NOTE

FORECLOSURE SALES UNDER THE UCC DURING THE COVID-19 PANDEMIC: WHAT IS COMMERCIALLY REASONABLE?

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Under the Uniform Commercial Code (UCC), "every aspect" of a foreclosure sale must be commercially reasonable. The traditional commercial reasonableness standard was tested during the first year of the COVID-19 pandemic, as the unprecedented circumstances imposed by state restrictions prompted increased judicial scrutiny of UCC foreclosure sales. This occurred most prominently in the context of commercial property mezzanine loan foreclosures. A mezzanine loan is a property loan secured by a pledge of equity interests in the property-owning entity rather than a security interest in the property itself. As state mortgage foreclosure moratoriums restricted lenders' abilities to foreclose on commercial property, mezzanine lenders initiated UCC foreclosures to circumvent this barrier and take control of their collateral.

This Note argues that courts adopted a more probing and holistic analytical approach to commercial reasonableness analyses during the first year of the pandemic. This approach more closely analyzed the procedures employed by foreclosing lenders and contextualized fair price considerations within wider market and societal concerns. This Note then proposes ways for secured creditors to protect their foreclosure sales during future periods of market uncertainty. Although secured creditors cannot fully insulate their foreclosure sales from fair

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price challenges in a market downturn, they should employ additional procedural safeguards to deflect commercial reasonableness challenges aimed at the alleged procedural irregularities of such sales.

I. INTRODUCTION

The COVID-19 pandemic disrupted the United States and world economies on a scale not seen since the Great Recession of 2008-2009.[1] An unprecedented range of commercial activities suffered, "from services generally to tourism and hospitality, medical supplies and other global value changes, consumer electronics, and financial markets to energy, transportation, [and] food[.]"[2] Beginning in March 2020, the United States struggled to manage the pandemic's public health consequences while also containing the economic and commercial fallout. In April 2020, 20 million American workers were laid off or fired, driving the unemployment rate to 14.7%, its highest since the Great Depression.[3] As cases declined in the summer months, the unemployment rate decreased to 7.9% by September 2020.[4] Troublingly, the first few months of 2021 saw an expansion in COVID-19 cases.[5]

1 JAMES K. JACKSON ET AL., CONG. RSCH. SERV., R46270, NO. 54, GLOBAL ECONOMIC EFFECTS OF COVID-19, at 1–2 (2020).

2 *Id.* at 3.

3 *Id.* at 6.

4 *Id.* This calculation does not include the 20.8 million Americans working part-time not by choice or searching for employment *Id.* at 6 n.23.

5 Madeline Holcombe & Dakin Andone, *The U.S. Reported More Than 4,000 Covid-19 Deaths in One Day for the First Time Ever*, CNN (Jan. 8, 2021, 2:25 AM), https://www.cnn.com/2021/01/07/health/us-coronavirus-thursday/index.html [https://perma.cc/N7HY-GDCM]; *see also* Ankita Rao, *U.S. Records More Than 5,000 Covid Deaths in Single Day After*

During the ensuing summer, the new Delta variant of the COVID-19 virus spread aggressively across the country, overwhelming the South and compelling a new wave of mask and vaccine mandates in most parts of the United States.[6]

Commercial real estate is one of the economic sectors that has been most harmed by the COVID-19 pandemic. Stay-at-home orders and state restrictions on commercial businesses shuttered properties nationwide and left owners with little cash flow and mounting debt.[7] Commercial mortgagors, saddled with large mortgage and mezzanine loans, lacked the funds necessary to satisfy their loan payments.[8] In response, a number of states instituted restrictions on residential and commercial mortgage foreclosure actions, many of which remained in effect until 2021.[9] By late-2020, businesses had reopened but were operating at limited capacities under fluctuating state restrictions.[10] Although the state foreclosure restrictions largely prevented mortgage lenders from initiating foreclosure proceedings, they did not dissuade

Data Audit, GUARDIAN (Feb. 5, 2021, 9:00 AM), https://www.theguardian.com/us-news/2021/feb/05/us-covid-coronavirus-death-toll [https://perma.cc/HCH7-XBL8].

6 Julie Bosman & Mitch Smith, *Delta Surge Drives Home Painful Truth: Covid Isn't Going Away*, N.Y. TIMES (Sept. 5, 2021), https://www.nytimes.com/2021/08/16/us/covid-delta-variant-us.html [https://perma.cc/J656-M4LL].

7 Matthew Goldstein, *Worried Lenders Pounce on Landlords Unable to Pay Their Loans*, N.Y. TIMES (Aug. 13, 2020), https://www.nytimes.com/2020/08/13/business/commercial-landlord-loan-foreclosure.html [https://perma.cc/WQG6-SQJP].

8 *Id.*

9 *See COVID-19 Related Eviction and Foreclosure Orders/Guidance 50-State Tracker*, PERKINS COIE LLP (Oct. 5, 2021), https://www.perkinscoie.com/en/news-insights/covid-19-related-eviction-and-foreclosure-ordersguidance-50-state-tracker.html [https://perma.cc/L9QM-QZ34].

10 *As U.S. Breaks Hospitalization Records, N.Y. and Other States Add Restrictions,* N.Y. TIMES (Nov. 15, 2020), https://www.nytimes.com/live/2020/11/11/world/covid-19-coronavirus-live-updates#ny-will-limit-private-gatherings-and-require-bars-and-restaurants-to-close-daily-at-10-pm [https://perma.cc/9LQW-JZMD].

mezzanine lenders from foreclosing on commercial borrowers who defaulted on their scheduled loan payments.[11]

Mezzanine loans differ from mortgage loans in a variety of aspects that influence foreclosure procedures. Unlike mortgage loans, in which a lender exchanges loan proceeds for a security interest in real property, mezzanine loans are secured by a specialized form of collateral—a pledge of equity interests in the borrower entity itself.[12] Consequently, mezzanine loans are governed by the Uniform Commercial Code (UCC) rather than state real property law, allowing mezzanine lenders to hold foreclosure sales despite mortgage foreclosure restrictions.[13] Such foreclosures provide lenders with a unique opportunity to acquire control over the underlying property at prices far less than fair market value.[14]

As a result, mezzanine loan foreclosures proliferated after March 2020.[15] Mezzanine lenders customarily foreclose by conducting a public foreclosure sale of the collateral.[16] Section

11 *See* Goldstein, *supra* note 7.

12 Brian W. Harvey & Eric D. Lemont, *When Mezz Gets Messy . . .*, RESOURCE: A GOODWIN PROCTOR PUBL'N FOR THE REAL EST. INDUS., Fall 2009, at 6, 6.

13 *See* Mark S. Edelstein & Jeffrey J. Temple, *Courts: A Foreclosure Pandemic Pause? (Part 2)*, MORRISON & FOERSTER LLP (Aug. 18, 2020), https://www.mofo.com/resources/insights/200818-foreclosure-pandemic.html [https://perma.cc/4P98-WX4S].

14 *See* Keith Larsen, *Rising UCC Foreclosures are "the Tip of the Iceberg": Mezz Lenders Are Gunning for Distressed Developments as Defaults Increase*, THEREALDEAL (Dec. 17, 2020, 1:00 PM), https://therealdeal.com/issues_articles/the-tip-of-the-iceberg/ [https://perma.cc/36LQ-FLQM].

15 *See id.*

16 James D. Prendergast, *Real Estate Mezzanine Lending Collateral Foreclosure: Insurance Tailored to the Operation of the U.C.C. Is Not a Luxury – it's a Necessity*, 27 PRAC. REAL EST. L. 11, 26 (2011) (discussing the requirements of public foreclosure sales in the context of mezzanine loan foreclosures); Peter E. Fisch, Steven Simkin & S.H. Spencer Compton, *Foreclosing on a Mezzanine Loan Under UCC Article 9: A Guide to Remedies and Strategies*, PAUL, WEISS, RIFKIND, WHARTON & GARRISON LLP 5 (July 24, 2008), https://www.paulweiss.com/media/102837/24Jul08RE.pdf [https://perma.cc/P2FR-2JKS] (noting that mezzanine lenders foreclosure

9-610(b) of the UCC requires "every aspect" of such sales to be "commercially reasonable," with the UCC and case law clarifying what qualifies a sale as "commercially reasonable."[17]

The pandemic has tested the adequacy of the "commercial reasonableness" standard in section 9-610 auction processes while generating a renewed focus on price. Litigation regarding UCC foreclosure sales during the first year of the pandemic almost exclusively involved mezzanine lenders in commercial real estate transactions seeking to dispose of their collateral.[18] Despite the specialized nature of mezzanine loan collateral and mezzanine loan foreclosures, judicial determinations as to what qualifies as a commercially reasonable foreclosure sale have significant implications for all UCC foreclosure sales during and after the pandemic.

This Note argues that UCC foreclosure sales received increased judicial scrutiny during the pandemic as courts adopted a more probing and holistic analytical approach to commercial reasonableness analyses. This approach more closely analyzes the procedures employed and contextualizes fair price considerations within wider market and societal concerns. Although secured creditors cannot fully insulate their foreclosure sales from fair price challenges in a market downturn, they should employ additional procedural safeguards to deflect commercial reasonableness challenges aimed at the alleged procedural irregularities of such sales. Part II provides background on UCC foreclosure sales, the commercial reasonableness standard as defined by the UCC and case law, and the nature of mezzanine loan collateral in the context of UCC foreclosures. Part III examines the relevant UCC foreclosure case law during the pandemic, focusing on public foreclosure sales of mezzanine loan

through public sales and that a public disposition is preferred when a lender wants to purchase the collateral).

17 U.C.C. § 9-610(b) (AM. L. INST. & NAT'L CONF. OF COMM'RS ON UNIF. STATE L. 2012).

18 This statement is based on searches on Westlaw, Lexis, Google, and other search engines and databases. Search results are on file with the Columbia Business Law Review.

collateral. This case law reveals that, during the first year of the pandemic, courts reconsidered the commercially reasonable nature of a number of procedural aspects of foreclosure sales. It also demonstrates that courts placed an increased emphasis on fair price by factoring the implications of economic and social instability into their commercial reasonableness evaluations. Part IV considers two new issues regarding UCC foreclosures sales that courts may be compelled to address in the context of mezzanine loan collateral. The first centers around the definition of a "market collapse" and the reasonableness of holding foreclosure sales during such a collapse, while the second evaluates the good faith implications inherent to scheduling foreclosure sales during a pandemic. Part V offers various procedural considerations and techniques for secured creditors to adopt in their security agreements or otherwise to establish "fairer" foreclosure sales insulated from commercial reasonableness challenges.

II. BACKGROUND

Although the UCC offers some guidance on what may qualify as a commercially reasonable foreclosure sale, case law has clarified the commercial reasonableness of certain procedures while leaving others open to challenge by debtors. Section II.A examines the relevant UCC provisions and comments. Section II.B provides an overview of the judicial tests for determining the commercial reasonableness of foreclosure sales under the UCC. Section II.C offers a brief overview of mezzanine loans and mezzanine loan foreclosures to facilitate the analyses of recent foreclosure cases in Part III.

A. Standards for Commercially Reasonable Foreclosure Sales Under Article 9

Article 9 of the UCC sets forth the processes and procedures governing secured transactions between a debtor and secured party. It applies to any transaction in which a

contract generates a security interest in personal property.[19] The debtor and secured party ordinarily create a security interest by entering into a security agreement.[20] A "security interest" under the UCC does not include an interest in real property, but it does cover an interest in "investment property."[21] Investment property is "a security . . . security entitlement, securities account, commodity contract, or commodity account."[22] This definition encompasses stock in a corporation as well as membership interests in a limited liability company, partnership, or other corporate entity, if so designated in the entity's foundation documents.[23] Otherwise, such membership interests are considered "general intangibles" under Article 9—the more common arrangement.[24] Significantly, lenders often take a security interest in membership interests as collateral in financing transactions, including those involving mezzanine loans.[25]

When a debtor defaults on its obligations, the secured creditor has a right under section 9-610 to foreclose on the collateral, dispose of it, and, if the creditor desires, purchase it at the subsequent foreclosure sale according to specific procedures.[26] Although the UCC does not define what qualifies as a default, it is commonly acknowledged to be "whatever the security agreement says it is[]"[27]—subject to the UCC's good faith requirement that the secured creditor is

19 U.C.C. § 9-109(a)(1).

20 *Id.* § 9-102(a)(73).

21 *Id.* §§ 1-201(b)(35), 9-314(a), 9-328.

22 *Id.* § 9-102(a)(49).

23 *See* Philip H. Ebling & Steven O. Weise, *What a Dirt Lawyer Needs to Know About New Article 9 of the UCC*, 37 REAL PROP. PROB. & TR. J. 191, 207–10 & 207 n.75 (2002).

24 *Id.* at 211; Norman M. Powell & James D. Prendergast, *Mezzanine Loans: The Vagaries of Membership Interest Collateral*, PRAC. REAL EST. L., Sept. 2010, 57, 59.

25 *See* Ebling & Weise, *supra* note 23, at 207–08.

26 U.C.C. § 9-610.

27 JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE 1326, 1328 (6th ed. 2010) (quoting 2 GRANT GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 43.3, at 1193 (1965)).

"honest[] in fact and . . . observ[es] . . . reasonable commercial standards of fair dealing."[28]

Whether a disposition is public or private determines if other bidders are afforded an opportunity to outbid a secured party for its collateral.[29] A secured party that intends to purchase the collateral must stage a public disposition open to other potential purchases unless the collateral "is customarily sold on a recognized market or the subject of widely distributed standard price quotations."[30] Thus, securities of companies sold on a recognized market, such as the New York Stock Exchange, can be sold through a private sale, whereas equity interests in a limited liability company and other forms of mezzanine loan collateral often must be auctioned off through a public foreclosure sale.[31]

1. Overview of Commercial Reasonableness Under Section 9-610

Under section 9-610(b), "every aspect" of a foreclosure sale must be "commercially reasonable."[32] This includes the "method, manner, time, place, and [any] other terms" of the sale.[33] Although the reasonableness inquiry is fact intensive for each challenged transaction, the UCC provides a secured party with key procedural benchmarks that it must follow for its foreclosure sale to be commercially reasonable.[34] Indeed, commercial reasonableness under section 9-610(b) hinges

[28] U.C.C. § 9-102(a)(43).

[29] *See id.* § 9-610 cmt. 7 ("[A] 'public disposition' is one at which the price is determined after the public has had a meaningful opportunity for competitive bidding.").

[30] *Id.* §§ 9-610(b), (c)(2).

[31] *See infra* Section II.C.1.

[32] *Id.* § 9-610(b).

[33] *Id.*

[34] *See, e.g.*, Anthony G. Eonas & Erin M. Secord, *Exploring the Creditor's Duty of Reasonable Care Under UCC Article 9 Amidst Recession and Revision*, 89 OR. L. REV. 623, 628 (2010); *In re* Excello Press, Inc., 890 F.2d 896 (7th Cir. 1989) (noting that "[w]hether a sale was commercially unreasonable is . . . a fact-intensive inquiry; no magic set of procedures will immunize a sale from scrutiny").

upon the robustness of the procedural means employed to advertise and conduct the foreclosure auction, especially as compared to industry practice.[35] This involves a substantial "marketing process" to attract additional bidders, including (1) the issuance of a foreclosure notice; (2) adequate advertising in relevant publications or through other means that reach the applicable market and potential bidders; (3) access to the collateral, or, in the case of collateral such as equity interests in a property-owning entity, access to property and diligence materials regarding the underlying asset; and (4) allowing sufficient time between notice and sale.[36]

Subsequent sections clarify some of these requirements. For instance, section 9-611 requires the secured creditor to notify the debtor of the sale at least ten days before "the earliest time of disposition set forth in the notification,"[37] which makes the notice "timely as a matter of law."[38] Section 9-613 sets forth the information that the secured party must include in the foreclosure notice, such as (1) a description of the debtor, the secured party, and the collateral that the secured party plans to dispose; (2) the planned method of disposition; and (3) the "time and place" of the sale if the disposition is public, or the "time after which any other disposition is to be made" if the disposition is private.[39]

2. Overview of Section 9-627 Guidelines

Section 9-627 contains some guidance for determining whether a foreclosure sale is commercially reasonable. First, section 9-627(a) states that a sale is not rendered commercially unreasonable solely because the secured party

[35] Eonas & Secord, *supra* note 34, at 639–40; *see also* Prendergast, *supra* note 16 (describing notice requirements).

