UCC Foreclosures on Collateral: Effectuating a Sale and Evaluating Article 9 Alternatives

Protecting Creditor and Borrower Interests and Overcoming Obstacles to the Sale

MONDAY, NOVEMBER 17, 2014

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MECHANISMS FOR DISPOSING OF DISTRESSED ASSETS: A COMPARISON OF UCC FORECLOSURES, BANKRUPTCY SALES, ASSIGNMENTS FOR THE BENEFIT OF CREDITORS, AND RECEIVERSHIPS

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Issues For Secured Party, Debtor and Buyer

- Risks to Secured Party – tax, employee obligations, lender liability, etc.
- Speed to Close – to preserve enterprise value
- Sale "Free and Clear"
- No Representations and Warranties
- Successor Liability
- Cost
- Lease and Contract Assumption
- Employee Issues
- Fiduciary Duties of Debtor's Board
- Which Vehicle/Mechanism to Use
Different Constituencies/Different Interests

• Debtor/Management/Board
  – Maximize price
  – Minimize liability for breach of fiduciary duty claims arising out of decisions made while the company is insolvent or in the zone of insolvency
  – Avoid liability under guaranties
  – Avoid tax liability

• Buyer
  – Minimize price paid and transaction costs
  – Minimize successor liability
  – Avoid competitive bidding
  – Access to management and documents for due diligence
  – Close sale quickly
  – Acquire assets free and clear
Different Constituencies/Different Interests

• Secured Party
  – Maximize price
  – Get out quickly – get bad loan off the books
  – Avoid liability for Debtor’s employee and tax obligations
  – Minimize the risk of being accused of not acting in a commercially reasonable manner
  – Avoid lender liability for “controlling” the Debtor
  – Don’t “throw good money after bad” – sometimes a loan just has to be written off
UCC Sale

- Basics
  - Need secured party with perfected security interest to cooperate
  - Debtor must be in default – 9-601(a)
  - No judicial proceedings required
  - Secured party forecloses lien and sells assets through agreement (Bill of Sale, Foreclosure Sale Agreement)
  - Title, but not possession, transferred – implications on consent of Debtor
  - Sale free and clear of foreclosing & junior liens, not senior liens – 9-617(a)
  - Typically lower transactions costs than alternatives
  - Contracts and leases cannot be assumed and assigned
  - Private vs. public sale
UCC Sale

• Private Sales
  – Specified buyer; no auction or overbid process
  – Secured Party may not bid at private sale
    ▪ limited exception essentially for publicly traded securities – 9-610(c)(2)
  – Notice requirements:
    ▪ contents – 9-611(c)
    ▪ safe harbor notice – 9-613
    ▪ time required – 10 days – 9-612(b)
    ▪ 25 days for federal tax liens – 26 U.S.C. § 7425(c)(1)
    ▪ check statutes for state tax lien notice requirements
    ▪ review UCC search
  – No disclosure of identity of buyer or terms of sale
  – No risk to buyer of being outbid
UCC Sale

• Public Sales
  – Auction or other competitive bidding through licensed third party auctioneer or investment banker
  – Formal marketing process
  – Secured party may credit bid – 9-610(c)(1)
  – Notice requirements – same as private sale
  – Safe harbor for public sales notice – 9-613
  – To satisfy “commercial reasonableness,” should publish as well – 2 places
  – Also notify potential purchasers
  – Allow inspection
  – Public disclosure to notice parties and auction attendees
  – Risk of a buyer being outbid
UCC Sale

• Commercial Reasonableness
  – All sales must be commercially reasonable – 9-610(b)
  – Definition not practical – 9-627(b)(3):
    ▪ “in conformity with reasonable commercial practices among dealers in the type of property that was the subject of the disposition”
  – Price obtained is not dispositive – 9-627(a)
  – Commercial reasonableness important to deficiency, but also in minimizing fraudulent transfer and successor liability risks
    ▪ Good idea for secured party to try to maximize value
    ▪ Cast a wide net for notice of public sale
    ▪ Get evidence of value
    ▪ Market the collateral (have debtor do it)

• Additional Steps for Mitigating Risk of Fraudulent Transfer and Successor Liability
  – Undersecured secured party example
  – Don’t sell to an insider; and if you do, do public sale
  – No “Clear Channel” risk in UCC sale
UCC Sale

• Additional Risks
  – Involuntary Bankruptcy
  – Voluntary Bankruptcy or Injunctive Relief
    ▪ Where cooperation of Debtor for transfer of possession not necessary because collateral is intangible
  – No Court order
  – No third party exercising independent judgment for transaction
  – Challenges raised after the fact

