Assignment 21
Disposition of Collateral

Disposition of Collateral: Article 9

• After default, secured party can dispose of collateral by judicial process [§§ 9-601(a)(1), (f)]
• Step 1: Secured party must first sue for judgment on the debt (reduce its claim to judgment)
• Step 2: Sheriff’s sale in satisfaction of judgment
  – Sheriff’s sale is public auction, conducted by sheriff in accordance with state statutes and rules of civil procedure governing execution sales (not by Art. 9)

Disposition of Collateral: Article 9

• Article 9 alternatively allows secured party to dispose of the collateral without judicial process or supervision [§ 9-610(a)]
  – Secured party can hold a public sale (auction open to public) or a private sale [§ 9-610(b)]
  – However, any disposition by the secured party must be “commercially reasonable” in all respects [§§ 9-610(a), (b)]

Redemption

• Until disposition occurs, debtor may “redeem” the collateral [§§ 9-623(a), (c)]
• To redeem, debtor must pay secured party
  – (1) full amount of the outstanding debt, plus
  – (2) secured party’s reasonable expenses of collection/enforcement, including any attorney fees to which secured party is legally entitled under contract and applicable law [§ 9-623(b)]
Pre-Sale Notification

- Article 9 requires secured party to give notification prior to sale/disposition of collateral [§ 9-611(b)]
  - Debtor needs to know by what date he/she must act to redeem the collateral and protect his/her ownership
  - Other parties with an interest in the collateral (e.g., junior lienholders), whose interests could be wiped out, need notice to be able to act to protect their interests (e.g., by paying debt owed to foreclosing creditor or by buying at the foreclosure sale)

Pre-Sale Notification: Issues

- Who has to receive notification prior to secured party’s disposition of the collateral?
- What does the notice have to say?
- How much notice is required?
- What happens if the secured party fails to give notice?
- When, if ever, is the secured party excused from having to give notice?

Pre-Sale Notification: Problem 1

- Bank loaned Levin $120,000
  - Levin signed promissory note for $120K
  - Stoops signed guarantee of Levin’s debt, and
  - Uphoff granted a SI in his Aston Martin (to secure repayment by Levin)
- Levin defaults, Bank repossesses Uphoff’s car

- PCB gives notice to Uphoff as follows:
  - “On Thursday, Nov. 15, 2012, at 10:00 a.m. on the front steps of the Putnam County Courthouse, Putnam County Bank (Secured Party) will conduct a public auction sale of your 2005 Aston Martin Vantage Roadster (the “Collateral”). You are entitled to an accounting of the unpaid balance of the indebtedness secured by the Collateral, which you may obtain by calling Bubba Charles at Putnam County Bank, 260-258-2910.”
- Has PCB complied with its obligations under Article 9 in providing notice?
§ 9-611(b): Bank must give pre-sale notification to the following persons:
- Debtor (i.e., owner of car, § 9-102(a)(28)(A)); here, that is Uphoff [§ 9-611(c)(1)]
- Secondary obligor [§ 9-611(c)(2)]; here, that is Stoops, the guarantor [§ 9-102(a)(71)]
  - If Stoops has to pay off Bank, as a surety Stoops would be “subrogated” to Bank’s SI in the car (common law); Stoops is thus entitled to notice so he can protect his subrogation right

In addition, if the collateral is not “consumer goods,” secured party must also give pre-sale notification to:
- Any person that notified the secured party of its interest in the collateral [§ 9-611(c)(3)(A)], or
- Any person that has filed a UCC-1 covering the collateral [§ 9-611(c)(3)(B)]

Rationale?
- Any subordinate security interest or other subordinate lien will be extinguished by Article 9 disposition [§ 9-617(a)(3)]
- Thus, parties with subordinate interests need notice, prior to disposition, to protect their interests in the collateral (e.g., by paying off the senior secured party, or by bidding at the sale)

In Problem 1, if Uphoff uses the car as company car (“equipment”), Bank would also have to give notice to:
- Any creditors whose liens are noted on the title certificate for the car
- Any creditors that had requested that Bank provide notice prior to a foreclosure sale
- If the car is “consumer goods,” notice would only have to go to Uphoff (debtor) and Stoops (secondary obligor)

