

**COMMENTARY ON THE
ENFORCEMENT OF
SECURITY INTERESTS UNDER
UCC REVISED ARTICLE 9**

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I. Introduction

A. Overview

This paper will discuss selected enforcement provisions of Revised Article 9 of the Uniform Commercial Code (“Revised 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 comment on the revisions to current Article 9 (“Current Article 9”) – and retentions therefrom – which may be of interest to commercial litigators and the judiciary. The bulk of this presentation will be concerned with the revisions of those provisions which relate to the enforcement of security interests upon default and the consequences of non-compliance. These default provisions, currently consisting of 7 subsections within Part 5 of Current Article 9, are relocated under Revised Article 9 to Part 6, and expanded to 28 subsections. As the following discussion will show, Revised Article 9, if enacted in the State of New York, not only will bring greater (though by no means absolute) clarity to the law of secured transactions, but, in fact, will resolve at least one long-standing split within New York’s Appellate Division.

B. Background

In 1990, the Permanent Editorial Board for the UCC, with the support of its sponsors (the American Law Institute (the “ALI”) and the National Conference of Commissioners on Uniform State Laws (the “NCCUSL”)), established a committee to review Article 9 of the Uniform Commercial Code and to recommend possible revisions. The committee, in a report issued in 1992, recommended the creation of a drafting committee to revise Article 9. The ALI and the NCCUSL duly appointed a drafting committee (the “Drafting Committee”) in 1993, and, in 1998, both sponsors approved the result of the Drafting Committee’s efforts: Revised Article 9.

Among the goals of the Drafting Committee was to simplify and clarify the rules for the enforcement of a security interest. The default and enforcement provisions of Part 6 of Revised Article 9 are divided into two subparts: (1) Default and Enforcement of Security Interest, and (2) Noncompliance with Article. To date, Revised Article 9 has been adopted in a majority of the states and has been introduced in the legislatures of several other states, including New York.

C. The Parties to a Secured Transaction

As a preliminary matter, it is important to note that Revised Article 9 not only modifies and clarifies the terms by which the parties to a secured transaction are to conduct themselves, but also redefines these parties. In both Current and Revised Article 9, a “secured party”, as used herein, is the person to whom a security interest in collateral has been granted. U.C.C. § 9-105(1)(m); Rev. U.C.C. § 9-102(a)(72)(A). By contrast, Current and Revised Article 9 employ dramatically different definitions of the term “debtor” In Current Article 9, the term “debtor” carries no less than four meanings: (1) the “person who owes payment or other performance of the obligation secured, whether or not he owns or has rights in the collateral”; (2) “where the debtor and the owner of the collateral are not the same person, . . . the owner of the collateral in any provision of the Article dealing with the collateral”; (3) “the obligor in any provision dealing with the obligation”; and (4) both the owner and the obligor “where the context so requires.” U.C.C. § 9-105(1)(d). In Revised Article 9, by contrast, a “debtor” simply holds an interest (typically, an ownership interest), as opposed to a security interest or other lien, in the collateral. Rev. U.C.C. § 9-102(a)(28)(A).¹ Revised Article 9 further “creates” new parties: the “obligor,”

¹ Revised 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. Rev. U.C.C. § 9-102(a)(28)(B) and (C). It should be noted that the enforcement provisions contained in Part 6 of Revised 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

or, simply put, the person who owes the obligation secured (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 secured claim. Rev. U.C.C. § 9-102(a)(59) and (71). Whereas Current Article 9 does not explicitly address the issue whether a guarantor is entitled to the same notices and protection as a debtor under the default provisions, Revised Article 9 generally provides that a guarantor is entitled to such notices and protection. Rev. U.C.C. §§ 9-601(d) and 9-602.

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

A. Overview

A security interest becomes enforceable when it attaches to the debtor’s rights in the collateral. Upon the debtor’s default, the secured party is entitled to pursue the rights and remedies set forth in the security agreement and in Article 9. U.C.C. § 9-501(1); Rev. 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 complied with Article 9’s provisions governing the enforcement of a security interest. The enforcement provisions of Revised Article 9, among other things, modify and clarify: (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 both Current and Revised Article 9 are triggered by a default under the security agreement. U.C.C. § 9-501(1); Rev. U.C.C. § 9-601(a). Neither

uncollected receivables or instruments or full or limited credit recourse to the debtor or secondary obligor. Rev. U.C.C. §§ 9-601(g) and 9-607(c).

Current nor Revised Article 9 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 trigger a default. Rev. U.C.C. § 9-601, cmt. 3. Typical defaults usually include a failure to make payment of the secured obligation when due, a breach of non-payment contractual obligations, warranties or covenants, or any event which causes the secured party to deem itself insecure, such as a downturn in the debtor's business.