• Conclusion on UCC Sales
  – Viable option to transfer assets as going concern
  – Benefits and drawbacks
  – Under right circumstances, UCC Sale is comparatively inexpensive, efficient and quick
363 Sale

• How it works
  – Debtor files bankruptcy, typically Chapter 11
  – Debtor brings motion to approve bid procedures and sell under Bankruptcy Code Section 363
  – Court typically holds two hearings – bid procedure hearing and sale hearing
  – Stalking horse bidder and an opportunity to overbid through auction process
  – Court issues sale order
363 Sale

• Pros
  – Because Court approval is required and results in a sale order, objections and challenges raised before closing – by the time buyer closes, buyer and secured party have comfort level
  – Sale free and clear of liens, claims, encumbrances
    • Exception for junior liens not paid in full from sales proceeds – Clear Channel v. Knupfer (In Re PW, LLC), 391 B.R. 25 (9th Cir BAP 2008)
    • Distinguishing Clear Channel – e.g., In Re Boston Generating, 440 B.R. 302, 333 (Bankr. SDNY 2010) (foreclosure actions under state law satisfy 363(f)(5)); In Re Jolan, Inc., 403 B.R. 866 (Bankr. W.D. Wash 2009) (state legal and equitable proceedings exist where junior lienholder can be compelled to accept money satisfaction); In re NAMCO Capital Group, Inc. (Bankr. C.D. Cal. 2011, Case No. CV 10-0766-GAF) (unpublished) (notwithstanding Clear Channel, 363(m) renders moot free and clear sale order under 363(f)); In Re Nashville Senior Living, LLC, 407 B.R. 222 (9th Cir. BAP 2009) (same).
    • Title insurance
  – Risk of successor liability virtually eliminated, but order may be overridden by certain liabilities – e.g., environmental
  – With some exceptions (e.g., personal service and certain IP contracts), contracts and leases can be assumed and assigned over objections of third parties
  – Debtor’s management protected from breach of fiduciary duty claims by order
  – Cap on lease rejection damages
  – No risk of secured party not acting in commercially reasonable manner
363 Sale

- Cons
  - Expensive – administrative costs and buyer, secured party, or both often have to contribute
  - Creditors Committee may have to be "compensated"
  - Slowest – 45-60 or more days (but Arizona case - 21 days from petition date to date of auction/sale hearing – helped that purchase price doubled from stalking horse bid)
  - Risk of being outbid
  - Every term of sale is public record
  - Loss of control to the bankruptcy court
Assignment for the Benefit of Creditors

• How it works
  – Debtor assigns all of its assets to a third party assignee
  – Third party assignee liquidates assets for Debtor’s creditors
  – Proceeds of liquidation are distributed according to priority
  – Assignee may be able to pursue preferences
  – ABCs commonly used to effectuate distressed asset sales
  – Because ABC and sale occur without court involvement and notice, any challenges are made post-closing
Assignment for the Benefit of Creditors

• Pros
  – Faster than 363 Sale – as soon as 1-10 days after assignment
  – Cheaper than 363 Sale
  – In California, Assignee can occupy leased premises for up to 90 days following the assignment by paying rent at the lease rate, even if the lease allows the lessor to evict the lessee upon making an assignment for the benefit of creditors (Cal. Civ. Code § 1954.1)
  – Best when secured party is vastly undersecured and cooperative
  – Assignee might not require marketing and auction (if valuation and pre-assignment marketing)
  – Can be done in conjunction with UCC Sale to wipe out junior liens
Assignment for the Benefit of Creditors

• Cons
  – Less protection from successor liability
  – Assets cannot be sold free and clear of liens without consent of lienholders, including secured party (exception for combined UCC Sale)
  – Buyer closes before knowing whether there will be challenges to sale
  – Contracts and leases cannot be assumed without consent of third parties
  – Board can be accused of making ABC = breach of fiduciary duty (mitigate risk by D&O policy)
  – Involuntary Bankruptcy risk
  – May not be available if Debtor is in multiple states
Equity Receivership

• How it works
  – Typically, secured party files lawsuit seeking appointment of receiver - Court appoints neutral third party as receiver
  – Receiver’s duties are subject to statute and court order – can include operating the business, selling property
  – Receivers can be appointed in federal or state court
  – Receiver must account to the Court
Receivership

