

Client Alert

July 2022

Unwinding a Completed UCC Foreclosure: Not So Fast

Following years of forced inaction caused by the COVID-19 pandemic, lenders are again enforcing their rights against defaulting commercial real estate borrowers. In anticipation of a potential flurry of UCC foreclosures, mezzanine lenders and borrowers should be reminded that seeking to unwind a completed UCC foreclosure sale is not permitted by New York law.

On June 6, 2019, in *Atlas MF Mezzanine Borrower, LLC v. Macquarie Texas Loan Holder*, 174 A.D.3d 150, 152 (N.Y.S.3d 2019), New York’s Appellate Division, First Department, held that mezzanine borrowers may not invalidate a lender’s UCC disposition of its collateral after the sale’s conclusion. The court reasoned that if courts were allowed to unwind UCC sales, “it would only serve to muddy the waters surrounding nonjudicial sales . . . and to deter potential buyers from bidding in nonjudicial sales.”

Background

In *Atlas*, Atlas purchased 11 apartment complex properties financed with a \$71 million mezzanine loan from Macquarie. Atlas pledged its 100% equity interest as collateral for the loan. On January 3, 2017—one day after the loan’s maturity date—Macquarie notified Atlas of its default and demanded payment. Eight days later, on January 11, 2017 Macquarie notified Atlas that it intended to sell Atlas’ equity in a nonjudicial public sale.

Prior to Macquarie’s disposition, Atlas moved to enjoin the sale. The trial court denied Atlas’ pre-sale request for a preliminary injunction, noting that Atlas “failed to demonstrate irreparable injury that cannot be redressed through a monetary award.”

While waiting for the court to decide on its request for an injunction, Atlas attempted to participate in the UCC auction. Macquarie rejected Atlas’ high-bid of \$77 million and transferred the equity to KKR REPA AIV-2 L.P. (“KKR”) for \$76.75 million. Macquarie kept the sale’s \$836,891.45

attorney

Adam H. Friedman
afriedman@olshanlaw.com
212.451.2216

practice

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surplus, stating that it had incurred more than \$1.3 million in attorneys' fees. Atlas alleged that the court should invalidate Macquarie's transfer to KKR, return Atlas' collateral, and impose punitive damages on Macquarie for conducting a commercially unreasonable disposition.

Macquarie moved to dismiss and the trial court denied its request. Macquarie then appealed to the Appellate Division, First Department.

Unwinding UCC Disposition

In a decision that has given lenders assurance in the finality of UCC sales, the appellate court dismissed Atlas' first cause of action seeking to invalidate or "unwind" the sale of pledged equity. The court ruled that "unwinding" a disposition was not a remedy contemplated by the UCC and that the remedy for the borrower was to seek to enjoin the sale prior to the closing of the UCC disposition. The court supported its conclusions citing UCC 9-625, which addresses the remedies available to a debtor when a secured party fails to comply with Article 9 of the UCC. Specifically, Section 9-625 allows the court to "order or restrain collection, enforcement, or disposition of collateral on appropriate terms and conditions" if the secured party is noncompliant.

While the court determined that Atlas could not unwind the UCC sale, it held that Atlas could seek money damages for Macquarie's allegedly unreasonable sale.

Conclusion

Atlas offers a helpful clarification for mezzanine borrowers and lenders that find themselves facing a UCC disposition following a borrower's loan default.

For borrowers:

Atlas sends a clear message to defaulting borrowers: to prevent an allegedly improper UCC sale, the borrower should seek to enjoin the lender's disposition as early as possible. To do so, borrowers must show that they will suffer irreparable harm if the sale goes through and that money damages are inadequate. This requirement poses a challenge for mezzanine loan borrowers because collateral equity is not unique in the same way that collateral real property is.

Should a borrower fail to enjoin the lender's disposition, according to *Atlas*, its only remedy will be damages. The court measures damages "in the amount of any loss caused by a failure to comply with [UCC 9-625(5)]."

attorney

Adam H. Friedman
afriedman@olshanlaw.com
212.451.2216

practice

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For lenders:

Lenders should adhere to the commercial reasonability standards outlined in the UCC to ensure that they do not subject themselves to a suit for damages. Though commercial reasonableness is determined on a case-by-case basis, courts will often assess the notice, marketing, manner and timing of the disposition, and determine if the lender adequately maximized the disposition's proceeds.

Please contact the Olshan attorney with whom you regularly work or the attorney listed below if you would like to discuss further or have questions.¹

attorney

Adam H. Friedman
afriedman@olshanlaw.com
212.451.2216

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¹ Greyson Cohen, a law clerk with Olshan, assisted with the research and drafting of this client alert.