

OUTLINE: UCC Default Provisions

A SUMMARY OF THE ENFORCEMENT PROVISIONS OF ARTICLE 9 OF THE UNIFORM COMMERCIAL CODE

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January 2012

This paper will summarize the enforcement provisions of Article 9 of the Uniform Commercial Code as contained in the 2010 Official Text. Article 9 sets forth various rights and remedies of a secured party with respect to the collateral upon the debtor's default. Article 9 also requires that the secured party proceed to enforce its security interest in ways which give minimum protections to the debtor and certain other interested parties.

Default.

A secured party has rights and remedies under part 6 of Article 9 upon default by a debtor. The remedies of a secured party are not exclusive, and the secured party may resort to anyone remedy without losing rights under the others. §9-601 (c). What constitutes a "default" is not defined in Article 9 and is determined by the terms of the security agreement or other agreements between the debtor and the secured party. Events of default contained in loan agreements, promissory notes and security agreements typically include the debtor's nonpayment, misrepresentations, failure to comply with covenants, cross-defaults and the debtor's bankruptcy. A default occurs under an agricultural lien when the secured party has the right to enforce the lien. §9-606.

Secured Party's Options after Default.

Upon the debtor's default, the secured party may take possession of collateral, but only if doing so will not result in a breach of the peace. §§9-609(a) and (b). The secured party may collect the collateral from account debtors and other persons obligated on collateral. §9-607. Also, the secured party may, subject to certain debtor and third party protections, either sell or otherwise dispose of the collateral and apply the proceeds to the satisfaction of the secured debt or retain the collateral in satisfaction of the secured debt. §§9-610 and 9-620. In addition, the secured party may judicially foreclose on the collateral under local judicial foreclosure procedures. §9-601 (I). Below is a fuller discussion of the secured party's options of collection, disposition and retention relating to the collateral.

Collection. When agreed between the debtor and the secured party but in any event upon the debtor's default, the secured party may collect payments directly from account debtors and other persons obligated on collateral by notifying the account debtors and obligated persons to pay the secured party directly. §9-607(a). If there is credit recourse to the debtor (as in the case of a full or partial recourse loan to the debtor), the collection must be made in a commercially reasonable manner. §9-607(c). Article 9 provides a mechanism by which a secured party that is an assignee of an obligation secured by a real estate mortgage may become the mortgagee of record upon the mortgagor's default in order to foreclose nonjudicially on the mortgage. *See* §9-607(b).

The secured party may receive and apply against the secured debt funds in a deposit account over which the secured party has control. §§9-607(a)(4) and (5). Furthermore, the secured party may deduct the secured party's collection expenses from collections made by it in a commercially reasonable manner. §9-607(d).

Disposition. The secured party may sell or otherwise dispose of the collateral by public or private sale and apply the proceeds of the disposition towards the satisfaction of the secured debt. The following discussion highlights the requirement of the commercial reasonableness of the disposition, the requirement of notification of the disposition, provisions of Article 9 relating to the disposition itself, and a special provision that adjusts a secured party's deficiency claim in the event of a disposition to an insider for low value.

Requirement of Commercial Reasonableness. Every aspect of the disposition must be commercially reasonable. §§9-610 and 9-615. The obligation of the secured party to exercise commercial reasonableness may not be waived by the debtor or an obligor. §9-602(7).

Requirement of Notification of Disposition. Unless the collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market, the secured party must send the debtor and certain other persons reasonable authenticated notification of the time and place of any public disposition or reasonable authenticated notification of the time after which any private disposition is to take place. §§9-611, 9-612 and 9-613. The notification must be given not only to the debtor and any secondary obligor, but also to all persons who have given to the secured party an authenticated notification of an interest in the collateral and to all secured parties and other lienholders of the collateral disclosed on a search of the proper filing office within certain time parameters §§9-611 (b), (c) and (e)). In a commercial transaction, 10 days prior notification of disposition is ~ se reasonable. §9-612(b). Article 9 also sets forth "safe harbor" disposition notification forms in commercial and consumer transactions. §§9-613 and

614. The debtor or any secondary obligor may waive its right to receive the disposition notice but only in an authenticated agreement made after default. §9-624(a).

