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Secured Creditors Holding Lien Creditors Hostage: Have a Little Faith in Revised Article 9

TIMOTHY G. HAYES*

INTRODUCTION

Heralded as the Uniform Commercial Code's (UCC) "crowning achievement," Article 9 successfully melded together a hodgepodge of state laws into a nearly uniform system.¹ Building on its earlier siblings, revised Article 9—enacted in 2001—furthered this ideal.² Touted as a "reorganized, rewritten, renumbered, and expanded" doctrine, revised Article 9 brought fundamental changes to the law governing security interests, particularly by simplifying filing requirements and reorganizing priority rules.³ Yet beyond these substantive differences, the revised Article still harbors many of the same ills of its predecessor.⁴ Chief among those ills—and part of this Note's focus—is the decision to leave continued uncertainty surrounding a lien creditor's ability to obtain the debtor's equity in property already encumbered with a security interest.

For example, assume secured creditor XYZ Corporation ("XYZ") has a security interest in a piece of personal property that Bill, the debtor, holds. XYZ's interest in the collateral secures an underlying obligation worth many times less than the actual value⁵ of Bill's collateral. This difference between what Bill owes XYZ for that

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1. Edward J. Janger, *Predicting when the Uniform Law Process Will Fail: Article 9, Capture, and the Race to the Bottom*, 83 IOWA L. REV. 569, 571 (1998); Robert K. Rasmussen, *The Uneasy Case Against the Uniform Commercial Code*, 62 LA. L. REV. 1097, 1098–99 (2002). See also William J. Woodward, Jr., *The Realist and Secured Credit: Grant Gilmore, Common-Law Courts, and the Article 9 Reform Process*, 82 CORNELL L. REV. 1511, 1521 (1997) ("There were no uniform statutory antecedents to Article 9 and the process of developing it involved perhaps the largest burst of legal creativity in modern commercial law.").

2. Revised Article 9 has been enacted in all fifty states and the District of Columbia. Press Release, National Conference of Commissioners on Uniform State Laws, States Uniformly Enact UCC9 Revisions (July 2, 2001), available at <http://www.nccusl.org/nccusl/pressreleases/pr1-07-01.asp>.

3. Julian B. McDonnell, *Is Revised Article 9 a Little Greedy?*, 104 COM. L.J. 241 (1999). Among the changes from prior Article 9, revised Article 9 permits security interests to cover more types of collateral, authorizes electronic security agreements and filings, changes the choice-of-law rule governing perfection of most collateral to the law of the debtor's jurisdiction, and introduces new priority rules to cover deposit accounts and the revised definition of a purchase-money security interest. For a discussion of these and other changes, see U.C.C. § 9-101 cmt. 4 (2001).

4. For an entertaining discussion of the stark differences between prior Article 9 and revised Article 9 (and to get a sense of how the author was feeling when drafting this Note), see Jean Wegman Burns, *New Article 9 of the UCC: The Good, the Bad, and the Ugly*, 2002 U. ILL. L. REV. 29 (2002).

5. The process of valuing debtors' equity in collateral is one of many questions

underlying obligation and the actual value of the collateral constitutes Bill's equity in the collateral. Now, assume third-party ABC Rentals ("ABC") has a claim against Bill and reduces that claim to a judgment. ABC wishes to collect on that judgment by seizing Bill's equity in the collateral over which XYZ holds a security interest. Can ABC obtain a writ of execution/attachment and order the sheriff to seize the collateral notwithstanding XYZ's valid security interest? Or, must ABC receive permission from secured creditor XYZ before the sheriff can levy on the collateral?

This quagmire, whether ABC must receive XYZ's permission before seizing the collateral to satisfy its judgment, has been left without a clear solution in revised Article 9.⁶ Since the UCC has not provided an answer, the courts are left to decide. But by leaving the question to the courts, the UCC has introduced non-uniformity⁷ in the system, going against one of its central tenets⁸ and raising transaction costs for all involved. More importantly, many courts that have ruled on this question have taken a patently inequitable position toward the lien creditor: if the sheriff does levy on the collateral without XYZ's approval, lien creditor⁹ ABC remains liable for conversion.¹⁰ In essence, even though a sale of Bill's collateral would net more than the underlying obligation owed to XYZ, XYZ may still block ABC from realizing Bill's equity in the collateral—perhaps indefinitely.

To be sure, secured creditor XYZ could repossess the collateral, sell it within a reasonable time in an Article 9 sale, and then give the excess proceeds to lien creditor ABC.¹¹ Problem solved. But XYZ could just as easily seize the collateral and either refuse to sell it in an Article 9 sale,¹² ignore the default and return the collateral to debtor Bill,¹³ or keep the property in satisfaction of Bill's underlying obligation.¹⁴

unanswered in current Article 9, although market value is typically used. See WILLIAM D. HAWKLAND ET AL., UNIFORM COMMERCIAL CODE SERIES § 9-401:1 (2002).

6. To be sure, revised Article 9 does point to one solution—marshaling. But marshaling does not apply when a secured creditor has only one source of collateral to secure the debtor's obligation. For a discussion of this drawback and more, see *infra* Part I.B.

7. Compare, e.g., *Grocers Supply Co. v. Intercity Inv. Props., Inc.*, 795 S.W.2d 225 (Tex. App. 1990) (holding that a secured creditor can regain possession over a lien creditor's levy on property and that the secured creditor had a conversion claim against the lien creditor) with *Citizens Bank of Lavaca v. Perrin & Sons, Inc.*, 488 S.W.2d 14 (Ark. 1972) (holding that the secured creditor had no conversion claim against a lien creditor who seized the collateral).

8. U.C.C. § 1-103(a)(3) (2001) (stating that one of the UCC's underlying purposes is "to make uniform the law among the various jurisdictions"). For more information about the pros and cons of uniform laws, see *infra* notes 100–04 and accompanying text.

