Default and Enforcement of Security Interests under Revised Article 9

Donald J. Rapson

Follow this and additional works at: https://scholarship.kentlaw.iit.edu/cklawreview

Recommended Citation
Donald J. Rapson, Default and Enforcement of Security Interests under Revised Article 9, 74 Chi.-Kent L. Rev. 893 (1999).
Available at: https://scholarship.kentlaw.iit.edu/cklawreview/vol74/iss3/4

This Article is brought to you for free and open access by Scholarly Commons @ IIT Chicago-Kent College of Law. It has been accepted for inclusion in Chicago-Kent Law Review by an authorized editor of Scholarly Commons @ IIT Chicago-Kent College of Law. For more information, please contact dginsberg@kentlaw.iit.edu.
DEFAULT AND ENFORCEMENT OF SECURITY INTERESTS UNDER REVISED ARTICLE 9

DONALD J. RAPSON*

INTRODUCTION

At its organizational meeting early in 1993, the Article 9 Drafting Committee made the decision to put the default and remedies (hereinafter “enforcement”) provisions of Article 9 (present Part 5) at the top of the list for potential revision. It was a wise and fortunate decision—and somewhat surprising given that the Drafting Committee was composed mostly of transactional attorneys and academics who, as a group, generally have less interest and experience in that aspect of secured transactions than in the more intellectually challenging subjects of perfection and priority.

There may have been a belief among most of the Drafting Committee that review of these provisions would be easy with few changes, allowing the project to get off to a rapid and good start. Some of us knew differently. Although Article 9 has been rightfully lauded as the “jewel” of the Uniform Commercial Code (“UCC”), the enforcement provisions have been a weak link. Numerous commentators have recognized that enforcement, particularly the flexible concept of “commercial reasonableness,” has been one of the most litigated areas in the entire UCC.1

* Retired Senior Vice President and Assistant General Counsel of The CIT Group, Inc.; Adjunct Professor of Law, New York University Law School; Lecturer-in-Law, Columbia Law School; Member, Permanent Editorial Board for the Uniform Commercial Code; Member, Article 9 Study Committee of the Permanent Editorial Board for the Uniform Commercial Code; Member, Article 9 Drafting Committee of the National Conference of Commissioners on Uniform State Laws (American Law Institute Representative); Adviser, Restatement of the Law Third, Suretyship and Guaranty.

The views expressed in this article are strictly the personal views of the author and should in no way be attributed, directly or indirectly, expressly or by implication, to The CIT Group, Inc., or any of its affiliate companies or to the directors, officers, or any other person employed by or associated with any of these companies.

The author acknowledges with thanks the helpful comments on this article of Professors Steven L. Harris and Timothy R. Zinnecker.

This appears to have been the result intended by the original drafters of Article 9. Professor Grant Gilmore, one of the Co-Reporters and its primary drafter, recounted:

Part 5 of Article 9, which consists of seven lengthy sections, is devoted to default rights. Despite the considerable amount of wordage, however, Part 5, rejecting the UCSA [Uniform Conditional Sales Act] approach of detailed statutory regulation, opts for a loosely organized, informal, anything-goes type of foreclosure pattern, subject to ultimate judicial supervision and control which is explicitly provided for.... The key provision in Part 5 is that the secured party’s disposition of the collateral must be in all respects “commercially reasonable.” This term is deliberately left undefined, although it is limited by a few statutory illustrations of reasonableness and unreasonableness. In substance Article 9 remits to the courts the task of determining standards and refrains from fashioning a statutory rule.2

That approach is in sharp contrast to the rest of Article 9 which provides precise rules governing the attachment, perfection, and priority of security interests in order to minimize uncertainty and the need for litigation to resolve disputes. Although such an approach may have been justifiable in the less litigious era of the 1950s, it is no longer acceptable to state rules governing enforcement rights in a “loosely organized, informal, anything-goes type of foreclosure pattern,” leaving it to the courts to exercise “supervision and control.”3 That is wasteful, expensive, inefficient, unfair, and detrimental to secured financing. Secured parties need clear guidance in establishing practices and procedures when enforcing their rights and remedies; debtors need protection from arbitrary and capricious enforcement. This seems particularly evident in light of the fact that enforcement permits the exercise of nonjudicial self-help—casting the burden of litigation upon aggrieved debtors who are often financially unstable and unable to afford expensive and time-consuming litigation. Moreover, too many court systems in the country are overburdened and lack the expertise to properly adjudicate...
Another consequence of the original drafters' approach is that the enforcement provisions are inadequately drafted, inexplicably providing no guidance concerning several fundamental issues. One well-known example is the failure of the statute to state the consequences of a failure to comply with the requirements of Part 5, resulting in three different judicial rules. Another example is the absence of rules for the calculation of deficiencies and the enforcement of deficiency claims. At an early meeting of the Drafting Committee, a leading consumer advocate characterized "abusive" deficiency actions as "the most fundamental problem that consumers have faced under Article 9." A third example is the uncertainty as to whether the secured party and debtor may effectively agree to a voluntary turnover of the collateral to the secured party in return for a stipulated partial satisfaction of the debt and the debtor's acknowledgment of liability for the remaining deficiency.

The Drafting Committee tackled these issues, as well as many others, head-on. Discussions were extensive and often contentious but conscientious and eventually productive. What has emerged is a thorough overhaul and complete revision of the enforcement provisions in a new Part 6 comprising twenty-eight sections.

Revised Article 9 has an initial uniform effective date of July 1, 2001. These new enforcement provisions then become the exclusive means for enforcing security interests arising not only under Revised Article 9, but also under present Article 9. With respect to secured transactions governed by non-Article 9 law before the effective date which would be covered by Revised Article 9 if entered into or created after that date, enforcement can be under that other law or the effective date, enforcement can be under that other law or present law will be applicable.

4. That is, the "absolute bar" rule, the "rebuttable presumption" rule, and the "offset damages" rule. See R. § 9-626 cmt. 4; Lloyd, supra note 1, at 699-700.
5. See Rapson, supra note 1, at 496-512.
8. See R. § 9-701.
9. See id. § 9-702(a). If, however, litigation or another action had commenced before the effective date, present law will be applicable. See id. § 9-702(c).
under Revised Article 9.\(^{10}\)

Although Part 6 is captioned "Default," it is important to recognize that Article 9 does not define the elements of a "default." That is a matter of contract law determined by the agreement of the parties. This point is made in the initial provision of Part 6:

**[Rights of secured party after default.]** After default, a secured party has the rights provided in this part and, except as otherwise provided in Section 9-602, those provided by agreement of the parties. . . .\(^{11}\)

and emphasized by the Official Comment:

**When Remedies Arise.** Under subsection (a) the secured party's rights arise "after default." Like former Section 9-501, this Article leaves to the agreement of the parties the circumstances giving rise to a default. This Article does not determine whether a secured party's post-default conduct can constitute a waiver of default in the face of an agreement stating that such conduct shall not constitute a waiver. Rather, it continues to leave to the parties' agreement, as supplemented by law other than this Article, the determination whether a default has occurred or has been waived. See Section 1-103.\(^{12}\)

In exercising its enforcement rights, the secured party needs to be cognizant of the new rules in Revised Article 9 for determining the law governing perfection, the effect of perfection or nonperfection, and the priority of a security interest in the collateral.\(^{13}\) The general rule is that perfection is governed by the law of the jurisdiction of the debtor's location.\(^{14}\) There are special rules, however, for goods covered by a certificate of title,\(^{15}\) deposit accounts,\(^{16}\) investment property,\(^{17}\) or letter-of-credit rights.\(^{18}\) In the case of possessory security interests, perfection is governed by the local law where the collateral is located.\(^{19}\) In addition, in those circumstances where

---

10. See id. § 9-702(b). An example is enforcing a security interest in a deposit account as original collateral. See id. § 9-109 cmt. 16.
11. Id. § 9-601(a).
12. Id. § 9-601 cmt. 3.
13. See id. § 9-301.
14. See id. § 9-301(1), 9-301 cmt. 4. The debtor's location is determined under Revised section 9-307. For example, the location of a "registered organization," e.g., a corporation, is its state of organization, i.e., state of incorporation. See id. § 9-307(e). "Debtor" is defined in Revised section 9-102(a)(28) and includes a person with a property interest in the collateral.
15. See id. § 9-303.
16. See id. § 9-304.
17. See id. § 9-305.
18. See id. § 9-306.
19. See id. § 9-301(2).
tangible or semi-intangible property is located in a jurisdiction that is different than the debtor's location, perfection is governed by the local law of the debtor's location, but "the effect of perfection or nonperfection and the priority of a nonpossessory security interest" is determined by the local law of the jurisdiction where the property is located. For example, if the debtor was a Delaware corporation that granted a security interest in equipment located in New Jersey, perfection would be governed by Delaware law, but if the secured party exercised its enforcement rights against the collateral in New Jersey, priority disputes with other secured creditors or lien creditors would be governed by New Jersey law.

Parts I, II, and III of this article examine the three basic methods of enforcement of security interests after default under Revised Article 9: collection and enforcement (Part I); repossession and disposition of collateral ("nonjudicial foreclosure") (Part II); and acceptance of collateral in full or partial satisfaction of the obligation ("strict foreclosure") (Part III). Part IV examines the special rules affecting enforcement of security interests in lease and license agreements. Part V examines special provisions in Revised Article 9 that resolve (and fail to resolve) important uncertainties under existing law: the consequences of a secured party's noncompliance with Article 9's enforcement requirements on deficiency claims, and the applicability of Article 9's enforcement requirements to certain assignments that take place upon default.

I. COLLECTION AND ENFORCEMENT BY SECURED PARTY

Revised section 9-607 replaces UCC section 9-502. It sets forth

20. That is, negotiable documents, goods, instruments, money, and tangible chattel paper.
22. See id. § 9-301 cmt. 7. All other matters of enforcement are determined by the Code's general choice of law rule under UCC section 1-105. Usually, this rule validates the choice agreed to by the parties.
23. A last-minute "compromise" between consumer and consumer-creditor advocates had the unfortunate consequence of leaving some of these issues to courts for "the determination of the proper rules in consumer transactions." Id. § 9-626(b) (dealing with the consequences of noncompliance); see infra text accompanying notes 277-87. For a report of that compromise, see REVISION OF UNIFORM COMMERCIAL CODE ARTICLE 9-SECURED TRANSACTIONS, REPORTER'S PREFATORY COMMENTS § 5(j) (1998), submitted to National Conference of Commissioners on Uniform State Laws at its Annual Meeting July 24-31, 1998, Cleveland, Ohio.
24. See supra text accompanying note 5; infra text accompanying notes 270-76.
25. Revised section 9-607 provides:
   (a) [Collection and enforcement generally.] If so agreed, and in any event on default, a secured party:
the rights, as between the secured party and the debtor, of the secured party to exercise collection and enforcement rights against third persons after default—or even earlier if so agreed between the secured party and debtor. This article focuses on the post-default aspect. Revised section 9-607 is much more expansive than prior law in making clear that the statute is applicable to collection and enforcement not only against a person who is an “account debtor,” but also against any “other person obligated to make payment or otherwise render performance to or for the benefit of the secured party,” e.g., a guarantor. Both types of “persons” are defined more

(1) may notify an account debtor or other person obligated on collateral to make payment or otherwise render performance to or for the benefit of the secured party;
(2) may take any proceeds to which the secured party is entitled under Section 9-315;
(3) may enforce the obligations of an account debtor or other person obligated on collateral and exercise the rights of the debtor with respect to the obligation of the account debtor or other person obligated on collateral to make payment or otherwise render performance to the debtor, and with respect to any property that secures the obligations of the account debtor or other person obligated on the collateral;
(4) if it holds a security interest in a deposit account perfected by control under Section 9-104(a)(1), may apply the balance of the deposit account to the obligation secured by the deposit account; and
(5) if it holds a security interest in a deposit account perfected by control under Section 9-104(a)(2) or (3), may instruct the bank to pay the balance of the deposit account to or for the benefit of the secured party.

(b) [Nonjudicial enforcement of mortgage.] If necessary to enable a secured party to exercise under subsection (a)(3) the right of a debtor to enforce a mortgage nonjudicially, the secured party may record in the office in which a record of the mortgage is recorded:

(1) a copy of the security agreement that creates or provides for a security interest in the obligation secured by the mortgage; and
(2) the secured party’s sworn affidavit in recordable form stating that:
   (A) a default has occurred; and
   (B) the secured party is entitled to enforce the mortgage nonjudicially.

(c) [Commercially reasonable collection and enforcement.] A secured party shall proceed in a commercially reasonable manner if the secured party:

(1) undertakes to collect from or enforce an obligation of an account debtor or other person obligated on collateral; and
(2) is entitled to charge back uncollected collateral or otherwise to full or limited recourse against the debtor or a secondary obligor.

(d) [Expenses of collection and enforcement.] A secured party may deduct from the collections made pursuant to subsection (c) reasonable expenses of collection and enforcement, including reasonable attorney’s fees and legal expenses incurred by the secured party.

(e) [Duties to secured party not affected.] This section does not determine whether an account debtor, bank, or other person obligated on collateral owes a duty to a secured party.

26. Revised section 9-102(a)(3) provides: “‘Account debtor’ means a person obligated on an account, chattel paper, or general intangible. The term does not include persons obligated to pay a negotiable instrument, even if the instrument constitutes part of chattel paper.”

27. R. § 9-607(a)(1).
broadly than under present law.

A. "Account Debtor"

Revised Article 9's definition of "account debtor" first clarifies whether an obligor on an "instrument" is an account debtor even when the instrument is part of "chattel paper." If the instrument is negotiable, the obligor is not an "account debtor" and its duties are always governed by UCC Article 3, not Article 9. In contrast, "the duties of an obligor on a nonnegotiable instrument are governed by non-Article 9 law unless the nonnegotiable instrument is a part of chattel paper, in which case the obligor is an account debtor."

