

Mezzanine Loan Workouts: UCC Dispositions and Title Insurance Issues

David Egdal, Partner, Shartsis Frieese

**Gary Zimmerman, Chief Underwriting Counsel Fidelity
National Title Group (UCC Plus)**

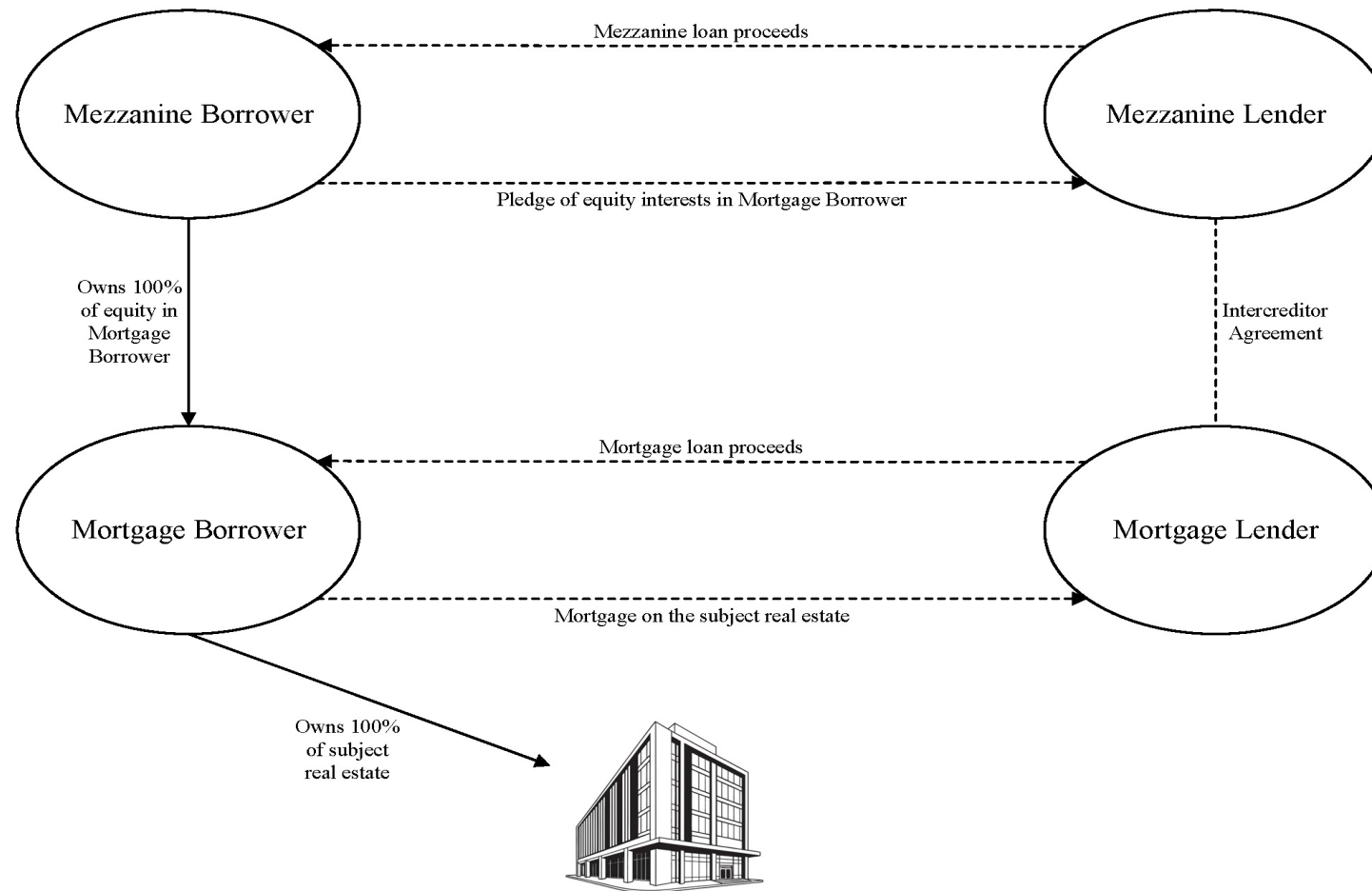
July 16, 2025



Agenda

- ❖ Part I -- UCC Workout Overview
 - ❖ Basic Overview of Mezzanine Loan Structure and Collateral
 - ❖ Approaching Distressed Assets
 - Pre-Negotiation Agreements
 - Document and Collateral Review
 - Preparing to Exercise Remedies
 - ❖ Overview of UCC Dispositions and Practical Considerations
 - UCC Public Sales (9-610)
 - UCC Retentions in Satisfaction (9-620)
 - Avoiding Problematic Lender Conduct
- ❖ Part II -- Special Focus: New Considerations for Post-Disposition Title Insurance and Impact of Conduct of UCC Disposition on later real property transactions

Basic Mezzanine Loan Structure & Collateral



Basic Mezzanine Loan Structure & Collateral (Cont.)