9. ABC becomes a lien creditor when the sheriff levies on the property. As such, this Note focuses primarily on the lien creditor "that has acquired a lien on the property involved by attachment, levy, or the like." U.C.C. § 9-102(52)(A) (2001). Note, however, that the bankruptcy trustee, among others, can constitute a lien creditor under Article 9. *Id.* § 9-102(52)(C).

10. See, e.g., *Grocers Supply*, 795 S.W.2d at 227; *Murdock v. Blake*, 484 P.2d 164, 169–70 (Utah 1971).

11. This assumes the lien creditor complies with U.C.C. § 9-615(a)(3)(A) (2001) and notifies the secured creditor of its intent to receive its portion of the collateral's proceeds.

12. See Lynn M. LoPucki, *The Death of Liability*, 106 YALE L.J. 1, 15 (1996).

13. Some courts have noted this problem and maintain that a creditor must do more than declare a default; the secured creditor must treat the debtor as if he or she was in default. See, e.g., *Frierson v. United Farm Agency, Inc.*, 868 F.2d 302, 304–05 (8th Cir. 1988).

14. U.C.C. § 9-620 (2001).

Irrespective of XYZ's motive, these latter options give XYZ the power to unilaterally make ABC's interest in Bill's collateral worthless.

Moreover, even if ABC forces the sale of the collateral without XYZ's permission, XYZ's refusal to dispose of the collateral jeopardizes ABC's position beyond the risk of conversion charges. For example, assume lien creditor ABC obtains a writ of execution/attachment, delivers the writ to the sheriff, and the sheriff complies with the writ by seizing and ultimately selling the collateral in an execution sale. In the vast majority of jurisdictions, XYZ's security interest follows the sale.¹⁵ Thus, an unsophisticated purchaser at Bill's "subject-to" sale would find the collateral subject to foreclosure at XYZ's discretion unless the purchaser (or, although unlikely, Bill) pays XYZ what is due on the underlying obligation.¹⁶ Even a sophisticated purchaser, fully aware of this problem, must still track prior security interests to know how much to bid on the collateral.

Because of these burdens, the purchaser's potential loss of the collateral, and the higher transaction costs associated with tracking prior security interests, prices obtained at "subject-to" sales are, unsurprisingly, "notoriously low."¹⁷ In turn, these low prices jeopardize the lien creditor's ability to recoup any of its judgment: the lower the price received, the less equity the debtor has in the collateral, and accordingly, the less equity the lien creditor has in the collateral. Given the possibility of the lien creditor losing its equity in the collateral, a solution to this dilemma should give the allow the purchaser to obtain the collateral free of any liens, thereby netting the highest possible price. Moreover, while the solution must remain cognizant of the reality that the secured creditor has a dominant position over a lien creditor in the Article 9 system, this hegemonic position must have limits.

Using existing case law and the structure of the UCC itself, this Note proposes a solution. First, lien creditors, by taking over the debtor's equity in the collateral, are parties to the security agreement. Any duties a secured creditor owes to the debtor should correspondingly apply to the lien creditor. Second, revised Article 9 introduced a new definition of "good faith," which adds an objective element of "reasonable commercial standards of fair dealing" to the prior subjective-only standard of "honesty in fact." The lien creditor's interest in the disposition of the collateral, coupled with this new good faith standard, ultimately should mean that the secured creditor may not freely dispose of the collateral without fairly dealing with the lien creditor's valid interest in the outcome of the disposition.

Part I of this Note fleshes out this dilemma in detail, stepping through the parts of Article 9 that create this problem and elaborating on the arguments that lien creditors traditionally have asserted to protect their interests. Finding those arguments wanting,

15. See U.C.C. § 9-315(a) (2001). *But see* Maryland Nat'l Bank v. Porter-Way Harvester Mfg. Co., 300 A.2d 8, 11 (Del. 1972) ("[U]nder the established case law of this State, the title acquired by the purchaser at the sale is free and clear of all liens theretofore existing."); Computer Scis. Corp. v. Sci-Tek, Inc., 367 A.2d 658, 661 (Del. Super. Ct. 1976) (stating that proceeds in such a sale are distributed according to priority of interests).

16. See, e.g., Brown v. Arkoma Coal Corp., 634 S.W.2d 390, 391 (Ark. 1982) ("A party holding a security interest can go against both the proceeds of the sale and the property.")

17. J. Peter Byrne, John G. Murphy, Jr. & William T. Vukowich, *Junior Creditors' Realization on Debtors' Equity Under U.C.C. Section 9-311: An Appraisal and a Proposal*, 77 GEO. L.J. 1905, 1920-23 (1989).

Part I then posits that the drafting process explains why Article 9 is not likely to address the problem for the foreseeable future. Part I then analyzes some possible solutions, such as introducing nonconforming state laws or federal preemption, and ultimately concludes that none of these solutions are likely to come to fruition. Part II, the crux of this Note, then sets forth a solution to this dilemma that uses the good faith provision the drafters recently modified in revised Article 9.

I. THE LIEN CREDITOR'S INABILITY TO OBTAIN THE DEBTOR'S EQUITY IN COLLATERAL

The secured creditor's control within the Article 9 system starts with the initial setting of the typical secured transaction. Article 9 leaves the definition of default up to the parties involved.¹⁸ Given that a secured creditor is often a commercial entity,¹⁹ the secured creditor normally drafts the security agreement, and with that, the definition of default. On the laundry list of events normally constituting default, the secured creditor almost assuredly includes whenever another lien attaches to the collateral.²⁰ Thus, by controlling the security agreement's definition of default, the secured creditor can assure itself an absolute right to possess the collateral over a lien creditor.

