UNIFORM NONJUDICIAL FORECLOSURE ACT

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ON UNIFORM STATE LAWS

and by it

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IN ALL THE STATES

at its

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UNIFORM NONJUDICIAL FORECLOSURE ACT

Prefatory Note

In 1974 the National Conference of Commissioners on Uniform State Laws promulgated the Uniform Land Transactions Act (ULTA). ULTA covered many aspects of real property law; a major portion of it was devoted to security interests in land, including foreclosure. In 1985, the Conference split these mortgage-related provisions into a separate act, the Uniform Land Security Interest Act (ULSIA).

No state has adopted either ULTA or ULSIA, although some elements drawn from the acts have been incorporated in state legislation. The present Act seeks to accomplish a further separation of foreclosure into a distinct statute that is a major revision of the foreclosure provisions of ULTA and ULSIA. The Act introduces two new forms of foreclosure that were not found in ULTA or ULSIA, and it eliminates ULSIA's provision, tracking UCC Article 9, that permitted nonresidential mortgages to be foreclosed by "reasonable disposition of the collateral" – a provision that was widely opposed as contrary to consumer interests. A large number of other changes have been made as well, making the Act more responsive to the needs of both lenders and borrowers.

A new act was appropriate because of a number of changes in the field of mortgage foreclosure law that have occurred since the drafting of ULTA in the early 1970s. These changes include considerable development by the courts of the constitutional concept of due process of law as applied to foreclosures; an expansion of the secondary mortgage market to include large numbers of conventional commercial mortgages; a vast increase in the securitization of both residential and commercial mortgages; and the publication of the Restatement (Third) of Property (Mortgages) in 1997.

A few states have adopted power of sale foreclosure statutes in recent years, but there are still nearly twenty states that have no practical form of nonjudicial foreclosure. The Act is offered in the belief that non-judicial foreclosure can be both fair to borrowers and efficient from the viewpoint of lenders, and will often be the preferable form of foreclosure for all of the affected parties.

The feasibility of nonjudicial foreclosure is demonstrated by the fact that about half of the American jurisdictions use it routinely, and by the implementation of two federal statutes that permit the U.S. Department of Housing and Urban Development to foreclose by power of sale the mortgage loans it holds. See Multifamily Mortgage Foreclosure Act, 12 U.S.C.A. §§ 3701-3717, adopted in 1981; Single Family Mortgage Foreclosure Act, 12 U.S.C.A. §§ 3751-3758, adopted in 1994; regulations applicable to both acts at 24 C.F.R. §§ 27.1 - 27.123.

Why nonjudicial foreclosure?

The fundamental premise of this Act is that, in the great majority of foreclosures, judicial involvement is unnecessary because there is no dispute between the debtor and creditor. The

validity of the note and security instrument are not in question, the payments are indeed in default, and the debtor typically has no defense to foreclosure. Of course there are cases in which a defense exists and deserves to be heard, but it makes little sense to force all foreclosures into court because a small fraction of them involve disputes of law or fact. Using the time of judges and the machinery of the courts to conduct routine foreclosures is often a misallocation of public funds as well as a waste of the secured creditor's resources.

The delays and inefficiency associated with foreclosure by judicial action are costly. They increase the risks of vandalism, fire loss, depreciation, damage, and waste. The resulting costs raise the prices of private mortgages and erode the economic value of government subsidy programs involving mortgages. They add to the portfolio of foreclosed properties held by lenders, secondary mortgage market investors, and government insurers and guarantors of mortgages. The availability of a uniform, less expensive, and more expeditious foreclosure procedure will ameliorate these conditions, and will facilitate the secondary market sale and resale of real estate loans.

Foreclosure is intended to accomplish two distinct purposes: (1) to *evaluate* the collateral and (2) to *liquidate* it. Evaluation is necessary in order to determine whether the lender has a surplus (to be distributed to junior lienors and the debtor) or a deficiency (to be demanded from the debtor and others who are personally liable on the debt). Liquidation is necessary because the lender, in nearly all instances, is not in the business of owning real property and does not want to retain the collateral for the long term.

However, there is no overarching principle that requires the evaluation and liquidation functions to be accomplished in a single process. Indeed, a persuasive case can be made that when both functions are done at once, as in the case of the traditional auction sale, both are likely to be done inefficiently. See Debra Pogrund Stark, Facing the Facts: An Empirical Study of the Fairness and Efficiency of Foreclosures and a Proposal for Reform, 30 U. Mich. J. L. Reform 639, 677-685 (1997). In recognition of these facts, the Act gives lenders the opportunity (although not the obligation) to bifurcate the evaluation and liquidation functions.

Features of the Act

Types of foreclosure. The Act provides for three methods of foreclosure and permits the secured creditor to elect the method to be used. The first is conventional foreclosure by means of an auction sale, conducted by a representative of the foreclosing creditor. In this foreclosure method, evaluation of the collateral (by means of the high bid at the sale) and liquidation (by means of a foreclosure deed to the high bidder) are combined.

The second and third methods of foreclosure authorized by the Act separate the evaluation and liquidation functions. The second method is foreclosure by negotiated sale. Such a sale will be consummated in much the same way as other real property sales; the property will probably be listed with a real estate broker and advertised extensively. This is usually an effective way of liquidating the property, but has not been used in this country as a method of evaluating the property for purposes of foreclosure because of concern about the potential for collusive price-

setting between the secured creditor and the purchaser.

In the procedure for foreclosure by negotiated sale authorized in this Act, that concern is eliminated. The creditor notifies the debtor and junior lien holders of the "foreclosure amount" that it is willing to offer for the property, and they can simply disapprove the sale if they are dissatisfied with that amount. If the amount is reasonable, and is more than the debtor and junior lienors could expect to recover from an auction sale, they have every reason to permit the sale to proceed. If one or more of them disapproves, the foreclosing creditor has three choices: (1) to discontinue the negotiated sale and resort to a different method of foreclosure; (2) to exclude the objecting party from the effect of the foreclosure, so that the objector will be unaffected by the foreclosure; or (3) to pay off the objecting party, if that person holds a lien. This last alternative is likely to be employed only when the objecting party's lien is for a minor amount.

The third foreclosure method authorized by the Act is foreclosure by appraisal. This method accomplishes only the first function of foreclosure, namely the evaluation of the collateral. It does not liquidate the property, but rather leaves it in the hands of the secured creditor, who will have the burden of liquidating it after the foreclosure is completed.

In a sense, foreclosure by appraisal is similar to common law "strict foreclosure," but in this Act it is surrounded with much more extensive safeguards to protect the interests of the parties who are being foreclosed and to ensure the integrity of the appraisal's result. The lender selects the appraiser, but the appraiser must meet reasonable professional standards of qualification and may not be an employee of the lender or servicer of the loan. As with foreclosure by negotiated sale, the secured creditor notifies the debtor and junior lien holders of the "foreclosure amount" that it is willing to offer for the property. Any debtor or junior lienor who is dissatisfied with the amount can simply disapprove it and, as with a foreclosure by negotiated sale, the foreclosing creditor must either exclude the objector from the foreclosure, pay off the objector, or discontinue the foreclosure by appraisal and employ a different method of foreclosure.

In a foreclosure by negotiated sale or by appraisal, the "foreclosure amount" is, in effect, an offer by the creditor. That offer need not be identical to the property's selling price (in the case of a negotiated sale) or the property's appraised value (in the case of a foreclosure by appraisal), but it must be at least 85 percent of that amount. The 15% margin is intended to allow the creditor ample latitude to cover the expenses of holding and marketing the property. A foreclosure amount lower than 85 percent is impermissible, and would warrant a court in enjoining the foreclosure or, if the foreclosure has been completed, assessing damages against the foreclosing creditor or setting the foreclosure aside if title has not passed to a bona fide purchaser.

With all three of these foreclosure methods sufficient protections, outlined in more detail below, have been included to assure protection of the legitimate interests of debtors and subordinate interest holders. However, foreclosures by auction have traditionally been known for producing prices that are well below market values. The principal reason for the adoption of the new methods, foreclosure by negotiated sale and by appraisal, is the belief that they will produce higher effective prices. If this is true they will come to be widely used, lenders will realize more

of the indebtedness owed to them, and borrowers will experience fewer deficiency claims and more surpluses.

At the same time, the Act aims to improve prices at auction sales by requiring foreclosing lenders to disclose title information (which they must necessarily obtain in any event in order to carry out the foreclosure process) and encouraging them to disclose other reports and information they possess. The Act also encourages debtors to permit pre-foreclosure inspection of the security property by prospective buyers, another feature intended to foster higher prices.

Systems of notice. The nonjudicial foreclosure statutes presently in effect may be divided into one-notice and two-notice systems. In a two-notice system, the secured creditor typically is required to send a notice of default, and after the passage of some time period, a second notice of foreclosure. Depending on the jurisdiction, the first notice may or may not coincide with an acceleration of the debt. If it does not, the period between the first and second notices (or some part of that period) may be thought of as a "cure" period, during which only arrearages need be paid to put the loan back "on stream."

The present Act creates a "two-notice" system. Debtors are given a notice of default and a 30-day period of cure before a notice of foreclosure may be issued to them. For nonresidential debtors this time period may be reduced to ten days by agreement. No provision is made for giving a notice of default to junior lien holders. Only after the cure period has expired can the foreclosing creditor accelerate the debt and give a notice of foreclosure.

After the cure period expires, an original notice of foreclosure must be given to all parties whose interests will be extinguished by the foreclosure. This is a departure from many of the existing nonjudicial foreclosure statutes that provide direct mailed notice of foreclosure only to the debtor. Under such statutes it is entirely possible for the foreclosure of a senior mortgage to terminate a junior mortgage without the holder of the junior lien even knowing that the termination has occurred. See, e.g., In re Ocwen Financial Services, Inc., 649 N.W.2d 854 (Minn.App. 2002). That sort of unfair result cannot occur under this Act.

The foreclosure cannot occur earlier than an additional 90 days after the notice of foreclosure is given. Thus, a minimum of 120 days will ordinarily elapse between the debtor's default and the date of foreclosure. During the 90-day period, any affected persons have the right to redeem the collateral from the security interest, although they must usually pay the accelerated balance due to do so.

In addition to these two notices, all affected parties will receive further warning that the foreclosure is about to occur. In the case of foreclosure by auction, a copy of the advertisement of the sale must be given to them; it may be included with the notice of foreclosure or sent separately. If foreclosure is by negotiated sale, the affected parties must be given a notice informing them of the proposed sale. In the case of foreclosure by appraisal, they will receive a copy of the appraisal report, informing them of the date that the foreclosure will take effect.

Due process: notice and hearing. When a governmental entity forecloses a mortgage,

judicial decisions make it reasonably clear that the entity must comply with the demands of the Due Process Clause, including the giving of notice reasonably calculated to inform those whose rights are affected, and the provision of a hearing at which such persons may present defenses to the foreclosure. See, e.g., Rau v. Cavenaugh, 500 F.Supp. 204 (D.S.D.1980); Ricker v. United States, 417 F.Supp. 133 (D.Me.1976); Turner v. Blackburn, 389 F.Supp. 1250 (W.D.N.C.1975). Contra, see Federal Deposit Insurance Corporation v. Morrison, 747 F.2d 610 (11th Cir.1984).

Whether these protections are also required when a private creditor forecloses is not settled. However, irrespective of the requirements of Due Process, fundamental fairness demands that all persons whose rights may be destroyed by a foreclosure should have advance notice of the proceeding and the opportunity to show why it should not go forward. As a three-judge federal court in North Carolina put it, "To propose to a homeowner that he trek to the courthouse or spend 20 cents to examine fine-print legal notices, daily for the duration of a twenty-year mortgage, as his sole protection against summary eviction, seems to us to offer him nothing of value." Turner v. Blackburn, supra, at 1258.

The Act therefore provides (in Sections 203 and 204) for notice to all those whose property rights are put at risk by foreclosure. It also provides, in Section 205, an opportunity for any other person who wishes to receive notice of the foreclosure to file a request for such notice in the public records.

In addition, Section 206 of the Act provides residential debtors the right to an informal meeting with a responsible representative of the secured creditor to present reasons why the foreclosure should not go forward. This meeting, which will be held only if it is affirmatively requested, is intended to guard debtors against the fundamental unfairness of a mistakenly-conducted foreclosure. The creditor's representative must have available at the meeting the evidence of the debtor's default. It is believed that right to a meeting will satisfy the hearing element of the due process requirement if a government agency is foreclosing under the Act. While the Act does not obligate creditors to hold a meeting with nonresidential debtors or with subordinate lienholders, neither does it preclude such a meeting.

It might be argued that the informal meeting process created by the Act is unnecessary because a debtor or junior lienor can always bring an action to enjoin an improper foreclosure. However, this step requires a good deal of affirmative effort by the plaintiff – the retaining of counsel, typically at significant cost, and the pursuit of litigation. It is not clear that this option is adequate to protect unsophisticated debtors.

Judicial intervention. In a great majority of cases, foreclosures under the Act are expected to proceed without judicial involvement. However, there are a number of situations in which a party may seek and obtain the intervention of a court. For example, a debtor who believes that there has been no default under the security instrument may seek a judicial review of that issue. A court may also be asked to postpone a foreclosure, to determine the priority of competing security interests, to direct foreclosure in bulk or by parcels, to marshal assets by directing the order in which parcels should be sold, or to direct the order of distribution of the proceeds of a foreclosure. These judicial orders are only illustrative, and many other forms of judicial

involvement may be envisioned. In these situations the court serves as a "safety valve," guarding against improper or overreaching actions by the foreclosing creditor.

Omitted parties. Mortgage law uniformly holds that a person who is not made a party to a judicial foreclosure is not bound by it, and such a person's interest survives the foreclosure. However, in foreclosures by power of sale there is little legal authority as to the effect of failure to provide notice to holders of junior interests. The Act explicitly provides that holders of junior interests who are entitled to notice are not bound by the foreclosure if they are not given notice. Hence their position is like that of an omitted party in a judicial foreclosure. See Nelson & Whitman, Real Estate Finance Law (4th ed. 2001) at §7.15.

Sometimes a foreclosing lender wishes to avoid terminating a particular subordinate interest by the foreclosure. Case law is about evenly divided as to whether this can be done against the junior interest holder's wishes. Id. at §7.12. The Act expressly permits the foreclosing creditor to give to any junior interest holder a "notice of preservation," effectively excluding that party from the effect of the foreclosure even though the party is given notice of the foreclosure. This sort of notice is most likely to be employed to preserve leases that the lender regards as advantageous.

Redemption. Mortgaged property may be redeemed in either of two ways: by equitable redemption before foreclosure and by statutory redemption for some fixed period of time after foreclosure. All states recognize equitable redemption, but only about half of the states have statutes permitting redemption after foreclosure. The Act recognizes the fundamental right to equitable redemption until the date of foreclosure, but does not permit post-foreclosure redemption. While post-sale redemption occasionally benefits a debtor or junior lienor, it is believed that in the aggregate such parties are disadvantaged by the depression in foreclosure bid prices that results from the uncertain status of title introduced by statutory redemption.

Title from foreclosures. No matter which method of foreclosure is employed, the Act provides that if the notice of foreclosure has been recorded, completion of the foreclosure process by recording an appropriate deed and affidavit conclusively establishes compliance with the Act in favor of good faith purchasers for value of the collateral. If a creditor fails to comply with the provisions of the Act in conducting a foreclosure, a court may, of course, assess damages against the creditor. In addition, a serious failure of compliance may warrant a court in setting aside the foreclosure if no bona fide purchaser's rights have intervened. The extent to which defects in the foreclosure process will cause a court to set aside a foreclosure is left to other law.

Deficiency liability. In general, no matter which of the three foreclosure methods is employed, the Act permits recovery of a deficiency by the foreclosing creditor if the obligation is a recourse debt. However, residential debtors who act in good faith are exempt from deficiency liability. In addition, deficiency liability is limited by the "fair market value" concept: a debtor may present proof of the property's fair market value, and may have the amount of the deficiency limited as though the foreclosure amount was at least 90 percent of fair market value. This limitation is available to all debtors if the foreclosure was by auction, but is available only to residential debtors in the case of a foreclosure by negotiated sale or by appraisal.

The "residential debtor" concept. The Act preserves, with some changes, the "residential debtor" concept employed (and termed the "protected party") in ULTA and ULSIA. It recognizes two classes of debtors: residential debtors and everyone else. Residential debtors are assumed to need additional legal protections from foreclosing creditors that are not essential to other persons.

"Residential debtor" includes both a person who owns a home on which a security interest exists, and anyone who is personally liable on an obligation that is secured by a home. "Home" is used here as a shorthand for "residential real property," which must be owner-occupied and contain no more than four dwelling units. Thus, "residential debtor" encompasses not only the usual consumer borrowers on home mortgage loans, but also relatives who guarantee their loans and purchasers who buy homes subject to, or with an assumption of, existing mortgages.

Several specific protections are provided for residential debtors in the Act. Some of them have been mentioned above, but all are catalogued here:

1. In general, the terms of the security agreement may fix the standards by which performance of an obligation under the Act is to be measured, so long as those standards are not manifestly unreasonable. However, such provisions are not binding on residential debtors.

2. The Act requires the foreclosing creditor to send debtors notices of default and foreclosure, as well as the advertisement or statement of the actual foreclosure. If these notices are given by mail, residential debtors are entitled to two copies, one of which must be given by registered or certified mail.

3. After sending a required notice, a foreclosing creditor may discover that the recipient's address was incorrect. The creditor is required to make a reasonable effort to discover a correct address and, if one can be found, to send a new notice. For residential debtors, any time period that is counted from the date of giving notice will now run from the date of the new notice. This principle is applied to nonresidential debtors as well, but is limited by a provision that the time period ends no later than 45 days after the date it would have ended if counted from the date the original notice was given.

4. The cure period allowed to debtors to reinstate their loans without acceleration is ordinarily thirty days after a notice of default is given. This period may be reduced by agreement of the parties to as little as ten days, but no reduction is permitted if any debtor is a residential debtor.

5. Residential debtors are entitled to demand a meeting with a representative of the foreclosing creditor and to review in that meeting the evidence that the foreclosure is legally warranted.

6. The Act prohibits the entry of deficiency judgments against residential debtors who have acted in good faith with respect to the property and the foreclosure. This provision employs the risk of a deficiency judgment as an incentive to encourage residential debtors to act responsibly by avoiding fraud or waste, providing pre-foreclosure access to the property to prospective

buyers, and relinquishing possession promptly after foreclosure. Deficiency claims may be asserted against guarantors of residential debtors.

7. A debtor faced with a deficiency judgment is entitled present proof of the property's fair market value, and to have the amount of the deficiency limited as though the foreclosure amount was at least 90 percent of fair market value. This limitation protects residential debtors no matter which of the three methods of foreclosure was employed; nonresidential debtors may assert the limitation on the deficiency only if the foreclosure was by auction.

8. A deficiency action against a residential debtor must be commenced within 90 days after the time of foreclosure; deficiency actions against nonresidential debtors are not thus limited, and are governed only by the jurisdiction's general statute of limitations.

9. A residential debtor who files an action to enjoin a foreclosure on the ground that it is legally improper is not required to post a bond in order to obtain a temporary restraining order or a preliminary injunction, even if a bond would ordinarily be required under the jurisdiction's law.

Predatory lending. There has been a good deal of legislative activity that attempts to ban or control "predatory lending" – a term that may have a number of meanings, but in general refers to activity by mortgage lenders that is unfair or deceptive to consumer borrowers. Nothing in the Act stands in the way of enforcement of such legislation, whether now in effect or adopted in the future. Under Section 105, a court may enjoin or otherwise take control of a foreclosure that would otherwise proceed nonjudicially under the Act. The remedies applied by the Court must be based on "the principles of law and equity." Those principles include predatory lending and other consumer protection legislation.

Note on the terminology of foreclosure. The term "foreclosure" is often used in modern practice in a sense that is inconsistent with its historical origins. In its inception in England, what was "foreclosed" was the debtor's "equity of redemption" – that is, by foreclosure the debtor was precluded from redeeming his or her land from the mortgage. Thus, one did not, properly speaking, "foreclose a mortgage," but rather foreclosed the debtor's equity of redemption.

Today, however, phrases like "foreclose a mortgage" or "foreclose a deed of trust" are in common use and introduce no apparent confusion. Likewise, we often say that a lender "forecloses the property" or "forecloses on the property." The Act follows the modern pattern.

[ARTICLE] 1

[PART] 1

DEFINITIONS AND OTHER GENERAL PROVISIONS

SECTION 101. SHORT TITLE. This [Act] may be cited as the Uniform Nonjudicial Foreclosure Act.

SECTION 102. DEFINITIONS. In this [Act]:

(1) "Collateral" means property, real or personal, subject to a security interest.

(2) “Common interest community” means real property with respect to which a person, by virtue of ownership of a unit, is obligated to pay for real property taxes, insurance premiums, maintenance, or improvement of other real property described in a declaration or other governing documents, however denominated. In this paragraph, “ownership” includes a leasehold interest if the period of the lease is at least [20] years, including renewal options.

(3) “Day” means calendar day.

(4) "Debtor" means a person that owes payment or other performance of an obligation, whether absolute or conditional, secured under a security instrument. The term includes a person that guarantees such an obligation and a person that owns property securing such an obligation, whether or not the person is personally liable on the obligation.

