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Enforcing Security Interests Outside of
Bankruptcy: Remedies Under the Uniform
Commercial Code

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Introduction to Remedies Under the Uniform Commercial Code (the “UCC”)

- Article 9 of the UCC (“Article 9”) provides a secured party with choice of remedies upon the occurrence of an “Event of Default” upon an obligation secured by personal property:
 - Foreclosure by Private Sale [9-610]
 - Foreclosure by Public Sale [9-610]
 - Acceptance of Collateral [9-620]
 - Judicial Enforcement [9-601]
 - Collection Rights [9-607]
- First, an overview of the process for each remedy.
- Second, issues arising in foreclosure upon mezzanine collateral.

Foreclosure by Private Sale or Public Sale [9-610]: Commercial Reasonableness

- Duty of commercial reasonableness on “[e]very aspect of a disposition of collateral, including the method, manner, time, place, and other terms”. [9-610(b)]
- Cause of action for damages against secured party if secured party fails to conduct a commercially reasonable disposition. [9-625(b)]
- Reduction in deficiency if secured party fails to prove conduct was commercially reasonable. [9-626(a)]
- Fact that a greater amount could have been obtained by a collection, enforcement, disposition, or acceptance at a different time or in a different method is not sufficient to preclude secured party from establishing that the collection, enforcement, disposition, or acceptance was commercially reasonable. [9-627(a)]

Foreclosure by Private Sale or Public Sale [9-610]: Commercial Reasonableness

- Safe harbor: A sale of collateral will be “commercially reasonable” if made:
 - in the usual manner on any recognized market;
 - at the price current in any recognized market; or
 - in conformity with reasonable commercial practices among dealers in the particular type of collateral. [9-627(b)]

A “recognized market” is one in which the items sold are fungible and prices are not subject to individual negotiation. [9-610, *Cmt. 9*]

- Agreement by parties: Parties may determine “reasonableness” by agreement if the standards are not manifestly unreasonable. [9-603]

Foreclosure by Private Sale or Public Sale [9-610]: Commercial Reasonableness

- Commercial reasonableness is a question of fact determined on a case-by-case basis. In re Excello Press, Inc., 890 F.2d 896 (7th Cir. 1989).
- Ford & Vlahos v. ITT Com. Fin. Corp., 8 Cal 4th 1220 (1994):
 - Advertised public sale of plane in local Phoenix newspapers.
 - Court: Not commercial reasonable because a type of collateral normally sold through dealers, not advertised in local newspapers.
- Highland CDO Opportunity Master Fund, L.P. v. Citibank, N.A., 2016 WL 1267781 (S.D.N.Y. Mar. 30, 2016):
 - Advertised auction in Wall Street Journal and investment bank conducting auction circulated information to 150 contacts.
 - Court: Commercially reasonable because prospective bidders were sophisticated financial entities able to obtain the auction information.

Foreclosure by Private Sale or Public Sale [9-610]: Notice

- Notice to be provided to specified “interested persons” :
 - “debtors”;
 - “secondary obligors;”
 - any secured party perfected by a financing statement;
 - any person sending an authenticated notification of a claim of an interest in the collateral; and
 - any secured party perfected by compliance with statute, regulation or treaty [9-611].
- Notice must be reasonable as to the manner in which it is sent, its timeliness and its content. [9-611, *Cmt. 2*]
- Safe-harbor for notice sent after default and 10 days before the earliest time of sale set forth in the notice. [9-612(b)]

Foreclosure by Private Sale [9-610]

- Article 9 “encourages private dispositions on the assumption that they frequently will result in higher realization on collateral for the benefit of all concerned”. [9-610, *Cmt. 2*]
- Secured party may purchase collateral at a private sale only if :
 - “the collateral is of a kind that is customarily sold on a **recognized market**; or
 - the **subject of widely distributed standard price quotations**”. [9-610(c)(2)]
- Notice: Notice only needs to include the “time after which” the sale is to be made. [9-613]

