

PART 5

**DEFAULT**

**Reporters' Introductory Note Draft**

This draft, which includes certain definitions in § 9-105, has been marked (additional material is underlined and deletions are indicated by ~~strikeout~~) to reflect changes to the February 8, 1994, draft (the February, 1994, Draft), which was considered by the Drafting Committee during its meeting on March 4-6, 1994. The changes were inspired, for the most part, by the Drafting Committee's deliberations. However, they reflect only our responses to those deliberations and do not necessarily reflect tentative positions taken by the Drafting Committee. We have not made any changes to provisions that affect real estate, e.g., draft §§ 9-501(d) and (e) and the bracketed sentence following draft § 9-502(3), pending discussions with persons having a particular interest in real estate.

**Reporters' Note to § 1-102**

This section did not appear in the prior draft. Accordingly, this section is marked to show changes from the current statutory text.

**§ 1-102. Purposes; Rules of Construction; Variation by Agreement.**

\* \* \*

(3) The effect of provisions of this Act may be varied by agreement, except as otherwise provided in this Act and except that the obligations of good faith, diligence, reasonableness and care prescribed by this Act may not be disclaimed by agreement but the parties may by agreement determine the standards by which the performance of such obligations is to be measured if such standards are not manifestly unreasonable. Notwithstanding the preceding sentence, the obligations of good faith, diligence, reasonableness and care prescribed by Part 5 of Article 9 may be disclaimed by agreement as provided in subsection (c) of Section 9-501.

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### Reporters' Explanatory Note

In accordance with the Drafting Committee's deliberations, draft § 9-501(c) provides that certain persons may waive rights generally enjoyed by borrowers and secondary obligors (sureties). These persons include sureties who have not themselves created a security interest in the collateral at issue. The change to § 1-102(3) would make clear that the liberal waiver provisions of Part 5 override the UCC's general prohibition against waivers of good faith, diligence, reasonableness, and care.

#### § 9-105. Definitions and Index of Definitions.

(1) In this Article unless the context otherwise requires:

(a) "Account debtor" means the person who is obligated on an account, chattel paper, instrument [, letter of credit] or general intangible;

\* \* \*

(cc) "Consumer obligor" means an obligor who is an individual and who incurred his or her obligation as part of a transaction entered into primarily for personal, family or household purposes;

(d) "Debtor" means a person who created a security interest in the collateral, whether or not the person [owes payment or performance of] [is obligated on] the obligation secured by the collateral. [The term includes

~~(i) the obligor, whether or not that person has rights in the collateral,~~

~~(ii) a person who has rights in the collateral and who has signed a security agreement covering the collateral or who otherwise has agreed to~~

~~create a security interest in the collateral,  
and~~

~~(iii) the seller of an accounts, chattel paper or  
general intangibles; a general intangible  
for money due or to become due.~~

~~If an obligor does not have rights in the collateral,  
the term "debtor" means the obligor in any provision  
dealing with the obligation, the debtor who has rights  
in the collateral in any provision of the Article  
dealing with the collateral, and may include both where  
the context so requires;~~

~~\* \* \*~~

~~(jj) "Obligor" means the person who owes payment or other  
performance of an obligation secured by a security  
interest and includes a guarantor or other surety for  
that obligation;~~

~~\* \* \*~~

~~(jj) "Obligor" means a person other than the debtor who,  
with the consent or acquiescence of the secured party:~~

~~(i) owes,~~

~~(ii) has provided property (other than the collateral)  
to secure, or~~

~~(iii) is otherwise [accountable] [liable] in whole or in  
part for~~

~~payment or other performance of an obligation secured  
by a security interest in the collateral;~~

~~\* \* \*~~

## Reporters' Explanatory Notes

1. The revision of the definition of "debtor" and the addition of the defined term "obligor" address concerns expressed at the two previous Drafting Committee meetings about how a broad construction of the term "debtor" may affect the secured party's duties under Part 5, especially the duty to send notification under § 9-504. Like the preceding draft, this draft distinguishes between the "debtor" and the "obligor." This draft redefines each of those terms in an effort to capture what we think is a significant difference between two classes of persons: (1) those persons who have created the security interest at issue and (2) those persons who may have a stake in the proper enforcement of the security interest but who have not created a security interest in the collateral. A member of the former class would be a "debtor" under the draft; a member of the latter would be an "obligor."

Some examples may be helpful:

Example 1: Mooney borrows money and grants a security interest in his Miata to secure the debt. Mooney is a "debtor"; he is not an "obligor." The definition of "obligor" ("a person other than the debtor") makes the categories mutually exclusive.

Example 2: Mooney borrows money and grants a security interest in his Miata to secure the debt. Harris co-signs the note. As before, Mooney is the "debtor"; Harris is an "obligor."

2. Although the "obligor" usually is a "secondary obligor" as defined in the draft Restatement of Suretyship (i.e., a surety), this is not always the case.

Example 3: Mooney borrows money on an unsecured basis. Harris co-signs the note and grants a security interest in his Taurus to secure his obligation. Inasmuch as Mooney did not grant a security interest, Mooney is not the "debtor." Having granted the security interest, Harris is the "debtor" and thus cannot, by definition, be an "obligor." Mooney "owes . . . or is otherwise [accountable] [liable] in whole or in part for payment or other performance of an obligation secured by a security interest in the collateral" (i.e., the Taurus); thus Mooney is an "obligor". Indeed, under the draft Restatement of Suretyship, Mooney would be the "principal obligor."

On occasion, the draft distinguishes between obligors who are secondary parties (e.g., Harris in Example 2) and those who are not (e.g., Mooney in Example 3). The draft uses the term "obligor who has a right of recourse against the debtor with respect to the obligation secured by the collateral" to describe the former.

3. When the principal obligor (borrower) and the secondary obligor (surety) each has granted a security interest in

different collateral, the status of each is determined by the collateral at issue.

Example 4: Mooney borrows money and grants a security interest in his Miata to secure the debt. Harris co-signs the note and grants a security interest in his Taurus to secure his obligation. When the secured party enforces the security interest in Mooney's Miata, Mooney is the "debtor" and Harris is an "obligor." When the secured party enforces the security interest in the Taurus, Harris is the "debtor" and Mooney is the "obligor."

4. Several issues may arise when the debtor disposes of its interest in the collateral subject to a security interest (e.g., when the debtor sells equipment-collateral without the secured party's authorization). The distinction between "debtor" and "obligor" turns on whether the person in question has created a security interest in the collateral. Thus, under the draft, a debtor who disposes of its interest in the collateral and no longer has a property interest in it remains a "debtor."

Under some circumstances, it may be appropriate to distinguish debtors who retain an interest (other than a security interest) in the collateral at the time of enforcement from those who do not. The draft refers to the former, more common type of debtor as a "debtor who has a property interest, other than a security interest, in the collateral." (If the Drafting Committee approves of the concept, later drafts might replace this phrase with a single defined term.) Sometimes a debtor may sell the collateral and retain a purchase money security interest to secure the price. The draft generally treats these debtors like other secured parties.

Some reported cases have adopted a broad reading of "debtor" in order to conclude that an unauthorized buyer who resells collateral receives "proceeds" under § 9-306(1). Under this draft, a court could not reach the intended result by using the revised definition of "debtor", inasmuch as the buyer did not grant a security interest in the collateral; however, the same result would obtain (i.e., what the buyer receives would be "proceeds") under draft § 9-306(b), which would delete the troublesome phrase "received by the debtor." A person who buys collateral subject to a security interest ordinarily would be excluded also from the category of "obligor" under this draft, because none of its property other than the collateral secures an obligation secured by a security interest in the collateral. If, however, the buyer assumes the secured obligation and the secured party consents to the assumption or acquiesces in it, then the buyer would be an "obligor." The Drafting Committee should consider whether this treatment is appropriate.

5. To be an "obligor," and thus to be entitled to the protections of Part 5, a person or its property must become obligated for the secured obligation "with the consent or

acquiescence of the secured party." The quoted phrase is designed to prevent the secured party from incurring duties to persons who are unknown to it.

6. The prior draft contained special provisions for individual non-debtor obligors in consumer transactions, such as co-makers of consumer notes. This draft labels those non-debtors "consumer obligors."

7. Article 9 includes most sales of accounts and chattel paper and applies to them the terms associated with secured debt (i.e., security interest, debtor, secured party, collateral). This "definitional shorthand" presents a number of problems, as the Octagon Gas case indicates. The Drafting Committee's deliberations to date indicate that revised Article 9 will continue to apply to sales of accounts and chattel paper, and that the Article's scope will be expanded to cover many sales of general intangibles for money due or to become due. However, the Drafting Committee has yet to consider whether to continue the current system of definitions. Pending a resolution of the issue, the part of the definition of "debtor" that includes the seller of accounts, chattel paper, or general intangibles appears in brackets. If the current approach is followed, some of the rules of Part 5 are likely to need adjustment. For one approach to these issues, see Plank, "Sacred Cows and Warhorses: The Sale of Accounts and Chattel Paper Under the U.C.C. and the Effects of Violating a Fundamental Drafting Principle," 26 Conn. L. Rev. 397 (1994).

8. We encourage the Drafting Committee to give serious thought to the following questions:

(1) Is the distinction between debtors and obligors conceptually sound?

(2) Is the distinction between debtors and obligors workable? For example, is the removal of certain primary obligors from the category of debtor acceptable?

(3) Have we used each term correctly in the following sections? Have we created special rules for secondary obligors, debtors having property interests, and consumer obligors in appropriate cases?

(4) What substantive rules should apply to a seller of accounts? Would it be appropriate generally to distinguish between (i) a seller against whom there is a right of recourse (whether enjoyed by the secured party directly or by an obligor against whom the secured party enjoys a right of recourse) and (ii) one against whom there is no right of recourse? See draft § 9-502(b). If so, would it be appropriate to treat the former like a "debtor who has a property interest, other than a security interest, in the collateral" (e.g., prohibit the seller from waiving a wide variety of rights)? Would it be appropriate to

treat the latter like an obligor (e.g., permit the seller to waive any and all rights to the extent provided by non-UCC law)? Or, in a true sale of intangibles, is the recourse available against the seller so insignificant as to warrant treating every seller as a debtor who does not have a property interest in the collateral?

If the Drafting Committee approves the approach of this draft in principle, we will continue to work with Neil Cohen to refine the concepts and the phrasing of the definitions and will, of course, conform the remainder of Article 9.

**§ 9-501. Default; Procedure When Security Agreement Covers Both Real and Personal Property.**

(a) Upon ~~When a debtor is in~~ default under a security agreement, a secured party has the rights and remedies provided in this Part and, except as limited by subsection (c), those provided in the security agreement. The secured party may reduce the claim to judgment, foreclose or otherwise enforce the claim or security interest by any available judicial procedure. If the collateral is documents, the secured party may proceed either as to the documents or as to the goods covered thereby. A secured party in possession has the rights, remedies and duties provided in Section 9-207. The rights and remedies referred to in this subsection are cumulative and may be exercised simultaneously.

(b) After default, the debtor and the obligor have ~~has~~ the rights and remedies provided in this Part, those provided in the security agreement and those provided in Section 9-207.

(c) To the extent that they give rights to the debtor or the obligor and impose duties on the secured party, the rules stated in the subsections referred to below may not be waived or varied by a debtor

~~(i) who has a property interest, other than a security interest, in the collateral or~~

~~(ii) who is an individual obligor in a transaction entered into primarily for personal, family or household purposes, including an uncompensated guarantor or other surety~~

~~by a consumer obligor except as specifically provided in this Part.; but the parties may by agreement determine the standards by which the fulfillment of these rights and duties (other than duties concerning taking possession of collateral without a breach of the peace under Section 9-503) is to be measured if such standards are not manifestly unreasonable:~~

- ~~(1) subsection (b) of Section 9-502, which deals with collection and enforcement of collateral;~~
- ~~(2) subsections ~~(a)~~, (d) and (e) of Section 9-504, which deal with disposition of collateral;~~
- ~~(3) Section 9-503 insofar as it imposes upon a secured party who takes possession of collateral without judicial process the duty to do so without breach of the peace;~~
- ~~(4) subsection (c) of Section 9-502 and subsection (b) of Section 9-504 insofar as they deal with application or payment of non-cash proceeds of collection, enforcement or disposition;~~
- ~~(5) subsections (c) and (d) of Section 9-502 and subsection (b) of Section 9-504 insofar as they require~~



accounting for or payment of surplus proceeds of collateral;

- (~~6~~4) ~~subsection (a) of~~ Section 9-505, which deals with acceptance of collateral in satisfaction of obligation;
- (~~7~~5) Section 9-506, which deals with redemption of collateral;
- (~~8~~6) subsections (a), (b), ~~and~~ (c) (1), (c) (2), ~~(3)~~ and (~~q~~7) of Section 9-507, which deal with the secured party's liability for failure to comply with this Part; and
- (~~9~~7) [any consumer-protection provisions.]