Note: Article 9 does not technically require Bank to give pre-sale notice to Levin (who is the “obligor,” but who is not the “debtor”)

Best practices: Bank should give notice to Levin anyway
- Because he is liable on the debt, Levin has an incentive to inform prospective buyers of the sale, as more bidders should produce a higher sale price (thus paying off more of Levin’s debt)
• Bank sent this notice to Uphoff:
  – “On Thursday, Nov. 15, 2012, at 10:00 a.m. on the
    front steps of the Putnam County Courthouse, Putnam
    County Bank (Secured Party) will conduct a public
    auction sale of your 2005 Aston Martin Vantage
    Roadster (the “Collateral”). You are entitled to an
    accounting of the unpaid balance of the indebtedness
    secured by the Collateral, which you may obtain by
    calling Bubba Charles at Putnam County Bank, 260-
    258-2910.”
• Is notice “compliant” with Article 9 requirements?

Content of Notice [§ 9-613(1)]
• Notification prior to sale is sufficient if it:
  – Identifies debtor and secured party
  – Identifies the collateral
  – States the method of intended disposition
  – States that debtor is entitled to an accounting of
    balance due (and charge, if any, for accounting)
  – States the time/place of a public sale, or the time
    after which a private sale will take place

In Consumer Goods Transaction:
• § 9-614(1): notice must contain all info
  required by § 9-613(1), plus the following:
  – Description of any liability recipient may have for
    a deficiency judgment [Missing in problem 1]
  – Phone number for payoff amount
  – Phone number and mailing address for further
    information regarding sale
• Problems: notice to Uphoff doesn’t meet § 9-
  614(1) content standards

Notice: Notice Period
• § 9-612(a): whether notice is sent w/in a
  reasonable time period is a question of fact
• § 9-612(b): “safe harbor” provision — notice sent
  10 or more days prior to sale is deemed sent w/in
  reasonable time in a nonconsumer transaction
  – Rationale: 10 days’ notice should be sufficient for
    debtor to protect its right to redeem (i.e., to find a
    refinancing loan, or to find a buyer)
“Consumer Transactions”

- If Levin incurred the debt for household purposes and Uphoff uses the car primarily for personal use, this is a “consumer transaction” [§ 9-102(a)(26)]
  - In some cases, Article 9 provides different rules for consumer transactions
  - E.g., “10 day” safe harbor in § 9-612(b) wouldn’t control in consumer transaction; thus, Bank might provide longer notice period (just to be safe)

Problem 3

- Neighborly Finance has a perfected SI in Bray’s Ferrari
- Bray is in default (debt = $120,000)
- Bank repossesses Ferrari, decides to sell it in a dealer auction run by Midwest Auto Auction
  - A “dealer auction” is an auction sale open only to dealers in goods of that kind (in this situation, cars)
  - Thus, a dealer auction is a “private sale” under Article 9, not a “public sale”

Remedy: Injunctive Relief

- § 9-625(a): if secured party is not complying w/ Article 9, court may “order or restrain … disposition of collateral on appropriate terms and conditions”
  - Thus, court might enjoin scheduled sale, and require Bank to schedule a new sale and give new/proper notice of that sale

When Notice Is Excused

- Pre-sale notice is excused [§ 9-611(d)] if:
  - Collateral is perishable,
  - Collateral threatens to decline speedily in value, or
  - Collateral is of a type customarily sold on a recognized market
- In Problem 3, can Neighborly Finance forgo giving notice to Bray because it is selling the car “on a recognized market”?

Problem 3

• No, a dealer auction is not a “recognized market”
  – In a “recognized market,” items are fungible and prices aren’t subject to negotiation (e.g., stocks, commodities) [§ 9-610 cmt. 9]
  – Cars aren’t fungible; their price is a function of their condition (“bluebook” is only an estimate of average value, not a trading price)
• Thus, NF must give pre-sale notice to Bray as required by § 9-611(c)

Problem 3

• Suppose Bray’s security agreement said: “Debtor agrees that in case of default, Secured Party need not give Debtor notice prior to sale of the collateral.”
  • Would this be enforceable?
    – No [§§ 9-602(7); 9-624(a)]; the debtor can only waive secured party’s obligation to provide pre-sale notice in an authenticated record, executed by the debtor after the debtor’s default.

