# community BANKER

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Welcome to the latest issue of the COMMUNITY BANKER.

The Community Banker is prepared by attorneys at Olson & Burns P.C. to provide information pertaining to legal developments affecting the field of banking. In order to accomplish this objective, we welcome any comments our readers have regarding the content and format of this publication. Please address your comments to:


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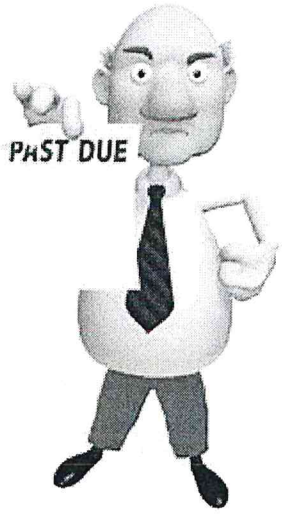
## REFRESHER ON THE BASICS: THE SALE OF COLLATERAL

Things went sideways, then south. Now you're liquidating your debtor's collateral. When this happens, your bank must follow certain procedures under N.D.C.C.Ch. 41-09, North Dakota's Uniform Commercial Code. This chapter is "Article 9", and a sale under Article 9 has three components: **1)** the repossession of your collateral, **2)** the notice requirements, and **3)** the disposition of the proceeds.

**Number 1 – Taking Possession of Your Collateral**: Before you can sell your collateral, you have to get your hands on the debtor's assets through repossession. N.D.C.C. § 41-09-106 is North Dakota's repossession statute and the only trigger is the existence of a default. The repossession happens in one of two ways – easy/voluntary or harder/involuntary. The best of all possible worlds is to have a voluntary and peaceful surrender, in writing, from the debtor. However, do not use a Bill of Sale to take back the collateral because you risk taking title to the collateral subject to inferior liens. The preferred method is to use a Voluntary Collateral Surrender Agreement where the parties acknowledge and understand that the nature of this transaction is simply that the bank is taking possession of its secured collateral as a secured party under the UCC as enacted in North Dakota.




Depending on your relationship with the debtor, the amount of the debt, the amount of the deficiency, or other considerations, your surrender agreement will provide either that surrender of the collateral completely satisfies the debt *or* that the bank preserves its right to pursue the debtor for the deficiency balance.

If the security agreement provides for this, you *might* get your debtor to assemble the collateral and make it available to you at a mutually convenient place for your pick up. Check your security agreements for surrender and assembly provisions. On the other hand, if your debtor is shifty, that request might give him time to hide or transfer the collateral.

Another self-help option is setoff. N.D.C.C. § 30.1-31-20 provides that "[w]ithout qualifying any other statutory right to setoff" a "financial institution has a right to setoff against the account." Consent is required, but consent language in the signature card is sufficient. Additionally, setoff plus a security interest in deposit accounts is allowed. Article 9 explicitly recognizes a secured party's right to take a consensual lien on a deposit account such as a checking, savings, money market, CD, or other account of a customer at a bank or credit union. The secured party can "repossess" money in the account the same way a lienholder could repossess a combine or a snowmobile (remember not to setoff social security or other protected funds).

Defaulting debtors are unhappy, confused, embarrassed, angry, and not feeling particularly cooperative. When your debtor is antagonistic (or has disappeared entirely), you may undertake "self-help" methods to repossess the collateral yourself – so long as there is no "breach of the peace." What constitutes a breach of the peace is a subject for another time, but in general, if the collateral is located on open land under sky, go ahead. Drive off in the RV parked at Walmart (first checking to see that no one is home), hook up the plow out in the field, or load up the pontoon at the dock of the waterfront restaurant. Be aware that a peaceable repossession *cannot* occur if the debtor is out there yelling at you to stop, or if breaking and entering into buildings is necessary. Also, *do not* take the sheriff along. Case law is unsettled as to whether that will automatically be a breach of the peace under the theory that it must be unpeaceable if the repo man requires protection.

Obviously, when self-help methods are not available, your only option is to pursue judicial foreclosure and get a judgment.

**Number 2 - Notice Requirements:** After you have your collateral, whether by repossession or by judgment, the secured party may sell, lease, license, or otherwise dispose of any or all of the collateral in its present condition or following any commercially reasonable preparation or processing. N.D.C.C. § 41-09-107. However, under N.D.C.C. § 41-09-108 a secured creditor is first required, in most circumstances, to "send a reasonable signed notification of disposition" after default. The notice is to provide the debtor, and other interested parties, an opportunity to monitor the disposition of the collateral, purchase the collateral and/or demand any surplus proceeds recovered from the sale. Therefore, a secured creditor must send notice that is reasonable as to manner, content, and time. Since the notice must be "signed", a secured creditor may not give a verbal notice to the debtor – don't give notice over the phone. The notice must be made either electronically or in writing.


