

14 months if payments were made in a timely manner. In signing the note, they were purchasing from FNB \$20,000 worth of used restaurant equipment they would use to operate the restaurant. The equipment became the collateral securing the obligation. Although historical details were sketchy, it appears that they made a deal with FNB to buy equipment and run a restaurant in an existing restaurant location in the building space they would be renting from the bank. Both testified that the restaurant initially belonged to defendant Papadopoulos, but both parties worked together in the restaurant as owners. They made payments of \$400 each for two months.

2. On January 29, 1993, two months after the defendants signed the note and before they had obtained a written lease from FNB, the FDIC seized FNB and took over its assets. The defendants continued to operate the restaurant in the building then in the hands of the FDIC. They stopped making payments on the note. They claim they did not know to whom they should make payments, yet they worked hard to try to negotiate with FDIC representatives for a lease of the restaurant space; the FDIC would not execute an extended written lease. After having exhausted efforts to obtain a written lease, defendant Papadopoulos eventually purchased the building from the FDIC in November of 1994 in order to guarantee the space for continued operation of the restaurant. This required him to invest capital in the building and incur expenses that he had not expected at the time the restaurant was opened, since he expected to obtain a lease of the space from FNB. Both defendants continued to operate the restaurant on a cooperative basis, although in their testimony both were evasive as to the terms of their arrangement with each other.

3. Defendant Pananas testified that in April of 1994, he bought out defendant Papadopoulos' interest in the restaurant, including the restaurant equipment, and organized the business as a corporation. Attorney Melvin Fink, who had been the attorney for both defendants in prior transactions, provided the legal work for the organization of the business by defendant Pananas. Both defendants remained liable on the original purchase money note, and there is no evidence that defendant Pananas' purchase of the business from defendant Papadopoulos included any agreement to indemnify Papadopoulos on the obligation on the note, despite Papadopoulos' prior business

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experience and the testimony that defendant Pananas became the sole owner. Even after the buy-out, although defendant Pananas was the predominant operator of the restaurant, defendant Papadopoulos continued to work there on a regular basis, and to be involved in the financial affairs of the restaurant, including writing checks to pay routine restaurant expenses.

4. In November of 1994, Federal Financial Company [hereinafter FFC], which is based in Illinois, purchased from the FDIC a portfolio of prior FNB loans, including the \$20,000 loan to the defendants. Even after the purchase, FFC did not obtain the physical file on the loan until January of 1995.

5. On January 6, 1995, an account representative from FFC wrote to each defendant by certified mail to demand payment in full, based on default regarding the terms of repayment. The letters stated that if the note balance, which was \$21,984 including interest, was not paid off by January 20, 1995, FFC would take action to secure its position.

6. On March 22, 1995, attorney Stephen Ankuda, acting on behalf of FFC, wrote to defendants Papadopoulos and Pananas to notify them to assemble the collateral and make it available to FFC for repossession and sale under the UCC. On March 31, 1995, Attorney Melvin Fink wrote to Attorney Ankuda listing the specific items of equipment constituting the collateral and offering to make it physically available upon 10 days written notice. In his letter, Mr. Fink referred only to defendant Papadopoulos as his client. Thereafter, Mr. Ankuda and Mr. Fink communicated directly about the specifics of the date and time upon which FFC's agent could pick up the collateral. Mr. Fink made arrangements about the pickup without ever telling Mr. Ankuda that he represented only Mr. Papadopoulos and did not represent Mr. Pananas.

7. Defendant Papadopoulos told defendant Pananas that the equipment needed to be assembled for pick-up by FFC. The defendants used it as an occasion to remodel the restaurant. Defendant Pananas removed all of the equipment from the restaurant, and stored it in a portion of the building that had formerly been a video store. The equipment included the booths, tables, lights, air conditioners, pizza pans, the counter-top sandwich preparation area, sink, slicer, freezer, cash

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register, telephones, trash barrels, *etc.* -- essentially everything needed to operate the restaurant. Defendant Papadopoulos took \$9,000 in cash, and traveled to Massachusetts to a restaurant that had had a fire and was selling its equipment. He purchased replacement equipment for Bravos. The defendants spent a total of \$10,000 to remodel the restaurant. The booths that they bought were not of a quality as good as the ones the defendants removed and piled in the video store. Nonetheless, the restaurant was completely refitted with the replacement equipment that defendant Papadopoulos bought, and the equipment the defendants had originally purchased was left in storage for FFC. Although at trial the defendants claimed that the restaurant has belonged solely to defendant Pananas since 1994, and that they had had a parting of the ways at some point, much of their detailed testimony was inconsistent with this assertion. The court finds that both defendants continued to be actively involved in the ownership and management of the business of the restaurant throughout the period from November 1992 to the present. The details of their relations with each other remain unclear.

