

# **Small Commercial Chapter 11 Panel: A Decent Burial — Winding Up the Small Business Debtor**

**Hon. Diane Finkle**

*U.S. Bankruptcy Court (D. R.I.); Providence*

**Michael J. Goldberg**

*Casner & Edwards, LLP; Boston*

**John G. Loughnane**

*Nutter McClennen & Fish LLP; Boston*

**David Peress**

*Hilco Streambank, LLC; Dedham, Mass.*

**Robert P. Wexler**

*The Tron Group; Boston*

## Alternative Venues to Restructure, Sell or Liquidate

### Out of Court

Alternative	Principal Law	Stay or Injunction	Right to sell assets	Eliminate Risk of Successor Liability	Priming Debt	Avoidance Powers	Reorg.	Liquidate	Discharge	Cost	Advances / Comments
Secured Party Sale	State Law	No	Yes, subject to Sr. Liens	Not entirely	No	No	Yes	Yes	No	Low	Quick asset sale, wipes out junior liens
Mortgage Foreclosure	State Law	No	Yes, free & clear Jr. Liens	Not Entirely	No	No	Yes	Yes	No	Low	Quick statutory power of sale
State Law Dissolution	State Law	No	No	No	No	Yes, 4 month look-back on attachments	No	No	Limited	Med.	Turn off lights and go home
Loan Workout	Fed., State Law	No	No	No	No	No	Yes	Not typically	No	Low	Low cost Consensual w/ lender
Composition Agreement	State Law	No	No	No	No	No	Yes	No	No	Med.	May be used in concert w/ indentured trust
Indenture Trust	State Law	No	Yes, Upon default	No	No	No	Yes	Yes	No	Med.	May be used in concert with composition agreement
Assignment for the Benefit of Creditors (ABC)	State Law	No	No	No	No	No	No	Yes	Limited	Med.	Out of court sale of assets
Deed in Lieu	State Law	No	No	No	No	No	Yes	Yes	No	Low	Expedites Transfer
Short Sale	State Law	No	No	No	No	No	Yes	Yes	No	Low	Expedites Transfer



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## Alternative Venues to Restructure, Sell or Liquidate

### Court Actions

Alternative	Principal Law	Stay or Injunction	Right to sell assets	Eliminate Risk of Successor Liability	Priming Debt	Avoidance Powers	Reorg.	Liquidate	Discharge	Cost	Advances / Comments
Receivership	Fed., State Law	No	Yes, with court approval	Yes, with court approval	No	No	No	Yes	No	Low	Frequently utilized by creditors for collection liquidation
Chapter 7 Bankruptcy	Federal	Yes	Yes, free and clear	Reduces risk	Yes	Yes	No	Yes	Yes	Low	Walk away but D&O scrutiny / preferences
Chapter 11 Bankruptcy	Federal	Yes	Yes, free and clear	Yes	Yes	Yes	Yes	Yes	Yes, upon reorg.	High	Discharge unsecured and under-secured obligations if successful in reorg.



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# Assignment for the Benefit of Creditors

## *A Primer*

Robert Wexler  
THE TRON GROUP



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## Alternative Venues To Restructure, Sell or Liquidate

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- Businesses can be restructured, sold or liquidated to maximize the value to creditors and shareholders under the following venues:
  - ✓ US Bankruptcy Court – Chapter 11 or Chapter 7
  - ✓ State Court – Receivership
  - ✓ State Court – Assignment for the Benefit of Creditors
  - ✓ State Court – Foreclosure
  - ✓ Secured Party Sale
  - ✓ Liquidating Agent or Chief Restructuring Office (CRO) of the Company
- Except for foreclosures and secured party sales, all the stakeholders are involved in the process. Unsecured creditors always retain their right to file an involuntary bankruptcy proceeding, which can terminate the operation of a State Court Receivership, ABC or Liquidating Agent/CRO. Such a filing may only delay a secured party foreclosure of real estate or a secured party sale.