(5) “Document” means a tangible medium on which information is inscribed.

(6) “Expenses of foreclosure” means the lesser of the reasonable expenses incurred by a foreclosing creditor or the maximum amounts permitted by other law of this State for expenses in connection with a foreclosure, including a foreclosure discontinued under Section 601. These

expenses include costs of transmission of notices, advertising, title evidence, inspections and examinations of the collateral, management and securing of the collateral, insurance, filing and recording fees, attorney's fees and litigation expenses incurred to the extent provided in the security instrument or authorized by law, appraisal fees, the fee of the person conducting the sale in the case of a foreclosure by auction, fees of court-appointed receivers, and other expenses reasonably necessary to the foreclosure.

(7) "Foreclosing creditor" means a secured creditor that is engaged in a foreclosure under this [Act].

(8) "Guarantor" means a person that is liable for the debt of another. The term includes a surety and an accommodation party.

(9) "Individual" means a natural person.

(10) "Interest holder" means a person that holds a legally-recognized interest in real or personal property that is subordinate in priority to a security interest foreclosed under this [Act].

(11) "Original notice of foreclosure" means the first notice of foreclosure given pursuant to Section 204 instituting a foreclosure under this [Act].

(12) "Person" means an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, government; governmental subdivision, agency, or instrumentality; public corporation, or any other legal or commercial entity.

(13) "Real property" means any estate or interest in, over, or under land, including minerals, structures, fixtures, and other things that by custom, usage, or law pass with a conveyance of land whether or not described or mentioned in the contract of sale or instrument of conveyance. The term includes the interest of a landlord or tenant and, unless the interest is personal property under the law of the state in which the property is located, an interest in a

common interest community.

(14) "Record," used as a verb, means to submit a document complying with applicable legal standards, with required fees and taxes paid, to the appropriate governmental office under [the recording act of this State].

(15) “Recording data” means the date and [book and page number] [document number] at which a document is recorded in the [office of the county recorder].

(16) "Residential debtor” means a debtor who is an individual and who owns, or is obligated on an obligation secured in whole or in part by, residential real property. The term includes a person that is owned or controlled by such an individual.

(17) "Residential real property" means real property that, when a security instrument is entered into with respect to the property, is used or is intended by its owner to be used primarily for the personal, family, or household purposes of its owner and is improved, or is intended by its owner to be improved, by one to [four] dwelling units.

(18) "Secured creditor" means a creditor that has the right to foreclose a security interest in real property.

(19) "Security instrument" means a mortgage, deed of trust, security deed, contract for deed, land sale contract, lease, or other document that creates or provides for an interest in real property to secure payment or performance of an obligation, whether by acquisition or retention of a lien, a lessor’s interest under a lease, or title to the real property. A document is a security instrument even if it also creates or provides for a security interest in personal property. If a security instrument provides that a default under any other agreement is a default under the security instrument, the security instrument includes the other agreement. The term includes a modification or amendment of a security instrument and a document creating a lien on real

property to secure an obligation owed by an owner of the real property to an association in a common interest community or under covenants running with the real property.

(20) "Security interest" means an interest in real or personal property created by a security instrument that secures payment or performance of an obligation.

(21) “State” means a State of the United States, the District of Columbia, Puerto Rico, the United States Virgin Islands, or any territory or insular possession subject to the jurisdiction of the United States.

(22) “Title evidence” means a title insurance policy, a preliminary title report or binder, a title insurance commitment, an attorney’s opinion of title based on examination of the public records or an abstract, or any other means of reporting the state of title to real property which is customary in the locality.

Legislative note: The definition of “recording data” should be adjusted to conform to the practice of the jurisdiction in referring to recorded documents.

Legislative note: Enacting states may wish to change the number of dwelling units in definition (17) to comply with local custom.

Comment

Introductory comment to definitions. American law recognizes that many different interests can be created in real property, and that many different sorts of documents can be employed to encumber those interests as security for debts and other obligations. The Act makes nonjudicial foreclosure available to virtually all consensually secured parties, no matter what interest in land has been made the collateral for the obligation and no matter what the nature or caption of the instrument creating the security interest.

Such conventional terms as “mortgage” and “mortgagor” are not used in the Act, since they could easily be construed as having a limiting effect on the Act’s coverage of security interests. Instead, the Act employs a set of terms that have no common law or statutory roots tying them to a particular form. In place of terms such as “mortgage,” “contract for deed,” “deed of trust,” etc., the Act substitutes the general term “security instrument” (see paragraph 19). In place of “mortgagor” or “installment contract purchaser” the Act substitutes “debtor” (defined in paragraph 4). In place of “mortgagee,” or “vendor,” the Act substitutes “secured creditor” (see paragraph 18). Instead of enumerating the various types of real property interests, such as “fee

estate," "leasehold," and the like, that can be used as security, the Act substitutes "collateral" as defined in paragraph (1). The interest in the collateral that is conveyed to or retained by the creditor is defined as a "security interest" (paragraph 20) and not as a "lien" or as "title." Hence, for the purpose of foreclosure under the Act it is unimportant whether a state follows the "lien theory" or "title theory" of mortgage law.

1. "Collateral" includes all of the interests in land and any included items of personal property that are subject to a security interest. The interests in land are subsumed under the term defined in paragraph (13) as "real property." The Act cannot be used to foreclose on a security interest in personal property alone, but can be used to foreclose on personal property in combination with real property; see Section 103(d).

2. "Common Interest Community." This definition is similar to that in the Uniform Common Interest Ownership Act. It encompasses condominiums, cooperatives, and planned communities that include common areas supported by the payments of individual owners. However, interests in cooperatives may not be foreclosed under the Act if they are treated as personal property under state law; see Section 103(b)(3).

3. "Day." Days must be counted to determine the expiration of various time periods prescribed by the Act. All days including Saturdays, Sundays, and holidays are counted. However, under Section 106, if a required act would fall on a Saturday, Sunday, or holiday, it may properly be performed on the next weekday.

4. "Debtor" encompasses not only original borrowers, but also guarantors, sureties, accommodation makers, assuming grantees, and other persons who are absolutely or conditionally liable on the secured debt. Hence, the term "debtor" often describes more than one person in a transaction. In most cases the person who is personally obligated to pay the secured debt (if anyone is so obligated) and the owner of the property securing the debt will be the same person at the inception of the transaction.

However, a person who owns property that is subject to a security interest is a "debtor" whether or not that person is personally liable on the obligation. There are at least two situations in which this principle may arise. The first is the case of person that obtains a fully nonrecourse loan secured by the borrower's property. The second is the case of the "nonassuming transferee." The latter case arises if an owner of property borrows money on its security and later transfers the property "subject to" the security interest, but without an "assumption" of liability by the transferee. The transferee "owns property that secures" the obligation, and hence is a "debtor" under this definition. The transferor may remain liable on the secured debt, and if so will also continue to be a "debtor." However, if the transferor is released from personal liability on the secured obligation, the transferor is no longer a "debtor."

The "property" owned by a "debtor" may be real property, or may be personal property if the security instrument and the foreclosure in question encompass that personal property. See Section 103(d).

The term "debtor" does not include a person who is not liable on the secured obligation and whose interest in the collateral represents less than fee simple ownership of the property interest that secures the obligation. For this reason, subordinate lienholders and the holders of leases, easements, and covenant enforcement rights are not "debtors" unless they are personally obligated on the secured debt, not a common arrangement. Such persons are "interest holders" (definition 9) if their interests are subordinate to the security interest being foreclosed. However, if the interest in property that is subjected to a security instrument is a leasehold interest (e.g., the interest of a ground lessee), then the leasehold tenant is the full owner of that leasehold interest, and hence is a "debtor" under this definition.

5. A "document" is a tangible medium, such as paper, with information inscribed on it. In some cases other law, such as the Uniform Electronic Transactions Act or the Electronic Signatures in Global Commerce Act, may classify information stored in electronic form as a document, or may authorize the giving of notices in electronic form. Such other law may apply to documents created and notices given pursuant to the Act.

6. "Expenses of foreclosure" includes the direct costs related to foreclosure, but does not include items not directly related to foreclosure, such as payment of property taxes, insurance premiums, or repairs. If an expenditure is related to the foreclosure, it is immaterial whether it was made before or after the notice of foreclosure was given.

Under other applicable law a secured creditor may have the right to expend money to protect the collateral, such as payment of taxes or the making of repairs, and add the expenditure to the balance of the obligation secured by the security instrument. See Restatement (Third) of Property: Mortgages § 2.2 (1997). However, these items are not "expenses of foreclosure."

All expenses of foreclosure are limited to reasonable amounts. However, the secured party is not required to seek competitive bids for foreclosure services, or to limit foreclosure expenses to the lowest possible amounts. Attorneys' fees are included as expenses of foreclosure only if they are authorized by the security instrument or by other applicable law.

8. "Guarantor" is employed in the Act to refer to all persons who promise to pay the debt of another. If a person allows his or her real property to be encumbered to secure the debt of another person, the owner of the property is a "debtor" under definition (4).

10. "Interest holder" is a person with an interest in property that is the subject of a foreclosure under the Act, provided that the interest is subordinate to the security interest being foreclosed. Interest holders are often "debtors" as well, but are not necessarily so. Holders of liens on the property subordinate to the security interest being foreclosed are "interest holders" but are ordinarily not "debtors." Other examples of interest holders include tenants under subordinate leases and the holders of subordinate easements and covenant enforcement rights.

11. "Original notice of foreclosure" is the notice given at the inception of a foreclosure under the Act pursuant to Section 202. If that foreclosure cannot be completed, and the secured creditor then pursues another foreclosure by the same method or a different method under the Act, the

notice given in pursuance of that method is not an "original notice of foreclosure."

12. "Person" includes both natural persons (individuals) and all forms of legally-recognized organizations.

13. "Real property" refers to the legal relationship or "interest" a person has against the world with respect to an object, the physical land or space. It includes common law estates, both freehold and nonfreehold, as well as rents, servitudes and other interests that are not estates because they do not include the right of possession of the land. Leaseholds are regarded as real property for the purposes of the Act, even though for other purposes of state law (e.g., decedents' estates) they may be regarded as personal property. Interests of cooperative apartment owners are not considered real property under this definition if they are regarded as personal property by applicable state law.

Even though rents are regarded under the Act as real property, the procedures of the Act cannot be employed by a creditor to reach or obtain rents prior to the time of foreclosure; see Section 103(b)(1).

A mobile home may or may not be regarded as real property, depending on state law and whether it is permanently affixed to the land. Because the Act is available only if the collateral to be foreclosed includes some real property, a mobile home that is classified as personal property cannot be the subject of a foreclosure under the Act unless some real property is also being foreclosed.

14. To "record" means that the person submitting an instrument has complied with the state's existing recording act. However, an instrument is "recorded" even if the personnel in the recorder's office index it incorrectly or otherwise fail to comply with their legal duties.

15. "Recording data" refers to the customary way of referring to the precise place where a document is recorded in the jurisdiction. Some jurisdictions customarily refer to book and page number, some to a document number, and others to other types of designations.

16. "Residential debtors" are regarded as needing protections from the acts of creditors that other borrowers do not need. A debtor may be a "residential debtor" even if the obligation is secured by other, nonresidential property in addition to "residential real property" (definition 17). If the residential real property is owned by an artificial entity, such as a trust or corporation, and is occupied by one or more individuals who control the entity, the entity is considered a "residential debtor." See comment to definition (17).

17. "Residential real property" is an essential term in defining "residential debtor" (definition 16). There are two elements in the definition, one relating to the use of the property and the other to the improvements on it. "Residential real property" must be used or intended to be used primarily for personal, family, or household purposes of its owner. This definition is similar to that of the Uniform Consumer Credit Code, the Federal Trade Commission's Holder in Due Course Rule, and various other consumer protection statutes. Some commercial or other

nonresidential use is permitted within this definition, so long as the primary use is residential.

"Owner" should be regarded broadly. Thus, if a house is owned by a trust and is occupied as a residence by a principal beneficiary of the trust, the house is considered to be in use for the "personal, family, or household purposes of its owner." Similarly, if a house is owned by a partnership, limited liability corporation, or other corporation, and the holder of a majority of shares or ownership interests in the entity resides in the house, it is considered to be in use for the "personal, family, or household purposes of its owner."

In addition, to be "residential real property," the real property must either be improved with one to four dwelling units at the time the security instrument is entered into, or the owner must intend at that time to so improve it in the future. A vacation home or other "second home" qualifies as residential real property, since there is no requirement that a dwelling unit on the premises be the primary residence of the owner, but only that the primary use of the premises be residential. The limitation on the number of dwelling units excludes larger apartment buildings.

18. "Secured creditor" includes a seller of real property who retains a lien or title to the real property sold for the purpose of securing the price, as well as a person, such as a mortgage lender, with a secured claim arising initially from a cash loan. It further includes any person to which the right to foreclose the secured interest is assigned or transferred.

"Secured creditor" is defined in terms of the right to foreclose the security interest. Ordinarily the security interest will automatically follow the obligation, unless the two rights are intentionally separated. See Restatement (Third) of Property: Mortgages § 5.4 (1997). Hence, a transfer of a promissory note will normally transfer the right to foreclose the corresponding security interest as well. However, an intentional separation may occur, in which case the holder of the security interest, not the holder of the obligation, is the "secured creditor."

The "right to foreclose" includes foreclosures accomplished by employees, agents, and servicers of the secured creditor. Some secondary market investors in mortgage loans, such as Fannie Mae, routinely hold in their own names the promissory notes representing the loans they acquire, but have the corresponding mortgages held in the names of their servicers for convenience in foreclosing. Since the note holders in such cases have the power to direct their servicers to foreclose, the note holders are the "secured creditors" under this definition.

19. "Security instrument." This definition recognizes that the title given to a document by its parties does not necessarily indicate whether it is a security instrument. The test is whether it creates a security interest. See comment to "security interest" (definition (20)) below. The caption or title and the precise form of the document are not dispositive. It does not matter whether the document is in the form of a contract or a conveyance of an interest in land, or whether the security interest is created by granting or by retaining it.

For purposes of the Act, a "security instrument" must cover real property. It may cover personal property in addition. However, an instrument that imposes a security interest only on personal property and not on any real property cannot be foreclosed under the Act. See § 103(d).

If the security instrument provides, as is ordinarily the case, that a default on another obligation, such as a promissory note, is a default under the security instrument, then the term "security instrument" includes the terms of the obligation as well. Hence, whether a particular term of the parties' agreement (such as an acceleration clause or a due-on-sale clause) is stated in a promissory note or in the mortgage that secures payment of the note will generally be immaterial for purposes of the Act. All modifications and amendments to the original documents are also part of the security instrument. Thus, "workout" or loan modification agreements are included.

A lien created to assist in the enforcement of owners' obligations in a common interest community or under covenants running with land in a residential subdivision is a security instrument under the Act and can be foreclosed under its provisions, provided that the rights in the common interest community are considered real property. See § 103(b)(3).

A lease may or may not create a security interest, depending on the its terms and the circumstances of its creation. Guidance may be obtained from UCC §1-203 (final Act 2002). Most leases and deeds are given for the purpose of granting the possession and economic benefits of the conveyed interest to the transferee, not for the purpose of securing performance of an obligation of the transferor. If this is the case, these transactions are not security instruments and the Act does not affect them.

Whether a document creates a security interest depends on the parties' intent. The intent in question is that relating to real estate law. For example, a "synthetic lease" transaction that is intended to create a security interest for legal purposes but a lease for accounting purposes is a security interest within the scope of the Act.

When a seller of real property retains title after the buyer enters into possession, the circumstances of the transaction and the intent of the parties must be examined in order to determine whether a security interest has been created. For example, if a buyer of real property takes possession a few days or weeks prior to the closing and transfer of legal title, it is usually apparent that the arrangement was made merely for the convenience of the buyer and not for the purpose of securing the buyer's obligation to complete the purchase. In other cases, particularly if a lengthy time is to elapse between the buyer's taking of possession and the completion of payment of the purchase price, and if the price is to be paid in installments, it will be clear that a "contract for deed" transaction was intended and that title was retained by the seller for purposes of security. If so, foreclosure under the Act is available to the seller if the requirements of § 103(a) are satisfied.

20. "Security interest." As indicated in the preceding comment, security interests can arise from documents labeled in a variety of ways. Mortgages, leases, deeds, and contracts may all create security interests. A security interest arises in any case in which a person receives or retains an interest in property for the purpose of securing an obligation owed to that person. Certain types of security interests, such as judgment liens and mechanics liens, may arise by virtue of statute or operation of law, but except for a lien of an owners' association on property in a common interest community, such security interests may not be foreclosed under the Act. See

Section 103(b)(2).

22. "Title evidence" may be denominated in a variety of ways, depending on local custom or practice. It might be termed, for example, a "foreclosure report," a "trustee's sale guaranty," or the like. Any form of title evidence customarily employed in foreclosures in the locality is acceptable.

SECTION 103. APPLICATION.

(a) Except as otherwise provided in subsection (b), this [Act] applies to, and authorizes the nonjudicial foreclosure of, every security interest in real property located in this State created on or after the effective date of this [Act], if the security instrument provides in substance that the security interest may be foreclosed pursuant to this [Act] or by nonjudicial process.

(b) This [Act] may not be used to foreclose:

(1) a security interest in rents or proceeds of real or personal property;

(2) a lien created by statute or operation of law, except a lien of an owners' association on property in a common interest community; or

(3) a security interest in property in a common interest community if under the law of this State that interest is personal property.

(c) A secured creditor may not give an original notice of foreclosure under this [Act] if a judicial proceeding is pending to foreclose the security interest or to enforce the secured obligation against a person primarily liable for the obligation. An original notice of foreclosure under this [Act] may be given even if a judicial proceeding is pending or a judicial order has been obtained for appointment of or supervision by a receiver of the collateral, possession of the collateral, enforcement of an assignment of rents or other proceeds of the collateral, collection or sequestration of rents or other proceeds of the collateral, or enforcement of the secured obligation

against a guarantor or a guarantor's property.

(d) If a security instrument covers both real property and personal property, a secured creditor foreclosing under this [Act] with respect to the real property may also proceed in the foreclosure against the personal property to the extent permitted by [Article 9 of the Uniform Commercial Code].

(e) This [Act] does not preclude or govern foreclosure or other enforcement of a security interest in real property by judicial or other action permitted law other than this [Act].

Legislative Note: In some jurisdictions special statutory provisions govern the termination of installment land contracts (contracts for deed). A jurisdiction adopting the Act may wish to consider whether foreclosure of such contracts should be excluded from its coverage, or alternatively whether the statute providing for termination of installment contracts should be repealed.

Legislative Note: If cooperative apartments and all other forms of common interest ownership are regarded as real property in an enacting jurisdiction, subsection (b)(3) may be omitted.

Comment

This section extends the reach of the Act to all types of consensual security interests in real property. The caption of the document creating the security interest is irrelevant so long as it contains a reference to nonjudicial foreclosure as required by subsection (a). In theory even an absolute deed may be foreclosed under the Act if it was given to create a security interest in real property, as determined by applicable law, and contains the necessary reference to nonjudicial foreclosure. The Act does not specify the circumstances or methods by which a security interest may be created; those matters are left to other law.

Foreclosure under the Act is available only if the security instrument so provides. The provision may either be by reference to the Act itself (e.g., "This mortgage may be foreclosed under the [State] Nonjudicial Foreclosure Act") or by reference to the concept of the Act (e.g., "This mortgage may be foreclosed by a nonjudicial procedure exercised by the mortgagee" or "This mortgage may be foreclosed by exercise of a power of sale by the mortgagee"). The provision need not include a precise reference to the Act, but need only refer to its fundamental concept, nonjudicial foreclosure.

Because an amendment or modification of the security instrument becomes part of it for purposes of the Act (see Section 102(19)), a security instrument that did not originally contain the terms necessary to subject it to foreclosure under the Act may be amended to do so.

Subsection (b)(2) removes from the Act's coverage security interests that are nonconsensual. For example, the Act does not apply to construction liens, judgment liens, tax liens, landlords' liens, vendors' liens, or vendees' liens, unless the lien in question arises by virtue of a document that provides for a lien between the parties.

In general, liens to assist in enforcement of covenants against owners in common interest communities (see § 102(2)) may be enforced under the Act. To the extent that such liens are regarded as being created by operation of law (for example, under a condominium statute), they comprise an exception to the general principle that the Act applies only to consensual security interests. Subsection (b)(3) excludes the foreclosure of security interests on cooperative units if such units are considered personal property, as is the case in some jurisdictions.

Security interests in rents or other proceeds generated by real or personal property are outside the scope of the Act. Secured creditors may employ a variety of methods for enforcement of those interests; the Act does not add to or detract from those methods. However, a person acquiring ownership of property by foreclosure under the Act is entitled to the rents and proceeds it generates after the time of foreclosure.

Subsection (c) is intended to prevent secured creditors from harassing debtors by commencing a foreclosure under the Act when a judicial foreclosure or an action on the debt is pending. However, judicial proceedings for appointment or supervision of a receiver, for enforcement of an assignment of rents, or for collection of rents and proceeds are not inconsistent with foreclosure under the Act, and foreclosure under the Act may be commenced despite the pendency of such proceedings. The same is true of actions against guarantors. Even a foreclosure against other property provided by a guarantor as security for the guaranty may proceed despite the pendency of a foreclosure under the Act against the principal security for the debt.