C. “Good Faith”

Under Article 1 of the Uniform Commercial Code, “good faith,” defined as “honesty in fact in the conduct or transaction concerned,” is a purely subjective standard. U.C.C. § 1-201(19). Current Article 9 does not define “good faith,” but rather imports Article 1’s definition. Revised Article 9, however, defines “good faith” in both subjective and objective terms, as “honesty in fact and the observance of reasonable commercial standards of fair dealing.” Rev. U.C.C. § 9-102(a)(43). When Revised Article 9 is enacted in New York, a secured party’s decisions as to whether to accelerate a debtor’s payment obligation and when and whether to pursue its contractual and statutory remedies will be measured according to this new, dual standard. 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, when New

York presumably enacts Revised 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. At least one New York court already has applied this dual standard to measure the merits of a creditor's decision to accelerate the debtor's payment obligation. See Blaine v. General Motors Acceptance Corp., 82 Misc.2d 653, 370 N.Y.S.2d 323 (Co. Ct. 1975).

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." Rev. U.C.C. § 9-601(a)(1). These remedies are essentially the same as set forth in Current Article 9. U.C.C. § 9-501(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 make payment to the debtor and apply the proceeds against the secured debt. U.C.C. § 9-501; Rev. U.C.C. § 9-607. The secured party may take possession of the collateral by judicial process (such as a replevin action) or without judicial process if such action will not cause a breach of a peace. U.C.C. § 9-503; Rev. 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. §§ 9-504 and 9-505; Rev. 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. § 9-501(5); Rev. 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. Rev. U.C.C. § 9-601, cmts. 6 and 8.

Revised Article 9, like current Article 9, provides that a secured party's rights to pursue its contractual and Article 9 remedies are "cumulative". U.C.C. § 9-501(1); Rev. U.C.C. § 9-601(c). Under Revised Article 9, however, the secured party is expressly permitted to exercise its rights "simultaneously," provided that, in so doing, "the secured party acts in good faith." Rev. U.C.C. § 9-601(c), cmt. 5. The official comments, however, 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. Rev. U.C.C. §9-601, Cmt 5 and 9-604, Cmt 2.

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. §§ 9-502(2) and 9-504(2); Rev. U.C.C. §§ 9-608 and 9-615(a).

E. Rights of Debtors and Obligors Upon Default

Current Article 9 provides that after a default, the debtor has the rights and remedies provided in Part 5, the security agreement and Section 9-207 (Rights and Duties When Collateral Is in Secured Party's Possession). U.C.C. § 9-501(2). Revised Article 9 extends these rights and remedies to both debtors and obligors (as defined in Revised Article 9), thus entitling a guarantor to the protections afforded under Revised Article 9. Rev. U.C.C. § 9-601(d). Revised Article 9, however, relieves a secured party of its duties toward an "unknown" debtor or obligor as defined in Revised Section 9-605. Rev. U.C.C. §§ 9-605 and 9-628. Current and Revised Article 9 both specify 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. § 9-501(3); Rev. 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. Rev. U.C.C. § 9-602. In all, Revised Article 9 lists twenty provisions (most of which are contained in Part 6) which are not waivable. Id. Revised Article 9 does provide that three of the non-waivable provisions set forth in Revised Section 9-602 may be waived by an agreement entered into after default. Rev. 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. Rev. U.C.C. § 9-624. The Official Comments to Revised Article 9 caution a court to carefully scrutinize post-default waivers that appear in agreements "that also address many additional or unrelated matters". Rev. U.C.C. § 9-602, cmt. 5.

Both the Current and Revised Article 9 allow 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. § 9-501(3); Rev. U.C.C. § 9-603(a). Revised 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. Rev. U.C.C. § 9-603(b). The Official Comments to Revised 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. Rev. U.C.C. § 9-602, cmt. 3.

F. Collection and Enforcement of Performance by Secured Party

Both Current and Revised Article 9 provide 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. § 9-502(1); Rev. U.C.C. § 9-607(a).² Revised Article 9, however, clarifies and expands a secured party's rights. For example, under Revised Article 9, a secured party may notify any party that owes a performance obligation (instead of or in addition to a payment obligation) to the debtor on any of the collateral and request that party to render performance to, or for the benefit of, the creditor. Rev. U.C.C. § 9-607(a)(1). Moreover, Revised Article 9 expressly permits the secured party to enforce this payment or performance obligation by exercising any rights that the debtor might have against the obligated party. Rev. 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. Revised Article 9 does not determine whether the party obligated on collateral owes a duty to the secured party. Rev. U.C.C. § 9-607(e).

Revised 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." Rev. U.C.C. § 9-607(c)(1) and (2). This duty may not be waived or varied. Rev. U.C.C. § 9-602(3).

² Section 9-607, as does Current Section 9-502, applies to the collection of collateral before default where the parties have agreed the secured party may collect the collateral.