This is explained in an informative Official Comment:

"Account Debtor." An "account debtor" is a person obligated on an account, chattel paper, or general intangible. The account debtor's obligation often is a monetary obligation; however, this is not always the case. For example, if a franchisee uses its rights under a franchise agreement (a general intangible) as collateral, then the franchisor is an "account debtor." As a general matter, Article 3, and not Article 9, governs obligations on negotiable instruments. Accordingly, the definition of "account debtor" excludes obligors on negotiable instruments constituting part of chattel paper. The principal effect of this change from the definition in former Article 9 is that the rules in Sections 9-403, 9-404, 9-405, and 9-406, dealing with the rights of an assignee and duties of an account debtor, do not apply to an assignment of chattel paper in which the obligation to pay is evidenced by a negotiable instrument. (Section 9-406(d), however, does apply to promissory notes, including negotiable promissory notes.) Rather,

28. "Obligor" is a new term defined in Revised section 9-102(a)(59) and includes a person who owes "payment or other performance of the obligation." See infra note 95 (quoting entire definition). It includes a "debtor," a "secondary obligor," and a principal obligor. The last is a person who is principally liable for the obligation but has not provided any collateral and, therefore, is not a "debtor." See R. § 9-102 cmt. 2a; infra text accompanying notes 87-96.

29. "Instrument" under present and Revised Article 9 includes both negotiable and non-negotiable instruments. Revised section 9-102(a)(47) provides:

"Instrument" means a negotiable instrument or any other writing that evidences a right to the payment of a monetary obligation, is not itself a security agreement or lease, and is of a type that in ordinary course of business is transferred by delivery with any necessary indorsement or assignment. The term does not include (i) investment property, (ii) letters of credit, or (iii) writings that evidence a right to payment arising out of the use of a credit or charge card or information contained on or for use with the card.

30. "Chattel paper" is defined in Revised section 9-102(a)(11) and includes a security agreement or lease taken together as a group with "an instrument or series of instruments." See infra note 292 (quoting entire definition).

31. The term "account debtor" expressly excludes "persons obligated to pay a negotiable instrument, even if the instrument constitutes part of chattel paper." R. § 9-102(a)(3).

32. Id. § 9-102 cmt. 5h.
the assignee’s rights are governed by Article 3. Similarly, the duties of an obligor on a nonnegotiable instrument are governed by non-Article 9 law unless the nonnegotiable instrument is a part of chattel paper, in which case the obligor is an account debtor.33

Thus, “account debtor” not only includes a person having a monetary obligation, but also includes a person with a performance obligation, e.g., a franchisor, lessor, or licensor. This is important to keep in mind in analyzing the secured party’s rights of enforcement against an “account debtor” in those circumstances where the debtor has granted a security interest in its rights as franchisee, lessee, or licensee.34 Revised section 9-607 tells us against whom the secured party has rights of enforcement, e.g., a franchisor, lessor, or licensor. It does not, however, determine whether an account debtor or other person obligated on collateral actually owes a duty to the secured party. That issue is governed by other provisions of Revised Article 9 and other law.35

B. “Other person obligated on collateral”

This phrase not only covers “the obligor on an instrument” referred to in present law,36 but also includes the debtor’s rights against other persons in addition to the account debtor or obligor on an instrument.37 This would include the debtor’s rights against persons under contracts relating to the collateral arising out of covenants, representations, and warranties that may have been breached. These kinds of claims “typically would be proceeds of original collateral under Section 9-315.”38 For example, a secured party’s security interest in “general intangibles” would include the debtor’s rights as the owner of real estate which is the subject of a construction contract with a builder to claim damages for the builder’s failure to properly construct the building.39

“Other persons obligated on collateral” would also include a bank that maintains a deposit account serving as collateral. The mortgagor under a mortgage which has been assigned by the mortgagee as collateral is a person “obligated on collateral.” The

33. Id.
34. See infra text accompanying notes 216-27.
35. See R. § 9-607(e), 9-607 cmt. 6.
36. See U.C.C. § 9-502(1).
37. See R. § 9-607 cmt. 3.
38. Id.
phrase also includes persons liable on a “supporting obligation,” i.e., a guarantor, a person providing collateral to secure the obligations of an account debtor or obligor on an instrument, or the issuer of a letter of credit. Revised Article 9 provides that the attachment of the secured party’s security interest in the original collateral automatically attaches to “a supporting obligation for the collateral” just as it attaches to proceeds. It is important to reiterate that the secured party’s enforcement rights against persons liable on supporting obligations are governed by other provisions of Article 9 and by other law.

C. Collections by Subordinate Secured Parties

Revised Article 9 confronts the difficult and controversial problem that sometimes arises when a subordinate (“junior”) secured party collects from an account debtor or other person obligated on the collateral. Under present law, the junior secured party may be entitled to retain the proceeds of the collection (e.g., a check) free of the claim of a senior secured party to those same proceeds if the junior secured party qualifies either as a holder in due course or as a "purchaser" taking possession of the instrument. Revised Article 9 continues the rule allowing a holder in due course of a negotiable instrument to “take priority over an earlier security interest, even if perfected” and makes it even easier for a purchaser of the instrument to attain priority by eliminating the requirements that the purchaser give “new value” and that the purchase be “in the ordinary course of” the purchaser’s business.

There are some factual circumstances when the junior secured

40. Revised section 9-102(a)(77) provides: “Supporting obligation’ means a letter-of-credit right or secondary obligation that supports the payment or performance of an account, chattel paper, a document, a general intangible, an instrument, or investment property.”
41. See R. § 9-607 cmt. 3.
42. See id. § 9-203(f).
43. See supra text accompanying notes 34-35; infra text accompanying notes 216-27.
44. See U.C.C. § 3-302; U.C.C. § 9-309.
45. UCC section 9-308 gives priority under some circumstances to a purchaser of chattel paper or instruments “who gives new value and takes possession of it in the ordinary course of his business.”
46. R. § 9-331(a).
47. See id. § 9-330(d). These requirements, however, are not eliminated for purchasers of chattel paper. See id. § 9-330(a)-(b); Donald J. Rapson, “Receivables” Financing Under Revised Article 9, 73 AM. BANKR. L.J. 133, 160-61 (1999); Donald J. Rapson, “Receivables” Financing Under Revised Article 9, 55 SECURED LENDER 8, 30 (1999) (updated version of the article in American Bankruptcy Law Journal).
party should not be able to attain such priority, and the Article 9 Drafting Committee spent considerable time attempting to provide a statutory formulation that would define those circumstances. Eventually, the Drafting Committee concluded that there was no one “right answer” and that the requirement of “good faith,” which is broadened under Revised Article 9 to include “observance of reasonable commercial standards of fair dealing,” should be a critical factor in deterring inappropriate conduct and in determining whether and when junior secured parties should attain such priority. An Official Comment directly addresses the issue:

**Collections by Junior Secured Party.** Under this section, a secured party with a junior security interest in receivables (accounts, chattel paper, promissory notes, or payment intangibles) may collect and retain the proceeds of those receivables free of the claim of a senior secured party to the same receivables, if the junior secured party is a holder in due course of the proceeds. In order to qualify as a holder in due course, the junior must satisfy the requirements of Section 3-302, which include taking in “good faith.” This means that the junior not only must act “honestly” but also must observe “reasonable commercial standards of fair dealing” under the particular circumstances. See Section 9-102(a). Although “good faith” does not impose a general duty of inquiry, e.g., a search of the records in filing offices, there may be circumstances in which “reasonable commercial standards of fair dealing” would require such a search.

Consider, for example, a junior secured party in the business of financing or buying accounts who fails to undertake a search to determine the existence of prior security interests. Because a search, under the usages of trade of that business, would enable it to know or learn upon reasonable inquiry that collecting the accounts violated the rights of a senior secured party, the junior may fail to meet the good-faith standard. See Utility Contractors Financial Services, Inc. v. Amsouth Bank, NA, 985 F.2d 1554 (11th Cir. 1993). Likewise, a junior secured party who collects accounts when it knows or should know under the particular circumstances that doing so would violate the rights of a senior secured party, because the debtor had agreed not to grant a junior security interest in, or sell, the accounts, may not meet the good-faith test. Thus, if a junior secured party conducted or should have conducted a search and a financing statement filed on behalf of the senior secured party states such a restriction, the junior’s collection would not meet the good-faith standard. On the other hand, if there was a course of performance between the senior secured party and the debtor which placed no such restrictions on the debtor and allowed

49. R. § 9-102(a)(43).
the debtor to collect and use the proceeds without any restrictions, the junior secured party may then satisfy the requirements for being a holder in due course. This would be more likely in those circumstances where the junior secured party was providing additional financing to the debtor on an on-going basis by lending against or buying the accounts and had no notice of any restrictions against doing so. Generally, the senior secured party would not be prejudiced because the practical effect of such payment to the junior secured party is little different than if the debtor itself had made the collections and subsequently paid the secured party from the debtor's general funds. Absent collusion, the junior secured party would take the funds free of the senior security interests. See Section 9-332. In contrast, the senior secured party is likely to be prejudiced if the debtor is going out of business and the junior secured party collects the accounts by notifying the account debtors to make payments directly to the junior. Those collections may not be consistent with "reasonable commercial standards of fair dealing."

Whether the junior secured party qualifies as a holder in due course is fact-sensitive and should be decided on a case-by-case basis in the light of those circumstances. Decisions such as Financial Management Services Inc. v. Familian, 905 P.2d 506 (Ariz. App. Div. 1995) (finding holder in due course status) could be determined differently under this application of the good-faith requirement.50

This Comment deliberately makes the result uncertain in some situations, leaving the issue to be resolved "on a case-by-case basis." This uncertainty is not designed to promote litigation but to deter junior secured parties from engaging in questionable courses of action that invite litigation. By using "good faith" to prevent the holder in due course rule from being a way of avoiding the priority rules of Article 9, while, at the same time, preserving the protection afforded by the holder in due course rule for appropriate circumstances, junior secured parties may be constrained from imprudent conduct.51 It should be borne in mind that this issue is not limited to the collection of accounts; it also exists with respect to the collection of other kinds of receivables, i.e., chattel paper, promissory notes, and payment intangibles.

50. Id. § 9-331 cmt. 5; see also id. §§ 9-330 cmt. 7, 9-607 cmt. 5.

51. A junior secured party may be entitled to retain the proceeds of the collection in circumstances where it does not qualify as a holder in due course but does qualify as a "purchaser" taking possession of the instrument. See id. § 9-330(d), 9-330 cmt. 7. The constraints imposed by the "good faith" requirement, however, are also applicable. See id. § 9-330 cmts. 6-7.
D. Specialized Kinds of Collection

1. Deposit Accounts

Security interests in deposit accounts as original collateral are now within the scope of Revised Article 9.52 Perfection can only be by "control"53 which is automatic if the secured party is the bank with which the account is maintained.54 "Control" by other secured parties is achieved by the debtor, secured party, and bank entering into a control agreement "that the bank will comply with instructions originated by the secured party directing disposition of the funds in the account without further consent by the debtor"55 or "the secured party becomes the bank's customer with respect to the deposit account."56 A security interest held by the bank, even if later in time, has priority over a conflicting security interest held by another party unless the other party has perfected its interest by either becoming the bank's customer57 or by a control agreement with the bank expressly agreeing to subordinate its security interest.58

Security interests in deposit accounts can be readily enforced by the bank that maintains the account by applying "the balance of the deposit account to the obligation secured by the deposit account."59 Other secured parties who have perfected by control60 "may instruct the bank to pay the balance of the deposit account to or for the benefit of the secured party."61 In that circumstance the bank is a "person obligated on collateral."62 The bank must comply with this instruction if the secured party is the bank's "customer," but if perfection is by a "control agreement," only if the agreement so provides.63 Otherwise, the bank has no duty to obey those

52. See id. § 9-109(a), 9-109 cmt. 16. They are excluded as original collateral under present law. See U.C.C. § 9-104(f). Perfection by filing in the deposit account as identifiable cash proceeds of other collateral continues to be permissible. See R. §§ 9-312 cmt. 5, 9-315.
53. See R. §§ 9-312(b)(1), 9-314(b).
54. See id. § 9-104(a)(1). We can expect that banks will almost always routinely take a security interest in the deposit account agreement.
55. Id. § 9-104(a)(2). The bank, however, "may exercise any right of recoupment or set-off." Id. § 9-340(a).
56. Id. § 9-104(a)(3). In this circumstance, the bank can only exercise a right of recoupment against the deposit account; it cannot set-off a claim against the debtor. See id. § 9-340(c).
57. See id. §§ 9-104(a)(3), 9-327 cmt. 4.
58. See id. §§ 9-104(a)(2), 9-339.
59. Id. § 9-607(a)(4).
60. See id. § 9-104(a)(2)-(3).
61. Id. § 9-607(a)(5).
62. Id. § 9-607(a)(1); see supra text accompanying notes 36-43.
63. See R. § 9-607 cmt. 7.
instructions\textsuperscript{64} and the secured party must then resort to judicial procedures,\textsuperscript{65} e.g., attachment, garnishment, or levy and execution under a court order or judgment.

2. Mortgages

Often, the secured party takes as collateral the debtor's rights as a mortgagee of real property—but may not have received a recordable assignment enabling it to become the mortgagee of record. The secured party has a right of enforcement against the mortgagor as a "person obligated on collateral."\textsuperscript{66} If permitted under real property mortgage law, the secured party may seek to nonjudicially foreclose that mortgage if the mortgagor is in default. Revised Article \textsuperscript{967} provides a helpful mechanism enabling the secured party "to become the assignee of record by recording in the applicable real-property records the security agreement and an affidavit certifying default."\textsuperscript{68} This enables the secured party to foreclose the mortgage nonjudicially if it can do so under applicable real property mortgage law.