• Pros
  – Receiver is appointed at instance of secured party; helpful if Debtor consents
  – Receivership allows business to operate to preserve enterprise value
  – Successor liability risk is reduced
  – Neutral court-appointed officer makes decisions, which protects secured party and Debtor
  – In California, receiver can sell personal property (California Code of Civil Procedure §568.5)
  – In California, secured party can credit bid (California Code of Civil Procedure §701.590(b))
  – In California, liens junior to secured party and all state tax liens (irrespective of priority) may be extinguished upon sale (California Code of Civil Procedure §701.630) [does 701.630 apply to receivership sales under 568.5?]
  – Unlike ABCs, national remedy under federal receiverships
Receivership

• Cons
  – Same cons as 363 sale – expensive, slow, risk of being outbid, terms of sale public record, loss of control to court and receiver
  – Operational issues – receiver may not be able to operate Debtor efficiently
  – Cannot force non-Debtor parties to assume contracts
  – Secured party (or another creditor) must be willing to seek appointment of receiver
  – Involuntary Bankruptcy risk
Control Under Each Vehicle/Mechanism

• 363
  – Debtor determines whether to file bankruptcy
  – Parties have less control because Court must approve everything
  – Creditors Committee and US Trustee can weigh in
  – Management maintains operational control in Chapter 11 so long as no Chapter 11 trustee is appointed

• ABC
  – Debtor determines whether to make ABC
  – Secured party’s consent is required because assignee cannot sell assets free and clear of secured party’s lien without secured party’s consent
  – Once ABC is made, control shifts to assignee
  – No Court oversight, so parties can act without risk of Court disapproval before the fact
Control Under Each Vehicle/Mechanism

• Receivership
  – Secured party (or even unsecured creditors) can seek the appointment of a receiver
  – Having the consent and cooperation of the Debtor is helpful, but not required
  – Parties have less control because receiver maintains operational control and the court must approve everything

• UCC Sale
  – Secured party determines whether to foreclose
  – Cooperation of Debtor practically (though not legally) required if Debtor is in possession of its tangible assets; otherwise, secured party and/or buyer must seek judicial relief since parties cannot exercise self help if doing so will breach the peace
  – No Court oversight, so parties can act without risk of Court disapproval before the fact
## Comparison Grid

<table>
<thead>
<tr>
<th></th>
<th>363 Bankruptcy Sale</th>
<th>ABC Sale</th>
<th>UCC Sale</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Legal and Business Due Diligence</strong> [Same across the board]</td>
<td>Must be performed</td>
<td>Must be performed</td>
<td>Must be performed</td>
</tr>
<tr>
<td><strong>Speed to Close</strong> [ABC/UCC/363]</td>
<td>Slowest – 45-60 or more days from filing of petition assuming executed APA as of petition date; requires court approval</td>
<td>Fastest – 1-10 days after ABC and execution of APA; no court oversight</td>
<td>Second fastest – At least 10 days after notice provided under UCC</td>
</tr>
<tr>
<td><strong>Sale “Free and Clear”</strong> [363/UCC/ABC]</td>
<td>Best protection – court order</td>
<td>Least protection – sale is free and clear of only those liens of consenting creditors</td>
<td>Second best – if foreclosing creditor is perfected and senior, all liens extinguished (except those not subject to foreclosure)</td>
</tr>
<tr>
<td><strong>Protection from Successor Liability and other Creditor Action against Buyer</strong> [363/ABC or UCC depending on facts]</td>
<td>Best Protection – court order – tougher to get if buyer is insider of seller; tort claims may be excluded from protection</td>
<td>Lesser Protection – maximized if assets were shopped pre-ABC, competitive bidding, sale to non-insider and assignee has independent valuation of assets; best when consenting senior creditor is significantly undersecured</td>
<td>Lesser Protection – maximized if public (rather than private) sale, aggressive advertising and notice, foreclosing creditor is significantly undersecured</td>
</tr>
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<td>Comparison Grid</td>
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<td><strong>363 Bankruptcy Sale</strong></td>
<td><strong>ABC Sale</strong></td>
<td><strong>UCC Sale</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Relative Cost (Not including Buyer’s due diligence costs, which should be about the same across the board) [UCC/ABC/363]</strong></td>
<td>Most expensive – significant professional fees and administrative costs</td>
<td>Middle ground – assignee’s fees and fees of assignee’s counsel</td>
<td>Cheapest</td>
</tr>
<tr>
<td><strong>Contracts and Leases [363/ABC or UCC]</strong></td>
<td>Best – can be assumed and assigned over non-debtors’ objections (with some exceptions) under Section 365</td>
<td>Cannot be assumed and assigned without consent of non-debtors; must negotiate; assignee can occupy leased premises up to 90 days after assignment by paying lease rate</td>
<td>Cannot be assumed and assigned without consent of non-debtors; must negotiate</td>
</tr>
<tr>
<td><strong>Competitive Bidding [Fact Specific]</strong></td>
<td>Almost always required, but can often negotiate bidding protections</td>
<td>At discretion of assignee – less likely required if assignee has independent valuation of assets, consenting senior secured creditor is undersecured, and buyer is not insider</td>
<td>Not required if private sale; in public sale, all noticed parties will be entitled to bid</td>
</tr>
<tr>
<td><strong>Protection of Seller’s Management (Important to Buyer because may affect Seller’s preferences) [363/ABC or UCC]</strong></td>
<td>Best Protection – court order (however, under BAPCPA, creditors could accuse mgmt of breach of fiduciary duties b/c preferences are harder and reclamation claims easier to establish)</td>
<td>Lesser protection – no court or other oversight (however, added protection for choosing ABC because preferences easier to establish and increase recovery to creditors)</td>
<td>Lesser Protection – Foreclosing creditor does not require Seller’s consent, but objecting creditor could fault Seller’s management for not filing bankruptcy</td>
</tr>
</tbody>
</table>
UCC Foreclosures: Protecting Creditors' and Borrowers' Interests:

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Overview:
Article 9 Foreclosure

- **Default**
  - Article 9 Remedies can only proceed after a default by the debtor.
  - A “default” is typically determined by the contractual agreement in place, so long as that definition is not manifestly unreasonable.
  - The UCC does not define a default.

- **Remedies**
  - Collection. *UCC §9607*
  - Dispositions. *UCC §9610*
  - Strict Foreclosure. *UCC §9620*
Article 9 Foreclosure: General Considerations

- Interested Parties
- Notice
- Rights and Duties
  - Rights that can not be waived
  - Post-default Waivers
- Commercial Reasonableness and Failure to Comply
  - When Deficiency or Surplus an Issue
Article 9 Foreclosure: Interested Parties

- **Interested Parties**

  - **Debtors**: Those who have a stake in the proper enforcement of a security interest by virtue of their non-lien property interest in the collateral.

  - **Obligors**: Those who, with respect to an obligation secured by a security interest, (1) owe payment or performance of the obligation (2) have provided property other than the collateral to secure such payment or performance or (3) are otherwise accountable for payment or performance of the obligation.
Article 9 Foreclosure: Interested Parties

- **Interested Parties**
  - **Secondary Obligors**: Those who have a stake in the proper enforcement of the security interest because either (1) they have a secondary obligation to pay the secured debt or (2) they have a right of recourse against the debtor or another obligor with respect to an obligation secured by collateral.
    
    • Secondary Obligor under the law of suretyship. A “Guarantor” is a secondary obligor.
  
  - **Secured Parties**: Those who have a security interest in the collateral.
Article 9 Foreclosure: Notice

- Who Receives Notice
  - Debtors
  - Secondary Obligors
  - Other Secured Parties and Lienholders

- A Secured Party does not owe a duty to provide notice to:
  - A debtor or obligor unless the secured party knows that the person is a debtor or obligor, knows the identity of such person and how to communicate with such person.
  - Another secured party or lien holder that has filed a financing statement against a person unless the secured party knows the person is a debtor and the identity of such person. *UCC §9605*
Article 9 Foreclosure: Rights and Duties

- Rights and Duties Generally
  - Rights that cannot be waived. *UCC §9602*
    - Collection and enforcement of collateral. *UCC §9602(3)-(4)*
    - Disposition of collateral. *UCC §9602(7)*
    - Secured Party’s liability for failure to comply with Article 9 *UCC. §9602(13)*
  - Agreement on Standards Concerning Rights and Duties. *UCC §9603*
    - The parties may determine by agreement the standards measuring the fulfillment of rights and duties, even if they cannot be waived. *UCC §9603(a)*
      - The standards must not be manifestly unreasonable. *UCC §9603(a)*
  - Post-default Waivers. *UCC §9624*
    - Notice of Disposition. *UCC §9620*
    - Redemption of Collateral. *UCC §9623*
Commercial Reasonableness