Revised Section 9-607 adds a new section, which accords to a secured party 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.” Rev. U.C.C. § 9-607(e). 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.” Rev. U.C.C. § 9-607, cmt. 10.³ Revised Section 9-607(e) 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. Rev. U.C.C. §§ 9-608(1)(A) and 9-615(a).

G. Possession or Control of Collateral by Secured Party

Revised Article 9, like Current Article 9, affords the secured party, after default, the right to take possession of the collateral through self-help or through judicial process. Revised U.C.C. § 9-601(a); U.C.C. § 9-503. Under Revised Article 9, a secured party’s right to engage in self-help repossession of collateral without judicial process is subject to two express limitations. Rev. U.C.C. § 9-609. First, as under current Article 9, a secured party cannot seize the collateral unless a default has occurred. Rev. 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 peace. Rev. U.C.C. § 9-609. Like Current Article 9, Revised Article 9 does not define what constitutes a “breach of peace.” If possession or control cannot be obtained without a breach of the peace,

³ Revised 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. Rev. § 9-607(b). Also, Revised Article 9 provides that a secured party may receive and apply against the secured debt funds in a deposit account over which the secured party has control. Rev. U.C.C. §§ 9-607(a)(4) and (5).

the secured party must avail itself of judicial intervention, such as by commencing a replevin action under CPLR Article 71.

Whereas under Current Article 9, a secured party may require a debtor to assemble and make the collateral available to it only if the security agreement so provides (U.C.C. § 9-503), Revised Article 9 extends that right to secured party upon default even if not provided for in the parties' agreement. Rev. U.C.C. § 9-609(c).

Both before and after default, the secured party has the duty under Section 9-207 to use reasonable care in the custody and preservation of collateral in its possession. U.C.C. § 9-501(2); Rev. U.C.C. § 9-601(b).

H. “Strict Foreclosure” and the Acceptance of Collateral in Partial Satisfaction

Both Current and Revised Article 9 permit a secured party the option of retaining (referred to as acceptance in Revised Article 9) the collateral and foregoing any claim for a deficiency judgment, provided that the secured party complies with the rules governing the notification if its intent to retain or accept the collateral and no timely objection is made. U.C.C. § 9-505(2); Rev. U.C.C. § 9-620, cmt. 2. Under Current Article 9, however, the secured party seeking to exercise this remedy, known as “strict foreclosure,” must be in possession of the collateral. U.C.C. § 9-501(3)(c). Revised Article 9 eliminates the requirement of possession (thereby extending this remedy to collateral such as general intangibles) and, unlike Current Article 9, permits the secured party, upon notice and affirmative consent, to retain the collateral in partial satisfaction of the secured obligation. Rev. U.C.C. § 620(a).

Revised Article 9 rejects those court decisions that have found that a secured party's delay in the collection and/or disposition of the collateral effected a “constructive strict foreclosure” upon the collateral. Rev. U.C.C. § 9-620, cmt. 5. The secured party therefore will

not be deemed to have accepted the collateral in satisfaction of the secured debt unless the secured party takes the affirmative steps specified in Revised Article 9. Rev. U.C.C. § 9-620(b). The secured party's delay in disposing of the collateral, however, will be "a factor relating to whether the secured party acted in a commercially reasonable manner for purposes of Section 9-607 or 9-610." Rev. U.C.C. § 9-620, cmt. 5.

I. Disposition of Collateral by Secured Party

1. A Secured Party's Right of Disposition

In terms similar to Current Article 9, Revised Article 9 permits a secured party, after default, to "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." Rev. U.C.C. § 9-610(a). Revised Article 9 grants the secured party an option unavailable to secured parties under Current Article 9: the option of licensing the collateral. Compare U.C.C. § 9-504(1) with Rev. U.C.C. § 9-610(a). This option will prove especially attractive to those secured parties whose collateral consists of rights to intellectual property.

The secured party may sell or otherwise dispose of the collateral by a public or private disposition, and apply the proceeds (net of reasonable expenses) against the secured debt. U.C.C. § 9-504(3); Rev. U.C.C. §§ 9-610(b) and 9-615(a). A public disposition is described in the Official Comments as one at which the price is determined by competitive bidding by the public. Rev. U.C.C. § 9-610, cmt. 7.

"Every" aspect of a private or public disposition, "including the method, manner, time, place, and other terms, must be commercially reasonable." Rev. U.C.C. § 9-610(b). Section 9-627 of Revised Article 9, discussed in H.(2) below, provides some guidance for determining the circumstances under which a disposition is "commercially reasonable." It bears observation that,

while Revised Article 9 does not impose upon a secured party a duty to prepare or process the collateral, a secured party “may not dispose of collateral ‘in its then condition’” when to do so would be “commercially unreasonable.” Rev. U.C.C. § 9-610, cmt. 4. The obligation of the secured party to exercise commercial reasonableness in the disposition of the collateral may not be waived. U.C.C. § 9-501(3)(b); Rev. U.C.C. § 9-602(7).

