PERSONAL PROPERTY AND THE UCC: SECURED PARTIES' RIGHTS AND REMEDIES IN TROUBLED TIMES

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In uncertain times, cash may be king for investors, but collateral—security pledged for the payment of an obligation—is king for all types of asset-based lenders. Prudent lenders routinely obtain personal guarantees from the principals of their borrowers, but more often than not, when a loan becomes troubled, both borrower and guarantor are unable to easily repay it. Accordingly, few asset-based lenders are willing to make loans without assured access to collateral to satisfy the underlying obligations.

Personal property almost always constitutes an important, if not crucial, aspect of the collateral given to secure a loan. Whether the collateral is accounts receivable, inventory, equipment, the right to make capital calls for a subscription line of credit, mezzanine equity interests, or the FF&E and contractual rights of a construction borrower, personal property can be the key to a successful loan recovery–whether independently or by unlocking the value of real property collateral.

Unless a secured lender can realize the value of the collateral after a borrower default, the security of collateral is largely illusory. Secured lenders must fully understand the value of their personal property collateral, the process of properly securing the collateral, potential strategies for liquidating the collateral upon a default and the legal requirements and timelines involved in collecting and foreclosing on the collateral.

Fortunately for secured lenders, the Uniform Commercial Code (which has been adopted by Utah with some amendments and is referred to herein as the "UCC"), provides a number of self-help and judicial remedies that can streamline and simplify the personal property foreclosure process for secured lenders. Consequently, it is important that secured lenders carefully consider their rights and options under the UCC as secured parties. The process is two-fold and intuitive in concept, even if more complex in practice.

Secured lenders need to be mindful of the fact that some personal property is outside of the scope of the UCC. Typically collateral that it outside the scope of the UCC includes life insurance policies, some intellectual property which must be pledged in accordance with federal law, deposit accounts in consumer transactions and some other limited types of personal property.

After a borrower defaults, a secured lender must carefully analyze its loan collateral. A secured party's rights to intangible collateral such as accounts receivable, intellectual property rights and goodwill often follow specialized rules, and it is important that lenders carefully analyze their rights and remedies with the help of experienced counsel. In addition, if a lender's collateral package includes real estate in addition to personal property, enforcement of rights and remedies simultaneously against personal property and real property and the role of Utah's so called One Action Rule and related laws must be carefully considered.

With respect to tangible personal property, a secured lender must first either take possession or obtain control of the collateral and then realize value from it.

Taking Possession of Tangible Personal Property Collateral

There are three ways a secured lender may take possession of tangible personal property collateral under the UCC:

- **Cooperative Borrower.** In a perfect world, a defaulting borrower would simply deliver the collateral to the lender upon request. While defaults, by their very nature, occur in an imperfect world with imperfect borrowers, being fair, reasonable and transparent with a defaulting borrower encourages that borrower to respond in kind and can avoid the hassle, expense and uncertainty of forcible seizure.

- **Peaceful Seizure.** A secured lender may also seize the collateral if it can do so without a breach of the peace. Unfortunately, the UCC does not define the term "breach of the peace," and Utah case law on the issue is relatively sparse. However, many courts across the country have found that almost any resistance from the borrower—potentially even the borrower merely insisting that the secured lender, or its agent (secured lenders will typically be responsible for the actions of their third-party collections agencies) stop, is all it takes for a secured lender to breach the peace if the collection efforts are not abandoned. Furthermore, the no-breach-of-the-peace requirement may not be waived. Notably, failure to comply with this requirement is not without consequence: seizing the collateral despite a breach of the peace and without a court order may render the secured lender liable for damages to the borrower and provide a basis for a court order prohibiting (at least on a temporary basis) the collection, enforcement or disposition of the collateral. The bottom line is that secured lenders should always proceed with caution when exercising this right.

- **Court Order.** A secured lender may also resort to the judicial process and seek a court order, whether a writ of replevin or other order, compelling the borrower to turn over the collateral. This approach typically starts with the filing of a complaint alleging a borrower default and damages to the secured lender.

Realizing Value from the Collateral

Once the tangible personal property collateral is obtained, secured lenders have two options under the UCC relative to realizing the value of that collateral (subject, of course, to some exceptions and conditions): (i) retaining the collateral in partial or full satisfaction of the underlying obligation, or (ii) a private or public sale of the collateral.

Keeping the Collateral

While retention is not a permissible remedy in all scenarios (e.g., in a consumer transaction, a secured lender may not accept collateral in partial satisfaction of the obligation it secures), and there are some inherent ownership risks, it can be an attractive remedy vis-à-vis sale of the collateral to reduce enforcement costs and permit more latitude in the timing and method of an eventual sale of the collateral. Note that there are a number of procedural requirements relative to retention, though retention is generally permissible if (i) the borrower executes a written agreement to the proposed retention (secured lender beware–this agreement must be entered into after the default), (ii) the secured lender has timely sent out all notices required by the UCC (this includes notice to the borrower and can include additional secured parties), and (iii) the secured lender doesn't receive a timely notice of objection from a person required to receive notice of the retention or another party with a subordinate interest in the collateral. Once the requirements of retention are met, the collateral belongs to the lender and may be transferred without regard to the rules that govern the sale of collateral under the UCC, which are discussed below. Additionally, the borrower would of course remain liable for any deficiency if the collateral is kept in only partial satisfaction of the obligation.

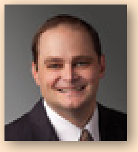
Selling the Collateral

Secured lenders have two options under the UCC when selling the collateral: (i) a court-supervised sale or (ii) a secured lender sale of the collateral. However, despite the dual options, many secured lenders prefer to sell the collateral themselves since it is typically less costly and time consuming. Secured lender sales may be either public or private, though a secured lender's right to credit bid and purchase the collateral at a private sale is qualified. While there are a number of detailed requirements relative to the form and timing of the notice of the sale, fortunately for secured lenders, there are relatively few specific requirements as to how the sale must be carried out. Rather, the touchstone is commercial reasonableness, as the UCC requires that "[e]very aspect of a disposition of collateral, including the method, manner, time, place, and other terms, must be commercially reasonable."

Commercial reasonableness is not fully defined under the UCC, and unsurprisingly, it is often litigated. There are, however, some guidelines and safe harbors. For example, the UCC clarifies that "[t]he 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 from that selected by the secured party is not of itself sufficient to preclude the secured party from establishing that the collection, enforcement, disposition, or acceptance was made in a commercially reasonable manner"—a very helpful secured-lender protection. In short, if the manner in which the secured lender carries out the sale and the price it obtains are consistent with the typical practices and prices for the sale of similar assets in the open market, the sale is more likely to be considered commercially reasonable.

Once the collateral is ultimately sold, the UCC has a hierarchy of how the proceeds are generally required to be applied: first, to reasonable expenses of the sale (including attorney's fees if provided for by agreement and not otherwise prohibited by law); second, to the secured obligations; and third, to the obligations secured by the subordinate security interests. Subject to a few exceptions, the borrower will, of course, typically remain liable for any deficiency and have the right to any surplus. However, special calculation requirements apply if the property was sold to certain interested parties, such as the secured lender or a person related to the secured lender.

Understanding the broad—if nuanced—secured party personal property rights and remedies under the UCC is critical to underwriting loans and understanding available asset recovery remedies. However, when they are understood and applied, personal property can be significant security in increasingly uncertain times. ■



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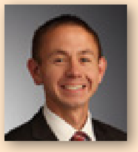

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