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Commercial Law

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Adoption of the Georgia versions of Article 4A and revised Article 8 of the Uniform Commercial Code ("U.C.C.") were the most significant developments in Georgia commercial law during the survey period. These changes became effective on July 1, 1992, long after the 1977 corresponding revisions of the Official Text of Article 8 sponsored by the Permanent Editorial Board for the U.C.C., but only shortly after the 1989 adoption of Article 4A as part of the Official Text. Article 4A is primarily concerned with wholesale wire transfers and should interest only a limited number of attorneys, and will not be discussed in this Article.

Revised Article 8, on the other hand, should draw a larger audience. It is designed to minimize the paperwork involved in issuance and transfer of securities and to govern security interests, transfers, and pledges of both certificated and uncertificated securities. The Georgia revisions to Article 8 have been thoroughly and thoughtfully reviewed elsewhere[1] and also will not be discussed in this Article. Professor Michael D. Sabbath[2] served as the reporter for the State Bar of Georgia subcommittee that considered and recommended adoption of the revisions. The subcommittee prepared "Georgia Reviser's Comments" to accompany and explain the proposed Georgia revisions. These comments are a valuable interpretive aid with regard to the Georgia version of Article 8.[3] No official comments were prepared to accompany Article 4A.

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1. Michael D. Sabbath & Albert H. Conrad, Jr., Proposed Revisions to the Georgia Uniform Commercial Code—Articles 2A, 6, 8, and 9, Ninth Annual Corporate and Banking Law Institute Program Materials, at 81 (1990) (Currently this is the only source for the comments).

2. Professor of Law, Walter F. George School of Law, Mercer University. University of Wisconsin (B.A., 1972); Emory University (J.D., 1975); Columbia University (LL.M., 1985). Member, State Bar of Georgia.

3. Use of the Georgia Reviser's Comments as an aid to statutory interpretation is certainly supported by the decision of the court of appeals in Roswell Bank v. Atlanta Utility Works, Inc., 149 Ga. App. 660, 255 S.E.2d 124 (1979), in which the court ruled that the

This Article reviews other Georgia commercial law developments of note during the survey period.

I. Foreclosures and Deficiencies

Whether the collateral consists of real or personal property, collecting deficiencies is one of the primary concerns motivating a lender to follow proper process in conducting nonjudicial foreclosure sales.[4] If the lender

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"Official Comments" should be considered as interpretive aids when the Georgia legislature adopts the proposed official text without change. *Id.* at 661, 255 S.E.2d at 125. The Georgia Reviser's Comments are Georgia's counterpart to the "Official Comments" that accompanied the Uniform "Official Text" of the U.C.C. Under the reasoning of *Roswell Bank*, the Georgia Reviser's Comments should provide the same interpretive aid as the "Official Comments" so long as the Georgia legislature adopted the proposed Georgia amendments without change. *See also* C. W. Matthews Contracting Co. v. Capital Ford Truck Sales, Inc., 149 Ga. App. 354, 254 S.E.2d 426 (1979) in which the court supported its conclusion by reference to a "Note to 1975 Amendment which follows Code Annotated § 22-404 (1977 ed., p. 78)." *Id.* at 356, 254 S.E.2d at 428. The note was prepared by John D. Hopkins, Chairman of the Corporate Code Revision Committee of the Section of Corporate and Banking Law of the State Bar of Georgia. *Id.* The Georgia Reviser's Comments are arguably more worthy of attention than Mr. Hopkins' "note" since the Georgia Reviser's Comments are provided by the Committee responsible for recommending the statute as adopted in Georgia, as opposed to a single individual.

4. Of course, collecting deficiencies is not a lender's only concern. The foreclosure itself might be wrongful for some reason, for example, the absence of default. In addition, even if the lender is entitled to foreclose, gross inadequacy of the nonjudicial foreclosure sale price combined with some procedural irregularity provides the basis under Georgia law for equitable relief setting aside the foreclosure. Giordano v. Stubbs, 228 Ga. 75, 79, 184 S.E.2d 165, 168 (1971). Finally, the foreclosing lender risks avoidance of the foreclosure sale on a constructive fraud theory if the debtor files a bankruptcy petition within one year of the foreclosure and if the foreclosure sale was not made in exchange for reasonably equivalent value. 11 U.S.C. § 548(a)(2) (1988). The survey period decision of a panel of the Eleventh Circuit Court of Appeals in Grissom v. Johnson, 955 F.2d 1440 (11th Cir. 1992), is instructive concerning this constructive fraud problem.

Satisfaction of antecedent debts is deemed to be value for purposes of section 548 avoidance actions. 11 U.S.C. § 548(d) (1988). The real issue in most section 548 cases involving foreclosure sales is whether the debt satisfied by the foreclosure was reasonably equivalent consideration in exchange for the asset transfer resulting from the foreclosure. With regard to this issue, most Georgia commercial lawyers are familiar with the 1980 decision of the Fifth Circuit in Durrett v. Washington Nat'l Ins. Co., 621 F.2d 201 (5th Cir. 1980). The court in *Durrett* concluded that a noncollusive and otherwise proper nonjudicial foreclosure sale which produced only 57.7% of the fair market value of the property sold could be avoided under section 548. *Id.* at 203. The court in *Durrett* also noted that foreclosure sales generating less than 70% of the fair market value of the collateral had not been approved by other courts. *Id.* Because of this observation, *Durrett* has been widely understood to establish a 70% threshold for testing the legitimacy of a nonjudicial foreclosure sale in a fraudulent conveyance proceeding under section 548.

For Georgia lawyers, this understanding was shaken somewhat by the decision of an Eleventh Circuit panel in Walker v. Littleton, 888 F.2d 90 (11th Cir. 1989). In *Walker* the court anticipates no deficiency or an uncollectible one, proper process is of lesser concern. On the other hand, if the lender anticipates that a collectible deficiency will remain following nonjudicial foreclosure(s) of all collateral, the lender has a clear incentive to carefully employ the process required by Georgia law for the conduct of its nonjudicial foreclosure. Generally speaking, whether the collateral consists of real or personal property, a lender whose nonjudicial foreclosure is governed by Georgia law must show that the foreclosure process was appropriately executed before the lender may obtain judicial assistance in collecting any deficiency. In addition, if the collateral is real property, the lender usually must show that the foreclosure sale brought "true market value," and if the collateral is personal property, the lender must show that the terms of the sale were "commercially reasonable."

The survey period produced three interesting decisions by the court of appeals concerning the meaning of the terms "true market value" and "commercially reasonable" price.[5] It also produced a decision by the court

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urged bankruptcy courts not to place inordinate weight upon *Durrett*'s so-called 70% rule. *Id.* at 93. In addition, the court in *Walker* ruled that no constructive fraud could be deemed to occur in a foreclosure sale that generated less than reasonable equivalent value if the debtor had no equity in the property because of the presence of junior liens. *Id.* at 93-94.

The decision in *Walker* foreshadowed the effective demise of the *Durrett* 70% rule as announced by a panel of the Eleventh Circuit in the survey period decision of *Grissom.* In *Grissom* the court specifically disavowed the 70% rule as a test for determining whether a foreclosure sale should be avoided as a constructive fraud. *Grissom*, 955 F.2d at 1449. Instead, the court ruled that whether reasonably equivalent consideration has been given in a foreclosure sale must be determined upon all the facts and circumstances. *Id.* at 1446. According to the court, the relevant facts would include the following:

> the bargaining position of the parties to the foreclosure sale, the marketability of the property that is sold, and the fact that prices achieved in foreclosure markets are notoriously lower than prices achieved in other markets . . ., whether or not the foreclosing party obtained a fair appraisal of the property before selling it, the extent to which the foreclosure sale was advertised, and the competitive conditions surrounding the sale.

Id. The court also stated that the *Durrett* 70% test, standing alone, usually is insufficient to make the foreclosure sale avoidable under section 548. *Id.* at 1449.

The decision in *Grissom* is understandably supportive of the decision in *Walker*, but its support is of questionable merit. The court in *Grissom* justifies *Walker* by noting that a debtor receives "value" when junior liens are extinguished by a senior creditor's foreclosure. *See id.* at 1446. Of course the debtor might be more thankful if these junior liens were satisfied, in whole or part, by the equity in the property above the senior creditor's debt. In most instances, missing an opportunity to partially or wholly satisfy junior debt is costly to the debtor and other creditors. The debtor usually must satisfy these claims with other resources, and other creditors are negatively impacted by the presence of a larger pool of remaining claims against the debtor and the debtor's assets.