The rules may be waived or varied by any other debtor or obligor to the extent and in the manner provided by other law. ~~Any other debtor may waive or vary rights given to the debtor and duties imposed on the secured party in this Part in accordance with other law.~~ In any event, the parties may by agreement determine the standards by which the fulfillment of the debtor's or obligor's rights and the secured party's duties (other than duties concerning taking possession of collateral without a breach of the peace under Section 9-503) is to be measured if the standards are not manifestly unreasonable.

(d) If the security agreement covers both real and personal property, the secured party may proceed:

- (1) under this Part as to the personal property without prejudicing any rights and remedies in respect of the real property; or
- (2) as to both the real and the personal property in accordance with the rights and remedies in respect of

the real property, in which case the other provisions of this Part do not apply.

(e) If the security agreement covers goods that are or become fixtures, the secured party may, subject to subsection [(8)] of Section 9-313, proceed under this Part or in accordance with the rights and remedies in respect of real property, in which case the other provisions of this Part do not apply.

(f) When a secured party has reduced the claim to judgment, the lien of any levy which may be made upon the collateral by virtue of any execution based upon the judgment shall relate back to the date of the perfection of the security interest in such collateral. A judicial sale, pursuant to such execution, is a foreclosure of the security interest by judicial procedure within the meaning of this section, and the secured party may purchase at the sale and thereafter hold the collateral free of any other requirements of this Article.

#### **Reporters' Explanatory Notes**

1. For the most part, the draft follows existing § 9-501. The important changes are noted below.

2. The secured party's remedies arise "[u]pon default under a security agreement." This language is broad enough to include a default by the borrower as well as by a surety. It leaves what constitutes a default to the agreement of the parties. A number of questions concerning whether a default has occurred have been litigated in the Article 9 context. Chief among these is whether a secured party's post-default conduct can constitute a waiver of default in the face of a security agreement stating that such conduct shall not constitute a waiver. Although the cases are not consistent, we see no need for a special rule on this point. Thus the draft would continue to leave to non-UCC law the determination whether a default has occurred. See § 1-103.

Many security agreements afford the debtor a grace period within which to cure a default. A number of jurisdictions have afforded cure rights to certain classes of debtors, such as consumers. The Drafting Committee may wish to consider whether

Article 9 should attempt to impose uniformity or leave the issue to the agreement of the parties and non-UCC law. We are inclined toward the latter approach. However, in accordance with the Drafting Committee's instructions, in a later draft we intend to provide a menu of consumer-protection provisions for its consideration.

3. Although existing § 9-501(1) provides that the secured party's remedies are cumulative, some courts and commentators are of the opinion that the remedies may not be exercised simultaneously, lest the secured party harass the debtor. Others think that the obligation of good faith, the liability scheme of § 9-507, and non-UCC law (including the law of tort and statutes regulating collection of debts) protect debtors adequately. The last sentence of subsection (a) adopts the latter view. Under draft § 9-209 (contained as part of the proposed revisions dealing with deposit accounts), a depository institution that takes a security interest in a deposit account maintained with that institution would enjoy, in addition to the rights and remedies described in § 9-501, any right of set-off that otherwise would be available under other law.

4. Subsection (c), dealing with waivers, has been revised to indicate restrictions on the ability to waive or modify three additional duties: (i) the duty to collect collateral in a commercially reasonable manner (Section 9-502), (ii) the duty to apply non-cash proceeds of collection or disposition in a commercially reasonable manner (Sections 9-502 and 9-504), and (iii) the implicit duty to refrain from a breach of the peace in taking possession of collateral under § 9-503. Subsection (c) explicitly excludes the last duty from those as to which the parties may by agreement determine the standards applicable to compliance.

Subsection (c) provides generally that the specified rights and duties "may not be waived or varied." However, it is not intended to restrict the ability of parties to agree to settle or compromise claims for past conduct that may have constituted a violation or breach of those rights and duties, even if the settlement involves an express "waiver." The official comments should be revised to make this point clear. The comments also should explain that the only restrictions on waiver imposed in Part 5 relate to waivers by a debtor having a property interest (other than a security interest) in the collateral or by a consumer obligor. A waiver by any other party, such as a junior lien claimant or a debtor who has sold the collateral and retains only a security interest in it at the time of the waiver, would be governed by non-UCC law, notwithstanding the first sentence of § 1-102(3), which generally prohibits disclaimers of the "obligations of good faith, diligence, reasonableness and care prescribed by this Act." A secured party who, on the assumption that the debtor no longer has an interest in the collateral, accepts from the debtor a waiver of one of the rights specified in subsection (c) runs the risk that it is mistaken and that the

waiver is invalid. A secured party may eliminate this risk by proceeding as if the purported waiver was not received.

This draft of Part 5 affords secondary obligors (sureties) many of the same rights as principal obligors; (however, non-debtor sureties, i.e., those who did not create a security interest in the collateral, would not be entitled to recover any surplus under § 9-502 or 9-504). Cf. Recommendation 31.A (recommending that sureties be considered "debtors" entitled to notification for purposes of §§ 9-504 and 9-507 and expressing no opinion with respect to other sections). One of the most important issues on which the Study Committee was divided was the extent to which a surety's purported waiver of rights under Part 5 would be effective. Following the majority view expressed at the November, 1993, Drafting Committee meeting, the draft takes the "pro-waiver" position described in Section 31.C of the Report: A non-debtor obligor (including a surety), other than a consumer obligor, may waive all of its rights and all of the secured party's duties under Part 5 in accordance with other law. Subsection (c) provides an exception to the "pro-waiver" rule for obligors who are individuals and who incurred their obligation as part of a transaction entered into primarily for personal, family or household purposes.

The official comments should recognize explicitly that the waiver of rights or duties by a surety would not prejudice the rights of a principal debtor. For example, the principal debtor could assert its claims and defenses arising out of a secured party's noncompliance with Part 5 in an action brought by the surety based on either reimbursement or subrogation. See Restatement (3d) Suretyship, Tentative Draft No. 2, §§ 20(1)(c); 24(1)(a) (April 2, 1993).

The Study Committee did not address the question of waivers by principal obligors who did not grant security interests. This is the scenario presented by Example 3 in Explanatory Note 1 following draft § 9-105. Under existing Article 9, to the extent that the principal obligor is a "debtor," its right to waive the protections of Part 5 is limited. Under the draft, a principal obligor who did not supply collateral is an "obligor." Like secondary obligors who do not supply collateral (i.e., who are not "debtors" under the draft), a non-debtor principal obligor is free to waive any and all of its rights in accordance with other law.

5. Subsection (d) alters existing subsection (4) to make clear that a secured party who exercises rights under Part 5 does not prejudice any rights under real property law.

In a number of states, the exercise of remedies by a creditor who is secured by both real estate and non-real estate collateral is governed by special legal rules. For example, under some anti-deficiency laws, creditors risk loss of rights against personal property collateral if they err in enforcing

their rights against the real estate. Under a "one-form-of-action" rule (or rule against splitting a cause of action), a creditor who judicially enforces a real estate mortgage and does not proceed in the same action to enforce a security interest in personalty may (among other consequences) lose the right to proceed against the personalty. Obviously, statutes of this kind create impediments to Article 9 secured parties. Several approaches are available to the Drafting Committee, among them: (i) revise Article 9 to override any limitations contained in other law; (ii) continue to submit to other law.

6. Subsection (e) is new. It is intended to make clear that a security interest in fixtures may be enforced under any of the applicable provisions of Part 5, including sale or other disposition either before or after removal of the fixtures (see existing § 9-313(8)). The official comments should explain that subsection (e) also serves to overrule cases holding that a secured party's only remedy after default is the removal of the fixtures from the real estate. See, e.g., *Maplewood Bank & Trust vs. Sears, Roebuck & Co.*, 625 A.2d 537 (N.J. Super. Ct. App. Div. 1993).

#### **§ 9-502. Collection and Enforcement Rights of Secured Party.**

(a) When so agreed, and in any event on default, the secured party is entitled:

- (1) to notify an account debtor to make payment or otherwise render performance to or for the benefit of the secured party, whether or not the debtor theretofore was making collections on the collateral;
- (2) to take control of any proceeds to which the secured party is entitled under Section 9-306; and
- (3) to enforce the obligations of the account debtor, including by exercising the rights and remedies of the debtor in respect of (i) the account debtor's obligation to make payment or otherwise render performance to the debtor, (ii) any property that secures the account debtor's obligations, and (iii) any

guarantor or other surety for the account debtor's obligations.

[Prior to exercising under paragraph (3) the rights of the debtor to enforce nonjudicially any [mortgage/deed of trust] covering real property the secured party shall [file/record] in the office where the [mortgage/deed of trust] is [filed/recorded] (x) a copy of the security agreement that entitles that entitles the secured party to exercise those rights and (y) an affidavit signed by the secured party stating that a default has occurred and that the secured party is entitled to enforce nonjudicially the [mortgage/deed of trust].].

(b) A secured party who by agreement is entitled to charge back uncollected collateral or otherwise to full or limited recourse against the debtor or against an obligor who has a right of recourse against the debtor with respect to the obligation secured by the collateral and who undertakes to collect from or enforce the obligations of ~~the~~ account debtors must proceed in a commercially reasonable manner. The secured party may deduct from the collections the reasonable expenses of collection and enforcement, including the reasonable attorneys' fees and legal expenses incurred by the secured party. ~~realization.~~

(c) If the security agreement secures payment or performance of an obligation:

- (1) The secured party shall apply or pay over for application the cash proceeds (Section 9-306) of collection or enforcement under this Section in the order following to:

- (i) the reasonable expenses of collection and enforcement, including the reasonable attorneys' fees and legal expenses incurred by the secured party;
  - (ii) the satisfaction of obligations secured by the security interest under which the collection or enforcement is made;
  - (iii) the satisfaction of obligations secured by any subordinate security interest in or lien on the collateral subject to the security interest under which the collection or enforcement is made if the secured party receives a written notification of demand for proceeds before distribution of the proceeds is completed. If requested by the secured party, the holder of ~~such~~ a subordinate security interest or lien must furnish reasonable proof of the interest within a reasonable time, and unless the holder does so, the secured party need not comply with the demand.
- (2) The secured party shall apply or pay over for application the non-cash proceeds (Section 9-306) of collection and enforcement under this Section ~~disposition~~ in a commercially reasonable manner.
- (3) The secured party must account to and pay the debtor for any surplus notwithstanding any agreement to the contrary, and, unless otherwise agreed, the debtor and the obligor are ~~is~~ liable for any deficiency. Recovery

of any deficiency under this subsection is subject to the provisions of Section 9-507.

[(d) A secured party is not obligated to:

- (1) apply the proceeds of collection or enforcement to the satisfaction of obligations secured by any security interest or lien that is not subordinate to the security interest under which the collection or enforcement is made; or
- (2) account to or pay the holder of such a security interest or lien for any surplus.]

(e) If the underlying transaction was a sale of accounts, chattel paper or general intangibles, the debtor is entitled to any surplus, and the debtor or obligor ~~or~~ is liable for any deficiency, only if the security its agreement so provides. Recovery of any deficiency under this subsection is subject to the provisions of Section 9-507.

#### **Reporters' Explanatory Notes**

1. As a general matter Part 5 deals with the rights and duties of debtors and secured parties following default. However, this section applies to the collection and enforcement rights of secured parties whether or not a default has occurred. Although seemingly anomalous, it is not unusual for debtors to agree that secured parties are entitled to collect and enforce rights against account debtors prior to default.

2. The primary substantive changes to this section are: (1) explicit provision for the secured party's enforcement of the debtor's rights in respect of the account debtor's obligations and any security or suretyship obligations that support the account debtor's obligations; (2) explicit provision for the application of proceeds recovered by the secured party in substantially the same manner as provided in draft § 9-504(b) and (c) for dispositions of collateral; and (3) reference to the applicability of § 9-507 in the event of the secured party's failure to comply with the commercial reasonableness requirement.



3. The rights of the secured party against the account debtor under subsection (a) include the right to enforce claims that the debtor may enjoy against others. Such claims might include a breach of warranty claim arising out of a defect in equipment that is collateral or a secured party's action for an injunction against infringement of a patent that is collateral. Those claims typically would be proceeds of original collateral under draft § 9-306(1).

Paragraph (a) includes a new, bracketed sentence that would permit the secured party whose collateral consists of a mortgage note to proceed after the debtor's default with a nonjudicial foreclosure of the real estate mortgage securing the note. Exercise of this right is conditioned upon the secured party recording the security agreement and an affidavit certifying default in the applicable real estate records. Of course, the secured party's rights derive from those of its debtor. The bracketed paragraph would not entitle the secured party to proceed with a foreclosure unless the mortgagor is in default or the debtor (mortgagee) otherwise enjoyed the right to foreclose. The Drafting Committee should consider whether the bracketed sentence should be retained.

