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Injunctive Relief

This remedy has long been available to debtors or junior creditor who may wish to enjoin a foreclosure sale of collateral for various and sundry reasons. But the question arises as to whether a secured creditor might be able to obtain an injunction whereby the debtor is prohibited from selling or otherwise disposing of or granting a security interest in collateral. Most security agreements provide that any such sale or disposition without written consent of the secured creditor would be a violation of the agreement. But if such a contract violation occurs because of such a wrongful disposition of collateral, the secured creditor's interest in the collateral disposed of might be in jeopardy (if disposition were in the ordinary course of business and the purchaser did not have specific knowledge of the cr editor's security interest). But if a security creditor sought such an injunction, it would have to show that money damages (payment of the defaulted debt balance) would not be "an adequate remedy at law."

Leading case in New York is *Division of Triple T Service, Inc. v. Mobil Oil Corp.*, 60 Misc. 2d 720, 304 N.Y.S.2d 191 (1969) . . . . . Case considered injunctive relief as remedy available in cases arising under UCC.

Such a showing might be sustainable if the collateral was of such a unique type and the potential collectability of the debt severely limited. Such collateral as valuable art works,

stamp collections or custom made jewelry might be sufficiently unique to provide adequate grounds for obtaining injunctive relief against its sale. In the alternative, the secured creditor could seek a restraining order against a purchaser of the collateral, if the secured party is unable to prevent the sale.

In *Pando v. Fernandez*, 124 A.D.2d 495, 508 N.Y.S.2d 8 (1st Dept. 1986), the plaintiff claimed an interest in debtor's lottery winnings and was able to enjoin the winner from disposing of lottery payments. The New York Appellate Court accepted the plaintiff's argument that an injunction was the only available means for plaintiff to ensure that enough of the prize money would remain to pay the plaintiff, given lack of alternative resources of defendant with which to pay plaintiff. (See also *Ma v. Lien*, 198 A.D.2d 186, 604 N.Y.S.2d 84 (1st Dept. 1993), *leave to appeal dismissed*, 83 N.Y.2d 847, 612 N.Y.S.2d 110).

Injunctive relief has been issued to a secured creditor to enjoin the debtor (a hotel) from using accounts receivable that it pledged to the creditor to repay partners of the debtor amounts of cash infusions into the debtor's accounts. *The Travelers Indemnity Co. v. Meriden Main Limited Partnership*, 1992 WL 121414 (Conn. Super.) (copy attached). The Connecticut Superior Court, in granting the injunction sought by the secured party, reasoned that the harm to the creditor from such use of proceeds of accounts it has a security interest in, coupled with the current financial problems of the debtor and its limited revenues, was greater than the harm to the debtor that would result from enjoining it from paying back the cash infusions to its partners.

A similar situation occurred in *Transamerica Rental Finance v. Rental Experts* (790 F.Supp 378 (D. Conn. 1992) (copy attached). In that case, the secured party sought by

way of injunctive relief to take over and operate the business of the debtor by reason of its default and subject to the posting of a bond. While the Court recognized that "monetary loss alone is insufficient to show irreparable harm," it cited to other case law that would permit such an injunction to issue upon a showing that "an action for damages would be inadequate because the defendant is insolvent or its assets are in danger of depletion and dissipation." Evidence of a "serious decline" in the debtor's business of a period of time immediately prior to the commencement of the injunction action was enough to convince the court that a money damage action was an inadequate remedy at law.

Injunctive relief was also granted to a lender who had purchased and [transferred] to borrowers certain chattels to prevent the uncontrolled sale and thereby dissipation of the chattels where money damage action would be unavailing. *Robjudi Corp. v. Quality Controlled Products, Ltd.* 111 A.D.2d 156, 488 N.Y.S.2d 787 (2d Dept. 1985).

Injunctive Relief in Fraudulent Transfer Claims:

Injunctive relief might also be available to prevent retransfer of property fraudulently transferred by a debtor to a third party in violation of the terms of a security agreement.

Injunctive Relief in Conversion Actions:

Secured lender has been granted a preliminary injunction prohibiting a borrower from converting its accounts receivable in which the lender had a security interest. The injunction order required the borrow to deposit the proceeds of the accounts receivable in

a bank account maintained with the lender. *Amity Loans, Inc. v. Sterling Nat. Bank & Trust Co. of New York*, 177 A.D.2d 277, 575 N.Y.S.2d 854 (1st Dept. 1991).