5. Government Nat'l Mortgage Ass'n v. Belue, 201 Ga. App. 661, 411 S.E.2d 894 (1991); Marett Properties, L.P. v. Centerbank Mortgage Co., 204 Ga. App. 265, 419 S.E.2d 113

of appeals[6] and one by a federal district court[7] concerning the scope of the confirmation requirement[8] following the nonjudicial foreclosure of real property. In addition, a survey period decision by the Supreme Court of Georgia[9] clarified the consequence of failing to follow proper process or failing to obtain a "commercially reasonable" price in the nonjudicial foreclosure of personal property.

A. Collecting Deficiencies Following Nonjudicial Foreclosures of Real Property

The survey period decision of the court of appeals in *Tarleton v. Griffin Federal Savings Bank*,[10] provides an entertaining, if not particularly noteworthy, beginning for this year's discussion concerning developments in the rules governing nonjudicial foreclosure sales of real property. Georgia creditors secured by real property normally hold deeds to secure debt that include a power of sale which may be exercised by the creditor if the debtor defaults on the underlying obligation.[11] The creditor exercises this power of sale without judicial assistance, but must use the same process as would be employed in a judicial sale.[12] That process requires that newspaper advertisements properly describing the property be published in the county in which the property is located.[13]

In *Tarleton*, Ms. Tarleton challenged the bank's confirmation petition, in part, based upon her contention that the legal advertisements were defective. Evidently the newspaper ads cited the location of the second page, rather than the first page, of the security deed. In addition, the ads accurately recited the location of the property twice, instead of only once.[14] Tarleton evidently conceded on brief that anyone relying upon the

(1992); HSL/LA Jolla Belvedere Enter. v. Federal Sav. & Loan Ins. Corp., 201 Ga. App. 447, 411 S.E.2d 329 (1991); *see infra* notes 24-36 and accompanying text.

6. Vaughan v. Moore, 202 Ga. App. 592, 415 S.E.2d 47 (1992); *see infra* notes 56-65 and accompanying text.

7. United States v. Yates, 774 F. Supp. 1368 (M.D. Ga. 1991); *see infra* notes 43-55 and accompanying text.

8. This process imposes upon the lender seeking collection of a deficiency following a nonjudicial sale of real property the burden of showing that proper process was followed and that the property sold in foreclosure for its "true market value." *See infra* notes 66-78 and accompanying text for a discussion of this process and citations.

9. Business Dev. Corp. v. Contestabile, 261 Ga. 886, 413 S.E.2d 447 (1992); *see infra* notes 66-69 and accompanying text.

10. 202 Ga. App. 454, 415 S.E.2d 4 (1992).

11. *See* O.C.G.A. §§ 44-14-161 to -165 (1982).

12. *See id.* § 44-16-162 (1982); *Id.* §§ 9-13-140 to -178 (1982 & Supp. 1992).

13. *Id.* § 44-14-162 (1982) & §§ 9-13-140 to -141 (1982).

14. 202 Ga. App. at 454, 415 S.E.2d at 6.

advertisement in searching the records would discover the security deed, albeit the middle of the security deed as opposed to its beginning.

Noting the established principle that technical errors will not suffice to avoid a foreclosure sale unless the error is one which could chill the bidding, the court in *Tarleton* found the pagination error to be harmless.[15] The court also dismissed Ms. Tarleton's objection that the advertisement was defective because it twice repeated the name of the property being foreclosed upon instead of stating the name only once.[16] With apparent humor, the court concluded that this error "would not confuse the bidding intentions of any potential bidder of sufficient mental capacity to enter a binding contract for the purchase of the real property."[17]

Of course, the price received, not the process followed, spawns by far the greatest number of controversies concerning nonjudicial foreclosure sales. Under Georgia law, the creditor who conducts a nonjudicial sale of real property under a power of sale in a deed to secure debt cannot obtain a deficiency judgment following the sale unless it initiates a "confirmation proceeding" in the local superior court within thirty days of the sale.[18] At this confirmation proceeding, the creditor must establish that proper process was followed and that the "property so sold brought its true market value."[19] In *Wheeler v. Coastal Bank*,[20] a panel of the court of appeals decided that "true market value" means the price that would be obtained by an owner in an arms-length transaction free of the shadow of default and potential bankruptcy.[21] The court held that it was inappropriate to reduce this price by anticipated expenses associated with carrying the property and liquidating it.[22] The court's view in *Wheeler* is certainly subject to question.[23]

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15. *Id.* at 455, 415 S.E.2d at 6.

16. *Id.*

17. *Id.*

18. O.C.G.A. § 44-14-161(a) (1982).

19. *Id.* § 44-14-161(b), (c). Regarding the burden of proof on the creditor, see Thompson v. Maslia, 127 Ga. App. 758, 195 S.E.2d 238 (1972) and Wheeler v. Coastal Bank, 182 Ga. App. 112, 354 S.E.2d 694 (1987).

20. 182 Ga. App. 112, 354 S.E.2d 694 (1987).

21. *Id.* at 114, 354 S.E.2d at 696.

22. *Id.* In *Wheeler* two appraisers testified that the "value" or the "probable selling price" of the collateral would be between $140,000 and $145,000 and the lender's appraiser testified that the lender would incur approximately $13,000 in costs attempting to resell the property after obtaining ownership. Consequently, according to the lender, the foreclosure sale price of $127,000 bid by the lender was the "true market value" of the property. *Id.* at 113-14, 354 S.E.2d at 696.

23. The definition of "true market value" in *Wheeler* imposes an unrealistic burden upon the creditor. Buyers willing to pay the price that a seller might obtain for the property in an unhurried, unpressured sale rarely attend nonjudicial foreclosure sales under power. If the creditor must bid such a price, the creditor usually will be the purchaser. Theoretically,

The *Wheeler* concept of true market value was at issue in two survey period decisions issued by the court of appeals. In *Government National Mortgage Ass'n v. Belue*,[24] the superior court denied confirmation of the nonjudicial sales of two townhomes located in a development with other townhomes that previously had been foreclosed upon, purchased, and resold by the same lender. The lender's appraiser based his opinion concerning the value of these two townhomes upon the resale prices received by the lender for three, comparable townhomes previously foreclosed by the lender. The lender's appraiser, however, did not use the actual resale prices of the other three townhomes for his comparison. Instead, the appraiser deducted two to three thousand dollars each in determining the true market value of the townhomes at issue. In the appraiser's opinion, these deductions were warranted because the lender had paid closing costs and discount points in the prior resales and thereby obtained resale prices that were higher than market.[25]

Although it does not so hold, it is clear from the court of appeals discussion that the court approved of the appraiser's deductions in determining true market value whereas the trial court did not. In the court of appeals view, the decision in *Wheeler* does not prohibit appropriate adjustments to the sales prices of comparable properties as distinguished from adjustments to the "true market value" of the foreclosed collateral in anticipation of costs associated with holding and reselling that collateral. The adjustments made by the lender's appraiser in *Belue* simply enabled the appraiser to establish the appropriate value of comparable units based upon truly comparable sales, rather than extraordinary sales.

Because of its misinterpretation of *Wheeler*, the trial court evidently believed that no competent evidence supported the lender's contention that its foreclosure sale obtained true market value. The debtors, on the other hand, did submit competent evidence that the collateral's value exceeded the foreclosure price. The presence of this contrary evidence apparently persuaded the court of appeals to affirm the trial court's decision against the lender upon the "any evidence" standard of review. This aspect of the appellate court's decision is troubling. Surely an error is harmful when its effect is to exclude the only competent evidence supporting

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the creditor's purchase satisfies the debtor's obligation in the amount of the purchase price. In reality, however, no portion of the obligation is satisfied until the lender receives cash or its equivalent. The term "true market value" in the confirmation statute should be the unhurried, unpressured price envisioned by the court in *Wheeler* less the expenses a bidder normally would incur in obtaining that price through resale of the property. Such a definition recognizes the constraints and limitations imposed upon the lender by the required nonjudicial foreclosure process and assures that the debtor whose default necessitated the collection process bears the normal and reasonably foreseeable costs of that process.

24. 201 Ga. App. 661, 411 S.E.2d. 894 (1991).

