

Mezzanine Loan Foreclosures: Effectuating a UCC Foreclosure Sale and Navigating Bankruptcy Pitfalls

Protecting Lender and Borrower Interests and Overcoming Obstacles to the Sale

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Mezzanine Loan Foreclosures

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Outline

- UCC alternatives
 - Collection
 - Disposition
 - Retention
- Bankruptcy Court alternatives
 - Bankruptcy Code § 363 sale
- State law alternatives
 - Assignment for benefit of creditors
 - Receivership
 - Workout
- Effect of 2022 Amendments to UCC

Review of mezz borrower

- Review docs
 - Security agreement
 - Financing statement
 - Other perfection status
 - Is there a 'default'?
- Priority
 - Secured parties
 - Lien creditors
- Effect on underlying borrower
 - Intercreditor agreement
 - Cross-default
- Business review
 - Value of collateral

Review of underlying OpCo borrower

- Review docs
 - Mortgage documents
- Priority
 - Title policy update
- Business review
 - Value of collateral

Secured party's choices

- Collection
- Disposition
- Retention

Possession of collateral

- Has issuer of borrower equity opted in to Article 8?
- See slide 11 re possible effect of possession (or lack of possession) under Article 8
- Clarification in 2022 Amendments on idea of ‘uncertificated certificates’

Collection

- UCC § 9-607:
‘If so agreed, and in any event after default, a secured party: (1) may notify an account debtor or other person obligated on collateral to make payment or otherwise render performance to or for the benefit of the secured party . . .’
See UCC §§ 9-404 and 9-406; new UCC § 12-106
- If Part 6 applies, **commercial reasonableness** applies sometimes (discussed below)
- Collection subject to risk of:
 - Debtor’s bankruptcy, and
 - Application of automatic stay to ongoing collection efforts
 - See *City of Chicago, Illinois v. Fulton*, ___ U.S. ___ (Jan. 14, 2021)

Collection – application to security interest to secure an obligation and sales

- UCC § 9-607(e):
‘ [t]his section does not determine whether an account debtor . . . owes a duty to a secured party.’
- Which ‘assignments’ are covered by the term?
 - *Contrarian Funds, LLC v. Woodbridge Group of Cos. (In re Woodbridge Group of Cos.)*, 606 B.R. 201 (D. Del. 2019).
 - *Durham Capital Corp. v. Ocwen Loan Servicing, LLC*, 777 F. App’x 952 (11th Cir. 2019)
- PEB Commentary No. 21 Use of the Term “Assignment” in Article 9 of the Uniform Commercial Code (March 11, 2020), 75 *The Business Lawyer* 2247 (Summer 2020)
 - 2022 Amendments
 - See slide 25 re application to restrictions on transfer

Disposition

- UCC § 9-610(a):
‘After default, a secured party may sell, lease, license, or otherwise dispose of any or all of the collateral’
- Methods
 - Sale
 - Lease
 - License
 - ‘Otherwise dispose’
- Commercial reasonableness applies to every aspect (discussed below)

Retention

- UCC § 9-620:
‘Except as otherwise provided in subsection (g), a secured party may accept collateral in full or partial satisfaction of the obligation . . .’
- No protection against fraudulent transfer (Uniform Voidable Transactions Act)

Rights of secured party prior to completion of enforcement

- Debtor is owner of collateral until foreclosure is completed
 - Does not matter that equity (or other collateral, such as a vehicle) may have been registered in name of secured party for perfection or protective purposes
 - Effect of transfer of record 'title'
 - Obtain proxy to vote interests in entity?
 - Look at entity law to see if proxy will be effective
 - Possible effect of UCC § 8-207(a) ('Before due presentment for registration of transfer of a certificated security in registered form or of an instruction requesting registration of transfer of an uncertificated security, the issuer ... may treat the registered owner as the person exclusively entitled to vote, receive notifications, and otherwise exercise all the rights and powers of an owner.')
- Lender liability issues?

Commercial reasonableness – when does it apply?

- Collections
 - Only if:
 - Payment rights secure an obligation, or
 - In a sale, if buyer has recourse to the seller or secondary obligor (UCC § 9-607(c)(2)) (may still be ‘recourse’ even if still a ‘true sale’)
- Dispositions UCC § 9-610(b)
‘Every aspect of a disposition of collateral, including the method, manner, time, place, and other terms, must be commercially reasonable.’
- Does not apply to retention
- Possible effect on deficiency claims discussed below

Commercial reasonableness

- Deciding whether to have a public or a private sale
 - UCC § 9-610
 - Decision whether to have a public or private sale itself must be commercially reasonable
- Effects:
 - Secured party cannot buy at a private sale in most circumstances – UCC § 9-610(c)
 - Information in foreclosure notice to debtor and others

What is a ‘public’ and a ‘private’ sale?

