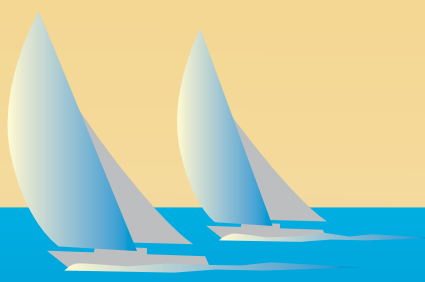


ARTICLE 9 FORECLOSURE SALES: A UNIQUE APPROACH/SAFE HARBOR?



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This article suggests the possibility of utilizing a "joint" foreclosure sale conducted by an assignee for the benefit of creditors who also acts as the selling agent for a foreclosing Article 9 secured party. This approach results in the transfer of title, elimination of junior liens and is designed to meet a statutory definition of "commercial reasonableness".



What Is Article 9?

Article 9 of the Uniform Commercial Code prescribes a statutory framework governing the foreclosure process for security interests in personal property. The default provisions of Chapter 6 of the Revised Uniform Commercial Code (the "Code") commencing at Section 9-601 through 9-629 set forth these security interests.¹

This is important to know because in foreclosure sales, secured creditors often have big concerns about the requirement to dispose of assets in a "commercially reasonable" manner as the Code requires (see Section 9-627).² Failure to conduct a commercially reasonable sale exposes the secured party to post-sale defenses and damages asserted by the debtor, guarantors and possibly other third parties, such as creditors or trustees in bankruptcy. Depending upon the gravity of the failure to comply with the Code, subordination claims may also be asserted in a bankruptcy case, especially when dealing with a private UCC sale to insiders or existing managers who have recently formed a "Newco" (the "Friendly Foreclosure") to acquire the assets.

Selling Assets the Right Way

Therefore, if you're a secured creditor, you need to determine the best and safest way to sell the assets: public sale, private sale or accepting the collateral as partial or full satisfaction of the debt (UCC 9-610, 9-621-9-623). If you choose either of the first two options, you need to determine who should conduct the sale, how it should be advertised, whether a landlord waiver exists, etc. Rarely will a secured party conduct the sale on its own, and if it does, such a decision should be commercially reasonable. The norm is to employ a professional such as an auctioneer. When selling to former insiders or management of the debtor privately, take extra care to avoid challenges and claims of bad faith, fraudulent conveyance, etc.

Having a fiduciary such as an assignee for the benefit of creditors, which concurrently conducts the ABC sale with the foreclosure sale as the "sales agent"

of the secured party, may insulate the secured party and substantially reduce the exposure to a successful challenge to the disposition. The "agency" must be clearly defined and documented so that the fiduciary duty owed by the assignee to the debtor's creditors is not compromised. The assignee's credibility and reputation may enhance the sale and perhaps generate a greater return.

The ABCs of ABC

An ABC is somewhat similar to a bankruptcy (Chapter 7 or 11). It does not create an automatic stay (Section 362 of the Bankruptcy Code), nor is there a plan process or a contract rejection procedure available. However, statutory provisions under California law³ enhance the common law assignment procedure. For example, writs of attachments obtained within 90 days of making the assignment are voided (California Code of Civil Procedure Section 493.030), and Civil Code provisions restrict lessors from exercising remedies for 90 days from the date of the ABC (Cal. Civil Code 1954.1). Upon commencement of the assignment, the debtor's property is beyond the reach of third-party unsecured creditors. However, the assignee takes the debtor's property subject to all existing liens; there is no stay or injunction preventing secured creditors from exercising their rights. Thus, to some extent the success of the assignment proceeding is consensual. Also, filing an involuntary petition in bankruptcy is available to recalcitrant unsecured creditors, which may terminate the ABC (See 11-USC-543: Turnover of Property by a Custodian).

The California assignee can also pursue preferences under Code of Civil Procedure 1800. However, Ninth Circuit Federal courts do not accept this position, ruling that state law preference recovery runs afoul of the supremacy clause (See: *Sherwood Partners, Inc v. Lycos, Inc.*, 394 Fed 3rd 1198, Ninth Circuit 2005). California intermediate Courts of Appeal have declined to follow the Ninth Circuit, holding that the Ninth Circuit decision is not binding upon state courts

(See *David R. Haberbusch v. Charles and Dorothy Cummins Family Limited Partnership*, 139 Cal App 4th at 1630 2006; *Credit Managers Association of California v. Countrywide Home Loans, Inc.*,¹⁴⁴ Cal. App. 4th 590 2006).