Receivership: When the circumstances warrant, a secured creditor may seek to have a receiver appointed to operate the business of the debtor and to make payments to its creditors. NYBCL, Art. 12. NY CPLR, Art. 64. The purpose of this drastic remedy would be to preserve the assets of the debtor in which the secured creditor has a security interest from being depleted. But the secured creditor must show more than the existence of a default that the "inadequacy of the security and the doubtful financial standing of the debtor." *Chase Manhattan Bank, N.A. v. Turabo Shopping Center, Inc.*, 683 F.2d 25 (1st Cir. 1982) at 26. Factors to be considered in addition to the debtor's default include: (1) fraudulent conduct of the debtor; (2) imminent danger of the collateral being lost or devalued, causing irreparable injury under the circumstances, (3) inadequacy of a claim for money damages, (4) the probability that the appointment of the receiver would do less harm to the debtor than a denial of the appointment would do to the creditor, and (5) the probable success of the creditor on the merits.

Under the NY Business Corporation Law, Art. 12, a receiver can be appointed by a judgment creditor with respect to a corporate judgment debtor against whom an execution has been returned unsatisfied, presuming that the creditor knows of the existence and location of assets of the debtor. New York Civil Practice Law and Rules, Art. 64 refers to the appointment of a temporary receiver *pendente lite* or with respect to property that is already the subject of an action. A motion for the court to appoint such a

receiver may be made before or after service of summons in the underlying case and at any time prior to judgment, or when an appeal is pending. The movant must prove to the court's satisfaction that the property is about to be removed from the state, lost or materially injured or destroyed. Unless the court directs otherwise, such a temporary receivership ends after final judgment is entered. Similar considerations regarding the necessity of showing imminent danger of harm and inadequacy of money damages applicable to injunctive receive also apply when seeking the appointment of a temporary receiver under CPLR Art. 64.

Federal law permits the appointment of a receiver to preserve the assets of a debtor in which a secured party has a security interest. FRCP 66; *see also New York Life Ins. Co. v. Watt West Invest. Corp.*, 755 F. Supp. 287 (E.D. Cal. 1991). In addition to proof of debtor's default, the creditor's security interest in the debtor's assets, and the likelihood of the creditor's success on the merits, the creditor must show that there is imminent danger that the debtor's asset will be lost, hidden, harmed, squandered or diminished in value, and/or fraudulent conduct by the debtor in respect of its assets, and that money damages would not suffice. Thus, the criteria for the appointment of a receiver are similar to that required for injunctive relief. But consider that although both the appointment of a receiver and the issuance of an injunction are "drastic remedies," the former, constituting direct control over the asset(s) of the debtor, is more onerous than the latter, which is more in the nature of a prophylactic remedy. Therefore, the threshold of proof required for the appointment of a receiver may be higher than for the issuance of an injunction.

SOME SUGGESTIONS FROM A LITIGATOR'S PERSPECTIVE:

Commercial litigators who regularly represent secured creditors should make every effort to advise their clients about the potential legal ramifications of various aspects of the post-default, pre-litigation process, so as hopefully to prevent troublesome circumstances from arising. Below is a list of suggestions that could be helpful in avoiding certain pitfalls that could be troublesome in the context of a secured party's lawsuit to recover either its collateral or a deficiency balance.

- Demand letters should not be sent out by the attorney who will represent the creditor in any envisioned lawsuit against the obligors. This is to avoid the possibility that the attorney who sent out such a letter might be called as a fact witness in the case.
- Although strict foreclosure has been rejected by Revised UCC 9-620, extensive delay after default in scheduling a public or private sale could be used as a defense to a secured creditor's claim either under the principle of failure to mitigate damages or, depending upon the possible effect of such delay on the ultimate sale of the collateral, as a basis for a defense of a commercially unreasonable sale. Therefore, the secured creditor should make every reasonable effort to repossess and liquidate the collateral within a reasonable time after default.
- Since it is often the case that debtors change their addresses after severe financial circumstances cause default in debt obligations,

the secured creditor who intends to schedule a foreclosure sale should check the addresses of all obligors to whom notice of sale is required to be sent. If the notice is sent out without any check as the accuracy of the address, and it is returned because the addressee no longer resides or is located at that address, the creditor may be required to make a good faith effort to locate the debtor. Although the creditor is not obligated to prove receipt of the notice by the debtor, the presumption that the notice was proper is rebuttable. Therefore, if certified mail notices are returned "unclaimed", "addressee unknown," etc., the creditor should make some reasonable effort to locate the debtor and document that effort.