- UCC § 9-610, Comment 7:
‘Although the term is not defined, as used in this Article, a “public disposition” is one at which the price is determined after the public has had a meaningful opportunity for competitive bidding. “Meaningful opportunity” is meant to imply that some form of advertisement or public notice must precede the sale (or other disposition) and that the public must have access to the sale (disposition).’

Notices – when required?

- Must give notice of proposed disposition
 - UCC § 9-611(b) (‘. . . a secured party that disposes of collateral under Section 9-610 shall send to the persons specified in subsection (c) a reasonable signed notification of disposition.’) [as revised by 2022 amendments]
- Not required in limited circumstances
 - UCC § 9-611(d) (‘Subsection (b) does not apply if the collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market.’)

Notices of disposition – to whom (UCC § 9-611(c))?

- Persons:
 - Debtor
 - UCC § 9-605(b) and 9-628(f) – duty to unknown debtor
 - Secondary obligor
 - Other secured parties who perfect by filing financing statement or under UCC § 9-311(a) in filing office then applicable for a new filing
 - Those who have requested notice
- Financing statement searches
 - Safe harbor – UCC § 9-611(e)

Notices – timing and content

- Content – UCC § 9-613
 - Public sale or private sale – UCC § 9-613(1)(C):
‘The contents of a notification of disposition are sufficient if the notification: . . . (C) states the method of intended disposition’
- Timing UCC § 9-613(1)(E):
‘The contents of a notification of disposition are sufficient if the notification: . . . (E) states the time and place of a public disposition or the time after which any other disposition is to be made.’

Commercial reasonableness

- Advertising
 - Consider underlying collateral (*i.e.*, what does the entity own)
 - Where?
 - How often?
 - Take into account likelihood of competitive bidding as against likely credit bid

Commercial reasonableness: providing data about the entity (to the extent available)

- Non-disclosure agreement
- Sale of ownership interests in single-asset entity
- Disclosures about underlying asset (often real estate)?
- Disclosure risks?
- Commercial reasonableness risks?

When can the secured party buy the collateral?

- Private sale?
 - UCC § 9-610(c) (emphasis added):
'A secured party may purchase collateral: . . . (2) at a private disposition **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.'
 - See discussion of retention of the collateral and attempt to waive this restriction
 - See discussion of 'recognized market' in 2022 UCC Amendments, § 9-620, Comment 9
- Public sale
 - UCC § 9-610(c):
'A secured party may purchase collateral: (1) at a public disposition ...'

Compliance with the securities and other laws

- Is the collateral a ‘security’ under federal or state securities law?
 - Not affected by definition of ‘security’ in UCC Article 8 or an opt-in to UCC Article 8
- Compliance with other types of laws:
 - FCC
 - Regulated items (e.g., liquor license)

Compliance with the securities laws -- Can the secured party make a 'public' sale of unregistered securities?

- '33 Act Rule 144
 - Depending on several factors, Rule 144 may permit public resales by the secured party:
 - Is the issuer a reporting company?
 - Is the debtor an 'affiliate' of the issuer?
 - How long has the debtor held the stock?
 - Secured party can 'tack' holding period of debtor (Rule 144(d)(3)(iv))
- If Rule 144 not available, use SEC no-action letters, which permit a public UCC sale if:
 - Not a subterfuge to make a public offering
 - Securities typically sold in a single or large block(s)
 - Securities typically sold to a single or small number of purchaser(s)
 - Securities acquired with investment intent
 - Securities subject to transfer restrictions
 - Bidders and buyers are financially sophisticated
 - See, e.g., General Electric Capital Corporation, 1998 WL 727229 (SEC No-Action Letter Oct. 19, 1998)

