

# Buchalter

THE END OF THE LINE:

The Options for the Commercial Lender When the Workout is no Longer Working Out

Presented by:  
Robert A. Willner  
Joseph Vargas  
Julian Gurule

June 24, 2020

LOS ANGELES  
NAPA VALLEY  
ORANGE COUNTY  
PORTLAND  
SACRAMENTO  
SAN DIEGO  
SAN FRANCISCO  
SCOTTSDALE  
SEATTLE  
BUCHALTER.COM

## PART ONE - EXIT OPTIONS GENERALLY

1. Sale of the paper
2. Article 9 Foreclosure
  - a. Public disposition (auction)
  - b. Private disposition
3. Article 9 Strict Foreclosure - Acceptance of Collateral
  - a. Full satisfaction of debt
  - b. Partial satisfaction of debt
4. Real Estate Foreclosure
  - a. Judicial
  - b. Non-Judicial
5. Assignment for the Benefit of Creditors
6. Bankruptcy Options

## PART TWO - SALE OF THE PAPER

1. Advantages.
  - a. Can be accomplished relatively quickly. Generally the time needed to draft and negotiate a loan purchase agreement
2. Disadvantages.
  - a. Buyer will expect a discount. Sale is rarely at par.

## PART THREE – ARTICLE 9 DISPOSITION

### 1. Article 9 Public Disposition

#### a. Disadvantages.

- i. Auctions or forced liquidations generally yield the lowest net proceeds to the secured party
- ii. Generally need to hire an experienced auctioneer. This is an added expense.
- iii. Landlords generally will not permit auctions on site so secured parties often need to move the collateral to a warehouse or other site. Cost of moving is an additional expense and the value of equipment is often reduced over what could be obtained if left in place.

#### b. Advantages.

- i. Secured party may purchase

## PART THREE – ARTICLE 9 DISPOSITION

### 2. Article 9 Private Disposition

#### a. Disadvantages.

- i. Secured party may not purchase unless the collateral is a kind customarily sold on a recognized market or the subject of widely distributed price quotations

#### b. Advantages

- i. Sale to strategic buyer generally results in a higher price
- ii. Avoid the expense of an auctioneer.

## PART THREE – ARTICLE 9 DISPOSITION

### 3. Procedure for Article 9 Dispositions

- a. Every aspect of the disposition must be commercially reasonable including the method, manner, time, place, and other terms.
- b. Notice of Disposition
  - i. "Notification Date" means the earlier of the date the secured party sends an authenticated notice of disposition to the debtor and any secondary obligor, or the date the debtor and any secondary obligor waive notice
  - ii. Authenticated notice of the sale must be sent to:
    1. The debtor
    2. Any secondary obligor
    3. Any other person who before the Notification Date has sent the secured party an authenticated notice of a claim of an interest in the collateral
    4. Any other secured party who, 10 days before the Notification Date, held a security interest in the collateral perfected by filing a financing statement
    5. Any other secured party who, 10 days before the Notification Date, held a security interest in the collateral perfected by compliance with a statute, regulation or treaty

## PART THREE – ARTICLE 9 DISPOSITION

- iii. Notice not required if the collateral is perishable or threatens to decline speedily in value, or is a type customarily sold on a recognized market
  - iv. Safe harbor. Notice to all required parties will be deemed given if the secured party requests a UCC lien search between 20-30 days prior to the Notification Date, and prior to the Notification Date the secured party either did not receive the requested search, or received the search and sent a notice of disposition to each secured party listed on the search whose financing statement included the collateral.
- c. Timeliness of Notice
- i. Generally notice sent at least 10 days before the disposition will be deemed to be reasonable time.
- d. Contents of Notice. Contents of notice will be sufficient if includes:
- i. Names of debtor and secured party
  - ii. A description of the collateral
  - iii. The method of disposition
  - iv. A statement that the debtor is entitled to an accounting and the charge, if any, for an accounting
  - v. The time and place of the sale