The Act does not impose a "one-action" or "security first" rule, prohibiting commencement of an action on the debt prior to foreclosure if the debt is secured by real property, as is found in a few states. But it does prohibit recovery of a deficiency against a residential debtor after a foreclosure under the Act in some circumstances; see § 607(b)(2).

Security instruments that chiefly affect real property often contain terms encumbering some items of personal property as well. It is permissible for lenders to employ the Act to foreclose on the real property, and to use other procedures consistent with Article 9 of the Uniform Commercial Code to realize on the security of the personal property. Alternatively a creditor may, at its option, sweep the personal property into a nonjudicial foreclosure of the real property under the Act. This is permissible under subsection (d), provided that the requirements of Article 9 for disposition of collateral are satisfied.

Subsection (e) preserves the existing authority of the courts to foreclose mortgages and other real property security interests. Even if the security agreement purports to make foreclosure under the Act the sole method of foreclosure, judicial foreclosure in equity will still be available. Nonjudicial foreclosure under the Act is simply an option available to secured creditors, to which they may resort if they wish. In some states other processes, such as strict foreclosure of

mortgages or forfeiture of installment sale contracts, are authorized by law and may continue to be used after adoption of the Act unless they are repealed by § 703.

SECTION 104. VARIATION BY AGREEMENT.

(a) Except as otherwise provided in subsections (b) through (d), the parties to a security instrument may not vary by agreement the effect of a provision of this [Act].

(b) The time within which a person must respond to a notice given by a secured creditor may be extended by agreement.

(c) The parties to a security instrument may vary the effect of a provision of this [Act] if the provision expressly permits the parties so to do.

(d) If no debtor under a security instrument is a residential debtor:

(1) the parties by agreement may determine the standards by which performance of an obligation under this [Act] is to be measured if those standards are not manifestly unreasonable; and

(2) an agreement by a guarantor waiving the right to receive notices under this [Act] with respect to the foreclosure of the property of a debtor whose obligation the guarantor has guaranteed is enforceable unless enforcement is prohibited by other law.

Comment

In general, the parties to a real property security instrument have freedom of contract with respect to their rights and remedies. However, for many centuries judicial policy has provided certain nonwaivable protections for the defaulting debtor and subordinate creditors. In the same way, the rights and duties associated with foreclosure under the Act may not be modified by agreement of the parties unless the Act specifically so provides. The parties are permitted to lengthen by agreement the time allowed to respond to a notice given by a secured creditor and, unless a residential debtor is involved, to establish by agreement reasonable standards of performance for obligations under the Act.

An amendment to a security instrument by mutual agreement to insert terms necessary to foreclose it under Section 103(a) is permissible.

Lenders frequently demand that guarantors waive the right to receive notices related to foreclosures. Such a waiver is recognized by the Act in nonresidential transactions, but only with respect to the foreclosure of the property of the principal debtor, not the foreclosure of the guarantor's property. To the extent that other law, such as Article 9 of the Uniform Commercial Code, restricts the enforceability of such waivers, those restrictions govern in a foreclosure under the Act notwithstanding the waiver. See UCC § 9-611(c)(2) and UCC § 9-602(7) (2000 revision).

SECTION 105. SUPPLEMENTAL PRINCIPLES OF LAW AND EQUITY

APPLICABLE. Unless displaced by a particular provision of this [Act], the principles of law and equity supplement this [Act].

Comment

An act governing foreclosure cannot anticipate all possible forms of conduct that would cause courts to intervene in the normal foreclosure process. Historically foreclosure has been subject to equitable principles, and the Act does not change that. Hence, this section provides that the fundamental principles of the common law, worked out over centuries, continue to apply to foreclosures. These principles include the law relating to acceleration, bankruptcy, capacity to contract, coercion, duress, estoppel, fraud, marshaling of assets, misrepresentation, mistake, principal and agent, redemption, subrogation, unjust enrichment, and other validating or invalidating cause.

For example, a court might "deaccelerate" an installment debt that had been accelerated under inequitable conditions (see, e.g., Federal Home Loan Mortg. Corp. v. Taylor, 318 So.2d 203 (Fla.App. 1975)); might enjoin or stay a foreclosure because the granting of the security interest was tainted with fraud, duress, or lack of capacity (see, e.g., National Management Corp. v. Adolfi, 277 A.D.2d 553, 715 N.Y.S.2d 526 (2000); or might order that multiple parcels be foreclosed in a particular order to avoid unnecessary harm to holders of subordinate interests under the doctrine of marshaling (see, e.g., Indiana Lawrence Bank v. PSB Credit Services, Inc., 706 N.E.2d 570 (Ind.App.1999).

A court might also intervene in a foreclosure under the Act because the loan being foreclosed had been made in violation of a "predatory lending" or other consumer protection statute.

The listing of legal and equitable principles in this comment is not exhaustive, but merely illustrative of the principles that supplement the Act.

SECTION 106. DAY OF PERFORMANCE. If this [Act] or a notice given pursuant to this [Act] requires performance on or by a certain day and that day is a Saturday, Sunday, or legal holiday, the performance is sufficient if done on the next day that is not a Saturday, Sunday, or legal holiday.

Legislative note: This section may be omitted if the jurisdiction has in force a general statute with substantially the same effect.

[ARTICLE] 1

[PART] 2

NOTICE AND KNOWLEDGE

SECTION 107. DEFINITIONS. In this [part]:

(1) "Address for notice" means:

(A) with respect to a notice given by a secured creditor:

(i) if the intended recipient has given to the secured creditor a security instrument or other document in connection with a security instrument that contains an address, the most recent address in the security instrument or document or the most recent address of which the secured creditor has knowledge;

(ii) if the sources described in subsubparagraph (i) do not disclose an address, the most recent address that is identifiable from examination of the public records in [the office of the county recorder] and, if personal property is being foreclosed together with real property, the public records containing filings of title transfers and security interests in the type of personal property being foreclosed;

(iii) if the sources described in subsubparagraphs (i) and (ii) do not disclose an address and the secured creditor knows the intended recipient is a tenant, subtenant, or assignee of a leasehold in all or part of the real property collateral, the address of the real property collateral or some portion thereof, including the designation of any office, apartment, or other unit that the secured creditor knows is possessed by the recipient, with the notice directed to the recipient by name, if known, or otherwise "To person occupying property at" followed by the physical address or description of the real property collateral;

(iv) if the secured creditor does not know that the intended recipient is a tenant, subtenant, or assignee of a leasehold in all or part of the real property collateral and the sources described in subsubparagraphs (i) and (ii) do not disclose an address, an address, if any, determined by reasonable efforts of the secured creditor to be a correct address for the recipient or, if none can be determined, the address of the real property collateral or some portion thereof; or

(B) with respect to a notice given by a person other than a secured creditor, the most recent address stated in a document provided by the recipient to the person giving notice.

(2) "Address of the individual conducting the foreclosure" means the address contained in a notice of default pursuant to Section 202(b)(6) or a notice of foreclosure pursuant to Section 204(b)(11).

(3) "Individual conducting the foreclosure" means the individual identified in a notice of default pursuant to Section 202(b)(6) or a notice of foreclosure pursuant to Section 204(b)(11).

(4) "Notice" means a document containing required information and signed by the person required to provide the information.

(5) "Recipient" means a person to which a notice is given.

(6) "Sign" means to execute or adopt a tangible symbol with the present intent to authenticate a document.

Comment

Any notice required by the Act must be in the form of a "document"—that is, a tangible medium (ordinarily paper) inscribed with the necessary information—and must be signed by the person giving the notice. Electronic notices are not expressly authorized by the Act. In some cases other law, such as the Uniform Electronic Transactions Act or the Electronic Signatures in Global Commerce Act, may classify information stored in electronic form as a document, or may authorize the giving of notices in electronic form. Those laws may apply to documents created and notices given pursuant to the Act.

Under subsubsection (1)(A)(i), the secured creditor must use the most recent address found in any document that the recipient has given the creditor in connection with the transaction. For example, if the recipient gave an address in the security instrument, but later notified the creditor of a change of address, the more recent address must be used. The same result follows if the recipient sent a letter to the creditor dealing with some other topic, and the recipient's more recent address was stated in the letter.

Under subsubsection (1)(A)(ii), the secured creditor may be required to examine the real property records in the appropriate recorder's or clerk's office. The examination contemplated here is one that is reasonable under the customary standards applicable to the locality. For example, if title examinations are customarily done for a 50-year period in the records, a search over that period is sufficient for purposes of this subsection.

Further under subsubsection (1)(A)(iii), if the collateral includes personal property the secured creditor may be required to consult "the public records containing filings of title transfers and security interests in the type of personal property." This description of the public records is necessarily general, since there may be a variety of available public records, depending on the type of property. For example, if the collateral is a motor vehicle the creditor may need to consult the records of a state department of transportation or a state department of revenue. If the collateral is an aircraft the creditor will need to consult the title registration records of the Federal Aviation Administration. The creditor is expected to be familiar with the types of public records that exist for the types of collateral the creditor accepts.

SECTION 108. MANNER OF GIVING NOTICE.

(a) Subject to subsections (b) through (f), notice is given by:

(1) handing it to the recipient;

(2) if the recipient's address for notice is an office, leaving it at the office with an

individual in charge or, if no one is in charge, leaving it in a conspicuous place in the office;

(3) if the recipient's address for notice is a dwelling, leaving it at the dwelling with an individual of suitable age and discretion residing therein; or

(4) depositing it with the United States Postal Service or a commercially reasonable delivery service, properly addressed to the recipient's address for notice, with costs of delivery paid.

(b) If the recipient is a residential debtor and the notice is given as provided in subsection (a)(4), an additional copy of the following notices must be deposited with the United States Postal Service, registered or certified mail, properly addressed to the recipient's address for notice, with costs of delivery paid:

(1) a notice of default;

(2) a notice of foreclosure;

(3) an advertisement of an auction sale pursuant to Section 303(b);

(4) a notice of proposed negotiated sale pursuant to Section 403; or

(5) a notice of appraisal pursuant to Section 503.

(c) If a person giving a notice pursuant to this [Act] and the recipient have agreed to limit the methods for giving notice otherwise permitted by subsection (a), that limitation is enforceable.

(d) If, at the time of giving a notice, the person giving the notice knows that the notice, if directed to the recipient's address for notice, will not be received by the recipient, the person giving the notice shall make a reasonable effort to determine an address for the recipient at which the notice is likely to be received and direct the notice to that address, if any, in addition to the recipient's address for notice. If an address at which the notice is likely to be received cannot be

determined by a reasonable effort, notice is sufficient if directed to the recipient's address for notice.

(e) If, after giving a notice and before the time of foreclosure, a person acquires knowledge that the notice will not be received at the address to which the notice was directed, the person shall promptly make a reasonable effort to determine an address for the recipient at which the notice is likely to be received and direct a copy of the notice to that address, if any. If an address at which the notice is likely to be received cannot be determined by a reasonable effort, the notice given in compliance with subsections (a) through (d) is sufficient. If a copy of the notice is given pursuant to this subsection:

(1) if no debtor is a residential debtor, notice sent in compliance with subsections (a) through (d) satisfies the requirements of this [Act] for the time for giving notice and operates to commence the running of any period that under this [Act] commences upon the giving of notice;

(2) if any debtor is a residential debtor, any period that under this [Act] commences upon the giving of notice runs from the date on which the notice is given pursuant to this subsection but ends no later than 45 days after the date it would have ended if counted from the date of the notice given in compliance with subsections (a) through (d).

(f) A notice to a foreclosing creditor is sufficiently addressed if directed to the address of the individual conducting the foreclosure.

(g) If a notice is not given in accordance with subsections (a) through (e) but is received by the recipient within the time it would have been received if properly given, it is treated as having been properly given as of the time of receipt.

Comment

This section provides for minimum methods of giving notice. There is no objection to a person's also giving notice through additional methods, provided that the requirements of this

section are satisfied.

In general, notices required by the Act may be transmitted by personal service, registered or certified mail, regular mail, or commercial delivery services. However, a special provision applies to certain notices, listed in subsection (b), when given to residential debtors. When one of these notices is given by mail or delivery service, a second copy must be given by registered or certified mail.

Proper dispatch, not receipt, satisfies the obligation "to notify" or "to give notice." For example, if notice is given by mailing with the U.S. Postal Service, the time of deposit of the notice with the postal system is the time notice is "given." When the essential fact is the recipient's receipt of the notice, that is stated.

Under subsections (d) and (e), if a person sending a notice knows at the time of sending or later discovers that the "address for notice" will not result in receipt of the notice by the recipient, the sender has a duty to make a prompt and reasonable effort to determine an address at which the notice is likely to be received, and to send a notice there. The "address for notice" might be incorrect because no such address exists, because the address has been mis-transcribed, because the recipient has moved, or for other reasons. A reasonable effort would ordinarily include use of any forwarding address provided by the U.S. Postal Service, the use of at least one generally-used telephone directory for the area in which the recipient is believed to be located, and at least one internet search database. As technology develops, other methods of address search may also become reasonable and hence obligatory under this subsection.

If an original notice is of a type that requires a second copy to be sent by registered or certified mail under subsection (b), a second copy of any "address correction" notice sent under subsections (d) or (e) must similarly be sent by registered or certified mail.

An issue of timing may arise under subsection (e). If a substitute notice is sent because the foreclosing creditor has discovered that the original address for notice is invalid, which notice commences the timing of future acts that depend on it? The answer depends on whether the foreclosure involves any residential debtor or not. If there is no residential debtor, the date of the original notice governs. If a residential debtor is involved, the date of the substitute notice governs, but the period cannot be extended by more than 45 days from the date it would have ended if counted from the original notice.

For example, assume a foreclosing creditor sends a notice of default by mail to a residential debtor's "address for notice" (the last address of the debtor as shown in the creditor's records) on August 1. Ordinarily the debtor would have 30 days (that is, until August 31) to cure the default under Section 202(c). On August 10 the Post Office returns a message stating that the debtor's address is invalid. The creditor then consults a directory (which may be a telephone book, a telephone assistance service, an internet search service, or some other agency) and discovers a more recent address for the debtor. The notice of default is mailed to the new address on August 11. The debtor's 30-day cure period, which would have expired on August 31 if based on the old notice, will expire on September 10 instead. However, no matter how late the incorrect address was discovered and a substitute notice sent, the cure period would not be extended beyond

October 15 which is 45 days from the date the cure period would have expired if counted from the August 1 date of the original notice.

SECTION 109. RECEIPT OF NOTICE.

(a) A notice is received by a foreclosing creditor:

(1) when it is delivered to and available at the address of the individual conducting the foreclosure; or

(2) when it is brought to the attention of the individual conducting the foreclosure, or when it would have been brought to that individual's attention if the recipient had exercised reasonable diligence.

(b) A notice is received by a recipient other than a foreclosing creditor:

(1) when it is delivered to and available at a place that satisfies the requirements of Section 108 for giving notice to that recipient;

(2) if the recipient is an individual, when it comes to the recipient's attention; or

(3) if the recipient is not an individual, when it is brought to the attention of the individual responsible for the transaction involving the security instrument or when it would have been brought to that individual's attention if the recipient had exercised reasonable diligence.

Comment

In most cases in which the timing of notice is significant in the Act, it is the *sending* of the notice that commences or must comply with the critical period. However, there are three types of notice as to which *receipt*, not sending, is the critical event. They are a request for a meeting under Section 206 (which must be received by the creditor within 30 days after notice of foreclosure was given); a written bid in a auction foreclosure under Section 308(a)(3) (which must be received no later than 24 hours before the scheduled time of the auction); and an objection to a proposed foreclosure by negotiated sale or by appraisal under Sections 403-404 and 503-504 (which must be received seven or more days before the proposed date of foreclosure).

SECTION 110. SUFFICIENCY OF NOTICE. A notice that contains minor errors or information not required by law is sufficient if the errors are not misleading and the information does not obscure the required information.

SECTION 111. REVOCATION OF NOTICE. Except as otherwise provided in Section 601, a person that has given a notice may revoke it by a subsequent notice unless the recipient materially changed its position in reliance on the notice before receiving the revocation.

SECTION 112. KNOWLEDGE.

(a) A person knows or has knowledge of a fact if:

(1) the person has actual knowledge of the fact;

(2) the person has received a notice or notification of the fact; or

(3) from all of the facts and circumstances known to the person at the time in question, the person has reason to know the fact exists.

(b) If a foreclosing creditor would have reason to know a fact only through an inspection of the collateral, knowledge of the fact is imputed to the creditor only to the extent that the creditor has made an inspection.

Comment

In the Act, the term "notice" is defined in Section 107(4) and refers to a document given by one person to another. The terms "knowledge" and "know" are defined in this section and refer to the state of mind of a person. Knowledge may be actual or may be "constructive," in the sense that knowledge is imputed to persons on account of notices they have received or on account of other facts and circumstances of which they have actual knowledge, and which would lead a reasonable person to gain knowledge of the fact in question.

Subsection (b) is intended to avoid imposing on a secured creditor an obligation to inspect

the collateral. There are many reasons a foreclosing creditor may find it wise or desirable to inspect the collateral, but under subsection (b) no notice will be imputed from such an inspection except to the extent that an inspection is actually carried out. For example, assume that a subordinate tenant is in possession of the real property collateral under an unrecorded lease of which the secured creditor has no actual knowledge and has received no notice. If the foreclosing creditor actually inspects the real property and sees evidence of the tenant's possession, the creditor may be held to have knowledge of the tenant's interest under subsection (a)(3). But if the creditor does not make an inspection, the fact that evidence of the tenant's possession would have been apparent upon an inspection is irrelevant. The creditor may complete the foreclosure without giving notice of foreclosure to the tenant, and the tenant's rights will nonetheless be terminated by the foreclosure.

[ARTICLE] 2

PROCEDURES BEFORE FORECLOSURE

SECTION 201. RIGHT TO FORECLOSE. A secured creditor has a right to foreclose under this [Act] if all conditions required by law and the security instrument as prerequisites to foreclosure are satisfied. A foreclosing creditor may pursue foreclosure by auction, negotiated sale, or appraisal or may simultaneously pursue more than one of these methods. If the foreclosing creditor pursues more than one method of foreclosure, the notice of foreclosure must so state.

Comment

The fundamental role of the Act is to permit secured creditors, after giving appropriate notice, to foreclose without the necessity of judicial process. This section defines when foreclosure under the Act is available. The giving of a notice of default under Section 202 and the expiration of the cure period provided in that section without cure being made is always a prerequisite to foreclosure.

If a secured creditor has a right to foreclose, the creditor may give notice of foreclosure (Sections 203 and 204), and foreclose against the collateral by auction (Article 3), negotiated sale (Article 4), or appraisal (Article 5), or by any combination of these methods. A statement of the secured creditor's elected method or methods of foreclosure must be given by the secured creditor in the notice of foreclosure as provided in Section 204(b)(8). The creditor may initially elect two or all three methods, and may then discontinue one or two of them and complete the third.

SECTION 202. NOTICE OF DEFAULT AND RIGHT TO CURE.

(a) Before notice of foreclosure may be given, a foreclosing creditor must give a notice of default to each debtor, and any period allowed for cure by this section and by the security instrument must expire without cure being made.

(b) A notice of default must identify the collateral and the objection and must state:

(1) with particularity, the facts establishing that a default has occurred;

(2) if the default is curable and cure requires the payment of money, the amount to be paid, including the daily rate of accrual for amounts accruing over time;

(3) if the default is curable and cure does not require the payment of money, the performance required to cure the default;

(4) if the default is not curable, that the default cannot be cured;

(5) the time within which cure must be made in order to prevent accrual of the secured creditor's right to foreclose;

(6) the name, street and mailing addresses, and telephone number of the foreclosing creditor if the foreclosing creditor is an individual or, if the foreclosing creditor is not an individual, the name, street and mailing addresses, and telephone number of an individual who is a representative of the foreclosing creditor, with whom a person may communicate for further information concerning the default; and

(7) that foreclosure may be commenced on account of the default and, if the default is curable, that foreclosure will not be commenced if the default is cured in a timely manner.

(c) Subject to subsection (e) and any additional right to cure provided in the security instrument, within 30 days after notice of default is given to the last person entitled to the notice, any person may:

(1) if the default is curable by the payment of money, cure the default; or

(2) if the default is curable but cannot be cured by the payment of money, promptly commence to cure the default, diligently proceed to cure the default, and complete the cure of the default within [90] days after the notice of default is given to the last person entitled to the notice.

(d) If no person is proceeding diligently to cure a default that is curable but cannot be cured by the payment of money, 30 days after the date the notice of default was given to the last person entitled to the notice the secured creditor may immediately terminate the period allowed for cure by this section by accelerating payment of the principal amount owing on the secured obligation or giving an original notice of foreclosure.

(e) If none of the real property collateral is residential real property, the 30-day period specified in subsection (c) for cure of a monetary default may be reduced by a term of the security instrument to a period not less than 10 days.

(f) A secured creditor may give a notice of default even if a previous notice of default for a different default is pending.

(g) The rights to notice of default and to cure a default provided by this section do not impair or limit any right to notice of default or to cure a default provided by the security instrument. The period for cure provided by this section and any period for cure provided by the security instrument run concurrently unless the security instrument provides otherwise.

(h) If a default is cured within the time for cure provided by this section or after expiration of that time but before acceleration of the principal amount owing on the secured obligation or the giving of an original notice of foreclosure, the secured creditor may not give a notice of foreclosure or accelerate the principal amount owing on the secured obligation because of that default. Any acceleration because of that default is ineffective.

