BLOGS

Franchise Sales/Transactions

Lender's Private Foreclosure Sale to Franchisor Deemed Commercially Reasonable Under California UCC

In *Jack in the Box, Inc. v. Mehta*, 2014 U.S. Dist. Lexis 68519 (N.D. Cal. May 19, 2014), the court approved the request of Jack in the Box ("JIB") to modify an existing order authorizing JIB to operate restaurants owned by previously terminated franchisees, as the court approved a private foreclosure sale of the restaurant assets by GE Capital Bank ("GECB"), a secured creditor of the franchisees, to JIB. Mehta's franchise agreements and leases were terminated by JIB due to payment defaults. In a lawsuit, JIB obtained a "turnover order" allowing it to take over operation of Mehta's restaurants. JIB then sought to modify the order to allow a private foreclosure sale by GECB to JIB.

Mehta objected to the proposed sale, arguing that it would not result in the highest and best price for the restaurant assets. In California, a secured creditor such as GECB has many options available to it upon a default by its obligor. Under the commercial code, it may "sell, lease, license, or otherwise dispose of any or all of the collateral in its present condition or following any commercially reasonable preparation or processing." A disposition of collateral is commercially reasonable if made in the usual manner on any recognized market, is made at the price current in any recognized market at the time of the disposition, or is made otherwise in conformity with reasonable commercial practices. Whether a transaction disposing of collateral was reasonable is generally a question of fact that depends on all of the circumstances existing at the time of sale.

In the present case, JIB negotiated a private deal with GECB to purchase GECB's collateral, comprised primarily of restaurant equipment and fixtures. The court found the private foreclosure sale to be commercially reasonable because (1) the asset purchase agreement was negotiated at arms-length between two sophisticated parties, (2) the price paid by JIB was the highest value since the equipment was being sold "in place" to allow for the continued operation of the restaurants, and (3) the terms of the purchase agreement were consistent with the terms of the California commercial code provisions. In short, the court found the private foreclosure sale between the franchisor and the secured creditor to be commercially reasonable under the circumstances.

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