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Beardmore v. American Summit Financial Holdings, Inc. 2002 WL 1817983 (U.S. Dist. Ct. Minn.)

This case serves as a strong reminder to proceed carefully when selling collateral after a default. By way of background, Article 9 of the Uniform Commercial Code states that "[a] secured party after default may sell, lease or otherwise dispose of any or all of the collateral in its then condition or following any commercially reasonable preparation or processing." After disposition, the secured creditor must provide an accounting with respect to any surplus and, unless otherwise agreed, is entitled to any deficiency. However, any disposition must be handled in a commercially reasonable manner and the failure to do so will cost a secured credit any rights to a deficiency and can cost it additional monetary damages. This obligation of reasonableness cannot be waived by agreement but the "parties may by agreement determine the standards by which performance of such obligations is to be measured if such standards are not manifestly unreasonable."

In the case at bar, Borrower defaulted and Lender decided to foreclose on certain stocks that had been pledged as collateral pursuant to the loan documents. Lender and Borrower entered into a letter agreement outlining the manner in which the sale was to occur. However, Lender breached the letter agreement during the process of selling the collateral. The court held that the breach of this letter agreement rendered the sale commercially *unreasonable* thereby costing Lender any chance at a deficiency judgment.



The lesson is clear. An agreement with the lessee that outlines what is a "commercially reasonable disposition" can be helpful to assure compliance with Article 9. Essentially, this sort of arrangement transforms the legal issue so that the key issue is not whether the sale is "commercially reasonable" but, rather, whether it is "manifestly unreasonable." Nonetheless, such an agreement can operate as double-edged sword and must be drafted carefully.

Note, as between a lessor and a lessee, the rules regarding commercial reasonableness discussed above apply to any lease that is not a true lease covered by Article 2A of the UCC. Such rules may also apply between a broker and a funder with respect to true leases whenever there is a discounting of the rent stream or other arrangement such that the funder merely obtains a security interest in the leased equipment rather than outright ownership.

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