25. *Id.* at 661, 411 S.E.2d at 894-95.

the lender's view of the case. Indeed, in a condemnation action concerning a valuation dispute, the supreme court has opined that:

> [w]here . . . the question is value, which must be established by opinion evidence, and the evidence is highly conflicting, the court cannot say that the exclusion of testimony of a witness on that issue was harmless error [simply] because four other witnesses had placed the value within the range of that excluded.[26]

The court of appeals in *Belue* evidently should have remanded the case to the trial court to enable that court to reconsider its decision in light of the fact that the lender's expert testimony was not fatally flawed under the decision in *Wheeler*. It is, after all, the trial court's task to weigh the evidence entitled to credence, not the appellate court's.[27]

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26. Williams v. Colonial Pipeline Co., 220 Ga. 381, 383, 139 S.E.2d 308, 310 (1964).

27. Indeed, this point was noted by the court in *Belue*. 201 Ga. App. at 662, 411 S.E.2d at 895. *Belue* was not the only questionable court of appeals decision concerning confirmations during the survey period. In HSL/LA Jolla Belvedere Enters. v. Federal Sav. & Loan Ins. Corp., 201 Ga. App. 447, 411 S.E.2d 329 (1991), the court of appeals affirmed a confirmation despite the absence of competent evidence proving that the sale brought true market value. *Id.* at 448, 411 S.E.2d at 331. In that case, the lender's expert testimony placed the true market value at $5.1 million. The borrowers' expert placed the value at $7 million. The lender was the successful bidder and purchased the property for $2,223,288 subject to a first mortgage. But no competent evidence was given concerning the amount of the first mortgage. Hearsay was offered to show that the first mortgage was $2,876,712, a figure which, not coincidentally, equals $5,100,000 when added to the lender's bid. And there was additional, competent testimony that the payoff on the first mortgage was in the neighborhood of $2.8 to $3 million. *Id.* at 447, 411 S.E.2d at 330.

Of course, if the payoff was even one dollar less than $2,876,712, then the property did not bring true market value upon foreclosure. A lender hardly carries its burden of showing true market value with testimony that the underlying indebtedness was between $2.8 and $3 million. If the indebtedness actually was $2,800,001, then the property brought substantially less than true market value.

Nevertheless, the court of appeals affirmed the trial court's judgment confirming the foreclosure sale. *Id.* Perhaps the court of appeals contemplated that the trial court could average $2.8 and $3 million to conclude that the underlying indebtedness was, most likely, $2.9 million. If so, then the property did bring true market value, assuming that the $5.1 million figure is correct. Of course, the trial court could just as easily have concluded that the best evidence of the value of the underlying mortgage would be specific proof of the exact amount, not testimony concerning a range within which the amount fell. Suppose the testimony had been that the underlying mortgage was somewhere between $200,000 and $5.6 million. Those two figures also average $2.9 million.

Most confirmation proceedings are uncontested. Borrowers commonly do not file written objections or responses to petitions for confirmation, and lender's counsel often prepare rather casually for the confirmation proceeding itself. With regard to the payoff on an underlying indebtedness, perhaps the wisest course is to seek a stipulation or admission prior to the hearing concerning the amount. Without such an admission or stipulation, the lender should be prepared to provide competent evidence of the payoff amount. No cautious lender should rely upon the opinion in *La Jolla Belvedere Enterprises*.

The court in *Belue* also affirmed the trial court's denial of the lender's request to resell.[28] Upon denial of confirmation, the trial court has the discretion to authorize the lender to conduct a resale "for good cause shown."[29] Denial of a request for resale extinguishes all hope that a deficiency judgment may be obtained. In affirming the trial court's denial of resale, the court in *Belue* noted evidence that the value of the foreclosed property had declined "due in part to the [lender's] failure to maintain the numerous other units therein which it had acquired by foreclosure."[30]

Is "good cause" shown to permit resale if the decline in value due to the lender's act or omission pales in comparison to the outstanding deficiency upon the underlying obligation? Suppose, for example, the decline in value is one thousand dollars and the deficiency sought to be collected is twenty thousand dollars. On these facts, since denial of resale means loss of the right to collect the deficiency, denial potentially imposes a twenty thousand dollar penalty for a one thousand dollar harm. This appears to be the clear consequence of the all-or-nothing format imposed in the confirmation process. Nothing in that statutory scheme suggests that the confirming court has the authority to grant resale conditioned upon the lender's agreement to credit the borrower for any losses caused by the lender's inappropriate act or omission. A different statutory scheme might simply require such a credit.[31] Or a different scheme might require that the lender, upon resale, obtain at least the price (plus interest) that the lender would have obtained had the lender conducted the initial foreclosure sale in accordance with the commands of the confirmation statute. In any event, the decision in *Belue* warns lenders to pay careful attention to both presale and postsale conduct. A lender's decision, for example, to close a going concern business property following the lender's purchase at foreclosure could lead to a denial of resale on the theory that the lender's action caused the value of the property to diminish following the foreclosure sale.

Belue was not the only survey period decision exploring the scope of the decision in *Wheeler*. In *Marett Properties, L.P. v. Centerbank Mortgage Co.*,[32] the lender was secured by one deed to secure debt giving it an interest in twenty-six lots. Noting that the deed to secure debt did not require individual foreclosure sales upon the lots, the court of appeals concluded that the true market value of the property "*would* be analyzed as 'a single investment opportunity' rather than by adding together the

28. 201 Ga. App. at 662, 411 S.E.2d at 895.
29. *See* O.C.G.A. § 44-14-161(c) (1982).
30. 201 Ga. App. at 662, 411 S.E.2d at 895.
31. This, in essence, is the scheme governing the consequences of error in the conduct of personal property nonjudicial foreclosures. *See infra* notes 66-78 and accompanying text.
32. 204 Ga. App. 265, 419 S.E.2d. 113 (1992).

true market values of each of the lots."[33] It is unclear whether the court carefully chose the word "would," as distinguished from "could." Immediately before its use of the word "would," the court in *Marett* quoted language from *First National Bank v. Childress-Ross Properties, Inc.*,[34] suggesting that whether the property should be considered as a single investment opportunity or as separate investment opportunities was within the discretion of the trial court.[35]

The court's use of the term "a single investment opportunity" is critical to its decision since it enabled the court to distinguish *Wheeler.* In *Marett* the lender's expert appraised the twenty-six lots as if they would be purchased by a developer. In calculating the price that might be paid by a developer for this single investment opportunity, the appraiser "considered those costs which a bulk purchaser would factor into determining market value of the property, such as carrying costs, reasonable profit and expenses."[36]

The survey period decisions in *Belue, Marett,* and *La Jolla Belvedere Enterprises* illustrate the significant pitfalls and traps for the unwary presented by the confirmation process.[37] Consequently, lenders are often interested in circumventing that process or minimizing the adverse impact of an inability to confirm a nonjudicial foreclosure sale. Two additional survey period decisions are instructive concerning the effectiveness of two of the strategies used by creditors to minimize the likelihood that the right to collect a deficiency will be lost in the confirmation process.

One of those strategies was promoted by the court of appeals decision in *Vaughn & Co. v. Saul.*[38] According to the decision in *Vaughn & Co.*, failure to obtain confirmation of a foreclosure under one deed to secure debt does not jeopardize the right to collect a deficiency judgment upon notes that were not sought to be satisfied by the unconfirmed foreclosure.[39] *Vaughn & Co.* consequently persuaded some creditors that use of multiple, cross collateralized notes and security deeds can minimize the risks associated with the confirmation process.[40] Last year's survey dis-

33. *Id.* at 266-67, 419 S.E.2d at 115 (emphasis added).

34. 189 Ga. App. 765, 766, 377 S.E.2d 533, 534 (1989) (referring to Marion G. Davis, Inc. v. Cameron-Brown Co., 177 Ga. App. 646, 340 S.E.2d 216 (1986)).

35. 204 Ga. App. at 266-67, 419 S.E.2d at 115.

36. *Id.* at 266, 419 S.E.2d at 114.

37. *See supra* note 27.

38. 143 Ga. App. 74, 237 S.E.2d 622 (1977).

39. *Id.* at 77, 237 S.E.2d at 625.

