

Commercial Law Newsletter

Joint Newsletter of the Commercial Finance and Uniform Commercial Code Committees



August 2019

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FEATURED ARTICLES

Noteholders Beware: Contract Rights and Choice of Law Provisions in an Indenture are Property Rights for Purposes of Commencing a Chapter 15 Case By Ira L. Herman & Evan J. Zucker

USEFUL LINKS AND WEBSITES

SUBMISSIONS FOR UCC LAW JOURNAL

Dear Readers:

As the Editor in Chief of the Uniform Commercial Code Law Journal (UCC Law Journal), I am delighted to invite you to submit articles for consideration. The Journal, which is published quarterly by Thomson Reuters, has a proud and distinguished tradition. Professor Louis Del Duca, who was without a doubt one of the great minds in the field of commercial law and a mentor to so many, served as the Journal's first Editor in Chief, and it is truly a privilege to follow him.

Over its history, thus far, the Journal has published articles written by many of the leading academicians and practitioners in the field of commercial law, and Principal Attorney Editor Lisa Ovsiovitch and I are very interested in hearing from prospective authors in both groups. The Journal welcomes articles relating to various aspects of the Uniform Commercial Code that may include, but are in no way limited to, such topics as each of the UCC articles, contract law, commercial arbitration, damages, the Sarbanes Oxley Act, the Truth in Lending Act, alternative

Joint Report from the Chairs

Dear Members:

Please email either of us if you have any ideas for either of the Committees or wish to participate in any project, subcommittee or leadership role. The Committees have a number of projects underway. Our subcommittees and task forces are very active and always welcome input. Please do not hesitate to volunteer!

We hope you enjoy this issue, and invite you to get involved in your committee(s).

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Featured Articles

Noteholders Beware: Contract Rights and Choice of Law Provisions in an Indenture are Property Rights for Purposes of Commencing a Chapter 15 Case

By: Ira L. Herman and Evan J. Zucker

payment systems in the modern era, commercial issues in gaming systems, issues related to prepaid accounts, issues related to the 2010 Article 9 Amendments, issues related to the UCC and bankruptcy, litigation, secured lending, issues related to trusts and trustees, searching and filing issues under Article 9, the CISG, etc.

The next deadline for submitting articles to be considered for publication is October 1, 2019. I would be glad to provide additional information, including Thomson Reuters' Submission Instructions and Specifications, to anyone who is interested in having an article published in the Journal. Articles should be submitted by e-mail if possible, and the preferred format is Microsoft Word.

Very truly yours,

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VIEW CURRENT REPORTS AND DEVELOPMENTS OF THE FOLLOWING COMMITTEES AND TASK FORCES:

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- [Subcommittee on Secured Lending](#)
- [Subcommittee on Syndications and Lender Relations](#)

The Bankruptcy Court for the Southern District of New York recently reaffirmed its view that it takes little to establish “property in the United States,” to qualify a foreign entity for ancillary relief under chapter 15 of the Bankruptcy Code. *See* 11 U.S.C. § 109(a). Specifically, in *In re PT Bakrie Telecom TBK*, the Court found that the New York governing law and forum selection clauses found in a trust indenture, constitute a contract right that is enough of a property interest to constitute - “property in the United States” for the purposes of Chapter 15. *In re PT Bakrie Telecom TBK*, 601 B.R. 707, 715-16 (Bankr. S.D.N.Y. 2019).

Background

PT Bakrie Telecom Tbk (“BTEL”), was in the business of providing a fixed digital radio cellular telecommunication national network and services. BTEL commenced the chapter 15 case to implement an Indonesian debt restructuring plan that would allow BTEL to avoid liquidation. The gravamen of BTEL’s financial distress – and the key issue in recognition – was its guarantee of certain 11.5% senior dues due 2015 senior notes issued by Bakrie Telecom Pte. Ltd. (the “Issuer”), a subsidiary of BTEL, in the principal amount of \$380 million, pursuant to a trust indenture governed by New York law.

Thereafter, the Issuer defaulted on the interest payments due November 2013 and May 2014. In September 2014, certain noteholders sued the Issuer for the unpaid past due interest and BTEL on its guarantee of that payment obligation, in New York. Subsequently the aggrieved holders delivered a notice of acceleration to BTEL, the Issuer and the Indenture Trustee demanding immediate payment of all of then outstanding principal and interest.

On October 23, 2014, one of BTEL’s creditors – not a noteholder - filed a PKPU application against BTEL in the Central Jakarta Commercial Court. A PKPU proceeding is a court-enforced suspension of payments process in Indonesia that is designed to provide a debtor a definite period of time to restructure its debt and reorganize its affairs pursuant to a composition plan with its creditors. While the PKPU proceeding was pending, BTEL engaged in restructuring negotiations with its noteholders, ultimately resulting in the Central Jakarta Commercial Court granting a Temporary Suspension of Payment and setting a schedule to vote on a composition plan. A number of the noteholders (the “Objecting Noteholders”), however, complained that they were being excluded from the PKPU process even though they filed claims. They were excluded because the administrator overseeing the PKPU proceeding denied their claims. Instead of each noteholder having a claim, BTEL listed the Issuer as its creditor owing the \$380 million. These noteholders also took issue with the restructuring process because they asserted that the Indenture Trustee did not consent to the Issuer voting the note debt instead of the noteholders and that the Issuer lacked standing to vote the debt. Despite these arguments, on December 8, 2014, the requisite majority of BTEL’s creditors voted to approve BTEL’s restructuring plan. Neither the Objecting Noteholders nor the Indenture Trustee appealed the decision approving the plan.

The same day that their claims were rejected in the PKPU Proceeding, the Objecting Noteholders commenced a second action in New York against BTEL for fraud, tortious conduct in connection with the offering, and a declaratory judgment that the PKPU Proceeding was invalid with respect to the Indenture. The New York court granted summary judgment on the Objecting Noteholders’ breach of contract claim and sustained their claims against the Issuer and subsidiary guarantors for fraud in connection with the offering. *See Universal Inv. Advisory SA v. Bakrie Telecom PTE, Ltd.*, 51 Misc.3d 1212(A) (Sup. Ct. N.Y. Cnty. 2016). On cross-appeals, the New York Appellate Division affirmed summary judgment in favor of the objecting noteholders. *See Universal Inv. Advisory SA v. Bakrie Telecom PTE, Ltd.*, 154 A.D.3d 171 (1st Dep’t 2017).