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## Alternative Venues to Restructure, Sell or Liquidate

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- Choosing the proper venue for the situation depends on the ability to work with the various stakeholders:
  - ✓ Shareholders
  - ✓ Guarantors
  - ✓ Secured Parties
  - ✓ Unsecured Creditors
  - ✓ Regulatory Agencies
  - ✓ Employees
  - ✓ Customers
  - ✓ Vendors



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## Alternative Venues to Restructure, Sell or Liquidate

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## ABC Basics

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### Assignment for the Benefit of Creditors (ABC)

*“A transfer of legal and equitable title to all debtor’s property to an Assignee with authority to liquidate the debtor’s affairs and distribute proceeds equitably to creditors.”*



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## ABC Basics

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### Legal:

- The Assignee has the rights of a lien creditor under UCC §9-309, so that unperfected security interests are junior to the rights of the Assignee. The practical result is that unsecured creditor actions and collections lawsuits become ineffective after an assignment has been made but unsecured creditors still retain all rights to file a bankruptcy.
- Transfer is subject to all existing liens. Assignee is bound to honor all valid perfected and enforceable liens.
- The Assignee is a disinterested 3<sup>rd</sup> party acting as a fiduciary for the benefit of all creditors.
- ABC's are creatures of both common law and statute and generally, states follow one of two approaches:
  1. Court supervision of assignment and Assignee.
  2. No court supervision but Assignee must follow laws applicable to and governing the liquidation of a business and its assets.
  3. The Assignment, for the most part, follows the priority and distribution provisions of the US Bankruptcy Code.



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## ABC Basics

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### Implementation:

- Secured creditor completes its due diligence on collateral, perfection, recovery, etc. and decides on strategy.
- The owners (Assignor) agree on an Assignee, which Assignee should be acceptable to the secured creditors.
- Secured creditor approves Assignee's wind down budget, time frame, sale process, asset disposition and projected recovery:
  - Weekly budget includes cash receipts, paydowns from asset dispositions, cost of operations, Assignee cost and new senior funding if required.
  - Secured creditor may enter into a credit facility with the Assignee if the company is going to be operated for any length of time.
  - Credit facility provides secured lender with the ability to opt out of the ABC if budget is not being met.
- UCC search done to determine liens on assets.
- With the secured creditor's approval and funding commitment, if any, Assignor assigns all of its assets to Assignee. Secured creditor, can , but is not required to, enter a formal liquidation/forbearance agreement.



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## ABC Basics

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- Taxing authorities are notified.
- The Assignee sends a notice of the general assignment to the creditors and provides them with an opportunity to file a claim.
- Assignee establishes its own bank account and where practical may also continue to use the company's operating and payroll accounts, subject to the secured creditor's agreement.
- Assignee begins implementing wind down plan in accordance with approved budget which may include completion of work in process, preparation of assets for sale, sale of inventory, etc.
- Assignee addresses any subordination agreements with senior lender.
- Assignee pays claims in accordance with bankruptcy code priorities.



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## ABC Basics

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### Assignee Qualifications:

- A professional experienced in insolvency matters and liquidations.
- Selected by the debtor with secured creditor's consent.
- Creditors can influence the selection by threatening an action to upset the general assignment.
- Co-Assignees can be selected, one by debtor, one by creditor.
- Assignees *should* be a disinterested party, no ironclad rule.
- Assignees *should* have the confidence of both assignor and stakeholders.
- Many states require the posting of a bond ranging up to 2X the liquidation value of the assets.



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## ABC Advantages

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- Engages valuable assistance of willing shareholders to help maximize the value of the assets. By voluntarily turning over the company to an Assignee, shareholders acknowledge that there is no value in their equity and/or ability to restructure the company.
- Maximizes asset recovery by operating the business, completing work in process, managing a going concern sale process and selling off assets.
- Minimizes the risk of a Chapter 7 or Chapter 11 filing by disgruntled creditors who do not feel their interests are being considered.
- Insulates secured creditors, to an extent, from possible claims arising from the liquidation process.
- Less costly and faster than Bankruptcy and State Court Receivership. Assignee in most assignments does need to hire an attorney for the Assignee and can use existing debtor counsel for special assignments.
- Stakeholders are able to maintain good lines of communication in the process.
- Unsecured creditor pool is still "friendly" and willing to provide services to the Company.



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## ABC Administrative Matters

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### Priority of Claims

- Many states have copied claim priorities established by the Bankruptcy Code.
- Some states have borrowed components of the Code believed by the legislature to be appropriate for that state.
- Properly perfected secured claims typically have priority over:
  - Taxes (except Real Estate and perfected IRS liens)
  - Wage and employee benefit claims
  - Priority unsecured claims
  - General unsecured claims
- The perfected secured claim is subordinate to statutes that create a trust or statutory lien in favor of definable creditors – for example, trust established for subcontractor payment in certain states.
- Vendors rights to reclamation.