8. Following the discussions between attorney Ankuda and Attorney Fink, an FFC representative contacted Stan and Son to pick up the equipment from the restaurant location and take it to the Stan and Son warehouse for storage. On June 9, 1995, Charles Horton, who at that point had worked for Stan and Son for 5 and one-half years, went to the restaurant property with a co-worker to pick up the equipment. Defendant Pananas was there, by prearrangement, and showed them where the equipment was. A few items had been left out in the rain and were in a deteriorated condition. Charles Horton hauled all the equipment back to the Stan and Son warehouse in Westmoreland, New Hampshire. On June 14, 1995, Stan and Son sent FFC's attorney a bill for \$435 for equipment removal and trucking.

9. Stan and Son has been in the business of buying and selling and trading new and used equipment for restaurants and groceries for 35 years. It regularly purchases repossessed equipment from banks. It has its own warehouse for storage, and it also engages in the business of trucking and storing equipment, as it did in this case for FFC. The usual pattern is that a bank will ask it to

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remove and store repossessed items. Then, nine times out of ten, the bank inquires whether Stan and Son is interested in purchasing the equipment. Once Stan and Son acquires ownership of used equipment, it arranges to sell it at an auction conducted for the purpose, or it adds individual items to other auctions or groups several lots of equipment for a single auction, or it sells equipment at its own showroom at its warehouse. Seventy per cent of its business involves used equipment. It has five competitors, who are located between Massachusetts and New York. It is clearly a dealer in used restaurant equipment, and a regular participant in a recognized market for used restaurant equipment. Its manager, Charles Horton, has sufficient knowledge and experience to be able to make knowledgeable appraisals of used restaurant equipment in the market area. By simultaneously operating removal and storage services, it is able to develop opportunities to make advantageous bids on equipment that it has already been asked to remove and store. Charles Horton testified that it would lose business if the prices at which it offered to buy equipment were too self-serving, but when Stan and Son is already responsible for storing equipment that will eventually need to be sold, it is well situated to be a potential buyer. Under those circumstances, any opinion of value it renders, unless there is independent appraisal information or the presence of competing bidders, most likely reflects its status as a bidder making an opening offer, rather than the opinion of an independent expert offering an opinion of the value at which the property would sell on the open market between a seller under no pressure to sell and a buyer under no compulsion to buy.

10. FFC's representative asked Stan and Son if it was interested in bidding on the equipment it was holding in storage. On June 14, 1995, Stan and Son made a bid of \$1,010.00 for the equipment, and submitted in writing a list of the equipment and the price it was offering for each of the items on the list. This was clearly labeled an "Equipment Bid" (Plaintiff's Exhibit 4), and contains the following language: "This is a bid on the equipment that was removed from the premises at 371 River Road, North Springfield, VT. on June 9, 1995." Although Charles Horton testified at the hearing that \$1,010.00 represented the fair market value of the equipment constituting the collateral as of June 9, 1995, it is clear that when the bid was made, it was a bid for purposes of purchasing the property,

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and not an independent appraisal of the property. FFC never obtained any independent information from any other source about the value of the property.

11. Used restaurant equipment generally sells for at least one-third of its cost new. Clean equipment in good condition will bring more than half of the cost new; equipment in bad condition is difficult to sell at all. Restaurant equipment that is worth \$20,000 in place in a restaurant setting, such as at an auction or sale that is held on site, can be worth as little as \$2,000 if the same equipment is sold in bulk from storage "off site". Most of the equipment that Stan and Son removed from Bravo's on June 9, 1995 was generally usable, although some items needed minor repairs. It was the same equipment the defendants had purchased two and one-half years earlier from the bank for \$20,000.

12. Stan and Son was paid \$435 for removal of the equipment, trucking to its warehouse, and storage.

13. On June 20, 1995, FFC's attorney wrote a letter to Mr. Fink informing Mr. Fink on behalf of both defendants that the property would be sold at private sale to Stan and Son for \$1,010.00 on or after July 5, 1995 "if we do not hear an objection to this sale from you or your clients." Mr. Ankuda named both Georgios Papadopoulos and Angelo Pananas as Mr. Fink's clients. Mr. Fink never contacted Mr. Ankuda to inform him that Mr. Fink did not represent Mr. Pananas. Given the history to date, it was reasonable for Mr. Ankuda to give notice to both defendants through Mr. Fink as the attorney for both of them, and his letter made plain the fact that he was intending to do just that.