Unless the collateral is perishable or threatens to decline speedily in value or is of the type customarily sold on a recognized market, the secured party must send the debtor and certain other persons reasonable notification of the time and place of any public disposition or the time after which any private disposition is to take place. U.C.C. § 9-501(3)(b); Rev. U.C.C. § 9-611(d). (Notification is discussed below in (2).) The secured party may purchase the collateral at a public sale, but may not purchase collateral at a private sale unless the collateral is of a kind customarily sold on a recognized market or is the subject of a standard price quotation. U.C.C. § 9-504(3); Rev. U.C.C. § 9-610(c). A secured party sale generally discharges all subordinate interests in the collateral. U.C.C. § 9-504(4); Rev. U.C.C. § 9-617(a).

Section 9-610 of Revised Article 9 does impose a new burden upon secured parties, however, providing that “[a] contract for sale, lease, license, or other disposition includes the warranties relating to title, possession, quiet enjoyment, and the like which by operation of law accompany a voluntary disposition of property of the kind subject to the contract.” Rev. U.C.C. § 610(d). Revised Article 9, however, eases this burden by permitting a secured party to disclaim these warranties by any lawful method or “by communicating to the purchaser a record evidencing the contract for disposition and including an express disclaimer or modification of the warranties.” Rev. U.C.C. § 610(e). Revised Article 9 further provides that a disclaimer in a

“record”⁴ is sufficient if it indicates “there is no warranty relating to title, possession, quiet enjoyment, or the like in the disposition” or uses words of similar import. Rev. U.C.C. § 9-610(f).

2. Notice of Disposition

Both Current and Revised Article 9 require that, unless the collateral is perishable or threatens to decline speedily in value or is of the type customarily sold on a recognized market, a secured party that elects to exercise its right to dispose of collateral must notify certain parties as to the forthcoming disposition. U.C.C. § 9-504(3); Rev. U.C.C. § 9-611(b),(d). Revised Article 9, however, both clarifies and effects significant changes to the rules governing a secured party’s duty of notification.

First, under Revised Article 9, a secured party must send a “reasonable authenticated notification of disposition”⁵ to the debtor and the secondary obligor. Rev. U.C.C. 9-611(c)(1),(2). The duty to send such notice may be dispensed when the debtor or secondary obligor are unknown to the secured party. Rev. U.C.C. § 9-605. In addition, the debtor and secondary obligor may waive the rights to such notice by agreement entered into after default. Rev. U.C.C. § 9-624(a). Note that Revised Article 9 does not require that a secured party notify the obligor, or, the party obligated on the debt (if this same party is not both the obligor and debtor) of the disposition. Further, Revised Article 9 imposes upon secured parties two new obligations: the duty to notify other secured parties of the disposition, and the duty to search for these secured parties. Rev. U.C.C. § 9-611(c)(3).

⁴ Under Revised Article 9, a “record” means information that is inscribed on a tangible medium or which is stored in an electronic or other medium and is retrievable in a perceivable form. Rev. U.C.C. § 9-102(a)(69).

⁵ Revised Article 9 generally provides for the “authentication” rather than a “signature” or a “writing” required under Current Article 9. Rev. U.C.C. § 9-102(a)(7). This change was intended to facilitate the use of electronic notice in addition to written notice.

Revised Article 9, however, somewhat eases the secured party's new burden of searching for other secured parties by including a "safe harbor" provision, according to which a secured party will have satisfied its statutory search duty as a matter of law if:

- (1) not later than 20 days or earlier than 30 days before the notification date, the secured party requests, in a commercially reasonable manner, information concerning financing statements indexed under the debtor's name [in the appropriate office]; and
- (2) before the notification date, the secured party:
 - (A) did not receive a response to the request for information; or
 - (B) received a response to the request for information and sent an authenticated notification of disposition to each secured party or other lienholder named in that response[.]

Rev. U.C.C. 9-611(e).

3. Contents of Notice of Disposition

Revised Article 9, unlike Current Article 9, specifies the contents of a compliant notice of disposition. Such a notice will be "sufficient" as a matter of law if it

- (A) describes the debtor and the secured party;
- (B) describes the collateral that is the subject of the intended disposition;
- (C) states the method of intended disposition;
- (D) states that the debtor is entitled to an accounting of the unpaid indebtedness and states the charge, if any, for an accounting; and
- (E) states the time and place of a public disposition or the time after which any other disposition is to be made.

Rev. U.C.C. § 9-613(1). Helpfully, Revised Article 9 provides a form of notification for secured parties to follow. Id.

