

**“AFTER THE DEFAULT: LITIGATION
UNDER
UCC ARTICLE 9”**

**DEFAULT RIGHTS AND
REMEDIES UNDER UCC
ARTICLE 9**

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I. Introduction

A. Overview

This paper will discuss selected enforcement provisions of Article 9 of the Uniform Commercial Code (“Article 9”) insofar as they apply to commercial secured transactions. (Consumer secured transactions are discussed briefly in Section III, below.) It is not an exhaustive treatment, but instead is intended to provide a brief overview of the default provisions of Article 9, with an emphasis on the remedies available to a secured party upon the default of a secured obligation.

B. The Parties to a Secured Transaction

Article 9 describes the parties to a secured transaction. A “secured party”, as used therein, is the party to whom a security interest in collateral has been granted. U.C.C. § 9-102(a)(72)(A). Under Article 9, a “debtor” simply holds an interest (typically, an ownership interest), as opposed to a security interest or other lien, in the collateral. U.C.C. § 9-102(a)(28)(A).¹ Additional parties defined in Article 9 include: the “obligor,” or, simply put, the party who owes the obligation secured by the collateral (and who may or may not also be the “debtor”), and the “secondary obligor,” a sub-class of obligors, who is essentially a guarantor or surety of the obligation secured. U.C.C. § 9-102(a)(59) and (71). Article 9 generally provides that a guarantor is entitled to the same notices and protection as a debtor under its Part 6. U.C.C. §§ 9-601(d) and 9-602.

¹ Article 9 also includes within the definition of a “debtor” (a) a seller of accounts, chattel paper, payment intangibles or promissory notes, and (b) a consignee. U.C.C. § 9-102(a)(28)(B) and (C). It should be noted that the enforcement provisions contained in Part 6 of Article 9 do not apply to (a) consignors or (b) a buyer of accounts, chattel paper, payment intangibles or promissory notes except as to a buyer’s obligation to use commercial reasonableness in the collection of the collateral where the buyer has a right of chargeback on uncollected receivables or instruments or full or limited credit recourse to the debtor or secondary obligor. U.C.C. §§ 9-601(g) and 9-607(c).

II. The Default Provisions of Article 9: A Selective Review

A. Overview

A security interest becomes enforceable when it attaches to the debtor's rights in the collateral. Upon a default, the secured party is entitled to pursue the rights and remedies against the collateral as set forth in the security agreement and in Article 9. U.C.C. § 9-601(a). The secured party's entitlement to the full exercise and enjoyment of these remedies, however, is contingent upon the extent to which it has complied with Article 9's provisions governing the enforcement of a security interest. The enforcement provisions of Article 9 addresses, among other things: (a) the duties imposed upon a secured party and the rights of debtors and obligors; (b) the standards by which a secured party's performance of its duties will be measured; and (c) the consequences of a secured party's failure to meet these standards of conduct.

B. Default

The enforcement provisions of Article 9 are triggered by a default under the security agreement. U.C.C. § 9-601(a). Article 9 does not define or otherwise list the incidents which will constitute a default, leaving the contracting parties to decide for themselves by agreement the events which will constitute a default. U.C.C. § 9-601, cmt. 3. Typical events of default include a failure to make payment of the secured obligation when due; a breach of non-payment contractual obligations, warranties or covenants; or the occurrence of an event which causes the secured party to deem itself insecure, such as a downturn in the debtor's business. It is not unusual for the parties' agreement to provide for either or both notice and an opportunity to cure an event of default before a default will occur.

C. “Good Faith”

Article 9 defines “good faith” in both subjective and objective terms, as “honesty in fact and the observance of reasonable commercial standards of fair dealing.” U.C.C. § 9-102(a)(43).² This dual standard is used to measure a secured party’s actions under Article 9, including decisions as to whether to accelerate a debtor’s payment obligation and when and whether to pursue its contractual and statutory remedies. It should be noted that the Uniform Commercial Code prohibits a waiver of the obligation of “good faith.” U.C.C. § 1-102(3).

