SECURED FINANCE NETWORK'S OPPOSITION TO PEB COMMENTARY NO. [ ] INJUNCTION AGAINST A NONCOMPLYING DISPOSITION UNDER SECTION 9-610 OF THE UNIFORM COMMERCIAL CODE

INTRODUCTION

This Opposition to PEB Commentary No. [ ] is made by the Secured Finance Network ("SFNet"). SFNet is the principal United States trade association for financial institutions that provide asset-based financing to commercial borrowers. SFNet has over 280 members, including substantially all of the major money-center and regional banks in the United States, as well as other independent lenders of all sizes. Financing provided by SFNet members and other U.S. asset-based lenders comprises a substantial portion of the United States credit market and currently exceeds $455 billion. SFNet members provide financing to businesses on an international, national, regional, and local scale. Most of the companies who receive credit from SFNet members depend on this financing for working capital to operate and grow their businesses.

In Commentary No. [ ], the Permanent Editorial Board for the Uniform Commercial Code (the "PEB") proposes that "to the extent that general state law principles governing equitable relief would limit the power granted to courts by Section 9-625(a) [of the Uniform Commercial Code (the "UCC")] by precluding the availability of equitable relief where a collectable money damages remedy is available, Section 9-625(a) displaces those general principles." ABI & NCCUSL, *Permanent Editorial Board for the Uniform Commercial Code, PEB Commentary No. [ ]: Injunction Against a Noncomplying Disposition Under Section 9-610 of the Uniform Commercial Code 2* (September 8, 2021) (the "Commentary"), https://www.ali.org/media/filer_public/42/27/4227e935-9558-4e32-a1ec-33aa96096ece/draft-commentary-injunction-noncomplying-disposition.pdf. PEB asserts that such general state law principles are inconsistent with UCC 9-625(a) and do not further the Article 9 policy of debtor protection from secured party misbehavior. Accordingly, the PEB concludes that UCC 9-625(a) gives courts flexibility in issuing an injunction notwithstanding the availability of a collectable money damages remedy.

SFNet respectively submits that PEB's expansion of UCC 9-625 by way of the Commentary is not appropriate. Nothing in the terms, structure, purpose, or history of the UCC, including UCC 9-625(a), shows an intention to displace or modify, explicitly or by implication, the general state law principles governing injunctive relief. The Commentary ignores well-settled principles of equity and is inconsistent with the underlying purposes of the UCC to promote certainty, predictability, uniformity, and freedom of contract. Moreover, for the reasons explained below, if judges follow the Commentary and ignore these principles, commercial borrowers will suffer the negative consequences of reduced credit availability and increased cost of credit.[1] On the other hand, general equitable considerations protect the rights of the debtor while balancing the rights of the secured party. To the extent that no other adequate remedy at law is available (such as monetary damages) and the aggrieved party has suffered an irreparable harm, the traditional equitable principles may weigh in favor of awarding an injunction. However, if the debtor can be made whole and its rights are otherwise protected under the UCC or other applicable law, a debtor should not be able to avail itself of the benefits of an injunction. Accordingly, SFNet objects to the PEB's recommendation for the reasons stated below.

DISCUSSION

Injunction is an extraordinary remedy that should be granted cautiously. *See Weinberger v. Romero-Barcelo*, 456 U.S. 305, 311-12, 102 S. Ct. 1798, 1803 (1982) ("It [injunction] 'is not a remedy which issues as of course,' or 'to restrain an act the injurious consequences of which are merely trifling.' An

[1] This Opposition is directed at commercial transactions, not consumer loans.

injunction should issue only where the intervention of a court of equity 'is essential in order effectually to protect property rights against injuries otherwise irremediable.'") (internal citations omitted). It is well established that injunction is the proper remedy when the aggrieved party has suffered irreparable injury and there is no adequate legal remedy to address the injury. *Id*. The United States Supreme Court advises that "a major departure from the long tradition of equity practice should not be lightly implied." *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388, 391, 126 S. Ct. 1837, 1839 (2006) (vacating the judgment of the Court of Appeals for the Federal Circuit because the Court of Appeals did not apply the generally applicable four-factor test for permanent injunctive relief in a dispute arising under the Patent Act; instead, the Court of Appeals applied its "general rule that courts will issue permanent injunctions against patent infringement absent exceptional circumstances.") (citations omitted). The Supreme Court's directive is relevant here as well:

> These commonplace considerations applicable to cases in which injunctions are sought in the federal courts reflect a "practice with a background of several hundred years of history," a practice of which Congress is assuredly well aware. Of course, Congress may intervene and guide or control the exercise of the courts' discretion, but we do not lightly assume that Congress has intended to depart from established principles. As the Court said in *Porter v. Warner Holding Co.*, 328 U.S. 395, 398, 66 S.Ct. 1086, 1089, 90 L.Ed. 1332 (1946):
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> > "Moreover, the comprehensiveness of ***this equitable jurisdiction is not to be denied or limited in the absence of a clear and valid legislative command***. Unless a statute in so many words, or by a necessary and inescapable inference, restricts the court's jurisdiction in equity, the full scope of that jurisdiction is to be recognized and applied. 'The great principles of equity, securing complete justice, should not be yielded to light inferences, or doubtful construction.' *Brown v. Swann*, [35 U.S. 497, 503] ..."

Weinberg, 456 U.S. at 313 (internal citations omitted) (emphasis added).

There is no "necessary or inescapable inference" that UCC 9-625 was intended to supplant state law nationwide. *See Ennis Mgmt., LLC v. Ennis Prop. Mgmt., Inc*., No. CV065006341, 2009 WL 4685259, at *4 (Conn. Super. Ct. Nov. 17, 2009) (holding that "unless some provision of the UCC explicitly displaces or is in apparent conflict with a debtor's alternatively claimed remedies, the protection afforded by article nine is merely cumulative, as opposed to exclusive."); *see also Berthot v. Sec. Pac. Bank of Ariz.*, 170 Ariz. 318, 823 P.2d 1326 (Ct. App. 1991) (denied on other grounds) (explaining that the UCC only displaces common law when the statute does so expressly or by necessary implication); *U.S. Nat'l Bank of Or. v. Boge*, 311 Or. 550, 564, 814 P.2d 1082, 1090 (1991) (finding that the UCC's definition of "good faith" displaced the common duty of good faith because the existing structure of the UCC's provisions, which differ in defining "good faith," show a conscious legislative choice to displace the common duty of good faith). It seems that the PEB disagrees with the Courts across the country that have in fact held otherwise. In light of the extraordinary nature of the injunctive remedy and the settled principles it is governed by, the PEB should not encourage courts to interpret the UCC to displace state law principles for granting equitable relief.

PEB argues that limiting Section 9-625(a) "by factors that reject relief whenever there is a collectable money damages remedy would be logically equivalent to Section 9-625(a) not being included in the UCC." Commentary at 3. PEB cites UCC 1-305(b), Comment 2, to claim further that judges have broad discretion to change the rules for injunctive relief. Pursuant to 1-305(b): "Any right or obligation declared by [the Uniform Commercial Code] is enforceable by action unless the provision declaring it specifies a different and limited effect." Comment 2 to UCC 1-305 explains that "[w]hether specific performance or other equitable relief is available is determined not by this section but by specific provisions and by supplementary principles. Cf. Sections 1-103, 2-716." Based on this language, PEB concludes that

"whether an order or restraint is available to an aggrieved party to prevent a secured party from proceeding with a non-complying Article 9 disposition is determined by a combination of Section 9-625(a) and traditional principles on which injunctive relief may be granted, rather than on those traditional principles alone." Commentary at 4.

Contrary to Comment 2 to UCC 1-305, however, no "specific provision" of Section 9-625 supplants general equitable principles or implies in any way that courts are free to ignore "irreparable harm" as a necessary component for equitable relief. In fact, the statute as written expressly incorporates equitable relief, unmodified as it may be applied under non-UCC law. UCC 9-625(a) states: "If it is established that a secured party is not proceeding in accordance with this article, a court ***may order*** or restrain collection, enforcement, or disposition of collateral on appropriate terms and conditions." (emphasis added). Injunctive relief is expressly incorporated and made permissive, without any suggestion that the critical components of historical equitable relief should be disregarded by the reviewing court. Comment 2 to UCC 9-625 clarifies that "[s]ubsections (a) and (b) [of UCC 9-625] provide the basic remedies afforded to those aggrieved by a secured party's failure to comply with this Article."