The Disposition Itself. The secured party may disclaim or modify disposition warranties otherwise given to a foreclosure transferee. §9-610(e). The secured party may purchase the collateral at a public disposition. The secured party may not purchase collateral at a private disposition unless the collateral is of a kind customarily sold on a recognized market or is the subject of standard price quotations. §9-610(c). A secured party disposition generally discharges all subordinate interests in the collateral. §9-617(a). Furthermore, Article 9 provides for a title clearing mechanism for the secured party to effect a transfer of record title to titled collateral to the foreclosure purchaser of that collateral. §9-619.

Insider Dispositions for Low Value. If a secured party, a person related to a secured party (see §§9-102(a)(62) and (63) defining "person related to" for individuals and organizations, respectively) or a secondary obligor acquires collateral at a foreclosure disposition and the amount of the foreclosure proceeds so paid is significantly below the range of proceeds that a complying disposition to an unrelated purchaser would have brought, any deficiency calculation is required to be readjusted to reflect a credit to the debtor for the higher amount of any such disposition proceeds that would have been paid to the secured party by such a hypothetical unrelated purchaser. §9-615(f).

Retention of Collateral in Satisfaction of the Secured Debt. The secured party may under some circumstances retain the collateral in total satisfaction or, in the case of a commercial transaction, partial satisfaction of the secured debt. The following discussion highlights certain limitations of the retention remedy, the requirement that the secured party send to the debtor and others an advance notice of the secured party's proposal to retain collateral, the effect of a person entitled to receive the proposal objecting to the proposal, and the effect of acceptance of retention.

Limitations on Retention Remedy. If the collateral is consumer goods, the secured party may not propose to retain collateral which is not in the possession of the secured party. Otherwise, a secured party may propose to retain any collateral, whether tangible or intangible and even tangible collateral that is at the time in the debtor's possession. See §9-620(a)(3). A secured party in a commercial transaction may propose to retain collateral in partial satisfaction, rather than total satisfaction, of the secured debt. In that case, the debtor must, after default, affirmatively consent to the retention. §9-620(c)(1). But in a consumer transaction, the secured party may only propose

to retain collateral in total satisfaction of the secured debt. §9-620(g). Moreover, the remedy of retaining the collateral in satisfaction of the secured debt is not available for certain consumer goods where a significant portion of the purchase price of the goods or of the secured debt has already been paid. §9-620(e).

Requirement to Send a Proposal of Retention. The secured party must send a proposal to retain the collateral not only to the debtor but also to all persons who have given to the secured party an authenticated notification of an interest in the collateral and to all secured parties and other lienholders of the collateral disclosed on a search of the proper filing office. §9-621 (a). If the secured party proposes to retain the collateral in partial satisfaction of the secured debt, the secured party must send the proposal to any secondary obligor as well. §9-621 (b). The debtor or a secondary obligor may waive its right to receive a retention notice, or agree to the secured party's retention, but only after default. §§9-602(10) and 9-620(c)(1).

Effect of Objection to Retention. If the secured party receives an objection from the debtor, a secondary obligor or another secured party or lienholder entitled to notice and the objection is received within 20 days after the notice was sent, the secured party may not retain the collateral in satisfaction of the secured debt. §§9-620(a) and (d).

Effect of Acceptance of Retention. Acceptance of retention of the collateral generally discharges all subordinate interests in the collateral. §9-622.

Application of Noncash Proceeds.