Revised Article 9 makes clear that whether a form that lacks the foregoing information is "nevertheless sufficient is a question of fact," and that a form that contains "minor errors that are

not seriously misleading” will be sufficient as a matter of law. Rev. U.C.C. § 9-613(2) and (3)(B).

4. Timeliness of Notification

In a further innovation, Revised Article 9 provides that “whether a notification is sent within a reasonable time is a question of fact”; however, “a notification of disposition sent after default and 10 days of more before the earliest time of disposition set forth in the notification is sent within a reasonable time.” Rev. U.C.C. § 9-612.

5. Application of Non-Cash Proceeds

If the secured party receives non-cash proceeds, such as a promissory note, upon the disposition of the collateral, the secured party need not “apply or pay over” for application non-cash proceeds from the disposition unless the failure to do so would be commercially unreasonable. Rev. U.C.C. § 9-615(c). If it does “apply or pay over” non-cash proceeds, the secured party must do so in a commercially reasonable manner. *Id.* A similar provision applies to non-cash proceeds from the secured party’s collection of collateral. Rev. U.C.C. § 9-608(3).

6. Other Provisions

Other provisions relevant to the disposition of collateral includes Revised Section 9-617 (Rights of Transferee of Collateral) and Revised Section 9-619 (Transfer of Record or Legal Title).

J. The Consequences of a Secured Party’s Non-Compliance

1. Remedies for a Secured Party’s Non-Compliance with Article 9

Whereas Current Article 9 allows the debtor to seek to have a court “order or restrain” the “disposition” of collateral by a secured party on the basis of the secured party’s failure to comply

with the enforcement provisions (Part 5) of Current Article 9, Revised Article 9 authorizes an aggrieved party to seek, and a court to grant, injunctive relief against a secured party, prior to the disposition of the collateral, if the aggrieved party establishes “that [the] secured party is not proceeding in accordance with *this article*.” U.C.C. § 9-507; Rev. U.C.C. § 9-625(a) (emphasis added). In addition, the scope of injunctive relief under Revised Article 9 has been expanded from Current Article 9 to allow the debtor to request a court to order or restrain both the “collection” and “enforcement” of collateral as well as the “disposition” of collateral provided by Current Article 9. Rev. U.C.C.

Under Current Article 9, “after the disposition of collateral, the debtor or any person entitled to notification or whose security interest has been made known to the secured party prior to the disposition has a right to recover from the secured party any loss caused by a failure to comply with the provisions of this Part.” U.C.C. § 9-507(1). Revised Article changes the current law by rendering a secured party potentially liable for any loss caused by its failure to comply with any provision of Article 9, such as Revised Section 9-207 (duties of secured party in possession of collateral). Rev. U.C.C. § 9-625(b) and cmt. 2. Revised Article 9 also eliminates any implication that such a claim may only be brought after the disposition of the collateral. The damages for which the secured party may be liable “are those reasonably calculated to put an eligible claimant in the position that it would have occupied had no violation occurred.” Rev. U.C.C. § 9-625, cmt. 3.

Revised Article 9 further modifies the list of parties who are entitled to recover damages due to a secured party’s non-compliance with this article, providing that “a person that, at the time of [the secured party’s failure to comply], was a debtor, was an obligor, or held a security interest in or other lien on the collateral may recover damages . . . for its loss.” Rev. U.C.C. § 9-

625(c)(1). The secured party, however, will not be liable to any of the above parties who was not “known” to it. Rev. U.C.C. § 9-628(a) and (b). Revised Article 9 also provides that in addition to any actual damages recoverable under Revised Section 9-625(b), a secured party is liable for \$500 in statutory damages for its failure to comply with specific provisions of Article 9. Rev. U.C.C. § 9-625(e). For example, the failure of a secured party to file a termination statement when required to do so under Revised Section 9-513 will render the secured party liable to the debtor for the \$500 statutory damages, irrespective of any actual damages suffered by the debtor. Rev. U.C.C. § 9-625(e)(4).

2. **The “Commercial Reasonableness” Standard, Revisited**

Revised Article 9 provides that a secured party may pursue a deficiency action against the debtor and any other obligor if the proceeds collected and applied do not extinguish the debtor’s entire unpaid obligation. Rev. U.C.C. §§ 9-608(4) and 9-615(d). A secured party’s entitlement to a deficiency judgment against a debtor and obligor, however, is contingent upon its observance of “commercially reasonable” standards of conduct relating to the enforcement of its rights under Article 9.

