

Loan Agreements A-Z:
Drafting and Enforcing Commercial Loan Agreements
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Part I – Loan Agreement Terms

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CONSIDERATIONS/APPROACH

- Structure
 - Commitment Letter/Term Sheet
- Purpose of Loan-Capital Needs
- Nature of Borrower(s)/Lender
- Ultimate Goal/Counsel Role

BASIC LOAN TERMS

- Revolving Line of Credit
 - Amount and Availability of Advances
 - Termination/Expiration
 - Letters of Credit
 - Use of Proceeds
 - Interest/Default Interest
 - Calculation
 - Payment
 - Payments/Prepayments
 - Late Fee

BASIC LOAN TERMS (continued)

- Term Loan
 - Amount/Funding
 - Maturity
 - Use of Proceeds
 - Interest/Default Interest
 - Calculation
 - Payment
 - Payments/Prepayments
 - Late Fee
 - Conversion

BASIC LOAN TERMS (continued)

- Revolver/Term Loan
 - Parties-Joint and Several Liability
 - Fees

REPRESENTATIONS

- Specifically Negotiated/Appropriate Qualifiers
- Standard Representations/Schedules
 - Organization/Good Standing/Authorization/No Conflicts
 - Litigation/Liabilities
 - Condition, Location and Title to Assets/Collateral
 - Licenses/Permits/Compliance with Law
 - Material Contracts and Compliance with Contracts
 - Employment/Labor Matters
 - Intellectual Property
 - Environmental Matters
 - Taxes
 - Insurance
 - Financial Information/Material Adverse Change
 - Capitalization
 - Subsidiaries/Investments
 - Line of Business
 - Full Disclosure

COVENANTS

- Specifically Negotiated/Appropriate Carve-Outs
- Affirmative Covenants/Negative Covenants/Financial Covenants
- Applicable to Borrower(s)/Guarantors

COVENANTS (continued)

- Standard Affirmative Covenants Examples
 - Payments
 - Compliance with Law
 - Maintenance of Assets/Licenses/Permits
 - Maintenance of Principal Bank Account/Minimum Balance
 - Compliance with Laws/Contracts/Permits
 - Conduct of Business/Line of Business
 - Delivery of Financial Statements-Audit/Review/Compilation
 - Field Exam
 - Delivery of Reports/Compliance Certificates
 - Notification of Liabilities/Litigation/Collateral Damage/Material Adverse Change/Event of Default
 - Payment of Taxes
 - Maintenance of Security Interest

COVENANTS (continued)

- Standard Negative Covenant Examples
 - Indebtedness
 - Contingent Liabilities
 - Sale/Disposition of Assets
 - Merger
 - Formation of Subsidiaries/Entering into Investments
 - Restricted Payments
 - Loans
 - Change of Control
 - Negative Pledge/Liens
 - Change in Senior Management
 - Change in Line of Business
 - Amendment to Governance Documents

COVENANTS (continued)

- Standard Financial Covenants/Examples
 - Minimum Net Income
 - Maximum Leverage Ratio
 - Minimum Interest/Fixed Charge Coverage Ratio
 - Maximum Debt to EBITDA
 - Maximum Capital Expenditures

CONDITIONS TO FUNDING

- Initial Funding/Subsequent Advances
 - Execution of all Documents (Loan/Security/Guarantees)
 - Accuracy of Representations
 - No Event of Default
 - Legal Opinion
 - Governance Documents/Consents/Incumbency
 - Diligence Matters—Good Standing/Lien Results/Insurance
 - Perfection of Security-UCC-1s
 - Compliance with Covenants
 - No Material Adverse Change
 - Notice of Borrowing

EVENTS OF DEFAULT

- Specifically Negotiated/Appropriate Exceptions
- Grace Periods
- Standard Events of Default Examples
 - Non-Payment
 - Breach of Representations or Covenants
 - Breach of Security Agreement or Other Related Agreements
 - Bankruptcy/Insolvency Matters
 - Cross-Default—Borrowers/Guarantors
 - Death of Guarantor
 - Judgments/Litigation
 - Material Adverse Change Borrower/Guarantor

MEANINGFUL BOILER PLATE

- Assignment
- Amendment
- Choice of Law
- Fees/Expenses

Part II – Collateral and Perfection

Roger Iorio, Esq.