(i) During a period allowed for cure of a default under this section, a secured creditor may enforce any remedy, other than foreclosure, provided for by the security instrument and enforceable under law other than this [Act] if enforcement does not unreasonably interfere with the ability of the debtor against which enforcement is sought to cure a default under this section.

Comment

The Act requires two notices prior to foreclosure, the notice of default specified by this section and the notice of foreclosure specified by Sections 203 and 204. A notice of default is required by this section in all cases as a prerequisite to the giving of a notice of foreclosure. If the default is curable, this section provides a period for cure, and no notice of foreclosure may be given until the period has expired. The period may be expanded by the terms of the security agreement beyond that provided by this section. If the default is not curable, no period of cure is provided and, unless the security instrument provides otherwise, the secured creditor can give a notice of foreclosure immediately after giving the notice of default.

The default must be described "with particularity." It is not sufficient to state "borrower has defaulted in making monthly payments" or "borrower has failed to comply with the covenants in the security instrument." Instead, the specific payments (with dates due and amounts) or the specific covenants must be identified. See the illustration below.

Illustrations of curable defaults include a borrower's failure to pay money by a specified date, failure to repair the collateral, failure to comply with local building codes, and failure to carry casualty insurance if no insurable event has occurred during the period of failure. Illustrations of non-curable defaults include a borrower's failure to maintain a specific net worth on a specified date, failure to carry casualty insurance if an insurable event has occurred during the period of failure, and transfer of the collateral in violation of an enforceable due-on-sale clause.

The notice under this section advises the debtor or debtors of the facts establishing that a default has occurred, what must be done to cure it if it is curable, and that foreclosure may ensue if it is not cured within the allowed time period. Non-debtor parties, such as subordinate lienholders and other interest holders, are not entitled to receive notice under this section, although if they otherwise become aware of the default, they may cure it if they wish.

The notice must contain the information needed for a debtor to contact the creditor or the creditor's representative in person, by mail, or by telephone. This information must lead to the actual ability to contact the creditor or representative. For example, if the telephone number leads only to a computer answering system, and does not make it feasible for a caller to speak to the actual individual who represents the creditor, a court might well find the notice insufficient to comply with the Act. This principle also applies to other notices required by the Act that must include such contact information, such as a notice of foreclosure under Section 204(b)(11), an advertisement of an auction foreclosure under Section 303(c)(6), and so forth.

The terms of the security instrument fix the amount or performance required to cure the default. The amount must be stated on a per diem basis with respect to items whose amount changes with the passage of time, such as interest on the loan principal. To be effective, a cure must include reimbursement to the secured creditor of all legally recoverable expenses incurred by the secured creditor on account of the default. Examples might include attorneys' fees, late fees, and fees for property inspection. See the illustrative notice below. Upon request, the secured creditor must explain the basis upon which any such fees are calculated. The Act does not deal

with the enforceability of such fees, but leaves that matter to other law. Since redemption requires payment of the secured obligation in full, a cure under this section is not a redemption and the security interest remains in existence.

The cure period runs from the date the secured party gives the notice of default to the last debtor entitled to it. If the default is monetary, it must actually be cured within 30 days. In the case of a nonmonetary default, however, acceleration and foreclosure can be avoided if continuing and diligent efforts to cure are commenced within 30 days, even if a complete cure cannot be accomplished within that time. However, if those diligent efforts to cure cease before cure is completed, and in all events after 90 days if the cure is not completed, the secured creditor may then immediately proceed to accelerate the debt or to give notice of foreclosure without taking any other preliminary action.

Illustrations of nonmonetary defaults include the commission of waste by the debtor, a transfer of the property in violation of a covenant in the security instrument, a failure to keep the real property insured as required by the security instrument if an insured loss occurs, or the like. In some situations a lender may convert a nonmonetary default into a monetary default by paying the money necessary to cure and then demanding reimbursement from the borrower.

In practical effect, the cure period may last longer than the 30 or 90 days indicated in this section. For example, suppose a nonmonetary default occurs and the debtor is given notice of the default under this section. The debtor then commences and continues diligent efforts to cure the default. At the end of 90 days, if the cure is incomplete the secured creditor is entitled to accelerate the debt or send an initial notice of foreclosure. However, suppose the creditor does not do so, and with an additional time period – say, 120 days from the date of the original notice – the debtor completes the cure. This cure is effective and the secured creditor cannot thereafter accelerate or send a notice of foreclosure on account of that default. Thus the cure period is at least 30 or 90 days as provided in this section, but may be effectively extended if the secured creditor takes no action until a longer period passes. If cure is made within the time permitted by this section, subsection (h) "deaccelerates" any acceleration of the obligation that the secured creditor has initiated.

This section generally applies whether or not any of the debtors are residential debtors. However, if no debtor is a residential debtor, the 30-day cure period for cure of a monetary default may be reduced by the security instrument to as little as 10 days.

The security instrument may provide debtors with additional protections, including rights to notice and grace periods, beyond those provided by the Act. Such protections must be observed before notice of foreclosure can be given. However, any time period for cure under the security instrument and the time for cure granted by this section will run concurrently unless the parties have agreed that they will not do so. For example, if the security instrument provides for a 60-day grace period for the cure of monetary defaults, and the notice of default is given on September 1, the default may be cured any time prior to October 31.

The cure periods provided by this section inhibit acceleration and the instigation of foreclosure under the Act, but do not necessarily stand in the way of other remedies the secured creditor may

have. Exercise of such other remedies is barred only if they would unreasonably interfere with the debtor's ability to cure the default. For example, if the security instrument gives the creditor a security interest in the rents generated by the real estate collateral, and if that interest is otherwise enforceable under applicable law on account of the default in question, the creditor may assert its rights against the rents despite the fact that the cure period has not expired. If in doing so the creditor notifies the tenants that they are now to pay their rents directly to the creditor, this action may result in reduced cash flow to the debtor, but since the creditor must apply the rent received toward the property's operation and management and to the secured debt, the creditor's action does not unreasonably interfere with the debtor's ability to cure the default.

Illustration: Notice of Default

First Financial Corporation
677 First Avenue
Ashland, Example 12344
December 1, 200_

To: Mary and John Jones
455 South Main Street
Ashland, Example 12345

Dear Ms. and Mr. Jones:

1. This notice affects real property located at Lot 13, Block B, Ridgefield Addition No. 2, in the City of Ashland, County of Pembroke, State of Example. The street address of this property is 455 South Main Street, Ashland, Example 12345.

2. This property is subject to a first mortgage executed by Mary and John Jones to First Financial Corp. on 23 June, 1999, and recorded in Book 455, Page 244, Official Records of Pembroke County, State of Example.

3. The mortgage and its accompanying promissory note require payments to First Financial Corp. of $1,455.00 principal and interest on the first day of each calendar month.

4. Your obligations under this note and mortgage are now in default as follows: (a) The payments for August 1, September 1, and October 1, 200_ have not been made. (b) The premium of $588 on the homeowners insurance policy issued by Firefighters' Insurance Co., due on October 1, 200_, was not paid by you as required by Clause 12 of your mortgage. This premium was paid by First Financial Corp. on October 14, 200_ in order to keep this insurance in force.

5. You can cure these defaults within the time stated by tendering at the office of First Financial Corp., 677 First Avenue, Ashland, Example 12344 the following sums of money:

August 1, 200_ payment:	$1,455.00
Late fee for above payment:	$ 72.75
September 1, 2000_ payment:	$1,455.00
Late fee for above payment:	$ 72.75

October 1, 200_ payment:	$1,455.00
Late fee for above payment:	$ 72.75
Reimbursement of insurance premium paid by First Financial on 10/15/0_:	$ 588.00
Interest on insurance premium at 7.5% per annum to date of this notice: 5.66	
Attorneys' fees in connection with this notice:	$ 200.00
Total due as of 12/01/0_:	$5,376.91
Additional per diem interest after 12/01/0_:	$ .12 per day

If First Financial Corp. is required to expend additional money on account of your defaults, you must also reimburse those expenditures in order to cure your defaults.

Payment must be made by cash, cashier's check, certified check, or postal money order.

6. If you do not cure these defaults within 30 days of the date of this notice, by December 31, 200_, First Financial Corp. may commence foreclosure proceedings against the real estate, which could result in your loss of ownership of this property. If you cure these defaults within the time allowed, no foreclosure will be commenced.

7. If you have any questions about the defaults mentioned above or the calculation of the amounts owed, you may contact Sandra A. Mortgagee, a loan officer with First Financial Corp. She can be contacted at 677 First Avenue, Ashland, Example 12344, telephone number 123-654-3210, e-mail address mortgageesa@firstfinancial.com.

[Signed] Sandra A. Mortgagee, Loan Officer
First Financial Corporation

SECTION 203. NOTICE OF FORECLOSURE: MANNER OF GIVING.

(a) If a secured creditor has a right to foreclose under Section 201, the secured creditor may commence foreclosure by giving a notice of foreclosure. The notice is a prerequisite to foreclosure and must comply with subsections (b) and (c) and Section 204.

(b) A foreclosing creditor shall record a copy of the notice of foreclosure in [the office of the county recorder] of each [county] in which any part of the real property collateral is located. All persons acquiring an interest in the real property collateral after the notice of foreclosure is recorded have knowledge of its existence and contents. If a notice of foreclosure is not recorded,

a foreclosure under this [Act] is void.

(c) Except as otherwise provided in subsection (d), a foreclosing creditor shall give a notice of foreclosure to each of the following persons no later than five days after recording the notice of foreclosure pursuant to subsection (b) if the person can be identified as of the time the notice of foreclosure is recorded:

(1) any person that the foreclosing creditor knows is a debtor;

(2) any person specified by a debtor in the security instrument to receive notice on the debtor's behalf;

(3) any person shown by the public records in [the office of the county recorder] of the [county] in which any part of the real property collateral is located to be an interest holder in the real property collateral;

(4) any person the foreclosing creditor knows is an interest holder in the real property collateral; and

(5) any person that has recorded in the public records in [the office of the county recorder] of the [county] in which any part of the real property collateral is located a request for notice of foreclosure satisfying the requirements of Section 205.

(d) If, after recording the notice of foreclosure, the foreclosing creditor acquires knowledge of an interest holder whose interest existed at the time the notice of foreclosure was recorded, the foreclosing creditor shall give a notice of foreclosure to that interest holder no later than five days after acquiring the knowledge.

(e) A foreclosing creditor, within 10 days before or after recording a notice of foreclosure, shall affix a conspicuous sign on the real property collateral stating that foreclosure has been commenced and identifying the foreclosing creditor.

(f) An original notice of foreclosure is ineffective if given after the expiration of the period of limitation for foreclosure of a security interest in real property by judicial proceeding.

Comment

This section is designed to provide a fair opportunity to receive notice of foreclosure for all persons who may be adversely affected by it. In the case of governmental lenders and others whose actions fall under the Due Process Clause of the federal constitution, compliance with this section should ensure that the notice requirements of due process will be met.

This section does not require foreclosing creditors to resort to factual investigation of the property in order to determine where notice of foreclosure must be given. Lenders need consult only their own records, the usual public land title records and, for personal property collateral, the office where UCC financing statements are filed. Since notice must be given to persons with recorded interests under subsection (c)(3), there is a practical requirement that the foreclosing creditor perform a title examination down to the date and time that the notice of foreclosure is recorded. However, there may be parties, such as grantees of the original borrower and subordinate interest holders, that have not recorded their conveyances as of that date, and the foreclosing creditor may not have knowledge of their rights. In such situations, they are not entitled to notice of foreclosure, and their rights will be cut off despite the fact that no notice of foreclosure is given to them. But if the foreclosing creditor gains knowledge of such persons' rights prior to the date of foreclosure, the creditor must give them notice of foreclosure within five days of learning of them. Learning of such persons and giving them notice does not delay the foreclosure or extend any time period under the Act.

The foreclosing creditor is not required to discover who is in possession of the real property. Under the definition of "knowledge," (Section 112), the foreclosing lender is not regarded as knowing of the presence of tenants on the premises if it could gain such knowledge only by an inspection and no inspection has been made. However, posting a sign stating that foreclosure has been commenced a conspicuous place on the real estate is required by subsection (e). Posting is likely to come to the attention of persons, such as tenants, subtenants, and leasehold assignees, who have unrecorded interests, and to give them actual knowledge.

Recording of the notice of foreclosure is required by subsection (a). Once a notice of foreclosure is recorded, the foreclosing creditor need not be concerned about giving notice to persons who acquire interests in the collateral after the time of recording but before the foreclosure sale. The recorded notice is analogous to the doctrine of *lis pendens*, and provides imputed knowledge to such parties.

Recording of the notice is an absolute requirement for foreclosure under the Act, since certain time periods involved in a foreclosure are measured from the time of recording. For this reason, a purported foreclosure in the absence of recording of the notice of foreclosure is void, even if the property has passed into the hands of a good faith purchaser for value. This is an exception to the conclusive effect of the affidavit following foreclosure, as provided in Section 605.

No notice of foreclosure is necessary to persons holding interests in the property with priority superior to the security instrument being foreclosed; such persons are unaffected by the foreclosure and have no need of notice.

Notice of foreclosure need not be given to guarantors of the secured obligation who have waived their right to notice if there are no residential debtors in the transaction and if the waiver is otherwise enforceable under applicable law. See Section 104(d)(2).

The only effect of a foreclosing creditor's failure to give notice to a person entitled to notice under subsection (c) is to preserve that person's interest. See Section 603(2). The failure does not impair the foreclosure's effect on the interests of other persons, and does not impair the foreclosing creditor's security interest or its priority with respect to the interest of the person who was omitted from notice. The failure to give notice under the Act is analogous to the effect of omitting a necessary party to a judicial foreclosure proceeding.

Under subsection (f), the same statute of limitation that governs judicial foreclosures governs foreclosures under the Act.

SECTION 204. NOTICE OF FORECLOSURE: CONTENT.

(a) The heading of a notice of foreclosure must be conspicuous and must contain the following: "NOTICE OF FORECLOSURE. YOU ARE HEREBY NOTIFIED THAT YOU MAY LOSE YOUR RIGHTS TO CERTAIN PROPERTY. READ THIS NOTICE IMMEDIATELY AND CAREFULLY."

(b) A notice of foreclosure must contain:

(1) a statement that the foreclosing creditor is commencing foreclosure;

(2) a statement that the foreclosure will terminate the rights in the collateral of the person given the notice of foreclosure unless the foreclosing creditor elects to give a subsequent notice of preservation of interest to that person pursuant to Section 210;

(3) the date of the notice, the name of the owner of the collateral as identified in the security instrument, a description of the real property collateral as stated in the security instrument, the interest in or portion of the collateral being foreclosed, a description of any

personal property collateral to be included in the foreclosure, and, at the secured creditor's option, the street address of the real property collateral, if any;

(4) the recording data for the security instrument;

(5) a statement that a default exists under the security instrument and the facts establishing with particularity the default;

(6) a statement that the foreclosing creditor has accelerated or, by virtue of the notice, is accelerating the due date of the principal amount owing on the secured obligation, making that amount immediately due, or a statement that the foreclosing creditor elects not to accelerate the due date;

(7) a statement that the collateral may be redeemed from the security interest by payment or performance of the obligation in full before foreclosure, the amount to be paid or other action necessary to redeem, including a daily amount that will allow calculation of the total balance owed as of future dates, and an estimate of any further amount the foreclosing creditor anticipates expending to protect the collateral;

(8) a statement of the method or methods of foreclosure the foreclosing creditor elects to use and the earliest date on which foreclosure will occur if redemption is not made;

(9) if applicable, an explanation of what a residential debtor can do to avoid a claim for a deficiency under Section 607;

(10) if applicable, a statement:

(A) that the debtor may request a meeting with a representative of the foreclosing creditor to object to the foreclosure as provided by Section 206;

(B) that the debtor may be advised or assisted by another person at the meeting; and

(C) of the last date on which the request must be received by the foreclosing creditor;

(11) the name, street and mailing addresses, and telephone number of the foreclosing creditor if the foreclosing creditor is an individual or, if the foreclosing creditor is not an individual, the name, street and mailing addresses, and telephone number of an individual who is a representative of the foreclosing creditor, with whom a person may communicate for further information concerning the foreclosure; and

(12) an explanation of any workout or loss mitigation plan generally available from the foreclosing creditor.

Legislative Note: If an adopting jurisdiction has a substantial population of non-English-speaking residents, the jurisdiction should give consideration to requiring that the conspicuous heading on the notice of foreclosure be given in other languages in addition to English.

Comment

The amount that must be paid to redeem ordinarily will be stated as the balance owing as of a fixed date, plus a *per diem* amount representing the accruing interest on that balance. If a debtor seeks further information about the amount needed to redeem (for example, the basis of attorneys' fees or other expenses), the creditor must cooperate reasonably in providing that information.

Under subsection (b)(3), the foreclosing creditor may foreclose against all of the collateral or only part of it. The security interest will continue to exist on the part omitted from the foreclosure until the secured obligation is fully discharged. If a portion of the collateral is not covered by the initial foreclosure, the foreclosing creditor may institute a subsequent foreclosure under the Act or otherwise foreclose on the remaining collateral if necessary at a later time. See Section 306 regarding foreclosure by auction on multiple parcels.

The notice must state the facts establishing a default "with particularity" – that is, in reasonable detail. For example, it is not sufficient to state "borrower has not made payments when due" or "borrower has failed to comply with the covenants in the mortgage." In the case of a default in payment, the notice should specify the dates and amounts of delinquent payments. In the case of a breach of mortgage covenants, the relevant covenants should be identified, as in the illustration below.

If the notice is directed to a residential debtor, it must explain the "safe harbor" conduct, as provided in Section 607(c), that will ensure the debtor freedom from deficiency liability. A notice of foreclosure failing to contain such an explanation would violate the Act, and would warrant a

court in concluding that the foreclosing creditor is estopped to make a claim of deficiency liability.

The mention in subsection (b)(12) of "workout or loss mitigation plans" refers to any generally available programs to assist defaulting borrowers that the foreclosing creditor may have established. It does not, however, require a creditor to establish such programs.

If the security agreement contains an acceleration clause, as is very common, the foreclosing creditor will ordinarily want the notice of foreclosure to effect an acceleration of the obligation. This is permissible by virtue of compliance with subsection (b)(6). However, if the lender wishes, it can expressly disclaim an acceleration in the notice of foreclosure.

Once the obligation has been accelerated, the foreclosing creditor is under a duty to stop the foreclosure process only if the creditor receives payment or performance of the obligation in full. If the obligation is a money debt, full payment will result in the discharge of the security interest, and performance by the debtor of the other covenants in the security agreement thereafter is irrelevant. Nothing in the Act prevents a lender from voluntarily "deaccelerating" as part of a workout agreement with a borrower, even after an acceleration or the notice of foreclosure has been given. Such a deacceleration is possible, if the lender is willing, at any time before the foreclosure.

The following is an illustrative notice of foreclosure complying with the requirements of this section.

NOTICE OF FORECLOSURE.
YOU ARE HEREBY NOTIFIED THAT YOU MAY LOSE YOUR RIGHTS TO CERTAIN PROPERTY.
READ THIS NOTICE IMMEDIATELY AND CAREFULLY.

1. This is a notice that First Financial Corp. is commencing a foreclosure on certain property in which you hold or may hold an interest.

2. If completed, the foreclosure will terminate your rights in the property unless First Financial Corp. elects to send you a notice stating that your rights are being preserved.

3. This notice is given December 1, 200_, and affects property owned by Mary and John Jones ("the debtors"). The real property is located at Lot 13, Block B, Ridgefield Addition No. 2, in the City of Ashland, County of Pembroke, State of Example. The foreclosure will affect the fee simple absolute interest in the real property. No personal property is being included in the foreclosure. The street address of this property is 455 South Main Street, Ashland, Example 12345.

4. This property is subject to a mortgage executed by Mary and John Jones to First Financial Corp. on 23 June, 200_, and recorded in Book 456, Page 244, Official Records of Pembroke County, State of Example.

5. The mortgage and its accompanying promissory note require payments to First Financial Corp. of $1,455.00 principal and interest on the first day of each calendar month. The payments for August 1, September 1, and October 1, 200_ have not been made and are now in default. In addition, the premium for the casualty insurance required to be carried by the owner under the terms of the mortgage was not paid when due on October 1, 200_, and was paid by First Financial Corp. on October 14, 200_ in order to keep this insurance in force. The owners have not reimbursed First Financial Corp. for this expenditure, as required by Clause 19 of the mortgage.

6. First Financial Corp. is hereby accelerating the unpaid balance on the promissory note. This means that the entire balance of $137,455.34 is now due and payable. This sum includes interest to the date of this notice and the insurance premium expense mentioned in paragraph 5. Interest will continue to accrue on this balance at the rate of 7.5% per annum (which is $30.13 per day), and will be added to the principal due until paid in full.

7. The debtors or the holders of any property interests subordinate to the mortgage of First Financial Corp. may prevent a foreclosure of the real property by paying the full balance of $137,455.34 on December 1, 200_, plus interest at the rate of $30.13 for each day thereafter to the date of payment. Payment must be made before the time of foreclosure in order to prevent foreclosure from occurring.