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## ABC Administrative Matters

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### Tax Issues

- Assignee may be responsible for all pre and post assignment tax returns.
- Assignee must collect applicable sales tax when selling assets that are not held for resale.
- Gain or loss on assignment is typically reflected on Assignor's tax returns.
- Any tax based on the forgiveness of debt is usually the assignor's responsibility.
- Care needs to be given to file all taxes.



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## ABC Administrative Matters

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### Priority

- When enacted, §9-309 of the UCC gives the Assignee the rights of a perfected secured creditor as of the date of the assignment.
- The provision enables the Assignee to preserve the assets of the assignment estate at the position it was in immediately prior to the execution of the general assignment for the benefit of all creditors.
- Only valid perfected secured claims (blanket security interest, liens of taxing authorities, holders of P.M.S.I) at the time of the assignment can properly assert a right to payment with higher authority than an Assignee.
- Assignee can use its rights as Assignee of the debtor's assets to seek to recover assets under applicable state laws, including fraudulent transfers.
- Some states are considering enacting statutes with provisions for the avoidance of preferential payments.



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## ABC Administrative Matters

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### 401K/Pension Plans

- Various employee benefit programs, from 401(k) plans to self-funded medical plans (cafeteria plans) need to be addressed and funds distributed to the plan's participants.
- The plan's assets are not assets of the assignor or subject to the rights of the Assignee.
- An officer of the assignor needs to stay on board to ensure the plan is properly terminated, plan assets distributed and all necessary tax returns and related filings completed. In some instances Assignee can become the plan administrator.



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## Closing the Estate

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- Once the debtor's assets have been liquidated and the proceeds distributed to appropriate creditors, the assignment can be closed.
- It is good practice for the Assignee to provide interim reports to the court and creditors.
- The Assignee prepares a final accounting and filing with the court, and if required sends this to the creditors.
- The final step is for the Assignee to request and/or notify the court, if required, to close the estate and to send out notice to all creditors.
- The notice will:
  - Confirm termination of the assignment administration.
  - Inform all parties that no further activity will be undertaken by the Assignee.
  - Indicate that no additional distributions will be made.



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## Closing the Estate

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- When the Assignee makes distributions, checks will often be returned as undeliverable. As part of the fiduciary duty to creditors, the Assignee should attempt to locate the creditor and forward the check.
- As a result of unclaimed checks, the estate may have funds left over which could be redistributed to all known creditors after some designated period of time or given to a charity similar to bankruptcy creditor trusts.



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## Sample ABC Assignment

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Company manufactures solid ash wood bedroom and juvenile furniture in the medium price-point range with national retail distribution.

### Financial Condition (pre Tron)

- Sales \$14.6 million
- EBITDA (\$ .9 million)
- Working Capital Assets \$ 6.8 million
- Accounts Payables \$ 1.1 million
- Senior Debt \$ 3.2 million
- Liquidation value \$ 2.8 million



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## Sample ABC Case

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### Key Issues

- Orphan business and unclear business plan.
- Furniture manufacturing moving overseas to China.
- Company's efforts to turnaround the business or locate investors had failed.
- Parent unable to provide funding due to covenant "defaults".
- Senior Lender pressing for liquidation.
- WARN Act concerns.
- Company owned state of the art manufacturing facility underutilized and unable to be readily sold.



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## Sample ABC Case

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### Results

- Transferred all assets and 120 employees to Tron professional as Assignee under Assignment for the Benefit of Creditors.
- Replaced President of the division with a Tron consultant.
- Reduced overhead, developed inventory reduction plan, and lowered breakeven point.
- Operated the business for three months while aggressively marketing the business to strategic and financial buyers.
- Sold business to private equity group which acquired the business with seller notes, non recourse financing backed by USDA and \$500,000 of working capital.
- Bank paid out in full and total dividends to creditors of 35 cents.