- Commercially reasonable collection, disposition and application of proceeds. *UCC §§ 9607(c), 9608(a)(3), 9610, 9615(c) and 9627*
- Every aspect of a disposition must be commercially reasonable. *UCC §9610(a)-(b)*
  - Method/Manner; Time; Place; “Other Terms”
- Any collection and enforcement by a secured party must be commercially reasonable.
- Failure to Comply may result in damages and loss or reduction of deficiency.
  - *UCC §§ 9625 and 9626*
Article 9 Foreclosure: Commercial Reasonableness

- **Safe Harbor (§9627(b)(c))**:  
  - Usual manner in “recognized market”  
  - Current price in “recognized market”  
  - Conform with reasonable commercial practices among dealers in the particular type of collateral  
  - Judicial approval

- “Recognized Market” is very narrow
Examples of Commercially Reasonable Sales

  - Secured party had a duty to conduct its disposition of aircraft in a commercially reasonable manner even though the debtor had abandoned the aircraft to the secured party in connection with its assignment for the benefit of creditors. The secured party’s disposition was commercially reasonable because it was conducted through a reputable, experienced broker who sold the aircraft in a manner consistent with standard industry practice. Specifically, the broker marketed the aircraft, obtained offers from various entities, rejected a low bid, and ultimately sold the aircraft for the best offer it could get at that time. While the fair market value of the aircraft on the day it was abandoned determines whether there was a deficiency at all, i.e., whether the sale was commercially reasonable, the deficiency owed must be based on the actual sales price.

- **Center Capital Corp. v. PRA Aviation, LLC, 2011 WL 442107 (E.D. Pa. 2011)**
  - Disposition of a plane was commercially reasonable when the secured party used a reputable broker in a manner consistent with standard industry practice, aggressively marketed the aircraft for three months, rejected two low bids, and sold the plane for the best offer it received.

- **People’s United Equipment Finance Corp v. Hartmann, 447 Fed. Appx. 522 (5th Cir. 2011)**
  - Public sale of equipment at which the secured party was the only bidder was commercially reasonable because the sale was conducted in accordance with industry standards and various pricing resources indicated the sale price was the fair market value as of the date of the sale.
Article 9 Foreclosure: Commercial Reasonableness

Sales Not or Possibly Not Commercially Reasonable

  - Despite a Cayman Islands choice-of-law clause in the security agreement covering a yacht, Florida law governed the liability of the guarantor because the guaranty so provided and the secured party so agreed during the early stages of the litigation. Thus, the guarantor's liability required analysis of whether the secured party complied with the Article 9 rules relating to disposition of the collateral. The secured party's disposition of the yacht was not commercially reasonable because: the price was $300,000 less than the next lowest offer and $2.5 million less than the asking price; the yacht captain recommended against the sale; the broker did not market the yacht to European buyers even though the yacht was geared to the European market due to its style and European manufacture, and the European yacht market was stronger; the broker failed to market the boat aggressively; and the broker advertised the yacht as a bank repo. Because the secured party failed to rebut the presumption that a commercially reasonable sale would have yielded the amount of the secured obligation, the guarantor was not liable for the deficiency. However, pursuant to a clause in the guaranty agreement by which the guarantor promised to reimburse the secured party for the reasonable costs of preserving and liquidating the collateral, the guarantor was responsible for the dockage fees, repairs and maintenance costs, insurance premiums, and taxes incurred by the secured party after it took possession.

  - Secured party was not entitled to summary judgment on the sale of dump trucks via a public online auction where its only evidence was an affidavit by the auction house manager stating that such sale “typically commands fair market value and therefore a commercially reasonable price”, whereas an affidavit by the debtor's owner indicated among other things, that she was familiar with industry standards for the sale of construction equipment, that the auction did not comply with such standards and that the bidders were not permitted to inspect the equipment.
Article 9 Foreclosure: Commercial Reasonableness

  - Secured party did not prove that its private sale of an airplane was commercially reasonable even though the secured party claimed the sale price exceeded the appraised value of the collateral because the secured party did not provide any evidence that the sale was conducted in conformity with industry standards.

