

January 1977

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Recommended Citation

Michael J. Gallagher, *Secured Transactions: Judicial Approval under Section 9-507(2) as a Tool to Assure a Commercially Reasonable Disposition of Collateral*, 53 Chi.-Kent L. Rev. 701 (1977).

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SECURED TRANSACTIONS: JUDICIAL APPROVAL UNDER
SECTION 9-507(2) AS A TOOL TO ASSURE A
COMMERCIALLY REASONABLE DISPOSITION
OF COLLATERAL*

The judicial approval clause of section 9-507(2) of the Uniform Commercial Code¹ is an innovative addition to the law of secured transactions. The clause provides a measure of certainty for a secured party concerning the commercial reasonableness of his disposition while protecting the rights of the debtor at the same time. Briefly, the judicial approval procedure may be outlined as follows: after default² occurs, the secured party has several remedies,³ including the right to sell, lease or otherwise dispose⁴ of the collateral pledged as security for the debt incurred. If the secured party decides to dispose of the collateral, as often happens,⁵ he is bound to conform to the statutory standard of making a commercially reasonable disposition.⁶ Where a secured party does not comply with the commercially reasonable standard, a debtor may recover damages caused by the failure to comply with the standard.⁷ Because judicial approval of a disposition is conclusive⁸ as to the issue of commercial reasonableness, prudent⁹ use of

* The assistance provided by Ira S. Kolb of the law firm of Schwartz, Cooper, Kolb & Gaynor Chartered of Chicago, Illinois in the development of this article is acknowledged with gratitude. Any opinions expressed herein are solely those of the author.

1. Hereinafter referred to in the text as the Code U.C.C. § 9-507(2) provides in part:

A disposition which has been approved in any judicial proceeding or by any bona fide creditors' committee or representative of creditors shall conclusively be deemed to be commercially reasonable, but this sentence does not indicate that any such approval must be obtained in any case nor does it indicate that any disposition not so approved is not commercially reasonable [emphasis added].

2. Article Nine does not define "default." Instead, default is left to the discretion of the parties to be defined in the security agreement. While a debtor's non-payment is the starting point for default, care and foresight will dictate what further should be inserted to protect the secured creditor from unnecessary risks. J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE § 26-2 (1972).

3. U.C.C. § 9-501(1) provides that when a debtor defaults under a security agreement, a secured party has the rights and remedies of part 5, those provided in section 9-207, as well as those, except as limited by section 9-501(3), which are contained in the security agreement.

4. U.C.C. § 9-504(1).

5. "The secured party will ordinarily dispose of collateral consisting of goods, documents, investment securities and general intangibles." 2 W. DAVENPORT & R. HENSON, HANDBOOK ON SECURED TRANSACTIONS 87 (1966).

6. U.C.C. § 9-504(3) provides: "every aspect of the disposition including the method, manner, time, place and terms must be commercially reasonable."

7. Under section 9-507(1), if the disposition has not yet occurred, it may be ordered or restrained as is appropriate. Where the disposition has occurred, a debtor may recover any loss caused by a failure to comply with the provisions of part 5.

8. C. McCORMICK, HANDBOOK OF THE LAW OF EVIDENCE 804 (2d ed. E. Cleary 1972). Professor Cleary states that a conclusive presumption is irrebuttable, one which "the adversary is not allowed to dispute . . . at all." *Id.* In formulating the conclusive presumption the courts

this tool in "appropriate"¹⁰ cases would preclude a subsequent attack by a debtor.

Among those decisions which have interpreted the judicial approval clause, a divergence of opinion has arisen. Three areas of dispute stand out. The first area of dispute concerns whether approval may only be granted in advance of a disposition or whether "post-sale" approval is warranted as well. The second area of dispute centers on the proper standard of review of the court in the approval hearing. The issue presented is whether a court should exercise an "intense evaluation" in shaping the terms of a disposition, especially the price term, or whether a court is to be merely a "judicial filter" through which the arguments of the parties may flow, with the parties themselves as the ultimate architects of the terms of the disposition. The third area of dispute involves the ultimate effect judicial approval is to have. The issue is whether the conclusive presumption is intended to preclude *any* review by a court in a collateral proceeding. One court has limited the effect of judicial approval to extend only to those terms expressly included in the approval order.¹¹

This note will review and analyze the pertinent authorities¹² with a view toward reconciling them. When it is considered that the underlying policy of article 9 is to allow for great flexibility in employing its provisions,¹³ and that any examination of these cases must be done with an awareness of the disparate factual situations in which they arose, it will be seen that approval may be granted either "pre-sale" or "post-sale;" that the appropriate standard of review is dependent upon whether the proceeding is "plenary" or "summary" in nature; and that the conclusive effect of approval should be preserved even under extraordinary circumstances.

OLD COLONY: "INTENSE EVALUATION" AS THE PROPER STANDARD OF REVIEW

A case in which an "intense evaluation" was employed is *Old Colony Trust Co. v. Penrose Industries Corp.*¹⁴ In *Old Colony*, the plaintiffs, senior secured creditors and a trustee for them, sought a declaratory judg-

are not really creating a presumption, but a rule of law. Therefore, once approval is granted in a judicial proceeding, its effect should be that no collateral attack of the approved terms be allowed.