Indeed, UCC 9-625(a) reaffirms the right of a debtor to seek injunctive relief to the extent that a secured party does not "proceed in good faith (Section 1-203), in a commercially reasonable manner (Sections 9-607 and 9-610), and, in most cases, with reasonable notification (Sections 9-611 through 9-614)" when enforcing its security interest against collateral. UCC §9-625, Comment 2. However, such relief is subject to the common law considerations, including a showing of irreparable harm and unavailability of money damages. To the extent that UCC 9-625(a) displaces equitable principles just by virtue of the general remedy it provides without setting any boundaries around it, then UCC 1-103(b) would be surplusage (not the other way around). UCC 9-625(a) and 1-103(b), each must be applied in conjunction with the other: UCC 9-625(a) give judges the discretion to issue an injunction under the UCC subject to traditional common law principles in accordance with UCC 1-103(b).

PEB argues that "the language of Section 9-625(a) is permissive rather than mandatory. A court may take into account factors that are typically considered when deciding whether to grant equitable relief . . . however, [a court may not] deny relief under Section 9-625(a) solely because of the availability of a collectable money damages remedy." Commentary at 3. Here, the PEB is attempting to legislate. Again, the "permissive" language in 9-625 is that the court may, or may not, grant an injunction. There is no suggestion that courts may opt out of traditional equitable rules.

Courts generally weigh four factors in determining whether injunction is appropriate, and the availability of monetary damages is just one of these factors:

> According to well-established principles of equity, a plaintiff seeking a permanent injunction . . . must demonstrate: (1) that it has suffered an irreparable injury; (2) that remedies available at law, such as monetary damages, are inadequate to compensate for that injury; (3) that, considering the balance of hardships between the plaintiff and defendant, a remedy in equity is warranted; and (4) that the public interest would not be disserved by a permanent injunction . . . The decision to grant or deny permanent injunctive relief is an act of equitable discretion by the district court . . . .

See eBay Inc., 547 U.S. at 391 (internal citations omitted). In cases where monetary damages are inadequate because it is difficult to prove their existence or amount, the second factor will weigh in favor of injunctive relief. *Cf.* Commentary at 3 (asserting that "denying relief under Section 9-625(a) merely because of the availability of a collectable money damages remedy would ignore the difficulty in proving the existence and amount of damages that follow from violation of the Section 9-610 rules in many cases.") However, to the extent that money damages can compensate the aggrieved party and the other requirements under applicable state law are satisfied, injunction should not be available under the UCC. In those cases, the

debtor can file bankruptcy and avail itself of the protection of the automatic stay. Moreover, the threat of bankruptcy can deter the secured lenders' misconduct in the first place. Accordingly, traditional equitable considerations are not inconsistent or in conflict with any of the terms of the UCC and should be applied in accordance with well-established precedent.

PEB further asserts that "[t]he discretion of the court to grant the injunction . . . notwithstanding the availability of the collectable money damages remedy also furthers the purpose under Article 9 of protecting the debtor and other parties against secured party misbehavior." Commentary at 4. PEB explains that the focus on the availability of collectible money damages "may fail sufficiently to create incentives for a secured party to conform its behavior to the requirements of Article 9." *Id*. Here, again, the PEB is trying to make a policy decision which is the province of state legislatures. Based upon prevailing law, a creditor foreclosing on collateral already generally has an incentive to act in a commercially reasonable manner in order to maximize disposition proceeds and not get sued. *See* Timothy R. Zinnecker, *The Default Provisions of Revised Article 9 of the Uniform Commercial Code: Part II*, 54 Bus. Law. 1737 (1999). As observed by the Seventh Circuit Court of Appeals:

> [W]hy shouldn't they maximize? Even if the secured party could be assured of a judgment for the full deficiency, why would it forgo a dollar today for the chance to enforce a deficiency judgment tomorrow? … [T]he secured party will expend every cost-justified effort because it prefers money now to judgment later…. Add the uncertainty of recovery in litigation and this preference for cash grows stronger. That the debtor has defaulted is an indication that it is unlikely to be good for all of any judgment the creditor is able to get.

