


A Refresher Course in Provisional Remedies

By Zachary G. Newman and Anthony P. Ellis

Following the recent economic tumult, lenders and financial institutions across the country have seen a staggering rate of defaulting loans. These institutions are increasingly looking to counsel to employ judicial measures to safeguard, preserve, and even repossess collateral pledged to secure the loans and additional assets of the borrower that could satisfy the debt. There are a variety of provisional remedies at a lawyer's disposal, many of which are codified in the Federal Rules of Civil Procedure and in state procedural rules.

To aid our discussion, we'll use a hypothetical commercial lending dispute involving a bank and one of its major clients, although the remedies discussed below are available in a wide variety of business torts litigation and other matters. In our hypothetical, Acme Bank, a Connecticut financial institution, has retained you in connection with a dispute with one of its lending clients, Buy-Mart, a New York-based superstore that specializes in "rock-bottom" prices. Buy-Mart is privately owned by Frank G. Reed, reigning patriarch of the Reed family, which owns substantial real estate assets in Brooklyn, New York.

About five years ago, Acme provided Buy-Mart with a $75 million loan, which Buy-Mart claimed it sought to expand its operations in New Jersey and Connecticut. Under the loan agreement, Buy-Mart was required to make monthly principal and interest payments of some $1 million per month for 10 years. Financial information submitted by Buy-Mart showed that Buy-Mart had substantial cash flow and net income, as well as significant projected growth, and both Reed and Buy-Mart represented in the loan documents that they had no preexisting debt. Buy-Mart collateralized the loan by granting the bank a senior security interest in certain valuable equipment and inventory. Reed, who owns a collection of valuable American memorabilia, provided an absolute and unconditional personal guaranty.

The lending relationship progressed smoothly until December 2009, when Buy-Mart missed its first loan payment. When Acme's account manager contacted Buy-Mart to discover what happened, he was told it was merely a clerical error, and payment was submitted approximately two weeks later. In January and February, however, Buy-Mart missed both monthly payments. Moreover, numerous articles appeared indicating that Buy-Mart's senior executives dramatically overstated Buy-Mart's earnings over the past five years and engaged in serious accounting fraud. The articles also indicated that Buy-Mart was suffering significant losses as a result of its expansion plans; that Buy-Mart had numerous trade creditors, all of which were holding Buy-Mart in default and seeking repayment; and that Reed was suspected of seeking to transfer his American memorabilia on his private jet to buyers located outside the United States.

The following discussion addresses the avenues of provisional relief that are available to Acme Bank to safeguard its collateral and to protect its rights.

Preliminary Injunctions and Temporary Restraining Orders

The injunction is the most commonly used remedy available to creditors. Because an injunction is designed to maintain the status quo during the course of any litigation, it is most appropriate where the defendant threatens to breach, or is suspected of breaching, an existing agreement or otherwise acting to impair his or her financial status, which ultimately would render a judgment ineffectual. Courts have broad discretion in deciding both whether to grant an injunction and, given that injunctions can come in all shapes and sizes, how to fashion the type of relief to best protect the moving party's interests.

Although both the federal courts and each state court have specific standards for granting injunctions, courts generally evaluate a wide range of factors, including: (1) whether the movant has demonstrated that it will likely succeed on the merits of its claims,[1] (2) whether the movant has shown an irreparable injury (one that cannot be compensated in money or for which compensation cannot be measured),[2] (3) whether a balance of the equities favors granting the injunction, (4) the adequacy of other remedies, and (5) the practical significance and enforceability of the injunction.[3]

To support the injunction request, the moving party will need to submit an affidavit or declaration from someone who has personal knowledge (in the Acme dispute, this would likely be a bank officer who had account responsibility or supervision), establishing each of the elements noted above to support the injunction request. In addition, the moving party generally should submit any documentary evidence available to substantiate the request and include news articles or publicly available records indicating high-risk, unauthorized transfers or a diminution in value of the

collateral, although most courts require more substantive documentation of immediate harm.[4] If the bank in our hypothetical succeeds in obtaining an injunction, most courts will require it to post a bond that protects the defendant from potential harm, should the defendant prevail in litigation.