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## Sample ABC Case

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### Discussion of Options

Option	Assignment for the Benefit of Creditors	Bank Foreclosure & Liquidation	Chapter 11
<b>Pros</b>	<ul style="list-style-type: none"> <li>✓ Owners &amp; management willing to help maximize recovery for creditors</li> <li>✓ Finish WIP</li> <li>✓ Satisfy WARN requirements while finishing WIP</li> <li>✓ Sell business as going concern</li> <li>✓ Dividend to unsecured creditors</li> </ul>	<ul style="list-style-type: none"> <li>✓ No additional bank capital required</li> <li>✓ No continued oversight of company operations</li> </ul>	
<b>Cons</b>	<ul style="list-style-type: none"> <li>✓ Required some continued funding by bank</li> <li>✓ Unhappy creditors could still force a chapter 7</li> </ul>	<ul style="list-style-type: none"> <li>✓ Asset liquidation value a lot less than going concern value</li> <li>✓ Lose value inherent in completing WIP inventory</li> <li>✓ WARN Act issues</li> <li>✓ Building hard to sell except through sale of business</li> </ul>	<ul style="list-style-type: none"> <li>✓ Did not have DIP financing for chapter 11</li> <li>✓ There was no viable exit plan</li> <li>✓ Process is very expensive</li> </ul>



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## Mining for IP Value in Small and Private Businesses

David Peress  
Executive Vice President  
Hilco Streambank  
dperess@hilcoglobal.com  
(781) 471-1239

[www.hilcostreambank.com](http://www.hilcostreambank.com)

[www.ipv4auctions.com](http://www.ipv4auctions.com)



## IP Assets - Small & Privately-Owned Businesses

Small and Private Businesses often have Intangible Assets than can be monetized in an asset sale separate and apart from liabilities and non-core assets such as real estate.

- Intangible assets commonly found in small and privately-owned businesses include:
  - Brands/Trademarks
  - Premium Domains
  - Content
  - Data
  - Technology, Know How, and Other Trade Secrets
  - Software
  - Version 4 Internet Protocol Addresses (IPv4)

## IP Assets - Small & Privately-Owned Businesses

- Brands
  - Usually trademarked
- Domain Names
  - The Most Valuable (Premium Domains) generally consist of Single words; especially nouns
  - 2,3, or 4 letter combinations
- Content
  - May be proprietary (created by or on behalf of the Seller) subject to copyright protection
  - May be public domain but presented in a collated and searchable format
  - May be certified or validated by technical sources
- Technology, Know How, and Other Trade Secrets
  - Patents and Pending Patents
  - Recipes
  - Formulations
  - Processes

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## IP Assets - Small & Privately-Owned Businesses

- Software
  - Privately developed software can have value if:
    - i. Developed In-House and not bolted onto or incorporating licensed code
    - ii. Seller has preserved Source Code
    - iii. The software is Well-Documented
- Version 4 Internet Protocol Addresses (IPv4)
  - Internet Protocol Addresses are the numbers assigned to servers so that they can be recognized by other servers
  - The supply of version 4 IP Addresses has been exhausted and there is a secondary market, especially for addresses acquired prior to 1997
  - Hilco Streambank is the market leading broker for the purchase and sale of IPv4 addresses around the world.
  - IPv4auctions.com is an online auction platform for selling blocks of IP Addresses

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## Key Questions

When reviewing opportunities to monetize the IP of small & privately-owned businesses, it is important to consider these questions:

1. Who owns the IP?
2. Are there third party interests or encumbrances in the IP?
3. How is the IP maintained and by whom?
4. Are there unique transfer issues or regulatory issues?

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## Case Studies – Cellect Technologies

- Secured Party Sale of Business located in Hyannis with Manufacturing Plant in Central New York
- Principal Assets Included:
  - Brands including related Trademarks
  - Proprietary formulations for manufacturing foam with applications in:
    - i. Bandages and other medical related products
    - ii. Oil spill remediation
  - Patents and Pending Patents
- Key Valuation Drivers:
  - Existing customer base with recurring demand
  - Well documented processes and formulations
- Outcome: Mid Six Figure Recovery on sale of IP to strategic buyer

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## Case Studies – Isis Parenting



- Wind-down of Needham based business providing Childbirth and Parenting classes and information
- Principal Assets Included:
  - Brand related trademarks and domain names
  - Curated content reviewed by medical professionals including obstetricians, midwives and lactation specialists
  - Customer/Subscription List
- Key Valuation Drivers:
  - Medically based and reviewed content
  - Tested and refined in-person and digital teaching modules
- Outcome: Low Six Figure Recovery on sale of IP to foreign buyer