Id. at 1744 (citing *In re Excello Press, Inc*., 890 F.2d 896, 901 (7th Cir. 1989); s*ee also Huntington Nat'l Bank v. Elkins*, 559 N.E.2d 456, 459 (1990) ("Given the economic realities of the lending industry, a secured creditor will generally attempt to obtain the highest possible price for the collateral since the recovery of a deficiency judgment against a defaulted debtor is usually dubious."); Edward J. Heiser, Jr. & Robert J. Flemma, Jr., *Consumer Issues in the Article 9 Revision Project: The Perspective of Consumer Lenders*, 48 CONSUMER FIN. L.Q. REP. 488, 495 (1994) (contending that a secured creditor has every incentive to maximize disposition proceeds "because every dollar sacrificed on the sale of collateral becomes an unsecured claim against a debtor who is necessarily a bad risk by virtue of his default"); Richard B. Wagner, *Proposed Consumer Changes to Article 9 of the Uniform Commercial Code Would Adversely Affect Consumer Credit*, 50 CONSUMER FIN. L.Q. REP. 92, 93 (1996) (noting "the powerful incentives that creditors have to maximize recovery from the sale of collateral given the uncertainty of collection of deficiencies")).

The UCC provides debtor protections in situations where the secured creditor is foreclosing on collateral with the intent to own it or resell it for a profit. Thus, the threat of injunction is not the only means of ensuring compliance with the UCC. *See also Weinberger*, 456 U.S. at 314 (pointing out that injunction was not the only means of ensuring compliance with the Federal Water Pollution Control Act, which also provides for fines and criminal penalties). For example, the debtor or an obligor may challenge the amount of the secured creditor's deficiency claim pursuant to UCC 9-615(f). Comment 6 to UCC 9-615(f) clarifies the purpose of this section as follows:

> Subsection (f) provides a special method for calculating a deficiency or surplus when the secured party, a person related to the secured party . . . or a secondary obligor acquires the collateral at a foreclosure disposition. It recognizes that when the foreclosing secured party or a related party is the transferee of the collateral, the secured party sometimes lacks the incentive to maximize the proceeds of disposition. As a consequence, the disposition may comply with the procedural requirements of this Article (*e.g.*, it is conducted in a commercially reasonable manner following reasonable notice) but nevertheless fetch a low price.

Subsection (f) adjusts for this lack of incentive.

UCC §9-615(f), Comment 6.

The UCC balances the interests of the secured party and the debtor and provides additional protections to the debtor where the secured party might have an incentive to violate the UCC. Moreover, this balancing of interests is consistent with and is incorporated in traditional equitable principles. *See Weinberger*, 456 U.S. at 312 ("Where plaintiff and defendant present competing claims of injury, the traditional function of equity has been to arrive at a 'nice adjustment and reconciliation' between the competing claims. In such cases, the court 'balances the conveniences of the parties and possible injuries to them according as they may be affected by the granting or withholding of the injunction.'") (internal citations omitted). The Supreme Court warns that "[i]n exercising their sound discretion, courts of equity should pay particular regard for the public consequences in employing the extraordinary remedy of injunction." *Id*. Accordingly, the award of injunction should not be considered a right unless the equitable considerations are satisfied. *See id.* ("[t]he award of an interlocutory injunction by courts of equity has never been regarded as strictly a matter of right, even though irreparable injury may otherwise result to the plaintiff").