9. The judicial approval clause was intended as a practical device to protect the rights of the parties to a transaction. The facts of each transaction differ, however, making the question of whether to obtain approval the special province of a party's attorney.

10. U.C.C. § 9-507, Comment 2.

11. *Bryant v. American Nat'l Bank & Trust Co. of Chicago*, 407 F. Supp. 360 (N.D. Ill. 1976).

12. In the interest of clarity, a chronological review of the authorities seems appropriate.

13. See note 41 *infra*.

14. 280 F. Supp. 698 (E.D. Pa. 1968), *aff'd*, 398 F.2d 310 (3d Cir. 1968).

ment¹⁵ first, to state that the debtors, owners of a radio station, were in default under the terms of a security agreement¹⁶ and second, to authorize the sale of the shares of stock of the radio station which was the collateral for the debt incurred. After extensive hearings it was concluded by the court that the debtors were indeed in default and that the proposed sale of the collateral was commercially reasonable as to every aspect, including method, manner, time, place and terms,¹⁷ and thereby was authorized.

In *Old Colony* the court set forth a test to determine whether approval is warranted. The court stated that a disposition:

is commercially reasonable if the party (1) acts in good faith, (2) avoids loss, and (3) makes an effective realization. Furthermore, the party may obtain court approval if he (4) sells in the usual manner in a recognized market, or (5) sells at the current price in a recognized market, or (6) sells in conformity with reasonable commercial practices among dealers in the type of property.¹⁸

As to the first element, the Code itself imposes an obligation of good faith in the performance of every contract or duty within its ambit.¹⁹ Elements two and three also are sensible because it is inherent in part 5 of article 9 that secured creditors may not arbitrarily disregard the debtor's rights by selling the collateral at a loss and then sue the debtor for the deficiency.²⁰ Rather, the secured party must proceed in order to recoup as much as is practicable for the defaulted-upon collateral.²¹ Also, elements four, five and six, as independent alternatives to one another, are valid methods of meeting the standard.²²

It has been argued subsequent to *Old Colony* that it is not the test itself with which fault may be found but whether the court or the parties should insure that it is satisfied.²³ The court in *Old Colony* took the position that it is the role of the court to make a diligent and intensive "evaluation"²⁴ of the terms of the disposition. In other words, the court should use this standard of review in order "to prevent 'unconscionable or dishonest' practices from

15. 28 U.S.C. § 2201 (1964) (amended Pub. L. 94-455, Oct. 4, 1976).

16. The defendant, Penrose Industries Corp., entered into two stock pledge agreements to secure a debt of \$1,740,000. Penrose defaulted under these agreements when it failed to make payments on two notes and a debenture after more than two years had elapsed. 280 F. Supp. at 702-03.

17. U.C.C. § 9-504(3).

18. 280 F. Supp. at 715.

19. U.C.C. § 1-203.

20. U.C.C. § 9-502(2) provides that unless otherwise agreed, the debtor is liable for any deficiency owed to the secured party. However, the secured party still is bound by the duty to make a commercially reasonable disposition under section 9-504(3).

21. In short, both parties have rights when default occurs which part 5 strives to protect.

22. Elements four, five and six are contained in section 9-507(2).

23. In re Zsa Zsa Ltd., 352 F. Supp. 665, 671 (S.D.N.Y. 1972), *aff'd mem.*, 475 F.2d 1393 (2d Cir. 1973).

24. 398 F.2d at 312.

becoming standard."²⁵ Much can be said in support of such a theory. After all, it is because the proceeding is judicial in nature, and thereby subject to the safeguards of the judicial process, that the conclusive presumption of commercial reasonableness was created.²⁶ It is arguable that if the court did not actively engage in an "intense evaluation" of the terms of the disposition so as to be in effect the drafter of a detailed plan of disposition, the approval proceeding might become unduly long and combative. An "intense evaluation" seems particularly appropriate in a declaratory judgment action, as in *Old Colony*, where the purpose of the action is to have a judicially enunciated statement of the rights of the parties.²⁷ Yet, while it may be preferable, in certain cases, for the court to evaluate intensely the terms of a disposition, once approval has been granted, such active judicial scrutiny is neither desired nor warranted by law.

FRONTIER AND UNWARRANTED JUDICIAL INTRUSION

An Illinois case, *Frontier Investment Corp. v. Belleville National Savings Bank*,²⁸ presented the dilemma of whether a court was the initial approving court or a collateral court and what its precise duty was in either situation. *Frontier* involved a sale of bank stock to a purchaser upon the debtors' default under a security agreement. The debtors sought a temporary injunction to restrain completion of the sale. The temporary injunction was denied with leave granted to the debtors to file additional pleadings. The purchaser then filed a separate suit to have a receiver appointed to effect the issuance of stock to him. A receiver was appointed to issue the stock to the purchaser. Upon court order in that action, the receiver was then discharged. The final order also stated that the issuance of stock to the purchaser was thereby "approved."²⁹ No appeal was taken from that order. However, the plaintiff-debtors in the injunctive action then filed additional pleadings alleging that the actions of the receiver were "void,"³⁰ or, alternatively, that the receivership proceeding did not purport to deal with the actual sale of the collateral, only the transfer of it, and therefore, did not approve the sale as commercially reasonable. The court in the injunctive proceeding granted summary judgment for the defendant, the purchaser of the stock. It was from the final order of that court that the plaintiff-debtors appealed.