- Wherever possible, the litigating attorney (or in-house counsel) should check the form of sale notice before it is sent to determine if it complies with Rev. UCC 9-613 (or 9-614 for consumer transactions).
- Affidavit of publication of all public notices of sale published in newspaper or or trade journals should be obtained and sent to the attorney who will be handling the deficiency claim.
- Invoices for repossession and sale expenses should be obtained by the creditor and forwarded to the litigating attorney.
- Any hard evidence of what took place at a public sale can be very helpful in countering allegations of the defendants that, for example, they attended the sale but were denied access. An auctioneer's statement of the circumstances of the relating to the sale can be helpful evidence of what took place at the sale. This statement

should include a description of the collateral offered for sale, the name of of the secured party, the name of the auctioneer, the date, time and location of the sale, the names of attendees (and whom they represent), the sequence of bidding process including the name of the bidders and the amounts bid, and the name of winning bidder, and the time the bidding was closed. It would be helpful if the auctioneer is not an employee of or related to an employee of the secured creditor, such as a professional auctioneer. Many secured creditors have their own employees conduct foreclosure sales of collateral because the cost of an auctioneer might be too high in relation to the potential sale price. This is certainly permissible, it makes objective evidence that the sale process was commercially reasonable more difficult if it is challenged.

- How long should you hold up a public sale beyond the scheduled time for a potential bidder (particularly an obligor) who has called the auction site and advised that he/she is "stuck in traffic" and will be late?

- It is strongly recommended that photos of hard collateral (equipment, furniture, etc.) that is being sold at public or private sale be taken on or shortly before the sale date. The condition of the collateral could become an issue in the deficiency case.

- Professional appraisals of collateral being sold at foreclosure sale

can also help to establish market value if an obligor succeeds in overturning the presumption that the sale was held in a commercially reasonable manner (stated values contained in published guides are also helpful).

- Some state laws require that a notice of secured creditor's intention to pursue a deficiency after foreclosure sale be sent to the obligors in advance of the sale.

- Post-sale demand letters: are they advisable? any risks?

- How to post sale proceeds on the account records of the secured party if it is the successful bidder.

- Resale of collateral purchased by the secured creditor at a public sale:
  (a) the shorter the time between the public sale and resale, if the resale price is higher than the successful bid price, the more likely there will be a challenge to the presumption of commercial reasonableness;
  (b) if the dealer on whose premises the public sale was held ultimately buys the collateral from the secured creditor (who was the only bidder at the public sale), it is highly likely that the deficiency obligor will challenge the commercial reasonableness of the public sale;
  (c) the same may be said with regard to a situation in which the

resale buyer was invited to the sale and either made a lower bid than the resale price or did not attend the sale and bought the collateral shortly thereafter for more than the secured party's successful bid at the public sale.

- Replevin actions: make certain that the location of the collateral sought is known to the secured creditor and that removal of the collateral would not cause damages to the premises from which it is removed.

- When a replevin order is obtained, either someone from the litigating attorney's office or from the secured party should arrange with the sheriff or marshall to go with him/her to the location of the collateral to assist in identification of the collateral.

RECENT CASES OF INTEREST:

Vornado PS, LLC v. Primestone Investment Partners, LP (821 A.2d 296, Dela. Chancery, Dec. 19, 2002): public auction of units in LP exchangeable for publicly traded stock. Debtor alleged that prior to the foreclosure sale, secured creditor became aware of information about the LP units that was not available to the general public. Court found sale of units was held in a commercially reasonable manner, although creditor was only bidder. Defendant alleged that private sale held at a later date would have brought a higher price, but court did not accept this argument. Debtor may be excluded from the bidding process because of his inability to show creditworthiness. Court also found that a public auction can be a reasonable method for disposing of collateral for which no established market exists.

