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FINANCIAL newsletter

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KEY CONSIDERATIONS IN ENFORCING THE BANK'S RIGHTS IN INVENTORY AND "FF & E"

The need to deal with troubled commercial loans can be an unhappy fact of life for commercial lenders. Sometimes doing so can yield satisfying results for all parties involved: a restructured business that returns to profitability; a restructured commercial loan that gets paid in full. But other times satisfying results are not in the offing, and enforcement must follow. This article addresses the key considerations for bankers to consider when enforcing the Bank's rights in inventory and in "FF & E" (furniture, fixtures & equipment) as collateral.

Evaluate. The first two steps are to evaluate the collateral, and to evaluate the Bank's rights in the collateral.

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Collateral: To evaluate the collateral, the banker should consider these steps: (1) confirm the nature and the identity of the collateral; (2) confirm the condition of the collateral; (3) obtain written appraisals of the collateral; (4) obtain expert recommendations regarding the method of disposing of the collateral; and (5) keep meticulous records of each of the foregoing steps. Appraisals are best obtained from two primary sources: (a) liquidation experts, such as but not limited to auctioneers, (b) industry experts, such as competitors of the borrower. Note that a bid is not an appraisal; be prepared to pay for appraisals. Appraisals, on the one hand, and expert recommendations regarding disposition, on the other, are the Bank's best protection against subsequent claims of commercial unreasonableness as to how the Bank dealt with the collateral.

The Bank's position. Evaluating the Bank's position in the collateral starts with (1) reviewing the Bank's Security Agreements to confirm a) that the Bank's rights extend to all of the collateral in which the Bank now seeks to enforce its rights, and (b) that the security interest covers the loans that the Bank seeks to enforce. (2) Next, the banker should confirm that the Bank is properly perfected, usually (but not always) by filing an appropriate UCC-1 Financing Statement (a) at the appropriate filing office (b) that covers the appropriate collateral, and that was filed (c) before any filings by any other purported secured creditors in the same collateral. But that is not all. (3) The banker still needs to consider the rights of other prospective claimants. These considerations include, but are not limited to, the potential rights of (a) prior-filed senior lien claimants; (b) purchase money security interest holders who may have filed behind the Bank, (b) tax lien claimants that may have filed behind the Bank but that have super priority rights against the Bank, (c) other possible hidden lien claimants, such as (but not limited to) perishable goods claimants and storage claimants.

Develop a Disposition Plan. The next step is to develop a commercially reasonable plan for disposing of the collateral. To what extent can or should the Bank consider using any of the individual principals of the borrower to assist in the disposition? Should the Bank attempt to store and dispose of the collateral on the borrower's premises, or to remove the collateral for subsequent disposition at a separate site? How to sell the inventory? How should the Bank best deal with large, heavy, difficult-to-remove equipment? Can all the FF & E or a good part of the FF & E, be sold as a unit? Should sale(s) be conducted as private sales or as public sales? If public, should there be one sale or multiple sales? What advertising, including but not limited to online advertising and publication, should be employed? As with questions of collateral evaluation, the banker should strongly consider obtaining expert advice, both from disposition experts and from industry experts, and to keep meticulous records of the advice obtained. This advice is further protection against subsequent claims of commercial unreasonableness.

Address Default and Acceleration, and Rule out Stoppers. Needless to say, the banker should confirm that an event of default under the loan documents continues to exist and that the debt has been accelerated. Next, the banker will want to rule out--or address--any legal impediments to the Bank's immediate right to seizure. Some of these are obvious, some not so much. They include: (1) any requirements in the loan documents for giving notices of default and opportunity to cure; (2) any facts or circumstances that may be argued to constitute a waiver of default; (3) any other legal action by any person or entity that may affect rights to the collateral and of which the Bank has notice; and (4) any bankruptcy filings.