\textit{E. Commercial Reasonableness}

As under present law,\textsuperscript{69} a secured party that exercises its collection and enforcement rights is required to "proceed in a commercially reasonable manner."\textsuperscript{70} There is no requirement of notice to the debtor. The secured party may deduct from the collections "reasonable expenses of collection and enforcement, including reasonable attorney's fees and legal expenses" incurred in proceeding against an account debtor or other third party.\textsuperscript{71} Revised Article 9 also follows present law\textsuperscript{72} in specifying that a secured party must "account to and pay a debtor for any surplus, and the obligor is

\textsuperscript{64} See id. § 9-341.
\textsuperscript{65} See id. § 9-607 cmt. 7.
\textsuperscript{66} See id. § 9-607(a)(1); \textit{supra} text accompanying notes 36-43.
\textsuperscript{67} See R. § 9-607(b).
\textsuperscript{68} Id. § 9-607 cmt. 8.
\textsuperscript{69} See U.C.C. § 9-502(2).
\textsuperscript{70} R. § 9-607(c).
\textsuperscript{71} See id. § 9-607(d). The reference to the deduction of "attorney's fees and legal expenses" clarifies what had been implicit under present law. The phrase does not, however, refer to attorney's fees and legal expenses incurred in proceeding against the debtor or obligor—the secured party's right to recover those costs is determined by the agreement of the parties. See id. § 9-607 cmt. 10; see also id. § 9-608(a)(1)(A).
\textsuperscript{72} See U.C.C. § 9-502(2).
liable for any deficiency”73—unless the “underlying transaction is a sale of accounts, chattel paper, payment intangibles, or promissory notes.”74

A new provision deals with noncash proceeds of collection and enforcement:

A secured party need not apply or pay over for application noncash proceeds of collection and enforcement under this section unless the failure to do so would be commercially unreasonable. A secured party that applies or pays over for application noncash proceeds shall do so in a commercially reasonable manner.75

An Official Comment explains this provision with an example:

**Noncash Proceeds.** Subsection (a)(3) addresses the situation in which an enforcing secured party receives noncash proceeds.

**Example:** An enforcing secured party receives a promissory note from the account debtor who is unable to pay an account when it is due. The secured party accepts the note in exchange for extending the date on which the account debtor’s obligation is due. The secured party may wish to credit its debtor (the assignor) with the principal amount of the note upon receipt of the note, but probably will prefer to credit the debtor only as and when the note is paid.

Under subsection (a)(3), the secured party is under no duty to apply the note or its value to the outstanding obligation unless its failure to do so would be commercially unreasonable. If the secured party does apply the note to the outstanding obligation, however, it must do so in a commercially reasonable manner. The parties may provide for the method of application of noncash proceeds by agreement, if the method is not manifestly unreasonable. See Section 9-603. This section does not explain when the failure to apply noncash proceeds would be commercially unreasonable; it leaves that determination to case-by-case adjudication. In the example, the secured party appears to have accepted the account debtor’s note in order to increase the likelihood of payment and decrease the likelihood that the account debtor would dispute its obligation. Under these circumstances, it may well be commercially reasonable for the secured party to credit its debtor’s obligations only as and when cash proceeds are collected from the account debtor, especially given the uncertainty that attends the account

73. R. § 9-608(a)(4). Note that “obligor” includes the “debtor” who provided the collateral. See id. § 9-102 cmt. 2a; supra note 28; infra text accompanying note 95.

74. R. § 9-608(b). The concluding sentence appearing in UCC section 9-502(2) does not appear in Revised Article 9: “But, if the underlying transaction was a sale of accounts or chattel paper, the debtor is entitled to any surplus or is liable for any deficiency only if the security agreement so provides.” No substantive change is intended by the deletion—the sentence was surplusage.

75. Id. § 9-608(a)(3).
debtor’s eventual payment. For an example of a secured party’s receipt of noncash proceeds in which it may well be commercially unreasonable for the secured party to delay crediting its debtor’s obligations with the value of noncash proceeds, see Section 9-615, Comment 3.

When the secured party is not required to “apply or pay over for application noncash proceeds,” the proceeds nonetheless remain collateral subject to this Article. If the secured party were to dispose of them, for example, appropriate notification would be required (see Section 9-611), and the disposition would be subject to the standards provided in this Part (see Section 9-610). Moreover, a secured party in possession of the noncash proceeds would have the duties specified in Section 9-207.76

Although seemingly noncontroversial in and of itself in this context, the same provision also appears (as noted in the Official Comment) in a later section dealing with foreclosures.77 The failure to credit the debtor with the value of the noncash proceeds in that context is more likely to be commercially unreasonable.78

II. NONJUDICIAL FORECLOSURE

Present and Revised Article 9 both state that after default, a secured party may “foreclose”79—but never define the word itself. “Foreclosure” means “[t]o shut out, to bar, to destroy an equity of redemption.... The process by which a mortgagor of real or personal property, or other owner of property subject to a lien, is deprived of his interest therein,”780 i.e., to “cut-off” the interest in the collateral of the debtor or of any other person claiming an interest that is subordinate to that of the foreclosing party. Foreclosure can be by a judicial proceeding or by nonjudicial means. This article focuses on nonjudicial foreclosure.

The loose and informal approach of present Article 9 to foreclosure is demonstrated by the skeletal statutory guidance on the procedure for conducting foreclosures. The key provision states:

Disposition of the collateral may be by public or private proceedings and may be made by way of one or more contracts. Sale or other disposition may be as a unit or in parcels and at any time and place and on any terms but every aspect of the disposition including the method, manner, time, place and terms must be

76. Id. § 9-608 cmt. 4.
77. See id. § 9-615(c).
78. See infra text accompanying notes 172-75.
79. See U.C.C. § 9-501(1); R. § 9-601(a)(1).
commercially reasonable. Unless collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market, reasonable notification of the time and place of any public sale or reasonable notification of the time after which any private sale or other intended disposition is to be made shall be sent by the secured party to the debtor, if he has not signed after default a statement renouncing or modifying his right to notification of sale. In the case of consumer goods no other notification need be sent. In other cases notification shall be sent to any other secured party from whom the secured party has received (before sending his notification to the debtor or before the debtor's renunciation of his rights) written notice of a claim of an interest in the collateral. The secured party may buy at any public sale and if the collateral is of a type customarily sold in a recognized market or is of a type which is the subject of widely distributed standard price quotations he may buy at private sale; and is supplemented by an explanation of "commercially reasonable manner":

The fact that a better price could have been obtained by a sale at a different time or in a different method from that selected by the secured party is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner. If the secured party either sells the collateral in the usual manner in any recognized market therefor or if he sells at the price current in such market at the time of his sale or if he has otherwise sold in conformity with reasonable commercial practices among dealers in the type of property sold he has sold in a commercially reasonable manner. The principles stated in the two preceding sentences with respect to sales also apply as may be appropriate to other types of disposition. A disposition which has been approved in any judicial proceeding or by any bona fide creditors' committee or representative of creditors shall conclusively be deemed to be commercially reasonable, but this sentence does not indicate that any such approval must be obtained in any case nor does it indicate that any disposition not so approved is not commercially reasonable.

There is no more statutory guidance.

In contrast, although Revised Article 9 repeats these provisions, it contains new provisions detailing to whom and when notice of disposition should be sent, the contents of the notification, including a "safe-harbor" form for all non-consumer-goods transactions, and mandatory requirements for the contents of the notification in

81. U.C.C. § 9-504(3).
82. Id. § 9-507(2).
83. See R. §§ 9-610(a)-(b), 9-627.
84. See id. §§ 9-611, 9-612.
85. See id. § 9-613.
consumer-goods transactions with another safe-harbor form. 86

A. Notification

1. To Whom

First, an “authenticated notification of disposition” 87 must be sent 88 to the debtor 89 and any “secondary obligor.” 90 Although the former is certainly consistent with present law, 91 the latter settles an existing uncertainty 92 and should be read in conjunction with another new provision that clarifies that secondary obligors, such as guarantors, cannot effectively waive the requirements of notification or “commercial reasonableness” 93 prior to default. 94

Notification need not be given, however, to an “obligor” 95 if it is neither a “debtor” nor a “secondary obligor.” “Obligor” includes not only a person who is a debtor or a secondary obligor, but also a person who is primarily liable for the obligation (“principal obligor”) but did not provide collateral securing the obligation and, therefore, is not a “debtor.” The rationale is that because such a person is liable in any event for the full amount of the obligation, there is no need for

86. See id. § 9-614.
87. Id. § 9-611(b).
88. See id. § 9-611(c)(1)-(2). This would include electronic notice. See id. § 9-102(a)(7) (defining “authenticate”), 9-102 cmt. 9b.
89. “Debtor” includes a person with a property interest in the collateral. See id. § 9-102(a)(28)(A).
90. “Secondary obligor” is defined in Revised section 9-102(a)(71) to mean “an obligor to the extent that: (A) the obligor’s obligation is secondary; or (B) the obligor has a right of recourse with respect to an obligation secured by collateral against the debtor, another obligor, or property of either.”
91. See U.C.C. § 9-504(3).
92. Is a guarantor a “debtor” as defined in UCC section 9-105(1)(d) and, thus, protected by the non-waivable rules of UCC section 9-501(3)(b)? See Harry C. Sigman, Guarantors’ Pre-Default Waivers of Article 9 Debtors’ Rights to Notice and Commercially Reasonable Disposition Should Be Effective, 29 IDAHO L. REV. 627, 629, 644 (1992) (analyzing conflicting judicial decisions and concluding that the courts “have been deficient. No sound policy argument has been set forth in the decisions”; and urging that waivers of notice of disposition and defense of commercial unreasonableness made by guarantors who were not owners of the collateral should be effective—a position first adopted by the Drafting Committee for commercial transactions but reversed at the end of the drafting process).
93. See R. § 9-602 cmt. 4.
94. Waiver of notification is permitted after default. See id. § 9-624(a).
95. “Obligor” is defined in Revised section 9-102(a)(59) to mean a person that, with respect to an obligation secured by a security interest in or an agricultural lien on the collateral, (i) owes payment or other performance of the obligation, (ii) has provided property other than the collateral to secure payment or other performance of the obligation, or (iii) is otherwise accountable in whole or in part for payment or other performance of the obligation. The term does not include issuers or nominated persons under a letter of credit.
notification because the person cannot be prejudiced by lack of notice.96 Secured parties may, nevertheless, continue to give notice to such a person as a matter of habit and business prudence.

If the collateral is other than consumer goods, Revised Article 9 also requires that notice be given to "any other person from which the secured party has received, before the notification date, an authenticated notification of a claim of an interest in the collateral."97 This is not new—indeed, it is the only way junior secured parties have a right to get notice under present law98—imposing a significant search and monitoring burden upon such parties. What is significantly new, however, is that notice must also be given to all secured parties (i.e., senior as well as junior) who, ten days before the notification date, have perfected their security interests by filing a financing statement or by complying with other applicable law, e.g., a certificate of title statute.99 This, of course, is a complete reversal of present law and a return to the Article 9 rule prior to its amendment in 1972.100 Junior secured parties who want notice of the foreclosure no longer have to search for senior secured parties and then notify them of their claim of interest in the collateral.101 Instead, the traditional search and notification burden is imposed upon foreclosing parties.

Revised Article 9 alleviates the foreclosing party's notification burden by affording a "safe-harbor" if "not later than 20 days or earlier than 30 days before the notification date, [it] requests, in a commercially reasonable manner" a search of UCC financing statements from the correct filing office and either receives no response or a response containing information about other secured

96. See R. § 9-102 cmt. 2a; supra note 28. In contrast, a person who is a "debtor" because he provided collateral securing the obligation of the principal obligor would be prejudiced by a lack of notice even though he is entitled to reimbursement or restitution from the principal obligor under suretyship principles as a "secondary obligor." See supra note 90. The ability to obtain reimbursement or restitution is, of course, problematic and dependent upon the financial circumstances of the principal obligor.

97. R. § 9-611(c)(3)(A). "Notification date" means the earlier of the date (i) the secured party sends the notice to the debtor and any secondary obligor or (ii) both waive, after default, their right to notice. See id. § 9-611(a); see also id. § 9-624(a) (providing for waiver of disposition notification). In most cases, the former will be the operative date.

98. See U.C.C. § 9-504(3).

99. See R. § 9-611(c)(3)(B)-(C). The notice must also be given to any "lienholder" who perfected its interest by filing a financing statement. See id. § 9-611(c)(3)(B). This would include the holder of an "agricultural lien" which is now within the scope of Revised Article 9, see id. §§ 9-109(a)(2), 9-310(a), and any other lien that may, under a non-uniform provision, be required to file a financing statement in order to perfect its interest.

100. See id. § 9-611 cmt. 4.

101. See supra text accompanying note 99.
parties, but not all others because the search is not current. If the foreclosing party sends notices to all those parties reflected on the search report, it has complied with the notification requirements and is protected. This means that a secured party who should have been revealed by the search report "has no remedy against a foreclosing secured party who does not send the notification" even though the foreclosure discharges its security interest.

Notice must also be sent to all senior secured parties from whom the foreclosing party has either received notice or of which it learns from a UCC search of financing statements, or who have perfected their security interests under other applicable law, even though the foreclosure will not discharge senior security interests. This is an important and useful change. Senior secured parties have an important interest in getting notice of a foreclosure by a junior secured party. That foreclosure may constitute an event of default that entitles the senior secured party to exercise its own enforcement rights. It can then preempt the junior's foreclosure with its own foreclosure action. Even if the senior secured party does not foreclose at that point, it can monitor the foreclosure conducted by the junior secured party and determine the identity, credit-worthiness, and reliability of the purchaser of the collateral which will still be subject to its senior security interest. The senior can then decide on its own course of action. Getting advance notice of the junior's foreclosure is particularly important when the collateral is inventory or intangible collateral because, although the senior security interest remains attached to the collateral, the collateral may be hard to locate or be dissipated after the foreclosure sale.