By way of example, security agreements may reserve to the secured party the right under certain circumstances to accelerate the debtor’s obligation and demand full payment of the balance due. Article 1 of the Uniform Commercial Code provides that a contractual term which permits a party to “accelerate payment . . . ‘at will’ or ‘when he deems himself insecure’ . . . shall be construed to mean that he shall have the power to do so only if he in good faith believes that the prospect of payment or performance is impaired.” U.C.C. § 1-208. Accordingly, under Article 9, a secured party’s acceleration of an obligor’s obligations and enforcement of rights against the debtor under those circumstances may be measured according to both an objective and a subjective standard.

D. Rights and Remedies of Secured Party Upon Default

Upon a default, the secured party “may reduce a claim to judgment, foreclose, or otherwise enforce the claim [or], security interest . . . by any available judicial procedure.” U.C.C. § 9-601(a)(1). Depending upon the types of collateral securing the debt, the secured party may have several options upon a default. Where the collateral consists of a right to payment, the secured party may collect from account debtors and other persons obligated to

² This definition was also included in the proposed 2001 amendments to UCC Article 1. See UCC § R1-201(b)(20).

make payment to the debtor and apply the proceeds against the secured debt. U.C.C. § 9-607.

The secured party may take possession of the collateral by judicial process (such as by obtaining an order of seizure or replevin) or without judicial process if such action will not cause a breach of the peace. U.C.C. § 9-609. The secured party may then sell or otherwise dispose of the collateral and apply the proceeds in satisfaction of the secured debt, or the secured party may retain the collateral in satisfaction of the secured debt. U.C.C. §§ 9-610 and 9-620. Finally, the secured party may decide not to foreclose on the collateral, but instead to obtain a judgment on the secured debt and then execute its judgment upon the collateral. U.C.C. § 9-601(f). Such execution sale will not be governed by Article 9, although the judicial lien created by such execution is deemed a continuation of the original security interest (if perfected) and not the acquisition of a new interest. U.C.C. § 9-601, cmts. 6 and 8. The secured party typically will be required to account to the debtor for any surplus in the collection or disposition of the collateral and the debtor and obligor will be liable to the secured party for any deficiency. U.C.C. §§ 9-608 and 9-615(a).

Article 9 provides that a secured party's rights to pursue its contractual and Article 9 remedies are "cumulative". U.C.C. § 9-601(c). Thus, the secured party may both enforce its rights in collateral and seek to obtain a money judgment on the debt in one action. A secured party, however, is expressly permitted to exercise its rights "simultaneously" provided that, in so doing, "the secured party acts in good faith." U.C.C. § 9-601(c), cmt. 5. The official comments, also reflect that Article 9 is not intended to supersede any non-UCC law which may prohibit under certain circumstances the simultaneous exercise of rights against a defendant. U.C.C. § 9-601.

E. Rights of Debtors and Obligors Upon Default

Article 9 provides that after a default, the debtor has the rights and remedies provided in its Part 6, the security agreement and Section 9-207 (Rights and Duties of Secured Party Having Possession or Control of Collateral). U.C.C. §9-601. These rights and remedies are extended to both debtors and obligors, thus entitling a guarantor to the protections afforded under Article 9. U.C.C. § 9-601(d). Article 9, however, relieves a secured party of its duties toward an “unknown” debtor or obligor as defined in Section 9-605. U.C.C. §§ 9-605 and 9-628.

Article 9 specifies certain rights of the debtors and obligors and duties of the secured party that may not be waived or varied by the debtor or guarantor. U.C.C. § 9-602. These rights and duties include the duty to collect and dispose of collateral in a commercially reasonable manner; the implicit duty to refrain from the breach of the peace in taking possession of the collateral; and the right to hold a secured party liable for the failure to comply with Article 9. U.C.C. § 9-602. In all, Article 9 lists twenty provisions (most of which are contained in Part 6) which are not waivable. *Id.* Article 9 does provide that three of the non-waivable provisions set forth in Section 9-602 may be waived by an agreement entered into after default. U.C.C. § 9-624. Those provisions consist of the right of a debtor or secondary obligor to notification of the disposition of collateral; the debtor’s right to mandatory disposition of consumer goods; and the right of a debtor or secondary obligor to waive its redemption rights. U.C.C. § 9-624. The Official Comments to Article 9 cautions a court to carefully scrutinize post-default waivers that appear in agreements “that also address many additional or unrelated matters”. U.C.C. § 9-602, cmt. 5.