Foreclosure by Public Sale [9-610]

- “[A] ‘public disposition’ is one at which the price is determined after the public has had a meaningful opportunity for competitive bidding.” [9-610, *Cmt. 7*] “Meaningful opportunity” implies:
 - “some form of advertisement or public notice” must precede the sale; and
 - the public must have access to the sale. [9-610, *Cmt. 7*]
- Advertising: Placement of an ad must be made with reference to the stated goal of maximizing participation by the public.
- Notice: Notice must include the time and place of the sale. [9-613]

Acceptance of Collateral/“Strict Foreclosure” [9-620]

- Process for acceptance of collateral:
 - Proposal
 - Notice
 - Objections
 - Acceptance
 - Transfer Statements
- Debtor cannot unilaterally cause acceptance; secured party must consent in authenticated record or send proposal. [9-620, *Cmt. 5*]
- Secured party is bound by its agreement to accept collateral and by any proposal to which the debtor consents. [9-620, *Cmt. 6*]
- Failure to comply with Article 9 will not prevent discharge of subordinate interests. [9-622(b)]

Acceptance of Collateral/“Strict Foreclosure”

[9-620]: Full Satisfaction and Unconditional

- Proposal is unconditional **and** in full satisfaction of the obligations.
- Acceptance:
 - **No objection from the debtor** within 20 days after transmittal of proposal [9-620(c)]; and
 - No objection received from (1) a person to which the secured party was required to send notice or (2) any other person holding a subordinate interest in the collateral. [9-620(a)]
- Secured party's acceptance of collateral:
 - discharges the obligation;
 - transfers all of a debtor's rights in the collateral to the secured party;
 - discharges the security interest that is the subject of the proposal and any subordinate security interest or other subordinate lien; and
 - terminates any other subordinate interest. [9-622(a)]

Acceptance of Collateral/“Strict Foreclosure”

[9-620]: Partial Satisfaction or Conditional Proposal

- Proposal is conditional **or** in partial satisfaction of the obligations.
- Acceptance:
 - Agreement by the debtor “in a **record authenticated after default**” [9-620(c)]; and
 - No objection received from (1) a person to which the secured party was required to send notice or (2) any other person holding a subordinate interest in the collateral. [9-620(a)]
- Secured party's acceptance of collateral:
 - discharges the obligation **to the extent consented** to by the debtor;
 - transfers all of a debtor's rights in the collateral to the secured party;
 - discharges the security interest that is the subject of the proposal and any subordinate security interest or other subordinate lien; and
 - terminates any other subordinate interest. [9-622(a)]

Judicial Enforcement [9-601]

- After default, secured party may reduce a claim to judgment, foreclose, or otherwise enforce the claim, security interest, or agricultural lien by any available judicial procedure. [9-601(a)]
 - Judicial foreclosure
 - Execution as a judgment creditor upon the collateral
- Article 9 provides a “safe harbor” for purposes of “commercial reasonableness” for any collection, enforcement, disposition, or acceptance “approved in a judicial proceeding” [9-627(c)]
- Approval in a judicial proceeding need not be obtained, and lack thereof does not mean that the collection, enforcement, disposition, or acceptance is not commercially reasonable. [9-627(d)]

Collection Rights [9-607]

- Article 9 authorizes the following remedies relating to collateral consisting of a “payment intangible” or an “instrument”:
 - Notification of an “account debtor” or other person obligated on collateral to pay to the secured party. [9-607(a)(1)]
 - Collection of proceeds under Section 9-315. [9-607(a)(2)]
 - Enforcement of the obligations of an account debtor or other person obligated on collateral and exercise the rights of the debtor in respect of the underlying obligation. [9-607(a)(3)]
- Secured party does not need to become the owner of the collateral to collect. [9-607, *Cmt. 6*]
- Secured party perfected by filing can exercise its collection rights notwithstanding the fact that another secured party perfected by possession has priority. [9-607, *Cmt. 5*]