4. Subsection (b) provides that the secured party's collection and enforcement rights under subsection (a) must be exercised in a commercially reasonable manner, unless the underlying transaction is a sale of accounts, chattel paper or general intangibles for the payment of money and the secured party (buyer) has no right of recourse against the debtor (seller) or against an obligor who has recourse against the debtor. (The phrase "who has recourse against the debtor" is necessary to carve out the obligor who is the principal obligor and not a secondary obligor (surety)). The secured party's rights to collect and enforce include the right to settle and compromise claims against the account debtor, subject to the standard of commercial reasonableness. The secured party's failure to observe the standard of commercial reasonableness could render it liable to an aggrieved person under draft § 9-507(b) and the secured party's recovery of a deficiency also would be subject to draft § 9-507.

5. The phrase "reasonable attorneys' fees and legal expenses," which appears in subsections (b) and (c), includes only those fees and expenses incurred in proceeding against account debtors. The secured party's right to recover these expenses arises automatically under this section. The secured party also may incur attorneys' fees and legal expenses in proceeding against the debtor or obligor. Whether the secured party has a right to recover those fees and expenses depends on whether the debtor or obligor has agreed to pay them, as is the case with respect to attorneys' fees and legal expenses incurred in disposing of the collateral under draft § 9-504(b)(1)(i). The parties also may agree to allocate a portion of the secured

party's overhead to collection and enforcement under subsection (b) or (c).

6. Subsection (c)(2), which is new, addresses the situation in which an enforcing secured party receives non-cash proceeds, such as the account debtor's promissory note. The secured party may wish to credit the debtor with the principal amount of the note upon receipt of the note or may wish to credit the debtor only as and when the note is paid. Subsection (c)(2) permits the secured party to do whatever is commercially reasonable. The parties may provide for the method of application of non-cash proceeds in the security agreement, if the method is not manifestly unreasonable. See draft § 9-501(c). See also Explanatory Note 3 to draft § 9-504.

7. We have inserted brackets around subsection (d). That subsection, which would relieve a junior secured party from any responsibility to apply or pay over collections to senior claimants, derives from § 9-504(c). It generated substantial controversy during the March, 1994, meeting. We suggest that the Drafting Committee revisit the issue after addressing the broader issue of negotiability of cash proceeds. See draft § 9-308A.

#### **§ 9-503. Secured Party's Right to Take Possession After Default.**

Unless otherwise agreed a secured party has on default the right to take possession of the collateral. In taking possession a secured party may proceed without judicial process if this can be done without breach of the peace or may proceed by action. If the security agreement so provides the secured party may require the debtor to assemble the collateral and make it available to the secured party at a place to be designated by the secured party which is reasonably convenient to both parties. Without removal a secured party may render equipment unusable, and may dispose of collateral on the debtor's premises under Section 9-504.

#### **Reporters' Explanatory Note**

The draft is identical to existing § 9-503. The Study Committee did not recommend revision of § 9-503. The only significant issue raised in the case law concerns the meaning of

"breach of the peace." We recommend against any attempt to define the term.

**§ 9-504. Disposition of Collateral After Default.**

(a) A secured party after default may sell, lease, license or otherwise dispose of any or all of the collateral ~~in its then condition or following any commercially reasonable preparation or processing.~~ Unless effectively excluded or modified, a contract for sale, lease, license or other disposition includes the warranties related to title, possession, use and the like that normally accompany such a disposition of property of the kind subject to the contract.

(b) (1) The secured party shall apply or pay over for application the cash proceeds (Section 9-306) of disposition in the order following to:

- (i) the reasonable expenses of retaking, holding, preparing for disposition, disposing and, to the extent provided for in the agreement and not prohibited by law, the reasonable attorneys' fees and legal expenses incurred by the secured party;
- (ii) the satisfaction of obligations secured by the security interest under which the disposition is made;
- (iii) the satisfaction of obligations secured by any subordinate security interest in or lien on the collateral if the secured party receives a written notification of demand for proceeds before distribution of the proceeds is completed. If

requested by the secured party, the holder of such a security interest or lien must furnish reasonable proof of the interest within a reasonable time, and unless the holder does so, the secured party need not comply with the demand.

- (2) The secured party shall apply the non-cash proceeds (Section 9-306) of disposition in a commercially reasonable manner.
  - (3) If the security interest under which the disposition is made secures payment or performance of an obligation,
    - (i) the secured party must account to and pay the debtor for any surplus; and (ii) unless otherwise agreed, the debtor and obligor are ~~is~~ liable for any deficiency. But if the underlying transaction was a sale of accounts, chattel paper or general intangibles, the debtor is entitled to any surplus, and the debtor or obligor ~~or~~ is liable for any deficiency, only if the security ~~its~~ agreement so provides. Recovery of any deficiency under this subsection is subject to the provisions of Section 9-507.
- (c) A secured party is not obligated to:
- (1) apply the proceeds of disposition to the satisfaction of obligations secured by any security interest or lien that is not subordinate to the security interest under which the disposition is made; or
  - (2) account to or pay the holder of such a security interest or lien for any surplus.

(d) ~~Every 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 of collateral, including the method, manner, time, place and terms, must be commercially reasonable. If commercially reasonable, the secured party may dispose of collateral (i) by public or private proceedings, (ii) by one or more contracts, (iii) as a unit or in parcels, (iv) in its then condition or following preparation or processing, and (v) at any time and place and on any terms.~~ The secured party may buy at any public sale. The secured party may buy at a private sale only if the collateral is of a type customarily sold on ~~in~~ a recognized market or is of a type which is the subject of widely distributed standard price quotations.

(e) The secured party shall send to the debtor and an obligor who has a right of recourse against the debtor with respect to the obligation secured by the collateral reasonable written notification of the time and place of any public sale or reasonable written notification of the time after which any private sale or other intended disposition is to be made, unless collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market. In the case of consumer goods no other notification need be sent. In other cases the secured party shall send written notification ~~(i) to any other secured party or other~~ person from whom the secured party has received (before sending written notification

to the debtor and the obligor or before the debtor and the obligor waive debtor's waiver of the right to notification) written notification of a claim of an interest in the collateral. collateral, (ii) to any other secured party who, [20] days before (a) the secured party sent written notification to the debtor or (b) the debtor waived the right to notification, held a security interest in the collateral perfected by the filing of a financing statement that (x) identified the collateral, (y) was indexed under the debtor's name as of that date and (z) was filed in the proper office or offices in which to file a financing statement against the debtor covering the collateral as of that date (Sections 9-103 and 9-401), and (iii) to any other secured party who, [20] days before (a) the secured party sent written notification to the debtor or (b) the debtor waived the right to notification, held a security interest in the collateral perfected by compliance with a statute or treaty described in Section 9-302(3). A secured party has complied with the notification requirement specified in clause (ii) of the preceding sentence if (x) not later than thirty days before (a) the secured party sent notification to the debtor or (b) the debtor waived the right to notification, the secured party requested, in a commercially reasonable manner, information concerning financing statements indexed under the debtor's name in the in the office or offices indicated in clause (ii)(z) of the preceding sentence, and (y) before (a) the secured party sent written notification to the debtor or (b) the debtor waived the right to notification, either (I) the secured party did not

~~receive a response to the request for information or (II) the secured party received a response to the request for information and the secured party sent written notification to the secured parties, if any, named in that response and whose financing statements covered the collateral.~~

(f) A debtor who has a property interest, other than a security interest, in collateral or a consumer obligor ~~who is an individual obligor in a transaction entered into primarily for personal, family or household purposes~~ may waive the right to notification of its disposition (subsection (e)) only by signing a statement to that effect after default. In the case of [consumer goods], any such signed statement ~~by the debtor~~ is ineffective as a waiver unless the secured party proves by clear and convincing evidence that the signer understood and expressly agreed to its terms.

(g) Unless otherwise agreed, a notification of disposition ~~that is~~ sent after default and ten days or more before the earliest time of disposition set forth in the notification is ~~shall be deemed to have been~~ sent within a reasonable time prior to the disposition. Whether a notification ~~that is~~ sent less than ten days before the earliest time of disposition set forth in the notification nevertheless is sent within a reasonable time is a question of fact to be determined in each case.

(h) (1) Unless otherwise agreed, the contents of a notification of disposition are sufficient ~~reasonable~~ if the notification (i) reasonably identifies the debtor and the secured party, (ii) describes ~~indicates~~

the collateral that is the subject of the intended disposition, (iii) states the method ~~manner~~ of intended disposition and (iv) states the time and place of any public sale or the time after which any ~~private sale or~~ other ~~intended~~ disposition is to be made, whether or not the notification contains additional information.

(~~2~~3) Whether a notification that lacks any ~~some~~ of the information set forth in paragraph (1) ~~or that is not substantially in the form specified in paragraph (2)~~ nevertheless is sufficient ~~reasonable~~ is a question of fact to be determined in each case.

(3) No particular phrasing of the notification is required.

(~~4~~2) The following sample notification, when completed, would contain sufficient information: ~~Unless otherwise agreed, the form of a notification of disposition is reasonable if the form is substantially as follows.~~

### **Notification of Disposition**

Debtor: \_\_\_\_\_.

Secured party: \_\_\_\_\_.

Mailing address ~~Address~~ of secured party: \_\_\_\_\_.

Collateral that is the subject of the intended disposition:  
\_\_\_\_\_.



The collateral will be disposed of by ~~in~~ the following method: ~~manner:~~ [insert, as applicable: public ~~private~~ sale, private ~~public~~ sale, lease, license, etc.].

[For public sale, if applicable] The disposition will be made at the following time and place: \_\_\_\_\_.

[For disposition other than public sale, if applicable] The disposition will be made sometime after: \_\_\_\_\_.

[End of Sample Form]

(i) A secured party's disposition of collateral after default transfers to a transferee for value all of the debtor's rights in the collateral, ~~and~~ discharges the security interest under which the disposition is made and any security interest or lien subordinate thereto [other than liens created pursuant to] [here should be listed acts or statutes providing for liens, if any, that are not to be discharged], and terminates any other interest subordinate thereto. The transferee takes free of all such rights and interests even though the secured party fails to comply with the requirements of this Part or of any judicial proceedings:

- (1) in the case of a public sale, if the transferee (i) has no knowledge of any defects in the sale, (ii) does not buy in collusion with the secured party, other bidders or the person conducting the sale, and (iii) acts in good faith; or

(2) in any other case, if the transferee acts in good faith.

If the transferee does not take free of such rights and interests pursuant to clause (1) or (2) of this subsection, the transferee takes the collateral subject to the debtor's rights in the collateral and subject to any security interest under which the disposition is made and any security interest, ~~or lien,~~ or other interest subordinate thereto. Except as provided to the contrary in this subsection or elsewhere in this Article, the disposition does not discharge any security interest or lien.

**Reporters' Note to Subsection (j)**

Subsection (j) has been reorganized to limit its scope; however, it has not been blacklined.

(j) A person who is liable to the secured party under a guaranty, indorsement, repurchase agreement or the like and who:

- (i) receives an assignment of a secured obligation from a secured party; or
- (ii) receives a transfer of collateral from a secured party and agrees to accept the rights and assume the duties of the secured party; or
- (iii) is subrogated to the rights of a secured party

has thereafter the rights and the duties of the secured party. Such a subrogation, assignment, or transfer is not a disposition of collateral under this Article and does not relieve the secured party of its duties under this Article.

## Reporters' Explanatory Notes

1. Subsection (a) changes existing subsection (1) in three ways. First, it deletes as unnecessary a sentence indicating that a foreclosure sale of goods is subject to Article 2. The second change follows Recommendation 30.F. It affords the transferee at a foreclosure sale or other disposition under § 9-504 the benefit of any title-related, quiet possession-related, and similar warranties that would have accompanied the disposition had it been conducted under ordinary circumstances. Thus, the § 2-312 warranties of title and against infringement would apply to a sale of goods, the analogous warranties of § 2A-211 would apply to a lease of goods, and any common law warranties of title would apply to dispositions of other types of collateral. See, e.g., Restatement (2d) Contracts § 333.

The approach to these warranties taken in the draft conflicts with that of Comment 5 to § 2-312: "Subsection (2) [of § 2-312] recognizes that sales by . . . foreclosing lienors and person 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." If the Drafting Committee approves the approach taken in the draft, then § 2-312, or at least Comment 5 thereto, should be conformed. It is necessary to provide explicitly for warranties related to title, possession, and use because the draft would change existing law with regard to some of these warranties. However, the words "[u]nless effectively excluded or modified" used in subsection (1) are intended to defer to other law the regulation of disclaimers of those warranties. Whether other statutory or implied warranties apply to a disposition under this section also turns on non-Article 9 law. For example, a foreclosure sale of a car by a car dealer would give rise to a warranty of merchantability (§ 2-314) unless effectively disclaimed (§ 2-316). The official comment to this section should explain clearly the limited nature of the warranties that it addresses.