§ 9-627. Determination of Whether Conduct Was Commercially Reasonable

(a) 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.

(b) A disposition of collateral is made in a commercially reasonable manner if the disposition is made: (1) in the usual manner on any recognized market; (2) at the price current in any recognized market at the time of disposition; or (3) otherwise in conformity with reasonable commercial practices among dealers in the type of property that was the subject of the disposition.

Problem 3

• After repossessing the Ferrari and giving proper notice of dealer auction sale, Neighborly Finance (NF) receives an offer from Bowman to buy Ferrari for $110,000
  • NF turns the offer down, saying: “Our policy is to sell collateral only in dealer auctions.”
  • Dealer auction brings $100,000 sale price
  • Was NF’s action “commercially reasonable”?
• NF’s manner of sale was commercially reasonable
  – Fact that NF had received a higher offer doesn’t, by itself, mean that NF acted in commercially unreasonable manner [§ 9-627(a)]
  – The secured party is not a “guarantor” of highest sale price for the collateral
  – If a dealer auction was consistent with “reasonable commercial practices among dealers” of cars [§ 9-627(b)(3)] — which it has been — then NF’s manner of sale was commercially reasonable

Problem 3: Counterargument

• NF might reasonably choose to sell in dealer auction, as matter of policy
• However, where NF has already received a third-party offer, NF’s auction sale should not be treated as “reasonable” unless NF establishes a “reserve price” for the auction = third-party bid received from Bowman

Sound Policy?

• Institutional lender could reasonably decide to sell its collateral via wholesale dealer auction (rather than making ad hoc judgments)
  – NF might reasonably conclude that evaluating 3rd party bids, on case-by-case basis, may not be justified based on cost-benefit analysis

Problem 3

• Suppose that the stereo and air conditioning were nonfunctional on Bray’s Ferrari
• Before foreclosure sale, should Neighborly Finance have a duty to fix them, or can it sell the car “as is”?
§ 9-610 is ambiguous
- § 9-610(a) appears to allow secured party to dispose of collateral “in its present condition”
- But, § 9-610(b) suggests that all aspects of secured party’s conduct must be reasonable
- Comments: the secured party can’t sell the collateral “as is” if that action would be commercially unreasonable “taking into account the costs and probable benefits” of repairing the collateral [§ 9-610 cmt. 4]

Is There a “Fix-Up” Duty?
- Problem: if repair will cost $4,000 (to put in a new stereo and fix the A/C), there’s no guarantee this will increase sale price of car by $4,000 or more
  - Any “unrecovered” costs of sale will either (a) increase obligor’s deficiency or (b) reduce debtor’s surplus
  - We don’t want secured party to incur costs that are unlikely to inure to the benefit of the debtor
- Contrast: if car was missing all 4 tires, creditor probably has duty to put tires on it before sale

Advertising
- Suppose Neighborly Finance sold the Ferrari by putting it in the Columbia Mall parking lot with a “FOR SALE” on it
  - Lambert then agrees to buy the car in a private sale for $100,000 (assume FMV of car is $115,000)
- Bray argues: “sale was unreasonable because you didn’t advertise the car in the newspaper.” Is Bray correct?
- Duty to conduct a “commercially reasonable” sale requires secured party to take reasonable steps to publicize availability of the collateral
  - § 9-610, cmt. 7: in a public sale, public must have “meaningful opportunity for competitive bidding,” which presumes “some form of advertisement”
- What steps are “reasonable” is not certain, and will vary depending on collateral
  - For “standard” collateral, minimal and mass-directed advertising may be sufficient
  - For “custom” or unique collateral, more target advertising may be required (Contrail Partners: secured party did not act reasonably when it sold a plane using only newspaper ads, rather than trade magazines)
§ 9-603. Agreement on Standards Concerning Rights and Duties.