40. Of course, use of multiple, cross collateralized notes and security deeds with respect to a "single investment opportunity" might jeopardize the creditor's ability to take advantage of the ruling in *Marett.* Use of multiple notes and deeds increases the risk that a court asked to confirm foreclosure sales will determine true market value by combining the separate retail values of the parcels described by each deed to secure debt. *See* First Nat'l Bank

cussed the impact of the decision in *C.K.C., Inc. v. Free*,[41] upon the *Vaughn & Co.* strategy.[42] This year the instructive survey period decision is *United States v. Yates*.[43] At the very least, both *C.K.C.* and *Yates* indicate judicial hostility toward the *Vaughn & Co.* strategy.

Evidently because of the inadvertence of its counsel, the lender in *Yates* failed to petition for confirmation within thirty days of the foreclosure sale. In an attempt to salvage the damage done by failing to confirm, the lender (and its counsel from whom the lender was seeking indemnification) contended that confirmation was unnecessary because the foreclosure sought to satisfy only one of two notes collateralized by the same property at separate times with separate deeds to secure debt.[44] The first deed to secure debt included a standard dragnet clause.[45] The court in *Yates* placed considerable emphasis upon this dragnet clause, suggesting that its presence alone was sufficient to require confirmation before any deficiency could be collected upon the second note.[46] The court emphasized that the lender had no discretion under its dragnet clause, and offered this observation to distinguish *Yates* from *Jerkins v. Savannah Valley Production Credit Ass'n*,[47] in which the secured party evidently had discretion concerning which future loans or advances would be secured by the collateral being given in a certain security agreement.[48]

The court in *Yates* also distinguished the decision in *Vaughn & Co.*, noting that *Vaughn & Co.* concerned separate notes, separate deeds, and separate properties.[49] The court in *Yates* found it significant that both deeds in its case described essentially the same property. The court concluded that "[t]he two debts in this case are 'inextricably intertwined,' and the foreclosure exhausted all security on both debts."[50] The lender's advertisement in *Yates* stated that the foreclosure was being conducted

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v. Childress-Ross Properties, Inc., 189 Ga. App. 765, 377 S.E.2d 533 (1989). If *Marett* applies, the creditor is evidently entitled to bid a wholesale price. If *Childress-Ross* applies, the creditor is stuck with retail prices on separate properties. Certainly, in light of the decision in *Marett*, a lender would be well advised not to use the *Vaughn & Co.* strategy if the properties involved are contiguous or could otherwise be considered a "single investment opportunity" by a typical borrower.

41. 196 Ga. App. 280, 395 S.E.2d 666 (1990).

42. *See* James C. Marshall, *Commercial Law*, 43 MERCER L. REV. 119, 130-31 (1991).

43. 774 F. Supp. 1368 (M.D. Ga. 1991).

44. *Id.* at 1369-71.

45. The standard "dragnet" or "open end" clause provides that the described collateral will secure any future obligations of the borrower to the lender.

46. 774 F. Supp. at 1372.

47. 157 Ga. App. 652, 278 S.E.2d 431 (1981).

48. 774 F. Supp. at 1372-73.

49. *Id.* at 1373.

50. *Id.* at 1375 (quoting Murray v. Hasty, 132 Ga. App. 125, 127, 207 S.E.2d 602, 604 (1974)).

to satisfy the first note and that any excess proceeds would be disbursed "to the holder of" the second deed to secure debt. Since the lender was the holder of that second deed to secure debt, the advertisement arguably indicated the lender's intent to satisfy both notes with the advertised foreclosure.[51]

The suggestion in *Yates* that the *Vaughn & Co.* strategy is dependent upon the presence of a discretionary dragnet clause is not supported by Georgia case law.[52] If it accurately reflects Georgia law on this question, however, the federal decision in *Yates* severely limits the usefulness of the *Vaughn & Co.* strategy. Many Georgia lenders would be understandably reluctant to employ discretionary dragnet clause language to further the *Vaughn & Co.* strategy. Such discretionary language certainly invites other lienholders to insist upon priority on the theory that the lender cannot exercise its "discretion" retroactively.[53]

Besides introducing minor doubts concerning the consequences of nondiscretionary dragnet clause language, *Yates* highlights a major flaw in the *Vaughn & Co.* strategy. How does the lender maintain unassailable priority with regard to excess sales proceeds? In *Yates* the lender's advertisement anticipated this possibility by announcing that excess proceeds would be distributed first to the holder of a junior encumbrance, an encumbrance held by the lender. And the court in *Yates* found this reference in the advertisement quite supportive of its conclusion that the two notes were inextricably intertwined.[54] Suppose the lender's advertisement had not mentioned distribution to the holder of the junior encumbrance. For that matter, suppose the lender had specifically disavowed any rights under its dragnet clause. With regard to excess proceeds, each of these changes might have created more problems than it solved.[55]

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51. *Id.* at 1371.

52. Nondiscretionary dragnet clauses have not affected the outcome of several cases, including *Vaughn & Co.* itself. *See*, for example, Reagan v. Small Business Admin., 926 F.2d 1078 (11th Cir. 1991).

53. If the lender can so exercise its discretion, is the *Jerkins*' distinction drawn in *Yates* a principled one?

54. 774 F. Supp. at 1374-75.

55. Regarding the hypothetical failure of an advertisement to mention, directly or indirectly, distribution of excess proceeds to satisfy additional indebtedness between the parties, there is authority suggesting that such a statement may be a prerequisite to the exercise of any right of setoff. *See* GEORGE PINDAR, GEORGIA REAL ESTATE PRACTICE AND PROCEDURE § 21-88 (1986). In any event, absent priority based upon the dragnet clause, the right of setoff arguably is subordinate to other liens that might have attached to the property between the date of the deed and the date of foreclosure. Such liens follow the proceeds. *Id.* Additionally, perfecting a U.C.C. lien in the excess proceeds of any foreclosure sale might not solve this priority problem for the lender since the rights of intervening real property claimants to follow the proceeds might prime those of the lender in the proceeds.

While the survey period decision in *Yates* circumscribed one strategy for avoiding confirmation problems, the survey period decision in *Vaughan v. Moore*[56] circumscribed another. "Suing before selling" has been another technique used by lenders to avoid the requirement of confirmation at least since the decision of the court of appeals in *Taylor v. Thompson.*[57] In *Taylor* a panel of the court of appeals held that the confirmation process need not be completed by a creditor who obtains judgment on the underlying obligation before conducting the nonjudicial foreclosure sale.[58] The court reached this conclusion by reasoning that the confirmation statute is in derogation of the common law and must be strictly construed.[59]

The decision in *Taylor* gave creditors an additional strategy for circumventing the confirmation requirement, that is, suing before selling. In the survey period decision in *Vaughan,* a panel of the court of appeals held that a creditor must confirm a nonjudicial foreclosure of real property although the creditor brought suit on the underlying judgment before conducting the nonjudicial sale.[60] The court noted that *Taylor* concerned more than merely bringing suit before selling; *Taylor* concerned obtaining a judgment before selling. The court reasoned that entry of a judgment following a nonjudicial sale would, in essence, be entry of a deficiency judgment.[61]

At the very least, the decision in *Vaughan* suggests that the *Taylor* strategy of "suing before selling" is better described as "obtaining judgment before selling." *Vaughan* may also foreshadow the ultimate demise of *Taylor.* In an interesting concurring opinion, Judge Beasley agreed that the creditor in *Vaughan* should have confirmed the nonjudicial sale. In her opinion, however, Judge Beasley questioned the decision in *Taylor* and suggested that confirmation should be required regardless the timing of any judgment on the underlying obligation.[62]

Although part of Judge Beasley's strategy is questionable,[63] her objective of discrediting *Taylor* has considerable merit. Judge Beasley observes

56. 202 Ga. App. 592, 415 S.E.2d 47 (1992).
57. 158 Ga. App. 671, 282 S.E.2d 157 (1981).
58. *Id.* at 673, 282 S.E.2d at 159.
59. *Id.*
60. 202 Ga. App. at 593, 415 S.E.2d at 47-48.
61. *Id.*
62. *Id.* at 593-95, 415 S.E.2d at 48-49 (Beasley, J., concurring specially).
63. O.C.G.A. § 44-14-161(a) provides that "no action may be taken *to obtain* a deficiency judgment unless . . . ." O.C.G.A. § 44-14-161(a) (1982) (emphasis added). Judge Beasley argues that, if strictly construed, this language prohibits any action to *satisfy* a deficiency judgment following foreclosure unless the nonjudicial sale has been confirmed. 202 Ga. App. at 594, 415 S.E.2d at 48 (Beasley, J., concurring specially). She concludes that prior judgments become deficiency judgments once a nonjudicial foreclosure sale is conducted. *Id.* She

that "[t]he courts" must look at the substance of things, not merely their form . . . ."[64] Indeed, there is no obvious policy reason why the timing of the foreclosure sale should affect the requirement of confirmation. The pleading and proof required of a creditor in an action for a "deficiency judgment" is essentially identical to that required in a presale action for judgment on the obligation. Both actions primarily consider whether the underlying obligation is valid, mature, and still owing (in part or in full). In contrast, the confirmation requirement is designed to assure that the process followed and price obtained at a nonjudicial sale complies with the statutory standard for such sales, questions that ordinarily have nothing to do with the validity and maturity of the underlying obligation.