Furthermore, by requiring notice to senior secured parties, Revised Article 9 provides a rational resolution of the issue under present law as to whether the junior secured party may keep the cash

102. See R. § 9-611(e), 9-611 cmt. 4.
103. See id. § 9-611(e).
104. Id. § 9-611 cmt. 4. It would have a remedy, however, if it had given the foreclosing party "notification of a claim of an interest in the collateral." Id. § 9-611(c)(3)(A), 9-611 cmt. 4. For this reason, junior secured parties should continue to follow the procedure under present law of giving such notification to senior secured parties. See supra text accompanying notes 97-98.
105. See R. § 9-617(a)(3); cf. infra text accompanying note 109.
106. See R. § 9-611(c)(3)(A).
107. See id. § 9-611(c)(3)(B).
108. See id. § 9-611(c)(3)(C).
109. This is a fundamental rule. See id. § 9-617(a)(3) (providing that the foreclosure only "discharges any subordinate security interest or other subordinate lien," other than specific liens under special state acts or statutes, e.g., taxes).
proceeds of its foreclosure or must pay them over to the senior secured party. 110 Revised Article 9 provides that the junior can “take[] the cash proceeds free of the security interest or other lien” if it receives them “in good faith and without knowledge that the receipt violates the rights of the holder of the security interest or other lien that is not subordinate.” 111 By requiring the junior to notify the senior secured party in advance of the foreclosure sale, the senior can take appropriate action to protect its own interests and reach the cash proceeds. The senior secured party can either commence its own foreclosure action or it can notify the junior secured party that receipt of the cash proceeds violates its rights and demand that the junior secured party pay over the proceeds. 112 If, however, the senior secured party takes no action, mere knowledge of the senior’s security interest will not prevent the junior from keeping the cash proceeds. But, if the UCC search conducted by the junior secured party revealed a financing statement filed by the senior secured party containing a statement to the effect that “retention of cash proceeds by any subordinate secured party violates the rights of the secured party identified herein,” the junior secured party may not be able to keep the cash proceeds. The plain meaning of the statute indicates that the foreclosing junior secured party would not then be “in good faith and without knowledge that the receipt violates the rights of the” senior secured party. 113 On the other hand, merely stating that receipt of the

110. See generally Cynthia Starnes, U.C.C. Section 9-504 Sales by Junior Secured Parties: Is a Senior Secured Party Entitled to Notice and Proceeds?, 52 U. PIT. L. REV. 563, 600-01 (1991) (describing present law as “a source of confusion and concern” and recommending amendment of Article 9 “to require a foreclosing party to notify all secured parties whose interests are on file”—substantially as has been done in Revised Article 9).

111. R. § 9-615(g). The phrase “violates the rights of the holder of the security interest,” which is used in several provisions in Revised Article 9, see, e.g., id. § 9-330, is drawn from the definition of “buyer in ordinary course of business” in UCC section 1-201(9).

112. Does that notification, in and of itself, suffice? If so, senior secured parties should give such notification as a matter of course—making this exception to the statute, the rule. If the junior pays over the cash proceeds or sufficient proceeds to satisfy the obligation owed to the senior secured party, the junior should then be subrogated to the senior’s security interest. But what if these cash proceeds only partially satisfy the obligation?

113. See R. § 9-615(g). Revised Article 9 appears to sanction the use of the financing statement as a so-called “bulletin board” to protect the interests of senior secured parties against (i) the granting of junior security interests, (ii) collections of accounts and receivables by junior secured parties, and (iii) purchases of chattel paper by subsequent financers. It would seem that the “bulletin board” could also be used for this purpose of reaching cash proceeds received by the junior—unless it can be said that the senior secured party’s statement that a particular course of action “violates its rights” does not necessarily mean that it has such rights or that they would be violated. For a broader discussion of the potential problems raised by the use of the financing statement as a “bulletin board” to convey “knowledge” that a particular action “violates the rights of the secured party,” see Rapson, supra note 47, at 146-47, 161-62.
cash proceeds "violates the rights" of the senior secured party may not, in and of itself, be sufficient to require a turnover. Arguably, it is too simple a way of negating the protection afforded by the statute to junior secured parties. Future events and practices will determine the impact of this provision.

2. Contents of Notification

Revised Article 9 provides that in a non-consumer-goods transaction, the "contents of a notification of disposition are sufficient" if the notification:

(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 account; and
(E) states the time and place of a public sale or the time after which any other disposition is to be made. The statute does not require a "particular phrasing of the notification," and a notification "providing substantially the information" is sufficient even if the notification includes additional information or "minor errors that are not seriously misleading." A "safe harbor" form of notification is set forth in the statute.

114. See supra text accompanying notes 110-12. As of the writing of this article, there is no Official Comment for Revised section 9-615(g). The author has suggested that the following be added as Official Comment 7:

Subsection (g) addresses the question of whether a junior secured party who disposes of collateral may retain and apply the proceeds to its secured debt or whether it is obliged to turn over the proceeds to a senior secured party or lienholder. Courts construing former Section 9-504 disagreed as to what was the proper rule. The senior party's security interest or lien is not discharged under Section 9-617(a). This subsection takes the position that the junior secured party may retain the proceeds free of the senior's security interest or lien if it acts "in good faith and without knowledge that the receipt violates the rights of the holder" of a senior secured party or other lien. Under Section 9-610(c), the junior secured party is required to send an authenticated notification of disposition to the holder of the senior interest. Mere knowledge of that senior interest or the assertion by the holder of that interest that its rights would be violated by the junior party's retention of the proceeds is not, in and of itself, "knowledge that the receipt violates" the senior party's rights within the purview of subsection (g). Additional facts or circumstances indicative of a violation of rights must be known or made known to the junior secured party before it would be required to turn over the proceeds to the senior secured party or lienholder.

115. R. § 9-613(1).
116. Id. § 9-613(4).
117. Id. § 9-613(3).
118. See id. § 9-613(5).
For consumer-goods transactions, the rules are significantly more stringent. The information described as being "sufficient" for non-consumer-goods transactions is mandatory, and the notification must also provide the following additional information:

(B) a description of any liability for a deficiency of the person to which the notification is sent;

(C) a telephone number from which the amount that must be paid to the secured party to redeem the collateral under Section 9-623 is available; and

(D) a telephone number or mailing address from which additional information concerning the disposition and the obligation secured is available.

The statute sets forth another "safe-harbor" form of notification. Although there is an exception for errors, this exception is more limited than in the case of non-consumer-goods transactions. It only applies to errors in additional nonmandatory information in the notification and then only if "the error is [not] misleading with respect to rights arising under this article." Thus, there is no exception for errors in information required by the statute. For example, if there was an error in the required telephone number or mailing address, the notification would not be sufficient and the secured party would apparently be liable "for damages in the amount of any loss caused by a failure to comply with this article."

Although actual damages may be unlikely, Revised Article 9 continues present law in providing for minimum statutory damages

119. Revised Article 9 refers to both "consumer transactions" and "consumer-goods transactions." The former, defined in Revised section 9-102(a)(26), includes the latter. "Consumer transaction" means "a transaction in which (i) an individual incurs an obligation primarily for personal, family, or household purposes, (ii) a security interest secures the obligation, and (iii) the collateral is held or acquired primarily for personal, family, or household purposes." Id. § 9-102(a)(26). A "consumer-goods transaction" means "a consumer transaction in which: (A) an individual incurs an obligation primarily for personal, family or household purposes; and (B) a security interest in consumer goods secures the obligation." Id. § 9-102(a)(24).

120. See supra text accompanying note 115.
121. See R. § 9-614(1)(A).
122. Id. § 9-614(B)-(D).
123. See id. § 9-614(3).
124. See id. § 9-614(5).
125. See id. § 9-613(3)(B).
126. Id. § 9-614(5); see id. § 9-614 cmt. 3.
127. See id. § 9-614(1).
128. See id. § 9-614(1)(C)-(D).
129. Id. § 9-625(b).
130. See U.C.C. § 9-507(1).
if the collateral is consumer goods. The debtor or a secondary obligor “may recover for that failure in any event an amount not less than the credit service charge plus 10 percent of the principal amount of the obligation or the time-price differential plus 10 percent of the cash price.”

Statutory damages can be substantial. Moreover, there is a possibility that the error giving rise to the noncompliance could be a wide-spread technologically caused error, e.g., one that results in the omission or transposition of a digit in a telephone number or address. Such an error could, in turn, give rise to a class action claim for statutory damages.

That would be an unfortunate and irrational result. Although most of the drafts of Revised Article 9 contained provisions based on the Federal Truth-in-Lending Act protecting against such draconian consequences where there was a good faith error and limiting the potential recovery in class actions, those provisions were scuttled at the end of the drafting process as part of the “consumer compromise.”

B. Commercial Reasonableness

Even though Revised Article 9 contains new expanded and detailed provisions governing the procedure for conducting foreclosure sales, the requirement that “[e]very aspect of a disposition of collateral, including the method, manner, time, place and other terms, must be commercially reasonable” continues to be critical. Accordingly, “commercial reasonableness” remains a highly fact-sensitive issue to be resolved by the courts on a case-by-case basis. Revised Article 9, nevertheless, offers some insights as to how the issue should be resolved.

1. Preparation of Collateral for Sale

The oft-litigated issue of whether a secured party has an affirmative duty to process or prepare the collateral prior to sale is

131. R. § 9-625(c)(2). Note that this provision applies to any transaction, commercial or consumer, where the collateral is “consumer goods”; i.e., it is not limited to consumer transactions or consumer-goods transactions.


133. See supra note 23; infra text accompanying notes 277-87.

134. R. § 9-610(b). This language is substantially identical to UCC section 9-504(3) quoted supra text accompanying note 81.
handled by an Official Comment:

[S]ubsection (a) does not grant the secured party the right to dispose of the collateral "in its then condition" under all circumstances. A secured party may not dispose of collateral "in its then condition" when, taking into account the costs and probable benefits of preparation or processing and the fact that the secured party would be advancing the costs at its risk, it would be commercially unreasonable to dispose of the collateral in that condition.\textsuperscript{135}

Accordingly, even though the secured party is not always under a duty to incur the expense of preparing the collateral for sale, there may be factual circumstances where the failure to do so would be commercially unreasonable. In essence, this follows the trend of judicial decisions\textsuperscript{136} under present law and is consistent with common sense.

2. Warranties

Relative to the issue of preparing the collateral for sale is the matter of warranties. Revised Article 9 rejects the approach taken by present law that warranties do not accompany a foreclosure sale.\textsuperscript{137} Instead, it provides that the contract for sale on foreclosure "includes

---

135. R. § 9-610 cmt. 4.
136. See, e.g., Franklin State Bank v. Parker, 346 A.2d 632, 635 (N.J. Union County Ct. 1975) (failing to make minor repairs to car which would have generated a higher foreclosure sale price was commercially unreasonable).
137. UCC section 2-312 comment 5 presently states:
Subsection (2) recognizes that sales by sheriffs, executors, foreclosing lienors and persons similarly situated are so out of the ordinary commercial course that their peculiar character is immediately apparent to the buyer and therefore no personal obligation is imposed upon the seller who is purporting to sell only an unknown or limited right. This subsection does not touch upon and leaves open all questions of restitution arising in such cases, when a unique article so sold is reclaimed by a third party as the rightful owner.

A conforming amendment to Revised Article 9 amends this Official Comment to read:
Subsection (2) recognizes that sales by sheriffs, executors, certain foreclosing lienors and persons similarly situated may be so out of the ordinary commercial course that their peculiar character is immediately apparent to the buyer and therefore no personal obligation is imposed upon the seller who is purporting to sell only an unknown or limited right. This subsection does not touch upon and leaves open all questions of restitution arising in such cases, when a unique article so sold is reclaimed by a third party as the rightful owner.

Foreclosure sales under Article 9 are another matter. Section 9-610 provides that a disposition of collateral under that section includes warranties such as those imposed by this section on a voluntary disposition of property of the kind involved. Consequently, unless properly excluded under subsection (2) or under the special provisions for exclusion in Section 9-610, a disposition under Section 9-610 of collateral consisting of goods includes the warranties imposed by subsection (1) and, if applicable, subsection (3).

R. § 2-312 cmt. 5.
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. These warranties may be disclaimed by language indicating that "There is no warranty relating to title, possession, quiet enjoyment or the like in this disposition"—or words of similar import. Furthermore, statutory or other warranties such as the implied warranties of merchantability or fitness may also apply to a sale or other disposition by the secured party. This is dependent upon the particular factual circumstances and is determined by non-Article 9 law, e.g., UCC Articles 2 and 2A. That law would also determine whether and how such warranties could be disclaimed.

This new focus on warranties will motivate secured parties to adapt their usual foreclosure procedures and disclaim all possible warranties to avoid potential liability. In some cases, however, doing so requires caution because it may raise an issue of "commercial reasonableness." For example, if the secured party is conducting a public foreclosure sale of new automobiles, would it be commercially reasonable for the automobiles to be sold without the customary manufacturer’s warranties that usually accompany the sale of new cars? To provide these warranties, the secured party usually has to incur the expense of servicing the automobiles ("prepping") to a standard required by the manufacturer in order to receive those warranties. Although these expenses can be added to the amount of the secured obligation, the secured party will have to analyze whether these expenses are likely to be cost effective in generating higher sales proceeds rather than just "throwing good money after bad."

C. "Low Price" Sales or Dispositions

An extremely controversial issue has been whether the reference to "terms" in the requirement for commercial reasonableness

138. R. § 9-610(d).
139. See id. § 9-610(f).
140. See id. § 9-610 cmt. 11. If the foreclosing secured party is a manufacturer or dealer of collateral being sold, these warranties may well arise absent a disclaimer. See id. Whether these warranties are made by a secured party that is a “captive finance company” affiliate of a manufacturer or seller of the particular kind of collateral is an issue under present law and will continue to be so. See U.C.C. § 2A-103 cmt. g (indicating that although a finance lessor does not make such warranties, the question of whether a captive finance company can, in fact, be a finance lessor is determined by the particular circumstances); see also Mercedes-Benz Credit Corp. v. Lotito, 703 A.2d 288 (N.J. Super Ct. 1997) (holding captive finance company liable).
141. See supra text accompanying note 81.
includes the "price" realized at the foreclosure sale, particularly if the debtor asserts that the price was "too low." Present law is very uncertain on this important issue and differs among the states. The problem has been compounded by the interpretation and application of the provision that: "[t]he fact that a better price could have been obtained by a sale at a different time or in a different method from that selected by the secured party is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner"; which appears in Revised Article 9 in substantially similar language:

The 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.

Does that provision make "price" irrelevant for purposes of determining whether the secured party has satisfied the requirement of "commercial reasonableness," without, however, precluding an inquiry into whether the "fair value" of the collateral has been credited against the obligation for purposes of calculating a deficiency claim? Or, does it mean that if the procedural requirements of "commercial reasonableness" have been complied with, the price received, no matter how low, is binding for all purposes, including the establishment of a deficiency claim?