The Illinois Appellate Court for the Fifth District affirmed the decision

25. 280 F. Supp. at 714.

26. It seems likely that the drafters were convinced that a judicial proceeding, imbued with the procedural and evidentiary protection guaranteed by law, was as valid a means of meeting the statutory standard as could be devised.

27. 280 F. Supp. at 712.

28. 119 Ill. App. 2d 2, 254 N.E.2d 295 (1969).

29. *Id.* at 6, 254 N.E.2d at 298.

30. *Id.*

of the lower court and held that the lower court's review of the facts of the sale, coupled with the approval of the sale in the receivership proceeding, determined that the sale of the stock was commercially reasonable as a matter of law.³¹ The holding in *Frontier* has been criticized as not giving the prior approval in the receivership proceeding the conclusive effect intended by the judicial approval clause.³²

In all fairness to the appellate court, it is unclear whether it based its affirmance upon the prior approval in the receivership proceeding or upon the lower court's collateral review of the already "approved" disposition. It is possible to argue that since the appellate court had "not been favored with too much of the proceeding in the receivership matter"³³ it did not feel secure that adequate approval had been granted in that proceeding but that adequate approval had been granted only in the injunctive proceeding.

In any event, if approval in the receivership proceeding occurred as a result of an open hearing on the terms of the disposition, then it was the duty of the collateral court to give the prior approval conclusive effect in any subsequent proceeding where the approved terms were attacked. If the injunctive court did not recognize the prior approval then it frustrated the purpose of judicial approval as a legal tool designed to give secured creditors a measure of protection from multiple suits, as well as directly contravening the statute. A court indulging in such collateral review would be engaged in an entirely unwarranted judicial intrusion into the prior court's approval. It is unlikely that the court in *Frontier* was engaged in any such judicial intrusion. What is more likely is the previously mentioned alternative that the appellate court, due to the sparse record in the receivership proceeding, decided to treat the injunctive proceeding as the first proceeding in which adequate approval was obtained. A court's role in that instance would be to examine directly the terms of the disposition to ensure that they comply with the test set forth in *Old Colony*.³⁴ This is what the appellate court did in *Frontier*, giving rise to the inference that it did believe itself to be the court of first approval and not an intruder upon the judgment of another.

GRANT AND POST-SALE APPROVAL

Grant County Tractor Co. v. Nuss,³⁵ involved the area of dispute of whether "post-sale" approval may be properly granted. In *Grant*, subsequent to the debtors' default under a contract and security agreement for a

31. *Id.* at 11, 254 N.E.2d at 300.

32. *Bryant v. American Nat'l Bank & Trust Co. of Chicago*, 407 F. Supp. 360, 365 n.4 (N.D. Ill. 1976).

33. 119 Ill. App. 2d at 10, 254 N.E.2d at 300.

34. 280 F. Supp. at 712.

35. 6 Wash. App. 866, 496 P.2d 966 (1972).

sale of a tractor, a rotovator and a packer, the secured party sold the tractor for salvage. Then the secured party brought suit to recover a deficiency judgment on all of the equipment. In their pleadings the debtors denied the plaintiff's allegations and sought both a rescission of the contract and damages, alleging that the equipment was defective. The trial court entered judgment "denying relief to either party. Both parties appeal[ed]." ³⁶

Upon appeal it was stated that the lower court had determined that the deficiency judgment would have been in the amount of \$3,507 if it was justified. Since the appellate court reversed the trial court's holding that no deficiency judgment could be entered due to the lack of notice, the appellate court reinstated the balance due the plaintiff for \$3,507. It was found that this amount represented what was owing on the sales contract minus the salvage value of the rotovator and packer. The court stated that "[t]his determination was a judicial disposition within [section 9-507(2)]." ³⁷ Judgment should have been entered accordingly. ³⁸

Grant is significant because the court held that the tractor sold for salvage before the judicial proceeding constituted "post-sale" approval. ³⁹ This was the first decision in which "post-sale" approval was recognized as valid.

Initially, judicial approval was intended to be an *advance* approval, *i.e.*, an approval obtained as a precondition to the actual disposition. Support for this theory is found in the Official Comment to section 9-507(2):

it is of great importance to make clear what types of disposition are to be considered commercially reasonable, and in an appropri-

36. *Id.* at 867-70, 496 P.2d at 967-69. The central issue in *Grant* was whether the plaintiff-secured party was entitled to a deficiency judgment when he had sold the tractor without giving reasonable notice of the sale to the debtor. The debtor alleged that the plaintiff's failure to give notice rendered the sale commercially unreasonable under section 9-504(3). Section 9-504(3) provides in part that:

reasonable notification of the time and place of any public sale or reasonable notification of the time after which any private sale or other intended disposition is to be made shall be sent by the secured party to the debtor, if he has not signed after default a statement renouncing or modifying his right to notification of sale.