In January 2018, the foreign representative of BTEL commenced its chapter 15 case by filing a chapter 15 petition for recognition of a foreign proceeding. The Objecting Noteholders contested recognition, arguing, among other things, that BTEL was ineligible for chapter 15 relief, because it did not have “property in the United States” within the meaning of section 109(a) of the Bankruptcy Code. BTEL disagreed, contending it had “property in the United States,” consisting of contract rights under an Indenture governed by New York law and subject to a New York forum selection provision. In response, the Objecting Noteholders

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argued that it would be inequitable for a foreign debtor to use an indenture as a sword and a shield – relying on the provisions of the Indenture as the sole basis for chapter 15 eligibility, after first freely and willfully ignoring the terms and obligations of the Indenture in its Indonesian PKPU Proceeding. The Bankruptcy Court, however, found that a debtor’s contracts rights are intangible property sufficient to satisfy the minimal property requirement under section 109 of the Bankruptcy Code and granted recognition.

Rationale

Chapter 15 of the Bankruptcy Code permits foreign debtors to obtain the protection of the United States bankruptcy courts in support of a foreign insolvency proceeding. In order to obtain such protection, the foreign debtor must be an eligible debtor within the meaning of the Bankruptcy Code. In *Drawbridge Special Opportunities Fund LP v. Barnet*, the Second Circuit held that section 109(a) of the Bankruptcy Code applies to chapter 15 cases and that all of the sections eligibility requirements, including the requirement that the entity “resides or has a domicile, a place of business, or property in the United States” must be met for a foreign entity to be eligible for chapter 15 relief. *Drawbridge Special Opportunities Fund LP v. Barnet (In re Barnet)*, 737 F.3d 238 (2d Cir. 2013).

Courts in the Southern District of New York have consistently construed the term “property” broadly to include intangible assets. For example, causes of action with a *situs* in New York owned by a foreign debtor is a sufficient property interest in the United States to satisfy the eligibility requirement. See *In re Berau Capital Res. Pte Ltd*, 540 B.R. 80, 82 (Bankr. S.D.N.Y. 2015) [hereinafter “*Berau*”]; *In re Octaviar Admin. Pty Ltd*, 511 B.R. 361, 372–74 (Bankr. S.D.N.Y. 2014).

Similarly, in *Berau*, the court found that while a retainer account is sufficient property in the United States, a United States dollar denominated debt indenture governed by New York law provided another “substantial basis” for satisfying the chapter 15 eligibility requirements. *In re Berau Capital Res. Pte Ltd*, 540 B.R. at 82. The court in *Berau* found that indentures are contracts that create property rights. These rights are intangible property. Under section 1502(8) of the Bankruptcy Code, the location of intangible property rights is to be determined under applicable nonbankruptcy law. Under New York law, contract counterparties can establish the *situs* of a contract, including the *situs* of the concomitant intangible property, by including New York governing law and a New York forum selection clause in a contract. The court noted that it “would be ironic if a foreign debtor’s creditors could sue to enforce the debt in New York, but in the event of a foreign insolvency proceeding, the foreign representative could not file and obtain protection under chapter 15 from a New York bankruptcy court.”

Relying on *Berau*, the Court in *PT Bakrie* found that the intangible property rights – contract rights – created by the Indenture alone satisfied the property requirement of section 109. In so finding, the Court rejected any attempt to add a subjective equitable component to the straight forward requirements of section 109. Specifically, the Court found that questions regarding whether BTEL and its affiliates had disregarded and repudiated its obligations under an agreement governed by New York law were not before the court, and, therefore, at the recognition stage, did not affect whether the debtor had an intangible property interest in New York at the time of the commencement of its chapter 15 case.

Conclusion

The importance of the *PT Bakrie* holding, and its underlying rationale should not be overlooked, even if the decision itself does not address a novel issue, as there are any number of foreign entities that have accessed and will continue to access the U.S. capital markets and have and will have U.S. dollar-denominated debt, subject to documentation that includes New York governing law and New York forum selection clauses. First, once again, it has been established that a foreign entity can readily access the U.S. bankruptcy court system to bind the entity’s U.S. creditors to the outcome of a foreign restructuring process. Second, such foreign outcomes may be at odds with the expectations of creditors who have relied on documents and the rights and remedies agreed to in such documents.

What's Market: 2019 Mid-Year Trends in Large Cap and Middle Market Loans Practical Law Finance

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If so, submit an article for possible publication in a future issue of the Commercial Law Newsletter. Publishing an article with the Commercial Law Newsletter is a great way to get involved with the UCC Committee and the ComFin Committee. Articles can survey the law nationally or locally, discuss particular UCC or Commercial Finance issues, or examine a specific case or statute. If you are interested in submitting an article, please contact one of the following Commercial Law Newsletter Editors: [Shadi Enos](#), [Paul Hodnefield](#), [Celeste Pozo](#), [Samuel R. Henninger](#), [Peter V. Marchetti](#), [Kristoffer A. Gredsted](#), or [Khyshboo Patel](#).

Following a bumpy end to 2018, the leveraged loan market remains muted so far in 2019. Borrowers continue to push for looser deal terms in their loan agreements, including their basket capacity, [MFNs](#), and [EBITDA](#) add-backs. Market participants prepared for [LIBOR's](#) possible demise with robust fallback language in their credit agreements. The market also showed increased interest in alternative financing such as green loans and sustainability-linked loans.

Market Trends and Developments

Following a disappointing second quarter, total US syndicated lending reached just over \$1 trillion through June 2019, a decrease of 33% compared to the levels seen through June 2018, and the lowest first half total in three years. [Leveraged](#) lending levels totalled \$354.3 billion for the first six months of the year with \$188.7 billion in 2Q19, a decrease of 54% year-over-year. [Investment grade](#) issuance reached \$495.9 billion through June 2019, with investment-grade refinancings dominating so far in 2019.

M&A leveraged loan issuance dropped 35% from the levels posted in the first half of 2018. [Leveraged buyout](#) (LBO) activity, which has led the M&A market so far in 2019, totalled \$33.1 billion in 2Q19, an increase of 12% compared to 2Q18. However, non-LBO M&A issuance reached \$23.4 billion in the second quarter of 2019, a decrease of 63% compared to the year-ago period.