  - Secured party did not conduct a commercially reasonable sale of chattel paper because it made no reasonable efforts to market the loan portfolio, it provided limited and conflicting notification of the sales, the auctioneer made no effort to solicit bids from individuals or entities in the industry by placing ads in trade publications and instead merely placed ads in the Boston Herald, which resulted in insignificant interest and a single bid from the secured party. However, this did not render the sale void and the debtor’s bankruptcy trustee failed to prove that any damages resulted.
Article 9 Foreclosure: Failure to Comply

- Basic Obligations of a Secured Party
  - Act in good faith. *UCC §§ 1203 and 9102*
  - Proceed in commercially reasonable manner

- Consequences: A person aggrieved by a secured party’s failure to comply may seek injunctive relief or recover damages for losses caused by non-compliance
  - A Secured Party may suffer from a loss or reduction of deficiency
Article 9 Foreclosure: Failure to Comply

- Persons entitled to recover damages for Secured Party’s non-compliance:
  - Debtor
    - Damages include losses due to the debtor’s inability to obtain alternative financing. §9625(b)
    - No consequential, special or penal damages. *UCC §1305*
  - Obligor
  - Holder of security interest in or lien against the collateral
**Article 9 Foreclosure: Failure to Comply**

- Minimum statutory damages of $500 for Secured Party’s failure to comply with specified provisions in which recovery may be had by the debtor. These include:
  - Failure to comply with the duties of a Secured Party who has control and receives an authenticated demand by the debtor. *UCC §9208*
  - Failure to comply with the duties of a Secured Party (assignee) when an account debtor has been notified of assignment and there is no outstanding secured obligation and the Secured Party (assignee) is not committed to incur obligations. *UCC §9209*
  - Failure to comply with the duties of a Secured Party who receives a request for accounting or list of collateral by the debtor. *UCC §9210*
Article 9 Foreclosure: Failure to Comply

- **Loss or Reduction of Deficiency**
  - If the secured party’s compliance is placed at issue, the secured party must prove compliance.
  - If the secured party cannot prove compliance, the deficiency is presumed to be eliminated. UCC §9626, cmt. 3
  - The secured party may rebut this presumption.
  - Dispositions vs. Acceptance in Satisfaction.
Article 9 Foreclosure: Failure to Comply

- Potential for Multiple Recoveries for a single disposition

- Potential that every party may be affected by non-compliance
  - Secured Party – lose deficiency
  - Second secured party – sue for losses
  - Debtor – sue for loss of surplus
Article 9 Foreclosure: Specific Remedies

- **Dispositions. UCC §9610**
  - Notification. *UCC §§ 9611, 9612*
  - Content. *UCC §9613*
  - Application of Proceeds. *UCC §9615*
  - Transfers. *UCC §§9617, 9619*

- **Collection. UCC §9607**
  - Application of Proceeds. *UCC §9608*

- **Strict Foreclosure. UCC §9620**
  - Proposal to Accept Collateral. *UCC §9621*
Public Dispositions. *UCC §9610*

- Requirements for Public Sale:
  - Meaningful opportunity for the public to competitively bid.
  - Meaningful opportunity = **access** and **publicity**

- Characteristics of a Public Disposition:
  - Often involves a public auction
  - An investment banker may be involved to solicit bids
  - May involve a stalking horse bidder
Public Dispositions. *UCC §9610*

- **Access:** A public disposition must take place on accessible property, during normal business hours and provide a meaningful opportunity for the public to bid.

- **Collateral available for inspection:** A public disposition should usually be held where the collateral is located, so that the public has an opportunity to inspect the collateral.
Article 9 Foreclosure: Specific Remedies - Dispositions

- Public Dispositions  *UCC §9610*
  - Publicity
    - Notice: time, place, terms of sale, collateral
    - Intangible Collateral:
      - Publicizing intangible collateral, such as membership interests and partnership interests, poses different issues because such collateral lacks a specific location
      - If the interest is in an entity that owns real estate in a single jurisdiction, local newspaper advertising may suffice
      - For collateral that consists of a multi-state business, wider advertising (including regional or national advertising) may be necessary, including advertising where the actual sale is to take place
Article 9 Foreclosure: Specific Remedies - Dispositions

- Private Dispositions:
  - A private sale is any sale that does not provide a meaningful opportunity for the public to competitively bid
    - Fewer Publicity Requirements

- Secured Party’s ability to bid

- Private Sales are encouraged by Article 9. *UCC §9610, comment 2*
Article 9 Foreclosure: Specific Remedies - Dispositions

- **Notification** *UCC §9611*
  - Authenticated
  - Parties Entitled to Receive Notice: Debtor, Secondary Obligors and Other Secured Parties and Lienholders

- **Adequate Lien Search**
  - Secured Parties or Lienholders that Notify Foreclosing Secured Party
  - Any Other Secured Party or Lienholder Perfected by Filing of a Financing Statement Properly Filed
  - *Safe Harbor*: Request information 20-30 days prior to the notification date. *UCC §9611(e)*
  - *Federal Tax Lien*: must consider Internal Revenue Code regulations.