Subsection (1) of the current § 9-504 appears to give the secured party the choice of disposing of the collateral either "in its then condition or following any commercially reasonable preparation or processing." The third change reflected in subsection (a) addresses this issue. A majority of courts that have considered the issue have held that the "commercially reasonable" standard of § 9-504(3) nevertheless may impose an affirmative duty on the secured party to process or prepare the collateral prior to sale, and White and Summers agree. At the March, 1994, meeting, the Drafting Committee was almost equally divided over whether the secured party should be permitted to sell the collateral in its then condition even if to do so would be commercially unreasonable. The draft comes down on the side of commercial reasonableness. Subsection (a) omits reference to the question of "then condition" versus "preparation or

processing." A corresponding change to subsection (d), however, would make clear that a disposition in the "then condition" and a disposition after "preparation and processing" must in any event be commercially reasonable. As an alternative, the Drafting Committee may wish to clarify the issue in an official comment along the following lines: A secured party is not entitled to 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 its then condition.

2. Some have questioned whether a secured party holding a junior lien has the right to dispose of the collateral under this section. See Recommendation 30.G. We propose to address issues arising from the enforcement of a junior security interest in an official comment along the following lines:

Subsection (a) is not limited to first-priority security interests. Rather, any secured party as to whom there has been a default enjoys the right to dispose of collateral under this subsection. The exercise of this right by a secured party whose security interest is subordinate to that of another secured party does not of itself constitute a conversion or otherwise give rise to liability in favor of the holder of the senior security interest, and, as subsection (c) makes clear, the junior secured party owes no obligation to apply the proceeds of disposition to the satisfaction of the obligations secured by the senior security interest.

The senior's priority status affords the senior the right to take possession from the junior secured party and conduct its own disposition, provided that the senior enjoys the right to take possession of the collateral from the debtor. See § 9-503. Accordingly, a junior converts tangible collateral by refusing to relinquish possession upon the demand of a secured party having a superior possessory right thereto.

This Article protects a senior who does not prevent the junior from disposing of the collateral. Under subsection (i), the junior's disposition does not of itself discharge the senior's security interest; unless the senior secured party has authorized the disposition free and clear of its security interest, the senior's security interest ordinarily will continue under § 9-306(2). Thus, if the senior enjoys the right to repossess the collateral from the debtor, the senior likewise may recover the collateral from the transferee.

When a secured party's collateral is encumbered by another security interest or by a lien, one of the claimants may seek to invoke the equitable doctrine of marshaling. As explained by the Supreme Court, that doctrine "rests upon the principle that a creditor having two funds to satisfy his debt, may not by his application of them to his demand, defeat another creditor, who may resort to only one of the funds." Meyer v. United States, 375 U.S. 233, 236 (1963), quoting Sowell v. Federal Reserve Bank, 268 U.S. 449, 456-57 (1925). The purpose of the doctrine is "to prevent the arbitrary action of a senior lienor from destroying the rights of a junior lienor or a creditor having less security." Id. at 237. Because it is an equitable doctrine, marshaling "is applied only when it can be equitably fashioned as to all of the parties" having an interest in the property. Id. This Article leaves courts free to determine whether marshaling is appropriate in any given case. See § 1-103.

Note the negative pregnant in the first paragraph of the proposed comment: disposition coupled with some other facts may constitute a conversion. Should any disposition that has the practical effect of putting the collateral out of the senior's reach constitute a conversion? The Drafting Committee may wish to consider whether the comment should attempt to be even more protective of an enforcing junior secured party.

3. Subsection (b) contains the rules governing application of proceeds and the debtor's liability for deficiency. These rules previously were split between subsections (1) and (2). Subsection (b) provides a "safe harbor" for a secured party who complies with its terms. However, a secured party who does not comply with subsection (b) is liable only as provided in § 9-507. Subsection (c) makes explicit what one reasonably may infer from subsection (b).

Paragraph (2) of subsection (b) addresses the application of non-cash proceeds of a disposition, such as a note or lease. It leaves the application of non-cash proceeds to a standard of commercial reasonableness. We would expect that where non-cash proceeds are or may be material, the parties would agree to more specific standards in the security agreement or in an agreement entered into after default. One approach to applying non-cash proceeds would be to credit the debtor with their present value. In the case of a note or lease, for example, the valuation would take account of the aggregate payments, the time value of money, the creditworthiness of the maker or lessee, and the other terms of the transaction. Another approach would be to credit the debtor with installments of cash proceeds as they are received. We believe that a statutory formula for applying non-cash proceeds would impose unwanted complication and unnecessary rigidity and that the matter is best left to the standard of reasonableness as fleshed out in the parties' agreement.

In setting the debtor's liability for a deficiency following a disposition that complies with the requirements of Part 5, the draft follows the prevailing view under current law: the deficiency is measured by the amount of the secured obligation remaining unpaid after the proceeds of disposition have been applied in accordance with the statute. Any challenge to the claimed deficiency should be based on the alleged failure to conduct a commercially reasonable disposition.

We have revised paragraph (3) of subsection (b) to impose an explicit requirement on the secured party to "pay" the debtor for any surplus, while retaining the secured party's duty to "account." Inasmuch as the principal obligor may not be the debtor, paragraph (3) now provides that the debtor and obligor are liable for the deficiency. The special rule governing surplus and deficiency when intangibles have been sold likewise has been revised to take into account the new distinction between debtor and obligor.

When the debtor sells collateral subject to a security interest, the original debtor (grantor of the security interest) remains the "debtor" and would be entitled to receive any surplus. This would be the case even though, as between the debtor (seller of the collateral) and the buyer (new owner of the collateral), the buyer would be entitled to the surplus. However, the draft permits the secured party to pay the surplus to the party with whom it has dealt--the original debtor. Were the rule otherwise, the debtor could, by its wrongful act, impose upon the secured party the risk of determining ownership of the collateral at its peril. The Drafting Committee should consider whether a special rule facilitating payment to the new owner (e.g., a rule patterned after § 9-318(3)) would be appropriate.

4. Some questions have arisen concerning the obligation to apply proceeds when there are multiple security interests in the same collateral. Following Recommendations 30.C and 30.E, we propose to add an official comment along the following lines:

The secured party is under no obligation to distribute proceeds of disposition to persons other than those specified in subsection (b). Three examples help to clarify the application of this subsection.

Case 1: Assume that three secured parties (in order of priority, SP-1, SP-2, and SP-3) each claims a security interest in the collateral and that the debtor has defaulted on its obligations to each secured party. SP-1 disposes of the collateral under this Section. If SP-3 makes demand and receives payment from SP-1 under subsection (b)(iii) but SP-2 does not, then SP-2 would have no rights against SP-1 (or, for that matter, against the collateral). Any recovery against SP-3 is governed by the law of restitution.

Case 2: Suppose that in the previous example, SP-3 makes demand and receives payment from SP-1 under circumstances giving rise to an objection by the debtor. The circumstances might include the fact that SP-3's purported interest in the collateral is not enforceable (perhaps because the description in the security agreement is defective or the person who signed the security agreement was not the debtor) or the fact that the obligation owed to SP-3 is not yet due. Inasmuch as a secured party who makes a good-faith application of proceeds of disposition in accordance with subsection (b) should not be held liable to a person who did not receive a payment to which the person was entitled, the debtor should have no recovery from SP-1. Any recovery from SP-3 to which the debtor may be entitled is governed by the law of restitution.

Case 3: Under the assumptions in Case 1, SP-2 enforces its security interest. Both SP-1 and SP-3 send a notification of demand for proceeds in a timely manner. SP-2 would have no obligation to distribute proceeds to SP-1. If SP-2 did distribute proceeds to SP-1, then SP-3 would be entitled to recover from SP-2 to the extent provided under § 9-507 (noncompliance) and from SP-1 to the extent provided by the law governing restitution. Although SP-1 is not entitled to share in the proceeds of disposition, SP-1 is not without remedy: Its priority status entitles it to recover possession from SP-2 before the disposition occurs. If SP-2 succeeds in disposing of the collateral, the disposition ordinarily will not discharge SP-1's security interest (see § 9-306(1)), and SP-1 ordinarily will be able to enforce its security interest against the transferee from SP-2. Moreover, although SP-2 is not obliged to distribute proceeds to SP-1, pursuant to § 9-306(2) SP-1 nonetheless would retain its security interest in any identifiable proceeds that remained after satisfaction of the obligations owing to SP-2 and SP-3.

5. In assessing subsections (b) and (c) as they apply to cases of multiple security interests, the Drafting Committee may wish to give special consideration to cases in which two security interests enjoy the same priority. This situation may arise by contract (e.g., pursuant to "equal and ratable" provisions in indentures) or, perhaps, by operation of law. See Recommendation 14.H (concerning two PMSI's in the same collateral). At present, equal-priority problems arise with insufficient frequency to justify treating them in either the statute or the official comments. However, Revised Article 8 would establish a rule of equal priority for certain security interests in investment property, and draft § 9-312(z) proposes the same rule for certain security interests in deposit accounts. In addition, the Study

Committee recommended that § 9-312 be revised to provide that qualifying PMSI's in the same collateral be afforded equal priority. See Recommendation 14.H. Particularly if the Drafting Committee adopts these revisions to § 9-312, explicit treatment of equal-priority cases seems appropriate. The Study Committee acknowledged that "a rule of equal priority may create complications when one secured party tries to enforce its security interest." The following paragraphs attempt to bring these complications to light.

The draft treats a security interest having equal priority like a senior security interest. Assume, for example, that SP-X and SP-Y enjoy equal priority, SP-W is senior to them, and SP-Z is junior. If SP-X disposes of the collateral under this section, then (1) SP-W's and SP-Y's security interests survive the disposition but SP-Z's does not and (2) neither SP-W nor SP-Y is entitled to receive a distribution of proceeds but SP-Z is.

The analogy fails when one considers the ability to obtain possession of the collateral. As the senior secured party, SP-W would enjoy the right to possession as against SP-X. We would not give SP-Y such a right; otherwise, the dog would be chasing its tail: Once SP-Y took possession from SP-X, SP-X would have the right to get possession from SP-Y, who would be obligated to redeliver possession to SP-X, and so on. We would leave the resolution of this problem to the parties and, if necessary, the courts.

Some may conclude that this difference between seniors and equals suggests that equals should not be treated as seniors in other respects, as well. The current draft says to seniors: If junior repossesses, you have the right to take over the sale and claim the proceeds off the top. If you don't do it, you keep your security interest but you do not get to share in the proceeds of junior's disposition. To the extent that SP-Y can neither take over the sale from SP-X nor claim the proceeds off the top, SP-Y is more like SP-Z (a junior) than like SP-W (a senior). This argument proves only so much. Section 9-504 should not treat SP-Y like a junior in all respects; specifically, it should not provide that SP-X's disposition discharges SP-Y's security interest. But perhaps the section should provide that SP-Y should be entitled to claim a share of the proceeds of SP-X's disposition.

Because little interest was expressed during the November, 1993, Drafting Committee meeting for affording those holding equal-priority security interests the right to demand a distribution of proceeds, we have not changed the draft to include such a right.

6. The draft divides current subsection (4) into three new subsections: Subsection (d) deals with the method of disposition, subsection (e) deals with the notification requirement, and subsection (f) deals with waivers. Subsections



(g) and (h), which create "safe harbors" for the timeliness and contents of notification, are new.

A. Subsection (d) maintains two distinctions between "public" and other dispositions: (1) The secured party may buy at the former, but not at the latter and (2) the debtor is entitled to notification of "the time and place of any public sale" and notification of "the time after which" any private sale or other intended disposition is to be made. (The draft also maintains the third distinction, which concerns the rights of transferees pursuant to a noncomplying disposition. See subsection (i).) The existing statute does not define "public sale," but the comments seem to equate the term with a public auction. See § 9-504, comment 1; § 2-706, comment 4. We see no need to add a statutory definition. Rather, we would expand upon the comments to reflect our understanding of the concept: A public sale is one at which the price is determined after the public has had a meaningful opportunity for competitive bidding. "Meaningful opportunity" is meant to imply that some form of advertisement or public notice must precede the sale and that the public must have access to the sale.

The draft now states more directly the overarching principle that all aspects of a disposition must be commercially reasonable. The reference to dispositions of collateral in "its then condition or following . . . preparation or processing" in current § 9-504(1) has been moved to subsection (d). See Explanatory Note 1, above.

Some might read the phrase permitting disposition "as a unit or in parcels" to refer only to tangible collateral. However, the phrase should not be read as a limitation on the secured party's right to dispose of intangibles in any commercially reasonable manner. For example, subject to the requirement of commercial reasonableness, a secured party may comply with subsection (d) by selling one or more accounts to one buyer and other accounts to another buyer, while enforcing still other accounts under § 9-502.

Some lawyers who have foreclosed upon investment securities have expressed the concern that the "public sale" of their collateral pursuant to § 9-504 would implicate the registration requirements of the Securities Act of 1933, and that the "commercially reasonable" requirements of § 9-504 might prevent a secured party from conducting a foreclosure sale without first complying with federal registration requirements. To meet this concern in part, we would add to the comment a statement to the effect that a § 9-504 disposition that qualifies for deviations from the rules for "private placement" exemptions under the Securities Act of 1933 in connection with public advertising may constitute a "public sale" within the meaning of § 9-504. We also would add to the comment a reference to the common practice of including in security agreements covering unregistered stock a requirement that the debtor cause the stock to be registered

under the 1933 Act if requested by the secured party. The debtor's failure to comply with such a requirement should free the secured party (insofar as Article 9 is concerned) to dispose of the unregistered stock in an otherwise commercially reasonable manner. An agreement along these lines would be enforceable as a "standard[]" that is not "manifestly unreasonable" pursuant to draft § 9-501(c).