[36] J. Dean Heller, *What's in a Name: Mezzanine Debt Versus Preferred Equity*, 18 STAN J.L. BUS. & FIN. 40, 52 (2012); Harvey & Lemont, *supra* note 12, at 7.

[37] U.C.C. § 9-612.

[38] WHITE & SUMMERS, *supra* note 27, at 1351; *see* U.C.C. §§ 9-611–13.

[39] U.C.C. § 9-613.

could have obtained a higher sale price by disposing of the collateral "at a different time or in a different method[.]"[40] Comment 2 clarifies this, noting that a low price suggests only that the court must ensure "that each aspect [of the disposition] was commercially reasonable."[41] This generally is interpreted as signifying that a low price, by itself, cannot prove commercial unreasonableness without some procedural defects—although some courts focus their unreasonableness inquiry on the proceeds of the sale.[42]

Second, section 9-627(b) clarifies that a disposition of collateral is commercially reasonable if it is 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."[43] These safe harbors are limited in practice and do not apply to dispositions of mezzanine loan collateral.

The first two safe harbors apply where the collateral can be sold on a recognized market.[44] A recognized market is one in which, like the New York Stock Exchange, "items are sold and fungible and prices are not subject to individual negotiation."[45] Since there are no recognized markets for mezzanine loan collateral, these two safe harbors do not apply

40 U.C.C. § 9-627(a).

41 *Id.* cmt. 2; *see infra* Section II.B.

42 *See* Andrea Coles-Bjerre, *Trusting the Process and Mistrusting the Results: A Structural Perspective on Article 9's Low-Price Foreclosure Rule*, 9 AM. BANK. INST. L. REV. 351, 355–56 (2001) (concluding that comment 2 intends "one . . . to judge the legitimacy of a foreclosure sale by the way it is conducted, not the price it generates—in other words, by reference to the process, not the results of that process"); *cf.* Michael Korybut, *Searching for Commercial Reasonableness Under the Revised Article 9*, 87 IOWA L. REV. 1383, 1387 (2002) (noting that in jurisdictions that subscribe to the "proceeds test" for commercial reasonableness, "although the secured party ha[s] to prove the sale was procedurally regular and reasonable, the sale price function[s] as the decisive factor of commercial reasonableness").

43 U.C.C. § 9-627(b).

44 *See* WHITE & SUMMERS, *supra* note 27, at 1344.

45 U.C.C. § 9-610 cmt. 9.

for dispositions of such collateral.[46] Meanwhile, section 9-627(b)(3) enables a secured party to establish the commercial reasonableness of its foreclosure sale by "showing conformity with the practices of reputable dealers in the trade."[47] Although this safe harbor can apply to foreclosure sales of mezzanine loan collateral, mezzanine lenders must nevertheless fulfill the section 9-610 reasonableness requirements to prove that their sales "conform" to the practices of other "reputable" mezzanine lenders, as only lenders that abide by section 9-610 can be considered "reputable."[48] As a result, mezzanine lenders and other secured parties unable to take advantage of the 9-627(b) safe harbors must show the commercial reasonableness of their foreclosure sales under section 9-610(b).

B. Judicial Interpretations of Commercial Reasonableness Under Section 9-610(b)

Courts use three tests to evaluate whether foreclosure sales are commercially reasonable.[49] Courts that concentrate their analysis on the procedures of the foreclosure sale employ

[46] Andrew R. Berman, *Risks and Realities of Mezzanine Loans*, 72 MO. L. REV. 993, 1016 (2007).

[47] Hicklin v. Onyx Acceptance Corp., 970 A.2d 244, 250 (Del. 2009) (finding that defendant finance company failed to conduct a commercially reasonable sale when it sold plaintiff's car for sixty-four percent of its fair market value at a private auction because defendant failed to prove that the sale was commercially reasonable in every aspect under section 9-610(b) and because defendant failed to establish that its sale conformed with the accepted practices of trade dealers).

[48] Malcolm K. Montgomery & Seth E. Burch, *The Commercially Reasonable Real Estate Mezzanine Loan Foreclosure – Lessons from the Front Lines*, REAL EST. FIN. J. (2010), *reprinted in* SHEARMAN & STERLING LLP (2010), https://www.martindale.com/matter/asr-959678.Mezzanine.pdf (on file with the Columbia Business Law Review).

[49] Frank Peretore, *Enforcement of Article 9 Security Interests: The Commercially Reasonable Sale*, EQUIP. LEASING NEWSL. (Law Journal Newsletters), Feb. 2013, https://www.lawjournalnewsletters.com/sites/lawjournalnewsletters/2013/02/26/enforcement-of-article-9-security-interests-the-commercially-reasonable-sale/ [https://perma.cc/UVP8-YLXZ] (describing "the proceeds test," "the totality of the circumstances test," and "the procedures test").

the "procedures test," whereas those that focus primarily on price apply the "proceeds test."[50] New York courts use both tests,[51] while other courts employ a test that considers the "totality of the circumstances" of the sale.[52] In *Solfanelli v. Corestates Bank, N.A.*, for instance, the Third Circuit applied the totality of the circumstances test and concluded that commercial reasonableness analyses under Pennsylvania law

[50] Korybut, *supra* note 42, at 1386. The Drafting Committee to the 1999 revisions to Article 9 intended to provide clarity on using the price of a foreclosure sale to determine commercial reasonableness, adding section 9-615(f) to indicate that a court should assess the sufficiency of the sale price only "(1) where the sale is commercially reasonable under revised section 9-610(b), . . . (2) where the purchaser is an interested party, such as the secured party herself . . . and (3) where the sale yields a price 'significantly below' the amount that would have been received if the sale had been to a disinterested third-party purchaser." *Id.* at 1389. Despite this, courts continue to apply both the proceeds test and procedures test to determine commercial reasonableness under 9-610(b). *See, e.g.*, Miller v. Greenwich Capital Fin. Prods. (*In re* Am. Bus. Fin. Servs.), 471 B.R. 354 (Bankr. D. Del. 2012) (applying New York law and finding that, under both the proceeds test and procedures test, the foreclosure sale of cash and certificates of beneficial interests in mortgage loan trusts was commercially reasonable); Bremer Bank, Nat'l Ass'n. v. John Hancock Life Ins. Co., No. 06-1534 ADM/JSM, 2009 WL 702009, at *30–39 (D. Minn. Mar. 13, 2009) (applying the proceeds test and the procedures test under New York law to determine that the sale of equity interest in an aircraft, an accompanying lease, and an unsecured claim for damages was commercially reasonable despite yielding a sale price that was roughly sixty-two percent of the plaintiff's evaluation of the collateral's value); WHITE & SUMMERS, *supra* note 27, at 1343 ("Despite the disclaimer in section 9-627(a) . . . price is everything. The facts we consider in determining whether a sale was commercially reasonable are almost entirely proxies for price.")

[51] *See, e.g.*, European Am. Bank v. Sackman Mortg. Corp. (*In re* Sackman Mortg. Corp.), 158 B.R. 926, 936 (Bankr. S.D.N.Y. 1993) (citing Bankers Tr. Co. v. J.V. Dowler & Co. 390 N.E.2d 766, 769 (N.Y. 1979)) ("The New York Court of Appeals has implicitly validated two tests for determining whether a disposition of property was commercially reasonable under [section 9-610], one focusing on the procedures employed, and the other on maximizing resale price.").

[52] Peretore, *supra* note 49; *see In re* Excello Press, Inc., 890 F.2d 896, 905 (7th Cir. 1989) ("The right inquiry is whether a particular method of sale was the commercially reasonable way to proceed under *these* circumstances with *this* equipment.").

require evaluating "whether [a] sale's every aspect is characterized by: (1) good faith, (2) avoidance of loss, and (3) an effective realization."[53]

Although commercial reasonableness is tied to the sale price of the collateral, a low price—as compared to fair market value—normally will not render the sale commercially unreasonable so long as the secured party makes a serious effort to achieve the highest possible sale price.[54] Usually, the disparity between the value of the collateral and the foreclosure sale price must satisfy the stringent "shock the conscience" standard.[55] One study conducted two years after the 1999 revision of Article 9 found that courts determine foreclosure sales to be commercially reasonable in 85% of cases when the sale price of the collateral is at least 63% of its fair value. Once the sale price drops below this 63% threshold, however, sales are found to be commercially reasonable in only 17% of cases.[56] These numbers do not suggest that sale price is the only factor that courts consider when determining the commercial reasonableness of a UCC foreclosure sale—foreclosure sales that result in bids markedly below 50% of fair market value have been upheld as commercially reasonable, often due to the robustness of the procedural

[53] Solfanelli v. CoreStates Bank N.A., 203 F.3d 197, 202 (3rd Cir. 2000) (finding that the secured party disposed of the collateral—common shares of stock in First Eastern Bank—in a commercially unreasonable manner because the secured party's delay in selling the stock and actions of "subterfuge" demonstrated commercial unreasonableness and a lack of good faith, despite the secured creditor's attempt to wave the commercial reasonableness standard in the applicable Security Agreement).

[54] *See* Prendergast, *supra* note 16, at 27–28.

[55] Peretore, *supra* note 49; *see* Adobe Trucking, Inc. v. PNC Bank N.A. (*In re* Adobe Trucking, Inc.) No. 10-70353-RBK, 2011 WL 6258233, at *6 (Bankr. W.D. Tex. Dec. 15, 2011), *aff'd*, 551 F. App'x 167 (5th Cir. 2014) ("Courts have consistently declined to disturb a foreclosure sale upon a challenge to the sale price of the collateral, except in the narrow circumstance where the price alone is so inadequate as to shock the court's conscience.").

[56] Jack F. Williams, *Debunking the Myth Engulfing Article 9 Collateral Dispositions,* 9 AM. BANKR. INST. L. REV. 703, 726–27 (2001).

aspects of the sale—but they do reveal a strong correlation between low sale price and commercial unreasonableness.[57]

C. Overview of Mezzanine Loans and Mezzanine Loan Foreclosure Sales

Since the onset of the pandemic, many courts have considered the commercial reasonableness of foreclosure sales in cases in which a secured party attempts to initiate a sale of a mezzanine borrower's equity interest in a property-owning entity.[58] Mezzanine loans are a common financing method in large commercial real estate transactions. By pairing mortgage and mezzanine financing, owners of commercial property can secure a higher loan-to-value ratio—in the range of 90-105% of the underlying property value rather than the 85-90% of that value found in traditional junior mortgage financing.[59] This generates larger profits for the property owner.[60]

Mezzanine loans are structured differently than mortgage loans, in which the borrower entity directly owns and has debt secured by real property.[61] In a mezzanine loan, the

[57] *See, e.g.*, DeRosa v. Chase Manhattan Mortg. Corp., 782 N.Y.S.2d 5, 9–10 (N.Y. App. Div. 2004) (finding that a foreclosure sale that generated a sale price of forty-five percent of the market value of the property was commercially reasonable due to the procedural means employed to conduct the sale); First Fed. Sav. and Loan Ass'n of Rochester v. Romano, 676 N.Y.S.2d 163, 164 (N.Y. App. Div. 1998) (noting that New York courts have found foreclosure sales that yielded sale prices as low as thirty percent and thirty-seven percent to be commercially reasonable).

[58] *See, e.g.*, 1248 Assocs. Mezz II LLC v. 12E48 Mezz II LLC, No. 651812/2020, 2020 WL 2569405 (N.Y. Sup. Ct. May 18, 2020) (order denying preliminary injunction); 893 4th Ave. Lofts LLC v. 5Aif Nutmeg, LLC, No. 511942/2020, 2020 WL 4936913 (N.Y. Sup. Ct. August 25, 2020) (order denying preliminary injunction); D2 Mark LLC v. OREI VI Invs. LLC, No. 652259/2020, 2020 WL 3432950 (N.Y. Sup. Ct. June 23, 2020) (order granting preliminary injunction); Shelbourne v. SR 677 BWAY LLC, No. 652971/2020 (N.Y. Sup. Ct. Aug. 3, 2020), *rev'd*, 139 N.Y.S.3d 799 (N.Y. App. Div. 2021) (order granting preliminary injunction).

[59] Berman, *supra* note 46, at 996.

[60] *See id.*

[61] Harvey & Lemont, *supra* note 12, at 6.

mezzanine borrower is a special purpose entity (SPE) whose only asset is equity interests in another entity—either the property owner (in transactions with one level of mezzanine debt) or another mezzanine borrower that itself is an indirect owner of the underlying property (in transactions with more than one level of mezzanine debt).[62] These equity interests commonly take the form of membership interests in a limited liability company, but they also can consist of "stock in a corporation, and [more] rarely limited or general partnership interests in a limited or general partnership."[63]

1. Comparing Foreclosures of Mezzanine Loan Collateral to Securities Foreclosures More Generally

Given these characteristics, mezzanine loan collateral more closely resembles securities or financial assets, forms of investment property. As touched upon above, mezzanine lenders can even require mezzanine borrowers to "opt in" to Article 8 of the UCC, which governs investment securities, by "expressly elect[ting] [in their operating agreements] to have [their] membership interest treated as a security" rather than as Article 9 "general intangibles[.]"[64] This provides lenders with two additional methods of perfection[65] depending on the

62 Berman, *supra* note 46, at 999.

63 *Id.* at 998–99.

64 Andrew L. Turscak, Jr. & James J. Henderson, *The Article 8 Opt In: A Potential Minefield for the Unsuspecting Lender*, BANKR. STRATEGIST (Law Journal Newsletters), Sept. 2016*; see* Grant Puleo & Michael Lyon, *Mezzanine Loans to Developers and Owners of Real Estate Projects: 10 Ways To Improve the Quality of the Equity Pledge*, REAL EST. FIN. J., Spring 2017, at 46, 46 (recommending lenders require issuers to "opt in" to Article 8 of the UCC).

65 Perfection refers to the process by which a secured party establishes the priority of their security interest in collateral over future creditors who may take security interests in the same collateral. *See* Ebling & Weise, *supra* note 23, at 196–97 n.22. If a secured creditor does not perfect its security interest in collateral, it could lose its collateral to later perfected creditors (upon bankruptcy or default) even if it was the first to advance funds to the debtor. *See* U.C.C. § 9-322(a)(1)–(2) (AM. L. INST. & NAT'L CONF. OF COMM'RS. ON UNIF. STATE L. 2012) (secured creditors with conflicting

type of security—control or possession—that give them priority over security interests previously perfected by a UCC filing.[66] It also reclassifies the membership interests as "investment property."[67] Yet, "investment property" remains "collateral" under Article 9, which means that the section 9-610 requirements for foreclosure sales still apply.[68]

Nevertheless, mezzanine loan collateral is treated differently than securities for foreclosure purposes because of the disparities in the markets for both goods. Unlike secured parties that foreclose on mezzanine loan collateral, secured parties that conduct foreclosure sales of securities can rely on the recognized market safe harbors in sections 9-627(b)(1) and 9-627(b)(2) to prove the sales' commercial reasonableness.[69] By contrast, mezzanine loan collateral is not sold on a recognized market. It is privately owned by SPEs, and its value is tied solely to the value of the underlying property, which can only be ascertained by expert appraisal.[70]

This specialized nature of mezzanine loan collateral also dictates other aspects of the sale. A secured party often desires to purchase its own collateral. However, as mentioned, a secured lender cannot purchase collateral at a private sale if the collateral lacks a "recognized market" or "standard price

perfected security interests in the same collateral "rank according to priority in time of filing or perfection" and "[a] perfected security interest . . . has priority over a conflicting unperfected security interest[.]").

66 *See* Puleo & Lyon, *supra* note 64, at 47.

67 *Id.* at 46.

68 Kenneth P. Weinberg, *Property and Transactions Subject to Collateral Categories Under Article 9*, MONITORDAILY, https://www.monitordaily.com/article-posts/property-transaction-collateral-categories-under-article-9/ [https://perma.cc/W4SP-H7TV]; *see* U.C.C. § 9-102(a)(12) (defining "collateral").

