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Secured Financing Under the Uniform Commercial Code: Remedies in Default

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SECURED FINANCING UNDER THE UNIFORM COMMERCIAL CODE: REMEDIES IN DEFAULT*

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NEW RULES WILL APPLY UNDER UCC

On July 1, 1965, Wisconsin attorneys must shift gears and apply an entirely new set of remedies when default occurs in secured transactions. Gone are the different statutory procedures that applied to chattel mortgages, conditional sales contracts, trust receipts, etc., on default. One basic set of rules will now apply to all secured transactions, regardless of the label which may appear at the top of the security agreement. Though the agreement may be labelled a chattel mortgage, or a conditional sales contract, or a trust receipt, default procedures for all will be the same, with some variations predicated on the type of collateral rather than on the label on the transaction.

SUMMARY OF REMEDIES[1]

On default of the debtor, the Code gives the secured party a choice of several remedies which are cumulative, not elective:

A. Take judgment and levy execution.[2]

B. Use real estate mortgage procedure when both realty and personality are involved.[3]

C. Apply any special remedies provided in the security agreement.[4]

D. Collect accounts and instruments which are collateral.[5]

E. Foreclose under Code procedures by taking possession of and disposing of collateral or retaining in full satisfaction.[6]

A. *Take Judgment and Levy Execution*

Occasionally it would be advantageous for the secured party to take judgment and levy execution, particularly if the security agreement provided for a confession of judgment. The lien of the levy on the original collateral would relate back to the date of the perfection of the security interest in such collateral.[7] Priority respecting original col-

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* This article is substantially the same as that contained in a chapter of the same title and by the same author appearing in the *Wisconsin Uniform Commercial Code Handbook*, a publication of the Institute of Continuing Legal Education for Wisconsin, a joint activity of the State Bar of Wisconsin, Marquette University, and the University of Wisconsin.

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[1] WIS. STAT. §§409.501-.507 (1963).

[2] WIS. STAT. §§409.501(1), (5) (1963).

[3] WIS. STAT. §409.501(4) (1963).

[4] WIS. STAT. §§401.102(3), 409.207(4), .501(1), (3) (1963).

[5] WIS. STAT. §409.502 (1963).

[6] WIS. STAT. §§409.207, .503 (1963).

[7] WIS. STAT. §409.501(5) (1963).

lateral would thus be preserved, while at the same time levy could be had against other property. Another possible advantage is that the secured party could purchase the original collateral at the execution sale without compliance with the restrictions imposed on foreclosure sales by section 409.504.

B. *Real Estate Mortgage Foreclosure Procedure*

If the collateral includes both real estate and personal property, the secured party may foreclose the entire collateral under the real estate mortgage foreclosure law if he so desires (optional). Then the UCC provisions do not apply. The long redemption period would usually make this remedy impracticable as to the personalty.

C. *Apply Any Remedies Provided in Security Agreement*

The security agreement itself may provide any and all reasonable remedies, *except* that the following rights of the debtor may not be waived or varied:

(1) Debtor's right to surplus proceeds of collateral.[8]

(2) Debtor's right to protective Code provisions as to disposition of collateral.[9]

(3) Debtor's right to protective Code provisions as to acceptance of collateral in full satisfaction.[10]

(4) Debtor's right to redeem collateral.[11]

(5) Debtor's rights and remedies against a secured party who fails to comply with default requirements of the Code.[12]

(6) The obligations of good faith, diligence, reasonableness, and care prescribed by the Code.[13]

Note that we are dealing here with waiver in advance of default in the terms of the security agreement. Distinguish the situation after default, when the debtor may waive any and all of his rights without consideration as long as no third party is adversely affected and the general obligations of good faith and reasonableness are not impaired.[14]

Because of the restrictions on freedom of contract listed above, the secured party appears to be prevented from devising any comprehensive new remedy by insertion in the security agreement. He is limited to such devices as providing for confession of judgment, for temporary use or operation of the collateral (consumed goods excepted),[15] for assembling by the debtor of scattered collateral,[16] or for payment of legal expenses of foreclosure by debtor (unless the secured party is a financial institution to which it is denied by law).

[8] WIS. STAT. §§409.502(2), .504(2) (1963).
[9] WIS. STAT. §§409.504(3), .505(1) (1963).
[10] WIS. STAT. §409.505 (2) (1963).
[11] WIS. STAT. §409.506 (1963).
[12] WIS. STAT. §409.507 (1) (1963).
[13] WIS. STAT. §401.102 (3) (1963).
[14] WIS. STAT. §§401.107, .203 (1963).
[15] WIS. STAT. §409.207 (4) (1963).
[16] WIS. STAT. §409.503 (1963).