This was one of the most difficult and contentious issues considered by the Article 9 Drafting Committee. It was resolved in two ways. First, the Drafting Committee concluded that while a "low price" is not itself an aspect of "commercial reasonableness," it may be relevant to the determination of whether the statutory aspects have been met. Two Official Comments contain the following statement: "While not itself sufficient to establish a violation of this Part, a low price suggests that a court should scrutinize carefully all aspects of a disposition to ensure that each aspect was commercially reasonable." Second, the Drafting Committee confronted the problem of deficiency claims based upon alleged low prices and

142. See Rapson, supra note 1, at 493-96.
143. U.C.C. § 9-507(2).
144. R. § 9-627(a).
145. See Rapson, supra note 1, at 501.
146. These "aspects" would include "the method, manner, time, place and other terms." R. § 9-610(b).
147. Id. §§ 9-610 cmt. 10, 9-627 cmt. 2.
developed a compromise solution \(^{148}\) covering those circumstances where the problem is most likely to arise, i.e., the purchaser at the foreclosure sale is “the secured party, a person related to the secured party, or a secondary obligor.” \(^{149}\) The rationale is that these persons do not have the economic incentive, in the absence of genuine competitive bidding by independent third parties, to bid for the collateral at prices that approximate the value of the collateral. \(^{150}\) Indeed, the incentive is to the contrary: the lower the bid, the greater the deficiency claim against the debtor. \(^{151}\)

Revised Article 9 adds a new rule:

[Calculation of surplus or deficiency in disposition to person related to secured party.] The surplus or deficiency following a disposition is calculated based on the amount of proceeds that would have been realized in a disposition complying with the requirements of this part to a transferee other than the secured party, a person related to the secured party, or a secondary obligor if:

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. \(^{152}\)

It is important to understand that this provision is operative and governs the calculation of the deficiency claim even though the foreclosure sale or disposition satisfies the procedural requirements of “commercial reasonableness.” \(^{153}\) In order for the debtor or obligor

\(^{148}\) See Rapson, supra note 1, at 532-36. The statutory formulation embodying the compromise was subsequently changed (but not in substantive principle) and now appears at Revised section 9-615(f). See infra text accompanying note 152.

\(^{149}\) R. § 9-615(f).

\(^{150}\) This is obvious when the purchaser is the secured party or “a person related to” the secured party which includes an affiliate. See id. §§ 9-102(a)(63)(A), 9-102 cmt. 22, 9-615 cmt. 7.

\(^{151}\) In the case of a secondary obligor, there is an incentive to bid less than the value of the collateral. Even though it, too, will be liable for a larger deficiency, if the secondary obligor pays that deficiency it has reimbursement and restitution rights and the right to be subrogated to the secured party’s deficiency claim against the debtor or obligor, i.e., the principal obligor. See RESTATEMENT (THIRD) OF SURETISHIP AND GUARANTY §§ 22, 27 (1995). Moreover, if the secondary obligor then becomes the owner of the collateral for less than the value of the collateral, it can reduce its costs by re-selling the collateral for a profit. As previously noted, the value of that right of subrogation depends upon the financial circumstances of the debtor or obligor. See supra note 96.

\(^{152}\) R. § 9-615(f).

\(^{153}\) See id. § 9-615 cmt. 6; see also id. §§ 9-610 cmt. 10, 9-627 cmt. 2.
to avail itself of the statutory protection in a non-consumer transaction, it has the burden of establishing that the foreclosure sale price "is significantly below the range of prices 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," i.e., what an independent third party would have bid at a commercially reasonable sale. Consequently, the effect upon the amount of the deficiency claim is exactly the same as would result under the "rebuttable presumption" rule if the sale had not complied with the requirements of commercial reasonableness, in which case the burden shifts to the secured party. In that circumstance, the secured party is still entitled to recover a deficiency, but it is calculated on "the amount of proceeds that would have been realized had the noncomplying secured party proceeded in accordance with the provisions of this part relating to collection, enforcement, disposition, or acceptance." As a practical matter, this results in the secured party having the burden of establishing that an independent third party would have bid an amount less than the amount of the obligation at a commercially reasonable sale. Thus, the inquiry in both cases is "What would an independent third party have paid for the collateral?"

This new provision for calculating deficiencies affords significant protection to debtors and obligors against abusive claims. Consumer advocates, in particular, have stressed their concern about deficiency claims. In response to this concern, Revised Article 9 provides an additional protection in a consumer-goods transaction by requiring the secured party to send the debtor and any consumer obligor an explanation of "how the secured party calculated the surplus or deficiency," including the "aggregate amount of obligations," the "amount of the proceeds of the disposition," the "amount . . . of expenses," and the "amount . . . of credits, including rebates of

154. Id. § 9-626(a)(5); see id. § 9-626 cmt. 5. In a consumer transaction, the determination of the proper rule imposing the burden of proof is left to the court. See id. § 9-626(b). This is another element of the "consumer compromise." See supra note 23; infra text accompanying notes 277-87.

155. See R. § 9-626(a)(3); infra text accompanying notes 272-76.

156. R. § 9-626(a)(3)(B); see infra text accompanying notes 270-76.

157. See R. § 9-626 cmt. 3. Although the statute here does not expressly require proof concerning a hypothetical sale to a third person, the easiest and most efficient way for the secured party to make its proofs is to provide testimony as to such a sale.

158. See supra text accompanying note 6.

interest." The secured party must send this explanation within fourteen days after receiving a request and “before or when the secured party accounts to the debtor and pays any surplus or first makes written demand on the consumer obligor after the disposition for payment of the deficiency.” This means that a consumer debtor or secondary obligor can receive an explanation of how a deficiency was calculated without having to “wait until the secured party commences written collection efforts.” If, however, the secured party does not receive such a demand and makes no “attempt to collect a deficiency in writing or account for and pay a surplus [it] has no obligation to send an explanation.”

This right to receive an explanation of how a deficiency claim was calculated enables a consumer obligor to make an early and informed decision as to whether to challenge that claim. Under present law, there is no requirement for an explanation and, although some secured parties give one as a matter of good business practice, many do not. The imposition of this requirement will hopefully motivate secured parties to exercise more care, caution, and fairness in the manner in which they conduct foreclosure sales and attempt to pursue deficiency claims.

The statutory sanctions for not complying with this requirement are relatively mild—recovery of any loss plus $500 if there is a failure to send an explanation in response to a request. There is no liability, however, for statutory damages. The secured party must also pay $500 if the failure to send an explanation prior to the time it “accounts to the debtor and pays any surplus or first makes a written demand on the consumer obligor after the disposition for payment of the deficiency” is “part of a pattern, or consistent with a practice, of noncompliance.” Although neither the statute nor the Official Comments speak to the particular point, if the facts demonstrate this or any other pattern or practice of noncompliance by the secured party, there may well be additional risks. A secured party who

160. Id. § 9-616(c).
161. Id. § 9-616(b)(1)(A)-(B).
162. Id. § 9-616 cmt. 2.
163. Id.
164. Some consumer creditors strongly opposed this requirement on the ground of added cost.
165. See R. § 9-625(b), (c)(1), (e)(6).
166. See R. § 9-628(d); supra text accompanying notes 119-33.
168. Id. § 9-625(e)(5); see id. § 9-616 cmt. 4.
engages in a practice or pattern of noncompliance could be subject to claims for injunctive or other equitable relief and liable for damages under “principles of law and equity” supplemental to Article 9, such as conversion or fraud based on misconduct. This, in turn, could lead to claims for punitive damages and to class actions. This new requirement for an explanation and the express statutory concern with a pattern or practice of noncompliance, together with the “consumer compromise” decision “to leave to the court the determination of the proper rules in consumer transactions” may increase those risks.

D. Application of Noncash Proceeds

Frequently the foreclosing secured party “finances” the acquisition of the collateral by the purchaser at the foreclosure sale. Credit terms are extended to the purchaser secured by the purchased collateral. The issue that then arises is much the same as previously discussed. Must the secured party credit the original debtor with the full purchase price (discounted to present value) or, if that price is not readily determinable, with the value of the purchased collateral, i.e., the “noncash proceeds”? Or can it wait until it receives cash proceeds from the new debtor’s required payments? As before, the rule is that the “secured party need not apply or pay over for application noncash proceeds ... unless the failure to do so would be commercially unreasonable.” Here, however, it will often be commercially unreasonable for the secured party not to do so, particularly if the noncash proceeds “are of the type that the secured party regularly generates in the ordinary course of its financing business in nonforeclosure transactions.” Thus, if the secured party

169. See id. § 9-625(a).
170. See U.C.C. § 1-103; see also id. § 1-106 (providing for the liberal administration of remedies). Although Revised section 9-625(b) provides for a claim for damages “caused by a failure to comply with this article” that provision is most likely directed to a particular transaction as distinguished from widespread patterns or practices of noncompliance, which arguably give rise to claims outside of Article 9. See R. § 9-625 cmt. 3 (noting that “principles of tort law supplement this subsection”). Inasmuch as Revised Article 9 does not mention punitive damages, they cannot be imposed unless allowed under such supplemental law. See U.C.C. § 1-106(1).
171. R. § 9-626(b); see supra note 23; supra text accompanying notes 119-33; infra text accompanying notes 277-87.
172. See supra text accompanying notes 75-78 (discussing Revised section 9-608(a)(3)).
173. See supra text accompanying notes 75-78.
174. R. § 9-615(c).
175. Id. § 9-615 cmt. 3.
is in the business of financing the acquisition of goods on a secured credit basis, the original debtor should not have to bear the risk of the secured party's credit judgment with respect to the new debtor. On the other hand, if the terms and structure of the purchase of collateral are out of the ordinary and the noncash proceeds are such that a "purchase price" or value of the purchase is not readily determinable, it may be commercially reasonable to credit the original debtor only as and when cash proceeds are paid by the new debtor.

III. ACCEPTANCE OF COLLATERAL IN FULL OR PARTIAL SATISFACTION OF OBLIGATION: "STRICT FORECLOSURE"

This third method of enforcement, sometimes called "strict foreclosure," is significantly changed and expanded under Revised Article 9. As a consequence, strict foreclosure should be used much more extensively than it has been under present law. It provides a method of enforcement that is nonadversarial, requires lower transaction costs, and is not likely to result in litigation. Revised Article 9 permits the parties to enter into an agreement for the voluntary turnover of the collateral to the secured party in return for an agreed-upon credit against the debt, with the debtor acknowledging its liability for the remaining deficiency. Present Article 9 makes no provision for acceptance of the collateral in partial satisfaction of the obligation.177

Present law permits acceptance of the collateral only in full satisfaction of the obligation. That limitation is conceptually consistent with traditional common law strict foreclosure. According to Professor Gilmore, the original draftsman of Article 9, "[t]he land mortgagee's right to a decree of strict foreclosure and the common law conditional seller's right to forfeit the buyer's equity on retaking of the goods (which automatically barred the seller's claim for the unpaid balance of the price) were both illustrations of this approach."179 Furthermore, the remedy under present Article 9 can only be exercised if the secured party is in possession of the collateral— which means that the remedy is not applicable to intangible collateral, e.g., accounts.

176. See id. §§ 9-620 to 9-622.
177. See U.C.C. § 9-505(2).
178. See id.
179. 2 GILMORE, supra note 2, § 44.3, at 1220.
180. See U.C.C. § 9-505(2).
It is arguable that an agreement for a turnover of the property in partial satisfaction of the obligation with a resultant deficiency liability is permissible under the UCC’s “freedom of contract” provision. On the other hand, establishment of a deficiency by agreement rather than by a “commercially reasonable” sale or disposition may, in effect, be an impermissible disclaimer of “the obligations of good faith, diligence, reasonableness and care” required for enforcement by nonjudicial foreclosure. Furthermore, the strict foreclosure rules in real estate mortgage law and the analogous provision for discharge of the obligation in the predecessor Uniform Conditional Sales Act made no provision for partial satisfaction with a resulting deficiency. Those rules are directly traceable to common law strict foreclosure, which did not permit deficiency claims.

Revised Article 9 thus effectuates a major change in present law by providing for partial satisfaction in addition to full satisfaction, except that acceptance of collateral as partial satisfaction is not permitted in a consumer transaction. In addition, unless the collateral is consumer goods, there is no longer a requirement that the secured party have possession of the collateral, thereby permitting use of strict foreclosure for intangible collateral. Unlike the enforcement remedies of collection and nonjudicial foreclosure, the remedy of acceptance in full or partial satisfaction of the...