❖ Compared to Mortgage Financing

- Priority: subordinate to mortgage but senior to common equity
- Collateral: real property vs. membership or partnership interests
- Applicable law: local law (or NY + local law) vs. UCC as adopted by the relevant jurisdiction (and subject to choice of law provisions in UCC)
- Intercreditor Matters: relationship between mortgage and mezzanine lenders governed by Intercreditor Agreement (highly negotiated)

❖ Key Takeaways

- While UCC remedies can (to some extent) be understood by reference to mortgage or deed of trust remedies, the UCC is a different animal and a UCC disposition cannot be wholly understood by analogy to traditional foreclosure models.
- Read the Code (and the comments). Especially the comments.
- Intercreditor requirements (and perhaps requirements of upstream equity) can significantly change the landscape.

The Distressed Asset Roadmap

- ❖ Recognizing you have a problem
- ❖ Preserving your rights (Pre-Negotiation Agreement)
- ❖ Determining the scope of the problem – new diligence and underwriting
- ❖ Figuring out your options
- ❖ Taking action (or not)

Pre-Negotiation Agreements

❖ Purpose of Pre-Negotiation Agreement (“PNA”):

- Sets the ground rules and preserves rights
- Permits open and honest communication between parties

❖ Key Provisions

- No deal until formal modification documentation executed (and no reliance)
- Confidentiality and inadmissibility of settlement negotiations
- Either party can terminate at any time (and for any reason)
- PNA should remain in-place until debt is repaid in full

❖ Strategic issues in the use of PNAs

- Maintenance of existing positions vs. improvement of lender’s position
- Seeking releases and waivers of defenses is likely counterproductive

Basic Steps for Troubled Assets

- ❖ **Problem identification:** current defaults, pending defaults, other risk exposure
- ❖ **Document review:** identify and review all transaction documents (including side letters, post-closing amendments, etc.)
- ❖ **Collateral review:** Identify all collateral securing the loan
- ❖ **New searches:** Update (1) lien searches on mezzanine collateral (start to think about UCC 9-611(e) “Safe Harbor” early on); (2) title searches on underlying real property; and (3) litigation, judgement, tax, and bankruptcy searches on borrower and guarantors
- ❖ **Real property matters:** valuation (appraisal) and site inspection

Basic Steps for Troubled Assets (Cont.)

❖ Get the BIG picture

- Look beyond the documents -- e.g., treatment of loan (balance sheet, syndicated, conduit, etc.), applicable sunset dates for fund/joint venture investments, alternative sources of financing/refinancing
- Beware of “Originator Syndrome” (and tread gently as needed)
- Consider exit & deleveraging strategies (note sales, pay-downs, etc.)
- Consider impact of environmental, zoning, and other matters that may impact value or use of the underlying real property

❖ Carefully Manage Default Notices and Acceleration

- Provide written notice of material defaults supporting an exercise of remedies
 - Dual goal: proper notice and “Pre-litigation Planning”
- Consider acceleration and impact on guarantors and other third-party credit enhancements (and whether additional notice is needed)
- Consider impact of cross-collateralization and cross-defaulted financings

Overview of UCC Dispositions

- ❖ UCC Article 9 controls
- ❖ Focus on two UCC remedies
 - 9-610 Public Sales: a public sale of the collateral securing the obligations
 - 9-620 Retention of Collateral: secured party retains the collateral in full or partial satisfaction of the debt (with or without conditions)
- ❖ Key Terms and Concepts
 - Lender is the Secured Party
 - Borrower is the Debtor (and guarantors are Secondary Obligors)
 - Disposition (not foreclosure)
 - The UCC can vary by state, but often the New York UCC applies to real estate related mezzanine financings
 - *Caution*: what you know about mortgage law is helpful (maybe) but not dispositive

Overview of UCC Dispositions (cont.)