A breakdown by industry sector shows that technology, financial services, and general manufacturing were the top three industries in terms of loan issuance for the leveraged loan market through June 2019.

[Refinancing](#) activity, a big driver in the market the past few years, has been muted so far in 2019, recording \$33.2 billion through the first six months of the year. New money deals have also been sluggish, and are down 33% compared with the first half of 2018. However, as several high value deals have already cleared the market in 2019, market participants anticipate a favorable environment for borrowers to take advantage of in the second half of the year.

[Middle market](#) issuance posted \$62.6 billion in the first half of the year, a 36% decrease compared to \$98 billion through June 2018. Of this volume, approximately \$50.8 billion

was large middle market issuance (deals valued over \$100 million) and approximately \$11.8 billion was traditional middle market issuance. Middle market institutional term loan yields dropped in the second quarter of 2019 for the first time in six consecutive quarters.

[Dividend recap](#) volume picked up in 2019, with market participants observing that a scarcity of M&A deals could be one reason why cash-rich investors are pursuing this type of financing. [Second lien](#) loan issuance remained steady, posting \$7.4 billion in the second quarter of 2019, up slightly from the \$7.3 billion reached in the same period last year.

[Collateralized loan obligation](#) (CLO) issuance continued its momentum from last year, topping \$65 billion for the first six months of the year, only slightly lower than the record \$68 billion reached through June 2018. However, CLO refinancings dipped significantly, from \$89 billion priced through the first half of 2018 to \$23 billion in the first half of 2019. Despite the robust CLO volume year-to-date, market participants anticipate a slow-down due to decreased demand and lack of underlying leveraged loans.

[Covenant-lite](#) loan issuance continued to dominate the leveraged loan market. According to market information, cov-lite deals currently account for 79% of loans in the S&P/LSTA Leveraged Loan Index. Some market observers remain worried that the prevalence of cov-lite deals could prevent the market from appropriately responding if a sudden deterioration in the economy causes widespread weakening of borrowers' creditworthiness so that risk in the market spikes.

For more information on covenant-lite loans, see [Practice Note, Covenant-lite Loans: Overview](#).

Leveraged Lending Guidance

Political leaders have begun to express views on banks' underwriting practices and where this might lead. In the wake of the conclusion of the Government Accountability Office (GAO) in 2017 that certain procedural requirements were not observed in the creation of the Leveraged Lending Guidance (LLG), governmental agencies have been reluctant to take enforcement action on the LLG because

they do not take enforcement actions based on supervisory guidance. Possibly because of this less stringent outlook, the number of deals with leverage levels above the limit set out in the LLG of six times EBITDA has started growing.

The regulators who created the LLG regarded excess leverage as a risk for the market. Senator Elizabeth Warren sent a letter to regulators last year questioning how they planned to tackle the increasing risks in the leveraged loan market, writing "I am concerned that the large leveraged lending market exhibits many of the characteristics of the pre-2008 subprime mortgage market. These loans are generally poorly underwritten and include few protections for lenders and investors..." Former Federal Reserve (Fed) Chair Janet Yellen also voiced her concern, warning that she is "worried about the systemic risks associated with these loans," in part because "there has been a huge deterioration in standards" and "covenants have been loosened."

Fed Chairman Jerome Powell has sought to ease these concerns. Although acknowledging that the current climate has some similarities to the pre-crisis market, Chairman Powell said that leveraged lending doesn't represent a current threat to the financial system. In his remarks at a recent Fed conference, Chairman Powell explained that regulators are more closely monitoring the situation this time around and that the system remains strong and is fully equipped to deal with possible financial losses.

Direct Lending

Direct lenders remain competitive players in the market despite easing of regulatory pressures on bank lenders. Investor demand remained strong and the increasing role of direct lenders in middle market loan deals continued. Market participants also observed a convergence of loan terms in direct lending deals. Some market observers also noted cases where lenders have provided the full commitment at the outset, and only later sold portions of the loan to additional investors to reduce their risk. Known as a "single dollar uni," this development could potentially move lenders away from the traditional [unitranche loan](#), which combines separate senior and subordinated debt financings into a single facility.

Interest Rates

The Fed issued four rate hikes last year and initially estimated two interest rate increases in 2019. Earlier this year it seemed the Fed had put a hold on interest rate rises, indicating that no more rate hikes would be forthcoming in 2019. The change coincided with lower expectations for economic growth and inflation. The Fed seems to have changed course, however, as it cut rates by .25% in July 2019. As of this writing, the current benchmark funds rate stands at 2% to 2.25%.

Tax Cuts and Jobs Act

The loan market continued to adapt to the Tax Cuts and Jobs Act (the Act), which was enacted at the end of 2017 and made significant changes to business taxation. Since its signing, the US Treasury has issued a few sets of proposed regulations some of which have been finalized. The impact of the Act on foreign credit support for US financings requires a nuanced analysis, but borrowers may now be more receptive to providing foreign guaranties and foreign credit support for US borrowers. The complexity of the analysis that a borrower must undertake to evaluate the potential impact under the new rules may, however, slow down changes in market practice.

For more information on tax reform and how this could affect the leveraged loan market, see [Article, Expert Q&A on Tax Reform Updates and the Leveraged Loan Market](#).

Defaults, DIPs, and Windstream

US leveraged loan defaults continued to fall in 2019, and market participants do not foresee an uptick in defaults in the near future.

There have been several sizeable [debtor-in-possession](#) (DIP) financings in 2019, including the \$1 billion Windstream Services deal. Windstream raised concerns in the market as it involved certain investors pushing their interests as credit default swap (CDS) holders above the interests of borrowers and other lenders. In the wake of Windstream, loan market participants may try to block these "net short lenders" by limiting their ability to vote. Other lender actions which could clear the market include adding net short lenders to a disqualified lender list, including a "sunset" provision for lenders calling a default, or blocking these lenders from owning loans.

For more information on CDS strategies, see [Practice Note, Understanding Credit Default Swaps \(CDS\): Unconventional Strategies](#). An update on Windstream is forthcoming.

Delaware Limited Liability Company Act

In 2018, the Delaware Limited Liability Company Act was amended to add, among other things, a division statute. These amendments went into effect on August 1, 2018. The division statute permits a Delaware limited liability company (LLC) to divide into two or more LLCs. Creating a division lessens the need to transfer assets and liabilities or assign contracts and licenses to newly formed LLCs. Under the statute, the dividing LLC's assets and liabilities are allocated to the dividing LLC and the resulting LLCs, as specified in a plan of division of the dividing LLC. Lenders entering into credit agreements involving Delaware LLCs should consider adding negative covenant language prohibiting divisions.