In the event of the secured party's receipt of noncash proceeds (*see* §9-102(a)(58) *defining "non-cash proceeds"*) by collection or disposition of the collateral, the secured party may value the noncash proceeds and apply them to the secured debt, but the secured party must do so in a commercially reasonable manner. Alternatively, unless the secured party's failure so to value and apply the noncash proceeds to the secured debt is commercially unreasonable, the secured party may reduce and collect or dispose of the noncash proceeds, as collateral, until the noncash proceeds have been converted to cash for application of the secured debt. §§9-608(a)(3) and 9-615(c); *see also Official Comment 4 to §9-608 and Official Comment 3 to §9-615.*

Surplus or Deficiency.

If the collateral secures an obligation, unless otherwise agreed, the secured party is to account to the debtor for any surplus in the collection or disposition of collateral, and the debtor is liable for a deficiency. In a secured transaction which is a sale of accounts, chattel paper, promissory notes or payment intangibles, unless

otherwise agreed, the debtor is not entitled to a surplus, and the debtor is not liable for a deficiency. §§9-608(b) and 9-615(e).

Redemption.

The debtor may redeem the collateral by paying off the secured debt any time before the secured party has disposed or is contractually committed to dispose of the collateral or has retained the collateral in satisfaction of the secured debt. §9-623. The debtor may waive its right of redemption in a commercial transaction, but only after default. §9-624(c).

Non-compliance.

Article 9 provides that the secured party is generally liable to the debtor for any loss caused by the secured party's failure to comply with the enforcement provisions of part 6 of Article 9. §9-625(b). Article 9 adopts a rebuttable presumption rule for commercial transactions where an improper foreclosure or other enforcement results in a deficiency claim: in a commercial transaction, the value of the collateral is presumed to have equaled the entire secured debt (thus eliminating the deficiency claim) unless the secured party is able to show otherwise. §9-626(a)(3). Article 9 does not address which measure of damages should be applied in a consumer transaction. A specific penalty, however, may be imposed, regardless of any damages being shown, on a non-complying secured party where the collateral is consumer goods. §9-625(c)(2). In some circumstances, a secured party who does not comply with the enforcement provisions of part 6 of Article 9, whether in a commercial or consumer transaction, may be liable for statutory damages as well. §§9-625(e)(5) and (6).

Status of Guarantors.

A guarantor or other secondary obligor (see §9-102(a)(71) defining "secondary obligor") of the secured obligations is entitled to many of the same rights and protections as is the underlying debtor. Article 9 requires disposition notifications to be given to guarantors and other secondary obligors, and it provides that a guarantor or other secondary obligor may not waive such notification unless the waiver is given after default. §§9-611(c)(2) and 624(a). A secured party is not, however, liable for failure to provide a disposition notification to a guarantor or other secondary obligor unknown to the secured party. §§9-628(a) and (b).

Certain Consumer Provisions.

Notice given to a consumer debtor ten days in advance of the secured party's disposition of the collateral is not ill± se a reasonable notice. §9-612(b). A secured party must, following disposition of collateral, provide a consumer debtor with an explanation of the calculation of any deficiency claim before making demand upon

the debtor for payment of that deficiency. §9-616. In a consumer transaction, a secured party may not retain collateral that is in the possession of the debtor and may not retain collateral in only partial satisfaction of the secured debt. §§9620(a)(3) and (g). A consumer debtor may not waive his right of redemption, even after default. §9-624(c). Article 9 leaves the courts to fashion an appropriate damage rule (e.g. rebuttable presumption, absolute bar or offset) in the case of a secured party's non-compliance with part 6 of Article 9. §9-626(b).

Certain Exclusions.

The enforcement provisions contained in part 6 of Article 9 do not apply to true consignors. Nor do these provisions apply to buyers of accounts, chattel paper, promissory notes or payment intangibles except for the buyer's obligation to use commercial reasonableness in the collection of collateral where the buyer has a right of chargeback on uncollected collateral or full or limited credit recourse to the debtor. §§9-601 (g) and 9-607(c).