noted the potential windfall to guarantors by extending the protections of section 846.103(2) as asserted by the Boyers. The court reasoned that relieving guarantors of their liability through the shortened redemption period undermines the security afforded a mortgagor who negotiates for and obtains a guaranty in the course of its underwriting a mortgage loan. The court held that the Wisconsin legislature could not have intended such a result when it enacted section 846.103(2).<sup>23</sup>

#### 4. The Dissent’s Case: Plain language has plain meaning.

Chief Justice Shirley Abrahamson, joined by one other justice, dissented from the court’s conclusions. In a trenchant opinion, the chief justice argued that the court resolved the issues of the *Boyer Construction* case through a narrow focus on the statutory phrasing of section 846.103(2), without an eye to the broader foreclosure scheme under which the case arose and without addressing the relationships among and commercial expectations of creditors, debtors and guarantors in the foreclosure process. Justice Abrahamson argued that the court’s narrow focus on the phrasing of section 846.103(2) failed to address the law governing guarantors and left open several issues with which she predicted future courts must wrestle.<sup>24</sup>

The chief justice argued that to honor the common and ordinary meaning of the language contained in section 846.103(2), and to give effect to the purpose and intent of the statute, guarantors of payment, like the Boyers, must fall within the class of persons protected by section 846.103(2) and against whom a mortgagor must waive judgment when seeking the shortened redemption period.<sup>25</sup> The chief justice agreed with the analysis of the Wisconsin Court of Appeals that guarantors of a mortgage loan (at least guarantors of payment, as were the Boyers) are personally liable for the underlying loan.

Justice Abrahamson noted that there was only one source of debt

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<sup>20</sup> See id. ¶¶ 59-60.

<sup>21</sup> See id. ¶ 61.

<sup>22</sup> See id. ¶ 70.

<sup>23</sup> See id. ¶ 76.

<sup>24</sup> See id. ¶¶ 83-85 (Abrahamson, C.J., dissenting).

<sup>25</sup> Id. ¶ 88.

underlying the Bank's claims in *Boyer Construction*: the business notes given by Boyer Construction to the Bank and guaranteed by the Boyers. She accused the court's majority of elevating form over substance to reach a counterintuitive result. Notwithstanding the Boyers' separate contractual obligation through their guaranty, the chief justice argued that the substantive effect of the Boyers' guaranty was to render the Boyers personally obligated to pay the debt secured by the Boyer Construction mortgages.<sup>26</sup>

Justice Abrahamson argued that the common and ordinary definition of the phrase "personally liable for the debt secured by the mortgage" contained in section 846.103(2) includes guarantors. She pointed to the majority opinion's recognition that the phrase does not clearly exclude guarantors, and that reasonable people could read the phrase to include guarantors like the Boyers. The chief justice concluded this point with the admonition that unless there is a good reason to interpret a statute other than by using the ordinary meaning of the words contained in the statute, the statute should be interpreted in a way that both lawyers and non-lawyers reading it will understand it clearly and simply.♦

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<sup>26</sup>Id. ¶¶ 90, 92