14. The defendants raised no objection, and FFC sold the equipment to Stan and Son for \$1,010.00. Stan and Son disposed of the equipment in a variety of ways, including sale at its warehouse, repair and sale, and tax deductible donation. On May 29, 1997, Stan and Son had for sale at its warehouse some of the pizza pans it purchased from FFC. Stan and Son had purchased pizza pans for 50 cents each. They were for sale at the warehouse for \$2.00 each. They were in a condition similar to, or better than, the condition of pans currently in use at Bravo's restaurant. Stan and Son disposed of the equipment at sales prices or benefit values in excess of an aggregate value of

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\$1,010.00.

15. Mr. Pananas testified that in his opinion, the value of the equipment removed on June 9, 1995 was between \$5,000 and \$7,000. Mr. Papadopoulos testified that at that time the equipment was worth \$8,000. Neither specified whether their values were based on in-place or off-site condition.

16. FCC claims a deficiency judgment in the amount of \$26,355.11, which is the balance due with interest after deduction of the net received on the sale of equipment to Stan and Son, plus \$1,861.75 in attorneys fees and costs.

CONCLUSIONS OF LAW

1. The Vermont Supreme Court has ruled consistently over a substantial period of time that a creditor who seeks a deficiency judgment following the repossession and sale of collateral must prove entitlement by meeting specific prerequisites. The Court has stated clearly that because allowing a deficiency judgment after repossession of the collateral is in derogation of the common law, strict compliance with statutory requirements is a condition precedent to obtaining such a judgment. Failure to meet these requirements is an absolute bar to a deficiency judgment in any amount. Chittenden Trust Co. v. Andre Noel Sports, 159 Vt. 387 (1992); Chittenden Trust Co. v. Maryanski, 138 Vt. 240 (1980). This approach has been in place both before and since the adoption of the UCC. The Court has enforced strict compliance with the requirements of 9A V.S.A. § 9-504(3) to ensure that debtors' interests in the value of the collateral are fully protected by the manner in which the creditor disposes of the collateral.

2. The first of the two significant requirements of § 9-504(3) is that the debtors have notice of any sale of the collateral. This is important because it gives debtors the opportunity to make sure interested purchasers have the chance to buy the property at a market value that is fair to the debtor. Adams v. B&D Builders & Developers, Inc., 144 Vt. 353, 357 (1984). In this case, defendants claim that although Mr. Papadopoulos received notice of the impending sale through a letter addressed to

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his attorney Melvin Fink, at the time of the notice Mr. Fink was not representing Mr. Pananas, and therefore there was no notice to Mr. Pananas. However, during the period of repossession and sale of the collateral Mr. Fink's correspondence on behalf of Mr. Papadopoulos purported to cover both debtors' interests in the property. Mr. Fink made arrangements for possession to be transferred to the creditor without clarifying that he was not acting on behalf of Mr. Pananas, who was specifically involved in arranging for transfer of possession and was physically present when the transfer occurred according to the terms of Mr. Fink's letter. More importantly, the letter giving notice of the sale of collateral, which was a letter from Attorney Ankuda to Attorney Fink dated June 20, 1995, specifically referred several times to "your clients" and included Angelo Pananas by name. There was a period of two weeks before the sale during which Mr. Fink could have clarified that he did not represent Mr. Pananas, and he did not do so. Mr. Fink has represented both debtors throughout this case, including on several motions, and he had represented Mr. Pananas previously when Mr. Pananas organized corporate status for the restaurant. Defendants' attempt to assert lack of notice on technical grounds after the fact is a pretext, and does not defeat the plaintiff's claim for a deficiency judgment. See Adams (constructive notice sufficient). Nonetheless, the issue is moot in view of the court's conclusion on the second prerequisite to a deficiency judgment as set forth below.

3. The second prerequisite to a deficiency judgment is that each and "every aspect of the disposition including the method, manner, time, place and terms must be commercially reasonable".

9A V.S.A. § 9-504(3). This requirement is clarified in 9A V.S.A. § 9-507(2):

(2) . . . 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 reasonable commercial practices among dealers in the type of property sold he has sold in a commercially reasonable manner. . . .

This issue is at the heart of this case. The question is whether FFC's method, manner, time, place and terms were commercially reasonable in its disposition of the collateral. The court concludes that it was not.