181. See U.C.C. § 1-102(3).
182. Id.
183. See U.C.C. § 9-504(3). The response would be that the agreement constitutes a reasonable determination of “the standards by which the performance of such obligation is to be measured” within the purview of UCC section 1-102(3).
185. See 2 GILMORE, supra note 2, § 44.3, at 1221.
186. This procedure is not permitted in the case of consumer goods if the debtor has paid 60% of the price or obligation, unless the debtor waives its rights after default. See U.C.C. § 9-505(1). This provision assumes that in those circumstances the debtor “thus has a substantial equity” which merits protection. See id. § 9-505 cmt. 1. In that circumstance, the secured party “must dispose” of the collateral under the foreclosure procedure unless that requirement is waived after default. See id. § 9-505(1). There is a similar “60% rule” in Revised Article 9. See R. §§ 9-620(a)(4), (e)-(f), 9-624(b). The secured party is required to dispose of the collateral within 90 days of taking possession or “any longer period to which the debtor and all secondary obligors have agreed.” Id. § 9-620(f).
187. See R. § 9-620(a).
188. See id. § 9-620(g).
189. See id. § 9-620(a)(3).
190. See id. § 9-620 cmt. 7.
191. See id. §§ 9-607 to 9-608.
192. See id. §§ 9-610 to 9-614.
obligation is not subject to a requirement of "commercial reasonableness," but it must be done in "good faith." \(^{193}\)

The procedural requirements set forth in the statute are complex and need close study. First, the debtor must consent to the acceptance. \(^{194}\) Consent to a full or partial satisfaction of the obligation can always be manifested "if the debtor agrees to the terms of the acceptance in a record authenticated after default." \(^{195}\) Such an agreement is the only method of consent permitted for a partial satisfaction. \(^{196}\) There is an additional method of consent by inaction permitted only for a full satisfaction: the secured party can send the debtor a proposal for acceptance in full satisfaction after default and, if it does not receive a notification of objection authenticated by the debtor within twenty days after the proposal is sent, the debtor's silence constitutes consent. \(^{197}\) The second condition is that the secured party not receive a notification of objection to the proposal \(^{198}\) from certain prescribed persons to whom it must first send the proposal \(^{199}\) or from "any other person, other than the debtor, holding an interest in the collateral subordinate to the security interest that is the subject of the proposal." \(^{200}\)

There cannot be an effective acceptance of the collateral without the secured party's consent. This "consent" can be manifested either in an authenticated record of agreement or by the act of sending the proposal to the debtor. \(^{201}\) This provision has the effect of rejecting the line of cases under present law finding a "constructive" strict foreclosure because of the secured party's delay or inaction following repossession of the collateral. \(^{202}\) Instead, "delay is a factor relating to whether the secured party acted in a commercially reasonable manner" in exercising its remedies under the collection or nonjudicial foreclosure provisions. \(^{203}\) Moreover, a "debtor's voluntary surrender
of collateral to a secured party and the secured party's acceptance of possession of the collateral does not, of itself, necessarily raise an implication that the secured party intends or is proposing to accept the collateral in satisfaction of the secured obligation. 204

The requirements for sending notification of the proposal 205 are substantially similar to those for sending notice of nonjudicial foreclosure. 206 The proposal must be sent to "any person from which the secured party has received, before the debtor consented to the acceptance, an authenticated notification of a claim of an interest in the collateral." 207 In addition, it must be sent to "any other secured party or lienholder [including a senior secured party] that, 10 days before the debtor consented to the acceptance, held a security interest in or other lien on the collateral perfected by the filing of a financing statement" 208 or perfected by complying with the requirements of other applicable law such as a certificate of title law. 209 Furthermore, if the proposal is to accept collateral in partial satisfaction of the obligation, the proposal must be sent to any secondary obligor. 210 If any of those persons object to the proposal, the secured party must receive notification of the objection from that person within a limited period of time, e.g., within twenty days after notification of the proposal was sent to the objector. 211 A timely objection "prevents an acceptance of collateral from taking effect," 212 necessitating that the secured party resort to either collection 213 or nonjudicial foreclosure as the means of enforcement. 214

204. Id. § 9-620 cmt. 5.
205. See id. § 9-621.
206. See id. § 9-611; supra text accompanying notes 87-114. There is no "safe-harbor," however, protecting the secured party against the risk of no response to its request for a UCC search from the filing office or a search that is not current. Cf. R. § 9-611(e); supra text accompanying notes 102-05. The reason for the difference is that because the secured party is not subject to the commercial reasonableness requirement in this circumstance, protection from the risk of filing office error and delay is not needed. See R. §§ 9-622(a)(3), 9-621 cmt. 2. Although subordinate security interests and liens are discharged even if not notified, see id. § 9-622(b), a non-notified subordinate party has the right to recover damages for any resulting loss, e.g., its "equity" in the collateral. See id. §§ 9-622 cmt. 2, 9-625(b).
207. R. § 9-621(a)(1).
208. Id. § 9-621(a)(2).
209. See id. § 9-621(a)(3).
210. See id. § 9-621(b). Unless the secondary obligor objects, it will be liable for the deficiency resulting from the agreement.
211. See id. § 9-620(d).
212. Id. § 9-620 cmt. 8.
213. See id. § 9-607.
214. See id. § 9-610. The secured party could, of course, foreclose judicially in a proceeding approved by the court. See id. § 9-627(c)(1).
Finally, Revised Article 9 cures a curious omission in the present law by setting forth the effect of an acceptance of collateral:

(a) **[Effect of acceptance.]** A secured party's acceptance of collateral in full or partial satisfaction of the obligation it secures:
   (1) discharges the obligation to the extent consented to by the debtor;
   (2) transfers to the secured party all of a debtor's rights in the collateral;
   (3) discharges the security interest or agricultural lien that is the subject of the debtor's consent and any subordinate security interest or other subordinate lien; and
   (4) terminates any other subordinate interest.

(b) **[Discharge of subordinate interest notwithstanding noncompliance.]** A subordinate interest is discharged or terminated under subsection (a), even if the secured party fails to comply with this article.215

This new remedy of permitting an agreement with a debtor for the acceptance of collateral in partial satisfaction of the obligation is one that secured parties should consider using on a regular basis. The secured party must be willing to offer the obligor a fair credit against the obligation. If offered in good faith, the debtor, secondary obligor, and junior secured parties and lienholders will have little motivation to insist upon a foreclosure sale with its attendant delay, expense, and uncertainty of result. There will then be no basis for a dispute about "commercial reasonableness." Revised Article 9 has made an important and useful change in making this a meaningful enforcement right and remedy.

**IV. ENFORCEMENT OF LEASES AND LICENSES**

Earlier in this article it was noted that although a secured party may have enforcement rights against a person who is an account debtor or a person who is obligated on collateral, provisions of Revised Article 9 or other law determine whether that person owes

215. *Id.* § 9-622. Although UCC section 9-505(2) contains no such provision, it is reasonable to assume that acceptance in full satisfaction of the obligation has the same effect as a nonjudicial foreclosure. See U.C.C. § 9-504(4). According to Professor Gilmore:

The junior security interests and liens are discharged. It is true that § 9-504(4) makes an express statement about the point and that § 9-505(2) does not. But "retention" under § 9-505 and "disposition" under § 9-504 are merely alternative ways of liquidating the transaction between the foreclosing secured party and the debtor; they should have the same effect on competing interests.

2 GILMORE, *supra* note 2, § 44.3, at 1225.
any duty to the secured party.216 That point has particular importance in the context of enforcing obligations owed under lease agreements, e.g., equipment leases, and license agreements, e.g., licenses of software.217

Upon default of the debtor, the secured party wants the account debtor to render performance of its obligations to the secured party or to a person to whom the secured party may, on foreclosure, sell the rights under the agreement. In the case of a lease or license, if the lessor or licensor grants a security interest in its rights under the lease or license agreement, the lessor or licensor is the debtor and the lessee or licensee, as the case may be, is the account debtor.218 The security interest, in essence, is in the right to receive payments, i.e., an account, and, upon default, the secured party will seek to enforce and collect that payment or to foreclose and sell that right to a third party. Generally, the lessee or licensee would not object to making payment to the secured party or to the third party unless it is entitled to receive a return performance from the lessor or licensor that would somehow be jeopardized.219 In order to avoid that risk, the lessee or licensee may negotiate for a contractual term in the lease or license prohibiting the granting or enforcement by the other party of a security interest without its consent, or making such granting or enforcement an event of default.

If the lessee or licensee grants a security interest in its rights under the lease or license agreement, i.e., a general intangible, that person is then the debtor and the lessor or licensor, as the case may

216. See supra text accompanying notes 34-35, 43. This point is emphasized in an Official Comment: "Neither this section [R § 9-607] nor former Section 9-502 should be understood to regulate the duties of an account debtor or other person obligated on collateral." R. § 9-607 cmt. 6.

217. A security interest in a "nonexclusive license of software" is a security interest in a general intangible. See R. § 9-408 cmt. 2.

218. See id. § 9-408 cmt. 5.

219. See U.C.C. § 2A-303 cmt. 5 ("[I]t is not likely that a transfer by the lessor of its right to payment under the lease contract would impair at a future time the ability of the lessee to obtain the performance due the lessee."). Although that statement in the Official Comments does not appear as a consequence of UCC section 2A-303(3) being replaced by Revised section 9-407 and the companion amendments to UCC section 2A-303 and the Official Comments thereto, it re-appears in proposed Revised Article 2A. See U.C.C. § 2A-403 cmt. 5 (Final Draft 1999). At its annual meeting in July 1999, the National Conference of Commissioners on Uniform State Laws ("NCCUSL") took no action with respect to proposed revisions to Articles 2 and 2A. On August 18, 1999, NCCUSL and the American Law Institute jointly announced "the formation of a new Drafting Committee to continue the effort to revise Article 2 (Sales) and 2A (Leases) of the UCC." See ALI and NCCUSL Announce New Drafting Committee for UCC Articles 2 and 2A (press release dated Aug. 18, 1999) (on file with author).
be, is the account debtor. In the event of a default, the secured party may, itself, want to use the leased property or license or may choose to sell the right to that property or license to a third party. The lessor or licensor, however, is likely to object to anyone else using or having possession of the property or license. Accordingly, the lessor or licensor often insists upon a contractual term prohibiting the granting or enforcement of a security interest by the other party without its consent or making such granting or enforcement an event of default.

The effect and enforceability of terms in lease and license agreements prohibiting the granting or enforcement of security interests or making such granting or enforcement events of default is a critical issue in secured financing. Furthermore, if there is no term prohibiting the granting or enforcement of a security interest in rights under the lease or license agreement there may, nevertheless, be circumstances where the grant or enforcement of a security interest constitutes an assignment or transfer which "materially impairs the prospect of obtaining return performance by, materially changes the duty of, or materially increases the burden or risk imposed on" the other party, entitling that party to some form of relief.

These matters came to the forefront in 1988 in connection with the promulgation of Article 2A-Leases and in the recent drafting of Revised Article 9 and the parallel drafting of former proposed Article

---

220. See R. § 9-408 cmt. 5, example 2.
221. A licensor, particularly in the case of software, has an important protection-worthy intellectual property interest in the license.
222. U.C.C. § 2A-303(3)-(5); see U.C.C. § 2-210(2). This is a codification of the common law "material impairment" rule.
223. UCC section 2A-303(1)(a) originally made enforceable a provision in a lease contract which prohibited a transfer. That provision would have precluded a party from granting a security interest in a lease agreement, including the sale of the lease agreement, without the consent of the other party. Professor Steven L. Harris drew attention to this problem in Steven L. Harris, The Rights of Creditors Under Article 2A, 39 ALA. L. REV. 803, 829-54 (1988). As a consequence, UCC section 2A-303 was amended as part of the 1990 amendments to Article 2A. The Official Comment described the "Changes" as follows:

The provisions of Sections 2-210 and 9-311 were incorporated in this section, with substantial modifications to reflect leasing terminology and practice and to harmonize the principles of the respective provision, i.e., limitations on delegation of performance on the one hand and alienability of rights on the other. In addition, unlike Section 2-210 which deals only with voluntary transfers, this section deals with involuntary as well as voluntary transfers. Moreover, the principle of Section 9-318(4) denying effectiveness to contractual terms prohibiting assignments of receivables due and to become due also is implemented.

U.C.C. § 2A-303, Changes. Professor Harris is one of the Co-Reporters for Revised Article 9. Professor Charles Mooney is the other Co-Reporter.
2B-Licenses. In both instances, the focus was on the conflicting policies on assignment and alienability: free alienability of rights, manifested by UCC section 9-318(4), which generally renders unenforceable a term in an agreement that prohibits the creation or enforcement of a security interest or makes either action an event of default; and freedom of contract, which gives one party to a contract the right to protect itself against an actual delegation of a material performance by the other party, complemented by the common law material impairment rule and its codification in UCC section 2-210(2), permitting an assignment of all rights unless there is such a material impairment.

A. Leases

Article 2A harmonized these conflicting policies by providing that a contractual term in a lease agreement prohibiting the creation or enforcement of a security interest or making such actions events of default

is not enforceable unless, and then only to the extent that, there is [1] an actual transfer by the lessee of the lessee's right of possession or use of goods in violation of the provision or [2] an actual delegation of a material performance of either party to the lease contract in violation of the provision.

Likewise, if there is no contractual prohibition, the granting or enforcement of a security interest by the lessor does not violate the material impairment rule unless, and then only to the extent that, there is an actual delegation of a material performance of the

224. On April 7, 1999, the NCCUSL and the American Law Institute jointly "announced that legal rules for computer information transactions will not be promulgated as Article 2B of the Uniform Commercial Code, but the Conference will promulgate the rules for adoption by states as the Uniform Computer Information Transactions Act." See National Conference of Commissioners on Uniform State Laws & American Law Institute, NCCUSL to Promulgate Freestanding Uniform Computer Information Transactions Act: ALI and NCCUSL Announce That Legal Rules for Computer Information Will Not Be Part of UCC (undated press release) (on file with author). In any event, there is no longer a conflict. See UNIF. COMPUTER INFO. TRANSACTIONS ACT § 103(c)(3) (Final Draft 1999) ("To the extent of a conflict between this [Act] and [Article 9], [Article 9] governs.").

225. UCC section 9-318(4) has been replaced by Revised section 9-406(d).

226. See U.C.C. § 2-210(2).

227. See supra text accompanying note 222.

228. U.C.C. § 2A-303(3) (emphasis added). UCC section 2A-303(3) has been replaced by Revised section 9-407. See infra text accompanying notes 232-46. There is no substantive change.

229. See supra text accompanying note 222.
lessor.” These rules are continued and re-stated in Revised Article 9.

1. Enforcement Against Lessee

Under Revised Article 9, enforcement of a security interest granted by the lessee in its rights under the lease agreement is not a problem unless:

1. There is a contractual term in the lease prohibiting enforcement of the security interest and either:
   a. a transfer of “the lessee’s right of possession or use of the goods in violation of the term”; or
   b. “a delegation of a material performance of [the lessee] in violation of the term”;

2. Even if there is no such term, there is a transfer in violation of the material impairment rule.

If any of those circumstances occur, the lessor can exercise its rights in the lease agreement governing default, including cancellation of the lease. If the lease agreement is silent but there is, nevertheless, a material impairment, the lessor can recover damages from the lessee and obtain appropriate judicial relief, “including cancellation of the lease contract or an injunction against the transfer.”

The practical effect is that the secured party cannot enforce its security interest by foreclosing and selling the lessee’s most important rights under the lease, i.e., to possess and use the goods without first obtaining the consent of the lessor. This is reasonable and does not seem to have imposed a difficult burden on secured financing.