## PART THREE – ARTICLE 9 DISPOSITION

- e. Application of Proceeds from Sale
  - i. Applied in the following order:
    1. Expenses of sale
    2. Satisfaction of the foreclosing secured party's secured debt
    3. Satisfaction of debt secured by a subordinate lien if
      - a. the foreclosing secured party receives a demand for proceeds from the junior secured party prior to the distribution of proceeds, and
      - b. the subordinate lien is senior to the interest of any consignor that has an interest in the collateral
    4. Any consignor that has an interest in the collateral if the foreclosing secured party receives a demand for proceeds from the consignor prior to the distribution of proceeds
  - ii. Unless the secured party is required to pay proceeds to a consignor, the debtor is entitled to any surplus from the sale
  - iii. The debtor is liable for any deficiency
  - iv. No surplus or deficiency if the underlying transaction is a sale of accounts, chattel paper, payment intangibles or promissory notes



## PART THREE – ARTICLE 9 DISPOSITION

### f. Rights of Purchaser

- i. Purchaser at disposition acquires all of the debtor's rights in the collateral, free of the security interest of the foreclosing secured party, and free of any subordinate security interests
- ii. Good faith purchaser not at risk if the secured party fails to comply with Article 9 requirements

### 4. Strict Foreclosure

#### a. Acceptance of Collateral can be for full or partial satisfaction of the debt

#### b. Requirements:

- i. consent of the debtor
  1. debtor's consent to an acceptance for full satisfaction of the debt will be deemed given if debtor fails to object within 20 days after the secured sends unconditional proposal to debtor
- ii. the secured party does not receive, within 20 days after the proposal was sent, an objection from:
  1. a person to which the secured party is required to send a notice of the proposal, or
  2. any other person, other than the debtor, holding a subordinate security interest in the collateral

## PART THREE – ARTICLE 9 DISPOSITION

- c. Parties entitled to notice of the proposal
  - i. Any person who before the debtor's consent has sent the secured party an authenticated notice of a claim of an interest in the collateral
  - ii. Any other secured party who, 10 days before the debtor's consent, held a security interest in the collateral perfected by filing a financing statement
  - iii. Any other secured party who, 10 days before the debtor's consent, held a security interest in the collateral perfected by compliance with a statute, regulation or treaty
  - iv. Any secondary obligor only if the acceptance is for partial satisfaction
- d. No safe harbor. The secured party assumes the risk of the filing office's delays and errors.
- e. Effect of Acceptance
  - i. Discharges the debtor's obligation to the extent of the debtor's consent
  - ii. Transfers to the secured party all of the debtor's rights in the collateral
  - iii. Discharges the secured party's security interest in the collateral and any subordinate security interest
  - iv. Any other subordinate interest in the Collateral, even if the secured party fails to comply with Article 9 requirements

## PART THREE – ARTICLE 9 DISPOSITION

### 5. Right to Redeem

- a. The debtor, any secondary obligor or any other secured party or lien holder may redeem the collateral by paying the secured debt in full and all of the secured party's expenses and attorneys' fees.
- b. Redemption may occur any time before the secured party has disposed of the collateral, or accepted the collateral in full or partial satisfaction of the debt

6. Waivers. The debtor may waive notice requirements and redemption rights only after an event of default. Pre-default waivers are not effective.

## PART FOUR - REAL ESTATE FORECLOSURE

1. Real Estate Remedial Options
  - a. Non-judicial Foreclosure (Trustee's Sale)
  - b. Judicial Foreclosure
  - c. Deed in lieu of Foreclosure
  - d. Enforcing Assignment of Leases and Rents
  
2. Impact of One Action and Anti-deficiency Rules
  - a. One Action Rule (CCP 726(a))
    - i. Under CA law, requires the creditor to seek recourse on the security first
    - ii. Limits creditors ability to take action directly on debt and against other non-pledged assets
    - iii. Does not prohibit creditor from taking action on other security such as UCC collateral
  
  - b. Anti-deficiency Rules
    - i. Prohibits a deficiency judgment against debtor after a non-judicial foreclosure
    - ii. Does not prohibit action against unsecured guarantors (provided appropriate waivers are obtained)

## PART FOUR - REAL ESTATE FORECLOSURE

### 3. Residential Considerations

- a. Many states, including CA, have special procedural hurdles to foreclosure if the property is residential and/or the loan is a consumer purpose loan
- b. These additional requirements can lengthen the foreclosure process