Enforceable Security Interest

- In order to create an enforceable security interest against a debtor, the following must be met:
 - The secured party must give value;
 - The debtor must have rights in the collateral; and
 - The debtor has “authenticated” a security agreement
 - A security agreement is typically “authenticated” by the debtor signing it, but the UCC also allows authentication by electronic signature or other similar process.
- A security interest can also be created by a pledge or control of certain types of assets.
- The security interest attaches to the collateral at the time when it becomes enforceable against the debtor.

Description of Collateral

- A description of personal or real property is sufficient, whether or not it is specific, if it reasonably identifies what is described.
- A description of collateral reasonably identifies the collateral if it identifies it by
 - specific listing,
 - category,
 - the definitions of the UCC,
 - quantity,
 - computational or allocational formula or procedure, or
 - any other method that is objectively determinable.
- A description of collateral as “all the debtor’s assets” or “all the debtor’s personal property” is not sufficient for purposes of the granting language of a security agreement.

Description of Collateral (continued)

- Examples of Collateral Categories:
 - Goods
 - Inventory
 - Equipment
 - Fixtures
 - Account
 - Chattel Paper
 - Investment Property
 - Letter of Credit Rights
 - Deposit Accounts
 - Money
 - Oil, Gas or other mineral rights
 - General Intangibles

Proceeds

- In addition in specific assets, the UCC also allows a secured party to obtain a security interest in the proceeds of such assets.

After Acquired Property Clauses

- The UCC allows a description of the collateral to include all collateral “in which the debtor now has or hereafter acquires an interest.”
- This would allow a secured party to obtain a lien on not only what is owned at the time that the security agreement is entered into, but also what is acquired by the debtor after the security agreement is entered into.

Example of Granting Language – Senior Financing

- As security for the performance of any and all debts, liabilities, obligations, warranties, representations, covenants, and undertakings of the company to the secured party, direct or indirect, absolute or contingent, due or to become due, now existing or hereafter arising, whether in connection with the Note or otherwise, including without limitation, any future extensions of credit or loans by the secured party to the company, the company does hereby grant to the secured party a security interest in all of the assets of the company, including, without limitation, the property listed on Schedule A annexed hereto (said property being hereinafter referred to as the “Collateral”), as well as all of the documents evidencing the same and all books and records concerning the same, together with any and all substitutions or replacements for any item of Collateral, which substitution or replacement may be effected only with the consent of the secured party.

Example of Granting Language – Mezzanine Financing

- Pledgor hereby pledges and grants to Lender, as collateral security for the prompt and complete payment and performance when due (whether at the stated maturity, by acceleration or otherwise) of the Debt, a security interest in all of Pledgor's right, title and interest to the following (i) the Pledged Securities; (ii) all securities, moneys or property representing dividends or interest on the Pledged Securities, or representing a distribution in respect of the Pledged Securities, or resulting from a split-up, revision, reclassification or other like change of the Pledged Securities or otherwise received in exchange therefor, and any subscription warrants, rights or options issued to the holders of, or otherwise in respect of, the Pledged Securities; (iii) all right, title and interest of the Borrower in, to and under any policy of insurance payable by reason of loss or damage to the Pledged Securities; (iv) all "accounts", "general intangibles", "instruments" and "investment property" (in each case as defined in the Code) constituting or relating to the foregoing; and (v) all Proceeds of any of the foregoing property of Borrower (including, without limitation, any proceeds of insurance thereon, all "accounts", "general intangibles", "instruments" and "investment property", in each case as defined in the Code, constituting or relating to the foregoing).