New "remedies" in the security agreement are thus circumscribed. However, there remains the very valuable right to determine in the security agreement the *standards* by which the fulfillment of the debtor's rights and the secured party's duties is to be measured if such standards are not manifestly unreasonable.[17] We will see below that there are at least four critical, vague Code requirements, none of which to date has had much judicial construction, and which could within reason be spelled out in the security agreement:

"Reasonable notice" could be exactly defined at five days.[18] Without this definition the attorney would probably give the more usual ten day notice.

If market price of the collateral is at least reasonably standard, stipulation in the security agreement that there exists a "recognized market" or that it is the subject of "widely distributed standard price quotations" would establish the right of the secured party to purchase the collateral himself at private (as against public) sale, and it would in the case of a "recognized market" eliminate the need for any notice to the debtor[19] and establish commercial reasonableness of a sale.[20]

"Commercially reasonable" can be defined in the security agreement so as to tell the secured party what he may and may not do in disposing of the collateral. The Code at section 409.507(2) of the Wisconsin statutes permits any commercially reasonable disposition and lists several methods, including sales to or through dealers. More private sales will now be acceptable and this is welcome, but at what price can you sell privately and not be subject to argument or litigation?

New and used cars, boats and motors, mobile homes, aircraft, trucks and trailers, cattle, tractors, farm equipment, construction equipment, and perhaps some other chattels have recognized valuation books showing average retail and sometimes average wholesale prices. Consider the feasibility of specifying in the security agreement that private sale at or near these prices shall be considered commercially reasonable.

Consider also the feasibility of attaching a schedule of agreed prices, decreasing with the passage of time, for chattels that depreciate in price at a relatively predictable rate.

D. *Direct Collection of Accounts and Instruments*

Where collateral consists of an account, chattel paper, contract right, general intangible, or instrument, upon default the secured party may notify the account debtor or obligor on the instrument to make direct payment to him, rather than to the assignor, whether or not the assignor was theretofore making collections on the collateral.[21]

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[17] WIS. STAT. §§401.102 (3), 409.501 (3) (1963).
[18] *Cf.* present trust receipt law.
[19] WIS. STAT. §409.504 (3) (1963).
[20] WIS. STAT. §409.507 (2) (1963).
[21] WIS. STAT. §409.502 (1) (1963). Although §409.502 in express terms refers

The secured party may also take control of any proceeds to which he is entitled under section 409.306.

Whenever the security agreement gives the secured party full or limited recourse against the debtor, or the right to charge back uncollected collateral, the manner in which the secured party collects against the collateral is of concern to the debtor and his creditors—it may increase the deficiency claim or reduce a possible surplus. Therefore, such secured party who undertakes to collect from the account debtors or obligors must proceed in a commercially reasonable manner.[22] He may deduct his reasonable expenses of realization from the collections. If there is no recourse against the principal debtor, neither the debtor nor his creditors have any legitimate concern with the disposition which the secured party makes of the collateral.

If the transaction is a *loan,* the secured party must account to the debtor for any surplus realized on the collateral (a non-waivable right of debtor), and, unless agreement is to the contrary, the debtor is liable for any deficiency; but if the transaction is a sale of accounts, contract rights, or chattel paper, the debtor receives no surplus and pays no deficiency unless the security agreement so provides.[23]

E. *Foreclosure Under Code Procedures*

In most cases the secured party will foreclose under sections 409.503 through 409.505 by taking possession of the collateral and either disposing of it or retaining it in full satisfaction.

(1) *Repossession*[24]

On default, the secured party has the right to take immediate possession of the collateral without judicial process if it can be done without breach of the peace (same as old law except for household furniture, which required legal process), unless otherwise agreed in the security agreement. If the debtor will not voluntarily surrender possession, the collateral map be replevied.

If the security agreement so provides, the secured party may require the debtor to assemble scattered collateral and make it available to the secured party at a designated place which is reasonably convenient to both parties.

The secured party may leave collateral which is heavy equipment on the debtor's premises, render it unusable, and dispose of it there. This may save the expense of moving and storing, to the benefit of both parties.

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only to accounts and instruments held as collateral, UNIFORM COMMERCIAL CODE §9-502, comment [all references are to the 1962 Official Text with Comments], indicates that the section applies also to chattel paper, contract rights, and general intangibles.

[22] WIS. STAT. §409.502 (2) (1963).

[23] *Ibid.*

[24] WIS STAT. §409.503 (1963).