In terms similar to those employed in Current Article 9, Revised Article 9 provides that “a disposition of collateral is made in a commercially reasonable manner if the disposition is made . . . in conformity with reasonable commercial practices among dealers in the type of property that was the subject of the disposition.” Rev. U.C.C. § 9-627(b)(3); U.C.C. § 9-507(2).⁶ Under Revised Article 9, as with Current Article 9,

⁶ While Revised Article 9 does not define “commercially reasonable”, Revised Section 9-627 specifies that certain dispositions are commercially reasonable if made (1) in the usual course on any recognized market; (2) at the price current in any recognized market at the time of disposition; or (3) otherwise in conformity with reasonable commercial practices among dealers in the type of property that was the subject of the disposition. Rev. U.C.C. § 9-627(h). In addition, a “collection, enforcement, disposition or acceptance” of collateral is commercially reasonable if it has been approved (1) in a judicial proceeding; (2) by a bona fide creditors’ committee; (3) by a representative

[t]he fact that a greater amount could have been obtained by a collection, enforcement, disposition, or acceptance at a different time or in a different method from that selected by the secured party is not of itself sufficient to preclude the secured party from establishing that the collection, enforcement, disposition or acceptance was made in a commercially reasonable manner.

Rev. U.C.C. § 9-627(a); U.C.C. § 9-507(2). According to the Official Comments, however, “[w]hile not itself sufficient to establish a violation of [Part 6], a low price suggests that a court should scrutinize carefully all aspects of a disposition to ensure that each aspect was commercially reasonable.” Rev. U.C.C. § 9-627, cmt. 2.

Revised Article 9 appears to have addressed, at least in part, an issue left unresolved by New York courts in cases such as Bankers Trust Company v. J. V. Dowler & Co., Inc., 47 N.Y.2d 128, 390 N.E.2d 766, 417 N.Y.S.2d 47 (1979). In Bankers Trust, the Court of Appeals affirmed a deficiency judgment in favor of a plaintiff and, in so doing, expressly rejected the defendant’s contention that plaintiff liquidated its collateral in a “commercially unreasonable” manner. The Court of Appeals recognized two tests for measuring “commercially reasonable” conduct:

some authorities suggest that optimizing resale price is the prime objective of the code’s default mechanisms and that the other factors listed are merely designed to ensure that the highest price is achieved. Others would have commercial reasonableness turn on the procedures employed.

Id., 47 N.Y.2d at 135, 417 N.Y.S.2d at 51 (citing U.C.C. § 9-507(2)) (other citations omitted).

Significantly, the Court of Appeals did not choose between these tests, but rather found that plaintiff’s conduct “survive[d] either test.” Id.

of creditors; or (4) by an assignee for the benefit of creditors. Rev. U.C.C. § 9-627(c). The absence of such approval does not mean that the collection, enforcement, disposition or acceptance is not commercially reasonable. Rev. U.C.C. § 9-627(d).

Following the example of Bankers Trust, New York courts similarly have refrained from choosing between the “optimization of resale price” and “procedures employed” tests. See, e.g., Dougherty v. 425 Development Associates, 93 A.D.2d 438, 462 N.Y.S.2d 851 (1st Dep’t 1983) (finding that a secured creditor’s sale of a penthouse apartment for less than 50% of what the debtor had paid for it in the prior year, in addition to other factors, precluded an award of summary judgment in favor of the secured creditor on the issue of the “commercial reasonableness” of the sale) and Kohler v. Ford Motor Credit Co., Inc., 93 A.D.2d 205, 462 N.Y.S.2d 297, 300 (3rd Dep’t 1983) (ordering “a trial to determine whether the price obtained by [the secured party] was commercially reasonable”).

Revised Article 9 appears to reconcile the “twin tests” identified in Bankers Trust by adopting the “rebuttable presumption rule” (discussed in (4) below), which effectively focuses on the impact of a secured party’s non-compliance with the enforcement requirements of Part 6 on the price obtained from the foreclosure sale. Moreover, Article 9 recognizes that a debtor or obligor may recover its actual and provable damages resulting from the secured party’s non-compliance with the foreclosure procedures even if such non-compliance did not affect the foreclosure sale price.

3. “Low Price” Dispositions to Related Parties

Revised Article 9, unlike Current Article 9, permits a debtor or obligor to challenge the amount of a secured party’s deficiency claim when the

- (1) the transferee in the disposition is the secured party, a person related to the secured party, or a secondary obligor; and
- (2) the amount of proceeds of the disposition is significantly below the range of proceeds that a complying disposition to a person other than the secured party, a person related to the secured party, or a secondary obligor would have brought.

Rev. U.C.C. § 9-615(f). Where the “secured party” concerned is an organization, Revised Article 9 defines a “person related to the secured party” as

- (A) a person directly or indirectly controlling, controlled by, or under common control with the organization;
- (B) an officer or director of, or a person performing similar functions with respect to, the organization;
- (C) an officer or director of, or a person performing similar functions with respect to, a person described in subparagraph (A);
- (D) the spouse of an individual described in subparagraph (A), (B) or (C); or
- (E) an individual who is related by blood or marriage to an individual described in subparagraph (A), (B), (C), or (D) and shares the same home with the individual.