An additional consideration is whether the bank needs immediate relief and, thus, should move for a temporary restraining order (TRO).[5] Again, although each state and the federal courts have their own specific standards for granting a TRO, certain common questions involve: (1) whether the bank can obtain a TRO ex parte or whether it will need to provide notice to the defendant, (2) the effective period of the TRO (e.g., a TRO is effective in federal court for 10 days),[6] (3) the burden on the moving party, and (4) the type of hearing that will be required by the court (which may differ from judge to judge). Some judges merely require a proffer (an informal presentation of evidence), while others may require a full evidentiary hearing with live testimony and the admission of evidence.

Finally, counsel should be aware of whether there are any specific injunctions available in the applicable jurisdiction that may either help or harm his or her cause. For instance, New York law recognizes "Yellowstone Injunctions," which a commercial tenant may use to retain control of the leased space after an owner declares a default.[7]

Turning back to our hypothetical, in determining whether an injunction was an appropriate remedy for Acme Bank, counsel should determine in consultation with the bank the type of injunction that may be most appropriate to accomplish the bank's goals, such as an injunction prohibiting Reed from transferring any assets to third parties, an injunction to prohibit Buy-Mart from engaging in any additional expansion operations that could have a material adverse change, or requiring Buy-Mart to immediately begin making loan payments to the bank.

Replevin and Its Relative, the Attachment

To the extent that any specific assets are pledged as collateral to the bank or are identified as property of the borrower and guarantor, state and federal courts may permit lenders to take either actual or constructive possession of those assets before a judgment has been entered.[8]

Repossessing pledged collateral is known commonly as *replevin* or an "order of delivery"[9] and is usually accomplished through a complaint in the jurisdiction where the property is located for replevin and a concurrent motion requesting immediate possession of the property.[10] The issue to be resolved on these motions is strictly whether Acme Bank, on the one hand, or Buy-Mart, on the other, has a superior possessory right to the collateral.[11] To succeed, the bank will need to demonstrate its indisputable right to seize and take possession of the collateral for the purpose of reducing the bank's outstanding indebtedness, which usually is satisfied by demonstrating a default under the loan agreement.[12] Like the injunction remedy, there is generally a bond requirement in most state's statutory schemes.

Repossessing noncollateral assets is generally referred to as "attachment" and is available in nearly all actions (matrimonial litigation being one notable exception in some states) after a complaint has been filed. Attachment differs from replevin in that the primary question is not whether the bank has a senior possessory right in the assets; instead, the question is whether the property could be transferred beyond the jurisdiction of the court and, thus, become unavailable to satisfy any potential judgment.[13] Moreover, an attachment is usually available only in an action on a claim for money. Some states even require the claim to be based in a contract.[14]

The decision of whether attachment should be awarded is within the discretion of the judge, provided the moving party can meet the statutory grounds applicable in that forum.[15] Courts consider a variety of factors when determining whether to grant a motion for attachment, including the probability of success on the merits, whether the amount demanded from the defendant exceeds potential counterclaims against the plaintiff, and whether there is evidence of intent to defraud on the part of the defendant, among others.

The method for obtaining an attachment is generally through a motion for attachment, and, again, the moving party may be required to post a bond. In connection with the motion, the moving party may be able to obtain limited disclosure concerning the debtor's assets and property.[16] Most states' statutes also permit the moving party to request a TRO if there is a threat that the defendant will move or attempt to move assets before the motion can be heard and determined. In terms of what can be attached, state law governs the issue, and it is important to determine the specific state limitations at issue.[17] However, in general, a court can attach only property that is located within its jurisdiction.