Official comment 2 to § 9-507 suggests that a disposition at wholesale is not per se commercially unreasonable: "One recognized method of disposing of repossessed collateral is for the secured party to sell the collateral to or through a dealer." Cases conflict, however, over whether disposition at wholesale is commercially reasonable when retail facilities are readily available. We would not address this issue and would leave courts free to resolve each case on its own facts.

Explanatory Note 7 to draft § 9-507 discusses the relationship between the requirement in draft 9-504(d) that "every aspect of the disposition, including the . . . terms, must be commercially reasonable" and the statement in draft § 9-507(d) that "[t]he fact that a greater amount could have been obtained by a . . . disposition 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 . . . disposition was made in a commercially reasonable manner."

B. Subsection (e) has been changed from the previous draft to take account of the new distinction between debtors and obligors. The duty to send notification runs not only to the debtor but also to an obligor who has recourse against the debtor. This resolves an uncertainty under existing law by providing that secondary obligors (sureties) will be entitled to receive notification of an intended disposition of collateral, regardless of who created the security interest in the collateral. If the surety created the security interest, it would be the debtor. If it did not, it would be an obligor. The draft also resolves the question of the secondary party's ability to waive the right to notification. See Explanatory Note 6C below. The definition of "obligor" ("with the consent or acquiescence of the secured party") is designed to eliminate the possibility that a secured party will be obligated to send notification to a secondary party of whom it is not aware.

Revised subsection (e) also may change existing law in two ways. First, the principal obligor (borrower) would not be entitled to notification of disposition in all cases. Suppose, as in Example 3 in Explanatory Note 1 following draft § 9-105, that Mooney borrows on an unsecured basis and Harris grants a security interest in his car to secure the debt. Mooney would be an obligor who does not have recourse against the debtor (Harris). As such, he would not be entitled to notification of disposition under the draft. Second, the owner of the collateral

would not be entitled to notification in all cases. For example, if the debtor sold the collateral subject to the security interest and the buyer did not assume the secured obligation with the consent or acquiescence of the secured party, then the new owner would not be a debtor or obligor and so would not be entitled to receive notification of disposition unless the new owner notified the secured party of its ownership interest. This result, whereby the secured party has no obligation to a person with a (potentially) secret interest in the collateral follows from the Drafting Committee's decision not to require the secured party to give notice to other secured parties of record.

The draft also makes some minor changes to the notification requirement as it appears in existing § 9-504. One of these is particularly worthy of note. Subsection (e) explicitly provides that notification of disposition must be "written." (We have used the defined term "written" for want of a better word. We assume that either we will be adjusting Article 9 generally to take into account the widespread use of fax machines, e-mail, and other substitutes for traditional writings, or Article 1 will be revised to deal with this issue.) In adding the word "written," the draft resolves a conflict in the reported cases.

Another conflict in the cases has arisen with regard to the meaning of the term "recognized market," as used in existing § 9-504(4). We would propose to address this issue in a comment explaining that a "recognized market" is one, like the New York Stock Exchange, in which the items sold are fungible and prices are not subject to individual negotiation. The comment might also specifically address the markets that have proven most troublesome: used automobiles and livestock (neither of which, in our view, qualifies).

Yet another conflict--one that the draft does not address--has arisen over whether the requirement of "reasonable notification" requires a "second try." That is, must a secured party who sends notification and learns that the debtor did not receive it attempt to locate the debtor and send another notification? The trend seems to be in favor of requiring a second try when a notification sent by certified mail is returned unclaimed. The draft would leave this issue to the courts.

The draft also would leave to the courts the resolution of all questions that might arise concerning a secured party who sends a notification and then decides not to proceed with the intended disposition. Nothing in the draft prevents a secured party from sending a revised notification if its plans for disposition change; provided, however, that the revised notification is reasonable and the revised plan for disposition and any attendant delay are commercially reasonable. We think a comment would be sufficient to address this question, the answer to which follows from the text of the statute.

Subsection (e) follows existing § 9-504(3) in providing that no notification need be given when the collateral is of a type customarily sold on a recognized market. We have heard two conflicting reactions to this rule. First, some have questioned the need for the rule. They believe that the only reason to dispense with notification is when the attendant delay would be likely to cause a reduction in the price obtained, e.g., when (as in subsection (e)) the collateral is perishable or threatens to decline speedily in value. The presence of a recognized market for the collateral is irrelevant to this concern. Another view is that the presence of a recognized market provides an independent check on the price received upon disposition, thereby eliminating the need to notify the debtor of an intended disposition. Under this view, notification probably also should be excused if the collateral is "of a type which is the subject of widely distributed standard price quotations." This phrase is found in subsection (d) as a circumstance under which the secured party may buy at a private sale. The Drafting Committee should consider whether any change to the notification requirement is warranted and, if so, what change would be appropriate.

C. The waiver rules in subsection (f) follow Recommendation 31.B. See also Reporters' Explanatory Note 4 to draft § 9-501 (dealing with waivers generally). In an effort at clarification, we have used the term "waive" instead of "renouncing or modifying," which appears in existing law. To see the operation of this subsection, consider the following examples:

Example 1: Corporation grants a security interest in its equipment to secure a \$5000 loan. President issues an unsecured guarantee of Corporation's debt. Corporation is the debtor, and President is the obligor. Under draft § 9-501(c), President is entitled to waive notification of disposition to the extent and in the manner prescribed by non-UCC law.

Example 2: Corporation owes \$5000 to creditor. The debt is secured only by equipment owned by Parent. Here, although Parent is a secondary obligor (surety), it is the debtor. Corporation, the principal obligor, is the obligor. As the obligor, Corporation is entitled to waive notification of disposition to the extent and in the manner prescribed by non-UCC law. See draft § 9-501(c). However, a purported waiver of notification by Parent would be effective only if in writing after default. See draft § 9-504(f). The draft makes no provision for waiving the rule prohibiting a secured party from buying at its own private sale. Transactions of this kind are equivalent to "strict foreclosures" and are provided for in § 9-505.

We have added further requirements for waivers in consumer transactions. First, the ability of a consumer obligor to waive the right to notification is restricted in the same manner as that of debtors. Second, the secured party bears the burden of proving that a purported waiver in a consumer case was understood and actually agreed to. (The brackets surrounding the phrase

"consumer goods" are meant to indicate that the Drafting Committee should determine precisely which consumer-related transactions should be governed by this rule. See the Attachment to Draft § 9-507.)

The Drafting Committee may wish to consider whether an official comment should address the relationship between the limitations on waiver in subsection (f) (as well as similar limitations in draft §§ 9-505(h) and 9-506(b)) and the non-UCC principles of estoppel. If so, what should the official comment say? For example, should a debtor who has actual knowledge of the information that a written notification would contain and who orally assures the secured party that no further notice is necessary be estopped from recovering damages on the basis of the secured party's failure to send written notification?

7. Subsection (g) is new and reflects Recommendation 32.A. The 10-day notice period is intended to be a "safe harbor" and not a minimum requirement. In order to qualify for the "safe harbor" the notification must be sent after default and must be sent in a commercially reasonable manner. Those requirements prevent a secured party from taking advantage of the "safe harbor" by, for example, giving the debtor a notification at the time of the original extension of credit or sending the notice by surface mail to a debtor overseas.

8. Subsection (h) is new and reflects Recommendation 32.B. To comply with the "reasonable written notification" requirement of subsection (e), the contents of a notification must be reasonable. The contents of a notification that includes the information set forth in subsection (h)(1) are sufficient as a matter of law, unless the parties agree otherwise. (The reference to "time" of disposition means here, as it does in existing § 9-504(3) and draft § 9-504(e), not only the hour of the day but also the date.) Although a secured party may choose to include additional information concerning the transaction or the debtor's rights and obligations, no additional information is required unless the parties agree otherwise. A notification that lacks some of the information set forth in paragraph (1) nevertheless may be sufficient if found to be so by the trier of fact. A properly completed sample form of notification in paragraph (4) is one example of a notification that would contain the information set forth in paragraph (1). No particular phrasing of the notification is required.

9. Subsection (i) derives from existing law. It expands the class of persons whose interests are discharged or terminated by a disposition to include not only junior security interests and liens but also all other junior interests. The newly added phrase, "or other interest," would include, for example, the ownership interest of a person who bought the collateral subject to the security interest. Under current law, such a person arguably would be a "debtor" whose rights the disposition would cut off. The subsection also adds a sentence intended to make

clear that the disposition does not discharge senior interests or interests of equal rank unless they would be discharged under other provisions of the UCC. The draft also changes "purchaser" to "transferee," inasmuch as a buyer at a foreclosure sale does not meet the definition of "purchaser" in § 1-201. Finally, the subsection sets forth not only the rights acquired by persons who qualify under (i)(1) or (2) but also the consequences for a transferee who does not qualify (e.g., a transferee with knowledge of defects in a public sale).

The draft adopts existing language in providing that a transferee for value acquires "all of the debtor's rights" in the collateral. This language may be too broad. For example, if the debtor owns collateral but creates a security interest in only half of its interest, the buyer at a § 9-504 disposition would acquire only a one-half interest. We are not aware of any problems that the quoted phrase has caused. The Drafting Committee may wish to consider whether the statute should be refined (e.g., by providing that a disposition transfers "the rights of the debtor in the collateral that are subject to the security interest").

The language "discharges the security interest under which the disposition is made" appears in existing § 9-504. It is intended to convey the notion that the transferee at foreclosure takes the collateral free of that security interest. The language is not intended to result in the discharge of any security interest in collateral that has not been disposed of, and, as far as we know, no one has ever advocated this misreading or viewed it as a non-trivial risk. But if the Drafting Committee desires, we can rewrite subsection (i) along the following lines:

A transferee for value takes free of (i) all the debtor's rights in the collateral, (ii) the security interest under which the disposition is made, and (iii) any other interests.

Inasmuch as the existing formulation seems to have worked quite well, we are inclined not to tamper with it. The draft provides for the termination, rather than discharge, of junior interests other than security interests or liens.

Secured parties may utilize the services of third persons to dispose of repossessed collateral. Assume that a secured party takes possession of goods collateral after default and entrusts the goods to a merchant, and further that the merchant then wrongfully sells the collateral to a buyer in ordinary course of business. That disposition would transfer to the buyer all of the secured party's rights and the rights that the secured party had the power to transfer (including those of the debtor). §§ 2-403(1); draft § 9-504(i). The sale would constitute a disposition under § 9-504 and as such would give rise to the

consequences specified in Part 5. The secured party would have a conversion claim against the merchant, and the debtor could assert its rights under Part 5 arising out the secured party's (probably) noncomplying disposition.

10. Subsection (j) is an effort to clarify existing subsection (5) along the lines suggested by Recommendation 33.A. The draft reflects the view that assignments of secured obligations and other transactions (regardless of form) that function like assignments of secured obligations are not dispositions to which this section applies. Rather, such transactions constitute assignments of rights and (occasionally) delegations of duties. Admittedly, application of the rule may require an investigation into the agreement of the parties, which may not be reflected in the words of the repurchase agreement (e.g., when the agreement requires a recourse party to "purchase the collateral" but contemplates that the purchaser will then conduct an Article 9 foreclosure sale). Subsection (j), like its predecessor, does not constitute a general and comprehensive rule for allocating rights and duties upon assignment of a secured obligation. Rather, it applies only in recourse situations. Whether the assignee of a secured obligation acquires the rights and duties of the secured party in other contexts is determined by other law.

The last clause follows general contract law to the effect that a party cannot discharge its duty merely by delegating it to another. The Drafting Committee may wish to consider whether the statute or comments should explain whether an assignment/delegation by the original assignee (e.g., SP assigns/delegates to A, who assigns/delegates to B) discharges the original assignee (A). We favor a comment to the effect that the ordinary rules governing delegation of duties, under which delegation does not relieve the party delegating from any duty to perform or liability for breach, would apply. The Report implies that the contrary rule might be appropriate when the subsequent assignee (B) in fact is the original secured party (SP). This scenario often arises in chattel paper financing, when the dealer (SP) assigns chattel paper to a financier (A) and then the dealer (SP/B) repurchases the paper. In support of a special rule governing repurchases, one might argue that the (account) debtor would not be prejudiced if the repurchase terminated the financier's (A's) obligation to perform the duties of a secured party. After all, the (account) debtor would become re-entitled to performance from the dealer (SP), the party with whom the debtor originally contracted. On the other hand, assignments of chattel paper may be so common that (account) debtors enter into the transactions with the expectation that the assignee will owe the duties of a secured party. If so, then the special rule would deprive debtors of their reasonable expectations. We are inclined to think that the need (if any) for a special rule is not so great as to justify the attendant complications.