69 Despite these safe harbors, secured parties cannot conduct sales that are clearly unreasonable. *Cf.* Solfanelli v. CoreStates Bank, N.A., 203 F.3d 197, 200 (3rd Cir. 2000) (finding that the secured party's eleven-month delay in disposing of common shares of stock on the NASDAQ was commercially unreasonable).

70 Berman, *supra* note 46, at 1015–16. This "specialized nature" of mezzanine loan collateral also dissuades third parties from purchasing it. *Id.* at 1016.

quotations."[71] Rather, it can only recover its collateral by being the highest bidder at a public disposition.[72] Thus, mezzanine loan collateral is almost always sold at a public disposition, whereas securities and other common investment property can be sold and recovered in a private disposition.[73]

Two cases illustrate how the recognized market safe harbors allow secured parties to dispose of and then purchase securities at private sales. In *Burns v. Anderson*, the secured party conducted a private foreclosure sale of stock in a publicly traded company.[74] Because the stock was "of a kind that is customarily sold on a recognized market," the sale was commercially reasonable, enabling the secured party to purchase the stock despite the private nature of the sale.[75] In *Ross v. Rothstein*, the secured party disposed of common stock in a public corporation on a securities market that was much more highly specialized than the market in *Burns*.[76] Yet, the court similarly found the secured party's disposition to be commercially reasonable because the specialized market was "sufficiently similar . . . [to] a 'recognized market' like the New York Stock Exchange."[77]

Without the protection of the recognized market safe harbor and the ability to hold a private sale, public dispositions of mezzanine loan collateral are subject to much more scrutiny than sales of securities. A mezzanine lender

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[71] *Id.* (quoting U.C.C. § 9-610(c)(2) (AM. L. INST. & NAT'L CONF. OF COMM'RS ON UNIF. STATE L. 2012)); *see supra* notes 30–31 and accompanying text.

[72] Berman, *supra* note 46, at 1016.

[73] *Id.*

[74] Burns v. Anderson, 123 F.App'x 543, 545–46 (4th Cir. 2004) (unpublished) (per curiam). The stock was "a thinly traded stock registered on the NASDAQ." *Id.* at 545. The secured party also adhered to the private foreclosure sale terms outlined in the Pledge Agreement, which complied with section 9-610. *Id.* at 547–48. Although this is an unpublished opinion, it remains an instructive illustration of the section 9-627(b)(1) safe harbor.

[75] *Id.* (quoting U.C.C. § 9-610(c)(2)).

[76] Ross v. Rothstein, 92 F. Supp. 3d 1041, 1047 (D. Kan. 2015) (considering secured party's sale of common stock of public corporation on the Over-the-Counter QB Tier Market).

[77] *Id.* at 1083–84.

must follow strict procedural requirements to ensure the reasonableness of its sale. In doing so, it must make every effort to attract viable auction participants even if it plans to "bid in" to the sale and purchase the equity itself as the highest bidder.[78]

2. Background Case Law on Mezzanine Loan Foreclosure Sales

The sale in *Vornado PS, L.L.C v. Primestone Investment Partners, L.P.* is a prototypical example of a commercially reasonable public foreclosure sale.[79] Thus, it provides a useful benchmark for evaluating subsequent court decisions on the commercial reasonableness of such sales. In *Vornado*, Vornado took a security interest in the partnership units of a limited partnership as collateral for a $62 million loan.[80] These units were convertible on a one-for-one basis into shares of a publicly-traded Real Estate Investment Trust (REIT), although the REIT could choose to provide cash for the conversion instead of shares.[81] Vornado believed that section 9-610(c) prevented it "from buying the [units] unless they were sold in a public sale" since they "were not subject to an established trading market."[82]

78 Berman, *supra* note 46, at 1016.

79 Vornado PS, L.L.C. v. Primestone Inv. Partners, L.P., 821 A.2d 296, 314–16 (Del. Ch. Ct. 2002), *aff'd without opinion*, 822 A.2d 397 (Del. 2003); *see, e.g.*, Prendergast, *supra* note 16, at 28 (discussing the case as an example of commercial reasonableness); Michael VanNiel & James W. May, *Limited Liability Company Membership Interests*: *What a Lender Needs to Do with LLC Collateral on Default*, BUS. L. TODAY, Mar.–Apr. 2009, at 46, 48 (discussing the same). Although the *Vornado* collateral was not mezzanine loan collateral, it was sufficiently similar to such collateral because it consisted of partnership interests, which are analogous to the limited liability company interests that most commonly compose mezzanine loan collateral. VanNiel & May, *supra*. For this reason, many consider this case to be an ideal benchmark for commercial reasonableness evaluations. *Id.*

80 *Vornado PS, L.L.C.*, 821 A.2d at 301.

81 *Id.*

82 *Id.* at 306.

Although Vornado was the only bidder at the ensuing public sale, the sale was found to be commercially reasonable because Vornado abided by section 9-610 and conducted the sale in a manner that suggested it made a serious effort to achieve the highest possible price for the collateral.[83] After determining that the sale price of the collateral was not unreasonably low, the court analyzed the procedures employed by the foreclosing creditor and found them to be "reasonable."[84] To conduct the sale, Vornado: (1) hired an investment bank, Goldman, Sachs & Co., to "develop[] a marketing process and identify[] potential purchasers," which eventually enabled the creditor to contact fifty-nine potential purchasers; (2) circulated an Information Memorandum about the collateral to thirty-three of these potential purchasers; (3) advertised the sale in the *New York Times* and *Chicago Tribune*, and (4) retained a licensed auctioneer to conduct the sale.[85] These procedures were even sufficiently robust to overcome Vornado's failure to disclose "some inside information" that it possessed regarding the REIT, Vornado's withholding of which the court considered reasonable because Vornado "had no sense of how reliable [the information] actually was."[86] The *Vornado* court thus seemed to employ variations of both the procedures test and the proceeds test in its evaluation of the sale. Most significant, this case demonstrates that courts are willing to overlook some indicators of commercial unreasonableness if the procedures employed plainly demonstrate that the lender made a good faith effort to sell its collateral at a high price to the widest possible audience.

In contrast to the *Vornado* sale, *National Housing Partnership v. Municipal Capital Appreciation Partners I, L.P.*[87] depicts a commercially unreasonable foreclosure sale. This case involved a secured party's public foreclosure sale of partnership interests in an SPE whose only asset was an

[83] *Id.* at 310, 314–16; *see* Prendergast, *supra* note 16, at 28.

[84] *Vornado PS, L.L.C.*, 821 A.2d at 315–16.

[85] *Id.* at 306–10.

[86] *Id.* at 316.

[87] 935 A.2d 300 (D.C. 2007).

affordable multifamily housing project subject to United States Department of Housing and Urban Development regulations.[88] The appellate court reversed the trial court's determination that the sale was commercially reasonable and remanded the case after determining that the trial judge "overlooked important testimony and based her decision on a clearly erroneous subordinate finding—that 'no evidence of commercial unreasonableness was presented[.]'"[89] To the contrary, the appellate court found evidence that the secured creditor inadequately conducted the procedural aspects of the sale. Because of its unfamiliarity with the market for the collateral, the secured creditor had a "duty to investigate the appropriate channels for disposing [its] collateral."[90] If it had done so, the secured creditor would have discovered that, due to the dearth of possible purchasers for partnership interests in affordable multifamily housing, it is industry custom to sell such interests through industry contacts.[91] Instead, the secured creditor initiated a flawed marketing campaign that failed to involve brokers, place advertisements in trade publications, or otherwise attempt to find or market the collateral to viable purchasers.[92] As a consequence, only three parties expressed interest in the sale, and the secured creditor ended up being the only bidder to appear at the public auction.[93]

These cases thus offer a brief overview of that which courts consider to be commercially reasonable conduct in foreclosure sales of mezzanine loan collateral. However, while courts

88 *Id.* at 317–18.

89 *Id.* at 321.

90 *Id.* at 318.

91 *Id.* at 318–19.

92 *Id.* at 317–18. Rather than pursue an advertising campaign targeting possible purchasers of the collateral, the secured creditor instead only placed four advertisements for the auction in the general classifieds section of *The Washington Post*. *Id.* at 317. The court thus noted that the secured creditor "made no effort to find likely purchasers in the housing industry or to market it to such potential purchasers, either directly or by contacting brokers and advertising in trade publications or other industry media," as required by the UCC. *Id.*

93 *Id.* at 317.

must determine whether a sale is commercially reasonable, under sections 9-602 and 9-603, the debtor and secured party can define the procedures that qualify as a commercially reasonable sale in their security agreement.[94] As long as such terms are not themselves "manifestly unreasonable,"[95] courts will likely uphold the commercial reasonableness of the attendant foreclosure if it is conducted in accordance with such agreed upon procedures.[96]

III. UCC FORECLOSURE SALES DURING THE COVID-19 PANDEMIC

The effects of the COVID-19 pandemic on real estate challenged previous judicial standards of the commercial reasonableness of public foreclosure sales. This Part considers case law regarding the commercial reasonableness of foreclosure sales during the pandemic with a focus on New York City, the venue in which a significant portion of commercial reasonableness litigation has occurred. Section III.A briefly describes the state of the commercial real estate market in New York and the relevant state foreclosure restrictions. Section III.B details the commercial reasonableness litigation surrounding mezzanine loans that has arisen since the start of the pandemic. Section III.B.1 considers two initial challenged foreclosure sales that were deemed commercially reasonable. The first foreclosure sale to be found commercially unreasonable during this period is

94 U.C.C. § 9-603 (AM. L. INST. & NAT'L CONF. OF COMM'RS ON UNIF. STATE L. 2012); *see* Peretore, *supra* note 49.

95 U.C.C. § 9-603

96 Peretore, *supra* note 49; U.C.C. § 9-603; s*ee In re* Adobe Trucking, Inc., No. 10-70353-RBK, 2011 WL 6258233, at *6 (Bankr. W.D. Tex. Dec. 15, 2011), *aff'd*, 551 F. App'x 167 (5th Cir. 2014) ("Courts which have addressed the issue find that where a contract provision exists dictating terms of sale which are not 'manifestly unreasonable,' and the sale is performed in accordance with those terms, the sale cannot be considered commercially unreasonable."); *cf.* Solfanelli v. Corestates Bank N.A., 203 F.3d 197, 201–02 (3rd Cir. 2000) (finding that the secured party cannot invoke section 9-603 and the foreclosure terms defined in its secured agreement to waive its duty to abide by the section 9-610 requirement that every aspect of the sale must be commercially reasonable).

examined in Section III.B.2, with particular attention given to the sale's inequitable procedural aspects. Section III.B.3 analyzes the most consequential case, *Shelbourne BRF LLC*, where the court relied on the turbulent nature of the real estate market to find the proposed foreclosure sale commercially unreasonable. Subsequent foreclosure cases are considered in Section III.B.4, while Section III.B.5 discusses the appellate review of *Shelbourne* and its worrying implications for future borrowers seeking to enjoin proposed foreclosure sales of their collateral.

A. New York: Foreclosure Moratorium Orders and the Commercial Backdrop

Many of the mezzanine loan foreclosure sales pursued by lenders in the first year of the pandemic involved properties located in New York.[97] As the epicenter of the pandemic and the largest metropolitan area in the United States, New York City was particularly impacted by stay-at-home orders and state business closure requirements.[98] Property owners, especially those in the city's hospitality industry, faced

[97] *See, e.g.*, 1248 Assocs. Mezz II LLC v. 12E48 Mezz II LLC, No. 651812/2020, 2020 WL 2569405 (N.Y. Sup. Ct. May 18, 2020) (order denying preliminary injunction); 893 4th Ave. Lofts LLC v. 5Aif Nutmeg, LLC, No. 511942/2020, 2020 WL 4936913 (N.Y. Sup. Ct. August 25, 2020) (order denying preliminary injunction); D2 Mark LLC v. OREI VI Invs. LLC, No. 652259/2020, 2020 WL 3432950 (N.Y. Sup. Ct. June 23, 2020) (order granting preliminary injunction); Shelbourne v. SR 677 BWAY LLC, No. 652971/2020 (N.Y. Sup. Ct. Aug. 3, 2020), *rev'd*, 139 N.Y.S.3d 799 (N.Y. App. Div. 2021) (order granting preliminary injunction).

[98] *See, e.g.*, James Parrott, *NYC Job Losses Proportionately Greatest Among Largest U.S. Cities*, NEW SCH. CTR. FOR N.Y.C. AFFS. (Apr. 9, 2021), http://www.centernyc.org/reports-briefs/2021/4/9/nyc-job-losses-proportionately-greatest-among-largest-us-cities [https://perma.cc/NP3Z-2BEP]; Stefanos Chen, *The Real Estate Collapse of 2020,* N.Y. TIMES (Dec. 29, 2020), https://www.nytimes.com/2020/12/25/realestate/nyc-real-estate-market.html [https://perma.cc/H36C-FDVX]; Nelson D. Schwartz, Patrick McGeehan & Nicole Hong*, New York Faces Lasting Economic Toll Even as Pandemic Passes*, N.Y. TIMES (June 21, 2021), https://www.nytimes.com/2021/06/20/business/economy/new-york-city-economy-coronavirus.html [https://perma.cc/W2BK-BTVJ].

dwindling incomes and mounting debts.[99] These encumbered owners subsequently struggled to fulfill their mortgage and mezzanine loan obligations.[100]

To alleviate these hardships, New York State issued a number of executive and administrative orders restricting lenders from pursuing mortgage foreclosure actions against most borrowers. On March 20, 2021, Governor Andrew Cuomo issued Executive Order 202.8, which instituted a blanket mortgage foreclosure ban for ninety days.[101] Executive Order 202.28 followed and prohibited mortgage foreclosure actions against borrowers "facing financial hardship due to the COVID-19 pandemic."[102] This moratorium was extended numerous times before expiring on January 31, 2021.[103] Meanwhile, the Chief Administrative Judge of New York issued Administrative Order 157/20 on July 24, 2020, which stayed all foreclosure auctions or foreclosure sales of property until October 15, 2020.[104] At the time of publication, New

[99] Miriam Hall, *NYC Hotel Employment Down 82% This Year, Survey Says*, BISNOW (Dec. 9, 2020), https://www.bisnow.com/new-york/news/hotel/most-hotels-in-ny-lost-80-noi-in-the-first-half-of-2020-107038 [https://perma.cc/NF8T-ZQDE] (discussing estimates that one-fifth of the hotel rooms in New York City will not survive the pandemic).

[100] *See, e.g.*, 1248 Assocs. Mezz II LLC v. 12E48 Mezz II LLC, No. 651812/2020, 2020 WL 2569405 (N.Y. Sup. Ct. May 18, 2020); D2 Mark LLC v. OREI VI Invs. LLC, No. 652259/2020, 2020 WL 3432950 (N.Y. Sup. Ct. June 23, 2020).

[101] N.Y. Comp. Codes R. & Regs. tit. 9, § 8.202.8 (2020). Amy G. Rhinehardt & Sunny I. Tice, *Executive Order 202.8 and 202.9: 90 Day Suspension of Mortgage Payments; Moratorium on Evictions and Foreclosures*, BOND SCHOENECK & KING ATTY'S (Mar. 27, 2020), https://www.bsk.com/news-events-videos/executive-order-2028-and-2029-90-day-suspension-of-mortgage-payments-moratorium-on-evictions-and-foreclosures [https://perma.cc/WDZ8-TGY2];

[102] N.Y. Comp. Codes R. & Regs. tit. 9, § 8.202.28 (2020).

[103] N.Y. Comp. Codes R. & Regs. tit. 9, § 8.202.70 (2020) (extending foreclosure moratorium until January 1, 2021); N.Y. Comp. Codes R. & Regs. tit. 9, § 8.202.81 (2020) (extending foreclosure moratorium until January 31, 2021).

[104] CHIEF ADMIN. JUDGE OF THE CTS., ADMIN. ORDER OF THE CHIEF ADMIN. JUDGE OF THE CTS., AO/157/20 (JULY 23, 2020), https://www.nycourts.gov/whatsnew/pdf/AO-157-20.pdf [https://perma.cc/3GGM-QLS4].