In our hypothetical, Acme Bank may be able to replevy the equipment and inventory, and attach Reed's memorabilia collection. Depending upon where such property was located, the bank may be able to apply for a mandatory injunction requiring Reed and Buy-Mart to bring the property to New York. However, if Buy-Mart can demonstrate that there is more than 100 percent collateral coverage, the bank may face an uphill battle to convince the court that the bank should receive additional security through an attachment or other available provisional remedies.

Acme Bank also should be counseled that, upon taking possession of collateral, it has the obligation to act in a commercially reasonable manner with respect to the collateral. This includes, but isn't limited to, safeguarding the collateral and preserving its value. Care must be given to the act of repossession, as well as the storage and disposition of the collateral, which is governed by article 9 of the Uniform Commercial Code, state law, and decisional authority. A bank's failure to act in a commercially reasonable manner with respect to collateral could have an impact on its ability to recover the indebtedness and could subject the bank to additional lender-liability claims.

Receivership

Receivership is a provisional remedy whereby a third party is appointed by the court to identify, marshal, preserve, and often liquidate property at issue in a litigation during the pendency of the litigation. Notably, most commercial loan agreements provide for this right, although lenders rarely invoke it for a variety of reasons. The option to order receivership, like other provisional remedies, is often left up to the broad discretion of the trial judge, along with how such a remedy should be imposed. Typically, courts view receivership as an extreme remedy and are not generally inclined to grant it.[18]

An order appointing a receiver may dramatically alter the litigation in favor of the creditor and encourage the debtor to discuss settlement.

Because a receiver is charged with representing the interests of all parties to the litigation, not just the creditor or party you represent, it is appropriate primarily in situations involving allegations or evidence of potential fraud in an otherwise legitimate business operation. It is also often useful in situations in which property or business operations are spread throughout multiple jurisdictions because the scope of the receivership can extend beyond jurisdictional boundaries. For example, in federal court, the receiver can exercise jurisdiction over property located in other jurisdictions merely by filing a copy of the complaint in the jurisdiction where the property is located and the order of appointment of the receiver.[19]

Ultimately, parties should carefully weigh the pros and cons of seeking a receivership. An order appointing a receiver may dramatically alter the litigation in favor of the creditor and encourage the debtor to discuss settlement. Receivership also offers the benefit of being a fluid remedy that can be crafted by the court to meet the needs of all parties. However, it can also be an extremely costly and burdensome remedy for all parties.

In our hypothetical, given Buy-Mart's competing creditors and the financial morass the company is in, the receivership may be an attractive option for Acme Bank. And it's likely that the bank has the contractual right to appoint a receiver under the terms of the loan agreement. However, numerous considerations have to be weighed with Acme Bank before pursuing this action. For example, under a court-appointed receiver, the bank may lose a certain amount of control over the proceeding, and the receiver may add a layer of costs the bank is unwilling to fund. Furthermore, the receiver could review the bank's course of conduct and make recommendations to the court that aren't in the bank's interests or that are in the interests of unsecured creditors or creditors that hold interests subordinate to the bank.

Notice of Pendency

The last potential provisional remedy is a notice of pendency (commonly referred to as "lis pendens"). A notice of pendency is a constructive notice filed in the real estate records that informs potential purchasers and creditors that the property at issue is subject to a lawsuit or claim and that the claim or eventual judgment could affect the title.

This filing does not require court authorization but typically requires there be a pending action that affects or impacts real property. Of note, there are risks that are associated with a filing, in that the filing party can be liable for the damages resulting from the filing and fees. These fees can be substantial if the filing impacts a potential sale of the property.

In our hypothetical, to determine whether a notice of pendency could be helpful to Acme Bank, it would need to consider whether any of its claims affect the title to real property. For those properties over which it held a duly recorded mortgage, there would be no need to file a notice of pendency. But, if Acme Bank discovered that Reed had transferred his homes not covered by the mortgages to his spouse the day after they signed the guaranties for $1, the transfer may be fraudulent as to the bank and may provide the bank with a claim that the transfer was a fraudulent conveyance. In this case, the bank may have a claim to set aside the transfer, and the bank would have the ability to file the notice of pendency to place the world on notice that there is a claim pending that could affect title to that real property.