8. If payment is not made in this amount, First Financial Corp. elects to foreclose by auction or by appraisal. The earliest date on which foreclosure can occur is March 3, 200_.

9. If the sum received by First Financial Corp. from the foreclosure (or the sum credited against the mortgage indebtedness in the case of a foreclosure by appraisal) is less than the unpaid balance on the mortgage indebtedness and expenses of foreclosure, the debtors, Mary and John Jones, may be held personally liable for any remaining unpaid sum. However, they can avoid this liability by compliance with [Section 607(c) of the Uniform Nonjudicial Foreclosure Act] by acting in good faith. Good faith is established if the debtors:

(1) peaceably vacate the real estate and relinquish any personal property collateral within 21 days after the time of foreclosure and the receipt of a notice demanding possession;

(2) do not engage in activity that significantly reduces the value of the property;

(3) do not commit fraud against the foreclosing creditor;

(4) do not permit significant uncured damage to the property by other persons or natural causes as a consequence of failure to take reasonable precautions against such damage; and

(5) provide reasonable access to the property for inspection by the foreclosing creditor and prospective purchasers.

10. If the debtors, Mary and John Jones, believe that the proposed foreclosure is improper, they may request a meeting with Sandra Mortgagee, a loan officer with First Financial Corp. in this matter, to discuss their objections with her. The debtors may bring another person to the

meeting to advise or assist them if they wish. Ms. Mortgagee can be contacted at 677 First Avenue, Ashland, Example 12344, telephone number 123-654-3210, e-mail address mortgageesa@firstfinancial.com. Ms. Mortgagee must receive a request for a meeting within 30 days after the date of this notice given above; that is, by December 31, 200_. Upon receiving such a request she will schedule a meeting, in person or by telephone, at a mutually convenient time.

11. For further information concerning this foreclosure, any interested person may contact Sandra Mortgagee at the address and telephone number stated in paragraph 10.

12. First Financial Corp. has a limited program to assist defaulting borrowers on residential loans. The program may permit a revision of the terms of the loan in order to make the payments easier for a borrower to make, and may allow borrowers to avoid foreclosure. If the debtors, Mary and John Jones, wish to investigate this program or determine whether they qualify for it, they should contact Sandra Mortgagee at the address and telephone number stated in paragraph 10.

[Signed] Sandra Mortgagee, Loan Officer First Financial Corp.

SECTION 205. REQUEST FOR NOTICE OF FORECLOSURE.

(a) Any person may record in [the office of the county recorder] of the [county] in which the security instrument is recorded a request for notice of foreclosure of a recorded security instrument. The request must state:

(1) the recording data for the security instrument;

(2) the names of the parties to the security instrument;

(3) the name and mailing address of the person requesting notice of foreclosure; and

(4) a legally sufficient description of the real property collateral affected by the security instrument.

(b) A person that records a request under subsection (a) before a notice of foreclosure is recorded is entitled to be given notice of foreclosure under Section 203(a). Recording a request does not affect the title to the real property collateral and does not impute knowledge to any person of an interest in the real property collateral held or claimed by the person requesting notice. A person that records a request for notice under this section may subsequently record an

amendment withdrawing the request or supplementing or correcting the person's name, address, or other information in the request. An amendment is not effective against a foreclosing creditor unless it is recorded before the recording of the notice of foreclosure.

(c) If a foreclosure is completed and a person that recorded a proper request under subsection (a) was not given timely notice of foreclosure, the person is entitled to recover $500 from the foreclosing creditor. No other remedy may be granted or sanction imposed against the foreclosing creditor on behalf of the person for failure to give timely notice of foreclosure under this Section.

Legislative Note: An enacting jurisdiction should consider whether its method of maintaining public real property records necessitates the inclusion of a legal description of the real property collateral in the request for notice under this section. If the jurisdiction maintains only name indexes, a legal description may not be necessary.

Comment

This section permits anyone to become eligible for receipt of a foreclosure notice. For example, a tenant under an unrecorded lease could record a request for notice under this section, and thus could ensure learning that foreclosure has been commenced. Even a person with no legal interest in the collateral, such as a property management company or the parents of the debtor, may record a request under this section.

SECTION 206. MEETING TO OBJECT TO FORECLOSURE.

(a) A residential debtor may request a meeting to object to a foreclosure. The request must be made by a notice received by the foreclosing creditor within 30 days after the notice of foreclosure is given to the debtor.

(b) If the foreclosing creditor receives a timely request for a meeting, the foreclosing creditor or a responsible representative of the foreclosing creditor shall schedule and attend a meeting with the residential debtor requesting it at a mutually agreeable time. The foreclosure may not be completed until the meeting is held or the debtor requesting the meeting fails without

reasonable cause to appear at the scheduled meeting. The representative may be an employee, agent, servicer, or attorney of the foreclosing creditor. The meeting may be held in person or by telephone, video conferencing, or other reasonable means at the election of the foreclosing creditor. If the meeting is held in person, it must be held at a location reasonably convenient to a parcel of the real property collateral unless the debtor and the creditor or representative mutually agree on a different location. If the foreclosing creditor receives requests from more than one residential debtor, the creditor or representative may attempt to arrange a consolidated meeting. The debtors requesting meetings shall cooperate with the foreclosing creditor's effort to do so.

(c) A meeting held pursuant to this section is informal, and the rules of evidence do not apply. The parties may be represented by legal counsel, and the residential debtor may be advised or assisted by another person to the meeting. Documents that provide evidence of the grounds for foreclosure must be available to the foreclosing creditor or representative and provided to the debtor at or before the meeting. The creditor or representative shall consider the objections to foreclosure stated by the debtor. No later than 10 days after the meeting, the creditor shall give to each debtor who requested the meeting a written statement indicating whether the foreclosure will be discontinued or will proceed and the reasons for the determination. Neither the objections to foreclosure stated by the debtor nor the reasons stated by the creditor or representative preclude any person from raising those or other grounds for objecting to or supporting foreclosure in any judicial proceeding. A statement or representation made by a person at the meeting may not be introduced as evidence in any judicial proceeding. Each party bears its own expenses in connection with the meeting.

(d) Neither the foreclosing creditor nor its representative is subject to liability for making a determination that is adverse to a residential debtor who requested a meeting under this section.

A debtor is not subject to liability for requesting or attending a meeting under this section.

Comment

The objective of the informal meeting process provided by this section is to ensure fairness to residential debtors who are at risk of losing their homes in a foreclosure. The meeting is not automatic, but is scheduled only if a residential debtor requests it. Foreclosing creditors have no obligation under the Act to conduct similar meetings at the request of nonresidential debtors, but may do so if they wish.

The responsible representative of the foreclosing creditor is required to determine whether the person requesting the meeting has a legal basis for stopping the foreclosure. This section does not list all of the possible bases for taking such action, and they are left to other law. Illustrative bases would include the fact that the security instrument is a forgery not executed by the debtor, that the secured obligation has already been paid in full, and that the debtor is not in default.

The creditor or creditor's representative must be able to show the debtor, at the meeting, the documentary evidence (commonly in the form of loan payment records) that establish the default that forms the basis of the foreclosure. If the meeting is held telephonically, this documentary information can be furnished to the debtor by mail or facsimile transmission.

It is believed that the meeting required by this section will satisfy the hearing demands of the Due Process Clause, at least with respect to an attack by a residential debtor, if the foreclosing creditor is a governmental entity and hence subject to Due Process obligations. Existing cases establish that the "hearing" need not be formal and need not be before a judicial officer. An employee of the same agency that is conducting the foreclosure is acceptable, at least if that officer is impartial and not in the chain of decision-making that decided to foreclose in the first instance. See Johnson v. U.S. Department of Agriculture, 734 F.2d 774 (11th Cir. 1984); Lisbon Square v. U.S., 856 F.Supp. 482 (E.D.Wis. 1994). (The latter case sustained the Federal Multifamily Mortgage Foreclosure Act, 12 U.S.C. § 3701 et seq., despite its failure to provide a neutral decision-maker.) Since government agencies can provide for such a neutral "responsible representative" by regulation or administrative action, the informal meeting required by this section should satisfy their Due Process obligations to residential debtors. However, since there is no requirement of a meeting with non-debtor holders of subordinate interests in the collateral or with nonresidential debtors, such persons may still be able to raise Due Process claims unless the foreclosing creditor grants them a meeting or hearing voluntarily.

In order to encourage a free flow of information at the meeting, the Act provides that statements made by the parties at the meeting cannot be introduced as evidence in subsequent judicial proceedings. This principle governs other sorts of subsequent hearings, such as administrative proceedings, as well. Only statements made at the meeting *per se* are barred; the underlying facts on which such statements may have been made (such as the records and correspondence of the parties) may, of course, be admissible.

The foreclosing creditor and representative cannot be not held liable for making a determination adverse to the debtor, even if their determination is shown to be wrong. However,

the foreclosing creditor may still be held liable for actually proceeding with the foreclosure if a legal basis for foreclosure did not exist or the foreclosure was conducted wrongfully. In order to encourage free exchange of information at the meeting, statements by the representative of the creditor or admissions by the debtor at the meeting cannot be used in a later judicial proceeding.

SECTION 207. PERIOD OF LIMITATION FOR FORECLOSURE. The time of foreclosure may not be less than 90 days nor more than one year after an original notice of foreclosure is recorded under Section 203 and not less than 30 days after any subsequent notice of foreclosure is recorded. The one-year period of limitation may be extended by agreement of the foreclosing creditor and all persons to which notice of foreclosure was required to be given, other than persons having interests that have been preserved from foreclosure by a notice of preservation pursuant to Section 210. All periods provided in this section are tolled for not more than 180 days while a court order expressly enjoining or staying the foreclosure is in effect and for the period of, and for 45 days after the end of, an automatic stay under Section 362 of the federal Bankruptcy Act (11 U.S.C. Section 101 et. seq.).

Comment

This section constrains the time that may elapse between the giving of an original notice of foreclosure and the foreclosure itself. The minimum time is 90 days, which gives the debtor an opportunity to redeem the collateral. The maximum time is one year, a period designed to prevent a foreclosing creditor's lengthy inaction from leading the debtor to believe that the foreclosure will not occur. The one-year limitation is applicable to all parcels of real estate described in the original notice of foreclosure.

SECTION 208. JUDICIAL SUPERVISION OF FORECLOSURE. An aggrieved person may commence a judicial proceeding for a violation of this [Act] or of other law or principle of equity in the conduct of the foreclosure. If the person commencing the proceeding is a residential debtor, a bond or other security may not be required as a condition for the granting of injunctive

relief. The court may issue any order within the authority of the court in a foreclosure of a mortgage by judicial action, including injunction or postponement of the foreclosure.

Comment

The objective of the Act is to provide a fair procedure under which foreclosures can take place without judicial supervision. However, cases will inevitably arise in which a party believes that judicial involvement or supervision of the foreclosure is necessary. This section provides for such involvement if requested by the debtor, the foreclosing creditor, a person who was entitled to notice of foreclosure under Section 203, or any other aggrieved party, such as a prospective or actual purchaser of the collateral.

The court's powers are analogous to those applicable in judicial foreclosure proceedings. For example, the court may enjoin the foreclosure; set a new foreclosure date; determine the priority of interests in the collateral; direct that the foreclosure be in bulk or by parcels; direct the sequence of foreclosure of parcels in order to marshal assets; or direct the order of distribution of the proceeds of the foreclosure.

The procedural aspects of injunctions against foreclosure – temporary restraining orders, preliminary injunctions, and permanent injunctions, and associated bond requirements – are not spelled out in the Act, but are left to other state law.

SECTION 209. REDEMPTION. A person having the right to redeem collateral from a security interest may not redeem after the time of foreclosure. Unless precluded from doing so by law other than this [Act], upon request a foreclosing creditor shall cooperate with a person that attempts to redeem the collateral from the security interest before the time of foreclosure by promptly providing information concerning the amount due or performance required to redeem.

Comment

Redemption is the equitable right of every debtor and subordinate interest holder to avoid foreclosure by paying or performing the secured obligation prior to foreclosure. This section embodies the fundamental concept of foreclosure – that its effect is to cut off the right of foreclosed parties to redeem the collateral from the security interest. Under the Act there is no right of redemption after the foreclosure is completed.

SECTION 210. NOTICE OF PRESERVATION. A foreclosing creditor may give to any interest holder a notice stating that the interest of the recipient in the collateral will be preserved from and will not be affected by the foreclosure. The notice must be given no later than 30 days before the time of foreclosure unless a later notice is authorized by a specific provision of this [Act]. A notice complying with this section preserves the interest from termination by foreclosure. A foreclosing creditor that gives a notice of preservation under this section may not later revoke the notice or foreclose against the interest of the person to which notice of preservation was given.

Comment

The purpose of a notice of preservation is to permit the foreclosing creditor to prevent a subordinate interest from being terminated by the foreclosure, as would otherwise occur under Section 603. For example, a foreclosing creditor may use a notice of preservation to avoid the termination of a subordinate lease if the creditor believes that the continuation of the lease would be advantageous. Ordinarily the creditor's use of a notice of preservation is entirely optional with the creditor. However, if the creditor has previously given a nondisturbance covenant to a particular tenant, the use of the notice of preservation will provide the creditor with a convenient means of complying with that covenant.

Generally speaking, the notice must be given no later than 30 days prior to the time of foreclosure. However, in a foreclosure by negotiated sale or by appraisal, if the secured creditor receives a notice from an debtor or interest holder objecting to the foreclosure, the creditor can proceed with the foreclosure despite the objection if the creditor gives the person objecting a notice of preservation. See Sections 404(a)(2) and 504(a)(2). Such notices are not subject to the general 30-day rule of this section, although they must be given before the time of foreclosure.

If a notice of preservation is given under this section, the foreclosing creditor is permanently barred from foreclosing against the interest of the person to whom the special notice was given. By contrast, if a foreclosing creditor merely fails to give notice of foreclosure to a person entitled to such notice, the person's interest is preserved from foreclosure (see Section 603), but a person who acquires the foreclosing creditor's rights by virtue of the foreclosure may later foreclose against the person to whom notice of foreclosure was omitted.

[ARTICLE] 3

FORECLOSURE BY AUCTION

SECTION 301. FORECLOSURE BY AUCTION. To foreclose by auction pursuant to this [Act], the secured creditor must comply with the requirements of this [article] and [Articles] 1, 2, and 6.

Comment

This Article describes the procedures for foreclosure by auction, presently the nearly universal method of foreclosing land security interests in the United States. It contains several features that are designed to make the auction sale more attractive to purchasers. These features include the obtaining and exposure to prospective purchasers of title evidence, the potential for making other information and reports available to prospective purchasers, and the authority of the foreclosing creditor to advertise the sale in other ways in addition to the traditional newspaper advertisement.

SECTION 302. TITLE EVIDENCE; OTHER INFORMATION.

(a) If a secured creditor elects to foreclose by auction, the foreclosing creditor shall obtain title evidence and make a copy thereof available upon request to any person. The title evidence must have an effective date no earlier than the time of recording of the original notice of foreclosure and must be issued no later than [30] days after the time of recording. Unless the title evidence is an attorney's opinion, the title evidence must state that the issuer is willing to provide a policy of title insurance to a person that acquires title to the real property by virtue of the foreclosure and the exceptions and exclusions from coverage which the policy will contain.

(b) A foreclosing creditor may make reports and information concerning the collateral other than title evidence available to prospective bidders at the foreclosure.

(c) A foreclosing creditor is not subject to liability because of error in any information disclosed to prospective bidders unless the foreclosing creditor had actual knowledge of the error

when the information was disclosed.

Legislative Note: If the operation of recorders' offices in an adopting jurisdiction is such that title companies or other searchers are unable to locate recorded documents within 30 days after they are submitted for recordation, it may be necessary to extend the 30-day period specified in subsection (a). On the other hand, if recorders' offices make documents available more rapidly than 30 days, it may be advisable to reduce the 30-day period somewhat.

Comment

This section's purpose is to encourage intelligent and knowledgeable bidding at foreclosure sales. Since no one can bid intelligently without first reviewing the title evidence, it is sensible for the foreclosing creditor to pay for that evidence once, rather than expecting multiple bidders to purchase it individually. The foreclosing creditor's expense in obtaining the title evidence can be included with other costs of foreclosure and added to the secured debt. A potential bidder, after reviewing the title evidence, may wish to contact the issuer and obtain a commitment running directly to the bidder.

Foreclosing creditors are encouraged, but not required, to disclose other information they may have concerning the property being foreclosed. Subsection (c) is intended to facilitate this sort of disclosure by limiting the creditor's potential liability for errors in the information. Subsection (c) does not impose liability for erroneous information, but rather states the conditions under which liability does *not* exist. A foreclosing creditor may wish to disclaim liability even for errors of which it has actual knowledge; the Act neither precludes nor validates a disclaimer of that type.

SECTION 303. ADVERTISEMENT OF AUCTION.

(a) After giving notice of foreclosure, a foreclosing creditor shall advertise a foreclosure auction under this [Article]

ALTERNATIVE A

[in a manner that complies with the publication requirements of the law of this State for judicial foreclosure of security interests in real property.]

ALTERNATIVE B

[by placing an advertisement in a newspaper having general circulation in each [county] where any part of the real property collateral is located. The advertisement must be published at least once per week for three consecutive weeks, and the last publication date must not be less than

seven nor more than 30 days before the advertised date of auction.]

(b) No later than 21 days before the advertised date of auction, the foreclosing creditor shall send a copy of the advertisement required by subsection (a) to the persons to which notice of foreclosure was required to be given under Section 203. The advertisement may be sent with the notice of foreclosure or may be sent separately in the manner prescribed for giving notices in [Part] 2 of [Article] 1. The foreclosing creditor may post on the real property collateral a copy of the advertisement or a sign containing information about the auction.

(c) An advertisement required by subsection (a) must contain:

(1) the date, time, and location [by street address and, if applicable, by floor and office number,] of the foreclosure auction;

(2) a statement that sale will be made to the highest qualified bidder;

(3) the amount or percentage of the bid that will be required of the successful bidder at the completion of the auction as a deposit and the form in which the deposit may be made if payment other than by cash or certified check will be accepted;

(4) a legally sufficient description, [the property tax map number] [the parcel identifier number], and the street address or, if there is no street address, location of the real property to be sold;

(5) a brief description of any improvements on the real property and any personal property collateral to be sold;

(6) if the foreclosing creditor is an individual, the name, street and mailing addresses, and telephone number of the foreclosing creditor, or, if the foreclosing creditor is not an individual, the name, street and mailing addresses, and telephone number of an individual who is a representative of the foreclosing creditor, with whom a person may communicate for further

information concerning the collateral and the foreclosure;

(7) a statement that a copy of the title evidence and any applicable reports concerning the collateral or additional information are available from the person identified pursuant to paragraph (6); and

(8) a statement as to whether access to the collateral for the purpose of inspection before foreclosure is available to prospective bidders and, if applicable, how to obtain access.

(d) An advertisement required by subsection (a) may contain any other information concerning the collateral or the foreclosure that the foreclosing creditor elects to include.

Legislative note: Adopting jurisdictions may select Alternative A, which incorporates the jurisdiction's existing auction foreclosure procedures, or may select Alternative B, under which the Act itself will specify those procedures.

Comment

The advertising requirement stated in this section represents a minimum. The foreclosing creditor may advertise the property in any other reasonable manner, and the cost of such advertisements is a proper foreclosure expense. For example, the foreclosing creditor may post information about the sale on an internet site that provides information about foreclosures, whether the site is operated by a private party or by an entity of state or local government.

The provision in subsection (b) concerning the posting of a sign or advertisement on the real property creates a legal license for the secured creditor or its representative to enter on the premises for that purpose, even if contrary to the wishes of the owner or persons in possession.

The following is an example of a sufficient advertisement.

Foreclosure Auction

A foreclosure auction will be held on March 27, 200_ at 10:00 am at the offices of Street and Black, Attorneys at Law, 1250 Main Street, Suite 400, Ashland, Example 12344. Sale will be made to the highest qualified bidder. The successful bidder must make a deposit of five percent of the bid immediately upon completion of the sale. The deposit must be in the form of a cashier's check or certified check.

The real property to be sold is Lot 13, Block B, Ridgefield Addition No. 2 (Parcel Number 134552), as shown in Plat Book 33, Page 141, Official Records of Pembroke County, State of Example, with a street address of 455 South Main Street, Ashland, Example 12345. The real property consists of a two-story single-family house with a detached garage. No personal property

is being sold with the real property.

For additional information concerning the property, contact Sandra Mortgage, a loan officer with First Financial Corp., 677 First Avenue, Ashland, Example 12344, telephone number 123-654-3210, e-mail address mortgageesa@firstfinancial.com. Prospective bidders may obtain copies of a preliminary title insurance report and an appraisal of the property by contacting Ms. Mortgagee. The property is vacant, and prospective bidders may obtain access for purposes of inspecting it by contacting Ms. Mortgagee. The property is located in Special Street Improvement District No. 34, as established by the City of Ashland, State of Example, and special assessments of $605 per year are assessed against it until the year 200_.

SECTION 304. ACCESS TO COLLATERAL. If a creditor foreclosing by auction has authority to grant access to the real property collateral, the creditor shall reasonably accommodate a person that contacts the creditor, expresses an interest in bidding at the foreclosure auction, and requests an opportunity to inspect the collateral.

