

Strict Foreclosure Under Revised Article 9

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Both Revised Article 9 of the Uniform Commercial Code (“Revised Article 9” or “Rev. U.C.C.”) and its predecessor (“Article 9” or “U.C.C.”) include strict foreclosure among the enforcement rights available to a secured party upon the default of a secured obligation. Strict foreclosure — referred to as an “acceptance of collateral” in Revised Article 9 — provides a post-default mechanism for the secured party to acquire the debtor’s interest in collateral without a foreclosure sale or judicial intervention. Rev. U.C.C. §9-620, Comment 1. Revised Article 9 (in revised sections 9-620 through 9-622) has both expanded the scope and clarified the procedural requirements of strict foreclosure from that contained in Article 9 (in section 9-505(2)). For example, Revised Article 9 and Article 9 both allow strict foreclosure in full satisfaction of the secured obligation, but Revised Article 9 also allows the secured party to accept collateral (other than consumer goods) in partial satisfaction of the secured obligation. Rev. U.C.C. §9-620(a). Moreover, while Article 9 by its terms permits strict foreclosure only when the secured party is in possession of the collateral (U.C.C. §9-505(2)), Revised Article 9 eliminates any requirement of possession. Rev. U.C.C. §9-620, Comment 7. As a result, intangible collateral that is incapable of possession (such as intellectual property) may be

accepted by the secured party in full or partial satisfaction of the secured obligation.

This article will summarize Revised Article 9’s requirements for a full or partial acceptance of collateral by an enforcing secured party. It should be noted that to the extent revised sections 9-620, 9-621 and 9-622 grant rights to the debtor and secondary obligors or impose duties upon the enforcing secured party, such rights and duties (with the exception of a debtor’s right to a mandatory disposition of consumer goods-collateral) are non-waivable. Rev. U.C.C. §§9-602(10) and 9-624(b). In addition, Revised Article 9 does not eliminate any non-UCC requirements that an enforcing secured party may have to satisfy to become the owner of collateral it accepts. Rev. U.C.C. §9-620, Comment 9. For example, the enforcing secured party accepting an automobile may have to comply with applicable motor vehicle certificate-of-title state law.

Requirements of Acceptance

Under Revised Article 9, an acceptance of collateral by the enforcing secured party in either full or partial satisfaction of the secured obligation requires: (1) the post-default consent to the acceptance by both the debtor and secured party (Rev. U.C.C. §9-620(a)(1) and (b)(1)); (2) that the enforcing secured party not have received a timely and authenticated (e.g., signed) objection to the acceptance from a party entitled to

notice or otherwise entitled to object (Rev. U.C.C. §9-620(a)(2)); and (3) good faith on the part of the enforcing secured party (Rev. U.C.C. §9-620, Comment 11). Upon the fulfillment of these requirements, the enforcing secured party’s acceptance of the collateral will be deemed “effective”. Rev. U.C.C. §9-620, Comment 3.

Debtor’s Consent

Revised Article 9 identifies the “debtor” as (1) a party holding an interest in collateral other than a security interest or other lien; (2) a seller of accounts, chattel paper, payment intangibles or promissory notes; or (3) a consignee. Rev. U.C.C. §9-102(a)(28). A debtor may consent to an acceptance of collateral in either full or partial satisfaction of the secured obligation by agreeing “to the terms of the acceptance in a record authenticated after default”. Rev. U.C.C. §9-620(c)(1) and (2). An “record authenticated” by a party includes a writing signed by the party as well as an electronic transmission to which the party has indicated its adoption or acceptance. Rev. U.C.C. §9-102(a)(7) and (69).

A debtor’s consent to the acceptance of collateral in full (but not partial) satisfaction of the secured obligation will be implied where the enforcing secured party: (1) sends to the debtor, after a default, a “proposal” that is unconditional

Continued on page 11

Strict Foreclosure, continued

(except for a condition that collateral not in the secured party's possession be preserved and maintained); (2) proposes to accept the collateral in full satisfaction of the secured obligation; and (3) does not receive a notification of objection authenticated by the debtor within twenty-days after the proposal is sent. Rev. U.C.C. §9-620(c)(2). While an enforcing secured party may send a proposal to accept collateral in partial satisfaction of the secured obligation, the debtor's consent to such proposal cannot be implied from the debtor's silence. Rather, the debtor must consent to a partial acceptance proposal in a record authenticated by it. Rev. U.C.C. §9-620, Comment 3.