Get Possession of the Collateral. Next, the Bank needs to determine just how it will get possession of the collateral for the purpose of disposition. Possibilities include: (1) *a consensual "Collateral Turnover Agreement".* This is the gold standard if it can be achieved. A well drafted CTA will include, among other things, a global release of the Bank for any alleged sins that it may have committed up to the time of the agreement, and will also include giving the Bank broad authority to determine just how and when to dispose of the collateral. (2) *Self-Help Seizure.* This alternative usually arises in the situation where the borrower voluntarily ceases operation and turns over the keys. While unwilling to sign a CTA, the borrower is willing to turn over the keys. It can

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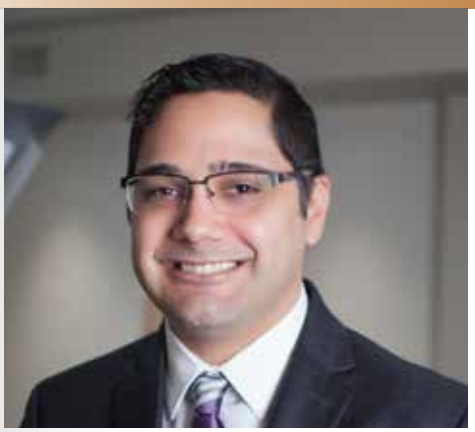
also arise in the situation where the Bank demands turnover, and the customer complies, but in that situation the Bank should make every effort to try and get a CTA as part of that process. (3) *Legal Action.* The Bank can bring what is called a "Replevin" action, which if successful gives the Bank the right to seizure upon obtaining final judgment. Under appropriate circumstances the Bank can speed things up in that lawsuit with a pre-judgment motion for "Claim and Delivery", which if granted gives the Bank the immediate right to seize the collateral. Both remedies involve giving the Bank the right to use the "force of the county" to gain possession, which, with the cooperation of the Sheriff, can include breaking down doors to get in. If the borrower will not voluntarily turn over possession, the foregoing legal action is a much safer remedy than engaging in self-help, because regardless what the loan documents might purport to say, engaging in self-help opens the Bank up to all kinds of nasty claims, including but not limited to breach of the peace and trespass.

Landlord Issues. In situations where the borrower is renting the premises where the collateral is located, and the borrower's landlord is not affiliated with the borrower and the bank does not have a defaulted mortgage on the premises, the banker needs to consider whether and just how to deal the borrower's landlord. Considerations include: (1) the Bank's rights and obligations under any existing Lessors Agreements; (2) whether to remove the collateral without the landlord's knowledge or consent; (3) assuming that the Bank does want to conduct a sale on the premises, negotiating further details as to any short term occupancy with the landlord, covering such points as duration, restrictions on use, costs, and the condition of the premises at termination; and (4) identifying and resolving any issues as to who has rights in the fixtures.

Insurance. Next, the banker needs to consider whether and to what extent to obtain insurance coverage on the collateral for the time it has the collateral in its possession.

Legal Notice of Disposition. Next, the Bank needs to send out an appropriate and timely Notice of Disposition, in accordance with the requirements of the Uniform Commercial Code. Note that this legal Notice of Disposition will be separate and different from whatever advertising and notifications the Bank's liquidation agent may send out. This Notice of Disposition is a legal document, and will affect the rights of the parties going forward, so it is prudent to consider consultation with legal counsel. Among other factors to consider, the banker will want to address the type of notice(s) to give (public or private), the amount of detail to give, the timing of the notice, and just who needs to be served.

Notice of Deficiency. Finally, assuming that upon the conclusion of the disposition the Bank is still facing a deficiency balance, the Bank should consider whether and how to give Notice of Deficiency. If consumers are involved, a Notice of Deficiency is mandatory. If not, it is something to strongly consider under appropriate circumstances. ■



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IMPLEMENTING CYBER SECURITY PROTOCOLS

The amount of personal and financial information stored and communicated electronically on a daily basis in the United States is staggering. This trend will only increase as new technologies develop and integrate into mainstream society. As a result, legislatures are making data privacy and cybersecurity laws a higher priority. Although there is no unified federal law on the subject, all fifty states have enacted data breach notification statutes.