Beyond giving the parties the ability to define default, revised Article 9's section 9-401, its official comment six, and the analogous section 9-311 of prior Article 9 also affect this problem. Both sections maintain that an agreement between the debtor and secured creditor, that prohibits a transfer or makes a transfer constitute a default, does not prevent the transfer from taking effect.²¹ But where prior Article 9 explicitly stated that "the debtor's rights in collateral may be voluntarily or involuntarily transferred," the revised Article's section 9-401 uses no such language.²² Instead, revised Article 9 states that this decision "is governed by law other than this article."²³

Although the change in the provision will not likely affect the law surrounding a lien creditor's rights,²⁴ a lien creditor no longer has explicit statutory authority to reach the debtor's equity in oversecured collateral.²⁵ Nonetheless, prior Article 9's explicit

18. See U.C.C. § 9-601 cmt. 3 (2001) ("[T]his Article leaves to the agreement of the parties the circumstances giving rise to a default.").

19. See LYNN M. LOPUCKI & ELIZABETH WARREN, *SECURED CREDIT: A SYSTEMS APPROACH* 668 (4th ed. 2003).

20. See generally, HAWKLAND, *supra* note 5, § 9-401:1.

21. Compare U.C.C. § 9-401(b) (2001) with U.C.C. § 9-311 (2000).

22. Compare U.C.C. § 9-311 (2000) with U.C.C. § 9-401 (2001).

23. U.C.C. § 9-401(a) (2001).

24. See, e.g., U.C.C. § 9-401, cmt. 5 (2001) ("[T]he debtor has rights in collateral (whether legal title or equitable) which it can transfer and which its creditors can reach."); BARKLEY CLARK & BARBARA CLARK, *THE LAW OF SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE* § 4.09[4] (2004) (asserting that a lien creditor has statutory authority to reach the debtor's equity because the same principle from prior Article 9's § 9-311 was carried forward into revised Article 9's § 9-401); HAWKLAND, *supra* note 5, § 9-401:1, at 9-629 ("Since revised Section 9-401 is not intended to be a complete statement of all of the rules applicable, results under revised Section 9-401 need not generally differ from those under original Article 9.").

25. Professor Julian McDonnell argues that "[d]ropping the affirmation of alienation is just another example of how the [drafters] have sought to make life as difficult as possible for lien

alienation provision never proved particularly helpful to a lien creditor. Despite the debtor having equity in the collateral, the lien creditor still had to cajole the secured creditor into selling the collateral before the lien creditor could obtain the debtor's equity. If the secured creditor procrastinated indefinitely²⁶ or accepted the collateral in full or partial satisfaction of the underlying obligation,²⁷ the lien creditor gained nothing. Thus, the impact of this relatively minor word change between the two provisions should not affect the analysis of this issue.

A. The Prototypical Problems: Enjoyment of the Sale

Assuming a lien creditor does get the sheriff to levy on and ultimately sell a piece of oversecured collateral without the secured creditor interfering presale,²⁸ the execution sale's proceeds are disbursed first for costs of sale and then to the lien creditor; any surplus goes to the debtor.²⁹ The secured creditor's security interest continues in the property, and the secured creditor can foreclose on the collateral in the hands of the execution sale's purchaser to seek reimbursement.³⁰ If, after foreclosing on the collateral, the secured creditor does not realize enough gains to satisfy the debtor's original debt, the secured creditor may seek a deficiency judgment against the debtor.³¹

creditors. . . . Lien creditors no longer have a statutory affirmation of their right to reach the debtor's equity in the collateral." McDonnell, *supra* note 3, at 260.

26. See *Grocers Supply Co. v. Intercity Inv. Props., Inc.*, 795 S.W.2d 225 (Tex. App. 1990) (holding that the right of a perfected creditor is to take possession of the collateral over a "mere" judgment creditor or the sheriff); *but see Frierson v. United Farm Agency, Inc.*, 868 F.2d 302 (8th Cir. 1988) (suggesting that a secured creditor cannot rely on a "default" to indefinitely hold onto collateral).

27. See U.C.C. § 9-620 (2001) (outlining Acceptance of Collateral in Full or Partial Satisfaction of Obligation; Compulsory Disposition of Collateral).

28. See, e.g., *General Motors Acceptance Corp. v. Byrd*, 707 S.W.2d 292, 295 (Tex. App. 1986) (stating that an execution sale can be held subject to the secured party's security interest). Whether a debtor has equity in the collateral is not necessarily easy to determine. See U.C.C. § 9-401 cmt. 6 (2001). In close cases, courts usually turn to the bids at the sale or other market prices, such as the rental value of comparable property, to gauge the price the collateral would obtain at sale minus the secured creditor's interest. If the secured creditor is substantially under-collateralized, however, it is clear that a lien creditor should not levy on the collateral in the first instance. No seasoned purchaser at an execution sale would bid on undersecured collateral, since the purchaser would receive nothing back if the secured creditor foreclosed. And if an unseasoned purchaser did bid more than the collateral's worth, the secured creditor may be able to trace and reclaim the proceeds. See *infra* text accompanying note 32. The problem that this Note analyzes assumes the debtor has equity in the collateral.

29. *General Motors*, 707 S.W.2d at 295-96.

30. *Id.* at 296. See also U.C.C. § 9-315(a) (2001) (stating that a security interest continues in collateral unless the secured creditor authorized disposition of the collateral free of the interest). Delaware is a notable exception—there the purchaser at an execution sale takes the collateral free of any security interests through a preemptive state statute. The secured creditor receives first priority (after the costs of the sale). See *supra* note 15.