**§ 9-505. Compulsory Disposition of Collateral; Acceptance of Collateral as Discharge of Obligation.**

**Reporters' Note to § 9-505**

As explained more fully in the Explanatory Notes below, draft § 9-505 has been almost entirely rewritten. Accordingly, the first eight subsections of the text are presented without any blacklining. Subsection (i) has been blacklined to show changes from the February, 1994, Draft. These changes were necessary to conform subsection (i) to the overall revision.

(a) In this Section, "proposal" means a written statement by a secured party containing the terms under which the secured party is willing to accept collateral in full or partial satisfaction of the obligation it secures.

(b) A secured party may accept collateral in full or partial satisfaction of the obligation it secures only if:

- (1) the debtor consents to the acceptance pursuant to subsection (c);
- (2) the secured party does not receive, within the time set forth in subsection (e), a written notification of objection to the proposal from a person to whom the secured party was required to send notification under subsection (f) or from any other person holding an interest in the collateral subordinate to the security interest that is the subject of the proposal; and
- (3) in the case of consumer goods, the collateral is in the possession of the secured party at the time the debtor consents to the acceptance.

A purported or apparent acceptance of collateral under this Section is ineffective unless the conditions of this paragraph (b) are met.



(c) For purposes of subsection (b) (1):

(1) the debtor consents to an acceptance of collateral in partial satisfaction of the obligation it secures only if the debtor agrees thereto in a signed writing after default; and

(2) the debtor consents to an acceptance of collateral in full satisfaction of the obligation it secures only if:

(i) the debtor agrees thereto in a signed writing after default; or

(ii) (x) the secured party sends written notification of a[n irrevocable] [unconditional] proposal to the debtor after default;

(y) in the proposal, the secured party proposes to accept collateral in full satisfaction of the obligation it secures; and

(z) the secured party does not receive a written notification of objection from the debtor within twenty-one days after the notification of the proposal is sent.

(d) In the case of [consumer goods], a writing signed by the debtor is ineffective as the debtor's agreement under subsection (c) (1) or (c) (2) (i) unless the secured party proves by clear and convincing evidence that the debtor understood and expressly agreed to its terms.

(e) To be effective under subsection (b) (2), a notification of objection must be received by the secured party:

- (1) in the case of a person to whom notification of the proposal has been sent pursuant to subsection (f), within twenty-one days after notification is sent to that person; and
- (2) in other cases, within twenty-one days after the last notification is sent pursuant to subsection (f) or, if no such notification is sent, before the debtor consents to the acceptance.

(f) Except in the case of [consumer goods], a secured party who wishes to accept collateral in full or partial satisfaction of the obligation it secures shall send written notification of its proposal to:

- (1) any person from whom the secured party has received, before the debtor consented to the acceptance, written notification of a claim of an interest in the collateral;
- (2) any other secured party or lien holder who, [20] days before the debtor consented to the acceptance, held a security interest in or lien on the collateral perfected [or evidenced] by the filing of a financing statement that (i) identified the collateral, (ii) was indexed under the debtor's name as of that date, and (iii) was filed in the proper office or offices in which to file a financing statement against the debtor covering the collateral as of that date (Sections 9-103 and 9-401); and

- (3) to any other secured party [or lien holder] who, [20] days before the debtor consented to the acceptance, held a security interest in [or lien on] the collateral perfected [or evidenced] by compliance with a statute or treaty described in Section 9-302(3).

In addition to sending notification to the persons specified in the preceding sentence, in all cases a secured party who wishes to accept collateral in partial satisfaction of the obligation it secures shall send written notification of its proposal to any obligor who has a right of recourse against the debtor with respect to the obligation secured by the collateral.

(g) 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 the debtor's rights in the collateral;
- (3) discharges the security interest that is the subject of the debtor's consent and any security interest or lien subordinate thereto; and
- (4) terminates any other interest subordinate thereto.

A subordinate interest is discharged or terminated regardless of whether the secured party is required to send, or does send, notification to the holder thereof; however, any person to whom the secured party was required to send, but did not send, notification has the remedy provided by subsection (b) of Section 9-507.

(h) A consumer obligor may waive the right to notification or the right to object to a proposal only by signing a statement to that effect after default. Any such signed statement is ineffective as a waiver unless the secured party proves by clear and convincing evidence that the signer understood and expressly agreed to its terms.

(i) If the debtor has paid [sixty] per cent of the [cash price] [obligation secured] in the case of a [purchase money] security interest in consumer goods [or [sixty] per cent of the loan in the case of another security interest in consumer goods], and has not consented to an acceptance, ~~waived the right to object to a proposed acceptance in full or partial satisfaction of the obligation (subsection (a))~~, a secured party who has taken possession of collateral must dispose of the collateral under Section 9-504 within [ninety] days after taking possession or within any extended period to which the debtor has agreed by signing a statement to that effect after default. Any such signed statement by the debtor is ineffective to extend the [ninety]-day period unless the secured party proves by clear and convincing evidence that the signer understood and expressly agreed to its terms.

#### **Reporters' Explanatory Notes**

1. With the exception of the special rule governing consumer transactions in subsection (i), this section has been entirely reorganized and rewritten. At the suggestion and with the guidance of Neil Cohen, we have "scrapp[ed] the awkward structure [we] inherited from existing Article 9 in favor of a more straightforward approach." The more straightforward approach we have adopted eliminates the fiction that the secured party always will present a "proposal" to which the debtor will have a fixed period to respond. By eliminating the need (but preserving the possibility) for proceeding in this fashion, we

have been able to eliminate much of the awkwardness of existing § 9-505. The succeeding Explanatory Notes contain a section-by-section analysis of the text. The remainder of this Note explains how the revised section is organized.

Subsection (b) sets forth the conditions necessary to an effective acceptance (formerly, retention) of collateral in full or partial satisfaction of the secured obligation. The first of these conditions is that the debtor must consent to the acceptance. Subsection (c) provides that this consent must be manifested either by the debtor's post-default, signed, written agreement to the acceptance or, in the case of an acceptance in full satisfaction, by the debtor's 21-day silence after receipt of a written "proposal" (as defined in subsection (a)). When the effectiveness of a consumer debtor's written consent is at issue, subsection (d) imposes a burden on the secured party to prove by clear and convincing evidence that the debtor understood and expressly agreed to the terms thereof.

The second condition necessary to an effective acceptance of collateral is the absence of a timely objection from a person who holds an interest subordinate to the security interest in question. Subsection (e) indicates when an objection is timely. The third condition applies only in the case of consumer goods: the secured party must be in possession of the collateral at the time of the debtor's consent (whether by signed writing or by silence). If any of these three conditions is not met, any purported or apparent acceptance in satisfaction is ineffective under this section.

In addition to the conditions described above, subsection (f) requires that a secured party who wishes to proceed under this section notify certain other persons who have or who claim an interest in the collateral. Unlike the failure to meet the conditions in subsection (b), failure to comply with the notification requirement of subsection (f) does not render the acceptance of collateral ineffective. Rather, the acceptance can take effect notwithstanding the secured party's noncompliance. Subsection (g) indicates that a person to whom the required notice was not sent has the right to recover damages under draft § 9-507(b).

Subsections (h) and (i) deal with consumer transactions. The former requires the secured party to prove that a consumer obligor understood and expressly agreed to a waive its right to notification of a proposal or its right to object. The latter requires the secured party to dispose of collateral under certain circumstances. These consumer-related provisions, like the others in this draft, will be discussed separately after a comprehensive review.

2. Subsection (a) is new. It defines the term "proposal." Under this draft, a "proposal" is necessary only if the debtor does not agree to an acceptance in a signed writing as described

in subsection (c)(1) or if notification must be sent to third parties under subsection (f). A proposal under subsection (a) need not take any particular form as long as it sets forth the terms under which the secured party is willing to accept collateral in satisfaction. A proposal to accept collateral should specify the amount (or a means of calculating the amount, such as by including a per diem accrual figure) of the secured obligations to be satisfied. At the March, 1994, meeting, the Drafting Committee discussed whether a secured party should be permitted to send a proposal that is revocable or whose effectiveness is conditional. Explanatory Note 3 below discusses this issue.

3. Subsection (b) contains the conditions necessary to the effectiveness of an acceptance of collateral. One way to satisfy subsection (b)(1) is for the debtor to agree to the acceptance in writing after default. See subsection (c)(1). Subject, perhaps, to a special rule in consumer transactions, we see no need to limit the types of proposals (e.g., conditional, revocable) to which the debtor can agree. Subsection (d) contains a special rule governing consent obtained in the case of consumer goods. This subsection derives from the February, 1994, Draft. Subsection (c)(2) contains an alternative method by which to satisfy the debtor's-consent condition in subsection (b)(1). It follows the proposal-and-objection model found in existing § 9-505. Under it, the debtor consents if the secured party sends a proposal to the debtor and does not receive an objection within 21 days. In accordance with the wishes of the majority at the March, 1994, meeting, subsection (c)(2) provides that silence is not deemed to be consent with respect to acceptances in partial satisfaction. Thus, a secured party who wishes to conduct a "partial strict foreclosure" must obtain the debtor's written agreement. In all other respects, the conditions necessary to an effective partial strict foreclosure are the same as those governing acceptance of collateral in full satisfaction. But cf. § 9-505(f), dealing with notification. The bracketed language in subsection (c)(2)(ii) recognizes the lack of consensus in the Drafting Committee over whether the debtor's failure to respond to a proposal should bind the debtor to a proposal to which, in effect, the secured party has not bound itself.

Subsection (b)(2) contains the second condition to the effectiveness of an acceptance under draft § 9-505: the absence of an objection from a person holding a junior interest in the collateral or from an obligor having a right of recourse against the debtor. Any junior party--secured party, lien holder, or non-debtor owner (such as a buyer who took subject to the security interest) is entitled to lodge an objection to a proposal, even if that person was not entitled to notification under subsection (f). Subsection (e), discussed in the following Explanatory Note, indicates when an objection is timely.

The draft does not impose any formalities or identify any steps that a secured party must take in order to accept

collateral once the conditions of section (b) have been met. Absent facts or circumstances indicating a contrary intention, the fact that the conditions have been met should provide a sufficient indication that the secured party has accepted the collateral on the terms to which the debtor has agreed or failed to object. As a matter of good business practice, an enforcing secured party may wish to memorialize its acceptance, such as by notifying the debtor that the strict foreclosure is effective or by placing a written record to that effect in its files. The Drafting Committee may wish to consider, however, whether the statute should state expressly (i) that the secured party is bound by its agreement to accept collateral and by any proposal to which the debtor consents and (ii) that acceptance of the collateral is automatic upon the secured party becoming bound and the time for objection passing (i.e., that the secured party's agreement to accept collateral is self-executing and cannot be breached).

Like the prior draft, this draft eliminates the requirement that the secured party be "in possession" for all collateral other than consumer goods. The possession requirement for consumer goods is retained in subsection (b) (3).

The text following paragraph (b) (3) is intended to make clear that a delay in collection of disposition of collateral does not constitute a "constructive" strict foreclosure. Instead, a delay that is unreasonable may be a factor relating to whether the secured party acted in a commercially reasonable manner for purposes of § 9-504. The official comments also should explain that a debtor's voluntary surrender of collateral to a secured party and the secured party's acceptance of possession of the collateral raises no implication whatsoever that the secured party intends or is proposing to accept the collateral in satisfaction of the secured obligation pursuant to this section.

Although not phrased as such, subsections (b) (1), (b) (3), and (c) afford rights to the debtor, i.e., the right not to lose its interest in the collateral in satisfaction of the secured obligation unless certain conditions are met. Thus, notwithstanding the failure of one or more of those conditions, an acceptance of collateral can be effective if the debtor waives its rights under this section. As draft § 9-501(c) indicates, only a debtor who lacks a property interest in the collateral at the relevant time (or whose only interest is a security interest) may waive its rights under this section. Other debtors (e.g., those who own the collateral) may not waive their rights.

4. Subsection (e) explains when an objection is timely and thus prevents an acceptance of collateral from taking effect. An objection by a person to whom notification was sent pursuant to subsection (f) must be received by the secured party within 21 days from the date the notification was sent to that person. Other objecting parties (i.e., third parties who are not entitled

to notification) may object at any time within 21 days after the last notification is sent under subsection (f). If no such notification is sent, third parties must object before the debtor agrees to the acceptance in writing or is deemed to have consented by silence. The former may occur any time after default, and the latter requires a 21-day waiting period. See subsection (c). The Drafting Committee may wish to consider alternative cut-off rules. For example, the statute might provide that those to whom notification is sent have the same time to object as other third parties--i.e., the time set forth in draft subsection (e) (2). Or the Drafting Committee might prefer to permit a person to whom notification has been sent to object within 21 days or before the debtor consents, whichever is later.