Rev. U.C.C. § 9-102(a)(62). If the obligor or debtor meets its burden (Rev. U.C.C. § 9-626(5)), the deficiency (or surplus) must be calculated “based on the amount of proceeds that would have been realized in a disposition complying with this part to a transferee other than the secured party, a person related to the secured party, or a secondary obligor.” Rev. U.C.C. § 9-615(f). According to the Official Comments, Revised Section 9-615(f) “recognizes that when the foreclosing secured party or a related party is the transferee of the collateral, the secured party sometimes lacks the incentive to maximize the proceeds of the disposition.” Rev. U.C.C. § 9-615(f), cmt. 6. Revised Article 9 thus contemplates that a disposition that may have been conducted in a “commercially reasonable manner” might nonetheless yield relatively low proceeds due to the secured party’s “lack of incentive.” *Id.* Simply put, a disposition may be procedurally correct yet still fail the “smell test.”

A review of the facts in Dougherty v. 425 Development Associates, 93 A.D.2d 438, 462 N.Y.S.2d 851 (1st Dep’t 1983) will demonstrate that Revised Section 9-615(f) will be of great use in supplying a method for resolving certain disputes over deficiencies and surpluses. In Dougherty, plaintiff Dougherty purchased both the proprietary lease and the stock allocated to a

penthouse apartment in Manhattan (the “Apartment”) from defendant 425 Development Associates. Id., 462 N.Y.S.2d at 851-52. Upon Dougherty’s default, 425 Development Associates disposed of the Apartment by conducting a public sale on notice. Id., 462 N.Y.S.2d at 852. The Apartment was purchased by defendant Penthouse A Associates, an entity which had offices at the same address as 425 Development Associates, for less than 50% of the amount which Dougherty had paid in the year prior to the disposition. Id., 462 N.Y.S.2d at 854-55. In his action to nullify the foreclosure sale, Dougherty alleged that the disposition “was not an arms length transaction at fair market value, but rather a sale to a nominee.” Id., 462 N.Y.S.2d at 855. The First Department expressed concern over the 50% realization, taking “judicial notice” of the escalating cost of cooperative apartments in Manhattan, and concluded that a triable issue of fact existed “as to whether the sale was at less than arms length and whether the apartment in question could have commanded a better price.” Id., 462 N.Y.S.2d at 856.

Revised Section 9-615(f) will provide courts with a method of resolving Dougherty-type disputes that is arguably more orderly and, with respect to the debtor or obligor, perhaps more equitable than can be found in a “commercial reasonableness” inquiry. Whereas the Dougherty court appeared to acknowledge that, on its face, the disposition in question appeared procedurally correct, it found that the relatively low yield raised “some concern about the sale itself.” Id. Construed strictly, determination that a foreclosure sale was conducted according to “reasonable commercial practices” might preclude further inquiry. Revised Section 9-615(f), however, allows debtors and obligors such as Dougherty to substantially “leapfrog” over the inquiry as to a disposition’s procedural correctness in order to focus on the parties involved and the proceeds realized.

4. The “Rebuttable Presumption” Rule v. the “Absolute Bar” Rule

When a secured party that fails to comply with the enforcement provisions of Article 9 attempts to recover the deficiency from the debtor or obligor, a majority of the states apply a presumption, rebuttable by the secured party, that the collateral disposed of equaled the amount of the secured debt. In a minority of states, a secured party’s non-compliance constitutes an absolute bar to its pursuit of a deficiency against the debtor or obligor. New York’s Appellate Division currently is split on this issue. The First and Fourth Departments have applied the “rebuttable presumption” rule. See, e.g., General Electric Credit Corporation v. Durante Bros. & Sons, Inc., 433 N.Y.S.2d 574 (1st Dep’t 1980) and Telmark, Inc. v. Lavigne, 508 N.Y.S.2d 737 (4th Dep’t 1986). The Second Department has applied the “absolute bar” rule. See, e.g., Long Island Trust Co. v. Porta Aluminum, Inc., 63 A.D.2d 670, 404 N.Y.S.2d 682 (2d Dep’t 1978). In addition, the Third Department has applied the so-called “offset-rule”, which places the burden upon the debtor to prove it was damaged. See, e.g., Stanchi v. Kemp, 48 A.D.2d 973, 370 N.Y.S.2d 26 (3d Dep’t 1975). Revised Article 9 resolves this split by adopting the “rebuttable presumption” rule. Rev. U.C.C. § 9-626(a)(3).