31. See *General Motors*, 707 S.W.2d at 296. Naturally, this presumes that the debtor is not insolvent. If the debtor is insolvent, the secured creditor must look to the proceeds of the execution sale for reimbursement, which could be unidentifiable at this point in time. See *infra* note 32. For situations that this Note posits, a secured creditor should not have to resort to a deficiency judgment. This Note presumes that the debtor has equity in the collateral. Thus,

If the secured creditor is unable to locate the collateral to foreclose on it, the secured creditor may then look to the proceeds of the execution sale.³² This poses a problem for a secured creditor who either did not know about the execution sale or who acquiesced and did not seek an injunction to keep the execution sale's proceeds identifiable.³³ Without identifiable proceeds, the secured creditor cannot follow its security interest and consequently will recover nothing.³⁴ This potential for loss gives the secured creditor an incentive to diligently monitor its collateral and enjoin any potential execution sale.

1. Enjoinment of the Sale and Repossession

In order to have the power to enjoin the sale, first the secured creditor must know beforehand that a levy has occurred. The secured creditor may have been notified of the sale from the sheriff or lien creditor, found out through routine monitoring of the collateral, or been informed by the debtor. Second, a default must have occurred as defined in the underlying security agreement between the secured creditor and debtor.³⁵

Since, as discussed above, nearly every security agreement includes a lien attaching to the collateral as one of the events that constitute default,³⁶ an issue lies with whether a mere technical default suffices: does the secured creditor have to show some further manifestation of treating the debtor as being in default before the court agrees a default has occurred? Some courts answer in the negative;³⁷ others hold that some

theoretically, the secured creditor should receive at least enough from the Article 9 sale to cover the debt owed it, although empirically this result is far from certain.

32. See U.C.C. § 9-315 cmt. 2 (2001) ("The secured [creditor] may claim both any proceeds and the original collateral but, of course, may have only one satisfaction.").

33. In *General Motors*, the secured creditor bought the collateral at an execution sale for \$18,500. It then sought an injunction to enjoin the disbursement of the proceeds from the sale. The court ruled against the secured creditor primarily because the creditor had an adequate remedy at law—to foreclose on the collateral it now had in its possession. When the court looked at the other bids, it determined that the collateral's fair market value was about \$37,000. The debt was approximately \$19,000. Thus, the court concluded that the secured creditor would just about break even if it sold the collateral in a "commercially reasonable" Article 9 sale. *General Motors*, 707 S.W.2d 292; see also *Brown v. Arkoma Coal Corp.*, 634 S.W.2d 390, 392 (Ark. 1982) (stating in dictum that if the secured creditor only went after the proceeds of the execution sale rather than foreclosing on the security interest, a one-and-a-half-year delay before seeking the proceeds could amount to ratification of the sale). For a discussion of other potential equitable remedies, see *infra* Part I.B.

34. See U.C.C. § 9-315(a)(2) (2001). There are tracing methods available to the secured creditor to help identify proceeds commingled with other funds, such as the "lowest intermediate balance rule," but these solutions are not always available. See U.C.C. § 9-315 cmt. 3 (2001). Also, the secured creditor has the burden of tracing the proceeds and is often unsuccessful. See, e.g., *In re Oriental Rug Warehouse Club, Inc.*, 205 B.R. 407 (Bankr. D. Minn. 1997). On the other hand, the secured creditor may have a third remedy—suing the lien creditor or a third-party on a conversion claim. See *infra* Part I.A.2.

35. See U.C.C. § 9-601 cmt. 3 (2001) ("[T]his Article leaves to the agreement of the parties the circumstances giving rise to a default.").

36. See, e.g., *Frierson v. United Farm Agency, Inc.*, 868 F.2d 302, 304–05 (8th Cir. 1998).

37. See, e.g., *Brescher v. Assocs. Fin. Servs. Co.*, 460 So. 2d 464 (Fla. Dist. Ct. App. 1984); *Grocers Supply Co. v. Intercity Inv. Props.*, 795 S.W.2d 225, 226–27 (Tex. App. 1990); *Murdock v. Blake*, 484 P.2d 164, 169 (Utah 1971).

manifestation beyond declaring a technical default is required.³⁸ But assuming a default, however defined, has occurred, most courts would then declare that the secured creditor has the right to enjoin the execution sale and repossess (or replevy) the collateral from the sheriff.³⁹

2. Conversion Charges

Once the debtor is in default,⁴⁰ the secured creditor has the right to repossess the collateral.⁴¹ If the lien creditor has knowledge of the secured creditor's possessory interest, any action that the lien creditor takes contrary to this interest will constitute conversion. While merely ordering the sheriff to levy on the collateral would probably not constitute conversion,⁴² being directly made aware of the default and then proceeding with the sale will.⁴³ Often these cases turn on miniscule differences in the

38. See, e.g., *Frierson*, 868 F.2d at 305 (dictum) (“[The secured creditor] cannot refuse to exercise its rights under the security agreement, thereby maintaining [the debtor] as a going concern, while it impairs the status of other creditors by preventing them from exercising valid liens. Allowing [the secured creditor] to do so would fly in the face of all Article 9”); *Bank of Hawaii v. DeYoung*, 992 P.2d 42, 44 (Haw. 2000); *First Nat'l Bank of Glendale v. Sheriff of Milwaukee County*, 149 N.W.2d 548, 550 (Wis. 1967) (“There was no evidence that the plaintiff deemed itself insecure or for any other reason demanded possession of the [collateral] from the debtor before the execution. If there had been such proof, the plaintiff would have been entitled to possession and could have recovered the property in a subsequent replevin action against the debtor . . .”).

39. If a “default” did not occur, either because there was no technical default or the court looked for some further act which it did not find, the secured creditor cannot enjoin the execution sale but still has priority to the proceeds. See *Brescher*, 460 So. 2d at 466 (explaining that in *Altec Lansing* no default had been declared); *J.N. Laliotis Eng'g Constr., Inc., v. Mastor*, 600 So. 2d 1271 (Fla. Dist. Ct. App. 1992) (following the line of cases holding that there can be no authority to stop the sale without a default); *Altec Lansing v. Friedman Sound, Inc.*, 204 So. 2d 740 (Fla. Dist. Ct. App. 1967) (holding that a secured creditor cannot dissolve a writ of execution).