Orix Credit Alliance, Inc. v. Young Express, Inc. (43 Fed. Appx. 650, 2002 WL 1932000, 4th Cir. 2002): equipment lender with prior perfected security interest in accounts receivable prevails over general lender with subsequently perfected security interest in same accounts. Orix made conversion claim: 4th Cir. overruled DC in saying that self-help attempt was not necessary given Orix's demand on Wachovia to relinquish possession (under old Art. 9); collateral remains subject to security interest upon sale or transfer and continues in 'identifiable proceeds' generated by disposition. Circuit Ct. disagreed with DC on whether there can be conversion of an undocumented intangible asset, since security interest continued in cash proceeds of receivables, therefore not an intangible asset: even the uncollected accounts were evidenced by a writing. Court also found that transfer of

accounts receivable and proceeds to Wachovia was breach of duty of defendants as trustees of debtor in liquidation and trustees should be held personally liable, but only as to the transfers made after termination of the corporate existence. Trustees actions constitute wrongful preference; directors have no authority to prefer a junior over a senior secured creditor.

Harris v. Key Bank, N.A. (51 Fed. Appx. 346, 2002 WL 31501362, 2d Cir. 2002): involved secured party exercising right of "strict foreclosure" permitted to retain surplus derived from sale of collateral. Strict foreclosure was most advantageous under old Art. 9 when the likelihood of recovery of any deficiency after sale was remote and creditor wanted to avoid risks involved in foreclosure sale, particularly an argument over commercial reasonableness. Under R9, partial strict foreclosure is permitted if with consent of debtor in writing. Lender does not have to be in possession of collateral to exercise remedy of strict foreclosure. However, written notice is required: either written consent or failure of debtor to object to notice to intent to accept collateral in full or partial satisfaction of debt within 20 days after date notice is sent. Silence constitutes consent. Lender must also send notices to junior secured creditors and they have same 20 day period within which to object. Therefore, acceptance of collateral in full or partial satisfaction of debt is not effective unless parties consent in writing or notice is sent and no objection received within 20 day period. If procedure is followed, all subordinate security interests are discharged, even if secured party fails to comply with all procedural requirements.

La Salle National Bank Ass'n. v. Mehdi Gabayzedeh (2003 WL 134997, N.D. Ill. 2003): bank group obtained summary judgment against unconditional guarantor who invoked 5th Amendment against self-incrimination! Court rejected defendant's claim that lenders breached their duty of good faith and fair dealing by requiring his personal guaranty in exchange for waiver of default resulting from overadvance. Court looked to plain language of guaranty.

In Re Cadiz Properties, Inc. (278 B.R. 744, 48 UCC Rep. Serv. 2d 440, Bankr. N.D. Texas 2002): escrow agreement governing possession of collateral is not substitute for foreclosure proceeding under R9. Escrow agreement provided that upon receipt of notice of default, escrow agent holding stock would release same to lender. Canfida loaned Alford $2.6M under promissory note and secured by deed of trust on Texas property; deed of trust was released & Alford pledged in substitution 100% of its shares in Cadiz. Alford & Canfida entered into an escrow agreement. Canfida claimed that it sent notice of default to escrow agent, but escrow agent never delivered stock to Canfida. Instead, Canfida as sole shareholder of Cadiz removed its directors and elected new board.. Old board voted to have Cadiz file chapter 11. Court rejected claim that because Canfida didn't try to dismiss the bankruptcy before the court considered the bid & sale procedures for Cadiz's assets, that Canfida had implicitly consented to the chapter 11 filing and waived its right to seek dismissal.

In Re Communication Dynamics, Inc. (300 B.R. 220, Bankr. D. of Dela., 2003): recoupment and setoff of amounts due to debtor from credits on goods paid for by debtor against amounts owed by debtor for other equipment purchased under the Agreement. Tennessee law provides that creditor's right to setoff is subordinate to lender's security interest if creditor was notified in writing of the security interest. Filing of UCC-1 is NOT actual or constructive notice of lien to account debtor. Debtor claimed that adequate notice was in fact given because creditor had downloaded Dun & Bradstreet report that contained information as to lien, thus actual notice. Court agreed wioth debtor on negative inference and found actual notice here. Authentication required by Rart. 9-404(a). Delivery of D & B report containing statement as to lien on all accounts receivable satisfies notice requirement. Recoupment: mutual debts must arise from same transaction. Right of recoupment is not subordinate to security interest in debtor's inventory in context of sales agreement.