Minnesota, in particular, requires every person or business that owns or licenses personal information to notify individuals of a data breach that resulted in or is reasonably believed to have resulted in the unauthorized "acquisition" of their personal information. In general, notice to affected individuals must be provided in the most convenient way possible and without unreasonable delay; however, notification can be delayed if law enforcement determines that notification would impede the criminal investigation.

Not all personal information is covered by Minnesota's breach notification statute. To trigger the notification requirements, a hacker must have accessed your first name or first initial and last name combined with any of the following unencrypted pieces of information: social security number, driver's license number; or a financial account number.

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A growing number of states also require that businesses and individuals who own private information implement measures for the protection of that data. Twenty-two states have enacted such laws, including Massachusetts, New York, and California. It is not clear when Minnesota will enact substantive protections for private information, but given the value of private information and the increase in cyber attacks it is likely that Minnesota will eventually enact legislation requiring administrative, technical, and physical safeguards for its protection.

Regardless of when Minnesota enacts such legislation, it is important to be proactive in protecting your information system. Organizations that are the subject of a data beach will usually face litigation, including class action lawsuits, from individuals whose information has been affected. The best way to mitigate your legal liability is by implementing a comprehensive information security program.

At a minimum, every security program should have a designated employee to maintain the information system; procedures for identifying and assessing internal and external risks to the system; policies relating to the storage, access and transportation of records containing personal information; reasonable restrictions upon physical access to records containing personal information; and regular monitoring to ensure that the program is operating effectively. ■

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JOINT STATEMENT PROVIDES FINANCIAL INSTITUTIONS WITH UPDATE RELAXING BSA-COMPLIANCE PRACTICES

On December 3, 2019, four federal agencies – the Board of Governors of the Federal Reserve System, Financial Crimes Enforcement Network (FinCEN), Federal Deposit Insurance Corporation (FDIC), and Office of the Comptroller of the Currency – along with the Conference of State Bank Supervisors issued a joint statement providing financial institutions with much-needed guidance on lending to hemp-related businesses.

The crux of the statement is that institutions providing financial services to hemp-related businesses will no longer have to regularly file Suspicious Activity Reports (SARs) to maintain compliance under the Banking Secrecy Act (BSA). Prior to this statement, financial institutions were relying on the outdated 2016 FinCEN guidance that, after the 2018 Farm Bill, is only really applicable to institutions providing services to marijuana-related businesses.

Recognizing that the 2016 FinCEN guidance is antiquated, FinCEN plans to issue additional, updated guidance after performing a comprehensive analysis of the USDA Interim Final Rule issued on October 31, 2019.

What does this mean for financial institutions currently, or contemplating, lending to hemp-related businesses? Although regular SARs are not required, financial institutions still need to monitor the compliance practices and account activity of such businesses. Ensuring such businesses hold the correct licenses and are not engaging in illicit marijuana-related activities are necessary to maintain BSA compliance. If a financial institution detects any suspicious activity, it should follow the 2016 FinCEN guidance and file SARs until FinCEN issues its forthcoming guidance.

Additionally, given the volatility of the hemp industry to date, financial institutions must ensure they implement and follow a risk-management plan when providing financial services to hemp-related businesses. This includes, but is not limited to, reviewing licenses on an annual basis; overcollateralizing; monitoring account activity; and reviewing business and marketing practices to ensure federal regulatory compliance under the FDA's FD&C Act.

The joint statement can be found at https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20191203a1.pdf.

The USDA Interim Final Rule, issued October 31, 2019, can be found at https://www.federalregister.gov/documents/2019/10/31/2019-23749/establishment-of-a-domestic-hemp-production-program. ■

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Gislason & Hunter represents numerous financial institutions and has a thorough familiarity with financial economic conditions, as well as an ever-evolving regulatory environment. We have extensive experience in the following banking areas:

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- Loan and workout agreements
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- Loan and credit agreements
- Subordination and participation agreements

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