The Washington Court of Appeals held that where a debtor does not receive notice of a sale of collateral where it is required, he may recover from the creditor any loss occasioned by the lack of notice. Because a debtor has this remedy, the creditor's failure to give reasonable notice did not deprive him of the remedy of a deficiency judgment. Instead the deficiency judgment could merely be reduced by the loss suffered by the debtor. The court also held that since the debtors gave written notice to the creditor of their intent to rescind the entire transaction, they thereby waived their right to notice and were estopped from claiming that notice should have been given them.

37. WASH. REV. CODE § 62 A 9.507(2) (1974).

38. 6 Wash. App. at 871, 496 P.2d at 970.

39. In reviewing the terms of the sale, the court concluded that it was commercially reasonable because the debtor waived the right to receive notice when it tendered the collateral back to the secured party, and gave written notice of an intent to rescind. Therefore, the secured party was reasonable in selling the tractor to reduce his loss. *Id.* at 870-71, 496 P.2d at 969.

ate case to give the secured party means of getting, by a court order . . . approval of a *proposed* method of disposition as a commercially reasonable one. Subsection (2) . . . provides for such *advance* approval⁴⁰

Moreover, it may be noted that in *Old Colony*, the first judicial approval case, approval of a *proposed* disposition was sought. However, to restrict so narrowly the use of this commercially useful tool is not in keeping with the underlying rationale of article 9. Implicit in its provisions is the amount of flexibility necessary to make article 9 commercially effective.⁴¹ Therefore, where the situation warrants it, "post-sale" approval is not violative of any authority but merely expands the use of approval beyond the suggestion of the drafters. Thus, in those instances, as in *Grant*, where practical considerations make "post-sale" approval more suited to the type of collateral being sold, "post-sale" approval should be permitted if the statutory standard is satisfied. *Grant* may be cited for the proposition that the role of the court and the powers it possesses as to when approval may be granted should be interpreted broadly. One court perceived the approving court's role to be much narrower. That case is discussed in the following section.

IN RE ZSA ZSA: THE COURT AS A JUDICIAL FILTER

*In re Zsa Zsa Ltd.*⁴² involved two of the areas of dispute: whether "strict scrutiny" is the proper standard of review, as well as the issue of the ultimate effect intended for judicial approval. *Zsa Zsa Ltd.* was in the cosmetics and allied products business. It petitioned for a Chapter XI arrangement⁴³ on September 23, 1970. Two persons became assignees of the security interest in the amount of \$300,000 in the assets of the debtor, *Zsa Zsa Ltd.*, as the result of a settlement between the debtor and the two secured creditors. The bankruptcy judge approved this settlement in October, 1971. On February 2, 1972, *Zsa Zsa* was adjudicated a bankrupt and a trustee in bankruptcy was appointed. Thereafter, an adversary hearing was held before a bankruptcy judge in order to discuss the terms of the sale. A public sale was scheduled for March 8, 1972. However, prior thereto, on March 6, the trustee moved to have a hearing to consider the terms of the

40. U.C.C. § 9-507, Comment 2.

41. 280 F. Supp. at 715 (quoting Hogan, *The Secured Party and Default Proceedings under the U.C.C.*, 47 MINN. L. REV. 205, 219-20 (1962)).

42. 352 F. Supp. 665 (S.D.N.Y. 1972), *aff'd mem.*, 475 F.2d 1393 (2d Cir. 1973).

43. 11 U.S.C. §§ 701-799 (1970). Chapter XI of the Bankruptcy Act was designed to provide an alternative to the liquidation of a debtor's business. The debtor and creditors formulate a plan of arrangement for the composition or extension of the debtor's unsecured indebtedness. If, however, liquidation becomes necessary, a standby trustee, who usually is elected at the first meeting of creditors, is then appointed by the court. This is what happened in *Zsa Zsa*. See 8 W. COLLIER, COLLIER ON BANKRUPTCY ¶ 6.15[2] at 869 (14th ed. 1976) [hereinafter cited as COLLIER].

upcoming sale. At that hearing there was a thorough discussion of major aspects of the proposed sale with an uninhibited opportunity for both sides to be heard. The trustee made several objections, as well as a request that the time of the sale be postponed until March 10. Moreover, the bankruptcy judge insisted that the notice of sale be worded more sharply to reveal that the sale was subject to his confirmation. The sale was then held on March 10. On March 21, another hearing was held to determine whether the sale should be confirmed. Arguments were heard and the testimony of the auctioneer was taken. The bankruptcy judge confirmed the sale in an order entered on March 23, 1972. A petition for the district court to review that order was then filed.

The district court in *Zsa Zsa* modified the role the approving court should perform. It stated that the basic inquiry centered on the meaning of the term "commercially reasonable," a term often repeated but not specifically defined in the Code. The court pointed out that its meaning is to be given substance from developing case law and that there are no dispositive holdings by the highest appellate court of any state as to the complete meaning of commercially reasonable. Therefore, satisfaction of the standard is not to be determined by any rigid test but rather by "the aggregate of circumstances in each case . . . that should be emphasized in a review of the sale."⁴⁴ That statement has a pragmatic ring to it, much like the test set forth in *Old Colony*.