In re Moffett (48 UCC Rep. Serv. 2d 740, 288 B.R. 721, Bankr. E.D. Va. 2002): repossession under R9 does not "transfer[] all material attributes of ownership in collateral from a debtor to secured party, therefore leaving debtor with only "bare legal title . . . excluded from the estate under BC541(d). See also, In re Sanders, 291 B.R. 97 (Bankr. E.D. Mich. 2003).

Allco Enterprises, Inc. v. Goldstein Family Living Trust (48 UCC Rep. Serv. 2d 752; Ore. Ct. App. 2002): Low bid price and suspicions of improprieties at auction sale, without

proof, do not constitute sufficient grounds for finding that the sale was not held in a commercially reasonable manner. Debtor claimed that the auctioneer bid on the collateral at the sale, that the collateral repossessed and sold under separate leases was not segregated by lease at the auction, and was sold for less than market value. Court rejected these unsubstantiated allegations, noting also that the lessee/debtor was involved in the selection of the auctioneer and promotion of the sale.

In re Wiersma (49 UCC Rep. Serv.2d 309; Bankr. Idaho 2002): Debtors' claim for breach of contract and breach of warranty arising from failing to exercise due care in performing electrical work at debtors' dairy that caused impairment in debtors' cows production of milk was a "general intangible" and not in the nature of a commercial tort claim under Rev. UCC Art. 9. Debtor's claim found to be "proceeds" as arising from the los of, and damage to, debtor's cows and milk in which creditor had a security interest.

In re Houlihan's Restaurant, Inc. (49 UCC Rep. Serv. 2d 180; Bankr. W.D. Mo. 2002): seller's right of reclamation under R9-102 (definition of lien creditor) is subordinate to pre-existing secured party's interest in debtor's inventory.

In re Robinson (49 UCC Rep. Serv. 327; Bankr. W.D. Okla. 2002): chapter 11 case. Secured creditor repossessed properly under R9-609 and gave pre-petition notice of intent to sell under R9-611 but didn't sell before filing. Therefore, Secured creditor must turnover

repossessed collateral to trustee because property not yet sold remains part of debtor's estate..

In re Downing (49 UCC Rep. Serv.2d 983; Bankr. W.D. Mo. 2002): sale notice was deficient for failing to inform debtor (1) whether sale was public or private; (2) that debtor would be liable for any deficiency; (3) amount of creditor's claim at time of sale; and (4) that debtor was entitled to an accounting.

In re Atlantic Orient Corp. (49 UCC Rep. Serv.2d 1138; Bankr. D.N.H. 2003): winning bidder at R9 foreclosure sale failed to tender payment in commercially reasonable manner within time permitted by agreement between seller & bidder, during which time debtor filed a chapter. Bidder's check fro 1/3 of purchase price payable to debtor not seller was not commercially reasonable and title did not pass to bidder but collateral became property of the debtor's estate. Title only passes to buyer upon full payment of purchase price.

Motors Aacceptance Corp. v. Rozier (50 UCC Rep. Serv. 313; M.D. Ga. 2003): secured party's lawful self-help repossession of car 4 days before debtor filed didn't remove car from estate because under Ga. law title remained with debtor after repossession and until sale.

Automotive Finance Corp. v. Smart Auto Center, Inc. (334 F.3rd 685; 7th Cir. 2003): not commercially reasonable to sell some of collateral at public auction and less valuable items

of collateral at private sale to potential auction bidders. Prior relationship between secured party and private buyer is not by itself sufficient to make private sale not commercially reasonable. Failure to obtain the best possible price at the public auction, held in a manner consistent with industry practice, does not render the sale commercially unreasonable.