York has in place legislation providing foreclosure protections to commercial property owners that own 10 or fewer commercial properties and employ 100 or fewer individuals.[105] Until January 15, 2022, such owners can stay foreclosure proceedings subject to a court hearing if they are experiencing "hardship" due to the pandemic.[106]

B. Commercial Reasonableness Cases During the Pandemic

Against this backdrop, a number of New York courts have heard cases in which mezzanine borrowers attempted to enjoin public foreclosure sales of their collateral due to alleged commercial unreasonableness.[107] The cases have turned on the New York courts' interpretations of the commercial reasonableness of mezzanine foreclosure actions in light of the tumultuous real estate market and the state mortgage foreclosure restrictions. Initially, courts focused their commercial reasonableness inquiries on the procedures governing the foreclosure sales. As the pandemic persisted, however, courts considered broader indicators, such as the mortgage foreclosure restrictions and the diminished vitality of the real estate market.

1. Initial Cases: 1248 Assocs. Mezz. LLC and 893 4th Ave. Lofts LLC

New York courts first addressed the commercial reasonableness issue in May 2020 in *1248 Assocs. Mezz II LLC v. 12E48 Mezz II LLC*, in which a New York Supreme Court

105 2021 N.Y. Sess. Laws ch. 417 (McKinney).

106 *Id.*

107 *See* 1248 Assocs. Mezz II LLC v. 12E48 Mezz II LLC, No. 651812/2020, 2020 WL 2569405 (N.Y. Sup. Ct. May 18, 2020) (order denying preliminary injunction); 893 4th Ave. Lofts LLC v. 5Aif Nutmeg, LLC, No. 511942/2020, 2020 WL 4936913 (N.Y. Sup. Ct. August 25, 2020) (order denying preliminary injunction); D2 Mark LLC v. OREI VI Invs. LLC, No. 652259/2020, 2020 WL 3432950 (N.Y. Sup. Ct. June 23, 2020) (order granting preliminary injunction); Shelbourne v. SR 677 BWAY LLC, No. 652971/2020 (N.Y. Sup. Ct. Aug. 3, 2020), *rev'd*, 139 N.Y.S.3d 799 (N.Y. App. Div. 2021) (order granting preliminary injunction).

justice denied a preliminary injunction of the proposed foreclosure sale of mezzanine loan collateral in a Midtown hotel developmental property.[108] In arguing against the reasonableness of the sale, the mezzanine borrower relied on Executive Order 202.8. The court found that the executive order did not apply to UCC foreclosures since it "addresse[d] [only] enforcement of a judicially ordered foreclosure."[109] And because the borrower failed to show that the foreclosure procedures themselves were unreasonable, its "anticipation of economic damage resulting from the . . . [procedural aspects] of the sale . . . [were] merely speculative" even considering the "economic shutdown" and travel restrictions.[110] Thus, the borrower did not meet its burden of proof for a preliminary injunction, which requires a showing of "irreparable harm" that cannot be remedied by post-sale monetary damages.[111]

Relying on analogous reasoning, another Supreme Court justice denied a different preliminary injunction request in August 2020 in *893 4th Ave. Lofts LLC v. 5Aif Nutmeg, LLC*.[112] This time, the mezzanine borrower argued that Executive Order No. 202.28 rendered the proposed foreclosure sale commercially unreasonable.[113] But because *1248 Assocs. Mezz II LLC* established that Executive Order 202.8 only covered mortgage foreclosures, the court held that Executive Order

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[108] *1248 Assocs. Mezz II LLC*, 2020 WL 2569405, at *1; Kevin Sun, *"Shameless": Suit Claims Lender Uses Pandemic To Rig Foreclosure*, THEREALDEAL (May 5, 2020, 7:00 AM) https://therealdeal.com/2020/05/05/shameless-suit-claims-lender-uses-pandemic-to-rig-foreclosure/ [https://perma.cc/5EXR-VHXD].

[109] *1248 Assocs. Mezz II LLC*, 2020 WL 2569405, at *1.

[110] *Id.*

[111] *Id.*

[112] *893 4th Ave. Lofts LLC*, 2020 WL 4936913, at *2. Although this case came after both *D2 Mark* and *Shelbourne BRF LLC*, in which the New York Supreme Court departed from such a strict interpretation of Executive Order 202.28, the court appears only to rely on *1248 Assocs. Mezz II LLC* in its analysis. *Id.*

[113] *Id.*

202.28 also applied only to mortgage foreclosures.[114] Accordingly, the court determined that there was "no basis upon which to" enjoin the foreclosure sale.[115]

2. Focusing on the Procedures Employed: D2 Mark

June 2020 marked the first instance of a court delaying a proposed mezzanine foreclosure sale. The court did so due to the sale's procedural defects, many of which were exacerbated by the pandemic. In *D2 Mark LLC v. OREI VI Invs. LLC*, the court found the defendant mezzanine lender's auction terms to be commercially unreasonable because they effectively made the defendant the only viable bidder.[116] As in *1248 Assocs. Mezz II LLC*, the underlying property was a hotel—The Mark Hotel—for which the mezzanine borrower defaulted on its mezzanine loan.[117] After securing a forbearance agreement for its mortgage loan, the plaintiff sought a similar agreement from its mezzanine lender, but the mezzanine lender instead issued a notice for a public foreclosure sale.[118] The lender hired Jones Lang LaSalle (JLL), a firm experienced in UCC foreclosure sales, to conduct the public auction.[119] JLL took a number of steps normally consistent with a commercially reasonable sale, including advertising the sale in the *Wall Street Journal* and a trade publication, contacting seven hundred potential bidders, and creating an online due diligence data room with over one hundred documents.[120]

114 *Id.* More specifically, per the court's interpretation in *893 4th Ave, 1248 Assoc. Mezz II LLC* stands for the proposition that Executive Order 202.8 does not cover UCC sales that are not judicial proceedings.

115 *Id.*

116 D2 Mark LLC v. OREI VI Invs. LLC, No. 652259/2020, 2020 WL 3432950 (N.Y. Sup. Ct. June 23, 2020) (order granting preliminary injunction).

117 *Id.* at *1.

118 *Id.* at *2.

119 *Id.*

120 *Id.* at **2–3.

Nevertheless, the court found the procedural aspects of the foreclosure to be commercially unreasonable, in part due to complications arising from the COVID-19 pandemic. First, the court found the mezzanine lender's thirty-six days of notice for the sale inadequate.[121] This short period was constrained further by the statewide business closure restrictions, which largely precluded potential bidders from accessing the hotel for due diligence purposes.[122]

Second, the court found the mezzanine lender's stringent financing requirements to be unduly restrictive. Not only did the lender require the victorious bidder to "submit a 10% nonrefundable deposit [at] the sale and the remaining 90% within 24 hours[,]" but the lender also restricted the plaintiff borrower from participating in the sale until fourteen days before the auction date, leaving the borrower with little time to secure financing that satisfied these requirements.[123] Indeed, almost all potential bidders struggled to acquire proper financing: 115 potential bidders accessed the data room, but only 2 bidders actually submitted their financial qualifications.[124]

The court also touched upon price considerations. The borrower argued that the final auction price would be unconscionably low because the value of the mezzanine loan was thirteen times below the hotel's actual value, as determined by a 2017 appraisal that the mezzanine lender vigorously disputed.[125] In response, the court made clear that the mezzanine lender could not reject the 2017 evaluation while also "expedit[ing] the sale [to] preclude[e] anyone from preparing a current evaluation report."[126] This is consistent with the requirement, illustrated in *Vornado*,[127] that a

121 *Id.* at *5.

122 *Id.* Potential bidders received access to the hotel only eight days prior to the sale. *Id.* at *3.

123 *Id.* at *5.

124 *Id.* at *3.

125 *Id.* at **3, 5.

126 *Id.* at *5.

127 *See supra* note 79 and accompanying text.

lender's foreclosure procedures must encourage a collateral sale at the highest price possible.

Importantly, the court briefly considered the commercial reasonableness of the sale in light of Executive Orders 202.8 and 202.28. Rather than reject their applicability, the court found them to be "persuasive authority" that normally reasonable business actions may be deemed unreasonable during a pandemic.[128] This observation seems tied to procedure rather than price—the court directed the lender to modify its notice to make it unequivocally clear that potential bidders could participate in the auction virtually.[129] Nonetheless, the court's consideration of the state mortgage foreclosure moratoriums marked a noteworthy shift in the New York Supreme Court's handling of commercial reasonableness matters.

3. Considering the Tumultuous Commercial Real Estate Market: Shelbourne

Shelbourne BRF LLC v. SR 677 BRWAY LLC,[130] decided a few months after *D2 Mark*, is the most consequential case issued to date, representing an expansion of the *D2 Mark* holding. In *Shelbourne*, the court enjoined a proposed mezzanine foreclosure sale by relying solely on price factors and market conditions.[131] *D2 Mark* considered the state foreclosure restriction executive orders to be only persuasive authority for finding the sale commercially unreasonable. In contrast, *Shelbourne* explicitly relied on Administrative Order 157/20, which stayed all mortgage foreclosure auctions of real property, in granting the preliminary injunction.[132]

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128 *D2 Mark LLC*, 2020 WL 3432950, at *5.

129 *Id.* at *6.

130 No. 652971/2020 (N.Y. Sup. Ct. Aug. 3, 2020), *rev'd*, 139 N.Y.S.3d 799 (N.Y. App. Div. 2021) (order granting preliminary injunction). For a discussion of the appellate review of *Shelbourne* and its possible implications for borrowers going forward, see *infra* Section III.B.5.

131 *Shelbourne BRF LLC v. SR 677 BRWAY LLC*, No. 652971/2020 (N.Y. Sup. Ct. Aug. 3, 2020), *rev'd*, 139 N.Y.S.3d 799 (N.Y. App. Div. 2021).

132 *Id.* This represents a significant departure from the holdings of *1248 Assocs. Mezz II LLC* and *893 4th Ave. Lofts LLC*, each of which refused to

Persuaded by the uncertainty in the commercial real estate market, the court decided that the logic of Administrative Order 157/20 was equally applicable to mezzanine loan foreclosure auctions.[133] Remarkably, the court collapsed the distinction between mortgage loans and mezzanine loans. It did so because the "valuation of an equity interest in a company that owns real estate is based on the value of the real estate itself."[134] Because the commercial reasonableness of the sale was directly related to the "severe turmoil in the real estate market," and since this turmoil might lead auction participants to submit discounted bids, the court reasoned that it was "highly uncertain" that the membership interests would sell for fair market value.[135]

The *Shelbourne* court's novel reliance on Administrative Order 157/20 induced a flurry of responses, generating both praise and criticism. Some observers suggested that the court unreasonably ignored the legal distinctions between mezzanine and mortgage foreclosures,[136] while others argued that the court was correct to treat the membership interests as analogous to interests in real property.[137] Regardless, the court's lack of procedural justifications for the injunction marked a clear departure from the previous three COVID-19

consider the Executive Orders in determining that the proposed foreclosure sales were commercially reasonable. *See* 1248 Assocs. Mezz II LLC v. 12E48 Mezz II LLC, No. 651812/2020, 2020 WL 2569405 (N.Y. Sup. Ct. May 18, 2020) (order denying preliminary injunction); 893 4th Ave. Lofts LLC v. 5Aif Nutmeg, LLC, No. 511942/2020, 2020 WL 4936913 (N.Y. Sup. Ct. August 25, 2020) (order denying preliminary injunction).

133 *Id.*

134 *Id.*

135 *Id.*

136 *New York State Supreme Court Temporarily Halts UCC Foreclosure of Mezzanine Loan*, CADWALADER, WICKERSHAM & TAFT LLP (Aug. 20, 2020), https://www.cadwalader.com/resources/clients-friends-memos/new-york-state-supreme-court-temporarily-halts-ucc-foreclosure-of-mezzanine-loan [https://perma.cc/6TGA-XDHA] (remarking that "the Court ignored the legal distinction between a mezzanine loan and a mortgage loan" even though "a mezzanine foreclosure is clearly not a mortgage foreclosure").

137 Edelstein & Temple, *supra* note 13 (noting that it "seem[ed] as though the court . . . correctly considered the membership interests at stake to be akin to real property interests").

era cases as well as pre-pandemic commercial reasonableness decisions.

When evaluating the commercial reasonableness of foreclosure sales, New York courts traditionally apply either the procedures or proceeds test instead of considering them together under a totality of the circumstances analysis.[138] In *Shelbourne*, however, the court adopted a modified totality of the circumstances approach. Rather than focus on the possibility of a low price, it concentrated on the likelihood that, due to market turmoil, a fair sale price was impossible to achieve—regardless of whether such a price would be low enough to "shock the conscience" of the court.[139] Meanwhile, the court relied on the state foreclosure sale moratorium as an indication that any foreclosure sale related to real property was not in good faith and was per se commercially unreasonable.

Chief Judge Marks ordered the resumption of all foreclosure matters on October 23rd, eight days after Administrative Order 157/20 expired.[140] Two weeks later, the *Shelbourne* court subsequently denied another request to enjoin the mezzanine foreclosure sale, citing the expiration of the order, the fact that other mezzanine foreclosures were "proceeding" under the "current conditions," and the inherent unfairness in requiring the mezzanine lender to continue

138 *See supra* Section II.B. The procedures test considers whether the procedures employed are manifestly unreasonable; the proceeds test considers whether the sale price "shocks the conscience" of the court; and the totality of the circumstances test accounts for procedural factors, price factors, and general good faith considerations. *Id.*; *see also* Beninati v. Fed. Deposit Ins. Corp., 55 F.Supp.2d 141, 150 (E.D.N.Y. 1999) (noting the general tendency of New York courts to apply the proceeds test and procedures test while acknowledging some courts have conducted a combined analysis of the two to determine commercial reasonableness).

139 *See* Shelbourne BRF LLC v. SR 677 BWAY LLC, No. 652971/2020 (N.Y. Sup. Ct. Aug. 3, 2020), *rev'd*, 139 N.Y.S.3d 799 (N.Y. App. Div. 2021) (order granting preliminary injunction).

140 CHIEF ADMIN. JUDGE OF THE COURTS, ADMIN. ORDER OF THE CHIEF ADMIN. JUDGE OF THE COURTS, AO/232/20, STATE OF N.Y. UNIFIED COURT SYSTEM (Oct. 22, 2020), https://www.nycourts.gov/whatsnew/pdf/2020_10_22_11_14_11.pdf [https://perma.cc/JH8P-EPC7].

paying for the property's upkeep and operating costs.[141] "Given the circumstances of this case and the current state of the pandemic," the court stated, "further enjoining this sale would be highly inequitable."[142]

Some viewed this decision as an indication that courts were "return[ing] to the approach [they] had [to commercial reasonableness] prior to the COVID-19 pandemic."[143] Yet, the *Shelbourne* court specifically cited the "current state of the pandemic" in its order permitting the sale. Chief Judge Marks, moreover, noted that foreclosure actions remain "subject to . . . [applicable] current or future federal and emergency relief provisions."[144]

4. Subsequent Cases Following Shelbourne

After *Shelbourne*, mezzanine borrowers seeking to stave off foreclosure relied just as heavily on arguments about the inherent unfairness of foreclosure sales as they did on the procedural irregularities of the proposed sale itself. In December 2020, a New York court ruled that another planned mezzanine foreclosure sale was commercially unreasonable in *301 West 53rd Street Junior Mezzanine LLC et al. v. CCO Condo Portfolio (AZ) Junior Mezzanine, LLC*.[145] This

141 Shelbourne BRF LLC v. SR 677 BWAY LLC, No. 652971/2020 (N.Y. Sup. Ct. Oct. 27, 2020) (order denying preliminary injunction).

142 *Id.*

143 Janice Mac Avoy et. al., *New York Supreme Allows Previously Enjoined UCC Foreclosure Sale To Proceed*, FRIED, FRANK, HARRIS, SHRIVER & JACOBSON (Oct. 29, 2020), https://www.friedfrank.com/siteFiles/Publications/FFTOCUCCForeclosureShelbourne10292020.pdf [https://perma.cc/YG88-GJFD].