5. The Drafting Committee did not reach a clear consensus on the notification requirements at its March, 1994, meeting. Accordingly, this draft retains the requirements of February, 1994, Draft; however, they have been revised to conform with the restructuring of the entire section. Like the prior draft, this draft adds to existing § 9-505 three classes of competing claimants to which the secured party must send notification: (i) holders of security interests, liens, and other interests who notify the secured party, (ii) holders of certain security interests and liens who have filed against the debtor, and (iii) holders of certain security interests and liens who have perfected by compliance with a certificate of title statute. The Study Committee recommended that the Drafting Committee add the former class and give serious consideration to adding the second group. See Recommendation 34.B. Addition of the third class poses little additional burden on the secured party. The liens referred to in subsection (e) (2) are those as to which applicable non-UCC law permits or requires notice to be filed in the UCC records. The draft uses the term "perfected" to apply to those liens as well as to security interests. Although one might quibble about whether a judicial lien is "perfected" by filing a "financing statement" or by notation, we think the meaning of the draft is clear and that any attempt to articulate more fully the concept of a "perfected" lien in the statute would be counterproductive. Moreover, in states where judicial liens are filed in the UCC records, it might be necessary in any event for the legislatures to conform subsection (2) to the applicable non-UCC statutes.

We favor requiring a secured party to search for and notify secured parties and lien holders whose properly-indexed filings against the debtor are of record in the appropriate public office as of a certain date. We encourage the Drafting Committee to consider expanding the notification requirement to include all secured parties and lien holders of record. All subordinate interests in the collateral will be discharged under subsection (g) if the collateral is accepted in full or partial satisfaction of the debtor's obligation. The collateral value may well exceed the amount owed to the enforcing secured party. Unless holders



of competing claims are afforded an opportunity to object to the foreclosure, an ill-advised or neglectful debtor may deprive these creditors of recourse to valuable collateral and instead impose upon them the burden of proving loss under § 9-507.

This draft adds an additional notification requirement to those found in the February, 1994, Draft. In the case of an acceptance of collateral in partial satisfaction, the secured party must send notification to any obligor having a right of recourse against the debtor. Sureties and other secondary parties who would be subrogated to the secured party's rights in the collateral have an interest in the amount of the debt discharged. Accordingly, they should be entitled to receive notification of a proposed acceptance of collateral. The requirement does not extend to strict foreclosures in full satisfaction, inasmuch as the entire secured obligation would be discharged, thereby discharging the surety. The requirement also does not extend to obligors other than those having recourse against the debtor. Thus, a principal obligor would not be entitled to notification of a proposed acceptance in partial satisfaction of collateral provided by a surety.

Where the debtor sells the collateral subject to the security interest, the buyer ordinarily would not be either a debtor or an obligor and so would not be entitled to notification under this section. See draft § 9-105 and Explanatory Note 4 thereto. This approach takes account of the fact that the secured party may have no way of knowing about the buyer. However, the buyer would have an interest in the collateral that is subordinate to the security interest and so would have the right to prevent the acceptance by notifying the secured party of its objection. See subsection (b)(2). Any acceptance in satisfaction would terminate the buyer's ownership interest. The draft permits the former owner (the debtor) to block an effective retention on the theory that in many cases disposition of the collateral will subject the former owner to liability to the new owner under a warranty of title. We realize that the draft might be refined to take account more precisely of the varying interests and circumstances, but we believe that simplicity is the prevailing virtue here.

6. Subsection (g)(1) is new. It expresses in the statute what we believe to be the fundamental consequence accepting collateral in full or partial satisfaction of the secured obligation--the obligation is discharged. Subsections (g)(2) though (4) indicate the effects of an acceptance on various property rights and interests. Subsection (g)(2) follows draft § 9-504(i) in providing that the secured party acquires "all the debtor's rights in the collateral." This language may be overbroad. See Explanatory Note 9 to § 9-504. Subsection (g)(3) reflects Recommendation 34.D concerning the effect of strict foreclosure on holders of junior security interests and liens. The effect is the same regardless of whether the collateral is accepted in full or partial satisfaction of the secured

obligation: all junior encumbrances are discharged, regardless of whether notice was required or, if required, sent. Subsection (g)(4) provides for the termination of other subordinate interests, such as the ownership interest of a person who bought the collateral from the debtor.

7. The Drafting Committee should continue to consider whether the twenty- and twenty-one-day periods specified in subsections (c) and (e) are appropriate.

8. This section does not purport to regulate all aspects of the transaction by which a secured party may become the owner of collateral previously owned by the debtor. For example, a secured party's acceptance of a motor vehicle in satisfaction of secured obligations may require compliance with the applicable motor vehicle certificate of title law. (In that connection, the official comments should urge the legislatures to conform those laws so that they mesh well with this section and § 9-504 and should urge judges to construe those laws and this section harmoniously.) A secured party's acceptance of collateral in the possession of the debtor may implicate statutes dealing with a seller's retention of possession of goods sold. See, e.g., Cal. Civ. Code § 3440.1 - .9.

9. If the collateral is accounts, chattel paper, or general intangibles, then a secured party's acceptance of the collateral in satisfaction of secured obligations would constitute a sale to the secured party. That sale would give rise to a new security interest (the ownership interest) under current §§ 1-201(37) and 9-102. The new security interest would remain perfected by a filing that was effective to perfect the secured party's original security interest. However, the official comments to § 9-203 and this section should explain that the procedures for acceptance of collateral under this section satisfy all necessary formalities and that a new security agreement signed by the debtor would not be necessary.

10. The principal consumer issue under § 9-505 is whether the general rules facilitating acceptance of collateral in satisfaction of secured obligations should be limited in a defined class of cases. (As to possible definitions of the class, see the Attachment to § 9-507.) Among the possible limitations are the following: (1) prohibit strict foreclosures altogether (i.e., require a disposition of collateral); (2) permit all strict foreclosures only when the debtor has agreed thereto in writing; (3) if the possession requirement generally is eliminated, retain the possession requirement; (4) impose a fixed period during which the secured party must dispose of the collateral unless the debtor agrees otherwise in writing after default (see existing § 9-505(1)).

This draft does not adopt the first alternative. It adopts the second alternative for acceptance of all types of collateral in partial satisfaction, see draft § 9-505(c)(1), and contains a

provision (subsection (h)) to insure that waivers by consumer obligors of the right to object to a proposal for acceptance in full satisfaction are knowing and voluntary. The draft also opts for the third alternative (concerning the possession requirement for consumer goods, see Explanatory Note 1) and the fourth. Subsection (i) continues a mandatory-disposition requirement, derived from current § 9-505(1). As with consents (see subsection (d)), protections have been added to ensure that extensions of the period of time for effecting a disposition are knowing and voluntary on the part of the consumer debtor.

If the Drafting Committee adopts the general approach of subsection (i), it also should consider how the affected class should be defined. Should it, for example, be limited to situations where the debtor has paid a specified portion of the secured obligations (e.g., sixty per cent, in current § 9-505(1))? The Drafting Committee also might wish to consider whether ninety days (also drawn from current § 9-505(1)) is an appropriate period within which to dispose of the collateral and whether any special rule is needed to deal with the case of a single loan secured by consumer goods and other collateral.

This draft does not employ the technique of a "constructive strict foreclosure" in order to deny the secured party a deficiency claim in the case of unreasonable delay. However, the secured party's noncompliance with § 9-504 or its failure to dispose of the collateral within the period specified in subsection (i) would give rise to a loss of deficiency under § 9-507 (assuming that the transaction would qualify for the special "consumer" exception in that section).

#### **§ 9-506. Debtor's Right to Redeem Collateral.**

(a) At any time before the secured party has collected collateral under Section 9-502, disposed of collateral or entered into a contract for its disposition under Section 9-504 or accepted collateral in full or partial satisfaction of the obligation it secures under Section 9-505, the debtor, any obligor who has a right of recourse against the debtor with respect to the obligation secured by the collateral, or any other secured party or lien holder, or any other person having an interest in the collateral may redeem the collateral by tendering fulfillment of all obligations secured by the collateral as well

as the reasonable expenses incurred by the secured party in collecting the collateral, 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, the reasonable attorneys' fees and legal expenses incurred by the secured party.

(b) A debtor who has a property interest, other than a security interest, in the collateral or a consumer obligor ~~who is an individual obligor in a transaction entered into primarily for personal, family or household purposes~~ may waive the right to redeem the collateral (paragraph (a)) only by signing a statement to that effect after default. In the case of [consumer goods], any such signed statement ~~by the debtor~~ is ineffective as a waiver unless the secured party proves by clear and convincing evidence that the signer understood and expressly agreed to its terms.

### **Reporters' Explanatory Notes**

1. The draft follows existing § 9-506 with a few changes, most of which are not substantive. In accordance with Recommendation 35, the draft extends the right of redemption to holders of nonconsensual liens. Subsection (b) sets forth the rules governing waiver in a separate paragraph.

2. The rules governing redemption of collateral are surprisingly sparse. For example, the statute is silent concerning the effect of redemption by a competing secured party, whether successive redemptions are possible, what happens if more than one person seeks to redeem, etc. We are unaware of any practical problems that have arisen under this section and so suggest that the Drafting Committee let sleeping dogs lie.

**§ 9-507. Secured Party's Failure to Comply With This Part.**

(a) If it is established that the secured party is not proceeding in accordance with the provisions of this Part, collection, enforcement or disposition of collateral may be ordered or restrained on appropriate terms and conditions.

(b) The secured party is liable for damages in the amount of any loss caused by a failure to comply with the provisions of this Part. The debtor, any obligor who has a right of recourse against the debtor with respect to the obligation secured by the collateral, or any person who, at the time of the failure, held an interest in ~~a security interest in or lien on~~ the collateral has a right to recover under this subsection; however, a debtor or obligor whose deficiency is eliminated or reduced pursuant to subsection (c) (2) (i) or (ii) ~~or who is entitled to a recovery under subsection (c) (2) (iii)~~ may not recover damages under this subsection.

[(bb) (1) This subsection applies only in the case of a  
[INSERT--see Attachment].

(2) The debtor has a right to recover from a secured party who fails to comply with the provisions of this Part an amount equal to [the credit service charge plus ten per cent of the principal amount of the debt or the time price differential plus 10 per cent of the cash price] less the amount of any damages recoverable under subsection (b). The recovery of a debtor whose deficiency is eliminated or reduced pursuant to subsection (c) (2) (i) or (ii) ~~or who is entitled to a~~

~~recovery under subsection (c)(2)(iii) shall be limited to the amount by which the amount otherwise recoverable under this paragraph exceeds the amount of the personal liability that is eliminated or reduced under subsection (c)(2)(i) or (ii). or the amount of the recovery under subsection (c)(2)(iii), as the case may be.~~

- (3) The secured party has the burden of establishing the amount of any limitation on the debtor's recovery under subsection (2).]

(c) This subsection applies to actions in which the amount of a deficiency or surplus is in issue.

- (1) The secured party need not establish compliance with the provisions of this Part unless the debtor or obligor places the secured party's compliance in issue, in which case the secured party has the burden of establishing that the collection, enforcement or disposition was conducted in accordance with the provisions of this Part. ~~Unless the secured party pleads compliance with the provisions of this Part or the issue of the secured party's compliance is actually litigated, any judgment for a deficiency is not conclusive in a subsequent action between the debtor and the secured party.~~
- (2) When the secured party fails to meet the burden of establishing that the collection, enforcement or

disposition was conducted in accordance with the provisions of this Part:

- (i) in the case of a [INSERT--see Attachment], for which no other collateral remains to secure ~~secured~~ the obligation, neither the debtor nor any obligor is ~~not~~ liable for a deficiency; and
- (ii) in other cases, the debtor's or obligor's liability for a deficiency is limited to any amount by which the sum of the expenses, attorneys' fees, and secured obligation (subsections (b) (i) and (ii) of Section 9-504) exceeds the greater of (x) the actual proceeds of the collection, enforcement or disposition and (y) the amount of proceeds that would have been realized had the noncomplying secured party proceeded in accordance with the provisions of this Part; however, the amount referred to in clause (y) is presumed to be equal to the sum of the expenses, attorneys' fees, and secured obligation (subsections (b) (i) and (ii) of Section 9-504) ~~the debtor is not liable for a deficiency if the secured party fails to produce evidence tending to establish the amount of proceeds that would have been realized had the noncomplying secured party proceeded in accordance with the provisions of this Part and, in the case of a [INSERT--see Attachment], any liability is not a personal liability of the debtor or obligor but can be satisfied only by enforcing a security~~

interest or other consensual lien against property securing the obligation, and

~~(iii) in all cases the debtor is entitled to recover from the secured party any amount by which the sum of the expenses, attorneys' fees, and secured obligation (subsections (b) (i) and (ii) of Section 9-504) is exceeded by the greater of (x) the actual proceeds of the collection, enforcement or disposition and (y) the amount of proceeds that would have been realized had the noncomplying secured party proceeded in accordance with the provisions of this Part.~~

(~~d~~3) The fact that a greater amount could have been obtained by a collection, enforcement or disposition 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 or disposition was made in a commercially reasonable manner.