- **Appropriate Office**
  - Certify results if possible
Article 9 Foreclosure: Specific Remedies - Dispositions

- **Timeliness of Notification** *UCC §9612*
  - Reasonable time before the date of disposition.
  - *Safe Harbor:* 10 days or more before disposition. *UCC §9612(a)*

- **Notification Date**
  - The earlier of date secured party sends notification to debtor and any secondary obligor or the date the debtor or any secondary obligor waives right to notification.
Article 9 Foreclosure: Specific Remedies - Dispositions

- Content of Notification  *UCC §9613*
  - Notification Must:
    - Describe debtor and secured party
    - Describe the collateral
    - Provide the method of disposition
    - Describe the time and place of disposition
  - Private Disposition: Debtor is entitled to notification of “time after which” a private disposition is to be made.  *UCC §9613(1)(E)*
    - State debtor is entitled to an accounting of unpaid debt
  - *Safe Harbor: UCC Form §9613*
  - Exceptions
Article 9 Foreclosure: Specific Remedies - Collection

- Collection and Enforcement by Secured Party. *UCC §9607*
  
- In General: This gives secured parties the right to collect collateral and to exercise the rights of the debtor against others.

  - Example: the right to collect accounts receivable and the right to require an account debtor to perform under its contract with the debtor.

  - A secured party is now entitled to notify an account debtor or “other person obligated on collateral” to make payment or “otherwise render performance.”
**Article 9 Foreclosure: Specific Remedies - Collection**

**Application of Proceeds.** *UCC §§ 9608; 9615*

- Cash proceeds are applied
  - FIRST, to expenses;
  - SECOND, to attorneys’ fees incurred (but only if provided by the agreement and not prohibited by law);
  - THIRD, to the obligations secured; and
  - FOURTH, to obligations secured by a junior security interest if the secured party has received an authenticated demand from the junior before distribution of the proceeds.

- In general, a secured party must pay a debtor for any surplus and the obligor will be liable for any deficiency.
  - Exception: debtor is not entitled to any surplus and obligor is not entitled to any deficiency if the underlying transaction is a sale of accounts, chattel paper, payment intangibles or promissory notes.

- A secured party need not apply non-cash proceeds for collection and enforcement unless failure to do so is commercially unreasonable. *UCC §§ 9608(a)(3) and 9615(c)*
Article 9: Specific Remedies – Strict Foreclosure

- **Strict Foreclosure:** Acceptance in Full or Partial Satisfaction. *UCC §9620*

- **Notification of Proposal: Recipients**
  - Debtor (debtor generally *must* consent)
  - Any party that sends secured party notice of security interest prior to debtor’s consent
  - If a partial satisfaction, any secondary obligor
  - Any party that held a security interest perfected by the filing of a financing statement 10 days before debtor consented
    - (Note: no lien search *safe harbor*)
Article 9: Specific Remedies – Strict Foreclosure

- Notification of Proposal: Content. *UCC §9621*

  - Amount (or calculation) of the secured obligations to be satisfied
  
  - Conditions (if any) under which the proposal may be revoked
  
  - Any other applicable conditions
Article 9: Specific Remedies – Strict Foreclosure

- **Strict Foreclosure: Full Satisfaction**
  - Notification of proposal
  - No objection to notification within 20 days of sending notification
  - Generally, Debtor must consent to acceptance
    - Deemed consent after 20 days and unconditional proposal
  - Possession is not required. *UCC §9620, cmt. 7*
Article 9: Specific Remedies – Strict Foreclosure

- **Strict Foreclosure: Partial Satisfaction**
  - Notification of proposal
  - Secured party must receive no objection within 20 days of sending notification
  - Debtor must consent to acceptance
  - Possession is not required. *UCC §9620, comment 7*
Article 9: Specific Remedies – Strict Foreclosure

- **Strict Foreclosure: Effect**
  - Discharge the secured obligation under which the acceptance occurs
  - Transfer to the secured party the debtor’s rights in the subject collateral
  - Discharge subordinate security interests and subordinate liens. *UCC §9622*
Rights of Transferee. *UCC §9617*
- General Rule: A good faith transferee (buyer) at a foreclosure sale acquires the collateral: (i) free of the debtor’s rights; (ii) free of the foreclosing secured party’s security interest; and (iii) free of any subordinate security interests or subordinate liens *even if the secured party had failed to comply with article 9 or the requirements of any judicial proceeding*.