Comment

A debtor has no general legal obligation to allow access to the real property prior to the foreclosure for the purposes of allowing prospective buyers to inspect. However, the debtor or the debtor's tenants may voluntarily grant such access, or the right of access may be granted by the terms of the security instrument. In the case of a residential debtor, the granting of reasonable access is an element that is considered in assessing the debtor's good faith, and hence the debtor's freedom from deficiency liability under Section 607.

If the foreclosing creditor is able to grant access to prospective bidders, it can do so in a manner reasonably convenient to itself. For example, the creditor may schedule inspections at certain times and days, and may require that interested prospective bidders meet that schedule.

SECTION 305. LOCATION AND TIME OF AUCTION. An auction under this [article] must be conducted:

(1) at a date and time permitted for an auction under judicial foreclosure of a security interest in real property;

(2) in a [county] where any part of the real property collateral to be auctioned is located;

and

ALTERNATIVE A

[(3) at a location where an auction under judicial foreclosure of a security interest in real property may be held.]

ALTERNATIVE B

[(3) at:

(A) a main door of the [county] courthouse or, if prominent signs near a main door identify that location, another location in the courthouse; [or]

(B) the site of the real property collateral [; or] [.]

[(C) a location that is readily accessible to the public and bears a standard street address.]]

Legislative note: Adopting jurisdictions may select Alternative A, which incorporates the jurisdiction's existing provisions concerning auction location, or may select Alternative B, under which the Act itself will specify the location. If Alternative B is selected, the jurisdiction may wish to identify some other public location in lieu of the "main door of the courthouse" in order to conform to local custom. It may or may not wish to include subsection (3)(C), which gives the creditor greater latitude in determining the location of the auction.

SECTION 306. FORECLOSURE OF TWO OR MORE PARCELS.

(a) Collateral consisting of two or more parcels of real property may be foreclosed by auction separately or in combination as provided in the security instrument. If the security instrument does not specify the manner of sale of two or more parcels, the auction may be conducted:

(1) by a separate auction of each of the parcels; or

(2) if at the time notice of foreclosure is recorded two or more parcels are contiguous, being used in a unitary manner, part of a unitary plan of development, or operated under

integrated management:

(A) by combining the parcels in a single auction; or

(B) by conditionally offering the parcels at auction both in combination and separately and accepting the higher of the two aggregate bids.

(b) If collateral consisting of two or more parcels of real property is not made the subject of a single auction, the foreclosing creditor shall discontinue sales of parcels or combinations of parcels when the total amount of bids received is sufficient to pay the secured obligation and the expenses of foreclosure.

Comment

This section deals with the question whether multiple parcels should be offered for sale separately or together. There is no corresponding provision in the Act for foreclosure by negotiated sale or by appraisal. The Act does not constrain the choice of the foreclosing creditor in those situations, since debtors and holders of junior interests can give a notice of objection and prevent the foreclosure from proceeding if they do not agree with the foreclosing creditor's choice.

The security instrument controls the manner of auction of multiple parcels. If it does not speak to the issue, the foreclosing creditor may in all cases sell the parcels separately. In its discretion, it may instead sell them in combination, or conditionally offer them separately and in combination, if they are contiguous, are being used in a unitary manner, are part of a unitary plan of development, or are operated under a single management. This test is applied as of the date the notice of foreclosure is given, and is intended to assure that the parcels have a sufficient relationship to one another that some prospective purchasers will probably be interested in buying more than one parcel. Note that the term "integrated management" does not necessarily require that the same business entity is managing the parcels; the test is whether as a practical matter the same management controls the parcels and operates them in an integrated fashion, even if it does so through multiple business entities. Likewise, the fact that the same entity conducts the management of two or more parcels does not necessarily establish that they are under "integrated management."

A court order marshaling assets or directing the order of sale of multiple parcels will supersede the provisions of this section.

SECTION 307. POSTPONEMENT OF AUCTION.

(a) An individual conducting an auction under this [article] may postpone the auction for any cause the foreclosing creditor considers appropriate. Announcement of the postponement and the time and location of the rescheduled auction must be given orally at the place and time advertised for commencement of the auction. No other advertisement or notice of the postponed time and place of auction is required. An auction may be postponed more than once, but each postponement may be for not more than 30 days.

(b) If an auction cannot be held at the time stated in the advertisement of auction because of an automatic stay under Section 362 of the federal Bankruptcy Act (11 U.S.C. Section 101, et seq.) or an express stay order issued by a court, the foreclosing creditor may reschedule the auction. The rescheduled auction must be advertised and a copy of the advertisement given to each person entitled to a copy as provided by Section 303.

Comment

The foreclosing creditor may elect to postpone the auction for up to 30 days. This may be deemed expedient, for example, because of inclement weather, the absence of sufficient bidders, or damage occurring to the property. The announcement of the postponement must be made "at" the advertised time and place. This does not require absolute temporal precision. If the auction is scheduled for 10:00 am, it may not be apparent to the person conducting the sale that few bidders, or no bidders at all, will appear until a few minutes past 10:00. Making the announcement of postponement after a few minutes delay is practical and acceptable.

A judicial stay, or an automatic stay in bankruptcy, acts as a postponement, but is not subject to the 30-day limitation. Postponements may not result in the date of the auction extending beyond the period of limitation stated in Section 207.

SECTION 308. CONDUCT OF AUCTION.

(a) An auction under this [article] must be conducted by a person designated by the foreclosing creditor according to the following rules:

(1) The person conducting the auction, before commencing the auction:

(A) shall make available to prospective purchasers copies of the title evidence;

(B) may make available to prospective purchasers other reports and information concerning the collateral; and

(C) may verify that a person intending to bid has the present ability to make the deposit stated in the advertisement but may not disclose the amount that a bidder is prepared to deposit.

ALTERNATIVE A

[(2) Any person, including a debtor and the foreclosing creditor, may bid at the auction. The individual conducting the auction, if authorized, may bid on behalf of the foreclosing creditor but may not bid for the individual's own account. The foreclosing creditor may bid by credit any amount up to the balance owing on the secured obligation, including the expenses of foreclosure.

(3) A person may submit a fixed bid by a document received at least 24 hours before the scheduled time of the auction by the person designated in the advertisement of auction to provide information about the property. The bid must be accompanied by a deposit satisfying the requirements of Section 309. The bid must be read aloud by the person conducting the auction before the auction is opened to oral bids.

(4) The property must be sold to the person that complies with this section and Sections 309 and 310(a) and bids the highest amount.

(5) The auction is completed by the announcement of the person conducting the auction that the property is "sold."]

ALTERNATIVE B

[(2) The auction must be conducted in the manner prescribed by law in this State for auctions of real property in a judicial foreclosure of a mortgage.]

Legislative note: Adopting jurisdictions may select Alternative A, under which the Act will supply the bidding procedures, or may select Alternative B, which incorporates the jurisdiction's existing bidding procedures for foreclosure auctions.

Comment

In addition to the title evidence which must be made available, the person conducting the auction may make other reports or information available to prospective bidders as provided in Section 302(b). The foreclosing creditor is protected against liability for errors in such information as provided in Section 302(c).

The foreclosing creditor may make a credit bid up to the amount owing on the secured obligation, and may make a cash bid to the extent of any bid exceeding the amount owing if the foreclosing creditor wishes to do so.

Bids sent by persons not attending the auction must be fixed – that is, for a specific amount. Contingent bids (i.e., bids with amounts dependent on the amounts of other bids made at the auction) are not permitted.

The completion of the auction is marked by the announcement "sold." However, title to the auctioned collateral does not pass to the successful bidder at that time, since the bidder is not yet required to pay the full bid price. On payment of the remainder of the bid, see Section 310. On the passage of title, see Sections 602 and 603.

SECTION 309. DEPOSIT BY SUCCESSFUL BIDDER. Immediately after the auction is completed, the successful bidder, if other than the foreclosing creditor or the creditor's agent, shall pay a deposit to the person conducting the auction. The deposit must be at least 10 percent of the amount of the bid or such lower amount as the advertisement of auction stated would be accepted. The deposit must be in the form of cash, certified check, or such other form of payment as was stated in the advertisement of auction to be acceptable or is acceptable to the person conducting the auction.

SECTION 310. PAYMENT OF REMAINDER OF BID.

(a) The successful bidder at an auction under this [article] shall pay the remainder of the bid to the foreclosing creditor within seven days after the date of completion of the auction.

(b) If payment of the remainder of the bid is timely made, the foreclosing creditor shall complete the foreclosure pursuant to Section 602.

(c) If payment of the remainder of the bid is not timely made, the foreclosing creditor shall discontinue the foreclosure pursuant to Section 601, and the deposit of the successful bidder is forfeited and must be distributed by the foreclosing creditor pursuant to Section 604. The defaulting bidder is not subject to any other liability on account of the default.

Comment

If the high bidder defaults in making timely payment of the remainder of the bid, the auction must be discontinued. Neither the second-highest bidder nor any other bidders are entitled to have their bids substituted for that of the high bidder.

SECTION 311. FORECLOSURE AMOUNT; DISTRIBUTION OF PROCEEDS. If foreclosure by auction under this [article] is completed pursuant to Section 602, the highest amount bid at the auction is the foreclosure amount. The foreclosure amount must be applied and distributed by the foreclosing creditor pursuant to Section 604.

[ARTICLE] 4

FORECLOSURE BY NEGOTIATED SALE

SECTION 401. FORECLOSURE BY NEGOTIATED SALE. To foreclose by negotiated sale pursuant to this [Act], the secured creditor must comply with the requirements of this [article] and [Articles] 1, 2 and 6.

Comment

This section provides for foreclosure by negotiated sale, a method that may in some cases be quicker and more efficient than the traditional auction sale. However, it may be employed only if no objection is made to it by those whose interests will be terminated by it. Those persons are entitled to notice of the negotiated sale, and if they make a timely objection to it, the sale cannot proceed unless the foreclosing creditor preserves their interests from the terminating effect of the foreclosure or discharges the obligations owed to them. If a foreclosure by negotiated sale cannot be completed because of such objections, the foreclosing creditor may either pursue a new foreclosure by negotiated sale or resort to one or more of the other methods of foreclosure. In all events the foreclosure must be completed within the period of limitation of Section 207.

SECTION 402. ADVERTISEMENT AND CONTRACT OF SALE.

(a) A creditor foreclosing by negotiated sale may enter into a contract of sale with a prospective purchaser or, if the collateral is sold in parcels, with more than one purchaser. The contract must state the gross sale price, before deduction of expenses of sale, that the purchaser will pay for the collateral. The foreclosing creditor's obligation to sell under the contract is subject to the following conditions, which must be stated in the contract:

(1) that no objection to the foreclosure is made under Section 404; and

(2) that no redemption of the collateral from the security interest is made before the time of foreclosure.

(b) The foreclosing creditor may advertise the collateral for sale to prospective purchasers

by whatever method the foreclosing creditor considers appropriate and may list the collateral for sale with a broker. The foreclosing creditor may post on the real property collateral a sign containing information about the sale.

Legislative Note: Adopting jurisdictions should consider whether the creditor's privilege of listing the property with a real estate broker, despite the fact that the creditor has not yet acquired title, would conflict with existing laws or regulations governing real estate brokerage. If so, an express provision overriding such laws in the context of a foreclosure under the Act would be appropriate.

Comment

The foreclosing creditor has wide discretion in advertising the property. Newspapers, broadcast media, magazines, the internet, and other reasonable methods may be used. The creditor may (but is not required to) place an advertisement on the real property being foreclosed.

While the contract of sale must state the gross cash price that the purchaser agrees to pay, the actual payment need not be in cash. The contract may provide may provide for installment payments or other forms of financing by the foreclosing creditor. Similarly, while the stated gross cash price must be net of all expenses of sale, the contract may allocate the expenses of sale between the foreclosing creditor and the purchaser in any manner they agree.

The right of the foreclosing creditor to post a sale on the property advertising its availability for sale is, in effect, a licence to enter on the property for that purpose, even if contrary to the wishes of the owner or tenants.

SECTION 403. NOTICE OF PROPOSED NEGOTIATED SALE; FORECLOSURE AMOUNT.

(a) If a foreclosing creditor enters into a contract of sale as provided in Section 402, the foreclosing creditor shall give notice of the proposed sale at least 30 days before the date of the proposed sale to the persons specified in Section 203(c). The notice of proposed sale must state:

(1) the date on or after which the foreclosing creditor proposes to sell the collateral;

(2) the gross sale price stated in the contract of sale;

(3) the amount that the foreclosing creditor offers to credit against the secured

obligation and distribute to other persons entitled thereto;

(4) the manner in which the amount stated in paragraph (3) will be applied, which must be consistent with Section 604;

(5) that if the sale is completed, title to the collateral will be transferred to the purchaser under the contract as of the time of foreclosure;

(6) if the foreclosing creditor is an individual, the name, street and mailing addresses, and telephone number of the foreclosing creditor, or, if the foreclosing creditor is not an individual, the name, street and mailing addresses, and telephone number of an individual who is a representative of the foreclosing creditor, with whom a person may communicate for further information concerning the foreclosure or to inspect a copy of the contract of sale; and

(7) that, if a debtor or person holding a lien on the real property collateral subordinate in priority to the foreclosing creditor's security interest objects to the foreclosure and gives the foreclosing creditor a notice so stating, and the notice is received by the foreclosing creditor no later than seven days before the date of proposed sale, the foreclosing creditor will discontinue the foreclosure by negotiated sale, give the objecting person a notice of preservation pursuant to Section 210, or, if the objecting person's interest is a lien, discharge the lien.

(b) The amount stated pursuant to subsection (a)(3) is the foreclosure amount.

(c) The foreclosure amount need not be identical to, but must be at least 85 percent of, the gross sale price stated in the contract of sale.

Comment

The foreclosure amount must be stated net of foreclosure and sale expenses; in other words, the foreclosing creditor is left with the responsibility for paying the foreclosure expenses and any other costs associated with performance of the contract of sale. The foreclosure amount may be more or less than the actual price the purchaser agrees to pay, and is determined in the foreclosing creditor's discretion, but must be at least 85% of the gross sale price.

The foreclosing creditor might arrive at the foreclosure amount by taking the gross sale price and reducing it by the various expenses of foreclosure and sale that the foreclosing creditor expects to pay. In effect, the foreclosing creditor is offering to apply this foreclosure amount against the secured indebtedness, to the payment of subordinate liens, and to the debtor, in that order. The persons who are entitled to object must decide whether this amount is acceptable to them. The gross sale price stated in the negotiated sale contract provides some basis for the debtor and subordinate lien holders to judge whether the foreclosure amount offered by the foreclosing creditor is acceptable. If one or more of them believes that a different form of foreclosure will produce a higher amount, there is a logical basis for the making of an objection to the proposed negotiated sale. However, there is no requirement that a person objecting give a reason for the objection. As a matter of self-interest, those with the right to object will not do so if they consider the proposed foreclosure amount reasonable.

The debtor and junior interest holders also have the right to protect themselves from the foreclosure by redeeming any time prior to the time of foreclosure.

The following is an illustrative notice of proposed foreclosure by negotiated sale.

Notice of Proposed Foreclosure by Negotiated Sale

1. First Financial Corp. gave notice on December 1, 200_, of its foreclosure of the property owned by Mary and John Jones, and located at Lot 13, Block B, Ridgefield Addition No. 2, in the City of Ashland, County of Pembroke, State of Example. The street address of this property is 455 South Main Street, Ashland, Example 12345.

This notice is to advise that First Financial Corp. proposes to complete the foreclosure by means of a negotiated sale to take place on March 15, 200_, pursuant to a contract of sale into which First Financial Corp. has entered.

2. The gross sale amount under the contract of sale is $125,500.

3. If the sale is completed, First Financial proposes to credit the sum of $113,750.

4. This sum will be applied in its entirety against the indebtedness owed to First Financial Corp. secured by the property, but will not be sufficient to fully discharge that indebtedness.

5. If the sale is completed, First Financial will transfer title to the property to the purchaser under the contract of sale, effective no earlier than the sale date given in paragraph 1.

6. For further information concerning this proposed foreclosure by negotiated sale, interested persons may contract Jane A. Doe, attorney at law, who represents First Financial Corp. in this matter. Ms. Doe can be contacted at 123 Main Street, City of Ashland, State of Example, at telephone number 123-654-3210, or by e-mail at doej@doelawfirm.com. Ms. Doe will also provide interested persons with the opportunity to inspect the contract of sale upon request.

7. If Mary or John Jones, or any person holding a lien on the property that is subordinate in

priority to the foreclosing creditor's security interest, objects to the foreclosure, the objecting person may give First Financial Corp. a notice so stating. The notice may be directed by Ms. Doe at the address and telephone number given in paragraph 6. Any such notice must be received by Ms. Doe on or before March 8, 200_. If a notice of objection is received by that date, First Financial will either:

(A) discontinue the foreclosure by negotiated sale and attempt to foreclose again by the same or a different method; or

(B) if the objecting person holds a lien on the property:

(1) give the objecting person a notice of preservation, which will have the effect of keeping the objecting person's lien in effect notwithstanding the foreclosure; or

(2) pay off and discharge the objecting person's lien.

[Signed] Jane A. Doe
Attorney at Law
Representing First Financial Corp.

SECTION 404. NOTICE OF OBJECTION TO FORECLOSURE BY NEGOTIATED SALE.

(a) If, seven or more days before the date of a proposed sale under this [article], the foreclosing creditor receives notice of objection to the foreclosure from a debtor or a person that holds a lien on the real property collateral subordinate in priority to the foreclosing creditor's security interest, the foreclosing creditor shall:

(1) discontinue the foreclosure pursuant to Section 601, in which case the notice of objection has no further effect;

(2) if the person that made the objection holds a lien on the real property collateral and the purchaser under the contract of sale consents, give notice pursuant to Section 210, before the time of foreclosure, to the person that made the objection that the person's lien will be preserved from termination by the foreclosure; or

(3) if the person that made the objection holds a lien on the real property collateral that can be discharged by payment of a sum of money, tender that sum or other consideration acceptable to the person and thereby discharge the lien, in which case the notice of objection has no further effect.

(b) If the foreclosing creditor gives notice pursuant to subsection (a)(2):

(1) the foreclosing creditor and the purchaser may adjust the gross sale price, but not the foreclosure amount, by mutual agreement to reflect the existence of the preserved lien;

(2) the foreclosing creditor may disregard the objection of the person to which the notice is given;

(3) the foreclosure by negotiated sale may be completed pursuant to Section 602;

(4) the affidavit recorded pursuant to Section 602 must state that the objecting person's lien is not terminated by the foreclosure; and

(5) the person notified is not entitled to any of the foreclosure amount by virtue of the preserved lien.

(c) If the foreclosing creditor pays the consideration or makes a tender as provided in subsection (a)(3) and keeps the tender in effect, the person to which the tender is made must provide the foreclosing creditor with a suitable document in recordable form evidencing that the person's interest has been discharged.

(d) After expiration of the time for objection specified in subsection (a), a person given notice of foreclosure pursuant to Section 203 and notice of proposed sale pursuant to Section 403 may assert that the foreclosure amount was inadequate only if it was less than 85 percent of the gross sale price stated in the contract of sale.

Comment

Under subsection (a), if the foreclosing creditor receives an objection to the proposed sale, there are two ways that the foreclosing creditor may neutralize the objection and carry out the sale. The first is simply to notify the objector under Section 210 that the objector's interest in the collateral will be preserved from the effect of the foreclosure. The holder of such an interest cannot reasonably object to the sale's consummation, since the foreclosure will not affect that interest. The affidavit that the foreclosing creditor must record in order to consummate the foreclosure must identify the subordinate interests in the property that are being terminated by the foreclosure, and also any interests that remain unaffected by the foreclosure because their holders were given a notice of preservation.

Before giving the objecting lienor a notice of preservation, the foreclosing creditor must obtain the consent of the purchaser under the contract. The reason is that the title to the property, as it will be received by the purchaser, will be changed if the objecting lienor's lien is preserved. Typically the purchaser will insist, in return for consenting to the preservation of the lien, a reduction in the purchase price equivalent to the amount of the lien. Even though the purchase price may be reduced by the parties' agreement, the foreclosure amount may not. Hence, any reduction in the purchase price will mean that the foreclosing creditor will receive less net value for the property.

An alternative way for the foreclosing creditor to neutralize an objection to the sale, provided by subsection (a)(3), is to tender the amount owed to the objector. This procedure is always permissible if the objector's interest can be discharged for a liquidated sum. Most mortgages and other liens fit this description. On the other hand, if the objector's lien secures performance of an act other than payment of a liquidated amount of money, or secures a contingent obligation to pay money, the "buy-out" procedure of subsection (a)(3) will be available only if the foreclosing creditor and the objector can reach an agreement as to the amount of money that objector will accept to discharge the lien.

Both of the methods of neutralizing an objection to the sale discussed above – preserving the objector's lien or paying it off – are likely to be used only in cases in which the objector's lien is for a relatively small amount. The reason is that both methods of neutralizing the objection also reduce the effective value of the security property to the foreclosing creditor, and if the reduction in value would be significant, the creditor is likely simply to try a different method of foreclosure instead.

A debtor or subordinate interest-holder who has been given the appropriate notices of foreclosure and of the proposed negotiated sale, and who does not prevent consummation of the sale by making a timely objection to it, is prohibited from attacking the sufficiency of the foreclosure amount thereafter, provided that the foreclosure amount was at least 85% of the gross sale price.