Sales of Assets Jointly by Assignee and Secured Creditor

As noted, Article 9 prescribes the procedures for disposing of collateral. (UCC 9-601-9-627) (See generally; Zinneker *The Default Provisions of Revised Article 9*, ABA publication, Section of Business Law-1999). These rules require the secured creditor to proceed in a “commercially reasonable manner” and prescribe the consequences of not complying with the Code (UCC Section 9-625).

Section 9-617, however, specifies the rights that a transferee acquires at a foreclosure sale, which are:

1. All of the debtor’s rights in the collateral
2. The sale discharges any junior security interest in the collateral (assuming appropriate notice has been given)
3. The sale discharge the secured party’s lien.

When the assignee sells the assets/collateral, the sale transfers the assignor’s (debtor’s) rights to the collateral to the purchaser, but this sale is subject to valid liens — all of which survive the sale unless the secured party consents, releases its lien and agrees to have its lien attach to the proceeds. Thus, by combining the Article 9 sale with the Assignee’s sale (by having the Assignee act as the secured party’s agent and conducting a joint sale), the sale is no longer subject to the foreclosing creditor’s liens and all the liens junior to it. The sale transfers whatever rights the debtor has in the collateral from both the Assignee and the foreclosing secured party.

This device also limits the leverage that a junior lienor may have to obtain a “carve-out” or other consideration from the Assignee or the debtor in exchange for its consent. Of course, there will be a carve-out of proceeds to cover the costs and compensation due to the Assignee,

but these costs would most likely be incurred absent an ABC and, in many cases, are negotiated.

In addition and perhaps more important, a joint sale utilizing the Assignee is by statutory definition a “commercially reasonable” sale under the UCC (UCC 9-627(c) (4)). This provision says:

“(c) A disposition ...is commercially reasonable if it has been approved in or by any of the following:...

- (4) By an assignee for the benefit of creditors” (emphasis added)

This eliminates another potential challenge to the sale (as long as it has been conducted in good faith). Of course, the Assignee must perform its fiduciary duties in connection with the sale and the administration of the ABC and ensure that:

1. If the sale is public, it has properly been advertised.
2. All notices, as required by the UCC, have been given properly and timely (unless waived post default as per the code (UCC 9-624)).
3. If the sale is private, then, in addition to the notice requirements, the Assignee should shop the offer from the “friendly parties” and obtain appropriate appraisals or other validation of the fairness of the “Friendly Foreclosure.”⁴

These efforts provide a distinct advantage to secured creditors and in the case of a “Friendly Foreclosure,” or a private sale to “Newco,” they also benefit the purchasers. The Assignee obviously benefits and earns a fee; the ABC estate may realize a greater return on the assets and distribute that return to the creditors of the debtor assignor. If that’s not possible, the assignor and the secured creditor might negotiate what, if anything, they should leave “on the table” for creditors.

In summary, asset sales are “commercially reasonable dispositions” when assignees concurrently sell collateral and act as the sales agent for secured parties in transactions that transfer ownership

of property to a purchaser and discharge the liens (including all junior liens) of secured parties. This preserves the rights to recover the deficiency and proceed against guarantors while minimizing the chances of challenges to the sale. In addition, purchasers benefit from “commercially reasonable” dispositions and may avoid future challenges as well. Thus, Article 9 foreclosure sales can be a “win/win.” TSL

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- ¹ All citations are to the California Uniform Commercial Code unless other indicated.
- ² Commercially reasonable dispositions are a question of fact and are judged by “hindsight” (UCC 9-627).
- ³ This article will discuss some unique provisions of the California law but the central theme of a joint sale is applicable to most states (except those whose ABC procedure is judicial; then the Code protects sales accomplished pursuant to a judicial proceeding. See UCC 9-627©(1)).
- ⁴ A discussion of “successor liability” is beyond the scope of this article.