Perfection of a Security Interest in Personal Property

- What to File
 - A UCC-1 Financing Statement the form of which is uniform throughout the country
 - The UCC-1 must contain a description of the collateral that is being pledged (typically the granting language set forth in the security agreement is used), but the UCC does allow a secured party to file a UCC-1 that covers “all assets” of the debtor.
 - Must contain the legal name of the debtor

Perfection of a Security Interest in Personal Property

- What types of assets are perfected by filing?
 - a security interest in almost all categories of assets of a debtor are perfected by filing, including without limitation, the following:
 - equipment
 - goods
 - inventory
 - general intangibles
 - accounts

Perfection of a Security Interest in Personal Property

- Where to File
 - Filing of a UCC-1 Financing Statement in the appropriate jurisdiction
 - if the debtor is a corporation, limited liability company or limited partnership – state of organization
 - if the debtor is an individual – state of primary residence
 - if the debtor is a non-registered entity (i.e., a general partnership) – state where it has its principal place of business
 - real estate related assets - county where the real estate is located
 - farm products – county where farm is located

Perfection of a Security Interest in Intellectual Property

- Perfection of a security interest in a patent is accomplished by filing under the UCC
- Perfection of a security interest in a trademark is accomplished by filing under the UCC
- Perfection of a security interest in a copyright, to the extent it is federally registered, is accomplished by recording with the United States Copyright Office
- Perfection of a security interest in an unregistered copyright is accomplished by filing under the UCC

Perfection of Security Interest in Certificate of Title Collateral

- With respect to goods that are covered by certificates of title, the UCC provides that the local law of the jurisdiction under whose certificate of title the goods are covered governs perfection and the effect of perfection or non-perfection.
- For instance, a security interest in motor vehicles is perfected not by the filing of a financing statement, but by compliance with the local jurisdiction's certificate of title statute.

Perfection of Security Interest in As-Extracted Collateral

- Section 9-102 of the UCC defines “as-extracted collateral” as follows:
 - Oil, gas or other minerals that are subject to a security interest that:
 - Is created by a debtor having an interest in the mineral before extraction; and
 - Attaches to the minerals as extracted; or
 - Accounts arising out of the sale at the wellhead or minehead of oil, gas or other minerals in which the debtor has an interest before extraction.
- Questions of perfection, the effect of perfection or non-perfection, and the priority of a security interest in as-extracted collateral are governed by the local law of the jurisdiction in which the subject wellhead or minehead, from which the as-extracted collateral is obtained, is located.
- To perfect a security interest in as-extracted collateral, a financing statement is to be filed in the office designated for filing or recording of record of a mortgage on the related real property.

Perfection of Security Interest in As-Extracted Collateral

- A financing statement with respect to as-extracted collateral is sufficient if:
 - it provides the name of the debtor;
 - provides the name of the secured party or a representative of the secured party;
 - indicates the collateral covered by the financing statement;
 - indicates that the financing statement covers as-extracted collateral;
 - indicates that the financing statement is to be filed in the real property records;
 - provides a description of the real property to which the as-extracted collateral relates, sufficient to give constructive notice of a mortgage under the laws of applicable state if the description were contained in a mortgage; and
 - indicates the name of a record owner of the related real property, if the debtor does not have an interest of record in the real property.

Perfection of Security Interest in Certificated and Uncertificated Securities

- A security interest in certificated securities and in uncertificated securities may be perfected by control or it may be perfected by filing.
 - A secured party has control of a certificated security if the certificated security is delivered to the secured party and (1) the certificate is endorsed to the secured party or in blank by an effective endorsement, or (2) the certificate is registered in the name of the secured party, upon original issue or registration of transfer by the issuer.
 - A secured party has control of an uncertificated security if: (1) the uncertificated security is delivered to the secured party, or (2) the issuer has agreed that it will comply with the instructions of the secured party without further consent by the registered owner. Delivery of an uncertificated security occurs when the issuer registers the secured party, or another person acting on behalf of the secured party, as the registered owner, upon original issue or registration of transfer.