40. Some authority suggests that the right to bring a conversion suit exists when the collateral is disposed of without the secured creditor's authorization. “In most cases, any distinction between [being in default or being an ‘unauthorized disposition’] is moot, because the security agreement defines default to include any unauthorized disposition of the collateral.” *Mammoth Cave Prod. Credit Assoc. v. Oldham*, 569 S.W.2d 833, 837–38 (Tenn. Ct. App. 1977).

41. See U.C.C. § 9-609(a) (2001). Conversely, before default, the secured creditor has no right to possession. Without a possessory right, most courts will not entertain an action for conversion. See, e.g., *Grocers Supply*, 795 S.W.2d at 227 (holding that a secured creditor with a right of possession *after default* may maintain an action for conversion); *Murdock*, 484 P.2d at 169 (“[T]he right to possession and sale of the collateral passed from the debtor . . . to the secured [creditor] . . . at the time of default, and these are the rights to which [the secured creditor] was entitled to be restored.”) (emphasis added).

42. See, e.g., *Citizens Bank of Lavaca v. Perrin & Sons, Inc.*, 488 S.W.2d 14, 15 (Ark. 1972); *Kennedy v. Fournie*, 898 S.W.2d 672, 678 (Mo. Ct. App. 1995) (“When the initial taking is authorized, demand and refusal are necessary to the existence of a conversion claim.”).

43. Compare *Citizens Bank*, 488 S.W.2d at 15 (“[T]he bare sale of the property [is] not a conversion in fact.”), with *Oregon Bank v. Fox*, 699 P.2d 1147, 1150 (Or. Ct. App. 1985)

degree to which the lien creditor is aware of the secured creditor's interest, although courts seem to impute the lien creditor with inquiry notice and do not necessarily require the secured creditor to demand return of the collateral.⁴⁴

Moreover, the secured creditor could possibly bring an action for conversion post-execution sale.⁴⁵ Courts would then ordinarily grant the secured creditor the *actual* value of the collateral at the time of the execution sale,⁴⁶ which can amount to more than what the lien creditor *received* at the sale.⁴⁷ This risk places an added burden on the lien creditor's ability to obtain debtor equity in oversecured collateral.

Conversely, a third-party purchaser at the execution sale of property encumbered with a security interest is normally not found liable for conversion,⁴⁸ although exceptions exist. If the purchaser takes some other action, beyond merely purchasing and using the collateral, that threatens to undermine the secured creditor's possessory right, the purchaser may face conversion charges. This may arise, for example, when a purchaser refuses to turn over the collateral after receiving a demand from the secured creditor.⁴⁹ Although the law is not necessarily clear cut, a purchaser at an execution sale is generally held to a lower standard than a lien creditor when determining liability. Nonetheless, the fact that a completely innocent purchaser may have to pay for the value of the collateral at the time of purchase (which equates to the time of conversion) only encourages depressed bidding at execution sales.⁵⁰

B. The Current Solutions: Waiver, Laches, Estoppel, and Marshaling

Beyond holding a party liable for conversion, a secured creditor can also repossess the collateral after default. When this happens, a lien creditor will want a speedy Article 9 sale to obtain the debtor's equity as quickly as possible. When a secured creditor refuses to conduct or delays an Article 9 sale, a lien creditor may use equitable

(Court held that secured creditor had security interest in debtor's accounts receivables once secured creditor gave debtor notice of default. The court found debtor's president liable for conversion where the president started to pay out to other creditors using proceeds from the accounts receivable.), and *Murdock*, 484 P.2d. at 164 (Secured creditor notified lien creditor that it claimed a security interest in the collateral and forwarded the security agreement to the lien creditor. The court held lien creditor liable for conversion where lien creditor then proceeded with sale.)

44. See, e.g., *Cooper v. Citizens Bank*, 199 S.E.2d 369 (Ga. Ct. App. 1973) (finding that the notation of the lien on a vehicle's certificate of title was enough to hold the lien creditor liable for conversion); *Grocers Supply*, 795 S.W.2d at 226-27 (Attorneys for lien creditor were aware of a prior recorded security interest but proceeded to levy on the collateral. Court imposed liability for conversion, covering costs and associated expenses.)

45. See *Murdock*, 484 P.2d. at 169.

46. *Id.* at 169-70. Before the execution sale, the secured creditor typically recovers costs associated with recovering the collateral. See *Grocers Supply*, 795 S.W.2d at 225.

47. Prices obtained at execution sales are frequently lower than the actual value of the collateral. See *Byrne et al.*, *supra* note 17 and accompanying text.

48. See *Citizens Bank*, 488 S.W.2d at 15 ("As far as this record shows, the [collateral], in the hands of the [third-party purchaser], was as fully accessible to [the secured creditor] as it would have been if [the debtor] had sold it directly to that [third-party purchaser], as he had a right to do.")

49. E.g., *Production Credit Ass'n v. Nowatzski*, 280 N.W.2d 118, 122 (Wisc. 1979).

50. See *supra* text accompanying note 17.

doctrines to assert its rights. Among the most common of these doctrines are waiver, laches, estoppel (or waiver by estoppel), and marshaling. For the most part, however, many of these tactics, apart from marshaling, rarely aid the lien creditor. Furthermore, some courts will dismiss claims to compel an Article 9 sale outright when the lien creditor is merely a judgment creditor.⁵¹

In general, if the secured creditor repossesses the collateral and then sits on its rights, equitable doctrines will not force the secured creditor to sell the collateral in an Article 9 sale, at least in an expeditious manner. "Except in cases where estoppel or laches may apply, a secured creditor's mere inaction does not constitute an implied waiver of its rights."⁵² Furthermore, the secured creditor does not "waive its security interest by allowing the debtor to retain possession of collateral and use it in the ordinary course of business."⁵³ Waits of two years or more before disposition of the collateral have been upheld,⁵⁴ although one court, under the laches doctrine, agreed that a 10-year delay in an attempt to recover on a defaulted loan was exorbitant and dismissed the claim.⁵⁵ As a whole, however, the courts look for a "clear, unequivocal, and decisive act" from the secured creditor before finding an implied waiver.⁵⁶ Rarely does mere inaction or silence suffice.

