Re-energizing an Injunctive Remedy To Stop UCC Foreclosures

The COVID-19 pandemic has badly shaken the commercial real estate market. A recent First Department decision has thrown an unfortunate barrier up against the hope for a turnaround.

By Y. David Scharf, David B. Saxe, and Aaron B. Lauchheimer, *New York Law Journal* – March 19, 2021.

The COVID-19 pandemic has badly shaken the commercial real estate market. A recent First Department decision, *Shelbourne BRF v. SR 677 Bway*, Case No. 2020-03604 (1st Dep't March 4, 2021), has thrown an unfortunate barrier up against the hope for a turnaround. *Shelbourne BRF* involved a mezzanine borrower that defaulted under a mezzanine loan. Mezzanine financing, which is typically layered on top of an existing senior loan, requires borrowers to grant lenders a security interest in membership interests associated with a limited liability company that ultimately controls the real property. In the event of a default, those borrowers' membership interests are subject to a foreclosure sale under Article 9 of the Uniform Commercial Code (UCC). As various real estate asset classes, including hotels, retail and commercial, continue to suffer as a result of COVID-19, lenders are stepping up their efforts to foreclose on mezzanine borrowers and take control of the underlying real estate.

Traditionally, borrowers facing a UCC foreclosure sale seek injunctive relief to stop a foreclosure sale. Some borrowers believe that *Shelbourne BRF* spells the end of a borrower's ability to do so. In *Shelbourne BRF*, the First Department focused on the preliminary injunction test set forth in CPLR 6301 and its related irreparable harm prong and held the IAS Court had improperly granted a borrower a preliminary injunction to stop a UCC foreclosure sale because "the feared loss of an investment can be compensated in money damages." That conclusion might be correct under a traditional CPLR 6301 jurisprudential analysis. But that analysis and resulting holding overlooks the remedial statutory protections contained in the UCC that are afforded to borrowers facing a UCC foreclosure sale.

UCC Article 9 contains clear guidelines concerning the way a lender must conduct a foreclosure sale in order for it to be deemed commercially reasonable. As a general matter, pursuant to 9-610(b), "[e]very aspect of a disposition of collateral, including the method, manner, time, place, and other terms, must be commercially reasonable." Pursuant to UCC §9-627(b), the sale of collateral after a default is commercially reasonable if made "(1) in the usual manner on any recognized market; (2) at the price current in any recognized market at the time of the disposition; or (3) otherwise in conformity with reasonable commercial practices among dealers in the type of property that was the subject of the disposition."

The legislature had a clear intent when enacting Article 9, and in particular, when requiring that the foreclosure sale be conducted in a commercially reasonable manner—to "insure that the debtor has an opportunity to redeem prior thereto, and that the property is not sacrificed at a price below its actual value." See *Sumner v. Extebank*, 88 A.D.2d 887, 888 (1st Dep't 1982). Commercial reasonableness requires a secured lender to employ the methods and procedures that will fulfill the UCC's prime objective of "optimizing resale price" at the sale. See *European Am. Bank v. Sackman Mortg.* (*In re Sackman Mortg.*), 158 B.R. 926, 936 (Bankr. S.D.N.Y. 1993). Thus, a sale to the highest bidder at a "poorly publicized, sparsely attended and inconveniently located auction would not be meaningful … ." *Hicklin v. Onyx Acceptance*, 970 A.2d 244, 251-52 (Del. 2009). "Whether a sale was commercially unreasonable is, like other questions about 'reasonableness', a fact-intensive inquiry; no magic set of procedures will immunize a sale from scrutiny." *In re Excello Press*, 890 F.2d 896, 905 (7th Cir. 1989) (applying N.Y. law); see also *Primavera Familienstiftung v. Askin*, 130 F. Supp. 2d 450, 545 (S.D.N.Y. 2001), amended on reconsideration in part, 137 F. Supp. 2d 438 (S.D.N.Y. 2001) ("[t]he inquiry into commercial reasonableness is a fact-intensive one that requires an inquiry into all the circumstances of the liquidation").

Within the UCC's statutory framework, aside from setting the guidelines for the way a foreclosure sale must be conducted, the UCC grants borrowers a means of protection not acknowledged by the court's decision in *Shelbourne BRF*. UCC §9-625(a) states that where the foreclosure sale is not conducted in a commercially reasonable manner, "a court may order or restrain collection, enforcement, or disposition of collateral on appropriate terms and conditions."

While case law and the traditional framework for a preliminary injunction may limit a borrower's ability to obtain injunctive relief, as the court held in *Shelbourne BRF*, courts cannot ignore the statutory remedies granted to borrowers by the legislature. As the Court of Appeals held in *Matter of Regina Metro*, the "New York State Constitution places legislative policy judgments squarely within the province of the legislature … [e]ven when a particular regulation may not be wise, 'it is for the legislature, not the courts, to balance the advantages and disadvantages of the [statute]." As the Court of Appeals concluded in *Matter of Regina Metro Co. v. New York State Div. of Housing & Community Renewal*, 35 N.Y.3d 332, 407 (2020) "the Legislature and Governor are responsible for making the final policy judgments that become law, and this Court is charged with exercising great restraint before invalidating an expression of popular will." Id. at 408.

The basic cannons of construction dictate that a court must give meaning to UCC §9-625(a) in the same manner as it does when interpreting any other statute. See *Majewski v. Broadalbin-Perth Cent. School Dist.*, 91 N.Y.2d 577, 583 (1998) ("It is fundamental that a court, in interpreting a statute, should attempt to effectuate the intent of the Legislature.") (citations omitted). Courts cannot deny a party a remedy afforded to it by the legislature. See *Matter of Bernstein Family Ltd. P'ship v. Sovereign Partners, L.P.*, 66 A.D.3d 1, 7 (1st Dep't 2009) ("No principle of law supports the proposition that courts are free to deny a party a statutory right … . To the contrary, we are required not only to conclude that the Legislature made a considered choice but to give effect to the plain meaning of the statute."); *Giambrone v. Giambrone*, 140 A.D.2d 206, 207

(1st Dep't 1988) (reversing lower court where the court "deprived plaintiff of a procedural and statutory remedy to which he was unconditionally entitled.") (citation omitted).

Taken together, a borrower facing a UCC foreclosure that is being conducted in a commercially unreasonable manner should be afforded the statutory protections granted to it by the legislature. Pursuant to UCC §9-625(a), that protection includes the right to obtain injunctive relief to stop a commercially unreasonable foreclosure sale. We believe that the remedial protections described in UCC §9-625(a) must be read into and as part of any traditional CPLR 6301 analysis in connection with an application for a preliminary injunction. Had that been done in *Shelbourne BRF*, in view of the fact that the borrower had contractually waived a claim for money damages, an injunction remedy was of utmost importance, and with all due respect, ought to have been imposed by the reviewing court, albeit on different grounds than granted by the motion court. Particularly where lenders are racing to conduct UCC foreclosure sales, many times to take control of distressed real estate assets at fire sale prices, that statutory protection is more important than ever.

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