However, the court in *Zsa Zsa* then proceeded to distinguish between its test and the test in *Old Colony*. It stated that in reviewing a sale a court should not be so concerned with "the *proceeds* received from the sale but rather the *procedures* employed for the sale."⁴⁵ It is not necessary that the court make certain that the secured creditor "avoided loss" and that he made an "effective realization" on the collateral.⁴⁶ Instead, where there has been a hearing such that all interests had an opportunity "to comment upon the arrangement for disposition of the collateral,"⁴⁷ there should arise the presumption that the sale is commercially reasonable. Since the sale of the assets in *Zsa Zsa* had the benefit of judicial guidance, even though the sale was not pursuant to a detailed plan of the bankruptcy judge, the plans had passed through "a judicial filter" that was sufficient to warrant a conclusive presumption. The court stated that the Code requires reasonableness; it does not hold the secured party to a hypothetical expected return.⁴⁸

44. 352 F. Supp. at 670.

45. *Id.* at 671.

46. Avoiding loss and making an effective realization were set forth in *Old Colony* as two of the elements a court should look to in deciding whether to grant approval. However, the court did not precisely state what it meant by these terms.

47. 352 F. Supp. at 672.

48. *Id.*

The holding in *Zsa Zsa* tempers the test in *Old Colony*. It does not require a court to inquire into the ultimate results of the sale but merely into the practices employed in conducting it. This is not to say that the holding in *Zsa Zsa* contemplates total abstention from a review of the "proceeds" of the sale but merely that a court should not put itself in the position of an advocate of an expected return. The court in *Zsa Zsa* implied that the *Old Colony* test would *require* an effective realization, which would increase the standard with which the secured creditor must comply. Yet, as in *Zsa Zsa*, even though a sale may be conducted in a commercially reasonable manner, the realization may not be very effective.⁴⁹

Also, the *Old Colony* test, if strictly construed, may be interpreted to mean that even though a commercially reasonable disposition was had, a court could order that a higher price be paid for the collateral so that an "effective realization" be assured. The court in *Zsa Zsa* indicated that to do so would be unfair when it stated: "If the secured creditor makes certain that conditions of the sale . . . conform to commercially accepted standards, he should be shielded from the sanctions contained in Article Nine."⁵⁰

BRYANT: GIVING MEANING TO "CONCLUSIVE" EFFECT

Bryant v. American National Bank & Trust Co. of Chicago,⁵¹ (*In re Nanz*) is probably the most significant judicial approval case to date. In both its holding and its dicta, *Bryant* dealt with all three of the areas of dispute and concluded: that approval may be granted before or after a disposition occurs;⁵² that the "judicial filter" approach is sufficient to warrant approval;⁵³ and that the conclusiveness of approval has its limits.⁵⁴

During 1973, ten debtors pledged and cross-pledged a controlling number of shares in the Suburban Trust and Savings Bank of Oak Park as collateral for a loan of more than five million dollars from the American National Bank and Trust Company of Chicago. In May, 1974, four of the debtors, including Nanz, defaulted on the loan. On July 16, American National demanded payment from Nanz, informing him that if payment was not forthcoming, his shares of stock would be sold to satisfy the debts. Soon afterward, Nanz filed a petition for an arrangement under chapter XII of the

49. *Id.* In *Zsa Zsa* only ten cents on the dollar was realized from the sale of collateral.

50. *Id.* at 671. Then the court reviewed the price received for the sale. The testimony of the auctioneer was that the price received of \$300,000, yielding a 10% return on the value of the collateral, was reasonable. Also, a bid had been received of \$350,000 for the collateral. Based on these facts, the court found that the price was a commercially reasonable one and that no more could be required of the secured creditor. *Id.*

51. 407 F. Supp. 360 (N.D. Ill. 1976).

52. *Id.* at 365 n.3.

53. *Id.* at 365.

54. *Id.* at 366-67.

Bankruptcy Act.⁵⁵ Nanz also obtained an order from the bankruptcy court restraining the sale of any of the shares in the controlling block of shares.

Since the bankruptcy court was not certain it had jurisdiction over the shares of stock owned by the other borrowers, Bryant agreed to obtain and did obtain consents from the other borrowers in order to have all the shares sold as a block. On October 25, at a hearing in which all interested parties were represented, the bankruptcy court approved the sale of Nanz's shares on the condition, among others, that the entire block of shares be sold as a unit.

A sale, attended by twenty-five persons, was conducted on the American National Bank's premises on December 2, 1974. The bank was the only bidder, purchasing the entire block of shares.⁵⁶

As to "post-sale" approval, the *Bryant* court noted that according to *Zsa Zsa*, approval may be obtained not only for proposed dispositions but also where the secured party has already disposed of the collateral.⁵⁷ However, while in *Zsa Zsa* the bankruptcy judge specifically provided in his pre-sale order that the sale was subject to a subsequent confirmation,⁵⁸ "post-sale" approval should also apply in other types of proceedings.

