

# UNDERSTANDING COLLECTION OPTIONS FOR LENDERS UNDER ARTICLE 9 OF THE UCC

*Hodgson Russ Bankruptcy, Restructuring & Commercial Litigation Alert*  
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We are frequently queried by our Canadian colleagues involved in cross-border lending transactions regarding a secured lender's rights and remedies in the event of a default. Indeed, one reality of the economic downturn is an increasing number of borrowers falling behind on loan obligations, an understanding of remedies available to lenders under Article 9 of the Uniform Commercial Code is essential to protecting a lender's rights.

## What is Article 9 of the Uniform Commercial Code?

Like the rest of the Uniform Commercial Code (the "UCC"), Article 9 is intended to create a uniform system across the country for creating and enforcing security interests. It must be noted, however, that while Article 9 has been adopted by every state, some states have made minor modifications to the law or have adopted the most recent version of the law. Accordingly, it is important to consult the applicable state law whenever conducting an Article 9 sale. Similarly, because each state has incorporated Article 9 into its own state statutory schemes, the number of the sections of Article 9 may vary from state to state. All section references contained herein are to New York's iteration of Article 9 of the UCC.

Secured lenders have a variety of options to exercise rights to their personal property collateral to recover indebtedness. Below is a brief summary of two common scenarios for enforcement of rights:

### 1) Lender's Self-Help and Cooperation from the Borrower

This typically involves a notice of default and opportunity to cure (approximately 10 days or the cure period specified in the underlying loan documents). If the borrower fails to cure the default, the lender may exercise its rights under Article 9 of the UCC and recover by:

- **Collecting on Accounts Receivable:** Section 9-607 allows the lender to collect any accounts receivable on which it has a perfected lien (this can be done with or without borrower's cooperation). A lender that knows the identity of the account debtor may simply provide written direction to the account debtor to pay the lender directly. Once a secured party has provided that notice, the lender must be paid by the account debtor. An account debtor that does not direct payment to the lender directly remains liable for its debt, even if the account debtor repays

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the borrower.

The lender may also apply the balance in any deposit account in which it has a perfected lien to the debt. Section 9-609 allows a secured party to request the borrower assemble the collateral and the lender may take possession of the collateral so long as the borrower cooperates.

- **Holding a “Commercially Reasonable” Sale:** Section 9-610 allows the lender to sell the collateral on a “commercially reasonable” basis. All aspects of the sale of the collateral must be “commercially reasonable.” Section 9-612 provides that 10 days’ notice after a default is commercially reasonable in a non-consumer transaction. An Article 9 sale may be a public auction sale or the lender may sell collateral at a private sale. The lender must be able to demonstrate the private sale was commercially reasonable. This is typically done through a third-party valuation of the collateral. If a private sale price can approximate the valuation, the lender will have a basis to defend it as commercially reasonable. A properly marketed public auction of collateral may be more appropriate if there is no information available on the value of the collateral.

If the borrower is cooperative in the sale process, it could be completed in approximately 100 days: 10 days (or the necessary cure period listed in the loan documents) following demand for payment; 60 days for marketing and auction sale (the 10 day notice of the Article 9 sale can be given during this marketing period); and 30 days for a buyer to close and remove collateral. A private sale might move in a faster timeline if a buyer is quickly identified.

A cooperative liquidation would typically involve a forbearance agreement and borrower’s written consent to the sale.

### 2) Judicial Foreclosure

The UCC does not prevent a secured creditor from resorting to the courts to obtain an order requiring a borrower to turn over collateral and authorizing a sheriff or officer of the law to repossess the collateral on its behalf. One advantage to this method of repossession is that the lender does not have to be concerned with its actions being considered a “breach of the peace” or liability for conversion during a court-ordered repossession. Judicial foreclosures, however, tend to be slow and expensive. In addition, as judicial foreclosures are not governed by the UCC. The judicial foreclosure process will vary state by state.

If a borrower does not consent to a cooperative liquidation under Article 9 of the UCC, they could elect to pursue a bankruptcy filing.

If you have questions about how proceeding with recovery under Article 9 or how these remedies may affect your business, please contact Garry Graber (716.848.1273) or James Thoman (716.848.1361).

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