For more information on the Delaware Limited Liability Company Act, see [Article, Expert Q&A on the Delaware Law Amendments Relating to Limited Liability Company Divisions](#). For an example of a credit agreement with Delaware LLC division language added, see What's Market, [SciPlay Holding Company, LLC](#) credit agreement summary. See also [Standard Clause, Loan Agreement: Negative Covenants](#).

LIBOR

LIBOR looks set to disappear, as panel banks are only required to support the LIBOR benchmarks and remain submitters until 2021. Although discussions about replacing LIBOR are ongoing in the syndicated loan market, market participants continue to take a proactive approach to prepare for LIBOR's potential discontinuation.

The Alternative Reference Rates Committee (ARRC), a committee created by the Fed, has identified the Secured Overnight Financing Rate (SOFR) as its recommended alternative to USD LIBOR. Although market participants seem to accept SOFR as an alternative, the rate is not a perfect substitute for LIBOR as it is a secured overnight rate only.

In April 2019, the ARRC released its recommended USD LIBOR fallback contract language for syndicated business loans, as it determined that more robust fallback language was necessary. According to the ARRC, robust fallback language should include, in general terms:

- Well-defined trigger events to signal conversion from LIBOR to a new reference rate (includes mandatory and "early opt-in" triggers).
- A successor rate (or successor rate waterfall).
- Spread adjustments to make the successor rate and LIBOR more comparable.
- Lender consent.

The recommended fallback language for syndicated loans provides for either:

- An "amendment approach" under which, following a trigger event, the borrower and administrative agent facilitate a streamlined amendment to replace LIBOR by selecting a successor rate and spread adjustment. The amendment approach provides that the borrower and the administrative agent propose a successor rate plus a spread adjustment after giving due consideration to any selection or recommendation by the Fed, the ARRC, or any evolving or then-prevailing market convention for USD syndicated loans.
- A "hardwired" approach under which fallback language has already been included in the original credit agreement resulting in the loan automatically converting to a successor rate after a trigger event occurs. The successor rate in this instance is either:
 - forward-looking term SOFR plus a spread adjustment;
 - if the forward-looking rate does not exist, a compounded average of daily SOFRs plus a spread adjustment; or
 - if neither exist, the hardwired approach reverts to the amendment approach.

Both the amendment and hardwired approaches have the same mandatory triggers. In essence, the mandatory fallback triggers for loans are:

- The benchmark administrator announcing that the administrator has stopped or will stop providing the LIBOR benchmark permanently.
- The administrator's regulator announcing that the administrator has stopped or will stop providing the LIBOR benchmark permanently.
- The benchmark administrator's regulator publicly stating that the benchmark is no longer representative.

For more information on LIBOR successor rates, see [Box, Current Trends in LIBOR Successor Rate Provisions](#) and [Article, Current Trends in LIBOR Successor Rates](#).

Brexit

Currently, the timing and terms of [Brexit](#) remain uncertain. Although the UK was initially set to leave the European Union (EU) on March 29, 2019, the Brexit negotiators have extended the exit date, which is currently October 31, 2019. British Prime Minister Theresa May announced that she was stepping down, amid ongoing political upheaval, and Boris Johnson replaced her in July 2019. Therefore, it is difficult to predict what Brexit will look like, but there are several possible outcomes:

- A hard Brexit, with no backup or replacement agreements or arrangements in place between the UK and the EU.
- A hard Brexit with agreements for areas such as science and technology.

- The UK reaches a deal with the EU that will go into effect on or before October 31, 2019, followed by either:
 - an arrangement outlining a future relationship to go into effect at the end of an agreed-on transitional period; or
 - a hard Brexit going into effect at the end of an agreed-on transitional period.
- European leaders grant the UK an additional extension beyond the October 31, 2019 deadline.
- The UK revokes its Article 50 notice and remains part of the EU.

Brexit is likely to have a significant impact on finance transactions and may affect the way deals are structured. For example, if the UK leaves the EU without agreements in place, an English law governed facility agreement would constitute a non-EEA law governed liability. Bail-in language may therefore need to be included in finance documents governed by English law to which EU-authorized financial institutions are party.

QFC Stay Rules

In September 2017, US bank regulators adopted final resolution stay rules for US global systemically important banking organizations (G-SIBs). The final resolution stay rules place restrictions on termination, liquidation, and certain other close-out rights on US G-SIB counterparties under their qualified financial contracts (QFCs). Covered QFCs are defined in the rules to include agreements such as swaps and derivatives contracts, repurchase agreements (repos), securities lending and borrowing agreements, and certain other financial contracts.

G-SIBs must bring certain existing QFCs into compliance with the resolution stay rules, as well as new in-scope QFCs entered on or after the applicable compliance date. Under the rules, counterparties to G-SIBs under QFCs must relinquish certain rights that they may have bargained for to bring the G-SIB QFCs into compliance. Compliance has been required for covered QFCs between G-SIBs since January 1, 2019.

[The Loan Syndications and Trading Association](#) (LSTA) recently published template credit agreement language to address the application of the final resolution stay rules to credit agreements where the loan documents provide credit support for the borrower's obligations under a related QFC. Market participants can insert the LSTA's language into their loan documents to bring their agreements into compliance with the requirements of the rules.

For more information on the QFC Final Stay Rules, see [Legal Update, LSTA Publishes New Credit Agreement Language Addressing Resolution Stay Rules Affecting Qualified Financial Contracts \(QFCs\)](#).