Compliance with other laws -- decisions

- *Burns v. Anderson* (United States Court of Appeals for the Fourth Circuit, No. 03-2162, December 15, 2004, unpublished opinion) – available at <http://pacer.ca4.uscourts.gov/opinion.pdf/032162.U.pdf> (secured party used appraisal process to sell thinly-traded stock, as provided for in the security agreement; sale was commercially reasonable)
- *Vornado PS, L.L.C. v. Primestone Investment Partners, L.P.*, 821 A.2d 296, 49 UCC Rep.Serv.2d 1348 (Del. Ch. 2002) (significant marketing process, including use of investment bank, by secured party to sell interests of partnership units was commercially reasonable)
- *Solfanelli v. Meridian Bank*, 206 B.R. 699 (Bankr. M.D. Pa. 1996) *aff'd* in part and *rev'd* in part 230 B.R. 54 (M.D. Pa. 1999) *aff'd* 203 F.3d 197 (3d Cir. 2000) (use of a 'market maker' with expertise in the relevant industry) to advise on the conduct of the sale of the collateral (stock traded on NASDAQ) was commercially reasonable)

Selected foreclosure issues during pandemic

- In-person foreclosure?
- Duration of marketing
- Access to information
- General status of market
- Sell selected assets or collective assets?
- Effect of temporary orders

Rights of transferee

- Effects of restriction on transfer
 - UCC §§ 9-406 and 9-408 do not apply to ‘securities’ (as defined in UCC Article 8)
 - Has there been an opt-in to UCC Article 8 under UCC § 8-103?
- Even if UCC §§ 9-406 and 9-408 do apply because interests in entity are not subject to Article 8, UCC §§ 9-406 and 9-408 may not have applicability if restrictions on transfer are in agreement among equity owners
- See slide 8 re meaning of ‘assignment’

Rights of transferee -- third-party transferee in a disposition under UCC § 9-610 – UCC § 9-617

- Rights acquired
 - UCC § 9-617(a)
'A secured party's disposition of collateral after default: (1) transfers to a transferee for value all of the debtor's rights in the collateral; (2) discharges the security interest under which the disposition is made; and (3) discharges any subordinate security interest or other subordinate lien [other than liens created under [cite acts or statutes providing for liens, if any, that are not to be discharged]].'
- Effect of secured party's failure to follow rules
 - Good faith transferee acquires these rights, even if secured party does not comply with rules – UCC § 9-617(b):
'A transferee that acts in good faith takes free of the rights and interests described in subsection (a), even if the secured party fails to comply with this article or the requirements of any judicial proceeding.'
 - Other transferees take collateral "subject to" the above interests – UCC § 9-617(c)
- PEB Commentary No. 22–Status of a Disposition Under Section 9-610 of the Uniform Commercial Code if the Transferee Does Not Act in Good Faith (August 24, 2020), 76 *The Business Lawyer* 233 (Winter 2020-2022)

Rights of transferee – secured party as transferee upon a ‘disposition’

- Not a voluntary transfer *by debtor* (UCC § 9-617, Comment 2:
‘Such a person [transferee at foreclosure] is a “transferee” inasmuch as a buyer at a foreclosure sale does not meet the definition of “purchaser” in Section 1-201 (the transfer is not vis-à-vis the debtor, ‘voluntary’).’

Consider waivers and provisions in security agreement on standards – UCC § 9-603

- Waivers:
 - Generally limited pre-default – UCC §§ 9-602 and 9-624
- Secured party and debtor may agree on standards for fulfillment of rights of debtor if standards are not ‘manifestly unreasonable’ – UCC § 9-603
- Consider including a provision where debtor acknowledges that:
 - Secured party will need to comply with SEC rules
 - Compliance with SEC rules may affect foreclosure sale price
 - Debtor agrees that sale in compliance with SEC rules can still be commercially reasonable

Retention of collateral – UCC § 9-622

- Rights acquired – similar to those in disposition – UCC § 9-622(a)
- Effect of ‘full’ retention
- Effect of failure to follow rules – UCC § 9-622(b):
‘A subordinate interest is discharged or terminated under subsection (a), even if the secured party fails to comply with this article’

Deficiency claims

- Effect of commercial reasonableness –
UCC § 9-625
- Effect of sale to secured party
 - UCC § 9-615(f)
- Effect on claims against a guarantor
 - Article 9 rules
 - Guaranty law rules

Bankruptcy Court alternatives and uses

- Effect of automatic stay (Bankruptcy Code § 362)
- Approval of foreclosure process (*see* UCC § 9-627(c))
- Transferee title free and clear of all claims?
- Lender liability protection?

Other state law alternatives

- Assignment for benefit of creditors
 - Recover fraudulent transfers?
 - Recover preferences?
 - Pending uniform law
- Receivership
 - Powers of receiver
- Workout