Deviation from the traditional common law considerations as suggested by the PEB could have negative public consequences. Making injunction available where it would not otherwise be pursuant to traditional equitable principles will make the secured creditor's recovery less certain and will therefore increase the risk to lenders of extending secured credit. That, in turn, will adversely impact the availability and cost of credit and the financing of businesses and ventures generally at a time when they need financing more than ever. *See* The Loan Syndications and Trading Association, *The Trouble with Unneeded Bankruptcy Reform: The LSTA's Response to the ABI Chapter 11 Commission Report* (October 2015) 28 ("LSTA Response"). Creditors consider various factors in deciding whether to extend credit. One important consideration is the anticipated recovery on the loan if the borrower is in default. *See id*. (discussing various studies showing that expected lower recovery to secured creditors given default results in an increased cost of loans and decrease of loan availability to some borrowers). As the Seventh Circuit explained in *First Wisc. Fin. Corp. v. Yamaguchi*, 812 F.2d 370 (7th Cir. 1987):

> Clarity is important to commercial transactions. The beneficiary of a guaranty relies on the undertaking in supplying credit. Unless the lender can determine the extent of its protection through objective criteria, the risk of doing business will go up, and with it the rate of interest charged for loans. Uncertainty thus injures honest, reliable debtors.

Id. at 373. The secured creditor's expected recoveries upon default are higher than those of the unsecured creditor, and as a result, secured loans cost less than unsecured loans. LSTA Response at 29. Lowering or making more uncertain the expected recovery of a secured creditor "would result in difficulties pricing loans, reduced loan sizes, more expensive credit, a reduction in lenders willing to provide credit (as risk-averse lenders will drop out of the market), and a decrease in the flow of capital to non-investment-grade companies." *Id*.

These consequences will have a negative effect on the availability of secured credit, which would be inconsistent with the overall purpose of the UCC. Ignoring the broadly accepted equitable principles and leaving the injunctive remedy solely to judges' discretion will create uncertainty and confusion, which directly conflicts with the UCC's purpose of promoting certainty and predictability. *See* Robyn L. Meadows, *Code Arrogance and Displacement of Common Law and Equity: A Defense of Section 1-103 of the Uniform Commercial Code*, 54 SMU L. Rev. 535 (2001). As Robyn Meadows also explains:

> Certainty of the law permits parties to structure their transactions with knowledge of the consequences of their choices. Certainty may also increase economic efficiency in the commercial arena. Certainty in secured lending, for example, is believed to reduce the cost and increase the availability of credit.

Id. at 545.

Another primary goal of the UCC that is promoted by following the equitable principles is "to make uniform the law among the various jurisdictions." UCC 1-103(a)(3). As the Supreme Court has pointed out, the equitable principles of injunctive relief "reflect a 'practice with a background of several hundred years of history.'" *Weinberg*, 456 U.S. at 313. Courts generally apply the settled equitable principles when deciding whether to issue an injunction under the UCC, which promotes uniformity within and among the various jurisdictions. *See* Commentary at 2, n. 6. Giving discretion to judges to decide when and whether to apply these principles will inevitably create differences and inconsistencies among and within jurisdictions. For example, some judges may require the showing of irreparable harm while others may not and some judges may continue to consider all four elements for injunction while others may not, which will result in different injunctive relief standards around the country. In light of the potential negative public consequences, the decision to deviate from established equitable principles should instead be left to the state legislatures.

Comment 1 to UCC 1-103 provides that: "The text of each section [of the UCC] should be read in the light of the purpose and policy of the rule or principle in question, as also of the Uniform Commercial Code as a whole, and the application of the language should be construed narrowly or broadly, as the case may be, in conformity with the purposes and policies involved." UCC 9-625(a) should not be construed broadly to displace or in any way modify the equitable considerations because such interpretation is in conflict with some of the primary purposes and policies of the UCC to promote uniformity, certainty, predictability, and freedom of contract. Neither the terms, nor the structure, nor the purpose of the UCC show an intent to displace the common law equitable considerations for injunctive relief.

Accordingly, SFNet opposes the PEB's recommendation as being inconsistent with the terms, structure, purpose, and history of the UCC. There is no cited evidence of any legislative intent to displace or modify, explicitly or by implication, the traditional equitable considerations for obtaining an injunction. In light of the extreme nature of this remedy and the potential adverse consequences, the decision to replace these considerations with a different standard should be left to the states, and not to the discretion of judges. The PEB should not issue its proposed Commentary to 9-625.