Article 9 allows the parties to determine by agreement the standards measuring the fulfillment of the rights and duties imposed by Article 9, provided such agreed standards are not “manifestly unreasonable.” U.C.C. § 9-603(a); see also Burns v. Anderson, 123 Fed. Appx. 543

(4th Cir. 2004) (court found that disposition of collateral was commercially reasonable since the secured party took title to collateral for an independently appraised value, which was the method agreed to by the parties in their agreement). Article 9, however, expressly prohibits the parties from specifying in their agreement the standards measuring fulfillment of the secured party's duty to take collateral without breaching the peace. U.C.C. § 9-603(b). The Official Comments to Article 9 indicate that while the specified rights and duties may not be waived by the debtor or obligor, the parties are not restricted from settling, compromising or waiving any past conduct that may have constituted a violation or breach of those rights and duties. U.C.C. § 9-602, cmt. 3.

F. Collection and Enforcement of Performance by Secured Party

Article 9 provides that, in the event of default and where the collateral consists of a payment obligation owed to the debtor, the secured party may collect payments directly from account debtors or persons obligated to make payment to the debtor by notifying these parties to pay the secured party directly. U.C.C. § 9-607(a).³ Further, a secured party may notify any party that owes a performance obligation to the debtor on any of the collateral and request that party to render performance to, or for the benefit of, the creditor. U.C.C. § 9-607(a)(1). Moreover, under Article 9 a secured party is permitted to enforce this payment or performance obligation by exercising any rights that the debtor might have against the obligated party. U.C.C. § 9-607(a)(3). For example, if the collateral consists of equipment, the secured party may enforce a claim for a breach of the manufacturer's warranty. Article 9 does not determine whether the party obligated on collateral owes a duty to the secured party. U.C.C. § 9-607(e).

³ Section 9-607 applies to the collection of collateral before default where the parties have agreed the secured party may collect the collateral.

Section 9-607 requires a secured party, which “undertakes to collect from or enforce an obligation of an account debtor or other person obligated on collateral” and “is entitled to charge back uncollected collateral or otherwise to full or limited recourse against the debtor or a secondary obligor,” to exercise its rights in a “commercially reasonable manner.” U.C.C. § 9-607(c)(1) and (2). This duty may not be waived or varied. U.C.C. § 9-602(c).

A secured party has the right to deduct from its collections its “reasonable expenses of collection and enforcement, including reasonable attorney’s fees and legal expenses incurred by the secured party.” U.C.C. § 9-607(d). As the Official Comments makes clear, however, the attorney’s fees and legal expenses that a secured party may recover under this section are limited to those “incurred in proceeding against account debtors or other third parties.” U.C.C. § 9-607, cmt. 10.⁴ Section 9-607(d) is an exception to the general rule that a secured party may not recover its reasonable legal expenses and fees incurred in enforcing its rights against the collateral unless provided for in the parties’ agreement. U.C.C. §§ 9-608(a)(1)(A) and 9-615(a).

G. Possession or Control of Collateral by Secured Party

Article 9 affords the secured party, after default, the right to take possession of the collateral through self-help or through judicial process. U.C.C. § 9-601(a). Under Article 9 a secured party’s right to engage in self-help repossession of collateral without judicial process is subject to two express limitations. U.C.C. § 9-609. First, a secured party cannot seize the collateral unless a default has occurred. U.C.C. § 9-609(a). Second, the secured party may take possession of the collateral or “without removal, may render equipment unusable and dispose of collateral on a debtor’s premises” only if it can do so without committing a breach of the peace.

⁴ Article 9 also provides to the secured party that is an assignee of an obligation secured by a real estate mortgage the right to become the mortgagee of record upon the debtor’s default in order to foreclose non-judicially on the mortgage. U.C.C. § 9-607(b). Also, a secured party may receive and apply against the secured debt funds in a deposit account over which the secured party has control. U.C.C. §§ 9-607(a)(4) and (5).