### 4. Non-judicial Foreclosure (Trustee's Sale)

- a. Private sale of property not requiring a judicial process (not available in all states)
- b. Advantages
  - i. Does not require the filing of a lawsuit
  - ii. Generally faster and less expensive than judicial foreclosure
  - iii. Can hold multiple sales for multi-property security
  - iv. Often results in a higher sales price (no debtor redemption right)
- c. Disadvantages
  - i. Under CA law, no deficiency judgment allowed

## PART FOUR - REAL ESTATE FORECLOSURE

### 5. Judicial Foreclosure

- a. Judicial action requesting a court order to sell property to satisfy debt (mandatory in some states)
- b. Advantages
  - i. In CA, availability of deficiency judgment after sale
  - ii. Often used in conjunction with the appointment of a receiver
  - iii. Judicial order can resolve open disputes with debtor/third parties
- c. Disadvantages
  - i. In CA, statutory redemption period in favor of debtor
    - 1. Allows debtor to maintain possession and redeem property for the final bid price at the sale
    - 2. 3 month period if debt is fully satisfied from sale proceeds
    - 3. 12 month period if debt is not satisfied from sale proceeds
  - ii. Existence of redemption right tends to result in lower sale price
  - iii. Takes longer and is more expensive than non-judicial foreclosure

## PART FOUR - REAL ESTATE FORECLOSURE

### 6. Deed in Lieu of Foreclosure

- a. Similar to UCC Strict Foreclosure
- b. Property is transferred to creditor in exchange for debt forgiveness (equivalent to sale of the property)
- c. Validity and enforceability depend on facts and circumstances
- d. Primary advantage is speed
- e. Disadvantage is title is taken by creditor subject to existing encumbrances on title (including those junior to creditor's mortgage)
- f. Creditor should:
  - i. not release mortgage
  - ii. take title in a single purpose entity
  - iii. obtain title insurance

## PART FOUR - REAL ESTATE FORECLOSURE

### 7. Enforcing Assignment of Lease and Rents

#### a. Appointment of Receiver

- i. Court action appointing receiver to enforce assignment of rents
- ii. Receiver collects rents and maintains property

#### b. Obtaining possession of rents

#### c. Making written demand on tenants

- i. Creditor makes demand to make payment directly to creditor
- ii. Generally will be authorized by standard loan documents
- iii. If there is an SNDA with the tenant, SNDA will generally provide for this

#### d. Making written demand on debtor

- i. Creditor makes demand upon debtor



## PART FOUR - REAL ESTATE FORECLOSURE

### 8. Mixed Collateral Considerations

- a. Loan secured by combination of real and personal property
- b. Separate Foreclosure
  - i. Creditor may proceed against UCC collateral in accordance with UCC rules and real property collateral under real property rules
- c. Unified Sale
  - i. Creditor may include the UCC collateral with the real property and sell together
  - ii. Real property rules apply with few exceptions
  - iii. Generally possible when personal property and real property are closely related

## PART FIVE - ASSIGNMENTS FOR THE BENEFIT OF CREDITORS

1. State Law Alternative to Chapter 7 Liquidation
2. Advantages
  - a. Faster and less expensive than Chapter 7
  - b. No court supervision
  - c. Unlike a Chapter 7 trustee, the Company can select an experienced liquidator to be the Assignee
3. Disadvantages
  - a. Slower and more expensive than Article 9 foreclosure
  - b. No court supervision
  - c. No court order approving the sale
  - d. Secured creditor consent required unless the secured creditor will be paid in full

## PART FIVE - ASSIGNMENTS FOR THE BENEFIT OF CREDITORS

### 4. Procedure

- a. Company enters into a contract with an independent third party (Assignee) which provides that the Company transfers all of its assets (but none of its debts) in trust to the Assignee. The Assignee assumes all of the Company's right, title and interest in and to the assets.
- b. Company provides the Assignee a certified list of its creditors and amounts owed
- c. The Assignee notifies the company's creditors and solicits claims
- d. The Assignee liquidates the assets and pays the proceeds to satisfy the creditors' claims in the priority of state law.
- e. Process generally takes up to 12 months to complete.