Under Revised Article 9, a secured party, in an action for a deficiency or surplus, need not prove its compliance with the Article 9 provisions relating to collection, enforcement, disposition or acceptance of collateral unless the debtor or a secondary obligor places the secured party’s compliance in issue. Rev. U.C.C. § 9-626(a)(1). Once raised, the secured party will have the burden of establishing its compliance with Part 6. Rev. U.C.C. § 9-626(a)(2). If the secured party fails to prove its compliance, the liability of a debtor or secondary obligor in a deficiency is limited to an amount by which the sum of the secured obligations, expenses and attorney’s fees exceeds the greater of:

(A) the proceeds of the collection, enforcement, disposition, or acceptance; or

(B) the amount of proceeds that would have been realized had the non-complying secured party proceeded in accordance with the provision [of Part 6].

Rev. U.C.C. §§ 9-626(3)(A) and (B). For purposes of Revised Section 9-626(3)(B), “the amount of proceeds that would have been realized is equal to the sum of the secured obligation, expenses, and attorneys’ fees, unless the secured party proves that the amount is less than that sum.” Rev. U.C.C. § 9-626(4).

For purposes of illustration, assume the secured obligation, expenses and legal fees equal \$100,000, and the secured party disposes of the collateral for \$50,000 and then seeks a \$50,000 deficiency judgment. If the debtor or obligor objects, the secured party will have the burden of proof as to its compliance with those provisions of Part 6 concerning collection, enforcement, disposition or acceptance. If it cannot establish compliance, the secured party will not be entitled to a deficiency unless it can prove that a disposition of the collateral in compliance with Part 6 would have realized less than \$100,000. For example, if the evidence establishes that a disposition in compliance with Part 6 would have brought \$75,000 for the collateral, the secured party will be entitled to a \$25,000 deficiency.

In situations involving a claim for a deficiency following a disposition of collateral to a related party for a low price (discussed in (3) above), the debtor or obligor will have the burden of establishing that the amount of the proceeds realized from the disposition was “significantly below” the range of prices that a complying disposition to a person other than the related party would have brought. Rev. U.C.C. §§ 9-626(5) and 9-615(f). The Official Comments to Revised Article 9 explain that the reason for placing the burden upon the objecting party rather than the

secured party is to discourage price challenges every time collateral is disposed to a related party. Rev. U.C.C. § 9-626, cmt. 5.

Finally, a debtor whose deficiency is eliminated under Revised Section 9-626 may recover damages for the loss of any surplus. Rev. U.C.C. § 9-625(d). To avoid a “double-recovery,” a debtor or secondary obligor whose deficiency was eliminated or reduced under Revised Section 9-626 may not recover any damages for the secured party’s non-compliance with the provisions of Part 6 relating to collection, enforcement, disposition or acceptance of collateral. Rev. U.C.C. § 9-625(d). Presumably, such debtor or secondary obligor may recover any damages it sustains by reason of the secured party’s non-compliance with other sections of Article 9.

III. Consumer Transactions

Revised Article 9 expands the post-default protections available in “consumer transactions,” or transactions involving “consumer goods.” These terms are defined in Revised Article 9 and essentially involve transactions by consumer debtors involving collateral that is used primarily for personal, family or household purposes. Rev. U.C.C. §§ 9-102(22)-(26). With respect to the enforcement provisions, Revised Article 9 carves out certain exceptions to the rules governing the rights and duties that are applicable only to consumer transactions or transactions involving consumer goods. For example:

- the “10 days per se reasonable notice” rule for notice of a secured party’s intended disposition of collateral does not apply with respect to a consumer transaction, Rev. U.C.C. § 9-612(b);
- the secured party may not “accept” consumer goods that are in the possession of the debtor, Rev. U.C.C. § 9-620(a)(3);

- the debtor may require the mandatory disposition of consumer goods if 60 percent of the secured obligation has been paid, Rev. U.C.C. § 9-620(e);
- the secured party may not “accept” the collateral in partial satisfaction of the secured debt, Rev. U.C.C. § 9-620(g);
- the debtor’s right to redemption in a consumer goods transaction may not be waived, even after default, Rev. U.C.C. § 9-624(c);
- courts have discretion in consumer transactions to devise an appropriate rule (e.g. absolute bar, rebuttable presumption, or offset) for calculating a deficiency or surplus in the event of a secured party’s non-compliance with the default provisions; Rev. U.C.C. § 9-626(b);
- the debtor in a consumer goods transaction is entitled to a detailed calculation of a surplus or deficiency, Rev. U.C.C. § 9-616; and
- in a consumer goods transaction, special rules apply to the contents and form of notification before disposition, Rev. U.C.C. § 9-614.

IV. Transitioning to Revised Article 9

Revised Article 9 takes effect on July 1, 2001 (if adopted in New York). Rev. U.C.C. § 9-701. With certain exceptions, Revised Article 9 will apply to a transaction or lien within its scope, even if the transaction or lien was entered into before the effective date. Rev. U.C.C. § 9-702(a). Revised Article 9 will not apply to any litigation pending on the effective date. Rev. U.C.C. § 9-702(c), cmt. 2.