Although the confirmation statute literally prohibits actions "*to obtain* a deficiency judgment,"[65] surely the legislature never intended to draw the distinction made by the court in *Taylor* and, perhaps, by the majority in *Vaughan*. No doubt the legislature never considered the possibility that rational creditors might obtain a judgment before selling. Rational creditors are interested in prompt satisfaction of obligations in default and, prior to the adoption of the unfortunate language in the confirmation statute, nothing in Georgia law or practice gave creditors any incentive to delay exercising their powers of sale. At the time of the adoption of the confirmation statute, the legislature would have thought (and therefore intended) that the confirmation statute would apply to all nonjudicial foreclosures of real property.

Certainly, unless some likely legislative objective would be thereby furthered, the confirmation statute should not be construed to itself create the means for its circumvention. And no likely legislative objective appears to be furthered by an interpretation that encourages creditors to delay nonjudicial foreclosures until judgment upon the underlying obligation has been obtained. Such an encouragement of delay increases, but does not assure, the likelihood that the debtor will remain in possession for a longer period of time and that the debtor's defenses to liability, if any, will be litigated before the debtor is deprived of possession. If policy objectives such as those suggested by this observation were sought to be served by the confirmation statute, however, the legislature surely would have chosen more direct, focused, and effective statutory language than the words "to obtain a deficiency judgment." Such policy objectives

then argues that enforcement of the prior judgment, now a deficiency judgment, should be deemed to be a prohibited "action" within the meaning of the confirmation statute. *Id.* Judge Beasley evidently ignores altogether the word "obtain" within the quoted language of O.C.G.A. § 44-14-161(a). Those who would defend the decision in *Taylor* surely would contend that "satisfying" a judgment is quite different from "obtaining" a judgment.

64. 202 Ga. App. at 594, 415 S.E.2d at 48.

65. O.C.G.A. § 44-14-161(a) (emphasis added).

would prompt legislation focusing upon the nature of the underlying dispute and the likelihood of the creditor's or debtor's success in the underlying litigation. The legislatively limited issues presented in a confirmation proceeding have nothing to do with the underlying obligation(s) between the parties. And note that, interpreted as it has been by the court in *Taylor*, the confirmation process does not prompt creditors to delay nonjudicial foreclosures because of concern about the merits of the underlying dispute. Rather, creditors invoke the *Taylor* strategy from concern that there will be a valuation dispute jeopardizing an otherwise collectible deficiency.

As Judge Beasley appears to do, other Georgia courts should consider rejecting the hypertechnical construction given the confirmation statute by the court in *Taylor*. That statute should be construed to fully accomplish its evident remedial objectives and the only likely legislative intent present at its adoption. In any event, Judge Beasley's concurrence in *Vaughan* is fair notice that creditors should not rely upon the continuing vitality of the *Taylor* strategy. And *Yates* demonstrates the narrow usefulness of the *Vaughan & Co.* strategy. In light of these developments, creditors concerned about losing a collectible deficiency because of an inability to confirm a nonjudicial sale may find judicial foreclosures an attractive alternative.

B. Collecting Deficiencies Following Nonjudicial Foreclosures of Personal Property

During the survey period, the supreme court clarified its decision in *Contestabile v. Business Development Corp.*, ("*Contestabile I*").[66] In *Business Development Corp. v. Contestabile*, ("*Contestabile II*"),[67] the court clearly stated that *Contestabile I* was not in conflict with *Emmons v. Burkett*.[68] *Contestabile II* contains a good summary of the decision in *Emmons*:

> In *Emmons* . . . we held that when a creditor forecloses on secured property without the statutorily required notice to the debtor, or when the creditor conducts a commercially unreasonable sale, a rebuttable presumption is created that the value of the collateral is equal to the indebtedness. The creditor may rebut the presumption by introducing (1) evidence of the fair and reasonable value of the secured property, and (2) evidence that the value of the collateral was less than the debt. If the creditor rebuts the presumption, he may maintain an action against the debtor or guarantor for the deficiency (the difference between the fair

66. 259 Ga. 783, 387 S.E.2d 137 (1990).
67. 261 Ga. 886, 413 S.E.2d 447 (1992).
68. 256 Ga. 855, 353 S.E.2d 908 (1987).

and reasonable value of the collateral and the amount of the debt). Any loss suffered by the debtor as a result of the failure to give notice or the commercially unreasonable sale is recoverable under O.C.G.A. § 11-9-507 and may be setoff against the deficiency.[69]

One survey period decision is instructive concerning the commercially reasonable price to be obtained upon foreclosure and, perhaps, the "fair and reasonable value of the secured property."[70] In *Lee v. Trust Company Bank*,[71] a panel of the court of appeals affirmed the grant of summary judgment to Trust Company based upon the affidavit of a bank officer that the foreclosure sale was accomplished through a recognized automobile auction and that the price obtained upon foreclosure was consistent with the prices published in the "Black Book."[72] Of particular interest is the court's description of the "Black Book" as a "guide to wholesale prices."[73] Thus the court in *Lee* evidently found a wholesale price to be commercially reasonable under the circumstances of that case, a marked contrast from the "true market value" that must be obtained to secure confirmation of the nonjudicial sale of real property.[74]

The decision of the court in *Lee* may be the first clear pronouncement by a Georgia court that a wholesale price is commercially reasonable. Unfortunately, however, the court in *Lee* misquotes U.C.C. section 9-507(2) in support of its conclusion. The court in *Lee* does so by quoting a paraphrased version of that statute in *McMillan v. Bank South*.[75] In both *Lee* and *McMillan* the troubling language is as follows: "If a secured party disposes of the collateral in conformity with the usual commercial practices of dealers in that type of property, he has sold it in a commercially reasonable manner."[76] U.C.C. section 9-507(2) actually provides, in relevant part:

If the secured party either sells the collateral in the usual manner in any recognized market therefor or if he sells at the price current in such market at the time of his sale or if he has otherwise sold in conformity with

69. 261 Ga. at 886, 413 S.E.2d at 448.
70. *Id.*
71. 204 Ga. App. 28, 418 S.E.2d. 407 (1992).
72. *Id.* at 29, 418 S.E.2d at 409.
73. *Id.*, 418 S.E.2d at 408.
74. "True market value" is defined in Wheeler v. Coastal Bank, 182 Ga. App. 112, 354 S.E.2d 694 (1987), as a retail price. *Lee* evidently permits certain personal property secured creditors to obtain a wholesale price upon foreclosure. The difference can be very dramatic and appears to further no policy objective.
75. 188 Ga. App. 355, 373 S.E.2d 61 (1988).
76. 204 Ga. App. at 29, 418 S.E.2d at 408; 188 Ga. App. at 355, 373 S.E.2d at 62-63.

> reasonable commercial practices among dealers in the type of property sold he has sold in a commercially reasonable manner.[77]

Lee and *McMillan* substitute "usual commercial practices" for "reasonable commercial practices." Those terms are not facially (or substantively) synonymous. In the relevant statutory language, the term "usual" occurs only with reference to selling in a "recognized market."