Perfection of Security Interest in Deposit Accounts

- The UCC provides that the local law of a bank's jurisdiction governs perfection and applies the following series of rules to determine a bank's jurisdiction:
 - if an agreement between the bank and the debtor governing the deposit account expressly provides the bank's jurisdiction for purposes of the UCC, that is the bank's jurisdiction;
 - if preceding clause does not apply and an agreement between the bank and the debtor governing the deposit account expressly provides that the agreement is governed by the law of a particular jurisdiction, that is the bank's jurisdiction;
 - if the preceding clauses do not apply and an agreement between the bank and the debtor expressly provides that the deposit account is maintained at an office in a particular jurisdiction, that is the bank's jurisdiction;
 - if the preceding clauses do not apply, the bank's jurisdiction is the jurisdiction in which the office identified in the account statement as the office servicing the customer's account is located; and
 - if the preceding clauses do not apply, the bank's jurisdiction is the jurisdiction in which the chief executive office of the bank is located.
- A security interest in a deposit account is perfected by control.
 - A secured party obtains control of a deposit account if:
 - the secured party is the bank in which the deposit account is maintained;
 - the debtor, secured party and bank have agreed in an authenticated record that the bank will comply with the instructions of the secured party with respect to the disposition of funds in the deposit account without the further consent of the debtor; or
 - the secured party becomes the bank's customer with respect to the deposit account.

Perfection of Security Interest in Rolling Stock

- Since Section 11,301 of Title 49 of the United States Code specifically governs perfection of security interests in railroad requirement, it trumps the UCC.
- In order to perfect a security interest in railroad cars, locomotives or other rolling stock (or accessories used) intended for use to interstate commerce, a secured party must file with the Surface Transportation Board. The filing of a UCC financing statement is not the proper method of perfection.

Part III – Remedies

Barry M. Schwartz, Esq.

Part III

- Remedies

- Getting the “box” or “wad” of documents
 - Verify that Event of Default has occurred
 - Send Notice of Default (“Default” is not defined under UCC)
 - Review Security Agreement for notice and cure opportunities
 - Verify that “attachment” (9-203) has occurred
 - Confirm that the Secured Party is perfected and confirm its priority by ordering a fresh UCC lien search

What are S.P.'s Rights?

- Per 9-601, Secured Party has the rights granted by Section 6 and other rights granted by debtor
- Many rights cannot be waived by debtor, per 9-602
- Secured Party's rights are cumulative, per 9-601(c)
- Secured Party's rights can be exercised simultaneously
- Secured Party can file a complaint and go thru court procedures (if no desire to use Article 9)

What Does S.P. Have?

- Assess the collateral:
 - Real Estate (Mortgage and Assignment of Rents and Leases)
 - Deposit Account pledged pursuant to “Deposit Account Control Agreement” (per 9-104):
 - Securities Account pledged pursuant to “Securities Account Control Agreement” (per 9-106 and 8-106)
 - Pledge Agreement (for stock, partnership or LLC membership interests)
 - Accounts Receivable: Notice re: payments

Get In Line for the Money

- Application of Cash Proceeds of Collection and Enforcement – Secured Party must (in order):
 - Be entitled to reasonable expenses and collection and, if the Security Agreement allows it, to reasonable attorneys’ fees and legal expenses incurred;
 - Satisfy obligations secured by the security interest (e.g., superior liens);
 - Satisfy obligations secured by any subordinate liens IF Secured Party receives an “authenticated demand for proceeds” before distribution of the proceeds (per 9-608(a)(1)(C))
 - Surplus (if any) goes to debtor

What is the Goal?

- For other Collateral, determine what the Secured Party wants to accomplish:
 - Public sale (9-610)
 - Private sale (9-610)
 - Consensual or “friendly” foreclosure or “strict foreclosure” -- Acceptance in partial or full satisfaction of the debt (9-620)

Will Debtor cooperate?

- Assess willingness of Debtor to cooperate and other possibilities:
 - Secured Party can take possession of collateral, or (without removal) render it operable, but only without breach of the peace (9-609)
 - If debtor will not cooperate, judicial intervention necessary

Who Gets the Notice of Sale?

- Order UCC/lien searches against debtor:
 - Notification “safe harbor” under 9-611(e)
 - Notice to:
 - Debtor
 - Secondary obligor (guarantor)
 - Anyone else who has sent an “authenticated notification of a claim of interest in the collateral” (9-611(c)(3)(A))
 - Any other secured party or lienholder that, 10 days before the notification date, holds a security interest on the collateral perfected by the filing of a financing statement
 - Notice does not need to be sent if collateral is perishable or threatens to decline rapidly, in value, or if of a type customarily sold on recognized market. (9-611(d)).

