

CAUTIOUS CREDITOR®

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ENFORCEMENT OF SECURITY INTERESTS UNDER REVISED ARTICLE 9

Last month's issue of the *Cautious Creditor*® provided a general introduction to Revised Article 9 of the Uniform Commercial Code recently enacted in the State of Indiana. Enforcement of security interests is an area of Article 9 that received significant attention, and Revised Article 9 attempts to resolve many of the disputed issues involving default and enforcement under current Article 9. This issue of the *Cautious Creditor*® summarizes some of the major changes in the enforcement of security interests under Revised Article 9.

Commercial Reasonableness

As is true under existing Article 9, Revised Article 9 requires a secured party exercising its collection and enforcement rights to "proceed in a commercially reasonable manner." Revised Article 9 contains new, expanded and detailed provisions governing the procedure for the handling and sale of repossessed collateral, and offers insights as to how commercial reasonableness should be evaluated. Revised Article 9 indicates that a low price does not, by itself, make a sale commercially unreasonable. Official comments to Revised Article 9 state that a low sale price suggests that a court should carefully scrutinize all aspects of a disposition to ensure that the sale was commercially reasonable.

In contrast to existing Article 9, Revised Article 9 contains new provisions detailing to whom and when notice of disposition should be sent, what information the notification must contain, and "safe harbor" forms for the contents of notification. Revised Article 9 also provides that the secured party may not dispose of collateral "in its then

condition" when, taking into account the costs and benefits of preparation or processing and the fact that the secured party would be advancing the cost at its risk, it would be commercially unreasonable to dispose of the collateral in that condition. Finally Revised Article 9 makes clear that a secondary obligor (guarantor) of an obligation subject to Article 9 is entitled to the same notices and protections as the debtor and is subject to the same restrictions upon waiver of those rights.

Rebuttable Presumption Rule

Courts have long debated whether a failure to meet the commercial reasonableness requirements of current Article 9 would bar the ability to seek all deficiency claims (the "Absolute Bar Rule"), or just reduce the secured party's deficiency to the extent the failure to comply affected the price obtained at the foreclosure sale (the "Rebuttable Presumption Rule"). Excepting consumer transactions, Revised Article 9 establishes, by statute, the Rebuttable Presumption Rule. Revised Article 9 leaves this issue to the courts in consumer transactions.

Acceptance of Collateral in Full or Partial Satisfaction of Debt

Whether a secured party may retain collateral in full or partial satisfaction of the debt is unclear under current Article 9. Revised Article 9 permits a creditor to retain collateral in full or partial satisfaction of a debt, if the debtor consents to the acceptance, and the secured party does not receive a notification of objection to the proposal from any person or entity holding an interest in the collateral.

Acceptance of collateral in satisfaction of the debt discharges junior claimants, a result unlikely under current Article 9.

Warranties

Revised Article 9 rejects the approach taken by present law that warranties do not accompany a sale of collateral. Instead it provides that the sale includes the warranties relating to title, possession, quiet enjoyment and the like which, by operation of law, accompany a voluntary disposition of the property at issue. 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. In particular circumstances, implied warranties of merchantability or fitness also may apply to a sale unless expressly waived. Disclaimer of warranties may be subject to court review and found commercially unreasonable under extreme circumstances.

Consumer's Right to Accounting

In the new provisions for calculating deficiencies, Revised Article 9 provides 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 surplus or deficiency was calculated, which must be sent upon demand and before a refund of the surplus or action to collect the deficiency is taken. This requirement is intended to motivate secured parties to exercise care in the manner in which they conduct sales and attempt to pursue deficiency claims.

Comments

The default and enforcement rules under Revised Article 9 are complex, and a cautious creditor should become familiar with the new procedures prior to the new law's effective date of July 1, 2001. Be forewarned that under Revised Article 9, a secured party failing to comply with the

requirements for disposition of collateral is liable for damages or any loss caused by the failure to comply, which may include loss resulting from the debtor's inability to obtain, or increased costs of, alternative financing. If the collateral is consumer goods, the debtor may recover other monetary damages, including statutory damages of \$500 in each case.

Cautious creditors regularly involved in the enforcement of security interests and the sale of collateral should review their enforcement procedures prior to Revised Article 9's effective date of July 1, 2001, and adjust the procedures to avoid the difficulties and potential liability resulting from failure to comply with the new enforcement procedures.

For more information in this area, please contact Henry A. Efromyson at 317-236-2397, Internet: efromyso@imdr.com.

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