A proposal to accept collateral must be in the form of a "record authenticated" by the secured party and include the terms on which the secured party is willing to accept the collateral. Rev. U.C.C. §9-102(a)(66). It should identify the collateral to be accepted, specify the amount (or means of calculating the amount, such as including a per diem accrual figure) of the secured obligation to be satisfied, state the conditions (if any) under which the proposal may be revoked, and describe any other conditions. Rev. U.C.C. §9-620, Comment 4. If the proposal contains any condition other than that collateral not in the enforcing secured party's possession be preserved and maintained, the debtor's consent thereto may not be implied by silence. *Id.*

Where the debtor has agreed to acceptance in a record authenticated by it, the enforcing secured party need not send a proposal to the debtor. Rev. U.C.C. §9-620, Comment 4. The enforcing secured party, as discussed below, will be required to prepare a proposal in those instances where revised section 9-621 requires a proposal be sent by it to other parties.

Secured Party's Consent

Some courts have interpreted Article 9 as permitting a "constructive" strict foreclosure when the secured party has taken possession of collateral without notifying the debtor in writing of its intent to retain the collateral in satisfaction of the secured obligation. Rev. U.C.C. §9-620, Comment 5. Revised Article 9 makes clear that there can be no "constructive" strict foreclosure. *Id.* A "purported or apparent" acceptance of collateral under Revised Article 9 will be "ineffective" unless both (1) the enforcing secured party consents to the acceptance in an authenticated record or sends a proposal to the debtor and (2) the other conditions of an effective acceptance are satisfied. Rev. U.C.C. §9-620(b). Thus, an enforcing secured party may consent to an acceptance only in a record authenticated by it or by sending a proposal. Rev. U.C.C. §9-620(b)(1).

Notice to Third Parties

Whether or not the debtor has affirmatively consented to the collateral's acceptance, Revised Article 9 requires that the enforcing secured party send a proposal to: (1) any party from which the secured party has received, at any time before the debtor's consent to the acceptance, an authenticated notification of a claim or interest in the collateral and (2) any party that, ten days before the debtor's consent to the acceptance, held a security interest in the collateral perfected by either the filing of a financing statement or by compliance with a statute, regulation or treaty as described in revised section 9-311. Rev. U.C.C. §9-621(a). Where the enforcing party seeks to accept collateral in partial satisfaction, the proposal must also be sent to any secondary obligors of the secured obligation. Rev. U.C.C. §9-621(b).

An objection by a party notified pursuant to revised section 9-621 must

be authenticated and will be effective only if it is received by the enforcing secured party within 20 days after the proposal was sent to the objecting party. Rev. U.C.C. §9-620(d)(1).

Unlike the notification provision in revised section 9-611 applicable to the sale or other disposition of collateral by a secured party, revised section 9-621 contains no "safe harbor" excusing compliance with its terms. Rev. U.C.C. §9-621, Comment 2. The enforcing secured party's failure to send a proposal to any party identified in revised section 9-621, however, will not render the acceptance ineffective if the other acceptance requirements are satisfied. *Id.* Rather, the non-notified party will have the right to recover damages under revised section 9-625(b) from the enforcing secured party for any loss caused by the lack of notice. Rev. U.C.C. §9-625(b). *Id.*

Other Parties Entitled to Object

Any party holding a subordinate interest in the collateral to be accepted, but not entitled to notice under revised section 9-621, may object to the acceptance. Rev. U.C.C. §9-620(a)(2)(B). Such objection must be authenticated and received by the enforcing secured party within 20 days after the last proposal was sent to any party entitled to notice. Rev. U.C.C. §9-620(d)(2)(A). If no proposal was required to be sent to any party, the objection will be effective only if it is received by the enforcing secured party before the debtor consents to the acceptance. Rev. U.C.C. §9-620(d)(2)(B).