Transfers of Record or Legal Title. *UCC §9619*
- A secured party may proceed under this section if (1) the collateral is subject to a certificate of title, (2) the debtor is the owner of record and (3) the secured party needs to become the owner of record to transfer the collateral at a foreclosure.
- Note: A transfer of record or legal title to the collateral to the secured party in accordance with this section is NOT a disposition of the collateral under Article 9.
Article 9 Foreclosure: Practical Considerations

- Security Interest in Inventory that Incorporates Intellectual Property Licenses Likely Does not Extend to the Rights of the Debtor under the License Agreement
  - Federal intellectual property law generally provides that unless the license agreement provides otherwise, the rights of the licensee under the license agreement are not assignable without the consent of the assignor.
  - Generally, license agreements do not permit the assignment of the licensee’s rights.
  - While Section 9-408(c) of the UCC provides that provisions of state law that would impair the creation, attachment, or perfection of a security interest are ineffective, this section is not able to override provisions of federal law regarding intellectual property that have this effect.
  - Even if Section 9-408(c) did apply to federal law, it would not enable a secured party itself to sell the inventory which incorporates the intellectual property without the consent of the owner of the intellectual property.
Article 9 Foreclosure: Practical Considerations

- Steps to Take in Order to Maintain a Security Interest in the Inventory with Licensed Intellectual Property
  - The secured party should obtain a consent from the licensor authorizing the secured party to sell the inventory, subject to the payment of certain specified royalties to the licensee.
  - Generally, the licensor should be willing to do so as it would generate royalties in a situation where the inventory may not otherwise be sold.
  - There may be some negotiation as to whether the secured party is entitled to conduct a going out of business sale, or whether the inventory must be sold to other retailers or through more normal channels.
  - The secured party may want to have the right to reserve against the credit line for the royalties so it can be sure that these amounts are paid.
Article 9 Foreclosure: Practical Considerations

- Impact of the License Agreement on the Ability of the Debtor to Reorganize
  - While obtaining a consent from the licensor should enable the secured party to sell the inventory, there is significant uncertainty as to whether the debtor would be able to assume the intellectual property licenses in in a reorganization proceeding under Chapter 11 of the Bankruptcy Code.
  - While some courts have held that the right of the debtor-in-possession to assume these license agreements is not contingent on their right to assign them to a third party, other courts have come to a different conclusion based on the language in the Bankruptcy Code.
  - As a result, it may not be possible for a debtor that relies on such license agreements to consummate a reorganization plan without the consent of the licensor.
Article 9 Foreclosure: Practical Considerations

- Determining Which Method of Foreclosure to Use
  - Conforming asset based loan where the collateral is comprised primarily of accounts receivable – collect the accounts receivable
  - Lender is interested in acquiring ownership of the collateral and is not concerned about maintaining the deficiency claim
    - use strict foreclosure
  - Third Party Foreclosure sale – use a public auction or a private sale
Special Collateral Issues: Foreclosure on Stock

- Both federal and state securities laws usually prohibit the public sale of unregistered securities.
- Membership interests in a LLC and LP are sometimes considered “securities”
  - Concern: public sale of stock
- Foreclosing Secured Party must:
  - publicize the sale sufficiently to satisfy the requirements of a public sale.
  - not take actions that may constitute a public offering of unregistered securities
  - Code recommends limiting the scope of advertising and publicity to those parties who satisfy an “accredited investor” standard. *UCC §9610, comment 8*
Special Collateral Issues: Foreclosure on Stock

- The SEC has issued certain no-action letters generally setting forth the following requirements:
  - Selling the pledged securities as a block to a single purchaser (no splitting up)
  - The purchaser represents that the securities will be taken with investment intent (and not with a view toward sale or distribution)
  - The securities will be subject to transfer restrictions, by bearing a legend that the securities may not be sold or transferred without registration
  - Seller will provide on request to any prospective purchaser information that the seller has concerning the issuer of the securities
  - The public auction will be conducted as prescribed under the UCC
Article 9 Foreclosure: Practical Considerations

- Special Collateral Issues: Membership Interests in Delaware LLC
  - Del. Code Ann. Title 6, Section 18-702 – Assignment of an interest does not allow an assignee to become a member
  - An assignee of LLC units has no right to participate in the management of the company or exercise any rights or powers of the members, unless expressly provided by the operating agreement or all members approve
  - Even if the operating agreement allows the assignee to exercise rights and powers of a member, the assignee cannot manage the LLC until either (1) all non-assigning members approve of the transfer of management power or (2) the procedure for complying with the transfer of management responsibilities, as stated in the operating agreement, is followed