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## Case Studies – Garden.Org



- Wind-down of National Gardening Association, NH based non-profit resource for gardening information.
- Principal Assets Included:
  - Brand related trademarks and domain names
  - Curated content suitable for licensing
    - i. “How-To” and DIY content
    - ii. Tips and Q&A content
    - iii. Species Catalogs
  - Customer Subscription List
- Key Valuation Drivers:
  - Reliable source of content for gardeners for nearly two decades
  - Highly ranking website with over 4MM users per year and meaningful advertising Revenue
- Outcome: Low Six Figure Recovery on sale of IP to Strategic Buyer

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## Streambank Leadership



Gabe Fried | CEO | [gfried@hilcoglobal.com](mailto:gfried@hilcoglobal.com)

Gabe has lead dozens of IP valuations and dispositions dating back to 2000. Prior to founding Streambank in 2007, Gabe was a Managing Director at XRoads Solutions Group in NY, and was consultant to IP and asset disposition firms such as Consor, Gordon Brothers Group, IP Recovery and The Ozer Group.



David Peress | EVP | [dperess@hilcoglobal.com](mailto:dperess@hilcoglobal.com)

David has spent twenty-five years in the restructuring and distressed investing industry. Until 2000, he was a bankruptcy partner at Young Conaway Stargatt & Taylor, LLP. He later served as Managing Director and General Counsel of The Ozer Group LLC an asset disposition firm, and led the special situations investing business for Crystal Capital, a multi-strategy private investment fund.



Jack Hazan | EVP | [jhazan@hilcoglobal.com](mailto:jhazan@hilcoglobal.com)

Prior to joining Streambank, Jack was most recently the General Counsel of AME, a leading apparel firm which was sold to LI & Fung. Prior to AME, Jack was a bankruptcy attorney at Kramer, Levin, Naftalis & Frankel LLP, and was General Counsel to Nobody Beats the Wiz during its bankruptcy and subsequent sale to Cablevision.

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**Boston**  
980 Washington St.  
Dedham, MA 02026  
(781)471-1239

**New York**  
1500 Broadway, Suite 810  
New York, NY 10036  
(212)610-5663

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## Overview of Secured Party Sales

John G. Loughnane  
Meghan E. Kelly  
Nutter, McClennen & Fish LLP  
Seaport West  
155 Seaport Boulevard  
Boston, MA 02210  
[www.nutter.com](http://www.nutter.com)

Set forth below is a brief overview of secured party sales under Article 9 of the Uniform Commercial Code. This overview is not intended to be a detailed summary of all aspects of a secured party's rights and obligations under Article 9. Rather the overview has been prepared as an aid to the panel discussion of a hypothetical presented in connection with the ABI Northeast 2016 session on out of court dispositions of middle market businesses.

### What is a Secured Party Sale?

- Under § 9-610(a) of the Uniform Commercial Code (UCC), “[a]fter default, a secured party may sell, lease, license, or otherwise dispose of any or all of the collateral in its present condition or following any commercially reasonable preparation or processing.”
- The sale is triggered by the debtor's default on its obligations. Once the secured party has taken the default action required under the relevant credit agreement, the secured party can conduct a sale of the collateral.

### Public vs. Private Sales

- Under § 9-610(b) of the UCC, “a secured party may dispose of collateral by public or private proceedings . . .”
- The choice between public and private sales is dependent upon what is “commercially reasonable” for the industry in which the collateral is being sold.
- Public Sales:
  - Public sales are sales by auction.
  - The secured party must ensure a public sale has been properly advertized.
  - A sale will not be considered a public sale if only a section of the public is allowed to attend, there must be full public access.
- Private Sales:
  - Private sales are used when a buyer has been identified prior to the sale.

- Private sales often more closely scrutinized in determining whether the sale was “commercially reasonable.” The secured party must be able to show that the collateral was marketed sufficiently before the sale.

How does a Secured Party Sale Work?