In lieu of storage, the secured party may repledge the collateral upon terms which do not impair the debtor's right to redeem it, or may use or operate the collateral for the purpose of preserving it or its value, or pursuant to a court order, or, except for consumer goods, as provided in the security agreement.[25]

The secured party may prepare or process the collateral in a commercially reasonable manner to make it more saleable.[26]

The provision of section 409.504(3) that each aspect of disposition of collateral must be commercially reasonable applies to repossession, storage, use, or preparation of the collateral as well.

(2) *Disposition*[27]

The secured party is not restricted to a sale of the collateral, but may also lease or otherwise dispose of it, providing that all aspects of the disposition, including the method, manner, time, place, and terms must be commercially reasonable.

(a) *Notice*[28]

Reasonable notice (no set period) must be given to the debtor of the time and place of any public sale, private sale, or other intended disposition, so as to permit him to participate in the sale or redeem as described below, *unless* the collateral is perishable, threatens to decline speedily in value, or is of a type customarily sold on a recognized market.[29] What constitutes "reasonable notice" may be inserted in the security agreement. The notice of sale can be utilized as an aid to voluntary repossession if the sheriff serving the notice is instructed to ask the debtor: "You don't mind if I take the chattels with me now, do you?"

The same notice (with the same exceptions) should be given to other secured parties who have filed their claims or who are known by the foreclosing secured party to assert secured claims, unless the collateral is consumer goods. Before disposition of the collateral, therefore, the records of the filing offices must be checked, except in the case of consumer goods.

(b) *Public or Private Sale or Disposition*

Disposition of the collateral may be by public or private proceedings, by way of one or more contracts, as a unit or in parcels, provided commercially reasonable. Any sale of goods also is subject to chapter 402 of the Wisconsin statutes, on "Sales." The secured party may always buy the collateral at a public sale; he may buy at a private sale

[25] WIS. STAT. §409.207 (1963).
[26] WIS. STAT. §409.504 (1) (1963).
[27] WIS. STAT. §409.504 (1963).
[28] WIS. STAT. §409.504 (3) (1963).
[29] *Cf.* old laws requiring notice of ten days for chattel mortgages, five days for trust receipts, and ten days plus posting plus newspaper notice if more than $500 paid for conditional sales contracts.

only when the collateral being sold is customarily sold in a recognized market or is the subject of widely distributed standard price quotations.

It is easy under both old law and the UCC to qualify public (auction) sale by advertising it and personally making sure that more than one bona fide bid is obtained. The Code, however, permits the wider use of private sales as a method of disposition, but they must meet the test of commercial reasonableness. Section 409.507(2) itemizes some commercially reasonable dispositions, but they are not required nor exclusive:

(1) Disposition in the usual manner in any recognized market therefor (secured party may buy); or

(2) Disposition at the price current in such market at the time of sale (secured party may buy); or

(3) Disposition otherwise in conformity with reasonable commercial practices among dealers in the type of property sold (private sale to or through a dealer); or

(4) Disposition approved in any judicial proceeding; or

(5) Disposition approved by any bona fide creditors' committee or representative of creditors.

The fact that a better price could have been obtained by a sale at a different time or in a different method is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner.

Previously, in section C, we have discussed the problems of sale price and possible assistance through the terms of the security agreement, particularly by reference to valuation books or scheduled prices.

In the absence of such terms in the security agreement, the valuation books would still be of help in setting a commercially reasonable price. A private buyer willing to pay average book value (average wholesale for dealers) could be located, or a dealer could be instructed to sell at average retail on commission; then ten days' notice could be given to the debtor to let him redeem or object.

The only two cases located which refer to valuation books[30] involved fact situations that limit their usefulness.

For chattels without book value, some evidence that the price at private sale was reasonable should be reserved, if possible, to limit later argument and litigation.

An affidavit of sale of the type required for chattel mortgage foreclosures under the old law is no longer necessary, but perhaps something of that nature will be needed to get a certificate of title from the state for cars, trucks, and boats.

A transfer of collateral from the secured party to a person liable to the secured party under a guaranty, indorsement, repurchase agree-

[30] Alliance Discount Corp. v. Shaw, 195 Pa. Super 601, 171 A. 2d 548 (1961); Family Fin. Corp. v. Scott, 24 Pa. D. & C. 2d 587 (1961).

ment, or the like, or who is subrogated to his rights, is not a sale or disposition of the collateral under this article. The transferee has merely acquired the rights and duties of the secured party.[31]

(c) *Title of Purchaser*[32]

If the secured party complies with the requirements of this Code or of any judicial proceedings, the purchaser for value of the collateral takes free of any rights of the debtor and of the holders of junior security interests and liens.