SECTION 405. COMPLETION OF SALE. Unless the foreclosing creditor discontinues

the foreclosure by negotiated sale pursuant to Section 404(a)(1), the foreclosing creditor may complete the sale as provided in Section 602 pursuant to the contract of sale.

[ARTICLE] 5

FORECLOSURE BY APPRAISAL

SECTION 501. FORECLOSURE BY APPRAISAL. To foreclose by appraisal pursuant to this [Act], the secured creditor must comply with the requirements of this [article] and [Articles] 1, 2 and 6.

Comment

This section provides for foreclosure by appraisal as an alternative to foreclosure by auction or negotiated sale. Unlike the latter two methods, foreclosure by appraisal transfers title to the collateral directly to the foreclosing creditor or its nominee. In that respect it is similar to strict foreclosure at common law. An important difference, however, is that the creditor must notify all subordinate interest holders of the amount, net of all expenses of foreclosure, that it is willing to pay for the property, and the foreclosure can proceed only if no objection is made by those whose interests will be terminated by the foreclosure. Those persons are entitled to notice of the negotiated sale, and if they make a timely objection to it, the sale cannot proceed unless the foreclosing creditor preserves their interests from the terminating effect of the foreclosure or discharges the obligations owed to them. If foreclosure by appraisal cannot be completed because of such objections, the foreclosing creditor may either pursue a new foreclosure by appraisal or resort to one or more of the other methods of foreclosure. In this way foreclosure by appraisal under this Section is similar to foreclosure by negotiated sale under Article 4. In all events the foreclosure must be completed within the period of limitation imposed by Section 207.

In some respects a foreclosure by appraisal is similar to a deed in lieu of foreclosure. Both result in a transfer of title of the collateral to the secured creditor. The important difference is that a foreclosure by appraisal has the same legal effect as any other foreclosure; that is, it terminates the subordinate interests in the collateral that are not specifically preserved, an effect that a deed in lieu does not have.

SECTION 502. APPRAISAL. A creditor foreclosing by appraisal shall obtain a written appraisal of the collateral. The debtor and other persons in possession of the collateral shall provide reasonable access to the collateral to the appraiser. The appraisal report must state the appraiser's conclusion as to the fair market value of the collateral as of a date not more than 60 days before the date of proposed foreclosure stated in the notice of appraisal. The appraisal must

be made by an independent appraiser who is not an employee or affiliate of the foreclosing creditor or its servicer and who is designated as a certified or licensed appraiser by the [Appraisal Certification Board] of this State with respect to the type of real property to be appraised. If the real property collateral is residential real property, the appraisal must conform to the underwriting requirements of institutional lenders that regularly lend money secured by first mortgages on residential real estate or regularly purchase those mortgages.

Comment

In a foreclosure under this Article the foreclosing creditor must obtain an appraisal of the collateral by a certified appraiser and forward it to the debtor and other holders of subordinate interests in the collateral. For residential real property, the appraisal must conform to the standards of the primary and secondary mortgage markets; at the present time, this means an appraisal meeting the requirements of Fannie Mae and Freddie Mac. However, such standards may evolve over time as practices in the mortgage market change.

The purpose of the appraisal is to assist the junior interest-holders in deciding whether or not to object to the amount of the creditor's offered foreclosure amount. However, that amount may be either lower or higher than the appraised value, and is determined entirely in the foreclosing creditor's discretion. If one or more of the subordinate interest-holders believes that a different form of foreclosure will produce a higher amount, they have a logical basis for making an objection to the proposed foreclosure by appraisal.

The reference to "the type of property to be appraised" is included in subsection (b) because appraiser certification systems in some jurisdictions make distinctions between, for example, residential and commercial appraisers. In such jurisdictions the appraiser employed under this Article must have the proper credentials for the type of property to be appraised.

Since persons in possession of the real property collateral have a duty to provide reasonable access to the appraiser, they may be subjected to a judicial order upon the petition of the foreclosing creditor if they fail to do so voluntarily.

If the foreclosure includes personal property collateral, the appraisal must cover it as well as the real property. In the secured creditor's discretion, a single appraiser may provide a report on the value of both real and personal property, or two different appraisers may be used for the two types of property.

SECTION 503. NOTICE OF APPRAISAL; FORECLOSURE AMOUNT.

(a) The foreclosing creditor shall give notice of the appraisal at least 30 days before the

date of proposed foreclosure to the persons specified in Section 203(c). The notice of appraisal must be accompanied by a copy of the appraisal report and must state:

(1) the date on or after which the foreclosing creditor proposes to foreclose the collateral;

(2) the appraised value of the collateral as stated in the appraisal report;

(3) the amount that the foreclosing creditor offers to credit against the secured obligation and distribute to other persons entitled thereto;

(4) the manner in which the stated foreclosure amount will be applied, which must be consistent with Section 604;

(5) that, if the foreclosure is completed, title to the collateral will be transferred to the foreclosing creditor as of the time of foreclosure;

(6) if the foreclosing creditor is an individual, the name, street and mailing addresses, and telephone number of the foreclosing creditor or, if the foreclosing creditor is not an individual, the name, street and mailing addresses, and telephone number of an individual who is a representative of the foreclosing creditor with whom a person may communicate for further information concerning the foreclosure; and

(7) that, if a debtor or person holding a lien on the collateral subordinate in priority to the foreclosing creditor's security interest objects to the foreclosure and gives the foreclosing creditor a notice so stating and the notice is received by the foreclosing creditor no later than seven days before the date of proposed foreclosure, the foreclosing creditor will discontinue the foreclosure by appraisal, give the objecting person a notice of preservation pursuant to Section 210, or, if the objecting person's interest is a lien, discharge the objecting person's interest.

(b) The amount stated pursuant to Section (a)(3) is the foreclosure amount.

(c) The foreclosure amount need not be identical to, but must be at least 85 percent of, the value of the collateral as stated in the appraisal report.

Comment

The foreclosure amount may be more or less than the value stated in the appraisal, and is determined in the foreclosing creditor's discretion, but must be at least 85% of the appraised value. The foreclosing creditor might arrive at the foreclosure amount by taking the appraised value and reducing it by the creditor's estimate of the probable expenses of holding and disposing of the property. In effect, the foreclosing creditor is offering to apply this foreclosure amount against the secured indebtedness, to the payment of subordinate liens, and to the debtor, in that order. The persons who are entitled to object must decide whether this amount is acceptable to them. The appraised value provides some basis for the debtor and subordinate lien holders to judge whether the foreclosure amount offered by the foreclosing creditor is acceptable. If one or more of them believes that a different form of foreclosure will produce a higher amount, there is a logical basis for the making of an objection to the proposed foreclosure by appraisal. However, there is no requirement that a person objecting give a reason for the objection. As a matter of self-interest, those with the right to object will not do so if they consider the proposed foreclosure amount reasonable.

The debtor and junior interest holders also have the right to protect themselves from the foreclosure by redeeming any time prior to the time of foreclosure.

The following is an illustrative notice of proposed foreclosure by appraisal.

Notice of Proposed Foreclosure by Appraisal

1. First Financial Corp. gave notice on December 1, 200_, of its foreclosure of the property owned by Mary and John Jones, and located at Lot 13, Block B, Ridgefield Addition No. 2, in the City of Ashland, County of Pembroke, State of Example. The street address of this property is 455 South Main Street, Ashland, Example 12345.

This notice is to advise that First Financial Corp. proposes to complete the foreclosure by means of a foreclosure by appraisal, to take place on March 15, 200_.

2. The appraised value of the property, as of January 20, 200_, is $126,750. A copy of the appraisal report is attached to this notice.

3. If the sale is completed, First Financial proposes to credit the sum of $113,750.

4. This sum will be applied in its entirety against the indebtedness owed to First Financial Corp. secured by the property, but will not be sufficient to fully discharge that indebtedness.

5. If the foreclosure is completed, First Financial will transfer title to the property to itself, effective no earlier than the foreclosure date given in paragraph 1.

6. For further information concerning this proposed foreclosure by appraisal, interested persons may contract Jane A. Doe, attorney at law, who represents First Financial Corp. in this matter. Ms. Doe can be contacted at 123 Main Street, City of Ashland, State of Example, at telephone number 123-654-3210, or by e-mail at doej@doelawfirm.com.

7. If Mary or John Jones, or any person holding a lien on the property that is subordinate in priority to the foreclosing creditor's security interest, objects to the foreclosure, the objecting person may give First Financial Corp. a notice so stating. The notice may be directed by Ms. Doe at the address and telephone number given in paragraph 6. Any such notice must be received by Ms. Doe on or before March 8, 200_. If a notice of objection is received by that date, First Financial will either:

(A) discontinue the foreclosure by appraisal and attempt to foreclose by a the same or a different method; or

(B) if the objecting person holds a lien on the property:

(1) give the objecting person a notice of preservation, which will have the effect of keeping the objecting person's lien in effect notwithstanding the foreclosure; or

(2) pay off and discharge the objecting person's lien.

[Signed] Jane A. Doe
Attorney at Law
Representing First Financial Corp.

SECTION 504. NOTICE OF OBJECTION TO FORECLOSURE BY APPRAISAL.

(a) If, seven or more days before the date of proposed foreclosure under this [article], a foreclosing creditor receives notice of objection to the foreclosure from a debtor or a person that holds a lien on the real property collateral subordinate in priority to the foreclosing creditor's security interest, the foreclosing creditor shall:

(1) discontinue the foreclosure pursuant to Section 601, in which case the notice of objection has no further effect;

(2) give notice pursuant to Section 210, before the time of foreclosure, to the person that made the objection that the person's interest in the collateral will be preserved from

termination by the foreclosure; or

(3) if the person that made the objection holds a lien on the real property collateral that can be discharged by payment of a sum of money, tender that sum or other consideration acceptable to the person and thereby discharge the lien, in which case the notice of objection has no further effect.

(b) If the foreclosing creditor gives notice pursuant to subsection (a)(2):

(1) the foreclosing creditor may disregard the objection of the person to which such notice is given;

(2) the foreclosure by appraisal may be completed as provided in Section 602;

(3) the affidavit recorded pursuant to Section 602 must state that the objecting person's interest in the collateral is not terminated by the foreclosure; and

(4) the person notified is not entitled to any of the foreclosure amount by reason of the preserved lien.

(c) If the foreclosing creditor pays the consideration or makes a tender as provided in subsection (a)(3) and keeps the tender in effect, the person to which the tender is made must provide the foreclosing creditor with a suitable document in recordable form evidencing that the person's interest has been discharged.

(d) After expiration of the time for objection specified in subsection (a), a person given notice of foreclosure pursuant to Section 203 and notice of appraisal pursuant to Section 503 may assert that the foreclosure amount was inadequate only if it was less than 85 percent of the appraised value of the collateral as stated in the appraisal report.

Comment

Under subsection (a), if the foreclosing creditor receives an objection to the proposed foreclosure by appraisal, there are two ways that the foreclosing creditor may neutralize the

objection and carry out the foreclosure. The first is simply to notify the objector under Section 210 that the objector's interest in the collateral will be preserved from the effect of the foreclosure. The holder of such an interest cannot reasonably object to the sale's consummation, since the foreclosure will not affect that interest. The affidavit that the foreclosing creditor must record in order to consummate the foreclosure must identify the subordinate interests in the property that are being terminated by the foreclosure, and also any interests that remain unaffected by the foreclosure because their holders were given a notice of preservation.

An alternative way for the foreclosing creditor to neutralize an objection to the foreclosure by appraisal, provided by subsection (a)(3), is to tender the amount owed to the objector. This procedure is always permissible if the objector's interest can be discharged for a liquidated sum. Most mortgages and other liens fit this description. On the other hand, if the objector's lien secures performance of an act other than payment of a liquidated amount of money, or secures a contingent obligation to pay money, the "buy-out" procedure of subsection (a)(3) will be available only if the foreclosing creditor and the objector can reach an agreement as to the amount of money or other performance that objector will accept to discharge the lien.

Both of the methods of neutralizing an objection to the foreclosure discussed above – preserving the objector's lien or paying it off – are likely to be used only in cases in which the objector's lien is for a relatively small amount. The reason is that both methods of neutralizing the objection also effectively reduce the value of the security property to the foreclosing creditor, and if the reduction in value would be significant, the creditor is likely simply to try a different method of foreclosure instead.

A debtor or subordinate interest-holder who has been given the appropriate notices of foreclosure and of the proposed foreclosure by appraisal, and who does not prevent consummation of the sale by making a timely objection to it, is prohibited from attacking the sufficiency of the foreclosure amount thereafter. In effect, such parties are estopped to question the foreclosure amount, provided that the foreclosure amount was at least 85% of the appraised value as shown on the appraisal report.

SECTION 505. COMPLETION OF FORECLOSURE. Unless the foreclosing creditor discontinues the foreclosure by appraisal pursuant to Section 504(a)(1), the foreclosing creditor may complete the foreclosure as provided in Section 602 on or after the date of proposed foreclosure.

[ARTICLE] 6

DISCONTINUANCE AND COMPLETION OF FORECLOSURE; RIGHTS AFTER FORECLOSURE

SECTION 601. DISCONTINUANCE OF FORECLOSURE.

(a) A foreclosing creditor may discontinue foreclosure under this [Act] at any time before:

(1) the completion of the auction in the case of a foreclosure by auction; or

(2) the time of foreclosure, in the case of a foreclosure by negotiated sale or by appraisal.

(b) If a foreclosing creditor discontinues foreclosure, the creditor shall give notice to the persons to which notice of foreclosure was required to be given under Section 203(b), advising them that the foreclosure has been discontinued and whether the foreclosing creditor will:

(1) continue to foreclose by another method under this [Act] pursuant to a notice of foreclosure previously given;

(2) commence another foreclosure by the same method pursuant to a new notice of foreclosure;

(3) commence foreclosure by a different method under this [Act] pursuant to a new notice of foreclosure;

(4) commence foreclosure by judicial proceeding; or

(5) abandon foreclosure.

(c) If a notice given by a foreclosing creditor under subsection (b)(2) or (3) includes all elements required for a notice of foreclosure under Sections 203 and 204, it constitutes a new notice of foreclosure and no additional notice of foreclosure is necessary to pursue a further

foreclosure under this [Act].

Comment

The foreclosing creditor's election to foreclose by auction, negotiated sale, or appraisal is not necessarily a final decision. Under this section the creditor can change course and foreclose by a different method instead. If the original (or a previous) notice of foreclosure reserved the right to proceed by more than one method, the creditor who discontinues foreclosure under this section need not give a new notice of foreclosure. Otherwise, a new notice of the foreclosure must be given if the foreclosure method is changed.

Under subsection (c), the foreclosing creditor may, at its option, combine a notice of discontinuance under this section with a new notice of foreclosure. Alternatively, the creditor may simply issue a notice of discontinuance and later give a new notice of foreclosure.

If the foreclosing creditor abandons the foreclosure, as provided in subsection (b)(6), the creditor will need to institute a new foreclosure, with a new original notice of foreclosure, in order to take further action under the Act.

SECTION 602. COMPLETION OF FORECLOSURE; DEED TO SUCCESSFUL BIDDER; AFFIDAVIT; TIME OF FORECLOSURE.

(a) To complete a foreclosure by auction pursuant to [Article] 3, a foreclosure by negotiated sale pursuant to [Article] 4, or a foreclosure by appraisal pursuant to [Article] 5, the foreclosing creditor shall:

(1) execute, deliver, and record in [the office of the county recorder] a deed without warranty of title, execute and deliver a bill of sale or other appropriate document of transfer with respect to personal property, if applicable, and execute and deliver any other documents that are necessary in order for the deed to be recorded, transferring the collateral:

(A) to or as directed by the successful bidder in the case of a foreclosure by auction;

(B) to or as directed by the contract purchaser in the case of a foreclosure by negotiated sale; or

(C) to the foreclosing creditor in its own capacity or to its nominee, in the case of a foreclosure by appraisal.

(2) execute and record in [the office of the county recorder] an affidavit containing:

(A) the recording data for the security instrument;

(B) identification of the foreclosing creditor and the debtor;

(C) a legally sufficient description of the real property collateral;

(D) the recording data for the notice of foreclosure;

(E) identification of the persons to which notice of foreclosure was given and the recording data for documents reflecting their interests in the collateral;

(F) the method of foreclosure employed and, if the foreclosure was by negotiated sale or by appraisal, a statement that no person entitled to object to the foreclosure made a timely objection, or identifying any person that made a timely objection and stating whether the person's interest was discharged by the secured creditor or was preserved from the effect of the foreclosure by the giving of a notice of preservation under Section 210;

(G) identification of any additional persons to which notices of preservation under Section 210 were given;

(H) a statement that the foreclosing creditor has complied with all provisions of this [Act] for a valid foreclosure; and

(I) identification of the person acquiring title to the collateral by virtue of the foreclosure.

(b) The time of recording of the deed is the time of foreclosure.

Comment

A foreclosure by negotiated sale or by appraisal need not be completed on precisely the proposed date of sale or foreclosure, but in all events must be completed within the period of limitation provided by Section 207. If the foreclosure is not completed until after the proposed date of sale or foreclosure, the right of the debtor and junior lien holders to object to the sale is not revived.

In a foreclosure by negotiated sale, the contract purchaser may wish to accept title to the collateral in its own name. However, if the purchaser desires to pass title directly to some other entity as a result of the foreclosure, the foreclosing creditor may designate such an entity as the purchaser's nominee in the deed, bill of sale, and affidavit that are recorded to signify the completion of the foreclosure.

In the case of a foreclosure by appraisal, the foreclosing creditor is both the grantor (in its capacity as creditor) and the grantee (in its capacity as recipient of title) on the deed and bill of sale, if any, transferring the collateral. Alternatively, the foreclosing creditor may prefer to transfer title to a nominee, such as a subsidiary or other related entity.

In a foreclosure by auction, title to the collateral does not pass to the auction purchaser at the completion of the auction, but only upon "compliance with Section 602(a)(1),", which not completed until the recording of the deed (and execution and delivery of the bill of sale and any other necessary documents). See Section 603. However, the successful bidder is under an obligation to complete the purchase or risk the loss of the deposit; see section 310. If a casualty loss occurs to the collateral after the auction, but before the recording of the affidavit, there is no legal basis for a discharge of the bidder from the obligation to purchase. Hence, it is advisable for the successful bidder to obtain casualty insurance on the property immediately after the auction is concluded.

The affidavit must include the recording data for the original security instrument, the notice of foreclosure, and the documents reflecting all subordinate interests of persons to whom notice of foreclosure was given. In some cases one or more of these documents may not be recorded, in which case the recording data may be omitted.

The following is an illustration of a sufficient affidavit under this section.

Affidavit of Foreclosure

County of Pembroke)
) ss
State of Example)

The undersigned, being duly sworn on March 27, 200_, makes the following statement concerning the foreclosure by appraisal of certain real property located in this county and state by First Financial Corporation pursuant to the Nonjudicial Foreclosure Act of this state.

A. The foreclosed security instrument: A mortgage recorded in Book 456, Page 244, Official Records of Pembroke County, State of Example.

B. Foreclosing creditor: First Financial Corporation, an Example corporation. Foreclosed debtor: Mary and John Jones, formerly of 455 South Main Street, Ashland, Example 12345.

C. Description of real property foreclosed: Lot 13, Block B, Ridgefield Addition No. 2, City of Ashland, County of Pembroke, State of Example.

D. Notice of foreclosure recorded: Book 678, Page 122, Official Records of Pembroke County, State of Example.

E. Notice of foreclosure was given to the following:

1. Foreclosed debtors Mary and John Jones, pursuant to deed recorded in Book 345, Page 344, Official Records of Pembroke County, State of Example.

2. Aluminum Specialties Co., pursuant to abstract of judgment recorded in Book 567, Page 455, Official Records of Pembroke County, State of Example.

3. Fast Loan Co., pursuant to mortgage recorded in Book 568, Page 566, Official Records of Pembroke County, State of Example.

F. Foreclosure was completed by appraisal. Objection to foreclosure was made by Aluminum Specialties Co. First Financial Corp. paid the amount of Aluminum Specialties Co's judgment lien and the lien was discharged. (See satisfaction of lien recorded in Book 679, Page 677, Official Records of Pembroke County, State of Example.)

G. No notices of preservation of interest were given to other persons by First Financial Corp.

H. First Financial Corp. has complied with all requirements of the Nonjudicial Foreclosure Act for completion of this foreclosure by appraisal.

I. By deed recorded on this date, title to the foreclosed real property was conveyed by First Financial Holding Co., Inc., an Example corporation.

[signed] First Financial Corp.
Phyllis Executive, Vice President

[Jurat]

SECTION 603. TITLE TRANSFERRED BY FORECLOSURE. Compliance with

Section 602(a)(1) transfers, to the persons identified in the deed or document of transfer, the title to the collateral held by the person that granted the security interest, subject only to:

(1) interests in the collateral having priority over the security interest foreclosed;

(2) interests of persons entitled to notice of foreclosure under Section 203(c) that were not given notice of foreclosure; and

(3) interests that were preserved from foreclosure by notice of preservation given pursuant to Section 210.