- When conducting a public sale, the secured party must **repossess** the collateral
  - Under § 9-609 of the UCC, the secured party has the right to repossess the collateral in the event of default, unless the parties have expressly agreed otherwise.
  - Three options for repossession:
    1. Self-Help: § 9-609(b)(2)
      - If the secured party uses self-help, he must ensure that there is no breach of the peace. Breach of the peace has been broadly defined to mean “a disturbance of public order by an act of violence, or by any act likely to produce violence, or which by causing consternation and alarm, disturbs the peace and quiet of the community.” (People v. Most, 171 N.Y. 423, 64 N.E. 175 (1902))
    2. Require the debtor to assemble and deliver the collateral: § 9-609(c)
      - This is a good option if the debtor is cooperative, but many debtors may not want to cooperate with the secured party, so this presents challenges.
    3. Traditional judicial foreclosure
      - If self-help or requesting that the debtor assemble the collateral does not work, the secured party can turn to the courts to obtain an order requiring the debtor to turn over the collateral to the secured party. The downside to this option is that the process can be slow and expensive.
- Whether the sale is public or private, the secured party must give **notice** under §§ 9-611 and 612 of the UCC.
  - Notice must be sent 10 days in advance and must include:
    1. Name of the secured party and debtor
    2. Description of collateral being sold
    3. Time, date and place of the sale if the sale is public; or the time after which the sale can be made if it is private

4. Statement that the debtor is entitled to an accounting of unpaid indebtedness
- Who receives the notice? Anyone with an interest in the collateral. This generally includes:
    1. The debtor
    2. Any guarantor of the debtor's obligations
    3. Any junior creditors to the secured party
  - To ensure that notice has been given to all of the necessary parties, the secured party should perform a UCC financing statement search 20-30 days before the sale of the collateral.
  - The secured party cannot rely on a pre-default waiver of notification. Under § 9-611, a waiver of notice is only valid if it is given post-default.
- In both private and public sales, the sale must be conducted in a **“commercially reasonable”** manner under § 9-610(b).
    - A sale usually will be deemed commercially reasonable if it is:
      1. Conducted in the usual manner in any recognized market
      2. Conducted at the price current in any recognized market at the time of sale or
      3. Conducted otherwise in conformity with reasonable commercial practices among dealers of the type of collateral that was the subject of the sale.
    - Prior to the sale, the secured party may choose to repair the collateral, or they may decide to sell it “as-is.” When deciding the best way to dispose of the collateral, the secured party should consider what will ensure generate the highest level of proceeds from the sale.
  - Following a private or public sale, the secured party must properly apply the **proceeds** to the sale under § 9-615:
    - The order of distribution of proceeds is as follows, each level must be satisfied before the next level receives anything:
      1. To the costs/legal fees associated with the sale
      2. To the secured party in satisfaction of debt owed
      3. To any junior creditors
      4. Back to the debtor

### Satisfaction of the Secured Party

- Rights under the UCC are cumulative with state rights, so if the disposition of the collateral does not make the secured party whole, the secured party can pursue the debtor for the deficiency in state court under § 9-615(d)(2) of the UCC
- A secured party must be careful to comply with the Article 9 requirements while conducting the sale. If the secured party fails to do so, the secured party will face a rebuttable presumption that the amount of proceeds that should have been produced by the sale is equal to the obligation plus costs under § 9-626(a)(3), which may result in a reduction in a deficiency claim.

### Effect of Disposition: § 9-617

- Upon the completion of a secured party sale,
  - The debtor's interest is transferred to the purchaser
  - The security interest of the secured party is discharged and
  - Any subordinate security interests or liens on the collateral are also discharged

### Can the Secured Party Repurchase the Collateral?

- It is possible for the secured party to repurchase the collateral at the sale, but to do so certain rules must be followed.
  - Private Sales: The secured party can only repurchase the collateral in its possession through a private sale if the collateral is of the type that is customarily sold on a widely-recognized market, for which there are known price quotes
  - Public Sales: If the secured party wants to repurchase the collateral in its possession, and it must be done through a public sale, the secured party must advertise the sale, the general public must have access to the sale, and there must be a "meaningful opportunity for competitive bidding"
- When repurchasing the collateral in its possession, the secured party should be mindful of § 9-615 of the UCC – the anti-deficiency provision. This is triggered when the collateral is sold to either the secured party or to a related party at a price that is significantly lower than what would have been charged to a third party.

### Benefits of a Secured Party Sale

- Avoid publicity of a public bankruptcy proceeding
- Avoid the higher cost associated with a court-managed bankruptcy sale

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