(a) [Agreed standards.] The parties may determine by agreement the standards measuring the fulfillment of the rights of a debtor or obligor and the duties of a secured party under a rule stated in Section 9-602 if the standards are not manifestly unreasonable.

Contracting re: Reasonableness

• Ambiguities regarding secured party’s fix-up and advertising duties provide a good example of the potential benefit of § 9-603(a)
  – Example: Debtor and Secured Party can agree, in the security agreement, as to the nature/extent of advertising that secured party will do prior to foreclosure sale; that agreement will be enforced unless it is “manifestly unreasonable”

Problem 2

• Green (secured party) has a perfected SI in the accounts of Smith (debtor) to secure Smith’s obligation to pay Green’s legal fees
  – Smith is in default in payment of legal fees
• JCN owes Smith $30,000 for plumbing work
• Green says: I plan to contact JCN and tell them “pay me $20,000 and your obligation is satisfied.” Can Green do this? Should he?

• After default, secured party (Green) can:
  – Notify the account debtor (JCN) to make payment [§ 9-607(a)(1)], and
  – Exercise the rights of the debtor with respect to the obligation of the account debtor [§ 9-607(a)(3)]
  – This includes the right to “settle” or “compromise” claims (i.e., to accept less than full payment in satisfaction of the account)
• But, b/c Smith is personally liable on the debt to Green, Green must act in a “commercially reasonable manner” [§ 9-607(c)]
Problem 2

• Thus, if JCN’s obligation on the account is clear and JCN is creditworthy, Green’s compromise of the account would be commercially unreasonable (it would deprive Smith of the $10,000 of “equity” he had in the account)
• If so, Smith could proceed against Green for damages [§ 9-625(b)] for Green’s failure to comply with Art. 9

Order of Applying Sale Proceeds

• (1) Reasonable expenses of repossession and sale [§ 9-615(a)(1)]
• (2) Debt owed to the foreclosing secured party [§ 9-615(a)(2)]
• (3) Debt owed to certain subordinate lienholders, if any [§ 9-615(a)(3)]
• (4) Remaining surplus to debtor [§ 9-615(d)(1)]
• If proceeds aren’t sufficient to satisfy the debt, obligor is liable for a deficiency [§ 9-615(d)(2)]

Consequences of Secured Party’s Failure to Comply w/Article 9

• § 9-625(b): Secured party is liable for damages in the amount of any loss caused by its failure to comply with Article 9
• § 9-625(c)(2): If collateral is consumer goods, in any event debtor may recover “consumer penalty” = – Credit service charge + 10% of principal; or – Time-price differential + 10% of cash price

Deficiency Judgments

• Default rule: obligor is liable for deficiency following foreclosure sale [§ 9-615(d)]. But what if secured party violated Article 9?
• Pre-2000: some courts held that if secured party violated Article 9, secured party could not recover a deficiency judgment from the obligor (the “absolute bar” rule)
  – E.g., McKesson Corp. v. Colman’s Grant Village, 938 S.W.2d 631 (Mo. Ct. App. 1997)
  – Rationale: better incentive for creditor to conduct reasonable sale, would produce higher sale prices
Why Not Have “Absolute Bar” Rule?

- Too harsh (“commercial reasonableness” standard is ambiguous, requires exercise of judgment, is subject to 20/20 hindsight by court)
- Losing entire deficiency is often out of proportion to the actual damage caused by secured party’s failure
- Secured party may “overcorrect” (e.g., run too many advertisements) to protect its right to a deficiency judgment, to detriment of debtor

Deficiency Judgments and the “Rebuttable Presumption” Rule

- If secured party fails to comply w/Article 9, its deficiency = total debt MINUS the greater of:
  - the actual foreclosure sale price, or
  - the price that would have resulted if secured party had complied with Article 9 (§ 9-626(a)(3))
- Presumption: price at “reasonable” sale would’ve equaled the debt balance (no deficiency)
- But secured party can rebut (§ 9-626(a)(4))
  - If secured party proves FMV of collateral << balance of debt, it can recover deficiency judgment for the difference (rationale: even a commercially reasonable sale would’ve left a deficiency)

Consumer Goods [§ 9-626(b)]