Whether or not U.C.C. section 9-507(2) is the appropriate authority, however, the court's conclusion in *Lee* seems appropriate. A wholesale price is commercially reasonable if that is the price typically obtained through a noncollusive foreclosure process accepted throughout a particular industry. Why would creditors routinely engage in a process that does not produce the greatest net recovery (sale price minus expenses, including lost profit) upon foreclosure? Surely creditors desire to maximize the value received from collateral, particularly given the expenses associated with collection of deficiencies and the likelihood that many debtors will be judgment proof. Courts should assume, as did the court in *Lee*, that a commonly accepted foreclosure process is commercially reasonable although it results in a sales price much less than retail value of the collateral. Also, the weight of authority does seem to be that a "dealers-only" market is a "recognized market" within the meaning of the U.C.C.[78]

II. Miscellaneous

A. *Attorney Fees Demand Letters and Notices to the Internal Revenue Service*

Two survey period decisions are reminders of the importance of care in drafting an attorney fees demand letter pursuant to O.C.G.A. section 13-1-11.[79] That code section, in pertinent part, provides that:

> Obligations to pay attorney's fees upon any note or other evidence of indebtedness . . . shall be . . . collectable . . . if [and only if]. . . (3) The [creditor] . . . shall, after the maturity of the obligation, notify in writing the maker, endorser, or party sought to be held on said obligation that the provisions relative to payment of attorney's fees in addition to the principal and interest shall be enforced and that such maker, endorser, or party sought to be held on said obligation has ten days from

77. O.C.G.A. § 11-9-507(2)(1982).

78. *See* Contrail Leasing Partners, Ltd. v. Consolidated Airways, Inc., 742 F.2d 1095 (7th Cir. 1984); Chrysler Credit Corp. v. Curley, 753 F. Supp. 611 (E.D. Va. 1990); Piper Acceptance Corp. v. Yarbrough, 702 F.2d 733 (8th Cir. 1983).

79. O.C.G.A. § 13-1-11 (1982).

the receipt of such notice to pay the principal and interest without the attorney's fees.[80]

In the 1978 decision in *General Electric Credit Corp. v. Brook*,[81] the supreme court stated that only "substantial compliance" was required with this statute.[82] In that case, the supreme court paraphrased the statute to require that:

> [n]otice shall (1) be in writing, (2) to the party sought to be held on the obligation, (3) after maturity, (4) that the provisions relative to payment of attorney fees in addition to principal and interest will be enforced, and (5) that the party has 10 days from the receipt of such notice to pay the principal and interest without the attorney fees.[83]

Demand letters for attorney fees should be as simple and brief as the law permits. Greater length and more detail increases the likelihood of an error sufficient to jeopardize the right to attorney fees. Nothing in Georgia law requires that the amount of principal and interest due or a payoff amount be recited in the notice.[84] But the holder of the note must be named,[85] and the notice must state the contract upon which it is based.[86]

In the survey period decision in *Goodrum v. Ensign Bank*,[87] the court found an attorney fees demand letter to be inadequate because it failed to identify the underlying obligation with sufficient specificity.[88] Defendant Goodrum had executed a guaranty in favor of a third party. This guaranty was ultimately assigned to plaintiff Ensign Bank. Ensign's demand letter, however, referenced only "a 'contract' which defendant 'executed . . . in favor of Ensign Bank.' "[89] Citing established Georgia authority that the demand letter must identify the contract upon which the demand is predicated,[90] the court found this notice did not sufficiently identify the underlying obligation upon which Goodrum was to be charged.[91] Since nothing in the court's opinion suggests that Goodrum might actually have been confused by Ensign's notice, the opinion is some

80. *Id.* § 13-1-11(a).
81. 242 Ga. 109, 249 S.E.2d 596 (1978).
82. *Id.* at 118, 249 S.E.2d at 602.
83. *Id.* at 119, 249 S.E.2d at 603.
84. Associates Commercial Corp. v. Storey, 192 Ga. App. 199, 201, 384 S.E.2d 265, 266 (1989).
85. Edenfield v. Bank of Millen, 7 Ga. App. 645, 649, 67 S.E. 896, 898 (1910).
86. Rylee v. Bank of Statham, 7 Ga. App. 489, 67 S.E. 383 (1910).
87. 202 Ga. App. 53, 413 S.E.2d 230 (1991).
88. *Id.* at 53, 413 S.E.2d at 231-32.
89. *Id.*, 413 S.E.2d at 231.
90. Pippin v. Brigadier Indus. Corp., 150 Ga. App. 401, 258 S.E.2d 18 (1979). *See also* Rylee v. Bank of Statham, 7 Ga. App. 489, 67 S.E. 383 (1910).
91. 202 Ga. App. at 53, 413 S.E.2d at 231-32.

authority that the test for sufficiency of the notice is an objective one. Nevertheless, creditors whose notices do not identify the underlying contract should seek to introduce evidence that this omission did not affect the subjective understanding of the party sought to be charged. Clearly, the court-imposed requirement that the attorney fees notice recite the underlying obligation is a true trap for the unwary attorney who relies upon the plain language of the statute. Evidence that the omission caused no harm should be readily accepted.

Unlike the notice deficiency at issue in *Goodrum*, the notice deficiency identified in the survey period decision in *Professional Cleaners v. Phenix Supply Co.*[92] is certainly forewarned by the statutory language. O.C.G.A. section 13-1-11 requires that the letter demand payment within ten days of *receipt* of the letter.[93] In *Phenix Supply* the demand letter required payment within ten days from the *date* of the letter.[94]

And of at least passing interest concerning notices is the decision of the United States Court of Appeals for the Eleventh Circuit in *Tompkins v. United States*.[95] A foreclosure sale will not discharge junior federal tax liens unless the foreclosing secured party complies with the notice requirements imposed by the Internal Revenue Code.[96] Tompkins did not give the required notice and Tompkins was the successful purchaser at the nonjudicial foreclosure sale he conducted under a power of sale. These facts prompted the Internal Revenue Service to contend that its tax lien was not extinguished by the foreclosure sale, that Tompkins' senior secured claim merged with his fee title as purchaser and that Tompkins took that fee title subject to the Service's lien. The Service conceded that Tompkins never manifested any intent that merger occur but argued that the merger was automatic.[97]

A panel of the Eleventh Circuit disagreed. Interpreting Georgia law, the panel concluded that, absent a manifestation of intent to the contrary, merger does not occur if the consequences would inequitably harm the foreclosing party because of the presence of intervening or junior liens.[98] The court then concluded that this Georgia rule was not preempted by federal law.[99] According to the court, 26 U.S.C. section 7425[100] governs only the question of extinguishing junior tax liens. State law governs

92. 201 Ga. App. 634, 411 S.E.2d 781 (1991).
93. O.C.G.A. § 13-1-11(a)(3) (1982).
94. 201 Ga. App. at 635, 411 S.E.2d at 782.
95. 946 F.2d 817 (11th Cir. 1991).
96. 26 U.S.C. § 7425 (1988).
97. 946 F.2d at 817-20.
98. *Id.* at 819.
99. *Id.* at 820-21.
100. 26 U.S.C. § 7425.

whether the foreclosing creditor's senior lien survives the foreclosure and any priority dispute between the two liens.[101]

B. Purchase Money Secured Creditors vs. Prior Judgment Lien Holders

On November 18, 1991, a panel of the court of appeals ruled that Georgia's U.C.C. subsection 9-310(d) granted certain judgment creditors priority over subsequent, timely perfected purchase money secured creditors.[102] Not surprisingly, this decision prompted a flurry of activity among Georgia commercial lawyers. The Georgia Bankers Association ("GBA") sponsored a wholesale amendment to Georgia's U.C.C. subsection 9-310(d). The GBA amendment was enacted as proposed and became effective July 1, 1992.[103] Consequently, subsection 9-310(d) now reads:

> A lien for other unpaid taxes or a duly rendered judgment of a court having jurisdiction shall have the same priority with regard to a security interest as it would have if the tax lien or judgment were a conflicting security interest within the meaning of Code Section 11-9-312 or an encumbrance within the meaning of Code Section 11-9-313, which conflicting security interest was perfected by filing or which encumbrance arose

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101. 946 F.2d at 820-21.

102. Corim, Inc. v. Belvin, 202 Ga. App. 396, 398-99, 414 S.E.2d 491, 493 (1991), *rev'd sub nom.*, Crossroads Bank of Ga. v. Corim, Inc., 262 Ga. 364, 418 S.E.2d 601 (1992). The court of appeals based its decision upon the following language from O.C.G.A. § 11-9-310:

> [A] perfected security interest in collateral takes priority over . . . [liens established by certain Georgia laws] provided, nevertheless, that:
>
> . . .
>
> (d) A lien for . . . a duly rendered judgment . . . takes priority over such perfected security interests, but only if . . . [the lien is appropriately recorded] prior to the perfection of the subject security interest, and if the subject security interest is not a purchase money security interest entitled to priority under subsection (2) of Code Section 11-9-301.