What Goes in the Notice?

- Send “Notification of Disposition of Collateral”:
 - Reasonableness of time is question of fact; per 9-612(b), 10 days is reasonable
 - Check security agreement for requirements
 - Minimum requirements set forth in 9-613
 - Attach a “Service List” as an Exhibit
 - After Event of Default, Secured Party can send a Notice to Assemble (9-609(c)).
 - Secured Party may want to use “short form” notice of sale for publication purposes

S.P. Sale Requirements

- Disposition of Collateral:
 - After Event of Default, Secured Party “may sell, lease, license or otherwise dispose of any or all of the collateral in present condition or following commercially reasonable preparation or processing.” (9-610(a))
 - “Every aspect of disposition of collateral, including method, manner, time, place and other terms, must be commercially reasonable”. (9-610(b))
 - Sale can be by public or private sale, by 1 or more contracts, as a unit or in parcels, at any time and place and on any terms. (9-610(b))
 - Secured Party can purchase at public sale, or in private sale only if collateral is customarily sold on meaningful market or subject of widely distributed standard price quotations. (9-610(c))

(continued)

- Warranties can be disclaimed. (9-610(e))
- Private sale – appraisal/valuation
- Public sale – advertising is appropriate
 - Use shorter version of Notice when publishing
 - Have client involved to determine appropriate means of advertising
 - Be careful about timing (publication dates; scheduling with auctioneer; due diligence)

Sale Considerations

- Use of auctioneer vs. do-it-yourself
- Walking the “fine-line” of satisfying UCC requirements and wanting a “robust” open sale

Application of Sale Proceeds

- Proceeds from Disposition:
 - Proceeds are used to reimburse Secured Party for reasonable expense of retaking, holding, preparing and disposing of collateral, and legal fees (if in Security Agreement). (9-615(a)(1))
 - Pay off senior lienholders and Secured Party (9-615(a)(1))
 - Pay off junior lienholders if they've sent written demand
 - If sale of collateral is to a secured party or someone related to secured party, the surplus or deficiency must be calculated by assuming a fair market value if the real proceeds are “significantly below the range of proceeds” that a sale to a non-related party would have brought. (9-616(f))

What Buyer Gets

- Buyer Status
 - A disposition transfers for value all of debtors' rights in collateral and discharges the security interest
 - Buyer can get a transfer statement for Secured Party for filing or recording (e.g. with NJ MVC)

Consensual Foreclosure

- Acceptance of collateral in full or partial satisfaction:
 - Secured Party can accept it in partial satisfaction of the debt if debtor agrees in writing after default (per 9-620)
 - Secured Party can accept it in full satisfaction of debt if:
 - Debtor agrees in writing; and
 - Secured Party sends an unconditional offer to others entitled to notice (e.g., other lien holders) and no objection is received within 20 days; and
 - No one else with an interest in the collateral objects within 20 days (9-621(a) and 9-620(b)(2))

Steps for Consensual Foreclosure

- When collateral is accepted in full satisfaction of debt, notice does NOT need to be sent to guarantors (since guarantors will have nothing to complain about).
- Other than “guarantor distinction”, Notice of Acceptance is sent to same universe of people entitled to Notice of Disposition of Collateral under 9-610
 - Must get fresh UCC lien search
 - But there is no “safe harbor” for UCC lien search done within 20-30 days

Differences from 9-610 Sale

- Secured Party has no “commercially reasonableness” standard
- Acceptance in full or partial satisfaction transfers to the Secured Party all of debtor’s rights in the collateral, and discharges secured party’s lien and any subordinate security interest.

Other Considerations

- Termination of personal guarantees once real property is sold at foreclosure (e.g., California)
 - Simultaneous real property foreclosure may take the lead
 - Curveballs may siderail your efforts
 - Loan workout
 - Voluntary or involuntary bankruptcy or insolvency
 - Sale of business/collateral/equity
 - Debtor failure to cooperate
 - Debtor lawsuit/TRO