- For noncompliant sales of consumer goods, the “rebuttable presumption” rule is not required
- Appropriate remedy is left to judicial resolution, and court can adopt “established approaches” [§ 9-626(b)]
- This would permit a court to apply the “absolute bar” rule, but would not require the court to do so (court could also apply the “rebuttable presumption” rule)

Problem 5

- Secured party repossesses a bulldozer and a crane from Debtor following default, sells them at public sale
  - Bulldozer sold to ABC Builders
  - Crane sold to Secured Party
- Secured party did not give notice to Debtor prior to sale as required by §§ 9-610, 9-611
- Can Debtor invalidate the sales?
Finality of Article 9 Foreclosures

- Sale after default transfers debtor’s title to buyer, extinguishes SI of the foreclosing secured party, and any subordinate liens [§ 9-617(a)]
- Foreclosure sale buyer takes free of these interests if it acted in “good faith,” even if secured party failed to comply with Article 9 [§ 9-617(b)]
  – Debtor’s remedy is only damages (including consumer penalty if collateral is consumer goods), but Debtor can’t set aside the sale or redeem the collateral from a good faith buyer
  – Policy: allowing “collateral attack” of foreclosure sales would discourage people from bidding to buy property at foreclosure sales (less certainty of title)

Problem 5

- If ABC Builders is a good faith buyer (likely), it took bulldozer free of Debtor’s redemption right, despite Secured Party’s failure to give notice
- Secured Party is unlikely to be treated as a “good faith” buyer of crane (secured party knew/should know it failed to give notice), so its claim of title to the crane remains subject to Debtor’s redemption right [§ 9-617(c)]

Problem 6

- 2010: Green loaned Sam Rubble $60K to finance his law studies, taking a SI in Barney Rubble’s Mercedes
- After Sam flunked, Green repossessed the car
  – Debt (w/interest) = $70K; car’s value <= $50K
- Can Green just keep the Mercedes in satisfaction of the debt?

Strict Foreclosure

- In early common law, foreclosure by a secured creditor was strict (forfeiture)
  – E.g., Secured creditor took “title” to property; if Debtor didn’t repay debt by “law day,” Creditor simply kept title in satisfaction of the debt
  – Concern: forfeiture is unjust, particularly in cases where the debtor had “equity” in the property (FMV > debt balance)
Article 9 Mandatory Disposition

- § 9-620(e): Secured party MUST sell the collateral after repossession if the collateral is consumer goods and:
  - SI is a PMSI on which obligor has repaid > 60% of purchase price, or
  - SI is a nonPMSI on which obligor has repaid > 60% of the debt
- Rationale: in this situation, Debtor is likely to have equity that should be protected by a sale
- Otherwise, nothing in Article 9 requires secured party to sell the collateral! [§ 9-610(a): after default, secured party “may” sell/dispose of collateral]

Article 9 Strict Foreclosure

- Green can propose to retain car in full satisfaction of the debt [§ 9-620(a)], since mandatory disposition rule will not apply on these facts (Sam has not repaid > 60% of the debt)
- If Barney accepts the proposal, or fails to respond w/in 20 days [§ 9-620(c)(2)], then
  - Green acquires Barney’s interest in collateral
  - Subordinate liens are extinguished [§ 9-622(a)], and
  - Secured obligation is fully satisfied
- If Green doesn’t make a “proposal,” title is still in Barney, who could still redeem the car [§ 9-623]

Problem 7

- Green sent Barney a strict foreclosure proposal (to retain title to Mercedes in full satisfaction of the debt), but Barney sent a written rejection of Green’s proposal
- Can Green continue to drive the car without selling it?

- Nothing requires Green to sell the car
  - § 9-610(a) provides that secured party “may” dispose of the collateral after default; § 9-620(f) mandatory disposition rule does not apply on these facts
- But, only a sale can cut off Barney’s right of redemption (i.e., Green is driving Barney’s car)
  - § 9-207(a) imposes duty of care on secured party
  - § 9-207(b)(4) allows secured party to use the collateral “for the purpose of preserving the collateral or its value” (not the case here)
  - Thus, if Barney later tried to redeem, court would likely apply “rental value” of the car toward the unpaid debt