The court in *Bryant* then dealt with the proper standard of review in the initial approval proceeding. The secured party is under the burden of making a commercially reasonable disposition in every aspect.⁵⁹ In order to meet the standard, the secured party may procure approval of the disposition in a judicial proceeding by proving either that one has, or will have, complied with the statutory standard. How compliance with the standard is proven, however, is where some dissension is encountered. In *Old Colony* an "intense evaluation" was conducted, one intended to "avoid loss" and to make an "effective realization" from the sale.⁶⁰ In *Zsa Zsa*, it was stated

55. 11 U.S.C. §§ 801-926 (1970). Chapter XII pertains to arrangements where the debtor is a person, not a corporation, who is the legal or equitable owner of real property or a chattel real which is security for any debt, and whose assets are real property which are put up as security for a debt. 9 COLLIER, *supra* note 43, ¶ 4.01 at 830.

56. The plaintiffs filed a three-count complaint on April 25, 1975 alleging that the sale of the shares was commercially unreasonable. The defendant, American National Bank, answered, denying plaintiffs' allegations of commercial unreasonableness, and stated as an affirmative defense that the sale was made pursuant to the order entered in a judicial proceeding and that therefore the sale was conclusively deemed to be commercially reasonable under section 9-507(2) of the Code. The plaintiffs moved to strike the affirmative defense while the defendant made a motion for summary judgment as to the count alleging commercial unreasonableness. The plaintiffs' motion to strike was denied and the defendant's summary judgment motion was granted in part. 407 F. Supp. at 367.

57. *Id.* at 365 n.3.

58. 352 F. Supp. at 668. An order confirming a sale is usually required by the local rules of the district in which the bankruptcy court sits. *See, e.g.*, Bankruptcy Rules, United States District Court for the Northern District of Illinois R. 3.03 G.

59. U.C.C. § 9-504(3): The secured party must make a commercially reasonable disposition as to "method, manner, time, place and terms"

60. 280 F. Supp. at 702. The court stated that four hearings were held before trial began in

that as long as the opportunity for all interested parties to be heard is given, a court, as a "judicial filter," should grant approval.⁶¹ The court in *Bryant*, citing both theories approvingly, stated that "the court which originally approves the transaction should examine each aspect of the sale and determine its reasonableness under the particular facts of the case."⁶² The court then asserted:

judicial approval of a disposition of collateral is given conclusive effect not because the tribunal *necessarily* scrutinized all aspects of the disposition and found them reasonable, but because the hearing allowed the parties to voice their objections and to comment upon the proposed transaction. If the parties have had an opportunity for thorough discussion of the sale's terms, it is appropriate to give the court's determination of reasonableness a conclusive effect.⁶³

These passages are not as contradictory as they appear because they are used in two different contexts. The first statement suggests the path a court might take to come to a conclusion of commercial reasonableness. The second statement recommends a test a collateral court may use to see whether it should give conclusive effect to the prior approval.

The court made a distinction between two of the areas of dispute: what is the standard of review a court should employ before it grants approval and what approval means once it is obtained.

The court in *Bryant* stated that approval is warranted when a minimum test is fulfilled. The test is whether the parties had a full and fair opportunity to participate in the proceedings in which the terms of the sale were established. That test then is to serve as a guide to a court in a collateral proceeding. If an opportunity to be heard was given in the prior proceeding, the collateral court must recognize the conclusiveness of the prior approval.⁶⁴

The *Bryant* court then discussed the ultimate effect of judicial approval. The result was that the court limited the ultimate effect of judicial approval and stated that conclusive effect should not be automatically extended to prior approval in all cases. Where it is alleged that the approved procedures were not followed; that there was fraud or overreaching on the part of the secured party; or that a term was not included in the court order of

an effort to hammer out the conditions of the proposed disposition. The trial itself took thirteen days and produced 2,027 pages of testimony and over 100 exhibits. An "intense evaluation" would seem essential in such a situation to bring order from potential chaos.

61. 352 F. Supp. at 672.

62. 407 F. Supp. at 365 n.4.

63. *Id.* at 364 (emphasis added).

64. This minimum test is required, of course, by due process considerations under the fifth and fourteenth amendments of the United States Constitution. "A fundamental requirement of due process 'is the opportunity to be heard.'" *Armstrong v. Manzo*, 380 U.S. 545, 552 (1965). See note 77 and accompanying text *infra*.

approval, the *Bryant* court concluded that a collateral court would be justified in reviewing the prior approval.⁶⁵ In light of these conclusions the *Bryant* court held: the price obtained in the block sale could not conclusively be deemed to be commercially reasonable because the price term was not mentioned in the original approval order entered in the bankruptcy proceeding; *to the extent* that the bankruptcy court order fixed the terms of the sale of the shares as a block, that sale was deemed commercially reasonable; and the terms fixed in the original approval order could only be reviewed to the extent that noncompliance, fraud or overreaching could be proved by the plaintiffs.⁶⁶

RECONCILING THE AUTHORITIES

In tracing the development of the pertinent authorities⁶⁷ interpreting judicial approval, the intention has been to spotlight the areas of contention rather than the areas of accord. For example, it does not seem necessary to stress the fact that approval may be obtained in any type of judicial proceeding, bankruptcy, declaratory judgment action, receivership, and so forth.⁶⁸ Nor does it seem a matter of dispute that an approval order may always be directly appealed and that conclusiveness only applies to an attack in a collateral proceeding.⁶⁹ Instead, the areas of dispute are more ripe for discussion.