Sovereign Bank v. Alvarado (2003 WL 21771751; Conn. Super. Ct. 7/15/03): denied summary judgment to secured creditor who gave general notice to debtor that sale of collateral would be either public or private and credited debtor with fair market value rather than actual foreclosure sale price (thus reducing debtor's deficiency). Secured creditor failed to show that foreclosure sale was commercially reasonable, although court found notice of sale sufficient. Giving the debtor the benefit of the higher market price does not eliminate the necessity of proving that the sale was commercially reasonable.

Ryfun v. 406 W. 46th St. Corp. (746 NYS2d 21, 1st Dept. 2002): coop failed to satisfy old Art. 9 (and in dicta also would have failed to satisfy R9 610 & 620) when coop foreclosed on stock certificate evidencing debtor's ownership of coop apartment. Where coop is in possession of the collateral for reasons other than holding the collateral as security for debt, the coop must comply with the notice and other procedural requirements under UCC-9 relating to foreclosure sale.

Town House Department Stores, Inc. v. Ahn (2003 WL 881004; Guam 2003): Guam's Rules of Civil Procedure, Rule 70(a) provides that a deficiency judgment after repossession

of personal property will not be granted unless the property was sold for a fair and reasonable price. Court found that foreclosure sale of collateral for 37% of market value was commercial reasonableness.

In re Iroquois Energy Management, LLC (284 B.R. 28, W.D.N.Y. 2002): Where debtor is located in New York and monies are paid to it from a foreign account debtor, the monies placed in escrow are general intangibles under pre-Revised Art. 9 and equity demands that the locus of these monies be deemed to be New York.

HEW Federal Credit Union v. Battle (772 A.2d 252, 45 UCC Rep. Serv. 670, D.C. Court of Appeals, 2001): secured creditor must give notice of sale of collateral to guarantor or forfeit its right to recover deficiency from guarantor.

Cub Cadet Corp. v. Mopec, Inc. (78 S.W.3d 205, W.D. Mo. 2002): secured creditor repossessed and sold collateral giving notice of sale to debtor, but failing to plead notice of sale. Trial Court denied creditor the opportunity to introduce evidence of sending of sale notice to debtor, and held that creditor could not recover deficiency without proving notice. Appellate Court affirmed. Lesson: be scrupulously careful in initial pleadings in Montana courts!

Morgan Buildings and Spas, Inc. v. Turn-Key Leasing (97 S.W.3d 871, Texas Court of Appeals, 2003): court enforced provisions of R9.505 that permit creditor to retain collateral

in full satisfaction of debt upon notice to debtor of creditor's intent to do so and no objection of debtor within time period provided under this provision.

Hopson v. Bank of North Georgia (258 Ga. App. 360, Ga. Ct. of Appeals, 2002): Grant of security interest in guarantor's interest in LLC entitles secured creditor to foreclose upon default, but security interest is limited by terms of LLC's operating agreement, which was expressly made part of security agreement and operating agreement limited creditor to guarantor's economic interest in LLC. Failure of guarantor to obtain unanimous consent from LLC members to guarantor's granting of security interest to creditor did not bar foreclosure upon default, but did limit scope of the interest conveyed.

Wells Fargo Bank, N.A. v. Temple View Investments (Utah Ct. App. 12/26/03): creditor's unilateral agreement to extend payment terms of note insufficient to extend statute of limitations. Efforts at negotiating settlement by debtor's attorney are not deemed to be admission of debt.

HSBC Business Credit USA, Inc. v. Kelley (Mich. Ct. App. 01/15/04): Failure of guarantors to offer evidence in support of defense of commercial unreasonableness of foreclosure sale results in summary judgment for creditor.

CIT Group/Equipment Financing, Inc. v. Roberts (Ala Ct. Civ. App. 12/30/03): After debtor filed for bankruptcy, it placed equipment in which creditor had a security interest in storage without notifying creditor. Debtor agreed to turn over equipment to creditor, but

storage yard refused. Court ruled that lack of notice to creditor of storage, coupled with lack of any express or implied contract between them, entitles creditor to return of equipment collateral without having to pay storage charges.

Palo Savings Bank v. Sparrgrove (Iowa Ct. App. 01/14/04): Creditor's right to recover "collection" costs, including attorneys' fees, from guarantor did not extend to recover of such costs and fees incurred by creditor in connection with its efforts to recover the collateral from the debtor in its bankruptcy case.