If the secured party fails so to comply, the purchaser for value still take free of all such rights and interest:

(1) In the case of a public sale, if he has no knowledge of any defects in the sale and he does not buy in collusion with the secured party, other bidders, or the person conducting the sale (not actively in bad-faith; no duty to inquire); or

(2) In any other case, if he acts in good faith.

When a junior security interest is foreclosed, the purchaser takes subject to senior interests that were perfected, but free of junior liens.

(d) *Application of Proceeds*

The proceeds of disposition must be applied in the following order:

(1) To the reasonable expenses of retaking, holding, preparing for sale, selling, and the like and, to the extent provided for in the security agreement and not prohibited by law, the reasonable attorneys' fees and legal expenses incurred by the secured party;

(2) To the payment of the debt;

(3) To the satisfaction of indebtedness secured by any subordinate security interest in the collateral if written notification or demand therefor is received before distribution of the proceeds is completed. If requested by the secured party, the holder of a subordinate security interest must seasonably furnish reasonable proof of his interest, and unless he does so, the secured party need not comply with his demand.

(e) *Surplus or Deficiency*

The secured party must account to the debtor for any surplus realized on the collateral (a non-waivable right of debtor), and, unless agreement is to the contrary, the debtor is liable for any deficiency.[33] Where the secured party knows that the collateral is owned by a person who is not the debtor, the owner of the collateral and not the debtor is entitled to any surplus.[34]

(3) *Retention of Collateral in Full Satisfaction*[35]

A secured party in possession after default may propose to retain the collateral in satisfaction of the obligation (no deficiency to secured

[31] WIS. STAT. §409.504 (5) (1963).
[32] WIS. STAT. §409.504 (4) (1963).
[33] WIS. STAT. §§409.502 (2), .504 (2) (1963).
[34] WIS. STAT. §409.112 (1963).
[35] WIS. STAT. §409.505 (1963).

party; no surplus to debtor). Written notice of such proposal must be sent to the debtor, and, except in the case of consumer goods, to any other secured party properly filed or known by the secured party in possession to have a security interest in it. If the debtor or other person entitled to receive satisfaction objects in writing within thirty days from the receipt of the notice, or if any other secured party objects in writing within thirty days after the secured party obtains possession, the secured party must follow the procedure for disposition of section 409.504. In the absence of such written objection, the secured party may retain the collateral in satisfaction of the debtor's obligation.

Consumer goods exception:[36] If the debtor has paid 60% of the cash price in the case of a purchase money security interest in consumer goods, or 60% of the loan in the case of another security interest in consumer goods, the secured party must dispose of the collateral under procedures set out in section 409.504 within ninety days after taking possession, unless the debtor after default (but not before) has signed a statement renouncing or modifying his rights to the collateral. The debtor may recover under section 409.507(1) if the secured party fails to comply.

(4) *Debtor's Right to Redeem Collateral*[37]

So long as the secured party has not disposed of collateral in his possession, or contracted for its disposition, and so long as his right to retain it has not become fixed under section 409.505(2), the debtor or any other secured party may redeem.

To redeem, he must tender fulfillment of all obligations plus the expenses reasonably incurred by the secured party in retaking, holding, and preparing the collateral for disposition, in arranging for the sale, and to the extent provided in the agreement and not prohibited by law, his reasonable attorneys' fees and legal expenses.

The fact that the secured party has sold or contracted to sell part of the collateral would not affect the debtor's right to redeem what was left by tendering the full amount less the net proceeds of the collateral sold.[38]

The risk of accidental loss of or damage to the collateral while in the secured party's possession is on the debtor to the extent of any deficiency in insurance coverage.[39]

The right to redeem may be waived in writing after default.

(5) *Debtor's Remedies On Improper Disposition or Foreclosure*[40]

Injunction: If it is established that the secured party is not proceeding in accordance with sections 409.501 through 409.507 (*e.g.*, is com-

[36] WIS. STAT §409.505 (1) (1963).
[37] WIS. STAT. §409.506 (1963).
[38] UNIFORM COMMERCIAL CODE §9-506, comment.
[39] WIS. STAT. §409.207 (1) (b) (1963).
[40] WIS. STAT. §409.507 (1) (1963).

mercially unreasonable), a court may order or restrain disposition on appropriate terms and conditions.

Damages: Any loss caused by failure to comply with the statute may be recovered when improper disposition has occurred, either by the debtor or by any person entitled to notice or whose security interest has been made known to the secured party prior to the disposition. If the collateral is consumer goods, the debtor has the right to recover in any event an amount not less than the credit service charge plus 10% of the principal amount of the debt or the time price differential plus 10% of the cash price.