2019 Mid-Year Loan Trends

Issues that continued to feature prominently in the parties' negotiations of large cap and middle market syndicated loans during the first half of 2019 include:

- Most-favored nation (MFN) negotiations, including inclusion of sunset provisions and other carve-outs to application of the MFN (for an example of a credit agreement with a 50-basis point MFN and a 12-month sunset, see What's Market, [Prairie ECI Acquiror LP](#) credit agreement summary).
- The designation of "unrestricted subsidiaries," including restrictions on a borrower's ability to transfer material assets out of the collateral pool (for an example of a credit agreement that includes a provision restricting the transfer of material intellectual property to an unrestricted subsidiary, see What's Market, [Roadrunner Transportation Systems, Inc.](#) credit agreement summary).
- EBITDA cost-savings/synergies addbacks (for examples of credit agreements containing cost-savings EBITDA addbacks, see What's Market credit agreement summaries for [Six Flags Theme Parks Inc.](#) ("run-rate" cost savings), and [Arrow Bidco LLC](#) credit agreement (20% cap with a 24-month look-forward period)).
- Mandatory prepayment provisions, including leverage-based step-downs, excess cash flow (ECF) sweep reductions on a dollar-for-dollar basis, and carry-forward deductions (for an example of a credit agreement with a leveraged-based step-down and ECF sweep reduction on a dollar-for-dollar basis, see What's Market, [Twin River Worldwide Holdings, Inc.](#) credit agreement summary).
- LIBOR fallback language, with emphasis on conversion triggers and the applicable margin (for examples of credit agreements with LIBOR successor language, see What's Market credit agreement summaries for [Tradeweb Markets, Inc.](#) credit agreement, and [Roku Inc.](#) credit agreement).
- Documentary protections in existing and new credit agreements against potential suits by lenders, including limiting the voting rights of lenders that are "net short" and limiting the discretion of the agent in connection with exercise of remedies.

Market participants have also shown an increasing interest in more environmentally-conscious loan types, such as green loans and sustainability-linked loans (for an example of a sustainability-linked loan, see What's Market, [Xylem Inc.](#) credit agreement summary). For further discussion on developments in sustainability-linked loans, see [Box, An Expert's View: Sustainability-Linked Loans](#).

Looking Forward

Despite the dip in leveraged lending levels in 2019, market participants are optimistic loan volumes will continue to rebound as more borrower-friendly terms clear the market. Market observers also anticipate an increase in M&A activity in the second half of the year. The leveraged loan market will also likely continue to grapple with geopolitical risks in 2019 and beyond, including the uncertainty surrounding Brexit, frosty trade relations between the US and China, and rising tensions with Iran. Regulators and lawmakers will likely continue their debate concerning leveraged loan risk. Market observers are also expected to continue to prepare their loan documents for LIBOR discontinuation.

The market statistics cited in this article (unless otherwise stated) were provided by Refinitiv LPC

UCC Spotlight

By [Carl S. Bierre](#) and [Stephen L. Sepinuck](#)



The purpose of this column is to identify some of the most disconcerting judicial decisions interpreting the Uniform Commercial Code or related commercial laws. The purpose of the column is not to be mean. It is not to get judges recalled, law clerks fired, or litigators disciplined for incompetence. Instead, it is to shine a spotlight on analytical errors, and thereby provide practitioners and judges with reason to disregard the decisions.

Durham Commercial Capital Corp. v. Ocwen Loan Servicing, LLC, No. 17-15572, [2019 WL 2290886](#) (11th Cir. May 29, 2019)

This decision deals with a secured party's right to collect from an account debtor. Both the court's analysis and holding are a bit unclear, with the result that even if the decision is not wrong, it muddies the waters of Article 9.

Durham Commercial Capital Corp. ("Durham") obtained a security interest in a law firm's accounts. Durham notified Ocwen Loan Servicing, LLC ("Ocwen") – one of the firm's clients, and hence an "account debtor" – to remit to Durham any payments due to the firm. After receiving that instruction, Ocwen nevertheless paid the firm more than \$1.3 million. Durham then sued Ocwen under U.C.C. § 9-406(a), claiming Ocwen breached a statutory duty to make payment to Durham.

The law relating an account debtor's obligations is quite clear. Prior to receiving a proper instruction otherwise, the account debtor may discharge its obligation by paying the debtor; but after receiving an instruction from either the debtor or the "assignee" to pay the assignee, the account debtor may discharge its obligation only by paying the assignee. U.C.C. § 9-406(a). The court started its analysis with this rule but concluded that it does not create a private right of action for secured parties and that therefore the lower court's judgment for Durham had to be reversed.

In addressing the issue, the court examined both the language and structure of the Uniform Commercial Code. Unfortunately, despite careful and repeated reading, it is unclear if the court concluded that secured parties do not have a cause of action under U.C.C. § 9-406(a) because:

- (i) U.C.C. § 9-406(a) gives no one a private right of action;
- (ii) secured parties are not "assignees" within the meaning of U.C.C. § 9-406(a); or
- (iii) both (i) and (ii).

Depending on what the court meant, its conclusion ranges from troubling to simply incorrect.

If the court concluded that U.C.C. § 9-406(a) does not create a private cause of action for anyone, its decision would not be completely aberrational. In recent years, several other decisions, including the widely noted *Forest Capital, LLC v. Blackrock, Inc.*, [658 F. App'x 675](#) (4th Cir. 2016), have reached the same outcome. *See also, e.g.*, *FPP Sandbox, LLC v. Redstone Commc's Grp., Inc.*, No. 8:18CV106, [2018 WL 4259841](#) (D. Neb. July 24, 2018); *Integrity Factoring & Consulting, Inc. v. Triple S Materials, L.P.*, No. 5:16-CV-885-DAE, [2017 WL 8020218](#) (W.D. Tex. Nov. 20, 2017); *Ara, Inc. v. Waste Mgmt. Nat'l Servs., Inc.*, No. 17-159 (MJD/SER),

[2017 WL 4857428](#) (D. Minn. Oct. 25, 2017), *opinion and order vacated*, No. 17-cv-159 (MJD/SER), [2018 WL 1737277](#) (D. Minn. Feb. 13, 2018).

Other courts, including the district court in this case, have reached the opposite conclusion. *E.g.*, *United Capital Funding Corp. v. Ericsson Inc.*, No. C15-0194JLR, [2018 WL 3619633](#) (W.D. Wash. July 30, 2018), *rev'd on other grounds*, [728 F. App'x 682](#) (9th Cir. 2018); *see also* *Reading Co-operative Bank v. Constr. Co.*, [984 N.E.2d 776](#) (Mass. 2013) (holding that an account debtor that, despite agreeing to pay secured party directly, sent twelve checks to the debtor, was liable to the secured party under U.C.C. § 9-406 for the full amount of all those checks – \$3 million – even though the secured obligation was only \$530,000).