“Post-Sale” Approval

It has been discussed that approval has been sought and granted both before and after a sale has taken place. It might be argued that if approval can be granted after the disposition has taken place, the approval would not benefit a secured party because he would then be subject to attack by a debtor. This argument ignores the essence of judicial approval. It is not intended to allow the secured party to avoid meeting the commercially reasonable standard, but to give the secured party the opportunity to concentrate all attacks on the disposition in one proceeding. The genius of the device is that once approval is obtained, the secured party is insulated from further claims for damages by debtors alleging that he did not proceed in a reasonable manner if he has acted in good faith and has complied with the

65. 407 F. Supp. at 366-67.

66. *Id.* at 367. An appeal was never taken from that order and no evidence was ever adduced to show any fraud or noncompliance.

67. One other case is available, but it sheds little light on the meaning of the judicial approval clause. That case's holding merely recognizes that a sale of eleven corporate notes (the collateral) by a bank after a disposition had been approved by a bankruptcy judge shall be given conclusive effect by a subsequent court. *First Nat'l City Bank v. Cooper*, 50 App. Div. 2d 518, 375 N.Y.S.2d 118 (1975) (per curiam).

68. *Bryant v. American Nat'l Bank*, 407 F. Supp. at 364 n.1.

69. *Id.* at n.2.

statutory standard. The benefit to debtors is that they have an opportunity to participate in, and voice objections to, the sale. If a particular disposition, for example, a salvage sale or a public auction, seems more suited to "post-sale" approval than another method of disposition, such as an almost consummated sale whose only condition precedent is judicial approval, the flexible policy inherent in article 9 seems perfectly compatible with allowing for both types of approval.⁷⁰

The Standard of Review

The decisions interpreting the proper standard of review in approval proceedings, either "intense evaluation" or "judicial filter," may also be reconciled. Here the type of sale being held is not as important as the type of proceeding involved. A declaratory judgment action, such as the one brought in *Old Colony*, lends itself more readily to "intense evaluation" than would other types of proceedings, most notably, bankruptcy proceedings. Declaratory judgment actions, by their nature, require that the court make a final determination of the rights and duties of the parties by sifting through a myriad of facts and issues in order to make detailed findings and conclusions.⁷¹ This was particularly true in *Old Colony*.⁷²

Bankruptcy proceedings, on the other hand, are quite different. A bankruptcy court's jurisdiction is summary in nature.⁷³ In other words, a bankruptcy proceeding "will usually be instituted and carried out in a quicker, less formal manner than that necessary in the ordinary law suit."⁷⁴ Section 23 of the Bankruptcy Act⁷⁵ provides that the United States district courts shall have exclusive jurisdiction over all controversies at law and in equity as distinguished from proceedings under the Bankruptcy Act, between trustees and adverse claimants. The clear implication is that where there is no "controversy"⁷⁶ such that a "plenary action"⁷⁷ is necessary, the bankruptcy court has exclusive jurisdiction to decide matters pertaining to bankruptcy administration in a summary manner. Thus, the "judicial filter" standard of review in judicial approval is nearly identical to the concept of summary jurisdiction. Both are recognized as requiring essentially that an

70. The sale in *Grant* was a salvage sale while the sale in *Zsa Zsa* was a public auction. In *Old Colony*, on the other hand, the agreement was conditional upon obtaining approval *before* the sale.

71. 22 AM. JUR. 2d *Declaratory Judgments*, § 1 (1965).

72. See note 59 *supra*.

73. 2 COLLIER, *supra* note 43 ¶ 23.02[1], at 438.

74. *Id.* ¶ 23.02[2], at 440.

75. 11 U.S.C. § 46 (1970).

76. 2 COLLIER, *supra* note 43, ¶ 23.02[1], at 439.

77. A plenary action is an ordinary civil action with summons, formal pleadings, full trial and judgment, 2 COLLIER, *supra* note 43 ¶ 23.02[2], at 441-42.

opportunity to be heard be afforded parties before the court instead of a full-blown adversary proceeding.⁷⁸

It is significant that the two decisions which embraced "judicial filter" as the proper standard of review, *Zsa Zsa* and *Bryant*, were cases arising in a bankruptcy setting. While summary jurisdiction was not expressly referred to in either decision, both cases may stand for the proposition that a bankruptcy court cannot be required to do more than act as a "judicial filter" in approval proceedings. This is because that standard of review more closely corresponds to the authority bestowed upon the bankruptcy court than does the "intense evaluation" standard of review. This is not to say, however, that a bankruptcy court may not, in its discretion, exercise a more intense review of the terms of a disposition.⁷⁹ Rather, this means merely that a higher standard of review could not be demanded of the court.

The Ultimate Effect of Approval

Finally, with regard to the third area of dispute, the ultimate effect to be given approval in a subsequent proceeding, the restrictions mentioned in *Bryant*⁸⁰ seem reasonable. If there is a failure to conform to the approved pre-sale procedures, or, "non-compliance," clearly, an attack upon a disposition is justified. If, however, non-compliance with a pre-sale order is alleged, the better procedure is to return to the court where approval was obtained and voice a protest in that forum. In that way, the conclusive presumption is not disturbed because the attack is direct and not collateral.