Conclusion

Provisional remedies offer an avenue of immediate relief and protection for a creditor or plaintiff, but counsel must fully weigh the benefits and risks of such a strategy from legal, business, and procedural perspectives before fully pursuing these paths. ■

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Endnotes

1. To demonstrate the likelihood of success on the merits, a plaintiff need not show certainty of success. For example, under New York law, a prima facie showing of a right to relief is sufficient; actual proof of the case should be left to further court proceedings. *See, e.g., Terrell v. Terrell*, 279 A.D.2d 301, 303, 719 N.Y.S.2d 41, 43 (N.Y. App. Div. 1st Dep't 2001) (citation omitted). Moreover, "[i]t is well settled that a likelihood of success on the merits may be sufficiently established even where the facts are in dispute and the evidence is inconclusive." *Four Times Square Assocs., L.L.C. v. Cigna Invs., Inc.*, 306 A.D.2d 4, 5, 764 N.Y.S.2d 1, 2 (N.Y. App. Div. 1st Dep't 2003).

2. Some courts have held that a showing of irreparable harm is usually considered the single most important requirement in determining whether to issue a preliminary injunction. *See Anacomp v. Shell Knob Servs., Inc.*, No. 93-4003, 1994 U.S. Dist. LEXIS 223, at *16 (S.D.N.Y. Jan. 10, 1994). This prong also can be the most difficult to establish given that the case law uniformly provides that if there is an available legal remedy, irreparable harm cannot be established. *See, e.g., Interbake Foods, LLC v. Tomasiello*, 461 F. Supp. 2d 943 (N.D. Iowa 2006) (harm is irreparable if there is no adequate remedy at law).

3. *See Tempur-Pedic Int'l, Inc. v. Waste To Charity, Inc.*, No. 07-2015, 2007 WL 535041, at *9 (W.D. Ark. Feb. 17, 2007) (finding that the defendants would not experience harm if they were enjoined from the distribution and sale of misappropriated mattresses). As articulated in *Universal Marine Ins. Co. Ltd. v. Beacon Ins. Co.*, 581 F. Supp. 1131 (D.N.C. 1984), courts have an interest in enjoining acts that are in violation of contracts and that support conversion and possible fraud claims. *See id.* at 1138 (finding overriding public interest in the prevention of fraud and that the public interest against encouraging or tolerating fraud can be protected only if an injunction is issued); *Tempur-Pedic Int'l*, 2007 WL 535041, at *9 (noting that injunctions have been issued throughout the country to protect plaintiffs in matters where fraud is involved); *Marsellis-Warner Corp. v. Rabens*, 51 F. Supp. 2d 508 (D.N.J. 1999) (granting preliminary injunction based on state law claims of fraud).

4. Notably, a likelihood of success on the merits in many jurisdictions may sufficiently be established even where the facts are in dispute and the evidence is inconclusive. *See Hamilton Watch Co. v. Benrus Watch Co.*, 206 F.2d 738, 740 (2d Cir. 1953).

5. *See, e.g.*, Ma v. Lien, 198 A.D.2d 186, 187, 604 N.Y.S.2d 84, 85 (N.Y. App. Div. 1st Dep't 1993) (court concluding sub silencio that denying the injunctive relief sought would render the final judgment ineffectual); Bass Bldg. Corp. v. Vill. of Pomona, 142 A.D.2d 657, 659, 530 N.Y.S.2d 595, 597 (N.Y. App. Div. 2d Dep't 1988) (injunctive relief granted where victory on the merits would otherwise be meaningless); see also Nat'l Bank of Detroit v. Michael Kaufman Cos., No. 95-1788, 1996 U.S. App. LEXIS 25283, at *8 (6th Cir. Aug. 30, 1996) ("[T]he whole point of a security interest is to limit the debtor's rights to dispose of assets after default on credit obligations.").