In this case FFC sold at a private sale to the party storing the collateral on its behalf.

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obtained no independent appraisals, valuations, or bids to establish the market value of the collateral. It placed the collateral in the possession of a dealer in that type of collateral for storage, paid the dealer for transportation and storage, and then asked the very same dealer for a price bid without obtaining any independent information about whether the offer was "the price current in such market" (*i.e.*, the market in used restaurant equipment in New Hampshire, Vermont, and western Massachusetts). It is predictable that the offer Stan and Son would make for the collateral would be a value that would be advantageous to it, since it knew it already had possession of the collateral, and that therefore FFC would probably want to avoid further transaction costs. There is no evidence that Stan and Son, as a dealer, would sell such collateral in that manner, or at that price, on its own behalf. *See Jackson State Bank v. Beck*, 577 P.2d 168, 170 (Wyoming 1978) (price received when creditor purchases collateral from self does not suffice to show fair market value); Granite Equipment Leasing Corp. v. Marine Development Corp., 230 S.E.2d 43, 45 (Georgia App. 1976) (private sale at low price does not sustain burden of proving fair market value at time of repossession); Luxurest Furniture Manufacturing Co. v. Furniture Warehouse Sales, Inc., 209 S.E.2d 63, 65 (Georgia App. 1974), *rev'd on other grounds*, 214 S.E.2d 373 (Georgia 1975), *conformed to*, 215 S.E.2d 292 (creditor who wears two hats by accepting his own bid only emphasizes the self-serving aspect of the sale, and does not provide sufficient evidence of fair market value). Indeed, the evidence is that it would not. Its own method of disposing of the collateral was to sell it individually for higher prices. This is amply demonstrated by the fact that Stan and Son bought the pizza pans at the offer price of fifty cents each, and then later sold them for \$2.00 each.

The statute requires FFC to sell the collateral "in conformity with reasonable commercial practices among dealers in the type of property sold". FFC never found out what dealers would do to maximize their return from the sale of such collateral; instead it gave Stan and Son the opportunity to obtain the collateral at an advantageous price and dispose of it to its benefit, all in derogation of

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the interests of the debtor.¹ Other indicia of commercial reasonableness are whether or not there is a big discrepancy between the value of the collateral at the time the debtor purchased it, and the amount of the sale price. FMA Financial Corp. v. Pro-Printers, 590 P.2d 803 (Utah 1979) (discrepancy between appraised price and sale price); Granite Equipment Leasing Corp. v. Marine Development Corp., *supra* (discrepancy between sale price and value of collateral); Mercantile Financial Corp. v. Miller, 292 F. Supp. 797 (E.D. Penn. 1968) (goods sold for substantially less than the price originally paid, and less than price received on resale). In this case, the debtors purchased used equipment in November of 1992 for \$20,000, and FCC claims that it was worth only \$1,010 in June of 1995, two and one-half years later, yet Stan and Son obtained higher prices when it later sold the collateral, as shown by the fact that it offered the same pizza pans for sale at four times the price. In addition, the evidence showed that restaurant equipment that is worth \$20,000 in place can be worth only \$2,000 "off site" in a bulk sale. Here, the FCC is responsible for the decision to convert the collateral from "in place" to "off site" by asking for it to be assembled for pick-up and storage, and therefore the FCC is responsible for the resulting diminishment in value. The evidence shows that a commercially reasonable manner of disposing of used restaurant equipment is to sell it "in place". Stan and Son itself represented that such was the preferred method of disposition among dealers. Mr. Papadopoulos also testified that he acquired the replacement equipment by buying it at a restaurant that had a fire, indicating that the person responsible for disposing of that equipment had preferred the "in place" method of disposition even when there had been a fire. The court is not suggesting that in every case, restaurant equipment has to be sold "in place". However, as a matter of law, the burden is on the party seeking a deficiency judgment to show that all aspects of the sale were commercially reasonable. In this case, for the variety of reasons described, FCC has not met its

¹ It does not matter that the debtors had notice of the sale, because notice to the debtor does not undercut the independent requirement that all aspects of the sale must take place in a commercially reasonable manner. It is the burden of the creditor (or creditor's assignee as in this case) to prove its entitlement to a deficiency judgment by first showing that its sale took place in a commercially reasonable manner, separate and apart from the notice requirement. *Cf. Exumest, supra*, at 65 (debtor took no action with respect to the notice of private sale, claiming press of bankruptcy).