The conclusion that U.C.C. § 9-406(a) creates no private right of action has always been somewhat questionable. The *Durham Commercial* court sided with *Forest Capital* largely based on the premise that recognizing a right of action under U.C.C. § 9-406(a) would make that provision duplicative of U.C.C. § 9-607(a)(3). But that is incorrect. Rightly understood, U.C.C. § 9-607(a) deals with *when* a secured party may collect, whereas U.C.C. § 9-406(a) helps to determine *what* a secured party may collect. Ultimately, however, the issue should be largely immaterial, because an account debtor who pays the debtor after being properly instructed not to do so will not have discharged its obligation, and a claim against the account debtor will unquestionably exist on the underlying contract between the debtor and the account debtor. *See Forest Capital*, [658 F. App'x at 682–83](#) (expressly noting that the secured party did not properly plead a case for simple breach of contract); *Integrity Factoring*, [2017 WL 8020218](#), at *5; *Ara*, [2017 WL 4857428](#), at *5. Consequently, the issue should be simply a matter of proper pleading, and the *Durham Commercial* court acted harshly in simply directing the entry of judgment against the secured party.

In a more grievous mistake, though, the Eleventh Circuit appears to have concluded that a secured party is not an “assignee” within the meaning of U.C.C. § 9-406(a), and thus even if that provision does create or allow for a private right of action, such a right is not one that secured parties have.

Although the term “assignment” is not defined in the statutory text, there is a sort of stealth definition in U.C.C. § 9-102, comment 26. That comment makes it clear that depending on the context, the term may refer to the transferee of either an outright ownership interest or a limited interest, such as a security interest. Although this comment does not state that every reference to an “assignee” includes a secured party, the vast majority of courts have concluded that the references in U.C.C. § 9-406(a) to “assignor” and “assignee” include, respectively, a debtor and a secured party. *See, e.g.*, *Nisbet, Inc. v. Wells Fargo Bank*, No. SA-14-CV-00469-RP, [2015 WL 1408839](#) (W.D. Tex. Mar. 26, 2015); *Swift Energy Operating, L.L.C. v. Plemco-South, Inc.*, [157 So. 3d 1154](#) (La. Ct. App. 2015). *Contra* *CapitalPlus Equity, LLC v. Glenn Rieder, Inc.*, No. 17-CV-639-JPS, [2018 WL 276352](#) (E.D. Wis. Jan. 3, 2018); *Factor King, LLC v. Housing Authority for Meriden*, No. CV176010391S, [2018 WL 6016838](#) (Conn. Super. Ct. Oct. 29, 2018).

Indeed, courts interpreting New York law have treated a borrower granting a security interest in accounts as an “assignor” under U.C.C. § 9-406 and, implicitly, the lender as an “assignee.” *See ImagePoint, Inc. v. JP Morgan Chase Bank*, [27 F. Supp. 3d 494](#), 507–09 (S.D.N.Y. 2010). Moreover, U.C.C. § 9-406(a) of revised Article 9 was based on U.C.C. § 9-318 of old Article 9, which similarly used the terms “assignor” and “assignee.” And courts interpreting old U.C.C. § 9-318 almost uniformly regarded a lender with a security interest in accounts as an assignee, *see, e.g.*, *Bank of Waunakee v. Rochester Cheese Sales, Inc.*, [906 F.2d 1185](#), 1190 (7th Cir. 1990), including courts interpreting New York law, *see In re Johnson*, [439 B.R. 416](#), 432 (Bankr. E.D. Mich. 2010), *aff'd on other grounds*, No. 10-14292, [2011 WL 1983339](#) (E.D. Mich. 2011), and – most significantly – the Eleventh Circuit itself! The circuit court was quite emphatic on this point:

If, as the Bank claims, it has only a perfected security interest in the accounts receivable, it is nevertheless still an “assignee” within the meaning of section 25-9-318. “For purposes of [U.C.C. § 9-318], the courts and the UCC have made no distinction between a party with a security interest in a debtor’s accounts receivable and a party who is an assignee of a debtor’s accounts receivable.” *Bank of Waunakee v. Rochester Cheese Sales, Inc.*, [906 F.2d 1185](#), 1190 (7th Cir. 1990) (applying Wisconsin’s identical version of U.C.C. § 9-318). It seems clear that “a secured party with a security interest in accounts or general intangibles is the assignee under [U.C.C.] § 9-318.” *In re Otha C. Jean & Assocs., Inc.*, [152 B.R. 219](#), 222-23 (Bankr. E.D. Tenn.1993) (applying Tennessee’s identical version of U.C.C. § 9-318). This interpretation is in accord with the purpose of section 25-9-318, which is to govern the third-party rights that arise when contract rights are assigned as part of a secured transaction.

First Nat'l Bank of Boston v. Thomson Consumer Elecs., Inc., [84 F.3d 397](#), 399 (11th Cir. 1996).

This conclusion that a secured party is an “assignee” under U.C.C. § 9-406 makes excellent sense. For one thing, if U.C.C. § 9-406(a) covered only assignees who bought receivables, and not secured parties with a security interest in receivables to secure an obligation, there would be a gaping hole in Article 9. There would be no rules on whether, when, and how the account debtor whose obligation was collateral for a loan could discharge its obligation by paying the debtor or the secured party. Separately and more broadly, Article 9 takes substantial measures to accommodate outright and collateral transfers of receivables under the same rules where this is sensible, because “[i]n many commercial financing transactions the distinction is blurred.” U.C.C. § 9-109, cmt. 4.

Certainly as applied to U.C.C. § 9-406(a), there is no good reason why – or any reason why – the same rule should not apply to both types of transferee.

The Eleventh Circuit reached its conclusion that secured parties are not “assignees” within the meaning of U.C.C. § 9-406(a) based on deference to what it took to be applicable state law under *IIG Capital LLC v. Archipelago, L.L.C.*, [829 N.Y.S.2d 10](#) (N.Y. App. Div. 2007). See *Durham Commercial*, [2019 WL 2290886](#), at *4. But the court in that case said no such thing. In that case, a factor brought an action against an account debtor that continued to pay the debtor after allegedly receiving an instruction to pay the factor. The account debtor moved to dismiss, in part, based on the claim that the factoring agreement did not cover all of the debtor’s accounts and the schedule of which accounts were sold was not part of the judicial record. The court ruled that, at the pleading stage, the factor had made sufficient allegations to go forward.