2. Enforcement Against Lessor

Enforcement of a security interest granted by the lessor in its interests under the lease agreement or in its residual interest is not a problem unless:

1. There is a contractual term in the lease agreement prohibiting enforcement of the security interest and a

231. See R. § 9-407.
232. Id. § 9-407(b)(1).
233. Id. § 9-407(b)(2).
234. See id. § 9-407(c).
236. Id. § 2A-303(4)(b) (presently U.C.C. § 2A-303(5)(b)).
“delegation of a material performance” of the lessor;\textsuperscript{237} or

2. Even if there is no such term, there is a transfer in violation of the material impairment rule “and then only to the extent that, enforcement actually results in a delegation of material performance of the lessor.”\textsuperscript{238}

Thus, the crucial question in both circumstances is whether there is a “delegation of material performance” of the lessor. When might that happen?

Initially, it needs to be determined whether the “lessor, in fact, has any remaining obligations to perform.”\textsuperscript{239} If it does not, there is no problem. “If it does, it is then necessary to determine whether there has been an actual delegation of ‘material performance.’”\textsuperscript{240} The Official Comments to UCC section 2A-303 provide important guidance and state that in order for there to be “remaining performance,” there has to be “an affirmative duty to render stipulated performance” and that “it is instructive to focus on the difference between ‘operating’ and ‘non-operating’ leases as generally understood in the marketplace.”\textsuperscript{241} This Official Comment gives as an example the circumstance where there has been a transfer of ownership of an airplane which prevents the lessee from continuing to operate the airplane.\textsuperscript{242}

If there has been such a “delegation of material performance” of the lessor in violation of a contractual term, the lessee can then exercise its rights under the lease agreement, including cancellation of the lease.\textsuperscript{243} If the lease agreement is silent, but there is, nevertheless, such a delegation, the lessee can recover damages from the lessor and obtain appropriate judicial relief, “including cancellation of the lease contract or an injunction against the transfer.”\textsuperscript{244} The practical effect is that a secured party seeking to enforce its security interest in the lessor’s interest under the lease agreement or in its residual interest has to exercise caution in exercising collection rights against the

\textsuperscript{237} See R. § 9-407(a), (b)(2).
\textsuperscript{238} Id. § 9-407(c).
\textsuperscript{239} Id. § 9-407 cmt. 3.
\textsuperscript{240} Id.
\textsuperscript{241} R. § 2A-303 cmt. 3 (presently U.C.C. § 2A-303 cmt. 7); see id. § 2A-303 cmt. 4 (presently U.C.C. § 2A-303 cmt. 8).
\textsuperscript{242} See id. § 2A-303 cmt. 4 (presently U.C.C. § 2A-303 cmt. 8). For example, under 49 U.S.C. §§ 44101, 44102 (1994), the lessee can only operate an airplane in the United States that is owned by a person satisfying certain citizenship or corporate qualifications.
\textsuperscript{244} Id. § 2A-303(4)(b) (presently U.C.C. § 2A-303(5)(b)).
or foreclosing and selling the lessor's interest under the lease. The secured party must analyze the effect of such enforcement upon the lessee in terms of whether there will be a "delegation of material performance" of the lessor. Good practice would mandate that such an analysis be made by the secured party before entering into the secured transaction with the lessor—the critical inquiry being "whether and how the secured party will be able to enforce its security interest if the lessor defaults."

B. Licenses

In the case of licenses, there has also been a harmonization of the conflicting policies on alienability and assignment but it takes a somewhat different approach than what was done with respect to leases. Here, the debate centered on the position principally advanced by licensors of software that contractual terms prohibiting the granting of security interests in license agreements or making such granting or enforcement events of default should be enforceable. In addition, the software licensors urged that even in the absence of such a contractual term, the granting or enforcement of a security interest should be subject to the material impairment rule. These licensors were extremely concerned about protecting their intellectual property rights in the license and viewed any granting or enforcement of a security interest with respect to the license agreement as a serious threat to those rights, whether the security interest was granted by the licensor or licensee. For several years, drafts of proposed Article 2B supported the position advanced by the software licensors. Revised Article 9 resolves the issue in a conceptually simple and straightforward manner.

In the case of a security interest granted by the licensor in its right to receive payments under the license—an "account"—any contractual term or "rule of law, statute, or regulation" (such as the

245. See R. § 9-607.
246. See id. § 9-610.
247. See supra text accompanying notes 223-27.
248. Although this article focuses on software licenses, the analysis is applicable to other general intangibles "including a contract, permit, license, or franchise." R. § 9-408(a), (c). For an extended discussion of this debate, see Steven O. Weise, The Financing of Intellectual Property Under Revised UCC Article 9, 74 CHI.-KENT L. REV. 1077 (1999).
249. See supra text accompanying note 222.
material impairment rule\textsuperscript{252}) which prohibits or restricts the creation, attachment, perfection, or enforcement of a security interest in that right to payment or makes such creation, attachment, perfection, or enforcement an event of default or gives the licensee a claim, right of termination, or remedy, is ineffective.\textsuperscript{253} Free alienability governs as in the case of any account.

A security interest in the licensee's rights under the lease agreement—a "general intangible"\textsuperscript{254}—is treated differently and affords significant protections to licensors against enforcement. In essence, a contractual term prohibiting the "creation, attachment, or perfection of a security interest" in the licensee's rights or making such creation, attachment, or perfection an event of default or giving the licensor a claim, right of termination, or remedy is also ineffective.\textsuperscript{255} Likewise ineffective is a "rule of law, statute, or regulation" (including the material impairment rule\textsuperscript{256}) which prohibits or restricts the creation, attachment, or perfection of a security interest in the licensee's rights under the license agreement or makes such creation, attachment, or perfection an event of default or gives the licensor a claim, right of termination, or remedy.\textsuperscript{257}

Enforcement, however, is a different matter. Here, Revised Article 9 gives way to law other than Revised Article 9, if any, that

\textsuperscript{252} See supra text accompanying note 222.
\textsuperscript{253} See R. § 9-406(d), (f).
\textsuperscript{254} See id. § 9-408 cmt. 2.
\textsuperscript{255} See id. § 9-408(a). Revised section 9-408(a) provides in pertinent part:

[Term restricting assignment generally ineffective.]

\textsuperscript{256} See supra text accompanying note 222.
\textsuperscript{257} See R. § 9-408(c). Revised section 9-408(c) provides in pertinent part:

[Legal restrictions on assignment generally ineffective.] A rule of law, statute, or regulation that prohibits, restricts, or requires the consent of a government, governmental body or official, ... or account debtor to the assignment or transfer of, or creation of a security interest in, a ... general intangible, including a contract, permit, license, or franchise between an account debtor and a debtor, is ineffective to the extent that the rule of law, statute, or regulation:

(1) would impair the creation, attachment, or perfection of a security interest; or
(2) provides that the creation, attachment, or perfection of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the ... general intangible.
makes such contractual terms or legal rules effective. It provides in pertinent part:\(^{258}\)

**[Limitation on ineffectiveness under subsections (a) and (c).]** To the extent that a term in . . . an agreement between an account debtor and a debtor which relates to a . . . general intangible or a rule of law, statute, or regulation described in subsection (c) would be effective under law other than this article but is ineffective under subsection (a) or (c), the creation, attachment, or perfection of a security interest in the . . . general intangible:

1. is not enforceable against the . . . account debtor;
2. does not impose a duty or obligation on the . . . account debtor;
3. does not require the . . . account debtor to recognize the security interest, pay or render performance to the secured party, or accept payment or performance from the secured party;
4. does not entitle the secured party to use or assign the debtor's rights under the . . . general intangible, including any related information or materials furnished to the debtor in the transaction giving rise to the . . . general intangible;
5. does not entitle the secured party to use, assign, possess, or have access to any trade secrets or confidential information of the . . . account debtor; and
6. does not entitle the secured party to enforce the security interest in the . . . general intangible.\(^{259}\)

Accordingly, even though a secured party may take and perfect a security interest in the rights of a licensee under a license agreement, the secured party's right to enforce that security interest may be limited by law other than Revised Article 9 if that law either validates or contains prohibitions or restrictions on the assignability or transfer of the licensee's rights.\(^{260}\) The secured party needs to make a comprehensive legal analysis to determine whether there is such other law before taking the security interest and, again, before enforcing its security interest in the event of a default. If there is any such law, the secured party must then determine the identity of the other party to the license agreement, e.g., the licensor, and obtain that party’s consent before it can exercise its enforcement rights. Upon those rights being sold, assigned, or transferred, the secured party's

---

258. Revised section 9-408 also applies to security interests in health-care-insurance receivables, promissory notes, and payment intangibles. In order to focus solely upon licenses of software, the quotations of Revised section 9-408 have used ellipses to delete references thereto. See supra notes 248, 255, 257.

259. R. § 9-408(d).

260. Neither Article 9 nor the Official Comments indicate whether there is such other law or what it provides. See id. § 9-408 cmt. 2.
perfected security interest will then attach to the proceeds.\textsuperscript{261} If there is no such other law, there are then no restrictions against the secured party enforcing its rights under Revised Article 9.

The practical problem for the secured party will be the determination of whether there is a license agreement with which it needs to be concerned. Much equipment, e.g., motor vehicles, printing presses, and medical equipment, usually utilizes software. Is that software subject to a license agreement that, under other law, effectively limits the secured party’s enforcement rights? Revised Article 9 assists that determination by distinguishing between “software”\textsuperscript{262} which is a “type of general intangible”\textsuperscript{263} and, therefore, is subject to the potential restrictions on enforcement\textsuperscript{264} and so-called “embedded software” which, instead, is treated as “goods”:\textsuperscript{265}

“Software” means a computer program and any supporting information provided in connection with a transaction relating to the program. The term does not include a computer program that is included in the definition of goods.\textsuperscript{266}

“Goods” means all things that are movable when a security interest attaches. . . . The term also includes a computer program embedded in goods and any supporting information provided in connection with a transaction relating to the program if (i) the program is associated with the goods in such a manner that it customarily is considered part of the goods, or (ii) by becoming the owner of the goods, a person acquires a right to use the program in connection with the goods. The term does not include a computer program embedded in goods that consist solely of the medium in which the program is embedded. The term also does not include . . . general intangibles . . . .\textsuperscript{267}

These mutually exclusive definitions are complex, technologically fact-sensitive, and difficult to apply in practice. A secured party repossessing sophisticated equipment collateral will have to expeditiously determine whether it can treat the equipment as “goods” and exercise its enforcement remedy of foreclosure without delay, or whether it has to be concerned with prohibitions or restrictions in a license agreement that necessitate communication with and gaining the consent of a licensor. These problems, of course,

\textsuperscript{261.} See id. § 9-408 cmts. 7-8.
\textsuperscript{262.} See infra text accompanying note 266.
\textsuperscript{263.} R. § 9-102 cmt. 25.
\textsuperscript{264.} See id. § 9-408(d).
\textsuperscript{265.} See infra text accompanying note 267.
\textsuperscript{266.} R. § 9-102(a)(75).
\textsuperscript{267.} Id. § 9-102(a)(44).
exist under present law, but there has been little focus on the issues and no guidance towards a resolution. Revised Article 9 not only focuses attention upon the problems and potential risks but also provides guidelines for dealing with them. How, whether, and to what extent secured parties will be able to adjust to these new rules and adapt their existing procedures remain to be seen.

V. SPECIAL PROVISIONS

A. Consequences of Noncompliance

Revised Article 9 expands the remedial provisions governing noncompliance to cover violations of all of Article 9, not just the provisions on default and enforcement. This allows an aggrieved debtor, obligor, or holder of a competing security interest or lien to seek injunctive or other equitable relief or to recover damages.

1. Commercial Transactions

Most importantly, Revised Article 9 resolves the issue under present law concerning the effect of noncompliance with the requirements for “collection, enforcement, disposition, or acceptance” of collateral. This resolution, which has its greatest impact in the context of a noncomplying secured party’s ability to enforce a deficiency claim, is applicable to all transactions other than consumer transactions. Revised Article 9 adopts the rule approved by the majority of courts that have considered the issue, the “rebuttable presumption” rule:

(a) [Applicable rules if amount of deficiency or surplus in issue.]

In an action arising from a transaction, other than a consumer transaction, in which the amount of a deficiency or surplus is in issue, the following rules apply:

(1) ....

(2) ....

(3) Except as otherwise provided in Section 9-628, if a secured party fails to prove that the collection, enforcement, disposition, or acceptance was conducted in accordance with the provisions of this part relating to collection, enforcement, disposition, or acceptance, the

268. See id. § 9-625(a)-(b).
270. See R. § 9-626 cmts. 2-4; Lloyd, supra note 1, at 721-24.
271. See R. § 9-626(a).
liability of a debtor or a secondary obligor for a deficiency is limited to an amount by which the sum of the secured obligation, 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 noncomplying secured party proceeded in accordance with the provisions of this part relating to collection, enforcement, disposition, or acceptance.

(4) For purposes of paragraph (3)(B), the amount of proceeds that would have been realized is equal to the sum of the secured obligation, expenses, and attorney's fees unless the secured party proves that the amount is less than that sum.\(^2\)

The reason for calling this the "rebuttable presumption" rule is succinctly demonstrated by the following Official Comment:

Unless the secured party proves that compliance with the relevant provisions would have yielded a smaller amount, under paragraph (4) the amount that a complying collection, enforcement, or disposition would have yielded is deemed to be equal to the amount of the secured obligation, together with expenses and attorney's fees. Thus, the secured party may not recover any deficiency unless it meets this burden.\(^2\)

A secured party which has objectively evaluated or assessed the value of the collateral prior to conducting the disposition should usually be able to assemble the factual proofs needed to satisfy this burden.\(^2\)

A related issue concerns the effect of an elimination or reduction of the deficiency claim under the rebuttable presumption rule upon a claim for damages against the secured party arising out of its noncompliance. Revised Article 9 resolves the issue with the following new provision:

A debtor whose deficiency is eliminated under Section 9-626 may recover damages for the loss of any surplus. However, a debtor or secondary obligor whose deficiency is eliminated or reduced under Section 9-626 may not otherwise recover under subsection (b) for noncompliance with the provisions of this part relating to collection, enforcement, disposition, or acceptance.\(^2\)

Thus, this resolution "eliminates the possibility of double recovery or

\(^2\) Id. § 9-626(a).
\(^3\) Id. § 9-626 cmt. 3.
\(^2\) See supra text accompanying notes 155-57. Prudent secured parties "routinely make or obtain valuations of the collateral prior to the foreclosure sale in order to establish an upset or let go price." Rapson, supra note 1, at 498.
\(^2\) R. § 9-625(d).
other over-compensation arising out of a reduction or elimination of a deficiency."