Redemption of Collateral [9-623]

- A debtor, any secondary obligor, or any other secured party or lienholder may redeem collateral. [9-623(a)]
- To redeem collateral, a person must tender:
 - fulfillment of all obligations secured by the collateral; and
 - the reasonable expenses and attorney's fees of secured party. [9-623(b)]
- Redemption may occur at any time before a secured party:
 - has collected collateral;
 - has disposed of collateral or entered into a contract for its disposition; or
 - has accepted collateral in full or partial satisfaction of the obligation it secures. [9-623(c)]

Issues in Mezzanine Collateral

- Private Sale
 - Restrictions on ability of secured party to purchase
- Public Sale
 - Public offering restrictions
 - Commercial Reasonableness
- Intercreditor Agreements
- Article 8/Certificated Securities
- Restrictions on Transfers
- UCC Title Policy

Mezzanine Collateral: Private Sale - Restrictions on Secured Party as Purchaser

- Secured party may purchase collateral at a private sale only if:
 - “the collateral is of a kind that is customarily sold on a **recognized market**; or
 - the **subject of widely distributed standard price quotations**”. [9-610(c)(2)]
- “A market in which prices are individually negotiated or the items are not fungible is not a recognized market, even if the items are the subject of widely disseminated price guides or are disposed of through dealer auctions.” [9-610, Cmt. 9]
- Exception for “widely distributed standard price quotations” has typically been very narrowly construed by the judiciary.

Mezzanine Collateral: Public Sale - Limitations on Public Offerings

- Federal and state securities laws generally prohibit the offering and public sale of unregistered securities.
- Sale that qualifies for a “private placement” exemption under the Securities Act of 1933 may constitute “public” sale. [9-610, *Cmt. 8*]
- Securities and Exchange Commission has issued no-action letters for foreclosure sales meeting certain criteria:
 - Pledged securities are sold as a block to a single purchaser;
 - Purchaser represents that the securities will be taken with investment intent;
 - Securities will be subject to transfer restrictions (restrictive legend);
 - Pledgee provides prospective purchasers, upon request, information that the seller has concerning the issuer; and
 - Public auction is conducted in the manner prescribed by the UCC.

Mezzanine Collateral: Public Sale - Commercial Reasonableness

- Agreement by parties: Parties may determine “reasonableness” by agreement if standards are not manifestly unreasonable. [9-603]
- Vornado PS, L.L.C. v. Primestone Inv. Partners, L.P. 821 A.2d 296 (Del. Ch. Ct. 2002):
 - Provided 20 day’s notice to the debtor.
 - Retained a licensed auctioneer.
 - Hired Goldman Sachs to develop marketing process.
 - Advertised in the Chicago Tribune and the New York Times.
 - Goldman Sachs contacted 59 prospective purchasers and sent information memorandum to 33 prospective purchasers.
 - Secured party made only bid.
 - Sale found to be commercially reasonable.

Mezzanine Collateral: Public Sale - Commercial Reasonableness

- Atlas MF Mezzanine Borrower, LLC v. Macquarie Texas Loan Holder, LLC, 2017 WL 729128 (S.D.N.Y. Feb. 23, 2017).
 - Provided six weeks' notice to debtor.
 - Hired CBRE, a licensed auctioneer, to run marketing process and conduct foreclosure sale.
 - CBRE sent marketing materials to approximately 8,400 investors in the multifamily property industry.
 - CBRE and secured party uploaded 189 documents to data site.
 - 69 prospective bidders signed a confidentiality agreement.
 - Advertised in Real Estate Alert and the Wall Street Journal.
 - Sale found to be commercially reasonable.