The court then briefly disagreed with the factor’s alternative argument, that it had a back-up security interest in all of the debtor’s accounts, and that this was a sufficient basis for its claim under U.C.C. § 9-406(a); the court noted that the factor’s right collect based on its back-up security interest was expressly conditioned on an event of default, and no such default was alleged. *IIG Capital*, [829 N.Y.S.2d at 13](#). In that context, the court discussed whether a secured party was an “assignee” for the purposes of U.C.C. § 9-406(a), but this discussion was pure dicta. More to the point, the court did not say that a secured party was not an assignee for this purpose, merely that the cases that the factor had cited, which interpreted old Article 9, did not support the point. *Id.* Thus, in several ways, the Eleventh Circuit went seriously astray on the “assignee” matter.

In re TSAWD Holdings, Inc.,
[595 B.R. 676](#) (Bankr. D. Del. 2018)
No. 16-10527, [2018 WL 6885922](#) (Bankr. D. Del. Nov. 26, 2018)
[601 B.R. 599](#) (Bankr. D. Del. 2019)

In a trio of decisions from the liquidation proceedings for The Sports Authority Holdings, Inc. and its affiliates, the Bankruptcy Court for the District of Delaware perpetuated a misinterpretation of what constitutes a “consignment” for purposes of Article 9’s scope. At issue was whether a particular creditor’s knowledge prevents the debtor from being “not generally known by its creditors” to be substantially engaged in selling the goods of others as specified in U.C.C. § 9-102(a)(20).

Each decision involved the priority of a different consignor of goods as against the lenders in a \$300 million term loan secured by, among other things, the debtors’ inventory. Bank of America was the initial administrative agent for the term loan, and was later succeeded by Wilmington Savings Fund Society (“WSFS”).

One of the suppliers, Performance Apparel Corp. (“PAC”), had filed a financing statement and sent notification of its transaction with the debtors to the term lenders. These acts together generally confer priority on the consignor over a prior secured party. See U.C.C. §§ 9-324(b), 9-103(d). However, PAC apparently never filed a continuation statement. WSFS argued that PAC’s failure to file a continuation statement rendered PAC’s interest unperfected, entitling WSFS to priority. *In re TSAWD Holdings, Inc.*, [595 B.R. at 680–81](#). PAC responded that the term loan agreement expressly identified PAC’s interest as a “permitted lien”; accordingly WSFS as agent, and the lenders as principals, had actual knowledge of the consignment; and therefore, PAC’s transaction with the debtors was not a consignment covered by Article 9, see § 9-109(a)(4), and PAC’s failure to file a continuation statement did not cause WSFS to have priority in PAC’s consigned inventory. *Id.* at 681. The court accepted this line of reasoning, observing that Article 9 is designed to prevent secret liens and that WSFS’s knowledge prevented PAC’s property rights from being secret to WSFS. *Id.* at 683–85.

The second supplier, M.J. Soffe, LLC (“Soffe”) had failed to file a financing statement or notify the term lenders until one month before the debtors’ bankruptcy petition. In contrast to its PAC ruling, the court ruled that neither Bank of America (“B of A”) nor WSFS had actual knowledge of the Soffe consignment transaction. Soffe maintained that B of A, in its capacity as a co-lender to Soffe’s parent, knew of Soffe’s consignment relationship with the debtors, but the court concluded otherwise and ruled that even if it did know, that information was confidential and thus could not be imputed to the term lenders themselves. *In re TSAWD Holdings, Inc.*, [2018 WL 6885922](#), at *4–7. The court accordingly concluded that the transaction was subject to Article 9, and that WSFS had priority with respect to Soffe’s consigned goods delivered before, but not after, Soffe filed its financing statement. *Id.* at *7.

The third supplier, Sport Dimension Inc., was similar to Soffe in having filed and given notice only one month pre-petition, but Sport Dimension’s notice had gone only to B of A, which by that time had been succeeded by WSFS as reflected by an amended UCC-1 for the term loan. The court found no actual knowledge by the term lenders, either as to the particular consignments by Sport Dimension or as to the debtor’s being “substantially engaged” in selling the goods of others. Hence the transaction was a consignment covered by Article 9, and the failure to notify WSFS prevented Sport Dimension from having a super-priority.

The problem in these opinions is their complete infidelity to the text and good sense of Article 9. The Code could not be clearer on this point. The issue is whether the putative consignee is “generally known by its creditors” to be substantially engaged in selling the goods of others – not what a particular competing creditor knows. The drafters of Article 9 were well aware of how to

phrase a rule based on a particular person’s knowledge, and did so in more than a dozen different provisions. See U.C.C. §§ 9-317(b), (c), (d), 9-320(b), 9-321(a), 9-323(b), (d)-(g), 9-330(b), (d), 9-337(1), (2); see also U.C.C. §§ 9-320(a), 9-321(b), (c), 9-341(2) (each expressly treating a claimant’s knowledge as irrelevant). The court in the *TSAWD Holdings* decisions did not notice Article 9’s precision on such issues; nor did it adequately note the clear line of cases that follow and apply the definition as written. See, e.g., *Overton v. Art Fin. Partners LLC*, [166 F. Supp. 3d 388](#) (S.D.N.Y. 2016); *In re Niblett*, [441 B.R. 490](#) (Bankr. E.D. Va. 2009); *French Design Jewelry, Inc. v. Downey Creations, LLC* (*In re Downey Creations, LLC*), [414 B.R. 463](#) (Bankr. D. Ind. 2009); *Rayfield Inv. Co. v. Kreps*, [35 So. 3d 63](#) (Fla. Ct. App. 2010).

The court did rely heavily on two cases suggesting that it would be “absurd” for a secured creditor that had knowledge of the consignment to have priority over the consignor, simply because other creditors do not have that knowledge – but this seemingly anomalous result is not absurd at all. In fact, it is grounded in very sound policy: to prevent intractable priority problems. If the nature of a consignment transaction between A and B – and the substantive rules that govern it – are determined by what C (a creditor of the putative consignee) knows, then consider what happens if there are multiple Cs, some of whom know the nature of the consignee’s business and some of whom do not. In such a case, the consignment transaction between A and B would apparently be both inside and outside of Article 9, depending on the creditor in question. This could lead to circular priorities, with no logical way to break the circle.