2. Consumer Transactions

In consumer transactions, the rules are quite different. If the collateral is "consumer goods," an aggrieved debtor or secondary obligor may recover, in any event, statutory damages for the secured party's failure to comply with the default and enforcement provisions (Part 6) of Revised Article 9.

What is the effect in a consumer transaction on statutory damages if the deficiency claim is reduced or eliminated? As a component of the "consumer compromise," the statute is intentionally silent. Moreover, the statute is even silent as to the consequences of noncompliance on the deficiency claim:

[Non-consumer transactions; no inference.] The limitation of the rules in subsection (a) to transactions other than consumer transactions is intended to leave to the court the determination of the proper rules in consumer transactions. The court may not infer from that limitation the nature of the proper rule in consumer transactions and may continue to apply established approaches.

This "compromise" provision evolved because certain consumer creditor advocates were strongly opposed to the Drafting Committee's proposal to give state legislatures the alternative of adopting for consumer transactions either the "absolute bar" rule (which automatically eliminates the deficiency claim) or the "rebuttable presumption" rule. These advocates were concerned that the formulation of the "absolute bar" rule as an alternative to the latter (which is applicable to all other transactions) would invite enactment of the former. In turn, consumer advocates were concerned that silence in the statute as to which rule should be followed for consumer transactions would invite courts to follow the "rebuttable presumption" rule. These consumer advocates reasoned that because Revised Article 9 prescribes that rule for all other

276.  Id. § 9-625 cmt. 3.
277.  See supra note 119 (explaining the difference between "consumer transactions" and "consumer-goods transactions").
278.  See R. § 9-625(c)(2); supra text accompanying notes 119-33.
279.  See supra note 23; infra text accompanying notes 280-87.
280.  See R. § 9-626 cmt. 3 ("Because Section 9-626 does not apply to consumer transactions, the statute is silent as to whether a double recovery or other over-compensation is possible in a consumer transaction.").
281.  Id. § 9-626(b).
282.  See supra text accompanying notes 270-74.
transactions, it might result in judicial reversals in those jurisdictions (albeit a minority) where courts had previously adopted the "absolute bar" rule. Accordingly, the two groups agreed upon the above language which allows the court to fashion its own rules for consumer transactions. In doing so, the court is supposed to close its eyes to the fact that Revised Article 9 adopts the "rebuttable presumption" rule for commercial transactions and did not adopt the rule for consumer transactions. As explained in the Official Comment:

**Consumer Transactions.** Although subsection (a) adopts a version of the rebuttable presumption rule for transactions other than consumer transactions, with certain exceptions Part 6 does not specify the effect of a secured party's noncompliance in consumer transactions. (The exceptions are the provisions for the recovery of damages in Section 9-625.) Subsection (b) provides that the limitation of subsection (a) to transactions other than consumer transactions is intended to leave to the court the determination of the proper rules in consumer transactions. It also instructs the court not to draw any inference from the limitation as to the proper rules for consumer transactions and leaves the court free to continue to apply established approaches to those transactions.

Courts construing former Section 9-507 disagreed about the consequences of a secured party's failure to comply with the requirements of former Part 5. Three general approaches emerged. Some courts have held that a noncomplying secured party may not recover a deficiency (the "absolute bar" rule). A few courts held that the debtor can offset against a claim to a deficiency all damages recoverable under former Section 9-507 resulting from the secured party's noncompliance (the "offset" rule). A plurality of courts considering the issue held that the noncomplying secured party is barred from recovering a deficiency unless it overcomes a rebuttable presumption that compliance with former Part 5 would have yielded an amount sufficient to satisfy the secured debt. In addition to the nonuniformity resulting from court decisions, some States enacted special rules governing the availability of deficiencies.

Thus, where consumer transactions are involved, Revised Article 9 continues the uncertainty that exists under present law. The reader is encouraged to form his or her own opinion as to the wisdom and merits of this "consumer compromise."

---

283. See R. § 9-626(a)(3)-(4).
284. See supra text accompanying note 281.
285. See supra text accompanying note 281 ("The court may not infer from that limitation.
286. R. § 9-626 cmt. 4.
287. In his capacity as a member of the Drafting Committee, the author abstained, on
B. Assignments to Secondary Obligors

In 1992, the author wrote an article, the title of which included the question “What Does Section 9-504(5) Mean?” This murky provision deals with “transfers of collateral” to secondary obligors that take place upon default. The article explored the meaning of the phrases “repurchase agreement” and “transfer of collateral” used in the present statute and asked for the meaning of “collateral” in this context. What is an agreement for the “repurchase” of “collateral”? Is it an agreement for the “repurchase of the paper,” e.g., a conditional sales contract of goods? Or is it an agreement for the “repurchase” of the particular goods covered by that conditional sales contract?

Agreements for the repurchase of the “paper” or for the repurchase of the “goods” are both used extensively in commercial financing. Each is a suretyship agreement, i.e., the person obligated to repurchase is a “secondary obligor,” but the two agreements are very different. A dealer in the business of selling or leasing goods from inventory will often sell to a financial institution the chattel paper executed by its customers, e.g., conditional sales contracts and leases, resulting from the sale or lease of the goods to buyers or lessees in the ordinary course of business. Frequently the sale to the
That is, the "chattel paper" is to be reassigned to the dealer in return for the dealer paying a "repurchase" price to the financial institution—often an amount equal to the remaining balance due under the chattel paper.

Other times, however, the agreement will require the dealer to "repurchase" the actual goods if the customer defaults and the goods are repossessed. In an analogous transaction, a manufacturer, as an inducement to a financial institution to provide inventory financing to a merchant that will purchase its products, agrees to "repurchase" the inventory if the merchant defaults in its obligation to the financial institution. In both instances, the obligation of the dealer or manufacturer, as the case may be, to "repurchase the goods" is conditioned upon it becoming the owner of the goods so that it can then re-sell them from its own inventory. The dealer or manufacturer will require, however, that the financial institution first take all measures required by Article 9 to foreclose the interests of the debtor and anyone else in the goods so that it can own the goods "free and clear." The "repurchase price" is usually an amount totaling the remaining balance due from the debtor under the chattel paper or financing agreement, which total is allocated to two components consisting of: the value of the goods being purchased; and if that value is less than the remaining balance, the right to enforce the resulting deficiency claim.

Accordingly, in order for a repurchase of the goods to be effectuated, the financial institution has to convey "clear title"—and that can only be accomplished by a sale, disposition, or acceptance of the collateral pursuant to the provisions of Article 9 governing enforcement after default, i.e., nonjudicial or strict foreclosure. But UCC section 9-504(5) causes confusion and problems by providing that "[s]uch a transfer of collateral is not a sale or disposition of the collateral under this Article." That statement is an absolute
nonsequitur in the context of an agreement for the repurchase of the goods. Implementation of that agreement necessarily requires a "sale or disposition" under Article 9—a reality that is wholly inconsistent with the plain meaning of the statute.\textsuperscript{297} As the author concluded in the article: "Notwithstanding the plain-meaning of the last sentence of section 9-504(5), in order to effectuate the transfer of collateral to a person liable under a repurchase agreement, there must be a sale or disposition of the collateral in compliance with Part 5 of Article 9."\textsuperscript{298}

The Drafting Committee directly confronted and resolved this problem as well as some related issues. Revised Article 9 sets forth a new formulation:

(a) \textbf{[Rights and duties of secondary obligor.]} A secondary obligor acquires the rights and becomes obligated to perform the duties of the secured party after the secondary obligor:

(1) receives an assignment of a secured obligation from the secured party;

(2) receives a transfer of collateral from the secured party and agrees to accept the rights and assume the duties of the secured party; or

(3) is subrogated to the rights of a secured party with respect to collateral.

(b) \textbf{[Effect of assignment transfer, or subrogation.]} An assignment, transfer, or subrogation described in subsection (a):

(1) is not a disposition of collateral under Section 9-610, and

(2) relieves the secured party of further duties under this article.\textsuperscript{299}

This provision accomplishes the resolution by carving out from its coverage agreements for the "transfer of collateral" if the "collateral" is the property covered by the security agreement, i.e., the "goods," as distinguished from the security agreement itself, i.e., the "paper," such as a conditional sales contract or lease. As a result, suretyship agreements for the "repurchase of goods," which necessarily require a foreclosure sale or other disposition pursuant to Article 9 in order to be implemented,\textsuperscript{300} are not governed by this provision.

The statute achieves this result by carefully limiting the kind of "secondary obligor" that is covered. It refers to the secondary obligor

\textsuperscript{297} See id.
\textsuperscript{298} Rapson, supra note 288, at 680.
\textsuperscript{299} R. § 9-618.
\textsuperscript{300} See, e.g., id. §§ 9-610, 9-620.
as one that "receives a transfer of collateral from the secured party and agrees to . . . assume the duties of the secured party" or is "subrogated to the rights of a secured party with respect to collateral." That language has the effect of excluding a secondary obligor that is agreeing to repurchase the goods because in such an agreement, the secondary obligor does not agree to "assume the duties of the secured party." Likewise, even though that secondary obligor will be subrogated under suretyship principles to the secured party's rights against the debtor with respect to the underlying debt, i.e., the deficiency claim, it will not be subrogated "with respect to collateral" because the security interest will have been discharged by the foreclosure so that there is no longer any "collateral." Consequently, the statute is concerned only with "assignments of secured obligations and other transactions (regardless of form) that function like assignments of secured obligations," e.g., "repurchases of paper." It is those transactions—and only those transactions—that are "not a disposition of collateral under Section 9-610."

The statute then goes on to deal with the corollary question of whether the assignor-secured party has a continuing responsibility if the assignee-secondary obligor thereafter fails to comply with the duties it succeeds to as a secured party under Revised Article 9. This troubling issue was also examined in the author's earlier article. Present Article 9 is silent on the question and there is scant judicial authority on the point. Under basic contract law, however, an assignment does not relieve an assignor of its duties to a third person.

Revised Article 9 resolves this issue by relieving the secured

301. Id. § 9-618(a)(2) (emphasis added).
302. Id. § 9-618(a)(3) (emphasis added).
303. Cf. id. § 9-618(a)(2).
305. See id. § 28(1)(a).
307. Id. § 9-618 cmt. 2.
308. Id. § 9-618(b)(1).
309. See Rapson, supra note 288, at 697-700.
310. See, e.g., Stoppi v. Wilmington Trust Co., 518 A.2d 82, 85 (Del. 1986) (secured party is not responsible); cf. MBank El Paso v. Sanchez, 836 S.W.2d 151, 153-54 (Tex. 1992) (secured party is responsible because it cannot delegate away its duty of peaceful repossession).
311. See RESTATEMENT (SECOND) OF CONTRACTS § 318(3) (1981) ("Unless the obligee agrees otherwise, neither delegation of performance nor a contract to assume the duty made with the obligor by the person delegated discharges any duty or liability of the delegating obligor.").
party of "further duties under this article." The rationale is that it is impractical to impose a continuing burden upon the assignor of the secured obligation to thereafter monitor the assignee that has become the secured party. This rule seems particularly justified in the common circumstance where the purchaser of the chattel paper has re-assigned the secured obligation to the dealer from whom it had initially purchased the paper.

CONCLUSION

The treatment of enforcement rights and remedies in Revised Article 9 is a great improvement over existing law—substantively, procedurally, structurally, and in fairly balancing the interests of secured parties and obligors. Revised Article 9 significantly enhances the remedies of collection and strict foreclosure and provides much needed procedural certainty to nonjudicial foreclosure. Although "commercial reasonableness" continues to be the guiding principle underlying the exercise of the enforcement rights and remedies of collection and nonjudicial foreclosure, Revised Article 9 provides important insights into its meaning and interpretation.

Several provisions offer a more efficient and fairer treatment of the much-litigated subject of deficiency claims. In particular, Revised Article 9 provides a special method for calculating a deficiency in those circumstances most susceptible to abuse—when the secured party, a person related to the secured party, or a secondary obligor acquires the collateral at a foreclosure disposition. That provision is complemented by the requirement in consumer-goods transactions that the secured party provide an explanation of how it calculated the deficiency when requested to do so or before making written demand for payment. Revised Article 9's expansion of the definition of "good faith" to include "observance of reasonable commercial standards of fair dealing" is consistent with the trend of other recent revisions to the UCC and will deter inappropriate conduct. The codification of the "rebuttable presumption" rule as the consequence

312. R. § 9-618(b)(2).
313. See supra text accompanying notes 25-78.
314. See supra text accompanying notes 176-215.
315. See supra text accompanying notes 79-175.
316. See supra text accompanying notes 134-40.
317. See supra text accompanying notes 141-57.
318. See supra text accompanying notes 158-71.
319. See supra text accompanying notes 44-51.
of noncompliance with Article 9’s enforcement provisions on
deficiency claims resolves an important issue. 320 Regrettably, there
was no resolution of this issue in consumer transactions, and the
“consumer compromise” 321 prevented the Drafting Committee from
adopting other provisions that would have promoted fair treatment of
both consumers and secured creditors.

Finally, Revised Article 9 resolves many substantive issues and
provides guidance on numerous problems that exist under present
law, e.g., the relationship between Article 9 and suretyship law,
including the enforceability of waivers by secondary obligors \(^\text{322}\) and
harmonization of conflicting policies concerning alienability and
assignability of rights, particularly in the context of changed business
practices resulting from the development of computer and software
technology. 323

Revised Article 9’s treatment of enforcement rights and
remedies is extensive and, at times, necessarily detailed and complex.
Careful study and attention are required. The author hopes that this
article will contribute to that effort.

320. *See supra* text accompanying notes 270-76.
322. *See supra* text accompanying notes 91-94.