Besides waiver and laches, lien creditors have also made estoppel arguments to compel a sale. Generally, "[i]n order to establish estoppel, the [lien creditor] must show that it was induced to change its position to its detriment in reliance on words or conduct amounting to a misrepresentation or concealment of a material fact."⁵⁷ Estoppel rarely succeeds because the secured creditor must explicitly, either via words or conduct, manifest some misrepresentation to the lien creditor that would cause the lien creditor to *detrimentally* change its position.

Casting aside the reliance and other proof issues, the lien creditor's position is almost always subordinate to any perfected secured creditor.⁵⁸ The secured creditor would have to outright promise (or in some other manner communicate) to the lien creditor that it plans to promptly dispose of the collateral or otherwise compensate the

51. See *Iselin v. Burgess & Leight Ltd.*, 276 N.Y.S.2d 659, 663 (N.Y. Sup. Ct. 1967) (holding that after default the debtor loses right of possession and that the secured creditor's failure to "foreclose on its lien at the first instance it believes, or has cause to believe, that the [d]ebtor cannot immediately repay the loan" is not a material issue of fact).

52. *Fleming v. Carroll Publ'g Co.*, 621 A.2d 829, 833-34 (D.C. 1993); see also *Yamaha Motor Corp. v. Tri-City Motors & Sports, Inc.*, 429 N.W.2d 871, 877 (Mich. Ct. App. 1988).

53. *Fleming*, 621 A.2d. at 834; see also *Brescher v. Assocs. Fin. Servs. Co.*, 460 So. 2d 464, 467 (Fla. Dist. Ct. App. 1984) (stating that secured creditors have the right to take possession of the collateral without explicit time constraints).

54. See, e.g., *Nat'l Acceptance Co. v. Mitsubishi Int'l Corp.*, 491 F. Supp. 1269, 1274 (E.D. Va. 1980) (holding that a secured creditor that waited two years to declare the debtor in default "in no way enhance[d] the position of junior creditors with respect to the collateral").

55. *Fifth Third Bank v. West*, 537 N.E.2d 262 (Ohio Mun. Ct. 1988).

56. *Washburn v. Union Nat'l Bank & Trust Co.*, 502 N.E.2d 739, 742 (Ill. App. Ct. 1986).

57. *Id.* at 741 (citing *Ptaszek v. Konczal*, 130 N.E.2d 257 (Ill. 1955)).

58. *Chicago Dist. Council of Carpenters Pension Fund v. Tessio Constr. Corp.*, 51 U.C.C. Rep. Serv. 2d (CBC) 268 (N.D. Ill. 2003) ("Notably, the [lien creditor] does not even attempt to dispute the [secured creditor's] claim that the [secured creditor's] security interest was perfected prior to its lien.").

lien creditor for the wait, an almost implausible situation.⁵⁹ Short of the secured creditor not telling the lien creditor it held a security interest in the property if the lien creditor inquired, estoppel seldom prevails for the lien creditor.⁶⁰

Finally, a lien creditor may ask the court to order the secured creditor to look to another source of property from the same debtor to satisfy the underlying obligation.⁶¹ This equitable doctrine, known as marshaling,⁶² is what the Article 9 drafters had in mind when confronted with this Note's problem.⁶³ In order for a lien creditor to successfully assert a marshaling argument, the following elements must be met: (1) common debtor between lien and secured creditor, (2) two or more sources of property available to foreclose on, and (3) the secured creditor being able to satisfy its claim from a source other than the collateral to which the lien creditor attached.⁶⁴

In *Shedoudy v. Beverly Surgical Supply Co.*,⁶⁵ for example, the lien creditors levied on the debtor's bank account in order to satisfy a \$50,000 judgment.⁶⁶ Before the sheriff disbursed the funds, the secured creditor sought to enjoin any release of proceeds. The secured creditor had an outstanding claim for about \$2 million, whereas the debtor had assets of \$33 million and a net worth in excess of \$10 million.⁶⁷ The court granted the lien creditor's marshaling request. All involved had a common debtor, and the debtor had multiple sources of collateral available to the secured creditor to foreclose upon. Moreover, "[i]n light of the equitable principles involved," the court decided not to wait for the secured creditor to actually foreclose on the collateral.⁶⁸ The court found that the UCC neither contemplated nor required the secured creditor to foreclose on its lien before marshaling.⁶⁹ To hold otherwise might "permanently and unjustifiably" deprive the lien creditor of its judgment.⁷⁰

Although marshaling does provide lien creditors with some leverage to obtain the debtor's equity in collateral, the doctrine is not infallible. Marshaling may not be used to prejudice parties with equal or greater interests in the collateral, which in this context includes other lien or secured creditors.⁷¹ Moreover, some courts have

59. Even when the two parties are in contact, being mistaken over which party's security interest has priority would still not constitute detrimental reliance. See *H. & Val J. Rothschild, Inc. v. Northwestern Nat. Bank*, 242 N.W.2d 844, 848 (Minn. 1976).

60. See *Manson State Bank v. Diamond*, 227 N.W.2d 195, 204 (Iowa 1975) (holding the secured creditor estopped from asserting its priority against a junior creditor when the secured creditor failed to disclose its interest in the collateral after an inquiry was made that caused the junior creditor to subsequently change its position).

61. *Shedoudy v. Beverly Surgical Supply Co.*, 161 Cal. Rptr. 164, 166 (Cal. Ct. App. 1980).