O.C.G.A. § 11-9-310(d) (1982) (amended 1992). The court of appeals read this language to provide that the prior recorded judgment lien primes the purchase money security interest unless the latter is entitled to "priority under subsection (2) of [O.C.G.A.] section 11-9-301." The court then concluded that subsection (2) of section 11-9-301 reverses this new order of priority only in narrow circumstances. That subsection provides that:

> If the secured party files with respect to a purchase money security interest before or within 15 days after the debtor receives possession of the collateral, he takes priority over the rights of a transferee in bulk or of a lien creditor which arise between the time the security interest attaches and the time of filing.

O.C.G.A. § 11-9-301(2) (1982). In essence, the court of appeals concluded that the lender's rights are prior only to those of the judgment lien creditor that arise during the 15 day grace period for perfecting a purchase money security interest. If the rights of the judgment creditor arose prior to that time, the purchase money secured creditor loses to the judgment creditor according to the decision of the court of appeals.

103. 1992 Ga. Laws 1028.

at the time the tax lien or judgment was duly recorded in the place designated by statute applicable thereto.[104]

This amendment clarifies the priority rules between security interests and judgment liens or tax liens (other than ad valorem tax liens that continue to have priority over security interests regardless the time of filing). The amendment is intended to make clear that priority disputes involving secured parties and judgment creditors or non-ad valorem tax lien holders will be resolved as if the judgment lien or tax lien was a security interest.

Besides clarifying the understood priority for purchase money lenders, the amendment also clarifies and protects the rights of lenders involved in revolving credit facilities. Lenders who finance retail sellers typically make credit advances as needed against collateral that usually includes the retailer's inventory and accounts. Advances are sometimes made and inventory and accounts sometimes "roll over" after a judgment or tax lien has been filed. The amendment makes clear that the earlier-filed rights of the lender prevail over the later-filed rights of the judgment or tax lien holder. This clarification is important because sections 6323(c)(2) and (d) of the Internal Revenue Code ("I.R.C.") as amended by the Federal Tax Lien Act of 1966 give priority to certain secured parties for forty-five days following the filing of a federal tax lien, but only if those secured parties have priority under state law with regard to judgment liens.[105] Without the amendment, there was some doubt concerning the priority of secured parties during this forty-five day period because Georgia's subsection 9-310(d) arguably granted priority to judgment liens.

Not only was there legislative action to address the decision of the court of appeals, but the supreme court granted certiorari and reversed in *Crossroads Bank v. Corim, Inc.*[106] The supreme court ruled that timely perfected purchase money secured creditors prevail over prior judgment lienholders.[107] No doubt the reversal by the supreme court caused some relief for many Georgia attorneys who had authored unqualified opinion letters that timely perfected purchase money secured creditors had priority over prior judgment lienholders. As things turned out, they were right after all.

C. Lingering Priority Problems Caused By 1985 Amendments Requiring Maturity Dates

Amendments often have unintended consequences, a fact illustrated by the *Crossroads Bank* litigation and also by a survey period bankruptcy

104. O.C.G.A. § 11-9-310(d) (Supp. 1992).
105. *See* 26 U.S.C.A. §§ 6323(c)(1)(B), (d)(2) (West 1989 & Supp. 1992).
106. 262 Ga. 364, 418 S.E.2d 601 (1992).
107. *Id.* at 366, 418 S.E.2d at 603.

court decision, *In re Rainbow Manufacturing Co.*,[108] which concerned the lingering effects of the 1985 U.C.C. amendments requiring that financing and continuation statements reflect the maturity date of the secured obligation. This amendment imposed the maturity date requirement only upon financing and continuation statements filed on or after July 1, 1985.[109] Including the maturity date was optional under prior law[110] but was common practice because most U.C.C. 1 financing statement forms included a block for the maturity date. The 1985 amendment also provided that the effectiveness of a financing statement would lapse within twenty days of any stated maturity date unless an appropriate continuation statement was filed.[111]

The newly imposed maturity date requirement received a great deal of bad press[112] and was quickly amended. On March 26, 1986, the governor signed into law legislation once again amending the requirements for effective financing statements.[113] The new law became effective on the day it was signed by the governor, and it eliminated the maturity date requirement with regard to amounts financed in excess of five thousand dollars.[114] It also included a savings clause intended to undo the havoc wreaked during the nine month period in which the maturity date requirement had been universally imposed. That savings clause provided in pertinent part that:

> any financing statement or continuation statement which was filed on or after July 1, 1985, . . . is effective for a period of five years from the date of filing notwithstanding any maturity date specified in any such financing or continuation statement and notwithstanding any provision of prior

108. 129 B.R. 702 (Bankr. M.D. Ga. 1991).

109. 1985 Ga. Laws 1517, 1520.

110. 1978 Ga. Laws 1081, 1123; O.C.G.A. § 11-9-403(2), (3) (1982) (amended 1985).

111. 1985 Ga. Laws 1517, 1520.

112. For example, *see* Christopher L. Carson, Albert H. Conrad, Jr. & C. Edwards Dobbs, *H.B.712: New Requirements for Financing Statements and Continuation Statements Filed in Georgia*, 22 GA. ST. B.J. 6 (1985) and James C. Marshall, *Commercial Law*, 38 MERCER L. REV. 85, 100 (1985).

113. 1986 Ga. Laws 357, 361.

114. *Id.* Actually, the 1986 amendments effectively eliminated altogether the requirement that financing statements show maturity dates. Maturity dates are no longer required so long as the amount financed exceeds $5,000. Below that amount, the maturity date must be shown only if the collateral consists solely of consumer goods. *See* O.C.G.A. § 11-9-403(8) (Supp. 1992). But financing statements need not be (and rarely are) filed by purchase money lenders secured by consumer goods. *Id.* § 11-9-302(1)(d). And nonpurchase money security interests in many consumer goods are ineffective under Federal Trade Commission regulations. *See* 16 C.F.R. § 444.2(a) (1992). Motor vehicles are the primary exception and financing statements are not used to perfect security interests in this type of collateral. *See* O.C.G.A. § 11-9-302(3)(b) (Supp. 1992); O.C.G.A. § 40-3-50 (1991).

law to the contrary, unless such financing statement or continuation statement lapsed prior to March 26, 1986.[115]

Unfortunately, the language of this savings clause arguably exacerbated, rather than ameliorated, the problems for some lenders caused by the 1985 maturity date legislation.

The court in *Rainbow* addressed the question whether a lender's financing statement had lapsed despite the filing of two continuation statements.[116] The lender in *Rainbow* filed its original financing statement on April 23, 1985. Although maturity date information was not then required, the lender's financing statement nevertheless reflected an October 1985 maturity date for the secured obligation. No doubt mindful of the new law, the lender dutifully filed a continuation statement within twenty days after the maturity date stated in its original financing statement. And, as required by the new law, this first continuation statement included a new maturity date, April 21, 1986, for the secured obligation. The lender filed its second continuation statement within twenty days of the second maturity date. This second continuation statement included the words "On demand" in the maturity date box.[117]

The court in *Rainbow* concluded that neither continuation statement was timely filed.[118] Citing authority from other jurisdictions, the court interpreted the words "A continuation statement *may be filed* . . . within six months prior to [lapse of the financing statement]"[119] to mean that the continuation statement *must be filed* within that period.[120] The court then ruled that the original financing statement filed April 23, 1985 was not scheduled to lapse until April 22, 1990 despite the inclusion of an October 1985 maturity date.[121] According to the court, the 1985 amendments simply did not apply to the lender's financing statement filed prior to the effective date of those amendments. Consequently, the court ruled that the lender's continuation statements were premature and ineffective.[122]

Assuming, for the sake of argument, that the first continuation statement was effective, the so-called "savings clause" may have rendered the

115. O.C.G.A. § 11-9-403(8). As originally adopted, the final words of the subsection were "the effective date of this act," a phrase that was changed in 1988 to "March 26, 1986." 1988 Ga. Laws 13, 15.

116. 129 B.R. 702 (Bankr. M.D. Ga. 1991).

117. *Id.* at 702-05.

118. *Id.* at 707.

119. O.C.G.A. § 11-9-403(3) (Supp. 1992).

120. 129 B.R. at 705 (citing *In re* Adam, 96 B.R. 249, 252-53 (Bankr. D.N.D. 1989); *In re* Hubka, 64 B.R. 473, 475 (Bankr. D. Neb. 1986); *In re* Hays, 47 B.R. 546, 550 (Bankr. N.D. Ohio 1985); *In re* Vermont Fiberglass, Inc., 44 B.R. 505, 509 (Bankr. D. Vt. 1984)).