Mezzanine Collateral: Public Sale - Commercial Reasonableness

- National Housing Partnership v. Municipal Capital Appreciation Partners I, L.P., 935 A.2d 300 (D.C. 2007).
 - Advertised public sale in the Official Notices section of The Washington Post.
 - Three telephone inquiries from prospective purchasers.
 - Secured creditor the only prospective purchasers at auction.
 - Court noted that advertising specialized collateral only in newspapers and periodicals of general circulation is likely to be inadequate.
 - Debtor introduced testimony that, interests in affordable multifamily housing are typically sold through brokers and industry contacts, not through classified advertising in newspapers and public auctions.
 - Court remand issue of commercial reasonableness.

Mezzanine Collateral: Intercreditor Agreements

- Notice and Standstill Provisions
 - In addition to UCC notice requirements, the ICA typically requires notice to parties before commencing an equity collateral enforcement action.
 - The ICA may also protect a mezz lender's right to foreclose without competing against a mortgage lender's right to foreclose against its collateral, but be mindful of required notice and limitations on time to commence or consummate a mezz foreclosure.
- Qualified Transferee (QT)
 - The mortgage lender will have negotiated through the ICA who can replace its borrower and assume the mortgage loan.
- Replacement Guaranty
 - Frequently a condition precedent to commencing or consummating is the replacement of the original sponsor's guaranties.

Mezzanine Collateral: Article 8/Certificated Securities

- Article 8 Opt-In: Equity interests in a limited liability company or partnership are “general intangibles” unless the issuer explicitly “opts in” to have the interests treated as investment property under Article 8 of the UCC (“Article 8”). [8-103]
 - “General intangibles”: Security interest perfected only by filing [9-310]; priority determined by filing order.
 - “Investment property”: Security interest perfected filing [9-312], possession [9-313] or control [9-314] ; security interest perfected by control or possession generally has priority over a competing security interest perfected by filing [9-328].
- Certificated Securities: Membership interests should generally be certificated and bear a legend regarding Article 8 election.
- Irrevocable Proxy: Prevents issuer from changing Article 8 election.

Mezzanine Collateral: Restrictions on Transfers

- Operating agreement of borrower generally contain restrictions on:
 - Assignments and transfers of membership interests
 - Grant of a security interest in a membership interest
 - Admission of a transferee as a member
- Restrictions impact two types of transfers:
 - Pledge of the membership interest
 - Transfer of the interest in the foreclosure
- “Membership interest” is not defined under Delaware state law; may be unclear as to what interest is being transferred
 - Economic Rights: payments and distributions
 - Governance Rights: admission to membership

Mezzanine Collateral: Economic Rights - Payments and Distributions

- Article 9 provides that a contractual restriction in an operating agreement is ineffective:
 - to the extent that it prohibits or restricts the **attachment, creation, perfection and enforcement** of a security interest in a **“payment intangible”**. [9-406(d)]
 - to the extent that it would impair the **creation, attachment, or perfection** of a security interest in a **“general intangible”**. [9-408(a)]
- Article 9 provisions allow secured party to enforce:
 - right to receive payments and distributions
 - attachment of a security interest without obtaining consents
- Delaware Revised Uniform Limited Partnership Act and Limited Liability Company Act override UCC Sections 9-406 and 9-408.

Mezzanine Collateral: Control Rights - Admission as Member

- Operating agreements typically require the consent of the members to admit a transferee as a member.
- UCC does not invalidate restrictions upon **enforcement** of a security interest in a “general intangible” and will not override restrictions upon admission of a transferee as a member. [9-408]
- Absent language in the operating agreement, purchaser may not be admitted as a member in the absence of the required consents.
- Purchaser would only be entitled to receive “proceeds and distributions” and not voting rights. [6 *Del. Code Section 18-702(b)*]

Mezzanine Collateral: UCC Title Policy

- Insures the attachment, perfection and priority of secured party's security instrument on membership interests:
 - Insuring secured party that debtor either has ownership rights in the collateral
 - Insuring secured party that debtor has a sufficient interest in the collateral that can be transferred to secured party

Other Topics to Consider

- Intellectual property as collateral
- Credit bidding strategies
- Provisional remedies
 - Receiverships
 - Charging orders

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