62. Some courts spell it "marshalling," although for consistency and what appears to be the majority preference, this Note denotes the doctrine as "marshaling."

63. See U.C.C. § 9-401 cmt. 6 (2001); U.C.C. § 9-311 cmt. 3 (2001).

64. See *Shedoudy*, 161 Cal. Rptr. at 166; *In re Robert E. Derecktor of Rhode Island, Inc.*, 150 B.R. 296, 299 (Bankr. D. R.I. 1993).

65. 161 Cal. Rptr. 164.

66. *Id.* at 166.

67. *Id.*

68. *Id.* at 168.

69. *Id.*

70. *Id.*

71. *Meyer v. United States*, 375 U.S. 233, 237 (1963) ("[M]arshaling is not bottomed on

interpreted “prejudice” loosely, including such variables as “undue delay” in receiving payment, among others, when determining whether to order marshaling.⁷² Ultimately the secured creditor must be able to recover fully from all remaining sources of collateral it has at its disposal. If there is doubt as to whether the secured creditor can fully collect after ordering marshaling, the court will not do so.⁷³ Finally, if there is only one source of collateral with debtor equity, marshaling will not be permitted.⁷⁴ To hold otherwise would violate the central premise that the debtor has more than one source of collateral which the senior creditor can turn to for satisfaction (and that the lien creditor has only one itself).

C. The Article 9 Drafters’ Inability to Solve This Dilemma

Since marshaling does not fully address the problem and other equitable doctrines remain wanting, other, more elegant solutions to this dilemma have been proposed. Indeed, many years before the promulgation of revised Article 9’s first draft,⁷⁵ a group of scholars advocated adding a new notice requirement to Article 9 whereby a lien creditor would notify the secured creditor of its intent to sell the collateral.⁷⁶ If the secured creditor did not intervene within a certain period of time after notification and promptly sell the collateral, the lien creditor could proceed with the sale.⁷⁷ Regardless of who sold the collateral, the purchaser at the sale would take free of the security interest.⁷⁸ Finally, the lien creditor would only be liable for conversion if the requisite notice was not given.⁷⁹

This earlier proposal solved many of the problems previously discussed. The provision would have given all parties involved predictable rules and the ability for the lien creditor to obtain the debtor’s equity in the collateral. Furthermore, by obtaining

the law of contracts or liens. It is founded instead in equity, being designed to promote fair dealing and justice.”).

72. *In re Woolf Printing Corp.*, 87 B.R. 692, 694 (Bankr. M.D. Fla. 1988) (holding that forcing the secured creditor to look to personal property rather than the insurance proceeds would cause “undue delay”).

73. The lien creditor normally has the burden of showing no prejudice to the senior creditor. *Id.* at 695.

74. Many states have homestead exemptions, which may deny marshaling to lien creditors altogether. These exemptions often force the secured creditor to go after non-homestead property first for satisfaction of its claim. If the secured creditor’s claim exceeds the debtor’s equity in all the non-homestead-exempt property, then the lien creditor will receive nothing. This result occurs even when the state’s homestead exemption amount is less than the value of the homestead property. In other words, although theoretically the secured creditor could be satisfied by forcing a sale of the homestead property, courts will compel the secured creditor to look for satisfaction from that property as an absolute last resort. *See Lee v. Mercantile First Nat. Bank of Doniphan*, 765 S.W.2d 17, 21 (Ark. Ct. App. 1989); LOPUCKI & WARREN, *supra* note 19, at 565.

75. This proposed notice theory was modeled off one found in the first drafts of original Article 9. *See infra* text accompanying note 93.

76. *See Byrne et al.*, *supra* note 17, at 1926.

77. Under their proposal, the lien creditor would have priority to the sale’s proceeds as well. *Id.* at 1927–28.

78. *Id.* at 1929–30.

79. *Id.* at 1928–29.

the best possible price through a non-subject-to sale, the proposal would have furthered the interest of all involved parties. Yet, despite its virtues, the proposal neither found its way into revised Article 9 nor are similar provisions likely to in the future.

The hindrance lies in the Article 9 drafting process itself; the same process that promotes Article 9's virtues of being uniform and predictable also must ensure its survival.⁸⁰ To that end, divisive proposals, usually those that would harm Article 9's passage in state legislatures, are almost always dropped. Conversely, proposals that maintain the status quo (i.e. proposals that further Article 9's original purpose of promoting the expansion of secured credit) survive.⁸¹

Academics have often argued that Article 9 favors secured creditors over involuntary creditors,⁸² and that this bias affects the likelihood of new proposals receiving favorable treatment.⁸³ Two proposals brought to the revised Article 9 Drafting Committee illustrate this dichotomy. The Warren Proposal, which advocated setting aside twenty percent of the collateral's value for involuntary creditors, met a hostile reception when it was sent to the Drafting Committee.⁸⁴ A "flurry of letters and short articles decrying either the details of the Proposal or what it could do to deserving borrowers" followed, and shortly thereafter the Proposal was unanimously rejected "with virtually no discussion."⁸⁵

On the other hand, a proposal which advocated changing the location of filing to the debtor's state of incorporation received a warm reception and eventually was incorporated into revised Article 9.⁸⁶ The drafters were "inclined to agree with [this

80. The official comment to U.C.C. § 9-701 (2001) states, among other things, that "uniformity is essential to the success of this Article," that "this Article is based on the general assumption that all States will have enacted substantially identical versions," and that "[a]ny one State's failure to adopt the uniform effective date will greatly increase the cost and uncertainty surrounding the transition."

81. Many academics are highly skeptical of Article 9's foundation. *See, e.g.*, David Frisch, *The Implicit "Takings" Jurisprudence of Article 9 of the Uniform Commercial Code*, 64 *FORDHAM L. REV.* 11, 11-12 (1995) ("Since the Code was first drafted, scholars have struggled to articulate a single unifying theory that explains all aspects of Article 9 priorities. Their efforts, however, remain largely unsatisfactory. . . . [I]t seems clear that commentators have done just about all that can be done from within the analytical models that have governed discourse to date.").