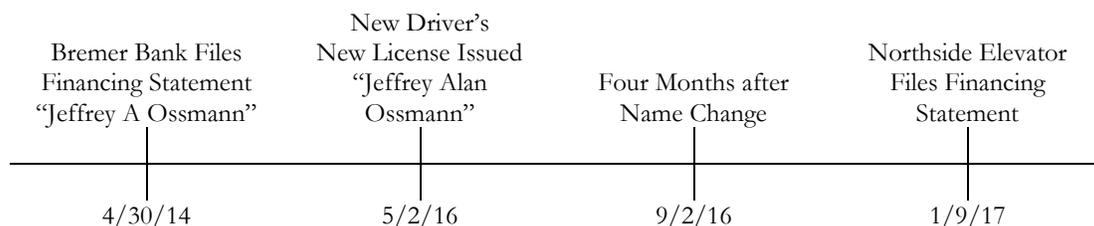
It is precisely for this reason that the definition of consignment was phrased somewhat objectively – in reference to the knowledge of creditors generally – rather than subjectively; why the earlier decisions have been heavily criticized, see Steven O. Weise, *Annual Survey of Commercial Law: Personal Property Secured Transactions*, [65 BUS. LAW. 1293](#), 1294 (2010); Stephen L. Sepinuck, *Misguided California Court Changes “Consignment” Standard*, 25 CLARKS’ SECURED TRANSACTIONS MONTHLY 1, 2-3 (Sep. 2009); and why the Permanent Editorial Board for the U.C.C. has issued new Commentary No. 20, amending the official comment for the consignment definition so that it specifies: “Clause (iii) does not apply solely because a particular competing claimant knows that the goods are held on consignment.” See PERMANENT EDITORIAL BD. FOR THE UNIFORM COMMERCIAL CODE, PEB COMMENTARY NO. 20 CONSIGNMENTS (Jan. 24, 2019), https://www.ali.org/media/finder_public/71/e1/71e1d5a9-3769-4087-ba21-21d2b8f485e2/peb-commentary-no-20-consignments.pdf.

In short, the courts in *TSAWD Holdings* and the cases it relied on essentially treated U.C.C. § 9-102(a)(20) as a priority rule. But it is not. It is a definition related to the scope of Article 9. The *TSAWD* court seems to have been unaware of new PEB Commentary and its drafts, and one hopes that litigators will alert future courts.

Northside Elevator, Inc. v. Ossmann,
No. 2018AP1596, [2019 WL 2291631](#) (Wis. Ct. App. May 30, 2019)

This is a case about the efficacy of a filed financing statement after a change in the debtor’s name. The court erred because it interpreted the filing office’s search logic rules as, effectively, placing a burden on the searcher that the Code quite clearly places on the filer.

The debtor was a farmer who obtained two loans from Bremer Bank and granted it a security interest in some equipment and future crops. The bank perfected its security interest by filing a financing statement that identified the debtor by the name then listed on his driver’s license: “Jeffrey A. Ossmann.” Two years later, the debtor obtained a new driver’s license that indicated his name as “Jeffrey Alan Ossmann,” replacing the initial with the full middle name. The following year, Northside Elevator, Inc. sold seed and fertilizer on credit to the debtor and he granted Northside a security interest in, among other things, future farm products. Northside perfected the security interest by filing a financing statement using the debtor’s full name.



Eventually, a priority dispute arose as to the priority in crops and their proceeds.

Applying the law to these facts is fairly simple. The issuance of a new driver’s license caused the debtor’s name to change for the purposes of Article 9. See U.C.C. § 9-503(a)(4) (alternative A). U.C.C. § 9-507, Official Comment 4 expressly provides that: “[A] debtor’s name may change, and a financing statement providing the name on the debtor’s then-current driver’s license may become seriously misleading, . . . if a debtor’s driver’s license is renewed and the names on the licenses differ.” U.C.C. § 9-507, cmt. 4. If thereafter a search under the debtor’s new name would not disclose the bank’s previously filed financing statement, that financing statement becomes seriously misleading. See U.C.C. § 9-506(a)–(c). If the bank’s financing statement became seriously misleading, it

was ineffective to perfect a security interest in collateral acquired by the debtor more than four months after the change of name (when the new license was issued). U.C.C. § 9-507(c). Consequently, Northside Elevator's security interest would have priority in all of the debtor's new crops and the proceeds thereof. *See* U.C.C. § 9-322(a)(2), (b).

The court expressly acknowledged that an actual search under the debtor's full name using the filing office's standard search logic had not disclosed the bank's financing. Under a proper understanding of the U.C.C. § 9-506(c) safe harbor, this would have been the end of the story and Northside Elevator would have won. Unfortunately, the court ruled to the contrary, by focusing not on the actual search results but on the filing office's administrative rules, which state that "[f]or first and middle names of individuals, initials shall be treated as the logical equivalent of all names that begin with the initials, and no middle name or initial shall be equated with all middle names and initials." *Northside Elevator*, 2019 WL 2291631, at *3. Stressing the "logical equivalent" language, the court wrote that a searcher who "fails to take advantage" of the filing office's search logic "cannot later complain that a financing statement is seriously misleading if that statement would have been disclosed if the searcher had availed himself or herself of the search logic." *Id.* at *4.

In essence, the court turned the rule on its head. Section 9-506(c) saves a financing statement that uses an incorrect name for the debtor only if the financing statement would be disclosed by "using the filing office's standard search logic" to search "under the debtor's correct name" (emphasis added). The court neglected the statutory role of the "correct name" and in effect misconstrued "using" the search logic (or, in the court's words, "tak[ing] advantage" and "availing [one]self" of it), apparently by searching under the variants discussed in the filing office rules. But multiple searches like these are precisely what the statutes are designed to avoid. Section 9-503, Official Comment 2 succinctly explains that "[s]earchers need a simple and predictable system in which they can have a reasonable degree of confidence that, without undue burden, they will discover all financing statements pertaining to the debtor in question." U.C.C. § 9-503, cmt. 2. For this reason U.C.C. § 9-506(b) expressly invalidates financing statements that cannot be found by a search as described in subsection (c). While some cases under former Article 9 had required a "diligent" or "reasonable" search, those were clearly overruled by enactment of revised Article 9. Nor should the filing office rule in this case about "logical equivalent[s]" have suggested a different result, because that rule is clearly intended to govern the retrieval of search results, not the searcher's burden of how to search. Under all of the statutes at issue here, not to mention U.C.C. § 1-103(a)(1)'s goal of "simplify[ing], clarify[ing], and moderniz[ing]" the law, search logic is nothing that a searcher is burdened with "using" in any way beyond simply searching under the debtor's correct name.

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