144 CHIEF ADMIN. JUDGE OF THE COURTS, ADMIN. ORDER OF THE CHIEF ADMIN. JUDGE OF THE COURTS, AO/232/20 (Oct. 22, 2020), https://www.nycourts.gov/whatsnew/pdf/2020_10_22_11_14_11.pdf [https://perma.cc/JH8P-EPC7].

145 301 West 53rd St. Junior Mezzanine LLC et al. v. CCO Condo Portfolio (AZ) Junior Mezzanine, LLC, No. 656178/2020 (N.Y. Sup. Ct. Dec. 9, 2020); Keith Larsen, *Foreclosures Tied to 4 HFZ Condo Buildings Halted, For Now*, THEREALDEAL (Dec. 10, 2020, 3:58 PM), https://therealdeal.com/2020/12/10/foreclosures-tied-to-4-hfz-condo-buildings-halted-for-now/ [https://perma.cc/AUG9-87JE].

foreclosure involved CIM Group's attempt to auction off equity interests in four junior mezzanine loans on four luxury residential properties in Manhattan.[146] In finding the sale commercially unreasonable, the court noted the various procedural irregularities, including the confusion created by the seller marketing and auctioning off the properties as one unit instead of allowing potential bidders to purchase the property interests of each property individually.[147] As with the unreasonable post-sale payment scheme in *D2 Mark*, the court also focused on the unduly restrictive nature of the "unreasonably high deposit" required from bidders to bid.[148] This requirement kept potential bidders, including the mezzanine borrower, from participating in the sale and effectively amounted to bid rigging because it guaranteed that the defendant would prevail.[149]

Significantly, HFZ Capital Group, the owner of the properties, argued that CIM Group's actions were a "predatory attempt to capitalize on the COVID-19 pandemic by conducting a rushed, commercially unreasonable sale[.]"[150] Although the court focused on the procedural aspects of the sale in its decision, this language signaled a trend in which mezzanine borrowers emphasize the alleged inherent unreasonableness of conducting a UCC foreclosure sale during a pandemic. Indeed, this language hewed closely to that used by the mezzanine borrower in *Shelbourne*, who similarly asserted that the defendant mezzanine lender was "capitaliz[ing] on the pandemic [by] us[ing] its junior and relatively small position on the property to obtain control over

146 Keith Larsen & Jerome Dineen, *HFZ Sues CIM To Halt Condo Foreclosure Sale*, THEREALDEAL (Nov. 12, 2020, 2:28 p.m.), https://therealdeal.com/2020/11/11/hfz-sues-cim-to-halt-condo-foreclosure-sale/ [https://perma.cc/5PB9-WTJQ].

147 *301 West 53rd St.*, No. 656178/2020, at 2.

148 *Id.*

149 *Id.*

150 Verified Complaint at 1, 301 West 53rd St. Junior Mezzanine LLC et al. v. CCO Condo Portfolio (AZ) Junior Mezzanine, LLC, No. 656178/2020 (N.Y. Sup. Ct. filed Nov. 11, 2020).

it" by organizing a hurried and inadequately noticed sale.[151] This phrasing, in turn, resembles that used by the *D2 Mark* plaintiff when it categorized its lender's proposed foreclosure sale as an "improper and predatory attempt to capitalize on the COVID-19 pandemic."[152]

Only a few days after *301 West 53rd Street* was decided, another mezzanine borrower attempted to enjoin a proposed mezzanine foreclosure sale related to a condominium building on the Upper East Side using the exact same language. In *WWML96 DE Mezz, LLC v. Series 2020A of Nahla Capital, LLC*, the plaintiff borrower once again asserted that the foreclosing lender's actions were a "predatory attempt to capitalize on the Covid-19 pandemic."[153] Justice Schecter, who heard *Shelbourne*, denied the injunction.[154] Unlike the three previously enjoined sales, however, the borrower's default preceded the pandemic.[155] This borrower even possessed a forbearance agreement, which notably was absent in *D2 Mark*, and the mezzanine lender initiated the foreclosure auction after the borrower failed to abide by the agreement terms.[156] As in her decision ordering the *Shelbourne* auction to proceed after its three-month injunction, Justice Schecter noted that the balance of equities favored the defendant mezzanine lender because it had "been paying the carrying

151 Verified Complaint at 6, Shelbourne BRF LLC v. SR 677 BWAY LLC, No. 652971/2020 (N.Y. Sup. Ct. filed July 20, 2020).

152 Complaint at 1, D2 Mark LLC v. OREI VI Investments LLC, No. 652259/2020, 2020 WL 3432950 (N.Y. Sup. Ct. filed June 6, 2020).

153 Sylvia Varnham O'Regan & Orion Jones, *Wonder Work Construction Sues Lender to Stop Foreclosure*, THEREALDEAL (Dec. 4, 2020, 8:00 AM), https://therealdeal.com/2020/12/04/wonder-work-construction-sues-lender-to-stop-foreclosure/ [https://perma.cc/28HF-FN5B].

154 WWML96 DE Mezz, LLC v. Series 2020A of Nahla Cap., LLC, No. 656721/2020 (N.Y. Sup. Ct. Dec. 7, 2020) (order denying preliminary injunction).

155 Sylvia Varnham O'Regan, *Mezz Lender Takes Control of Wonder Works' UES Condo*, THEREALDEAL (Dec. 14, 2020, 10:00 AM), https://therealdeal.com/2020/12/14/mezz-lender-takes-control-of-wonder-works-ues-condo/ [https://perma.cc/K8P7-J2YU].

156 *Id.*

costs of the property for almost a year."[157] Instead of undermining the previously enjoined cases, this decision rather reasonably suggests that courts may be unwilling to find a foreclosure sale commercially unreasonable if pre-pandemic distress is its primary cause.

5. Shelbourne On Appeal: Sending Borrowers Back to the Drawing Board?

On March 4, 2021, the First Department of the New York Supreme Court Appellate Division issued a brief decision concerning *Shelbourne* that may stymie borrowers' future abilities to enjoin proposed foreclosure auctions.[158] The *Shelbourne* defendant had appealed the trial court's initial decision enjoining the foreclosure despite the expiration of the preliminary injunction in October 2020 and the trial court's subsequent decision not to extend it. On appeal, the First Department found that the *Shelbourne* plaintiffs did not sufficiently demonstrate that the sale would cause the "irreparable harm" required to secure a preliminary injunction.[159] The court cited to a decade-old case in which it distinguished between losing a "commercial interest in" real estate—equity in a property-owning entity or, as in *Shelbourne*, interest in an entity that owns a property-owning entity—and losing "a unique piece of property in which [plaintiffs have] an unquantifiable interest" that cannot be satisfied with post-sale monetary damages.[160] "Notwithstanding the existence of the COVID-19 pandemic," the court wrote, "the feared loss of an investment can be compensated in [a post-sale action for] money damages."[161]

This reasoning is a rejection of the *Shelbourne* trial court's decision to collapse the distinction between mortgage and

157 *WWML96 DE Mezz, LLC*, slip op. at 1.

158 Shelbourne BRF LLC v. SR 677 Bway LLC, 139 N.Y.S.3d 799, 800 (N.Y. App. Div. 2021).

159 *Id.* at 800.

160 Broadway 500 W. Monroe Mezz II LLC v. Transwestern Mezzanine Realty Partners II, LLC, 915 N.Y.S.2d 248, 249 (N.Y. App. Div. 2011).

161 *Shelbourne BRF LLC*, 139 N.Y.S.3d at 800.

mezzanine loans when it issued the initial injunction. It is also analogous to the early pandemic decision of *1248 Assocs. Mezz II LLC*, where a different trial court also concluded that the plaintiff borrowers did not prove they would suffer "irreparable harm" by losing their mezzanine equity interests in the lender's proposed foreclosure auction.[162] The *Shelbourne* trial court issued the injunction out of concern that the "severe turmoil in the real estate market" would lead auction participants to undervalue the membership interests.[163] The First Department circumvented this concern by concluding that any issues arising from a commercially unreasonable auction could be addressed by a post-auction lawsuit for monetary damages.[164]

The First Department's decision was criticized for adhering too rigidly to "case law and the traditional framework for a preliminary injunction" rather than factoring in the intent of the New York legislature to afford borrowers the full protection of the UCC's statutory framework.[165] UCC section 9-625(a) specifically provides that "a court may . . . restrain . . . [a] disposition of collateral" where a foreclosure sale is not conducted in a commercially reasonable matter.[166] In the view of two experienced practitioners and one former First Department justice, the First Department should have applied these "remedial protections" to *Shelbourne* and

[162] 1248 Assocs. Mezz II LLC v. 12E48 Mezz II LLC, No. 651812/2020, 2020 WL 2569405, at *1 (N.Y. Sup. Ct. May 18, 2020); *See supra* Section II.B.1.

[163] Shelbourne BRF LLC v. SR 677 Bway LLC, No. 652971/2020 (N.Y. Sup. Ct. Aug. 3, 2020), *rev'd*, 1139 N.Y.S.3d 799 (N.Y. App. Div. 2021) (order granting preliminary injunction).

[164] *Shelbourne BRF LLC*, 139 N.Y.S.3d at 800.

[165] Y. David Scharf, David B. Saxe & Aaron B. Lauchheimer, *Re-energizing an Injunctive Remedy To Stop UCC Foreclosures*, N.Y. L. J. (Mar. 19, 2021, 10:16 AM), https://www.law.com/newyorklawjournal/2021/03/19/re-energizing-an-injunctive-remedy-to-stop-ucc-foreclosures/ (on file with Columbia Business Law Review).

[166] U.C.C. § 9-625 (AM. LAW INST. & NAT'L CONF. OF COMM'RS ON UNIF. STATE L. 2012); *see* Scharf et al., *supra* note 165.

upheld the injunction.[167] This is especially true given that the *Shelbourne* borrower had contractually waived its claim for money damages, preempting its ability to bring a post-sale damages lawsuit (an issue which the First Department did not address).[168] In such instances, the borrower's only recourse is stopping the sale itself.

It remains to be seen how the First Department's *Shelbourne* decision will impact future mezzanine borrowers' ability to secure preliminary injunctions against proposed foreclosure sales. Some commentators view the *Shelbourne* decision as a "huge road block" for borrowers.[169] Instead of focusing on the reasonableness of the *Shelbourne* auction procedures, the First Department seemingly "issued [a] blanket statement[] about mezzanine borrowers' inability to establish irreparable harm when facing a mezzanine loan foreclosure."[170] This could mean that even commercially unreasonable procedural defects no longer satisfy the preliminary injunction threshold.[171]

Certainly, the first case to cite *Shelbourne* suggests that the decision may become the "huge road block" that many fear. In *Wang v. CV Capital Funding, LLC*, Justice Schecter—the same New York Supreme Court justice that granted the initial *Shelbourne* injunction—denied a plaintiff borrower's preliminary injunction motion.[172] The plaintiff sought to

167 Scharf et al., *supra* note 165.

168 *Id.*

169 Marc L. Hamroff & Danielle J. Marlow, *New York Appellate Court Puts Huge Road Block in Way of Borrowers Seeking To Enjoin UCC Article 9 Sales*, MORITT HOCK & HAMROFF LLP (Mar. 25, 2021), https://www.moritthock.com/new-york-appellate-court-puts-huge-road-block-in-way-of-borrowers-seeking-to-enjoin-ucc-article-9-sales/ [https://perma.cc/7KCX-5AQZ].

170 Christopher Gorman & Maureen Bass, *NY Mezzanine Foreclosure Ruling May Limit Borrower Options*, ABRAMS FEINSTEIN (Mar. 18, 2021), https://www.abramslaw.com/webfiles/pdfs/202131952549_000.pdf. [https://perma.cc/7EHQ-WJ2J].

171 *Id.*

172 Wang v. CV Capital Funding, LLC, No. 653710/2021, 2021 WL 2499610 (N.Y. Sup. Ct. June 15, 2020) (order denying preliminary injunction).

forestall the foreclosure sale of membership interests in two limited liability companies that owned a parking garage, but the court determined, among other issues, that the plaintiff did not satisfy the *Shelbourne* standard of irreparable harm.[173]

Nonetheless, borrowers should wait until they know the full ramifications of *Shelbourne* before concluding that it marks the absolute end to their ability to secure preliminary injunctions. While the First Department's ruling remains persuasive authority for lower courts outside of its jurisdiction, the other three New York appellate courts and the lower courts within their jurisdiction may take a different view.[174] Indeed, in *Hello Living Developer Nostrand LLC v. 1580 Nostrand Mezz, LLC*, filed after *Shelbourne* in a Second Department trial court, the court granted a temporary restraining order (TRO) enjoining the proposed foreclosure sale of the lender's mezzanine loan collateral.[175]

Even if this decision restricts mezzanine borrowers' abilities to obtain preliminary injunctions, such borrowers can still challenge commercially unreasonable sales post-auction so long as they have not contractually waived their rights to do so. Indeed, pre-pandemic case law is composed almost exclusively of post-auction commercial reasonableness challenges. Finally, the First Department's decision in *Shelbourne* came over a year into the pandemic as state and federal COVID-19 restrictions expired and vaccination rates increased sharply. Above all else, this decision may simply demonstrate that courts will adopt a more borrower-favorable approach to preliminary injunctions in times of great societal

173 *Id.* It should be noted, however, that this case did not involve a mezzanine loan.

174 In addition, the Court of Appeals can always disagree with the First Department's analysis.

175 Hello Living Developer Nostrand LLC v. 1580 Nostrand Mezz, LLC, No. 034885/2021 (N.Y. Sup. Ct. Aug. 24, 2021) (order granting TRO). The sale was eventually allowed to proceed. *See* Hello Living Developer Nostrand LLC v. 1580 Nostrand Mezz, LLC, No. 034885/2021 (N.Y. Sup. Ct. Oct. 25, 2021) (order confirming the lifting of the TRO at a court hearing held on October 18, 2021).

uncertainty but return to previously established standards as society adjusts to the new normal.

IV. THE POSSIBLE LEGAL PATH FORWARD: MARKET COLLAPSES AND GOOD FAITH DISPOSITIONS

As COVID-19 cases climbed to alarming levels and millions of vaccine doses languished in warehouses while distribution efforts faltered, conditions struggled to improve in the first quarter of 2021.[176] Even as vaccinations increased during the spring and summer months, the Delta variant of COVID-19 spread rapidly across the country, ravaging the South and inducing the return of mask recommendations and mandates elsewhere.[177] Accordingly, impatient mezzanine lenders pursued foreclosures with increasing intensity as more mezzanine borrowers defaulted on their loans.[178] Mezzanine lenders that possess the ability to manage commercial real estate often derive tremendous benefit from foreclosure.[179] Through foreclosure sales, such lenders can acquire additional properties at the mezzanine loan value,

176 Nicole Acevedo, *December Was the Deadliest, Most Infectious Month Since the Start of the Pandemic*, NBC NEWS (Jan 2, 2021, 10:14 AM), https://www.nbcnews.com/news/us-news/december-was-deadliest-most-infectious-month-start-pandemic-n1252645 [https://perma.cc/HKX8-A2XG]; Rebecca Robbins, Frances Robles & Tim Arango, *Here's Why Distribution of the Vaccine is Taking Longer Than Expected*, N.Y. TIMES (Jan. 11, 2020), https://www.nytimes.com/2020/12/31/health/vaccine-distribution-delays.html [https://perma.cc/S3MF-G6WE].

177 Bosman & Smith, *supra* note 6.

178 Larsen, *supra* note 14; *cf.* Akiko Matsuda, *SL Green Looks To Foreclose on Ashkenazy's 690 Madison*, THEREALDEAL (Aug. 12, 2021, 9:00 AM), https://therealdeal.com/2021/08/12/sl-green-looks-to-foreclose-on-ashkenazys-690-madison/ [https://perma.cc/P957-4P5W] (providing an example of a UCC foreclosure auction initiated by a mezzanine lender); Akiko Matsuda, Chetrit Org's 850 Third Avenue Heads to Foreclosure Auction, THEREALDEAL (Aug. 9, 2021, 4:04 PM), https://therealdeal.com/2021/08/09/chetrit-orgs-850-third-avenue-heads-to-foreclosure-auction/ [https://perma.cc/4NR7-SRC3] (providing another such example).