Comment

This section fulfills the fundamental purpose of foreclosure: to transfer title to the collateral to the foreclosing creditor or other person who prevails in the foreclosure process, and to eliminate all of the interests subordinate to the security interest being foreclosed that were held by persons who were made parties to the foreclosure. Interests superior in priority to the security interest will survive the foreclosure, as will subordinate interests if their holders were entitled to notice and were not properly given notice of the foreclosure or if the foreclosing creditor gave them an appropriate notice under Section 210 to preserve their interests from the effect of foreclosure. The interests of all other persons in the collateral are terminated.

It is entirely possible that an interest will be terminated despite the fact that its holder did not receive notice of foreclosure. This can occur if the interest is not recorded and the foreclosing creditor has no knowledge of it. For example, an unrecorded lease will be terminated despite the fact that the tenant received no notice of foreclosure if the foreclosing creditor did not actually discover the lease's existence by an inspection of the property or other means, and hence did not (and was not obligated to) send a notice of foreclosure to the tenant, and if the notice of foreclosure posted on the property did not in fact come to the tenant's attention.

One equitable exception to the principle of termination of subordinate interests exists. If an owner of the equity of redemption in the real estate purchases at the foreclosure sale, the interests subordinate to the foreclosed mortgage are preserved. If this were not the result, a debtor could collude with the holder of a first mortgage and unjustly cleanse the title to the land of the junior liens. See Restatement (Third) of Property (Mortgages) § 4.9 (1997).

SECTION 604. APPLICATION OF PROCEEDS OF FORECLOSURE.

(a) After receiving proceeds of a sale but before applying them, the foreclosing creditor

may invest them in a reasonable manner. Within seven days after the time of foreclosure or such longer time as may be permitted by court order, the foreclosing creditor shall apply and distribute the foreclosure amount and any investment earnings thereon in the following order:

(1) in the case of a foreclosure by auction, to pay or reimburse the expenses of foreclosure;

(2) to pay the obligation secured by the foreclosed security instrument;

(3) to pay, in the order of their priority, the amounts secured by all liens terminated by the foreclosure; and

(4) to the person that owned the collateral at the time of foreclosure.

(b) If the foreclosing creditor, in applying the proceeds of the sale, acts in good faith and without actual knowledge of the invalidity or lack of priority of the claim of a person to which distribution is made, the foreclosing creditor is not liable for an erroneous distribution. The foreclosing creditor may maintain an action in the nature of interpleader for an order directing the order of distribution of the proceeds of the sale.

Comment

The balance owing on the secured obligation is not limited to principal and accrued interest on the secured debt. It may include late fees, default interest, prepayment fees, and other fees to the extent permitted by other state law. The enforceability of such fees is not governed by the Act. It may also include expenditures made by the foreclosing creditor to protect the collateral, such as property tax payments, insurance premiums, and expenditures to correct waste. See Restatement (Third) of Property: Mortgages § 2.2 (1997).

Any surplus from the foreclosure after payment of the foreclosure expenses (in the case of a foreclosure by auction) and discharging the secured obligation, is distributed to the holders of subordinate liens that were terminated by the foreclosure, and then to the debtor, in the order of their priority. As with existing law governing judicial foreclosure and most nonjudicial foreclosure statutes, distribution is limited to persons who hold liens, and is not made to persons holding other types of terminated interests, such as leases or easements, because of the difficulty of establishing the value (if any) of such interests. Persons having interests superior in priority to the security instrument being foreclosed are not entitled to receive any of the proceeds of the foreclosure, since it does not affect their interests.

In foreclosures by auction and negotiated sale, the foreclosing creditor is not permitted to deduct the expenses of foreclosure before distributing the foreclosure proceeds. This rule is applied because in those types of foreclosure, the creditor is expected to take such expenses into account in setting the foreclosure amount.

If the foreclosing creditor is uncertain about the priority of junior interests, it may apply for a court determination of priority. The court may extend the period for distribution of the proceeds to allow time to make the necessary determination.

SECTION 605. CONCLUSIVE EFFECT OF FORECLOSURE. Recording of the notice of foreclosure pursuant to Section 203(b) and recording of the documents pursuant to Section 602 conclusively establishes compliance with this [Act] in favor of purchasers of the collateral in good faith for value.

Comment

After the foreclosure has occurred, the powers of a court to change the result are limited. Damages may be assessed against a foreclosing creditor that has failed to comply with the Act or other legal or equitable duties in carrying out the foreclosure. For example, if there is proof that notices were not properly given, the court might award damages against the foreclosing creditor to the debtor or to third parties whose interests were terminated by the foreclosure without notice.

However, the court must recognize that if the proper documents have been recorded, compliance with the Act is conclusive in favor of a bona fide purchaser (BFP) of the collateral. For example, if the collateral has passed into the hands of a BFP, the court would not be authorized to issue an order taking the collateral out of the BFP's hands in order to order a reforeclosure on account of failure to give proper notices, but could nonetheless grant an award of damages.

This conclusive effect of foreclosure under the Act depends on the recording, at a minimum, of two documents: the notice of foreclosure, as required by Section 203(b) and the affidavit as required by Section 602(a)(2). Thus, at a minimum, anyone relying on the title derived from a foreclosure under the Act must verify that these documents are recorded.

Courts should employ their powers to grant damage awards or to set aside foreclosures only in cases in which the violation of the Act or the principles of law and equity are sufficiently serious that it is likely that they had a substantial detrimental impact on the foreclosure amount. No remedy should be awarded for minor violations that had no significant effect on the outcome of the foreclosure.

This section makes a foreclosure under the Act conclusive only with respect to compliance with the provisions of the Act itself. It does not ensure that there are no defects in the security

instrument or the creditor's right to foreclose. For example, if the security instrument is a forgery or was procured by fraud in the execution, the courts typically hold that any foreclosure under it will be void. This section does not change that result. Similarly, if the secured obligation was not in default, or had been fully paid, the secured creditor would have had no right to foreclose. In that case, the conclusive effect of this section will not validate the foreclosure.

SECTION 606. POSSESSION AFTER FORECLOSURE. If the rights acquired by a person by a foreclosure under this [Act] include the right of possession, the person may gain possession of the real property by an action under the [cite the forcible entry and detainer statute of the jurisdiction] or other appropriate judicial proceeding but may not dispossess persons in possession of the real property without a judicial order or judgment.

Legislative Note: The title and citation of the appropriate summary eviction statute should be substituted.

Comment

In rare cases, a security interest may be given on a nonpossessory interest in real property, such as a future interest. In such cases a person that acquires the interest by foreclosure is not entitled to possession. But in the great majority of real estate security transactions, the real estate involved is a possessory interest and the person acquiring it in foreclosure is therefore entitled to possession as against the debtor and as against tenants whose leases have been terminated by the foreclosure. If part of the real property is possessed by tenants whose leases were terminated and part by tenants whose leases were preserved in the foreclosure, the person acquiring the property in foreclosure is entitled to possession only against the tenants whose leases were terminated.

While a foreclosure under the Act gives the person acquiring the property the *right* of possession, the act does not create any process for giving that person *actual* possession or providing for the dispossession of other persons, such as the mortgagor or the tenants of the mortgagor. That is left to other state law.

This section's purpose is to make it clear that the state's summary eviction statute, commonly used by landlords, is available to enforce that right against both the debtor and tenants of the debtor. In the absence of this section, there is doubt in a number of states whether the landlord-tenant procedure would be available to foreclosure purchasers. The summary eviction statute is not necessarily the only process that foreclosure purchasers could employ; other judicial procedures, including common law ejectment, might also be available.

The closing phrase of this section is intended to make it clear that self-help eviction by the person acquiring the real property in foreclosure is not allowed. Those in possession may relinquish the property voluntarily, but if they do not, judicial process (whether in the form of an unlawful detainer judgment or some other appropriate judgment or order) must be employed to

remove them.

One who acquires real property in a foreclosure under the Act is entitled to possession against persons, such as former tenants, whose leases have been terminated by the foreclosure. If part of the real property is possessed by tenants whose leases were terminated and part by tenants whose leases were preserved in the foreclosure, the person acquiring the property in foreclosure may dispossess only the former tenants.

The Act does not address the question whether a foreclosing creditor may demand possession of the real property prior to the time of foreclosure; that matter is left to other law.

If personal property is acquired by virtue of the foreclosure, the person acquiring it may obtain possession in the manner set out in Uniform Commercial Code § 9-609.

SECTION 607. ENTITLEMENT TO DEFICIENCY.

(a) Except as otherwise provided in subsection (b), a creditor that has completed a foreclosure under this [Act] may obtain a judgment for a deficiency, as determined by Section 608, against a debtor that is liable for the secured debt owed to the creditor.

(b) A debtor is not liable for a deficiency after a foreclosure under this [Act] if:

(1) the person seeking the deficiency waived the right to a deficiency; or

(2) the debtor is a residential debtor, unless the debtor is found by the court not to have acted in good faith and the debtor's conduct caused significant loss or damage to the foreclosing creditor or the collateral.

(c) For purposes of this section, a residential debtor acted in good faith if the debtor:

(1) peaceably vacated the real property collateral and relinquished any personal property collateral within 21 days after the time of foreclosure and the receipt of a notice demanding possession by the person entitled to possession by virtue of the foreclosure;

(2) did not engage in activity, unauthorized by the foreclosing creditor, that significantly reduced the value of the collateral as of the time possession was relinquished to the person entitled to possession by virtue of the foreclosure;

(3) did not commit fraud against the foreclosing creditor;

(4) did not permit significant uncured damage to the collateral by other persons or natural causes as a consequence of the debtor's failure to take reasonable precautions against such damage; and

(5) provided reasonable access to the collateral for inspection by the foreclosing creditor and prospective purchasers if the debtor had the right of possession of the collateral.

(d) The absence of good faith must be established at a judicial hearing by the person seeking a deficiency judgment against a residential debtor. A residential debtor who does not satisfy the standards of subsection (c) nonetheless may have acted in good faith. The absence of good faith by one residential debtor does not make any other residential debtor liable for a deficiency.

(e) If liability of a residential debtor for a deficiency is barred by subsection (b)(2), liability of a guarantor of the residential debtor's obligation also is barred.

(f) An action to recover a deficiency against a residential debtor must be commenced within 90 days after the time of foreclosure.

Comment

A judgment for a deficiency is intended to assist the foreclosing creditor in collecting any portion of the secured obligation that is not satisfied by the foreclosure. Since only "a debtor who is liable for the secured debt" can be subjected to a deficiency judgment, it is necessary for a creditor seeking a deficiency to establish the personal liability of the person against whom the deficiency is claimed. For example, a nonassuming grantee of the collateral is a "debtor" as the Act uses that term, but would not be liable for a deficiency. The same is true of a borrower whose liability is absolutely "non-recourse." A deficiency may be recovered against anyone else, such as a guarantor, who is liable on the secured obligation.

As the term "deficiency" is used in the Act, it is inapplicable to holders of subordinate liens that are terminated by a foreclosure. These persons may have claims against the debtor or guarantors, but their claims are not "deficiency" claims and are not governed or limited by the Act.

A deficiency may not be sought until the foreclosing creditor has "completed" the foreclosure. Under Section 602, completion occurs when the creditor has delivered the deed, bill of sale, and other necessary documents and has recorded the deed and affidavit.

This section prohibits deficiency judgments against residential debtors (and their guarantors) if they have acted in good faith. Lenders generally believe that the threat of a deficiency judgment, even if it will rarely be enforceable as a practical matter, provides a useful inducement to borrowers to behave responsibly. The Act adopts that principle; under the "good faith" concept here, the risk of deficiency liability may dissuade a residential debtor from committing waste or fraud, or engaging in other acts detrimental to the foreclosing creditor's interests.

The definition of good faith in subsection (c) is a "safe harbor." The court must make an individualized finding of good faith or its absence, and it is possible that a court will find good faith despite a residential debtor's minor violation of the rules of subsection (c), particularly if the violation caused little harm to the secured creditor's interests. A court might also find that a debtor's conduct was justified because it resulted from the debtor's illness, lack of language ability, or for other reasons beyond the debtor's control, and hence did not constitute bad faith.

Since good faith is individualized, in a particular case some debtors may have acted in good faith although others did not. One residential debtor's lack of good faith will not result in a different residential debtor's liability for a deficiency. Even if a residential debtor did not act in good faith, the debtor has no deficiency liability unless the debtor's conduct caused substantial damage to the creditor or the collateral. The creditor seeking a deficiency has the burden of persuading the court on the issues of lack of good faith and substantial damage.

Under subsection (c), an element of the good faith "safe harbor" is the debtor's relinquishing of possession within 21 days after the time of foreclosure and notification to vacate. Another element is the debtor's not having engaged in acts that significantly reduced the property's value. Examples of acts that might have this effect include commission of waste, contamination of the property with hazardous materials, and use of the property for criminal purposes.

A creditor may waive the right to a deficiency, and if so, will not be permitted to recover it. The waiver might be found in the security instrument, in the notice of foreclosure, or in some other agreement or communication between the parties.

This section may prevent a foreclosing creditor from obtaining a deficiency judgment against a residential debtor, but if the creditor holds other collateral in addition to the property foreclosed under the Act, it does not prevent the creditor from recovering on such collateral. For example, the creditor might also have obtained a security interest in real property in a different jurisdiction, or in personal property that was not foreclosed under the Act. The antideficiency provisions of this section do not bar the creditor from realizing on those assets.

Some lenders routinely make loans, such as "home equity loans," secured by residential real property in an amount that exceeds the value of the property. The barring of deficiency judgments against good faith residential debtors in subsection (b) might appear to be unfair to such lenders, preventing them from recovering the full amount of their loans. However, a lender can readily

protect itself against this result by dividing its loan into two loans, one secured by the residential real property and based on its value, and the other for the remainder of the funds to be advanced, unsecured or secured by other collateral.

A deficiency action against a residential debtor must be commenced within 90 days after the time of foreclosure. The 90-day limitation also governs actions against guarantors of residential debtors, since they are classified as debtors. The Act provides no period of limitation for deficiency actions against parties other than residential debtors, and they are governed by the jurisdiction's general statute of limitations.

SECTION 608. DETERMINING AMOUNT OF DEFICIENCY.

(a) Subject to subsections (b) and (c), the deficiency to which a foreclosing creditor is entitled after a foreclosure under this [Act] is the balance remaining, if any, after subtracting the amount paid or applied on behalf of the creditor pursuant to Section 604(a)(1) and (2) from the balance owing on the secured obligation to the creditor, including principal, interest, and legally recoverable fees and charges.

(b) In an action by a foreclosing creditor for a deficiency:

(1) following a foreclosure by negotiated sale or appraisal, a residential debtor against which the action is filed may offer proof that the foreclosure amount was less than 90 percent of the fair market value of the collateral as of the time of foreclosure; or

(2) following a foreclosure by auction, a debtor against which the action is filed may offer proof that the foreclosure amount was less than 90 percent of the fair market value of the collateral as of the time of the auction.

(c) If the court, after a hearing on the proof offered pursuant to subsection (b), finds that the foreclosure amount was less than 90 percent of the fair market value of the collateral, the court shall substitute 90 percent of the fair market value of the collateral for the foreclosure amount for the purpose of determining the deficiency pursuant to subsection (a).

Comment

Subsections (b) and (c) are designed to prevent the foreclosing creditor from acquiring or disposing of the collateral at a price greatly below market value and also obtaining a full deficiency. These subsections are applicable irrespective of whether the foreclosing creditor or a third party acquires the collateral by virtue of the foreclosure.

Under these subsections, the defendant in the deficiency action is entitled to offer proof of the fair market value of the property as of the time of the sale. If the court finds that 90 percent of the fair market value was greater than the foreclosure amount, 90 percent of the fair market value must be used in lieu of the foreclosure amount in computing the deficiency. The 90 percent level is adopted in order to approximate the probable cost to the foreclosure purchaser of holding and liquidating the collateral, and to reflect the sense that it is usually unrealistic to expect foreclosure amounts significantly higher than 90 percent of fair value.

The fair market value limitation on deficiencies applies in favor of residential debtors (including their guarantors) no matter which method of foreclosure was employed. However, it applies in favor of other (nonresidential) debtors only when the foreclosure is by auction. The reason for this distinction is that nonresidential debtors are assumed to be more knowledgeable of market conditions than residential debtors, and hence are in a better position to reject under Sections 404 or 504 a proposed foreclosure by negotiated sale or by appraisal at an inadequate foreclosure amount.

Illustration 1: Assume a foreclosure by auction on the following facts:

Amount owing on foreclosed first lien:	$120,000	(excluding expenses of foreclosure)
Expenses of foreclosure:	$ 5,000	
Amount owing on sold-out second lien:	$ 10,000	
Sale price bid at foreclosure sale:	$ 80,000	
Fair market value of property:	$100,000	

In the absence of the limitation in subsections (b)(2) and (c), the bid of $80,000 (the "foreclosure amount") would have been distributed as follows:

$ 5,000 to pay expenses of foreclosure
$75,000 toward amount owing on foreclosed first lien

The deficiency recoverable by the foreclosing creditor would have been $120,000 minus $75,000, or $45,000.

Under the limitation in subsections (b)(2) and (c), assume that the court is presented with testimony as to fair market value and determines that the foreclosure amount ($80,000) was less than 90% of the fair market value of the property ($100,000). The court will compute the deficiency as if the foreclosure amount had been 90% of $100,000, or $90,000. A foreclosure amount of $90,000 would have been distributed as follows:

$ 5,000 to expenses of foreclosure
$85,000 toward amount owing on foreclosed first lien

The deficiency recoverable by the foreclosing creditor will therefore be $120,000 (the debt owed to the foreclosing creditor) minus $85,000 (the amount that would have been distributed to the foreclosing creditor if the foreclosure amount had been $90,000), or $35,000.

Illustration 2: Assume an auction foreclosure under the same facts as Illustration 1, except that the amount owing on the first lien is $80,000 instead of $120,000.

In the absence of the limitation in subsections (b)(2) and (c), the foreclosure amount of $80,000 would have been distributed as follows:

$ 5,000 to expenses of foreclosure
$75,000 toward amount owing of foreclosed first lien

The deficiency recoverable by the foreclosing creditor would be $80,000 minus $75,000, or $5,000.

Under the limitation in subsections (b) and (c), assume that the court determines that the foreclosure amount ($80,000) was less than 90% of the fair market value of the property ($100,000). The court will therefore compute the deficiency as if the foreclosure amount had been 90% of $100,000, or $90,000. A foreclosure amount of $90,000 would have been distributed as follows:

$ 5,000 to expenses of foreclosure
$80,000 to pay the debt secured by the foreclosed first lien
$ 5,000 toward the debt secured by second lien

Thus the debt secured by the foreclosed first lien will be regarded as fully paid, and the foreclosing creditor will not be entitled to recover any deficiency.

Illustration 3. If the foreclosure by negotiated sale or by appraisal, the computation is similar to that shown above except that none of the foreclosure amount is allocated to payment of the expenses of foreclosure; see Section 604(a). Assume a foreclosure by appraisal on the following facts:

Amount owing on foreclosed first lien:	$120,000	(excluding expenses of foreclosure)
Expenses of foreclosure:	$ 5,000	
Amount owing on sold-out second lien:	$ 10,000	
Foreclosure amount fixed by foreclosing creditor:	$ 70,000	
Fair market value of property:	$100,000	

In the absence of the limitation in subsections (b) and (c), the entire foreclosure amount, $70,000, would have been applied toward the $120,000 amount owing on foreclosed first lien. The

deficiency recoverable by the foreclosing creditor would have been $120,000 minus $70,000, or $50,000. If the debtor is not a residential debtor, subsections (b) and (c) are inapplicable, and this is the amount of the deficiency that the court will assess against the debtor.

If the debtor is a residential debtor, the limitation in subsections (b) and (c) will apply. Assume the court is presented with evidence of the property's fair market value and determines that the foreclosure amount ($70,000) was less than 90% of fair market value ($100,000). The court will compute the deficiency as if the foreclosure amount had been 90% of $100,000, or $90,000. This $90,000 amount will be applied toward the $120,000 amount owing on foreclosed first lien, leaving a deficiency recoverable by the foreclosing creditor of $30,000.

[ARTICLE] 7

MISCELLANEOUS PROVISIONS

SECTION 701. UNIFORMITY OF APPLICATION AND CONSTRUCTION. In applying and construing this Uniform Act, consideration must be given to the need to promote uniformity of the law with respect to its subject matter among states that enact it.

SECTION 702. EFFECTIVE DATE. This [Act] takes effect on _____.

Legislative Note: It is recommended that the effective date be delayed after the date of enactment in order to allow time for members of the bar and the affected industries to become familiar with the Act and to modify existing forms and procedures.

SECTION 703. REPEALS. The following acts are repealed: [Here list the statutes to be specifically repealed. Statutes governing judicial foreclosure should not be repealed.]

Legislative note: Adopting jurisdictions may find it necessary to amend their recording acts in order to permit the recording of notices of foreclosure, requests for notice of foreclosure, and affidavits of foreclosure that are required by the Act .

Legislative note: If an adopting jurisdiction has a preexisting law providing for nonjudicial foreclosure, it should be amended to limit its applicability to security instruments that were entered into prior to the effective date of the Act and that did not contain terms, as required by Section 103(a), permitting them to be foreclosed under the Act.

Legislative note: If an adopting jurisdiction has in effect a "predatory lending" statute or other statute intended to prohibit abusive, deceptive, or unfair terms or conduct in lending to consumers, it may be desirable to add a provision to the Act stating that the preexisting statute is not impliedly repealed and continues to apply to loans foreclosed under the Act.