DEBTOR'S NEGOTIATION OF FORECLOSURE SALE MIGHT EASE SECURED CREDITOR'S BURDEN IN COMPLYING WITH ARTICLE 9

When a creditor wishes to foreclose its security interest in personal property by selling the collateral, the creditor must conduct the disposition in a commercially reasonable manner and must normally provide advance notification of the disposition. UCC §§ 9-610(b) and 9-611(b). These duties run not merely to the debtor, but also to secondary obligors and other secured parties. *See* UCC §§ 9-611(c), 9-625(c)(1). The creditor's duty to conduct the disposition in a commercially reasonable manner cannot be waived at all under UCC § 9-602(7)), and its duty to provide notification can be waived only by a debtor or secondary obligor and only after default under UCC §§ 9-602(7) and 9-624(a)).

So, what if the debtor is the one who conducts the sale? What if, at the secured creditor's urging, the debtor sells the collateral and remits the proceeds to the secured creditor? Does the commercial reasonableness standard apply? Is notification required and, if so, to whom? A recent decision from Tennessee addresses these questions—in favor of the foreclosing creditor. *Regions Bank v. Trailer Source,* 2010 WL 2074590 (Tenn. Ct. App. 2010).

The Tennessee case. The case pitted two secured creditors against each other: Regions Bank had a senior security interest in the debtor's inventory of used trailers and Hyundai Translead had a junior security interest in the same property. After the debtor defaulted, the bank obtained possession of the certificates of title for the trailers. There were then two sales of the trailers. First the debtor negotiated, and the bank approved, a sale of 241 trailers to a single buyer, sight unseen and wherever located, for approximately $120,500 ($500 each). The debtor then held a second sale of 38 trailers for $53,000. The bank received the proceeds of each sale, leaving a deficiency and therefore nothing for Hyundai.

Hyundai sued, claiming that the sales were not commercially reasonable. The trial court ruled that the commercially reasonableness standard of UCC § 9-610 applied because the bank controlled the certificates of title, and therefore had constructive possession of the trailers and actual control of the sales. The trial court then ruled that the sales were not commercially reasonable because the bank had not inspected the collateral to assess the value of the trailers prior to consenting to the sales. The bank appealed.

The foreclosure sales were commercially reasonable. The Tennessee court of appeals reversed. It concluded that the sales were commercially reasonable. It noted that the bank did not know where the trailers were located, but that the trailers were scattered over several states. Moreover, locating, inspecting, and valuing the trailers would have been expensive, and both the debtor and the bank had an incentive to get a good price. Most important, the "real-world, practical situation facing the creditor must be considered in determining [the] reasonableness" of the bank's failure to get an appraisal before agreeing to the sale. Quoting the White and Summers treatise, the court concluded that it is sufficient if the creditor "puts forth what seems to be a good faith effort." That's comforting language for secured parties who conduct foreclosure sales.

Secured creditor had control of the collateral. More interesting was the court's predicate ruling on the applicability of UCC § 9-610(b) to the sale negotiated and conducted by the debtor. The bank argued that because it did not have possession of the trailers, UCC § 9-610(b) didn't apply. The court rejected this. Although acknowledging that actual possession by the secured party would normally be sufficient to trigger application of the UCC § 9-610(b) requirement of commercial reasonableness, at least when the issue is raised by the debtor, the court concluded that the issue is actually one of control. If the creditor "has the control or leverage to approve or disapprove the transaction," then the Article 9 foreclose requirements apply.

The court then noted that there were "several unique factors" demonstrating that the bank had the requisite control in this case. First, the bank had initiated legal action to obtain possession of the certificates of title, so that it was clear that the bank was seeking to obtain and sell the collateral. Second, both the bank and the debtor regarded the bank's possession of the certificates of title as important to controlling the disposition. Third, the bank not only consented to the sales, but also released the certificates of title, thereby taking an active role in the transaction.

Evaluation of the decision. The court's analysis is generally sound. A secured creditor should not be able to evade the requirements of UCC §§ 9-610(b) and 9-611(b) by operating through a cooperative debtor. Even though notice to the debtor could provide information on the right to an accounting and potential liability for a deficiency, a secured creditor who truly controls a disposition, conducted through the debtor, should not have to provide notification of the sale to the debtor. On the other hand, the secured creditor should be required to provide notice to secondary obligors and other secured parties. The creditor should also exercise its control to ensure that the sale is commercially reasonable.

The court's conclusion that the bank in this case had control also seems correct. However, the court's broad language about what triggers UCC § 9-610(b) is a bit troubling. A creditor who merely consents to a transfer of collateral should not necessarily be deemed to be in control of the transaction. Fortunately, the court did seem to acknowledge that the issue arises only with respect to transactions entered into after default. UCC § 9-610(a) (authorizing disposition after default) and UCC § 9-610(b) (seemingly referring to a disposition authorized under subsection (a)). Nevertheless, with a well-drafted security agreement, the debtor may always be in technical default. The commercially reasonable standard of UCC § 9-610(b) should not apply if the creditor merely authorizes a sale when the debtor is in default. It should apply, though, if the authorization is part of the creditor's exercise of its enforcement rights, as it was in this case.

It is worth comparing the Tennessee court's decision to the Eighth Circuit's decision two years ago in *Border State Bank v. AgCountry Farm Credit Services,* 535 F.3d 779 (8th Cir. 2008). In that case, the court ruled that secured lenders were not required to notify a junior secured party of a sale of the collateral conducted by the debtor. However, the court did not so much reject the junior's argument that notification is required if the lenders control the sale, as it concluded that there was no control. The only evidence offered on the subject was that the lenders had "discussed sale options" with the debtor and required that all proceeds be remitted to them. So, the two decisions seem easily reconcilable.

Concluding thoughts. A secured creditor who, after default, works with the debtor to conduct a sale of the collateral, may be tempted to think that notification of the sale is unnecessary and that the commercially reasonableness standard of UCC § 9-610(b) does not apply. That *may* be true, and notification *to the debtor* of the nature and time of the sale would seem to be superfluous.

Nevertheless, a cautious secured party should assume that the rules of UCC §§ 9-610(b) and 9-611(b) do apply, particularly with respect to secondary obligors and others with an interest in the collateral.

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