179 Larsen, *supra* note 14.

which, as *D2 Mark* demonstrated, is often a fraction of the value of the underlying real property.[180]

Thus, institutional real estate investors such as CIM Group and SL Green continue to take advantage of the distressed real estate market.[181] One lender scheduled a February 2021 public foreclosure sale for mezzanine loan collateral connected to the Denizen, a high-end rental apartment complex in Brooklyn, after the borrower defaulted on its $65 million mezzanine loan.[182] A few weeks later, the ownership entities of The Tillary Hotel, a luxury Brooklyn hotel and apartment building suffering from extraordinarily low occupancy rates, filed a voluntary Chapter 11 bankruptcy petition to thwart its mezzanine lender's scheduled foreclosure sale.[183] A mezzanine borrower in another foreclosure case, *GVS Portfolio 1 B, LLC v. Teachers Insurance Annuity Association of America*, also filed for bankruptcy in early March 2021.[184] This borrower previously succeeded in delaying its proposed UCC foreclosure auction for six months but turned to Chapter 11 when the court refused to grant another injunction.[185]

Filing for bankruptcy to capitalize on the automatic stay can be a viable option for some mezzanine borrowers intent on

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[180] *Id.*

[181] *See id.*

[182] Keith Larsen & Kevin Sun, *All Year Faces Foreclosure on Part of Bushwick Apartment Complex*, THEREALDEAL (Dec. 7, 2020, 3:33 PM), https://therealdeal.com/2020/12/07/all-year-faces-foreclosure-on-part-of-bushwick-apartment-complex/ [https://perma.cc/75W5-GHR4].

[183] Miriam Hall, *Brooklyn's Tillary Hotel Files for Bankruptcy*, BISNOW (Dec. 18, 2020), https://www.bisnow.com/new-york/news/hotel/isaac-hagers-tillary-hotel-in-brooklyn-files-for-bankruptcy-protection-107163 [https://perma.cc/K8RG-LYMK]. At the time of the bankruptcy filing, only five of The Tillary's sixty-four residential apartments were rented to tenants. *Id.*

[184] Todd E. Soloway & Michael Levison, *Adapting to the New Mezzanine Loan Foreclosure Dynamics*, N.Y. L. J. (Apr. 13, 2021, 2:13 PM), https://www.law.com/newyorklawjournal/2021/04/13/adapting-to-the-new-mezzanine-loan-foreclosure-dynamics/ (on file with Columbia Business Law Review). The borrower owned equity interests in sixty-four self-storage sites. *Id.*

[185] *Id.*

retaining control of their collateral. Indeed, bankruptcy filings may become more common after the First Department's decision in *Shelbourne* if the decision develops into the definite bar to preliminary injunctions that some predict.[186] Many borrowers, however, may lack a Chapter 11 reorganization scheme that can withstand scrutiny by a bankruptcy court. Future mezzanine borrowers can instead continue to challenge the commercial reasonableness of UCC foreclosure sales. As Part III demonstrated, the COVID-19 pandemic introduced a new layer of complexity into commercial reasonableness deliberations. Policy and market-based equitable fairness arguments became for a time as influential as the procedural considerations that traditionally determine the outcome of commercial reasonableness challenges.

This Part analyzes the potential influence of these additional considerations on ensuing mezzanine foreclosures by framing them in the context of pre-pandemic case law. It examines two new issues surrounding commercial reasonableness that courts may need to address during this pandemic—or the next. Section IV.A considers the ability of comment 3 to section 9-610 of the UCC to render foreclosure sales in a pandemic commercially unreasonable.[187] Section IV.B examines another aspect of commercial reasonableness that may be influential: the requirement that public foreclosures sales must be conducted in good faith.

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[186] *See, e.g.*, Mack Burke, *Protection Dissolving for Borrowers in NY Seeking to Halt UCC Sales*, COM. OBSERVER (Apr. 13, 2021, 11:00 AM), https://commercialobserver.com/2021/04/ucc-foreclosure-sales-distressed-commercial-real-estate-new-york-supreme-court/ [https://perma.cc/3ZE2-7SVL] ("The decision, in *Shelbourne* . . ., has also likely 'opened the floodgates' to a potential wave of last-resort Chapter 11 bankruptcy filings from borrowers who fail to receive injunctive relief to stop UCC auction sales and save their interests in properties[.]"); Gorman & Bass, *supra* note 170 ("An indirect consequence of Shelbourne's limitation on the availability of injunctive relief, therefore, may be an increase in bankruptcy filings by mezzanine borrowers who may have few, if any, other options.").

[187] U.C.C. § 9-610(b) cmt. 3 (AM. L. INST. & NAT'L CONF. OF COMM'RS ON UNIF. STATE L. 2012).

A. Conducting a Foreclosure Sale During a "Market Collapse"

The turbulent state of the real estate market has affected courts' evaluations of the commercial reasonableness of foreclosure sales during the pandemic. This has led some to suggest that comment 3 to section 9-610 is now relevant to commercial reasonableness considerations.[188] Comment 3 provides guidance regarding the period during which a secured party must dispose of its collateral.[189] It explains that Article 9 of the UCC does not denote a definite time frame within which a secured party must hold a foreclosure sale because the disposition period is largely situation-specific.[190] Significantly, however, comment 3 warns that "it may . . . be prudent not to dispose of goods when the [relevant] market has collapsed."[191]

The concept of a market collapse seems directly applicable to the state of the commercial real estate market during the pandemic, where property prices and valuation reports were

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[188] *See* Caroline A. Harcourt, Patrick E. Fitzmaurice & Russell DaSilva, *Distressed Real Estate During COVID-19: Court Finds UCC Foreclosure "Commercially Unreasonable" Because of Coronavirus-Related Market Turmoil*, PILLSBURY WINTHROP SHAW PITTMAN LLP (Aug. 21, 2020), https://www.pillsburylaw.com/en/news-and-insights/ucc-foreclosure-court-decision-distressed-real-estate.html [https://perma.cc/DQV9-B2N5] (suggesting that the *Shelbourne* court was influenced by comment 3 in issuing its decision); Stephen L. Sepinuck, *Foreclosing a Security Interest During a Pandemic,* 10 THE TRANSACTIONAL LAW. 3 (2020) (considering whether comment 3 applies to the current market).

[189] U.C.C. § 9-610(b) cmt. 3; *see also* Reply Mem. of Law in Further Supp. of Pls.' Appl. for a Prelim. Inj. at 10, Shelbourne BRF LLC v. SR 677 BWAY LLC, No. 652971/2020 (N.Y. Sup. Ct. filed July 31, 2020).

[190] U.C.C. § 9-610(b) cmt. 3.

[191] *Id.*; *see also* Joshua Sohn et al., *Insight: UCC Foreclosures, Mezzanine Loans, and Covid-19: What is 'Commercially Reasonable' in a Pandemic?*, BLOOMBERG Tax (July 29, 2010, 4:01 AM), https://news.bloombergtax.com/financial-accounting/insight-ucc-foreclosures-mezzanine-loans-and-covid-19-what-is-commercially-reasonable-in-a-pandemic?utm_source=rss&utm_medium=ACNW&utm_campaign=00000173-964e-de5a-a57f-b66f281f0000 [https://perma.cc/QBJ2-C9AQ].

fluctuating so rapidly that it became almost impossible to secure an accurate valuation of a property. Because of this, comment 3 could be interpreted as precluding mezzanine lenders from holding foreclosure sales. Yet no court has ever applied comment 3 to the situation at hand—where the commercial reasonableness of a disposition of collateral during a precipitous market decline is called into question because of the hurried nature of the sale.

One influential commentator argues that comment 3 should never influence commercial reasonableness considerations.[192] Because it is impossible to define a market collapse or determine when one occurs, a secured creditor's sale can never be deemed commercially unreasonable, as declaring a sale unreasonable would punish the creditor merely for incorrectly guessing the point of collapse.[193] A market collapse often induces default, which is the exact time at which a secured creditor will want to sell its collateral to protect its investment.[194] Thus, the secured creditor should not be penalized for availing itself of a fundamental protection for which it bargained at arms-length with the borrower.[195]

In many respects, this is a persuasive conceptual argument. For collateral sold on established markets, such as publicly-traded stocks or bonds, any market collapse may not be enough to displace foreclosure sales from the protection of case law since a real-time price quote is always available. Although the section 9-627(b) safe harbors for the section 9-610 commercial reasonableness requirement apply to "the method of a disposition [only], not . . . its timing or other terms[,]" it would be difficult to establish that the "timing" of a sale of stock was commercially unreasonable if the secured lender availed itself of the sections 9-627(b)(1) and (b)(2) safe harbors by quickly disposing of the stock "in the usual manner

192 Sepinuck, *supra* note 188.

193 *Id.*

194 *Id.*

195 *Id.*

on" and "at the price current in" any recognized market.[196] This action could reasonably be seen as the secured creditor exercising its statutory right to foreclosure to prevent further erosion of the value of its collateral in a highly uncertain time.

Practical considerations, however, show that the applicability of comment 3 may vary depending on the definition of a "market collapse" and the nature of the collateral. In highly-specialized markets that lack the characteristics of those for which the section 9-627(b) safe harbors apply—such as mezzanine loan collateral, in which the foreclosing lender must "make the market"—comment 3 potentially could render a disposition commercially unreasonable.[197] Indeed, a collapse in these markets differ from those that occur in markets with a real-time method for determining value because the combination of extreme value decline and dramatic value fluctuation renders price valuations inherently unstable. The state of the commercial real estate market during the pandemic was unique because of the difficulty of quantifying the impact of the pandemic on real property, the swift pace at which real property fluctuated during the pandemic, and, consequently, the inherent instability of any price evaluations. In such conditions, a public foreclosure sale could plausibly be seen as per se inherently unreasonable.

There is a dearth of case law regarding the applicability of comment 3 to the commercial reasonableness of UCC foreclosure sales. In *Layne v. Bank One*, the only case to address comment 3, the Sixth Circuit held that a secured creditor's sale of NASDAQ-listed stock whose price had declined in the eleven months after repossession was commercially reasonable because of the section 9-627(b)

196 Steven O. Weise & Stephen L. Sepinuck, *Personal Property Secured Transactions*, 72 BUS. LAW. 1143, 1157 (2018); *see* U.C.C. §§ 9-610(b), 9-627(b) (AM. L. INST. & NAT'L CONF. OF COMM'RS ON UNIF. STATE L. 2012).

197 D2 Mark LLC v. OREI VI Invs. LLC, No. 652259/2020, 2020 WL 3432950, at *5 (N.Y. Sup. Ct. June 23, 2020) (noting that because "[t]here is no recognized market" for mezzanine loan collateral, secured creditors "must make the market which is why the procedures defendant implements are crucial to create a commercially reasonable sale").

"recognized market" safe harbor.[198] The court indicated in dicta that comment 3 can justify a secured creditor's delay in selling its collateral.[199] It did not address whether a creditor's decision to sell rather than delay during market turmoil could render the sale unreasonable.[200] The Sixth Circuit also noted that courts often do not "second-guess" the timing of a sale, even if it occurs during a market decline.[201]

The cases that do consider the commercial reasonableness of sales during times of market uncertainty usually involve secured creditors who wait to dispose of repossessed collateral until a market decline—the opposite of the situation during the pandemic, in which mezzanine lenders swiftly proceeded with sales despite immense market instability.[202] In *Federal Deposit Ins. Corp. v. Air Atlantic*, the court found that the secured party's disposition of shares in mutual funds was commercially reasonable despite a five-year delay, during which time the market had "declined ruinously."[203] Other courts, however, have found "delayed" foreclosure sales to be commercially unreasonable where the delay prejudiced the debtor or decreased the value of the collateral.[204] In *Solfanelli v. Corestates Bank, N.A.*, the court held that the foreclosure sale was commercially unreasonable in part because the secured creditor "unreasonably 'sat' on [the plaintiff's] stock

198 Layne v. Bank One, Ky., N.A., 395 F.3d 271, 279 (6th Cir. 2005).

199 *Id.* at 280, n.9.

200 *Id.*

201 *Id.* at 281, n.10.

202 *See id.* at 280; *see also* Federal Deposit Ins. Corp. v. Air Atlantic, Inc. 452 N.E.2d 1143, 1147 (Mass. 1983) (affirming summary judgment for the plaintiff in part by finding the lender's five-year delay in disposing its collateral, shares in mutual funds, to be commercially reasonable despite the collateral's precipitous decline in value because "no exception is made for serious and notorious market declines" in the UCC).

203 *Air Atlantic, Inc.*, 452 N.E.2d at 1147.

204 *In re* Johnson, 116 B.R. 863, 866–67 (Bankr. M.D. Ga. 1990) (finding a sixth-month foreclosure sale delay to be commercially unreasonable because a portion of the collateral, food inventory, lost all value and the remaining collateral, equipment, was sold for less money that it would have brought had it been sold at the debtor's store).

for 11 months" instead of selling it shortly after repossession "when its price substantially satisfied the debt."[205]

This is consistent with the UCC. Although the secured creditor is not obligated to take possession of the collateral after a default occurs, once the creditor possesses the collateral, the timing of the disposition must be commercially reasonable.[206] In other cases that consider the commercial reasonableness of foreclosure sales during market declines, most find the sales commercially reasonable notwithstanding the downturn—even if the debtor presents the secured creditor with some evidence that the value of the collateral will recover.[207]

Despite this, the plaintiff in *Shelbourne* argued that, consistent with comment 3, the market for commercial property had indeed collapsed. For support, the plaintiff cited the defendants' own broker appraisal report, which detailed the pandemic's largely unquantifiable impact on the commercial real estate market.[208] The broker warned that the appraisal was "much more uncertain[]" and should be

[205] *See* Solfanelli v. Corestates Bank N.A., 203 F.3d 197, 200 (3rd Cir. 2000). For further discussion of *Solfanelli* see *supra*, Section II.B.

[206] *See* WM Capital Partners, LLC v. Thornton, 525 S.W.3d 265, 271–74 (Tenn. Ct. App. 2016) (noting a triable issue of fact over whether "the time between repossession and disposition [of the collateral] was commercially reasonable").

[207] *See, e.g.*, Bankers Trust Co. v. J. V. Dowler & Co., Inc., 390 N.E.2d 766, 770 (N.Y. 1979) (holding that secured creditor was entitled to dispose of the collateral whenever it desired due to the decline in the municipal bond market despite the presence of a buyer willing to pay full price for the bonds if the secured creditor waited another two and a half weeks); Citibank, N.A. v. Solow, 939 N.Y.S.2d 361, 362 (N.Y. App. Div. 2012) (holding secured creditor did not need to wait to dispose of its collateral and thus "undertake the risk of a declining market"); Sumner v. Extebank, 452 N.Y.S.2d 873, 888 (N.Y. App. Div. 1983), *aff'd as modified*, 449 N.E.2d 704 (1983) (holding that the secured party did not need to wait to sell the collateral until a viable bidder appeared because the collateral was "rapidly deteriorating").

[208] Reply Mem. of Law in Further Supp. of Pls.' Appl. for a Prelim. Inj., *supra* note 189, at 11 (noting (1) the pandemic's large impact on the commercial real estate market, (2) the "difficult[y] [of] quantify[ing] and assess[ing]" such an impact on the value of commercial property, and (3) the abnormal rapidity with which property values have fluctuated).

regarded with "a higher degree of caution" than usual.[209] Proceeding with the sale, the plaintiff subsequently argued, amounted to bid rigging because the market stifled competition and thus guaranteed that the defendant mezzanine lender would be the only viable bidder.[210] Though the trial court did not address comment 3 in its opinion, it tacitly acknowledged the reasoning behind the comment and plaintiff's allegations. The court even relied on the broker's attestations in the appraisal report to enjoin the sale.[211] The court also noted that the distressed real estate market could lead potential bidders to submit discounted bids, an argument similar to the bid rigging allegations advanced by the plaintiff.[212] And although the court eventually allowed the sale to proceed, it did so after the return of several indicators of market normalcy, including the resumption of some mezzanine foreclosure sales and the expiration of Administrative Order 157/20.[213]

The impact of comment 3 on the commercial reasonableness of foreclosure sales remains largely unexplored, but the trial court's decision in *Shelbourne* suggests that, in times of great market uncertainty, courts may be more amenable to unreasonableness arguments based on the reasoning underlying comment 3. Section III.B.4 detailed how subsequent mezzanine borrowers seeking to enjoin foreclosure sales adopted some language from the *Shelbourne* plaintiff's complaint. Perhaps future plaintiffs will do the same with the *Shelbourne* plaintiff's comment 3 contentions, compelling courts to address the issue, notwithstanding the First Department's March 2021 decision. In the near term, however, it is likely that disposing of collateral during a market downturn will continue to function

209 *Id.*

210 *Id.* at 11–12.