❖ Threshold Considerations:

- Validity of Security Interest: confirming creation, perfection, attachment
- Admission Issues: Identify potential restrictions on admission of new members in Organizational Documents; if not addressed at origination, may need to be addressed as part of the workout discussions
- Transfer Issues: identify potential restriction on transfer of interests (e.g., pursuant to the borrower's operating agreement, Intercreditor Agreement, or other applicable restrictions / second tier effects (e.g., change of control provisions in major contracts, etc.)
- Duty of Commercial Reasonableness: Per UCC 9-610(b), every aspect of a disposition of collateral, including the method, manner, time, place, and other terms, must be commercially reasonable (more on this later)
- Debtor's Mindset: consider debtor's mental state if cooperation is needed (especially when considering a conditional 9-620 tender)

UCC Dispositions – Public Sale (9-610)

❖ Basic Overview

- Notice: follow statutory form
- Advertising: old media, new media, other
- Public Sale: public auction creating a meaningful opportunity to bid

❖ Practical Issues

- Identifying notice parties
- Sale site (and managing “access”): physical, virtual
- Sale timing
- Advertising/marketing efforts
- Other considerations
 - Qualified Transferee requirements and other restrictions on bidding (consider impact on meaningful public access to bidding)
 - Do I need an auctioneer?
 - Bidder qualifications
- Post-Disposition Title Insurance (more on this later)

UCC Dispositions – Retention of Collateral (9-620)

❖ Retention in Satisfaction (9-620)

- Identification of notice parties
- Binding nature of proposal
- Conditional or unconditional: secured party may impose conditions to effectiveness of proposal to retain collateral in satisfaction of debt
- Acceptance: varies by nature of 9-620 by proposal
 - *Partial Satisfaction / Full Conditional Satisfaction*: debtor's agreement in writing after default and no objection with 20 days from any notice party or other holder of a subordinate security interest
 - *Full Satisfaction (unconditional)*: no objection from debtor within 20 days or debtor agrees to proposed acceptance in writing after default and no objection within 20 days from any notice party or other holder of a subordinate security interest
 - *Note*: no passive or implied acceptance absent an effective 9-620 proposal

❖ 9-620 considerations

- Ideal remedy for Mezzanine Loan collateral (more on this later)
- Beware of strategic assertions of objections by debtor or guarantor

Avoiding Common Workout Pitfalls

- ❖ Lender Liability: shorthand for borrower's claim that lender is liable, or the loan has been modified (or should be deemed modified) based any number of legal and equitable theories
- ❖ Managing Optics: how will lender conduct and the written record impact the judge's view of the lender (and borrower)
- ❖ Don't "chill the bid" (compare – note sale)
- ❖ A quick word on the one-action rule (CA)

Part II: Post-Disposition Title Insurance Matters

- ❖ **Key Issue:** how to best position a UCC disposition to allow a subsequent, third-party purchaser to obtain an owner's policy of title insurance for the underlying real property without exception for matters related to the UCC disposition
- ❖ **Overview**
 - Issues Arising from a 9-610 public sale: good faith vs. bad faith purchaser
 - UCCPlus Owner's Policy (or similar instrument) and related Title Company Underwriting Issues for 9-620 Public Sales
 - Current Issues and Trends

Good Faith Transferee (9-617)

Section 9--617. Rights of Transferee of Collateral.

(a) **Effects of disposition.** A secured party's disposition of collateral after default:

- (1) transfers to a transferee for value all of the debtor's rights in the collateral;
- (2) discharges the security interest under which the disposition is made; and
- (3) discharges any subordinate security interest or other subordinate lien other than liens created under any law of this state that are not to be discharged

(b) **Rights of good-faith transferee.** A transferee that acts in good faith takes free of the rights and interests described in subsection (a), even if the secured party fails to comply with this article or the requirements of any judicial proceeding.

(c) **Rights of other transferee.** If a transferee does not take free of the rights and interests described in subsection (a), the transferee takes the collateral subject to:

- (1) the debtor's rights in the collateral;
- (2) the security interest or agricultural lien under which the disposition is made; and
- (3) any other security interest or other lien.

9-617: What Do the Comments Say?

Comment 2: Title Taken by Good-Faith Transferee. Subsection (a) sets forth the rights acquired by persons who qualify under subsection (b)-transferees who act in good faith. Such a person is a “transferee,” inasmuch as a buyer at a foreclosure sale does not meet the definition of “purchaser” in Section 1-201 (the transfer is not, vis-a-vis the debtor, “voluntary”). By virtue of the expanded definition of the term “debtor” in Section 9-102, subsection (a) makes clear that the ownership interest of a person who bought the collateral subject to the security interest is terminated by a subsequent disposition under this Part. Such a person is a debtor under this Article. Under former Article 9, the result arguably was the same, but the statute was less clear. Under subsection (a), a disposition normally discharges the security interest being foreclosed and any subordinate security interests and other liens.