121. *Id.* at 707.

122. *Id.* at 706.

second continuation statement premature and ineffective. Although the court in *Rainbow* did not reach this issue, arguably the 1986 savings clause rendered irrelevant the maturity date stated in the lender's first continuation statement. If so, then it might be contended that the first continuation statement renewed the effectiveness of the financing statement until October 1990. Under that view, assuming that continuation statements must be filed within six months prior to lapse, the second continuation statement was woefully premature as well.

The decision in *Rainbow* should prompt lenders worried about priority disputes to carefully review the timing of the filing of prior continuation statements if they are relying upon priority predating the 1986 amendments. The decision in *Rainbow* is being appealed. If it correctly interprets Georgia law, however, no doubt many lenders have permitted their financing statements to lapse at some point because of an innocent misunderstanding like that evidently involved (or arguably involved) in *Rainbow*.[123] Lenders who discover potential lapse problems should take every opportunity to obtain appropriate subordination agreements or acknowledgements from competing lienholders before those lienholders become aware of the lender's dilemma.

D. Do Georgia Usury Laws Apply to "Untrue" Leases?

For many reasons, leasing has become an increasingly common substitute for secured lending. Georgia usury laws do not apply to true leases because there is no "loan or forbearance of money."[124] Consequently, attorneys often overlook the possible application of Georgia usury laws in structuring and unravelling "lease" transactions that might be governed by Georgia law. Lessor's attorneys typically consider the "lessor's" priority as a secured party in the event that a "lease" is deemed to be a disguised security agreement. The possible application of usury laws should be considered as well. If the alleged lease "truly" involved an outright sale and conveyance of a security interest, then arguably it also involved a loan or forbearance of money.

No Georgia case addresses the application of usury laws to disguised leases. Courts in other jurisdictions, however, have applied the voluminous U.C.C. Article 9 precedent to distinguish false and true leases for

123. Once a financing statement has lapsed, it is not revived by the filing of an untimely continuation statement. Kubota Tractor Co. v. Citizens & S. Nat'l Bank, 198 Ga. App. 830, 833, 403 S.E.2d 218, 222 (1991); *see also In re* Super Trends, 7 B.R. 532 (Bankr. M.D. Ga. 1980) (In which financing statement filed March 31, 1972 and continuation statement filed March 31, 1977, financing statement *not* revived).

124. Bailey v. Newberry, 52 Ga. App. 693, 695, 184 S.E. 357, 358 (1935).

usury law purposes.[125] If the "lease" is found to be a disguised loan, these courts then test the interest rate under the applicable state usury law.

The consequence to the lessor qua lender can be dramatic. If the "untrue" lease is found to violate Georgia usury laws, the penalty may be forfeiture of all interest.[126] And the typical "untrue" lease could violate Georgia usury laws in many different ways. For example, most leases do not disclose interest charges in simple interest terms as is required in Georgia for all loans with a principal amount of two hundred fifty thousand dollars or less.[127] Also, it is quite common upon default and "foreclosure" in a lease setting for the lessor to seek a deficiency judgment for the accelerated balance of the lease obligations despite the *en banc* decision of the court of appeals in *Adams v. D & D Leasing Co.*[128] holding that there must be a reduction to present value.[129] If the "lease" is untrue, the lessor's demand almost surely includes substantial unearned interest and may violate the Georgia usury law requirement that most unearned interest be rebated.[130] The typical lessor demand may also raise criminal usury problems like those discussed in *Norris v. Sigler Daisy Corp.*[131] and *Moore v. Comfed Savings Bank.*[132]

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125. *See, e.g.*, Hill v. Bentco Leasing, Inc., 708 S.W.2d 608 (Ark. 1986); Kinerd v. Colonial Leasing Co., 800 S.W.2d 187 (Tex. 1990).

126. *See* O.C.G.A. § 7-4-10(a) (1989).

127. *Id.* § 7-4-2(a).

128. 191 Ga. App. 121, 381 S.E.2d 94 (1989).

129. *Id.* at 123, 381 S.E.2d at 96.

130. O.C.G.A. § 7-4-2(b)(1) (1989).

131. 260 Ga. 271, 392 S.E.2d 242 (1990).

132. 908 F.2d 834 (11th Cir. 1990). Under Georgia law it is a misdemeanor for any person to charge or take more than 5.0% per month in interest on "any loan or advance of money, or forbearance to enforce the collection of any sum of money, . . . either directly or indirectly, by way of commission for advances, discount, exchange, or the purchase of salary or wages; by notarial or other fees; or by any contract, contrivance, or devise whatsoever." O.C.G.A. § 7-4-18(a) (1989). This limit overrides all other general and special usury statutes in Georgia and establishes a fixed upper limit for a lender's return on any type of loan transaction. 260 Ga. at 271, 392 S.E.2d at 242.

The decisions in *Norris* and *Moore* are reviewed in James C. Marshall, *Commercial Law*, 42 MERCER L. REV. 107, 119-21 (1990). Incidentally, Mr. Hilary P. Jordan astutely observed in a conversation with the author that the interest rate formula adopted by the supreme court in *Norris* results in a substantially lower interest rate figure than would be produced by the typical, simple interest calculation. The typical calculation recognizes that the principal balance declines during the life of a loan like that involved in *Norris* whereas the *Norris* formula assumes a constant principal balance for the life of the loan. The formula chosen by the court in *Norris* may permit simple interest rates in excess of 5.0% per month.

The decisions in *Norris* and *Moore* were applied in several survey period decisions. Southern District Bankruptcy Judge John Dalis followed both decisions in holding that a nonrebatable (even upon early pay-off or default) loan fee in the amount of $2,371.58 on a $23,715.90 principal amount, combined with the first month's $288.49 interest payment yields a first month interest charge of 11.2%, contravening the 5% monthly cap. *In re* Dent, Lessors concerned that their lease agreements may be "untrue" would be well advised to comply with Georgia usury laws as if the lease agreement were actually a loan agreement. Certainly, in light of the decisions in *Norris* and *Moore*, lessors should include a phrase in the lease providing for the rebate of all unearned fees and points upon prepayment to the extent (and only to the extent) needed to avoid a violation of Georgia's limitations on usury.

However, an appropriate savings clause is not itself sufficient to avoid the usury problems highlighted by the decisions in *Norris* and *Moore*. If the lessor (now "lender") makes a usurious demand, that demand can be difficult or impossible to retract, as is indicated by the decision of the supreme court in *Bell v. Loosier of Albany, Inc.*[133] In *Bell* the court concluded that a usurious demand contained in an "acceleration plus the filing of a complaint" could not be cured by later amendment of the complaint lessening the demand to a nonusurious amount.[134] Consequently, lessors concerned about a usury defense should conduct a usury analysis before making any demands and should consider reducing any potentially usurious demands to a nonusurious amount before making the demand. Whether such a reduction is appropriate may depend, in part, upon the lessor's judgment concerning the likelihood of a usury defense, the real benefit of the usurious demand versus the nonusurious demand and the rather severe consequences of a successful usury defense, if one is asserted. For their part, lessees aware of the usurious nature of a lessor's demand might be well advised to await the filing of a complaint before alerting the lessor to the usury problem. It is unclear from the decision in *Bell* whether a lessor can effectively undo a usurious demand prior to filing suit.

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130 B.R. 623 (Bankr. S.D. Ga. 1991). *See also In re* Evans, 130 B.R. 357 (Bankr. S.D. Ga. 1991). Judge Dalis refused to allow this "loan fee" to be spread over the life of the loan. Such spreading would have reduced the first month's payment below usury levels.

Southern District Judge Avant Edenfield, however, has questioned both Judge Dalis and the Eleventh Circuit's decision in *Moore*. In Johnson v. Fleet Finance, Inc., 785 F. Supp. 1003 (S.D. Ga. 1992), Judge Edenfield suggested that both Judge Dalis and the *Moore* panel misapplied Georgia law because they found the lenders' behavior morally offensive. *Id.* at 1008-1009. Judge Edenfield would allow all discount points and other interest charges to be spread over the life of the loan to determine whether the interest in each month violates the criminal interest cap. Judge Edenfield's approach purposefully ignores the possibility of an early payment of the loan.

133. 237 Ga. 585, 229 S.E.2d 374 (1976).

134. *Id.* at 585-86, 229 S.E.2d at 375.