As a secured creditor, provide reasonable notice of sale to the debtor/borrower, other or secondary obligors on the debt, and any other parties who may have an interest in the property – which means other secured creditors. Generally, be aware of three types of parties with interests in the collateral: a) any party that sends an authenticated notice of its interest in the collateral, b) other secured creditors and lien holders (but a secured creditor must only give notice to those secured creditors and lien holders who, as of 10 days before the sale, have a security interest perfected by a filing statement that identifies the collateral. That means a secured creditor must only give notice to those who can be found in a UCC search.), and c) a secured creditor must give notice to secured creditors perfected according to N.D.C.C. § 41-09-31 (perfection of security interests in property subject to certain statutes, regulations, and treaties) in the same collateral as of the date that the secured creditor sends notification to the debtor. A

secured creditor should look to the law of the debtor's home state and the state where the collateral is located to determine whether any other parties hold an interest perfected according to N.D.C.C. § 41-09-31. This seems like a big burden, but under N.D.C.C. § 41-09-108(5), a secured creditor is deemed to have satisfied all notice requirements if it performs a financing statement search between 20 and 30 days before the sale of the collateral.

Accordingly, it's important to complete and keep a *record* of a search of the records of the proper filing state before disposing of the collateral. Note that a secured creditor cannot rely on a pre-default waiver of notification such as a waiver of notification in the security agreement. N.D.C.C. § 41-09-108(1)(b) and N.D.C.C. § 41-09-99(8) together make clear that a debtor, secondary obligor, or other party holding an interest in the collateral only validly waives notice **after** the default.

There are exceptions to the notice requirement, and a secured creditor is exempt from providing notice under N.D.C.C. § 41-09-108(4) if the collateral is perishable (dairy products, seafood, fruit, or vegetables), threatens to decline speedily in value (seasonal products like Halloween pumpkins or Christmas trees), or is sold on a recognized market (publicly-traded stocks and bonds).

To ensure all potential interested creditors are properly notified, lenders should order a UCC search within 20-30 days prior to the sale. A notice of disposition of collateral should then be sent to all relevant parties at least *ten days* before the sale. N.D.C.C. § 41-09-109(2).

The notice should identify the debtor and the secured party, describe the collateral, state the intended method of disposition, state that the debtor is entitled to an accounting (and the charge of the accounting, if any), and give the time and place of a public disposition or the time after which any other disposition is to be made. N.D.C.C. § 41-09-110.

**Number 3 - Disposition of Proceeds**: Every aspect of a disposition of collateral, including the method, manner, time, place, and other terms, must be commercially reasonable. If commercially reasonable, a secured party may dispose of collateral by public or private proceedings, by one or more contracts, as a unit or in parcels, and at any time and place and on any terms. N.D.C.C. § 41-09-107(2). After the ten-day period has passed, the secured creditor can proceed with its sale. The sale of assets can be public or private.


The sale must be conducted in a manner that maximizes proceeds through reasonable efforts. Things such as price, manner of disposition, time of disposition, and collateral condition are all factors a court may consider when

determining the "commercial reasonableness" of the sale. Because every aspect of a collateral disposition must be commercially reasonable, a secured creditor should be careful to consider whether all of its choices with regard to the sale are reasonable and focused toward maximizing the proceeds of the sale. For example, should the collateral be repaired or sold as is? Though Article 9 doesn't require a secured creditor to repair collateral, a secured creditor arguably has not acted to maximize proceeds (and so failed to act in a commercially reasonable manner) if it doesn't make *inexpensive* repairs that would significantly increase the value of an equipment sale. Likewise, a creditor may have failed to act in a commercially reasonable manner if it hasn't cleaned the collateral before the auction or an inspection by a potential buyer.

When it's finally over, proceeds of the sale must then be distributed in the following order: (1) the reasonable expenses of the sale, (2) the secured debt, and (3) subordinate liens. N.D.C.C. § 41-09-111(1). If a surplus remains after *all* of the parties entitled to sale proceeds under the statutes have been paid, the surplus must be disbursed to the debtor.