## PART SIX - BANKRUPTCY OPTIONS

### 1. Pre-Arranged Section 363 Sales

- a. The borrower and the lender can select a purchaser of the borrower's assets before filing a chapter 11 case
  - i. The purchaser will often dictate what proceeding is used to achieve the transfer of the assets – e.g., section 363 sale vs. ABC
- b. Section 363 sales for operating business are almost always subject to overbid
- c. The borrower and purchaser enter into a “stalking horse” purchase agreement
  - i. The stalking horse purchase agreement functions just like a customary, non-distressed APA, but with additional bankruptcy-specific provisions
    1. For example, the purchaser gets consent rights over the section 363 sale order
- d. Once the chapter 11 case is filed, the borrower will ask the Bankruptcy Court to approve bid procedures that will govern the sale process and auction
- e. Bid protections – expense reimbursement, breakup fees – are commonly approved

## PART SIX - BANKRUPTCY OPTIONS

2. Secured Lender Credit Bid Rights in Bankruptcy
  - a. Section 363(k) provides secured creditors with right to credit bid
    - i. As an alternative to a third-party buyer, the senior lender can act as the stalking horse
    - ii. Secured lender has ability to credit bid with respect to all collateral
    - iii. Secured lender's credit bid does not extend to unencumbered assets
      1. Accordingly, secured lender's credit bid must provide cash consideration for unencumbered assets – e.g., interests in foreign subsidiaries
3. DIP Commitment / Cash Collateral Use / Budget
  - a. Senior lenders typically provide DIP financing to fund the chapter 11 process
    - i. DIP credit agreement
  - b. Debtor must obtain lender approval for a 13-week operating budget
    - i. Ordinary course operational expenses plus chapter 11 administrative costs, including debtors' professionals (attorneys, FAs, investment bankers), Committee's professionals, US Trustee fees
  - c. Roll up of prepetition secured debt – full roll up vs. creeping roll up
    - i. Challenges – unencumbered assets

## PART SIX - BANKRUPTCY OPTIONS

### 4. Timeline

- a. 60 – 90 days, but can go longer
  - i. What affects timing?
- b. Sale milestones
  - i. Sale milestones ensure that the lender maintains control over the progress of the sale process
  - ii. Sale milestones are typically set forth in the DIP credit agreement
  - iii. Sale milestones will contemplate, inter alia, (a) filing of chapter 11 case, (b) approval of “first day” motions, (c) approval of DIP financing, (d) approval of bid procedures, (e) bid deadline, (f) auction date, (g) sale hearing date, and (h) sale closing
  - iv. Failure to abide by sale milestones would be an event of default under the DIP facility
- c. COVID-19 has impacted sale processes
  - i. Delays, GOBS

### 5. Market Test

- a. Stalking horse credit bid is subject to over-bid at auction
- b. Debtor is a fiduciary of the estate with an obligation to secure the “highest and best” bid for its assets
- c. Role of investment banker

## PART SIX - BANKRUPTCY OPTIONS

### 6. Advantages of In-Court Process

- a. Bankruptcy Court's section 363 sale order increases certainty, bidding
- b. Section 363(f) bankruptcy provides that the debtor's property may be sold "free and clear" of any interest in such property
  - i. Bankruptcy Court section 363 sale order offers "gold standard" to purchasers of distressed assets – e.g., sale order ensures that debtor's prepetition liabilities or disputes re: asserted liens do not depress sale values
- c. Process can preserve going concern value for complex businesses
  - i. Chapter 11 allows value to be maximized by addressing issues beyond the capital structure – e.g., lease and contract rejection, collective bargaining agreement and pension issues, environmental liabilities
  - ii. Complex capital structures are better addressed in-court through chapter 11 – e.g., to address dissenting holders of junior claims, ABL vs. term loan collateral issues, automatic stay
  - iii. Need for immediate new money financing often drives chapter 11 decision – first priority, priming DIP seniority is available to protect new money
    1. DIP commitment alone can provide certainty to vendors and customers

## PART SIX - BANKRUPTCY OPTIONS

### 7. Disadvantages of In-Court Process

- a. Substantially greater costs
- b. Highly visible process
- c. Potential for challenges to senior liens
  - i. Perfection and similar issues may give the creditors' committee leverage to negotiate a greater settlement
  - ii. Potential for post-sale litigation to be maintained by creditors' committee against senior lenders – e.g., unsettled collateral disputes can survive post-closing
- d. Even lenders with clean collateral packages generally provide some set aside for general unsecured creditors – even just to settle nuisance value claims
- e. Denial of credit bid rights for “cause” under section 363(k) – unlikely, but worth mentioning