6. FED. R. CIV. PROC. 65(c).

7. *See* First Nat'l Stores v. Yellowstone Shopping Ctr., 21 N.Y. 2d 360 (N.Y. 1968).

8. *See, e.g.*, N.Y. U.C.C. § 9-601 cmt. 2 ("The rights of a secured party to enforce its security interest in collateral after the debtor's default are an important feature of a secured transaction.").

9. Numerous cases have enforced a lender's fundamental and critical right to repossess collateral following a default. *See Nat'l Bank of Detroit*, No. 95-1788, 1996 U.S. App. LEXIS 25283, at *8 ("[T]he whole point of a security interest is to limit the debtor's rights to dispose of assets after default on credit obligations."); *Roberge v. Bankers Trust Co.*, 84 A.D.2d 8, 446 N.Y.S.2d 443 (N.Y. App. Div. 3d Dep't 1981) (finding a lender has the ability to take possession of collateral and sell it to a third party following borrower's default of a security agreement).

10. By way of example, the procedure in Arkansas is called an "order of delivery." ARK. CODE ANN. § 18-60-101. Each state has its own statutory scheme for replevin, and that scheme should be consulted before counsel takes pen to paper to determine the statutory requirements for this type of relief. Under Federal Rule of Civil Procedure 65(a), replevin in federal actions is governed by the home forum's state substantive law.

11. Honeywell Info. Sys., Inc. v. Demographic Sys., Inc., 396 F. Supp. 273, 275 (S.D.N.Y. 1975) (plaintiff's right to the immediate possession of the collateral is sufficient to grant replevin).

12. Sequestration is a statutory remedy available in the case where multiple creditors are asserting claims against a single asset. It is available only after a lawsuit has been filed and does not alter the ownership of the property. It is a useful remedy in certain states to ensure that the value of the property is preserved until the litigation is concluded.

13. By way of example, California Code of Civil Procedure Section 483.015 provides, in pertinent part, that the amount to be secured by an attachment is the sum of "[t]he amount of the defendant's indebtedness claimed by the plaintiff" and "[a]ny additional amount included by the court under Section 482.110," less "[t]he value of any security interest in the property of the defendant held by the plaintiff to secure the defendant's indebtedness claimed by the plaintiff, together with the amount by which the value of the security interest that has decreased due to the act of the plaintiff or a prior holder of the security interest."

14. California Code of Civil Procedure Section 483.010 provides as follows: "Except as otherwise provided by statute, an attachment may be issued only in an action on a claim or claims for money, each of which is based upon a contract, express or implied, where the total amount of the claim or claims is a fixed or readily ascertainable amount not less than five hundred dollars ($500) exclusive of costs, interest, and attorney's fees."

15. *See, e.g.*, N.Y. C.P.L.R. Art. 62 (identifying statutory grounds for attachment under New York law); IND. CODE § 34-25-2-I (noting that attachment is available only when there is a claim for monetary damages and additional statutory factor is met).

16. An additional consideration in determining whether to seek an order of attachment is whether the bank should move for the order of attachment ex parte, i.e., without notice to the defendant. Special rules and requirements may be required in order to move ex parte, and state law generally requires a party to move to confirm an order of attachment shortly after the property is attached.

17. Like attachment and sequestration, prejudgment garnishment is another available remedy designed to preserve the value of a debtor's assets pending the outcome of the litigation. It is generally available to a creditor when a party wishes to preserve the value of assets belonging to the debtor that are in the possession of a third party for the benefit of the debtor, such as a bank. This remedy also is available ex parte and is governed by state law.

18. Some courts also take a hostile view of using the receivership remedy to effectuate a foreclosure sale and liquidation of assets. *See SEC v. Am. Bd. of Trade*, 830 F.2d 431 (2d Cir. 1987).

19. *See* 28 U.S.C. § 754.