Secondly, it is clear that a disposition could not be commercially reasonable where either fraud or overreaching on the part of the secured party is present. Judicial approval does not operate in a vacuum and it would countenance an attack based on wrong-doing. Again though, the better approach in such cases seems to be to return to the original tribunal which approved the disposition for redress and not to a collateral court.⁸¹

78. 2 COLLIER *supra* note 43 ¶ 23.02[2], at 441 states: "The hearing may be brief and less formal than the ordinary trial; but notice and hearing are generally necessary to satisfy the requirement of due process."

79. The differences between summary and plenary jurisdiction are not always rigidly observed. Thus, in many proceedings designated as summary, a party may file pleadings, present evidence and cross-examine witnesses. 2 COLLIER, *supra* note 43, at 439-40. Additionally, approval proceedings in a bankruptcy setting, while perhaps not subject to an intensive evaluation, do have the procedural protection provided by local rules of court. These rules provide safeguards as to the method of sale (usually by public auction), notice, exhibition of the collateral, etc. See, e.g., Bankruptcy Rules, United States District Court for the Northern District of Illinois R. 303.

80. See note 65 and accompanying text *infra*.

81. In *Oliner v. McBride Industries, Inc.*, 412 F. Supp. 490 (S.D.N.Y. 1975), the trustee in the *Zsa Zsa* matter brought a collateral action alleging fraud in the procurement of the prior approval. The court granted summary judgment for the defendants, stating that the fraud issue had been "necessarily determined" in the prior proceeding and that under New York law the trustee was collaterally estopped from asserting fraud in a subsequent action. Instead the trustee should have applied to reopen the bankruptcy proceedings. This view appears to

The last restriction provides that any term *not* included in the court order of approval may be attacked on the issue of commercial reasonableness. The facts in *Bryant* are helpful in understanding this restriction. At the bankruptcy proceeding in which approval was first obtained, the plaintiffs in *Bryant* appeared and requested that their shares of stock be sold with the bankrupt's shares as a block. This was intended to make a better realization on the sale. As pointed out in *Bryant*, the plaintiffs could not then attack that term since they had appeared in the bankruptcy proceeding in order to specifically request that the shares be sold as a block. However, since the price term was not mentioned in the order, it was not approved and, therefore, could be attacked.⁸² While this restriction poses limits on the extent of judicial approval, it may be overcome by a prudent party. One suggestion would be to secure a buyer before the hearing and attach a copy of the contract of sale to the court order itself. This was done in *Old Colony*.⁸³ When a contract of sale has not been entered into prior to the hearing, every effort should be made by counsel for the secured party to see that the court makes minimum findings as to each of the terms of the disposition and that such findings are specifically incorporated into a written order.

It is unlikely, though, that a situation would arise very often where a disposition approved as to method, manner, time, and place but not price, would yield a commercially unreasonable price. This is because the phrase "effective realization" (a phrase used, but not defined either in the Code or in the *Old Colony* decision) should be read to mean effective under the circumstances of the particular disposition involved. Therefore, where every other aspect of a sale is reasonable, the price term probably is also.

CONCLUSION

This note has dealt with the pertinent authorities which have, to date, interpreted the judicial approval clause of section 9-507(2) of the Uniform Commercial Code. Judicial approval was devised by the drafters as a means of assuring a commercially reasonable disposition of collateral after default has occurred. A court order approving a disposition of collateral is conclusive on the issue of commercial reasonableness. However, three areas of dispute appear to inhibit the invocation of this practical tool: when approval may be granted; what standard of review the court should employ in the approval proceeding; and the ultimate effect approval should have once it is obtained.

contradict *Bryant* and, indeed, only further judicial interpretation will reveal whether the two views are reconcilable. The rule expressed in *Oliner* seems the better view, since it is supported by both the doctrine of collateral estoppel and the public policy against piecemeal litigation.

82. 407 F. Supp. at 366.

83. 280 F. Supp. at 718-19.

The following are suggestions for solving these three areas of dispute respectively: (1) depending on the facts of the case, approval may be granted as either a "pre-sale" or "post-sale" device; (2) a court in an approval proceeding may "intensely evaluate" the terms of the disposition but it need only act as a "judicial filter," especially in a bankruptcy proceeding where a court normally exercises summary jurisdiction. All courts, of course, are also bound by the procedural due process requirement of notice and opportunity to be heard; (3) as to the ultimate effect of approval, once approval has been obtained, it should be given conclusive effect in a collateral proceeding. A court which disregards that rule is committing an unwarranted judicial intrusion into the prior court's holding. However, while there is authority that the conclusive presumption does not extend to a disposition where approved procedures were not followed, where fraud or overreaching was alleged, or as to terms which were not mentioned in the original approval order, contrary authority holding that where fraud is alleged a direct attack should be made in the forum where approval was obtained, is the better approach. In the interest of resolving all issues arising from a sale of collateral in one forum, direct attack also is the better route as to non-compliance and terms not mentioned in the original order.

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