# PRESENTERS



**Robert A. Willner | Shareholder | (213) 891-5107 | [rwillner@buchalter.com](mailto:rwillner@buchalter.com)**

Robert provides practical, business oriented, legal advice to his clients on how to best structure, document, and manage their lending transactions. Robert is an expert in a broad spectrum of middle-market lending, including structured finance, asset-based finance, cash flow lending, unitranche finance, acquisition financing, leveraged ESOP finance, lender finance, fund finance, tech finance, healthcare finance, cross-border transactions, equipment leasing, debtor-in-possession financing, trade finance, and factoring. Robert is also expert in problem loan workouts and restructurings, liquidations and foreclosures. His clients include commercial banks, alternative lenders, commercial finance companies, equipment leasing companies, factors, and other financial institutions.



**Joseph Vargas | Shareholder | (213) 891-5260 | [jvargas@buchalter.com](mailto:jvargas@buchalter.com)**

Joseph Vargas has a nationwide practice focused on the representation of commercial banks, private lenders and various financial institutions in a variety of real estate secured lending transactions, including acquisition, construction, rehabilitation, and bridge loan financing involving retail, industrial, office, multifamily, and hotel properties. He also has extensive experience in the representation of lenders and borrowers in various types of commercial lending transactions, including asset-based and both secured and unsecured financial transactions. Mr. Vargas also has substantial experience in the re-structuring of credit facilities, as well as advising clients through loan modification and forbearance arrangements of various credit types. His real estate transactional experience also includes the areas of acquisitions, leasing, development as well as tax motivated real transactions.



**Julian Gurule | Shareholder | (213) 891-5130 | [jgurule@buchalter.com](mailto:jgurule@buchalter.com)**

Julian represents a broad range of clients in both in-court and out-of-court restructurings, including private equity funds and other distressed investors, secured and unsecured creditors, debtors, administrative agents, indenture trustees, and purchasers of distressed assets. Mr. Gurule's practice regularly involves substantial financing, M&A, and litigation components. He has extensive experience in a variety of industries, including entertainment, hospitality, health care, gaming, retail, media, energy, real estate development, and manufacturing.

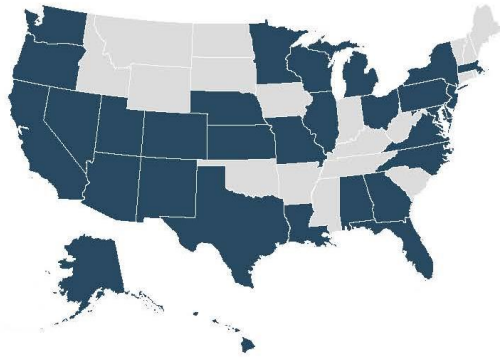
# BUCHALTER FIRM OVERVIEW

## FIRM OVERVIEW

Since the Firm's inception in 1933, Buchalter has established itself as a full-service law firm that provides counsel to clients at all stages, and helps them navigate any legal challenges and decisions they may face. Our clients are engaged in a diverse global economy governed by complex laws and regulations, and trust us as advisers and business partners.

300+ Attorneys Serving You In

14 Practice Areas | 25+ Industry Specialties | 9 Office Locations



States Where Buchalter Attorneys are Licensed To Practice

### Diversity & Inclusion

#### TOP FIRM FOR MINORITY ATTORNEYS

Named one of the best law firms for minority attorneys for the second consecutive year.



#### AMLAW 200'S TOP 50 FEMALE EQUITY PARTNERS

Buchalter ranked in top 50 of law firms in the AmLaw 200 annual ranking of the "A-List: Female Equity Partner Scorecard."



### Our Practices

Commercial Finance | Corporate | Energy & Natural Resources | Government, Regulatory & Administrative Health Care | Insolvency & Financial Law Group | Intellectual Property | Japan Practice | Labor & Employment Litigation | Privacy & Data Security | Products Liability | Real Estate | Tax, Benefits, & Estate Planning

### Premier Law Firm



LOS ANGELES | NAPA VALLEY | ORANGE COUNTY | PORTLAND | SACRAMENTO | SAN DIEGO | SAN FRANCISCO | SCOTTSDALE | SEATTLE

Buchalter