Comment 4: Title Taken by Nonqualifying Transferee. Subsection (c) specifies the consequences for a transferee who does not qualify for protection under subsections (a) and (b) (i.e., a transferee who does not act in good faith). The transferee takes subject to the rights of the debtor, the enforcing secured party, and other security interests or other liens.

Takeaway: It’s better to be a good-faith transferee [9-617(b)]

Issues Arising from 9-610 Public Sale

- ❖ Rights of a good faith purchaser / transferee (GFP) [9-617(a)-(b)]
 - Legal effect of a sale to a GFP: GFP takes the collateral free and clear-even if the secured party fails to comply with all of the provisions of 9-610
 - Discussion: Can a secured party who credit bids in at the sale be a good faith purchaser/transferee?
- ❖ Compare: bad faith purchaser [9-617(c)]
 - Question of fact
 - Legal effect: a purchaser at the sale who has not acted in good faith takes subject to the debtor's right of redemption and the debtor's borrower's right in the collateral
- ❖ Consider Atlas MF Mezzanine Borrower LLC v. Macquarie Texas Loan Holder LLC
 - Often cited as the reason why pledged collateral can never be affected after a UCC public sale concludes
 - Effect of **Permanent Editorial Board (PEB) Commentary No. 22** (August 24, 2020)
 - Who is the PEB?
 - What happened: PEB rejects Atlas MF
 - What it means: because a transferee of collateral who does not act in good faith takes subject to the debtor's rights, pursuant to UCC Section 9-617(c), the debtor retains whatever rights the debtor had in the collateral before the disposition, including the right to redeem the collateral

Issues Arising from 9-610 Public Sale (cont'd)

- ❖ **Why PEB Commentary No. 22 Matters:** amended comment 4 to 9-617 to confirm potentially continuing rights of debtor in connection with a bad faith transferee, which raises material concerns for title companies issuing owner's coverage on the underlying real property re: UCC sale compliance and authority to convey good title. This risk exists with respect to every public sale of equity interests.
- ❖ **Recent Developments:** Concerns have arisen that a subsequent sale of the underlying real property authorized by a successful bidder at the sale who did not cut off the rights of the original debtor would result in a total failure of title due to a lack of proper authorization.
 - Fidelity now offers to issue their proprietary "UCC Owner's Policy" with the goal of insuring the successful bidder at the sale as the new owner of the disposed collateral. Other title company products are available to address the same concern(s).
 - Data collection re: UCC sale follows typical underwriting requirements related to UCC policies and title insurance, including entity and authority matters
 - Active monitoring of UCC sale compliance (internal / external). Key issues include:
 - Potential litigation related to Good Faith/Bad Faith Transferee
 - Impact of a disposition not conducted in a commercially reasonable manner (insufficient advertising, sale timing and sale issues, other mechanical sale issues (data room, use of auctioneer, sale compliance, etc.)
- ❖ **Compare to our last down-market remedial cycle (2007-2009)**

Issues Arising from 9-610 Public Sale (cont'd)

Impact of Declining UCCPlus or similar coverage? Any owner's policy issued in connection with the underlying real property will likely contain an exception for UCC sale matters:

- ❖ Sample Exception: All losses, costs or damages arising or resulting from any defect in, objection to, or consequence of that certain public sale (the disposition of the collateral by public sale under Article 9, Part 6 of the Uniform Commercial Code) conducted by [name of auctioneer or other sale administrator] on _____, 202__ (the "Public Sale"), including, but not limited to, any litigation, administrative action or similar proceeding relating to, arising from or involving the Public Sale.
- ❖ Query: would you accept this as a purchaser or counsel your client to accept this type of exception?

Final Thoughts / Discussion

- ❖ Reflections on current transactions and trends
 - When to involve the title company?
 - Impacts on client counseling (costs & risks)
 - Impacts on general sale planning and execution
- ❖ Questions & Answers



David Egdal

Real Estate Partner
Shartsis Frieze LLP
San Francisco
degdal@sflaw.com
415-773-7393



Gary Zimmerman

Senior VP and Chief Underwriting Counsel,
Fidelity National Title Group UCCPlus Division
Chicago
Gary.Zimmerman@fnf.com
312-223-2441