Consequences of a Timely Objection

If the enforcing secured party receives a timely objection to its proposal from either the debtor or a party entitled to object, the enforcing secured party may

Continued on page 12

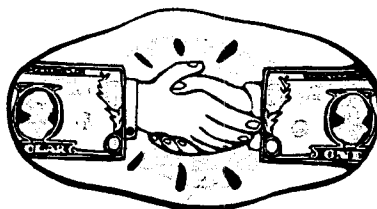
Strict Foreclosure, continued

not accept the collateral. Rev. U.C.C. §9-620(a). Under Article 9, the enforcing secured party is required to sell or otherwise dispose of the collateral if a timely objection to its strict foreclosure was received. U.C.C. §9-505(2). Revised Article 9 (except in the case of consumer goods-collateral) does not provide for a mandatory disposition of collateral upon a timely objection to acceptance. Rev. U.C.C. §9-620(e). A delay without justification in the disposition of the collateral, however, may expose the enforcing secured party to the risk that it may be found by a court not to have fulfilled its duty to dispose of collateral in a "commercially reasonable" manner. Rev. U.C.C. §9-610, Comment 3.

Good Faith

While the acceptance of collateral by the enforcing secured party is not subject to the "commercially reasonable" standard applicable to a sale or other disposition of collateral, the collateral must be accepted in good faith. Rev. U.C.C. §9-620, Comment 11. Thus, while the debtor and enforcing secured party are free to agree between themselves as to the amount of the secured obligation that will be satisfied by an acceptance, such agreement is subject to a good faith test. Rev. U.C.C. §9-621, Comment 2. Revised 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". Rev. U.C.C. §9-102(a)(43). The Official Comments to Revised Article 9 indicate that a secured party's proposal to accept collateral worth \$1000 in satisfaction of a \$100 debt, made in the hopes that the debtor may inadvertently fail to object, constitutes bad faith and would be ineffective. Rev. U.C.C. §9-620, Comment 11. The Official Comments also suggest that, in the "normal case",

proposals and acceptances should not be "second-guessed" on the basis of the involved collateral's "value" and that even a clear excess of collateral value over the secured obligation it satisfies does not necessarily demonstrate the absence of good faith. *Id.* Revised Article 9, therefore, leaves it to the courts to resolve challenges to the enforcing secured party's good faith in the acceptance of collateral.



Effect of Acceptance

Revised Article 9 does not impose any formalities or identify any steps that must be taken once the requirements for an acceptance have been satisfied. Rev. U.C.C. §9-620, Comment 6. The Official Comments suggest that, as a matter of good business practice, the enforcing secured party should notify the debtor in writing following an acceptance that the collateral has been accepted or, at the least, place a memorandum to that effect in its own files. Rev. U.C.C. §9-620, Comment 6.

An effective acceptance in full or partial satisfaction of the secured obligation: (1) discharges the secured obligation to the extent consented to by the debtor; (2) transfers to the secured party all of the debtor's rights in the accepted collateral; (3) discharges the secured party's security interest in the accepted collateral; and (4) discharges all security interests, liens or other interests in the accepted collateral that are subordinate to the security interest of the enforcing secured party. Rev. U.C.C. §9-622(a). As noted above, a subordinate interest is discharged even if the secured party failed to provide the holder of that interest with the proposal required by revised section

9-621. Rev. U.C.C. §9-622(b). The acceptance will not discharge any liens or security interests that have priority or are equal to that of the enforcing secured party.

Consumer Goods

Revised Article 9 imposes certain rules that are applicable only where the collateral consists of consumer goods. Strict foreclosure is not available where the consumer goods are in the possession of the debtor. Rev. U.C.C. §9-620(a)(3). If the secured party has taken possession of consumer goods, strict foreclosure will not be available where 60 percent of the cash price (in the case of a purchase-money security interest) or the principal amount of the secured obligation (in cases other than a purchase-money security interest) has been paid. Rev. U.C.C. §9-620(e). In either of those two instances (and unless waived by the debtor pursuant to revised section 9-624(b)), the secured party must sell or otherwise dispose of the consumer goods within 90 days after taking possession or any longer period to which the debtor and all secondary obligors have agreed to after default. Rev. U.C.C. §9-620(f). Finally, in a consumer transaction, the secured party may not accept the collateral in partial satisfaction of the secured obligation. Rev. U.C.C. §9-620(g).

Conclusion

Revised Article 9 seeks to encourage and facilitate the use of acceptance (strict foreclosure) as a remedy upon default of the secured obligation. For the most part, it provides a more straightforward and flexible mechanism than that contained in Article 9. One potential deterrent to an acceptance under Revised Article 9, however, may be a perceived risk in a particular case that a debtor or other interested party will later seek to challenge the acceptance as lacking good faith. ☐