(~~e~~4) A disposition of collateral is ~~deemed to have been~~ made in a commercially reasonable manner if the disposition is made:

(~~1~~i) in the usual manner on ~~in~~ any recognized market

therefor,

(~~2~~ii) at the price current in any such market at the time of the disposition, or

(~~3~~iii) otherwise in conformity with reasonable commercial practices among dealers in the type of property that was the subject of the disposition.



(f5) A collection, enforcement or disposition that has been approved in any judicial proceeding or by any bona fide creditors' committee or representative of creditors is ~~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.

(g6) In the case of a [INSERT--see attachment], if ~~if~~ the secured party's compliance with this Part is placed in issue in an action, the court shall award to the prevailing party on that issue the costs of the action and to the attorneys for that party their reasonable fees. [In determining the attorneys' fees, the amount of the recovery on behalf of the prevailing party is not a controlling factor.]

#### **Reporters' Explanatory Notes**

1. Subsection (a) is the first sentence of existing subsection (1), with the addition of the reference to "enforcement." Consistent with the changes to § 9-502, references to "enforcement" have been added to the references to "collection" and "disposition" throughout this section.

2. Subsection (b) derives from the second sentence of existing subsection (1) and sets for the basic remedy for failure to comply with Part 5: a damage recovery in the amount of loss caused by the noncompliance. The draft expands upon the existing sentence by affording a remedy to any aggrieved person holding an interest in the collateral, including a competing secured party, a lienholder, or the non-debtor owner of the collateral, regardless of whether the aggrieved person is entitled to notice and regardless of the secured party's knowledge. Cf. Recommendation 28.F. The remedy would be available even to holders of senior security interests and liens. A comment would explain that exercise of this remedy is subject to the normal rules of pleading and proof. See Recommendation 28.C. A comment would also explain that the "loss" may include the loss of an unrealized surplus and that a person who has delegated the duties of a secured party but who remains obligated to perform them is liable under this subsection. The last clause of this subsection

is intended to eliminate the possibility of double recovery or other over-compensation arising out of noncompliance with Part 5.

3. Where the secured party has failed to proceed in accordance with Part 5, the last sentence of existing § 9-507(1) affords a "minimum damage" recovery (a/k/a "penalty") in the case of consumer goods. Section 28.D of the Report explains that, allowing this recovery when the secured party is barred from recovering a deficiency would permit an overly-penal result and could entitle the debtor to a substantial windfall. The Study Committee did not discuss whether the provision should be retained for other cases, such as (1) wrongful repossession and (2) cases in which the secured party is barred from recovering a deficiency as a personal liability but not from other collateral (as in the "however" clause of subsection (b)(3)(ii)). At the November, 1993, meeting, the Drafting Committee considered whether a "minimum damage" recovery is appropriate and, if so, under what circumstances the recovery should be available and how it should be calculated. It reached no consensus on that issue.

Pending a comprehensive revision of the consumer-related provisions, this draft retains subsection (bb), which deals with consumer transactions (however the Drafting Committee may ultimately choose to define them). The first sentence of subsection (bb)(2), which derives from the third sentence of existing § 9-507(1), is drafted to provide a "guaranteed minimum" recovery, in accordance with the view expressed by some at the November, 1993, Drafting Committee meeting. However, any damages recoverable under subsection (b), including the amount of any unrealized surplus, would reduce the recovery under subsection (bb). Similarly, any amounts by which the debtor's personal liability for a deficiency are eliminated or reduced under subsection (c)(2)(i) or (ii) would be credited against the recovery under subsection (bb). The blacklined changes to subsection (bb) reflect the deletion of subsection (c)(2)(iii). See Explanatory Note 4, below.

4. The basic remedy is subject to the special rules contained in subsection (c). This subsection addresses situations in which the amount of a deficiency or surplus is in issue, i.e., situations in which the secured party has collected, enforced or disposed of the collateral. Subsections (c)(1), (2), and (3) contain the special pleading and proof rules applicable to a determination of the amount of a deficiency or surplus. Under subsection (c)(1), the secured party need not prove compliance with Part 5 as part of its prima facie case. If, however, the debtor raises the issue (in accordance with the forum's rules of pleading and practice), then the secured party bears the burden of proving that the collection or disposition complied. In the event the secured party is unable to meet this burden, then subsection (c)(2) explains how to calculate the deficiency. For most cases, the rebuttable presumption rule applies. As formulated in the draft, the rule means that the debtor or obligor is to be credited with the greater of the

actual proceeds of the disposition and the proceeds that would have been realized had the secured party complied with Part 5. If a deficiency remains, then the secured party is entitled to recover it. See subsection (c)(2)(ii). In many cases, the secured party may have agreed not to hold the debtor or obligor liable for a deficiency. An agreement of this kind may be explicit, as in the case of an obligor who makes a limited guarantee, or implicit, as in the case of a debtor ("hypothecator") who provides collateral to secure the debt of another. Nothing in Article 9 limits the effectiveness of such agreements.

Subsection (c)(2)(ii) contains a presumption that a complying disposition would have yielded an amount equal to the secured obligation, together with expenses and attorneys' fees. The secured party may not recover any deficiency unless it overcomes the presumption. It can do so by introducing evidence supporting a finding by the trier of fact of a different amount. See § 1-201(31) (definition of "presumed"). The presumption in subsection (c)(2)(ii) is not intended to affect the allocation of the burden of persuasion, which, under non-UCC rules of civil practice, normally would be imposed upon a secured party who seeks a deficiency, even if the secured party rebuts the statutory presumption in subsection (c)(2)(ii).

The previous draft contained an explicit provision (subsection (c)(2)(iii)) to the effect that the debtor would be entitled to recover any surplus, calculated as the amount by which the sum of the expenses, attorneys' fees and secured obligation is exceeded by the greater of (x) the actual proceeds of collection or disposition and (y) the amount of proceeds that a complying collection or disposition would have yielded. This formula was designed to capture the actual loss resulting from the secured party's failure to comply with Part 5. As the Explanatory Notes to the prior draft indicated, we included this provision in the interest of clarity; draft §§ 9-504(b)(3) and 9-507(b) made it unnecessary. The redefinition of the term "debtor" has made old subsection (c)(2)(iii) unworkable in certain cases. For example, if the debtor sells the collateral before the secured party enforces the security interest, the new owner of the collateral--not the debtor--should be entitled to any surplus. We have attempted to solve this problem by eliminating subsection (c)(2)(iii). We do not intend thereby to eliminate the secured party's liability for an unrealized surplus. As revised in this draft, § 9-507(b) would give the new owner, as a person "who held an interest in the collateral" at the time of the secured party's failure to comply with Part 5, a right to recover "damages in the amount of any loss" caused by the secured party's failure. The loss would be measured in the manner provided by old subsection (c)(2)(iii): the secured party ordinarily would be liable for the difference between the amount that a complying collection or disposition would have yielded and the amount necessary to satisfy the secured obligations (plus attorneys' fees and expenses) in full. This measure could be set

forth in the official comments. Normal rules of civil practice would dictate that a person who seeks a surplus would have the burden of proving the amount on which its surplus is based. (Note that the change in the definition of "debtor" did not necessitate a change to § 9-504(b)(3), which permits the secured party to pay the surplus to the debtor without having to investigate the state of title to the collateral.)

5. In accordance with Recommendation 28.B we have included an absolute bar rule for certain classes of transactions, to be determined by each state. The Attachment discusses how these classes might be defined. Subsection (c)(2)(i) sets forth the absolute bar rule. It reflects the approach of Recommendation 28.D, under which the absolute bar applies only to the debtor's personal liability but does not prevent the secured party from recovering the claim by foreclosing on additional collateral in the future. To be sure that the debtor receives appropriate credit when additional collateral is present, the second "however" clause of subsection (c)(2)(ii) applies the rebuttable presumption rule to the noncomplying disposition but indicates that the deficiency may be satisfied only by foreclosure of additional collateral, including real estate.

6. There is an inevitable delay between the time a secured party engages in noncomplying collections or dispositions and the time of a subsequent judicial determination that the secured party did not comply with Part 5. During the interim, the secured party, believing that the secured debt is larger than it ultimately is determined to be, may continue to make collections on and dispositions of collateral. If the secured indebtedness is discharged thereafter by the operation of the rebuttable presumption rule or the absolute bar rule, a reasonable application of § 9-507 would impose liability on the secured party for the amount of the excess, unwarranted recoveries. The Study Committee recommended that the official comments be revised to explain the appropriate result and analysis, and we concur.

7. Subsections (d), (e), and (f) contain rules addressing whether a disposition was commercially reasonable. They are borrowed from existing § 9-507(2), with some slight modifications. Arguably, these would be more appropriately located in § 9-504; however, we are inclined to leave them where they are now found. Note that subsection (e) is quite limited; it applies only to markets where there are standardized price quotations for property that is essentially fungible, such as stock exchanges.

Some observers (including White & Summers) have found the notion contained in draft subsection (d) (the fact that a better price could have been obtained does not establish lack of commercial reasonableness) to be inconsistent with that found draft § 9-504(d) (every aspect of the sale, including its terms, must be commercially reasonable). We conclude from the acceptance of both provisions at the March, 1994, meeting, that

the Drafting Committee perceives no inconsistency. In most cases there is a range of commercially reasonable prices that collateral will fetch. Disposing of collateral for a price within that range may be commercially reasonable even though the particular price is not the best price. The draft does not define fully the relationship between the two sections. In particular, it leaves open the question of how courts are to evaluate a disposition that yields an extremely low price. One approach would begin from the premise that the price is one of the "terms" that, under § 9-504(d), must be commercially reasonable. Under that approach, the trier of fact could predicate a finding that a procedurally sound disposition was non-complying solely on the basis of a low price. Others assert that a low price is relevant to whether a disposition has been commercially reasonable only to the extent that a low price suggests the need for careful judicial scrutiny of other aspects of the disposition. Under the latter approach, commercial reasonableness is exclusively a question of process. Those who follow the latter approach would acknowledge that where the price is extremely low, other aspects of the disposition (e.g., the time and manner) might well have been commercially unreasonable. But if they were not, then those who take the latter approach would not find fault with the disposition.

We invite the Drafting Committee to consider whether the official comments should address this issue and, if so, what approach they should take.

We would be inclined to move the portion of subsection (f) beginning with "but this sentence . . ." to the official comments. However, we have not proposed that change because it might indicate, erroneously, an intention to change the substance of current law in this respect.

8. The official comments to § 9-507 should explain that a waiver of rights or duties by a debtor, secured party, or other lien holder carries with it, by implication, a waiver of any right to a remedy or recovery under that section arising out of noncompliance with the right or duty that has been waived.

9. Subsection (g) has been revised to reflect the Drafting Committee's view that Article 9 should award attorneys' fees to the prevailing party only in "consumer" cases (however defined).

Attachment to Draft § 9-507

**Reporters' Note:** The Study Committee recommended that the Drafting Committee consider defining one or more special classes of transactions to which the absolute bar rule (i.e., the secured party's noncompliance with Part 5 bars the secured party from recovering a deficiency) would apply. Although the Study Committee did not attempt to reach a consensus on the details of a definition of an appropriate class, Section 28.B of the Report suggests some possible factors that the Drafting Committee might wish to consider.

We believe that, no matter how a revised official text of Article 9 might define these special classes, states would be quite likely to enact nonuniform amendments to the definition. We do not consider nonuniformity on this issue to be undesirable per se. However, we are concerned that the nonuniform amendments may be negotiated and enacted in undue haste and that, consequently, they may not be drafted as well as one might like. To deal with (what we believe to be) the inevitable tendency towards nonuniformity while nevertheless controlling the quality of the draftsmanship, we propose to offer the states a menu, from which each state can pick and choose the elements that make up the special class or classes of transactions that would be subject to the absolute bar rule. Most of the menu appears below. A portion appears in the bracketed language in subsections (c)(2)(i) and (ii) concerning good faith.

INSERT to subsections (c)(2)(i) and (ii)  
(Each state to select one or more of the bracketed phrases)

[purchase money]

security interest

[in consumer goods]

[that]

[, [at the time of the collection or disposition]  
OR [at the time the security interest attached],]

[secured an obligation in an amount [in excess of [\$ \_\_\_\_\_]]  
OR [less than \$ \_\_\_\_\_]

[End of Insert]

Following are three examples of the way in which a state might enact subsection (c) (2) (i):

1. (i) in the case of a **purchase money security interest that, at the time of the collection or disposition, secured an obligation in an amount in excess of \$15,000**, for which no other collateral remains to secure the obligation, the debtor is not liable for a deficiency if the secured party failed to conduct the collection or disposition in good faith;

2. (i) in the case of a **security interest in consumer goods**, for which no other collateral remains to secure the obligation, the debtor is not liable for a deficiency;

3. (i) in the case of a **security interest in consumer goods that, at the time the security interest attached, secured an obligation in an amount less than \$50,000**, for which no other collateral remains to secure the obligation, the debtor is not liable for a deficiency;