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burden. This conclusion is consistent with conclusions reached in other cases in other jurisdictions with similar circumstances. See Smith v. Daniels, 634 S.W.2d 276 (Tenn. App. 1982) (manner of advertising inadequate to reach persons interested in purchasing the type of equipment); United States v. Cawley, 464 F. Supp. 189 (E.D. Wash. 1979) (very little effort to locate potential purchasers); FMA Financial Corp. v. Pro-Printers, *supra* (Utah 1979) (creditor's meager efforts to sell equipment, and low price obtained); Granite Equipment Leasing Corp. v. Marine Development Corp., *supra* (wide discrepancy between sale price and value of collateral); Mercantile Financial Corp. v. Miller, *supra* (assets neither sold in usual manner nor sold in conformity with reasonable commercial practices among dealers in the type of property sold).

4. A significant problem in this case, one that one intuitively balances off against the conclusion that the sale was not commercially reasonable, is that the result appears to result in a windfall for the debtors. The defendants borrowed \$20,000 from the bank and made only two payments of \$400 each. They used the collateral for over two years, and then when the loan was called, they took \$9,000 in cash on hand and used it to buy replacement equipment for the restaurant rather than repay the loan. They then left the collateral stored in a spare room for FFC to take away. When they received notice of the sale, they did nothing to protect their interests by trying to maximize the sale price. As a result of the court's conclusion that the sale was not commercially reasonable, defendants will have no further liability on their loan, and this outcome appears unjust. The defendants' position is that the result is fair given the circumstance that the same bank that loaned them the money never gave them the promised lease, under which they could have reliably operated the restaurant without having to buy the building. As events developed, the FDIC seized FNB's assets and defendants had to buy the building from FDIC at great complication, delay and expense. However, such considerations are not relevant as a matter of law.² The relevant consideration is which party, as a matter of law and policy, bears the greater responsibility for

² See Entry Order of January 15, 1997 granting plaintiff's motion for summary judgment based on the doctrine D'Oench Doehme.

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conducting itself in a manner to protect both creditors' and debtors' interests, and to prevent both windfalls and injustices. In this case, that burden was on FFC. Both the Vermont legislature and the Vermont Supreme Court have determined that it is the creditor who bears the responsibility of ensuring that a sale of collateral results in fair protection of the debtors' interest. The reason for that policy is aptly illustrated by this case. It is easy for repossessing banks and dealers in used equipment to fall into patterns that are advantageous to themselves in derogation of the debtors' interests in the collateral. The creditor benefits from a low sales price, because it can then acquire a substantial deficiency judgment which it can use as a lien against other assets; the dealer benefits because it acquires equipment at a low price and it can sell at leisure at a profit. If the law did not protect the debtors' interest in the value of the collateral, the debtors' position would be easily minimized. In effect, the creditors and dealers could work in tacit harmony for their mutual benefit, and shift the burden of making the creditor accountable to the debtor. This result would not be consistent with the terms and policies of the law. The law protects the debtors' interest by requiring the creditor to prove, as a condition precedent to recovery of a deficiency judgment, that any sale of the collateral occurs in a commercially reasonable manner, with notice. Otherwise the creditor is barred from any recovery at all.

While the operation of this rule may occasionally appear harsh in a given case, there are compelling reasons that substantiate it: the creditor has the opportunity to protect itself and avoid any forfeitures by making sure that its sales are conducted in accordance with normal market principles, and the certainty and predictability of outcomes under this rule are important factors in facilitating the efficiency of commercial transactions. In this particular case, FFC purchased the loan from the FDIC and took assignment of it after full opportunity to determine its value. It took a calculated risk on its value, and had the opportunity to maximize that value by paying attention to the commercial reasonableness of the sale. Its losses result from its own failure to pay sufficient detail to the market in which dealers in used restaurant equipment buy and sell such equipment. At a minimum, FFC could have obtained an independent appraisal or bid for the property, which would

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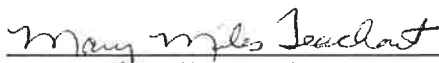
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have assured that the offer from Stan and Son would have been at fair market offer. Therefore, it is not unjust that the loss resulting from its failure to observe normal market practices should be the loss of FCC. Presumably, this outcome will assure that FCC and other creditors similarly situated will observe the requirements of 9A V.S.A. § 9-504(3) more actively, and the public policy objectives of the law will thereby be promoted.

ORDER

Judgment shall enter for the defendants. Plaintiff's action for a deficiency judgment is hereby DISMISSED, with prejudice.

Dated this 26th day of June, 1997.



Hon. Mary Miles Teachout,
Presiding Superior Court Judge

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