211 Shelbourne BRF LLC, No. 652971/2020, at 2 (N.Y. Sup. Ct. Aug. 3, 2020), *rev'd*, 139 N.Y.S.3d 799 (N.Y. App. Div. 2021) (order granting preliminary injunction).

212 *Id.* at 1–2.

213 *Id.* at 2.

as one of a number of indicators of commercial unreasonableness.

B. Good Faith Considerations

Pursuant to section 1-201, all conduct under the UCC is held to a general "good faith" standard.[214] In both sections 1-201(b)(20) and 9-102(a)(43), good faith is defined as "honesty in fact and the observance of reasonable commercial standards of fair dealing."[215] This is generally interpreted as creating an "obligation of fairness" to treat contract parties similarly rather than imposing some sort of "duty of care" triggered by a secured party's negligent acts.[216] Engaging in subterfuge can be considered a breach of good faith, but so too can failing to take steps to minimize damages resulting from a breach of contract.[217]

In the context of foreclosure sales under section 9-610, good faith functions in every situation as a prerequisite to commercial reasonableness.[218] Importantly, while good faith is required for a commercially reasonable sale, a secured creditor cannot, through its good faith conduct, turn an otherwise unreasonable sale into a reasonable one.[219] Courts often evaluate a secured creditor's good faith conduct as an explicit element of commercial reasonableness, although some consider it a separate but "related" standard.[220] Courts that

214 U.C.C. §§ 1-201(b)(20), 1-304 (AM. L. INST. & NAT'L CONF. OF COMM'RS ON UNIF. STATE L. 2012).

215 U.C.C. §§ 1-201(b)(20), 9-102(a)(43).

216 WHITE & SUMMERS, *supra* note 27, at 13; *see also* U.C.C. § 1-201(b)(20) cmt. 20 (noting that "'fair dealing' is a broad term that must be defined in context . . . [and] is concerned with the fairness of conduct rather than the care with which an act is performed").

217 Daniel Markovits, *Good Faith as Contract's Core Value*, *in* PHILOSOPHICAL FOUNDATIONS OF CONTRACT LAW 272, 275 (Gregory Klass, George Letsas & Prince Saprai eds., 2015).

218 U.C.C. § 9-610(b).

219 *See* Hicklin v. Onyx Acceptance Corp., 970 A.2d 244, 252 (Del. 2009) (noting that acting in good faith does not safeguard a secured creditor that disposes of collateral in a commercially unreasonable matter).

220 *See, e.g.*, *In re* Excello Press, Inc., 890 F.2d 896, 905 (7th Cir. 1989) (noting that a court may consider a secured party's good faith in its

include good faith in their commercial reasonableness analyses employ an iteration of the totality of the circumstances test.[221] The Third Circuit in *Solfanelli*, for instance, applied the totality of the circumstances test and found two factors indicating bad faith: (1) the secured creditor's eleven-month delay in disposing of the collateral and (2) the false statements that it made to the debtor.[222] These factors rendered the sale commercially unreasonable.[223]

If it is impossible to define a market collapse, a disposition during turbulent market conditions may still render a sale commercially unreasonable by serving as a manifestation of bad faith.[224] Although no court appears to have considered good faith explicitly during a market collapse situation, numerous courts have made clear that the good faith conduct of a secured party is tied closely to fair price—the element of commercial reasonableness most at issue during market declines. Many courts require "the secured party [to] make a

evaluation of the commercial reasonableness of a foreclosure sale); Solfanelli v. Corestates Bank, N.A., 203 F.3d 197, 200 (3rd Cir. 2000) ("[C]reditor acts as the debtor's fiduciary and has a corresponding good faith to maximize the proceeds of the collateral's sale."); Coxcall v. Clover Com. Corp., 781 N.Y.S.2d 567, 574 (N.Y. Civ. Ct. 2004) (noting that New York courts determine commercial reasonableness by evaluating whether the secured party "acted in good faith and to the parties' mutual best advantage" and collecting cases)*; cf. In re* Inofin, Inc., 455 B.R. 19, 46 (Bankr. D. Mass. 2011), *appeal dismissed*, 466 B.R. 170 (1st Cir. 2012) (noting that, under Massachusetts U.C.C. law, good faith as it applies to section 9-610 is a "related concept" to commercial reasonableness "and means 'honesty in fact and the observance of reasonable commercial standards of fair dealing'").

221 *See supra* Section II.B.

222 *Solfanelli*, 203 F.3d at 201–02.

223 *Id.*

224 This is, in fact, what the *Shelbourne* plaintiff argued. *See* Reply Mem. of Law in Further Supp. of Pls.' Appl. for a Prelim. Inj., *supra* note 189, at 10 ("Defendant's persistence in conducting the sale in a manner that Defendant itself recognizes could not generate any interested bidders is the height of bad faith and cannot suffice to sustain Defendant's burden of proving that '[e]very aspect of [the disposition of [the] Collateral, including the method, manner, time, and other terms, [are] commercially reasonable' and to the parties' 'mutual best advantage.'").

good faith effort to maximize the value of the collateral" in a foreclosure sale.[225] New York courts similarly require secured creditors to "act[] in good faith and to the parties' mutual best advantage" when conducting foreclosure sales.[226] Some courts, such as the Third Circuit in *Solfanelli*, take this one step further and hold that a secured creditor becomes the "debtor's fiduciary" when liquidating collateral and thus possesses "a corresponding good faith duty to maximize the collateral's sale."[227]

It is this conception of good faith—conducting a sale to the mutual advantage of the parties involved—that is most applicable to dispositions of mezzanine loan collateral during a pandemic. Many of the mezzanine lenders that instituted foreclosure proceedings did so after the mezzanine borrower defaulted on only one loan payment or while the borrower was participating in loan negotiations.[228] Considering the duration of the pandemic and the rapidity with which COVID-19 shut down society, it is unsurprising that many mezzanine borrowers were unable to avoid default.

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[225] Will v. Mill Condo. Owners' Ass'n, 848 A.2d 336, 342 (Vt. 2004) (quoting Chittenden Tr. Co. v. Maryanski, 415 A.2d 206, 209 (Vt. 1980)); *see also* Baldiga v. Moog, Inc. (*In re* Comprehensive Power, Inc.), 578 B.R. 14, 33 (Bankr. D. Mass. 2017) ("The term commercially reasonable is not specifically defined by the UCC and has been held to mean that a qualifying disposition must be made in the good faith attempt to dispose of the collateral to the parties mutual best advantage.") (internal quotation marks omitted) (citation omitted).

[226] 108th St. Owners Corp. v. Overseas Commodities Ltd., 656 N.Y.S.2d 942 (N.Y. App. Div. 1997) (collecting cases); *accord* Coxcall v. Clover Com. Corp, 781 N.Y.S.2d 567, 574 (N.Y. Civ. Ct. 2004).

[227] *Solfanelli*, 203 F.3d at 200.

[228] *See* D2 Mark LLC v. OREI VI Invs. LLC, No. 652259/2020, 2020 WL 3432950 (N.Y. Sup. Ct. June 23, 2020) (notice of foreclosure given after one missed payment that borrower cured); Verified Complaint, *supra* note 151, at 5 (same); Exhibit J at 2, WWML96 DE Mezz, LLC v. Series 2020A of Nahla Cap., LLC, No. 656721/2020 (N.Y. Sup. Ct. filed Dec. 3, 2020) (notice of foreclosure given after one missed monthly payment); Verified Complaint at 8–9 1248 Assocs. Mezz II LLC v. 12E48 Mezz II LLC, No. 651812/2020, 2020 WL 2569405 (N.Y. Sup. Ct. filed Apr. 30, 2020) (notice of foreclosure given while borrower is engaged in third party financing negotiations in which defendant lender was involved).

The *Shelbourne* plaintiff leaned on this reasoning when it argued that the proposed foreclosure sale was "the height of bad faith" and that the defendant mezzanine lender could not "sustain [its] burden of proving that" the sale was conducted "to the parties' 'mutual best advantage.'"[229] Although neither the trial court nor the First Department in *Shelbourne* reached these allegations, it is conceivable that courts will do so in the future.

As the pandemic persists, courts may be forced to evaluate the overall utility of a foreclosure sale. This entails an analysis into whether the mezzanine lender is pursuing the sale to secure the underlying property at a supremely cheap price that is not to the comparative mutual advantage of the borrower. This calculation will only become more challenging as nation-wide vaccination efforts return some normalcy to the country even as many aspects of society remain disrupted by the pandemic. In any case, because mutual advantage analyses are tied to sale price, good faith represents yet another way in which the pandemic has prompted increased attention on price considerations in section 9-610 foreclosure sales.

V. STEPS SECURED PARTIES CAN TAKE TO ENSURE THEIR FORECLSOURE ACTIONS ARE COMMERCIALLY REASONABLE

Part IV examined the possibility of good faith and market collapse considerations rendering foreclosure sales commercially unreasonable during a pandemic. This Part proposes actions that secured parties can take to safeguard foreclosure sales from both pre- and post-auction commercial reasonableness challenges while providing fairer sale terms for borrowers.

It is crucial for lenders to organize commercially reasonable sales to prevent protracted litigation that harms both parties. To be sure, some mezzanine borrowers can use commercial reasonableness challenges to frustrate their

229 Reply Mem. of Law in Further Supp. of Pls.' Appl. for a Prelim. Inj., *supra* note 189, at 12.

lenders' foreclosure plans and secure forbearance agreements or other accommodations.[230] For others, however, an injunction only postpones the inevitable foreclosure sale while costing both sides large fees and delaying the revitalization of the underlying property.[231] After the First Department's *Shelbourne* decision, moreover, borrowers may never even receive an injunction due to their inability to establish irreparable harm.[232]

Secured parties can take a number of precautions to ensure the commercial reasonableness of their public foreclosure sales and to preempt future litigation. Section V.A recommends four aspects of the foreclosure sale process that lenders can modify ex post to guarantee that their dispositions survive commercial reasonableness challenges brought before or after the sale occurs. Section V.B proposes ex ante ways in which lenders and borrowers can promote commercially reasonable foreclosures by modifying the contract terms in their security agreements.

A. Modifying the Procedural Aspects of Public

[230] After the injunction in *D2 Mark*, the parties negotiated an arrangement that allowed the plaintiff borrower to avoid foreclosure in exchange for increasing the principal and interest rate on the mezzanine loan. Larsen & Dineen, *supra* note 146; *see also* Patricia Clark, *NYC's Mark Hotel Banks on $1,300 Rates, Jean-Georges To Survive*, BLOOMBERG (Oct. 13, 2020, 9:05 AM), https://www.bloomberg.com/news/articles/2020-10-13/nyc-s-mark-hotel-banks-on-1-300-rates-jean-georges-to-survive [https://perma.cc/P6EK-WN6C] (reporting how, after the settlement between the parties, the Mark Hotel is surviving off of revenue from its luxury restaurant and profits generated by room rates that are twenty percent higher than pre-COVID levels despite occupancy rates that are fifty percent lower than average).

[231] The plaintiff in *Shelbourne* was not as fortunate as the borrower in *D2 Mark*. In the two months between the injunction and the court's subsequent decision ordering the foreclosure sale to proceed, the plaintiff could not secure an alternative arrangement to evade foreclosure. *See* Mac Avoy et. al., *supra* note 143.

[232] Shelbourne BRF LLC v. SR 677 Bway LLC, 139 N.Y.S.3d 799, 800 (N.Y. App. Div. 2021).

Foreclosure Sales

There are a few obvious standards that mezzanine lenders and other secured creditors must follow to make their foreclosure sales commercially reasonable during this pandemic or the next. First, the foreclosure notice must clearly state that potential bidders can participate in the foreclosure sale virtually as well as abide by all local and national health and safety regulations.[233] The court in *D2 Mark* found the proposed foreclosure sale to be commercially unreasonable partly because the mezzanine lender's notice was "equivocal" regarding the format of the sale.[234] Indeed, the notice stated that the sale would take place either "virtually or in a law firm office in New York City."[235] Such an imprecise statement could discourage potential bidders from participating in the auction process due to a justified reluctance to attend an in-person auction.[236]

Second, potential bidders must have sufficient time to access and inspect the collateral if necessary and feasible.[237] As has been discussed, the value of mezzanine loan collateral is directly tied to the value of the underlying property. Without the ability to visit the property and make their own assessments of its worth, potential bidders may offer inaccurate bids or may even be deterred from participating in the auction. *D2 Mark* showed that a court may find a proposed foreclosure sale commercially unreasonable if mezzanine lenders impose unnecessary barriers on bidders as a result of the pandemic, including preventing them from conducting

233 D2 Mark LLC v. OREI VI Invs. LLC, No. 652259/2020, 2020 WL 3432950, at **13 (N.Y. Sup. Ct. June 23, 2020).

234 *Id.* at *6.

235 *Id.* at *2.

236 *See New York Court Grants Injunction on Mark Hotel Mezzanine Foreclosure Sale: Implications for Mezzanine Lenders*, CLEARY GOTTLIEB STEEN & HAMILTON LLP (June 29, 2020), https://www.clearygottlieb.com/-/media/files/alert-memos-2020/new-york-court-grants-injunction-on-mark-hotel-mezzanine-foreclosure-sale.pdf. [https://perma.cc/5QQS-NYYB]

237 *See id.*; *D2 Mark LLC*, 2020 WL 3432950, at **5, 9.

adequate due diligence.[238] To forestall this scenario, mezzanine lenders must work around state and local property closure and stay-at-home orders to ensure that potential bidders have sufficient access to the underlying property.

Third, the cases heard by courts since the start of the pandemic make it clear that, in times of great market and societal uncertainty, some indicators of commercial reasonableness are not the bellwethers they once were. All of the mezzanine lenders in these cases hired an experienced real estate investment firm or auctioneer to structure and conduct their foreclosure sales.[239] Yet, this did not protect them from commercial reasonableness challenges. The court in *D2 Mark*, for instance, found many of the procedures employed by the real estate investment company—not specifying the auction medium on the notice, providing inadequate time to conduct due diligence, imposing excessive financial requirements on the winning bidder—to be commercially unreasonable.[240]

Fourth, the timing of the sale is a significant issue during a pandemic, as it affects the reasonableness of both the procedures that are employed and the price that is realized. Regarding the procedures employed, courts have indicated that previously reasonable lengths of time between notice and sale must be extended during a pandemic to satisfy commercial reasonableness requirements.[241] The trial court in *D2 Mark* suggested that at least sixty days of notice is required for public foreclosure sales of mezzanine collateral and similar commercial assets.[242] This is fifteen days longer

[238] *New York Court Grants Injunction on Mark Hotel Mezzanine Foreclosure Sale: Implications for Mezzanine Lenders*, *supra* note 236; *D2 Mark LLC*, 2020 WL 3432950, at *5.

[239] Indeed, most hired the same firm: Jones Lange LaSalle (JLL). *See, e.g.*, *D2 Mark LLC*, 2020 WL 3432950, at *2 (hired JLL); O'Regan & Jones, *supra* note 153 (same); Larsen & Sun, *supra* note 182 (noting hiring of the same).

[240] *D2 Mark LLC*, 2020 WL 3432950, at *5.

[241] *New York Court Grants Injunction on Mark Hotel Mezzanine Foreclosure Sale: Implications for Mezzanine Lenders*, *supra* note 236.

[242] *D2 Mark LLC*, 2020 WL 3432950, at *5.

than the usual forty-five days of notice and almost twice as long as the time frame proposed by the *D2 Mark* lender.[243] In *Hello Living*, the trial court similarly ordered the defendant lender to give the borrower at least sixty days of notice of any future sale.[244] Many lenders are even providing ninety days of notice to ensure that their sales are considered commercially reasonable.[245]

Timing is also a major concern for price considerations. The *Shelbourne* court noted one way in which disposing of collateral during such market upheaval could lead to an artificially low and commercially unreasonable sale price—by inducing bids far below the fair value of the collateral.[246] As detailed in Part IV, comment 3 and good faith considerations also weigh heavily on the sale price, as do general public policy concerns about conducting UCC foreclosure sales during a pandemic.

These timing considerations could have a large effect on the efforts of mezzanine lenders to conduct foreclosure sales during a pandemic. Foreclosure sale times lengthened during a period in which mezzanine lenders were motivated to dispose of collateral more quickly than usual to avoid multiple defaults and capitalize on the business opportunities that foreclosure provides.[247] At the same time, the window within which mezzanine lenders could hold foreclosure sales decreased. There may be only a finite amount of time, for instance, between the expiration of one foreclosure moratorium that renders a sale commercially unreasonable, such as Administrative Order 157/20, and the implementation of another order that has a similar disqualifying impact on foreclosure sales.

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243 *Id.*; *New York Court Grants Injunction on Mark Hotel Mezzanine Foreclosure Sale: Implications for Mezzanine Lenders*, *supra* note 236.

244 Hello Living Developer Nostrand LLC v. 1580 Nostrand Mezz, LLC, No. 034885/2021 (N.Y. Sup. Ct. Aug. 24, 2021) (order granting TRO).

245 *See* Burke, *supra* note 175.

246 Shelbourne BRF LLC v. SR 677 BWAY LLC, No. 652971/2020 (N.Y. Sup. Ct. Aug. 3, 2020), *rev'd*, 139 N.Y.S.3d 799 (N.Y. App. Div. 2021) (order granting preliminary injunction).

247 Larsen, *supra* note 14.

Mezzanine lenders have heeded the developments discussed above: the lender that foreclosed on the Denizen scheduled its UCC sale for February 5, 2021, around sixty days after providing notice of the sale to the borrower.[248] Future mezzanine lenders would be wise to follow suit, either to dissuade borrowers from challenging the commercial reasonableness of the sale or to ensure that the proposed sale withstands any procedural challenges that borrowers may bring pre- or post-sale.

B. Drafting for a Commercially Reasonable Foreclosure Sale

Lenders and borrowers can alleviate much of the controversy surrounding commercially reasonable sales during the negotiation phase by entering into fairer and more robust security agreements.[249] Under section 9-603(a), a debtor and secured party can set forth their own standards to determine the commercial reasonableness of foreclosure sales so long as such "standards are not manifestly unreasonable."[250] This includes the way in which the lender provides notice to the debtor, the length of time for which public notice is given, and the various publications in which notice must be published.[251] It also includes all of the components of a foreclosure sale outlined in section 9-610(b),

248 Larsen & Sun, *supra* note 182.

249 *See New York Court Grants Injunction on Mark Hotel Mezzanine Foreclosure Sale: Implications for Mezzanine Lenders*, *supra* note 236; Sohn et al., *supra* note 191.

250 U.C.C. § 9-603(a) (AM. L. INST. & NAT'L CONF. OF COMM'RS ON UNIF. STATE L. 2012); *see also* Sepinuck, *supra* note 188; Sohn et al., *supra* note 191.

251 Sohn et al., *supra* note 191; *see also* Atlas MF Mezzanine Borrower, LLC v. Macquarie Texas Loan Holder, LLC, No. 17 Civ. 1138 (LLS), 2017 WL 729128, at *4 (S.D.N.Y. 2017) (denying preliminary injunction for foreclosure sale after finding that the terms of the sale were commercially reasonable in part because the notice publication abided by the terms set forth in the pledge and security agreement).

including the "method, manner, time, place, and other terms."[252]

If they so desire, the parties to a mezzanine loan thus can attempt to define commercial reasonableness for any and all components of a sale. As the current pandemic demonstrates, however, this would be infeasible since the parties cannot account for all possible market conditions and intervening events. This also would be unwise for lenders. Defining commercial reasonableness with such sweeping rigidity leaves lenders open to breach of contract challenges if they deviate from the standards outlined in the security agreement.[253] This is true even if the subsequent sale is nevertheless commercially reasonable under section 9-610.[254]

Instead, lenders and borrowers should define the specific foreclosure sale components that have proved most troublesome in the pandemic. For mezzanine loans, this means taking several steps to define ex ante the procedural aspects discussed in Section V.A. This includes, for instance, provisions that (1) establish that the period between notice and sale must be at least sixty days, (2) set forth a minimum period in which potential bidders must be allowed physical access to the collateral, and even (3) define much of the contents of the sale notice itself, such as the financial requirements for bidders and the medium through which the foreclosure sale takes place.

From the mezzanine lender's perspective, these provisions should function as a safe harbor: Rather than require the lender to act in a certain way, the provisions should enable the lender's sale to be considered commercially reasonable if the mezzanine lender abides by the contract terms.[255] This protection would safeguard borrowers from protracted litigation and rushed sales due to the unreasonable actions of

252 U.C.C. § 9-610(b); *see also* Stephen L. Sepinuck, *Drafting for a Commercially Reasonable Disposition of Collateral*, 1 TRANSACTIONAL LAW. 1, 2 (2011).

253 Sepinuck, s*upra* note 252.

254 *Id.*

255 *Id.*

the mezzanine lender. It also provides lenders with a way to avoid charges of unreasonableness.

Price will be more difficult to contract around in a security agreement. To be sure, the parties can set specific price standards that establish facially reasonable sales. For instance, parties can indicate that a public foreclosure auction conducted in a particular manner is "per se commercially reasonable" even if the auction price is unexpectedly low.[256] Similar to recent debates about modifying force majeure clauses, however, a borrower with a particularly strong bargaining position might even insist on including language that deems any foreclosure sale conducted during a pandemic to be commercially unreasonable.[257] Even if such language is not included, it is doubtful that abiding by contract terms will insulate foreclosure sales from commercial reasonableness challenges if they result in extraordinarily low sale values that fail the proceeds test or the totality of the circumstances test. Sale terms that allow the collateral to sell for such a low price likely would be found to be "manifestly unreasonable" under section 9-603(a).

This is especially true for foreclosure sales conducted during a pandemic. As the court in *D2 Mark* observed, "what is reasonable during normal business times, may not be reasonable during a pandemic."[258] Moreover, the *Shelbourne* trial court granted the injunction due simply to the possibility of the lender achieving a low sale price because of the pandemic's destabilizing effects on property valuations. These cases demonstrate that, even if a lender abides by all

[256] Gulf Coast Farms, LLC v. Fifth Third Bank, No. 2011-CA-000965-MR, 2011-CA-001575-MR, 2012-CA-000491-MR, 2013 WL 1688458, at *6 (Ky. Ct. App. 2013) (holding that a public foreclosure sale was commercially reasonable despite an auction price below the appraisal price because the secured party disposed of the collateral in the manner prescribed as "per se commercially reasonable" in the parties' Loan and Security Agreements).

[257] *See* Andrew A. Schwartz, *COVID-19: Impossible Contracts and Force Majeure*, CLS BLUE SKY BLOG (Aug. 11, 2020), https://clsbluesky.law.columbia.edu/2020/08/11/covid-19-impossible-contracts-and-force-majeure/ [https://perma.cc/47CU-U5SA].

[258] D2 Mark LLC v. OREI VI Invs. LLC, No. 652259/2020, 2020 WL 3432950, at *5 (N.Y. Sup. Ct. June 23, 2020).

procedural requirements enumerated in the security agreement, a proposed foreclosure sale still could be found to be commercially unreasonable because of broader economic and societal circumstances.

Thus, it is important for lenders to specify commercially reasonable procedural aspects of foreclosure sales in their security agreements to deflect the many procedural challenges that borrowers may bring. By enumerating all procedural requirements where feasible, lenders can reduce the range of potential reasonableness challenges to those macro-factors over which they have no control. *301 West 53rd Street* demonstrates the advantage of defining foreclosure sale procedural requirements in a security agreement. The procedures described in the applicable security agreements allowed the mezzanine lenders to avoid a sixty to ninety-day delay in their foreclosure sales. Indeed, the court found that the proposed delay was "inconsistent with the terms of the Pledge and Security Agreements, which specifically define the timetable for a commercially reasonable UCC sale."[259] The court held that, after the lenders fixed the other procedural irregularities of the previously enjoined sale, they could "notice a UCC sale in accordance with this Decision and the terms of the Pledge and Security Agreements."[260] Had the mezzanine lenders reasonably defined all procedural elements in the security agreements, the borrower may have had no standing on which to challenge the proposed foreclosure sale.

In comparison, *Hello Living* demonstrates that courts will not respect overreaching security agreements. The trial court in *Hello Living* granted the plaintiff borrower a TRO despite the existence of a security agreement in which the parties had defined the terms of a sale and the borrower had waived its ability to contest the sale's commercial reasonableness.[261]

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259 301 West 53rd St. Junior Mezzanine LLC et al. v. CCO Condo Portfolio (AZ) Junior Mezzanine, LLC, No. 656178/2020, at 2 (N.Y. Sup. Ct. Dec. 9, 2020).

260 *Id.*

261 Verified Complaint at 11–13, Hello Living Developer Nostrand LLC v. 1580 Nostrand Mezz, LLC, No. 034885/2021 (N.Y. Sup. Ct. filed Aug. 17, 2021).

Upon lifting the TRO, the trial court even conditioned the future sale on court-defined timing, advertising, and bid deposit requirements in addition to the terms defined in the existing security agreement.[262]

Lastly, lenders should focus on defining in their security agreements the financial requirements that the borrower and other potential bidders must meet to participate in a public foreclosure sale. Mezzanine lenders and borrowers should work together to draft terms that fulfill the lender's requirements while enabling the borrower to take part in the sale. This could even mean allowing a cash-strapped borrower to have a representative bid at the sale and then transfer its winning bid to the borrower.[263] Doing so will preclude one of the borrower's most potent challenges to a foreclosure sale, even if the borrower or its representative cannot satisfy the previously negotiated financial requirements because of severe financial distress. Most importantly, strong lenders should not pressure borrowers to agree to overly favorable financial requirement terms in their security agreements. As noted above, courts will follow the terms of a security agreement as long as they are not "manifestly unreasonable."[264] Terms that are so one-sided for the lender

[262] Hello Living Developer Nostrand LLC v. 1580 Nostrand Mezz, LLC, No. 034885/2021 (N.Y. Sup. Ct. Oct. 25, 2021), *appeal filed* (order confirming the lifting of the TRO at a court hearing held on October 18, 2021). One day before the scheduled foreclosure sale, the borrower filed for Chapter 11 bankruptcy to retain control of its collateral. Keith Larsen, *Hello Living Staves Off Foreclosure on East Flatbush Project, For Now*, THEREALDEAL (Dec. 23, 2021, 3:49 PM), https://therealdeal.com/2021/12/23/hello-living-staves-off-foreclosure-on-east-flatbush-project-for-now/ [https://perma.cc/3DVV-HWS2]; *see* Voluntary Petition for Non-Individuals Filing for Bankruptcy, *In re* Hello Living Developer Nostrand LLC, No. 7:21-BK-22696 (Bankr. S.D.N.Y Dec. 21, 2021).

[263] Joshua Stein, *Risk Reduction for Mezzanine Loan Borrowers*, FORBES (Sep. 24, 2021, 10:00 AM), https://www.forbes.com/sites/joshuastein/2021/09/24/risk-reduction-for-mezzanine-loan-borrowers/?sh=ecaf7007fd6b (on file with the Columbia Business Law Review).

[264] *See In re* Adobe Trucking, Inc., No. 10-70353-RBK, 2011 WL 6258233, at *8 (Bankr. W.D. Tex. Dec. 15, 2011), *aff'd*, 551 F. App'x 167 (5th Cir. 2014).

could trigger such a finding. For instance, the proposed foreclosure sales in *D2 Mark* and *301 West 53rd Street* were found commercially unreasonable largely because the unduly restrictive pre- and post-financial requirements for potential bidders prevented the borrowers from participating in the sale and made the defendants the only viable purchasers.[265] It is doubtful that the court would have ruled differently if these restrictive requirements were defined in the relevant security agreements.

VI. CONCLUSION

Faced with a confluence of state and local restrictions on remedial mortgage actions, lenders are turning to mezzanine loan foreclosures and the comparatively brief foreclosure sale process under Article 9 of the UCC to take possession of commercial real estate. As many mezzanine lenders have discovered, however, the section 9-610 requirement that "every aspect" of a UCC foreclosure sale must be "commercially reasonable" can present significant challenges to their proposed foreclosure sales.[266] Part II introduced the relevant components of UCC foreclosure sales, the three main judicial tests of commercial reasonableness, and the unique nature of mezzanine loan collateral. Crucially, the absence of a market for mezzanine loan collateral means that lenders must dispose of their collateral at a public foreclosure auction to participate in the sale.[267]

Part III examined the case law addressing the commercial reasonableness of mezzanine loan foreclosure sales during the COVID-19 pandemic. Although courts initially discounted New York state closure and mortgage foreclosure restrictions in their commercial reasonableness evaluations, later courts explicitly relied on these restrictions in holding sales to be commercially unreasonable, though the First Department's

265 *Id.*; D2 Mark LLC v. OREI VI Invs. LLC, No. 652259/2020, 2020 WL 3432950, at *5 (N.Y. Sup. Ct. June 23, 2020).

266 U.C.C. § 9-610(b) (AM. L. INST. & NAT'L CONF. OF COMM'RS ON UNIF. STATE L. 2012).

267 Berman, *supra* note 46, at 1016.

Shelbourne decision may mark a shift in judicial opinion. Courts also more closely scrutinized the procedural aspects of the sales, in many instances finding pre-pandemic procedural standards to be commercially unreasonable.

Part IV considered two elements of commercial reasonableness that may be influential in judicial analyses in this pandemic or the next. This includes comment 3 to section 9-610, which challenges the commercial reasonableness of conducting dispositions during a "market collapse," and good faith considerations, as enumerated in sections 1-203(b)(20) and 9-102(a)(43).[268] Although a market collapse is difficult to define and may not influence dispositions of investment securities with standard price quotations, highly specialized collateral like that of mezzanine loans could be susceptible to comment 3 arguments. The same is true regarding the secured creditor's good faith duty to dispose of collateral to the mutual advantage of both parties. Courts have yet to address these elements fully, but plaintiffs are relying on them to support their commercial unreasonableness allegations.

Part V recommended steps that secured parties can take to protect foreclosure sales from commercial reasonableness challenges. Many of these precautions involve setting forth procedural standards in security agreements or similar documents that are per se commercially reasonable. Although this may not fully protect a lender from price-based commercial reasonableness challenges, it will insulate the lender from numerous other allegations so long as such precautions are not "manifestly unreasonable."[269] Most significant, lenders and borrowers should attempt to define the financial requirements that the borrower and other potential bidders must satisfy to take part in a foreclosure sale. Doing so will foster cooperation between lenders and borrowers as well as remove a challenge to commercial reasonableness that proved disqualifying in *D2 Mark* and *301*

[268] U.C.C. §§ 9-610(b) cmt. 3, 1-201(b)(20) and 9-102(a)(43).

[269] *Id.* § 9-603(a).

West 53rd Street.[270] Yet, lenders must not push for excessively restrictive financial requirements, which courts likely will find "manifestly unreasonable."

As mezzanine lenders continue to foreclose on their collateral, courts likely will face additional cases challenging the commercial reasonableness of foreclosure sales during the pandemic.[271] Future cases will provide further clarity on what can be considered commercially reasonable under section 9-610 in times of great market and societal upheaval. Not all eventualities can be predicted or protected against. Nevertheless, future mezzanine lenders and all other secured parties can reduce uncertainty and contentious litigation by incorporating the lessons from current case law into their drafting negotiations.

[270] *See* 301 West 53rd St. Junior Mezzanine LLC et al. v. CCO Condo Portfolio (AZ) Junior Mezzanine, LLC, No. 656178/2020, at 2 (N.Y. Sup. Ct. Dec. 9, 2020); *see also D2 Mark LLC*, 2020 WL 3432950, at *5.

[271] Larsen, *supra* note 14.