82. Involuntary creditors are those creditors involved in unbargained-for exchanges, and include most tort victims and many lien creditors.

83. Rasmussen, *supra* note 1, at 1103. *See generally* Lynn M. LoPucki, *The Unsecured Creditor's Bargain*, 80 *VA. L. REV.* 1887 (1994) (proposes an Article 9 system where most tort creditors would have priority over secured creditors).

84. *See* LOPUCKI & WARREN, *supra* note 19, at 672-75; *see also* Charles W. Hendricks, *Offering Tort Victims Some Solace: Why States Should Incorporate a 20% Set-Aside into Their Versions of Article 9*, 104 *COM. L.J.* 265, 268-70 (1999); Woodward, *supra* note 1, at 1512.

85. Janger, *supra* note 1, at 575; Woodward, *supra* note 1, at 1512; *see also* Elizabeth Warren, *An Article 9 Set-Aside for Unsecured Creditors*, 51 *CONSUMER FIN. L.Q. REP.* 323, 325 (1997).

86. Steven L. Harris & Charles W. Mooney, Jr., *Choosing the Law Governing Perfection: The Data and Politics of Article 9 Filing*, 79 *MINN. L. REV.* 663 (1997) (co-reporters on the revised Article 9 Drafting Committee discussing their perceptions of the proposal); Lynn M. LoPucki, *The Article 9 Filing System: Why the Debtor's State of Incorporation Should Be the*

proposal's] conclusion" because it reduced costs and simplified the process.⁸⁷ The Warren Proposal, however, was seen as disruptive to the entire Article 9 system. Whether the reasons for this divergence in the reception of the two proposals are grounded in certain interest groups capturing the Article 9 drafting process,⁸⁸ in fears of "enactability" of Article 9 in all the state legislatures,⁸⁹ or in a fundamentally different view on efficiency and distributional fairness,⁹⁰ the outcome remains the same: proposals aimed at simplicity and maintaining the status quo pass, while divisive proposals fail.⁹¹ The latter category seems to include any proposal that purports to adjust the third-party effects of secured credit, a type of problem this Note illustrates.⁹²

Moreover, these squabbles have happened before. In the 1949 original draft of Article 9, for example, a notice provision in favor of the lien creditor being able to sell the collateral after providing sufficient notice to the secured creditor was initially included.⁹³ This notice provision "mysteriously" disappeared in all subsequent drafts.⁹⁴ This omission may result from the perplexities involved with implementation,⁹⁵ although it seems equally plausible that the provision was dropped because it was just too divisive to secure passage in state legislatures.⁹⁶

Proper Place for Article 9 Filing: A Systems Analysis, 79 MINN. L. REV. 577 (1995); see also U.C.C. § 9-301 (2001).

87. Harris & Mooney, *supra* note 86, at 663.

88. See Kathleen Patchel, *Interest Group Politics, Federalism, and the Uniform Laws Process: Some Lessons from the Uniform Commercial Code*, 78 MINN. L. REV. 83 (1993); see also Alan Schwartz & Robert E. Scott, *The Political Economy of Private Legislatures*, 143 U. PA. L. REV. 595 (1995); Janger, *supra* note 1, at 578-94.

89. See Woodward, Jr., *supra* note 1, at 1521-26.

90. *Id.* at 1529-32. Compare Steven L. Schwarcz, *Threats to Secured Lending and Asset Securitization*, 25 CARDOZO L. REV. 1539, 1553-74 (2004) (claiming that the current Article 9 system is not only Kaldor-Hicks efficient but also does not harm unsecured creditors, including lien creditors, as a class), with Lopucki, *supra* note 83, at 1896-914 (claiming that involuntary creditors should have priority over secured creditors on efficiency and equitable grounds).

91. See Janger, *supra* note 1, at 573-79. A number of consumer-protection proposals incorporated into early drafts of revised Article 9 "proved highly controversial and led to a walk out by members of the consumer credit industry. Only an eleventh hour compromise saved the process," with virtually all divisive provisions removed. *Id.* at 576. For example, the Warren Proposal, see *supra* text accompanying note 88, raised questions that were "just too big, too direct, and too political for the [Article 9] revision process to handle." Woodward, Jr., *supra* note 1, at 1529; see also Janger, *supra* note 1, at 612-15 (discussing the Hillebrand Proposal that led to the walkout).

92. Janger, *supra* note 1, at 575.

93. See Byrne et al., *supra* note 17, at 1928-29. The notice provision at the 1949 convention was not nearly as refined as the one discussed earlier. See *supra* text accompanying note 76.

94. *Id.* at 1928.

95. *Id.*

96. From its inception the Article 9 drafting process was designed to further secured credit and "to do away with technicalities seized on by courts to dislodge security interests." Woodward, Jr., *supra* note 1, at 1519. To that end the original drafters "encouraged input from interested industries." Patchel, *supra* note 88, at 98. Moreover, concerns about "enactability" restricted the initial scope of Article 9; "fields that could be expected to cause political controversy were excluded or treated as severable." *Id.*

D. Alternative Solutions: Why a Lien Creditor Must Look to the Courts

If a lien creditor is unable to find relief in the Article 9 drafting process, there are three alternative solutions: individual states draft a nonconforming statute, federal preemption, or court-ordered protection. Some states have passed nonconforming statutes, with most requiring the lien creditor to settle the underlying amount the debtor owes to the secured creditor before the lien creditor can seize the collateral.⁹⁷ Not only is this solution impractical, as these statutes force a lien creditor to come up with a large cash outlay that it may not have before it can obtain any of the debtor's equity, but the solution also fails to promote uniform laws.⁹⁸ Federal preemption, however, would promote uniformity and consistency.

Whether a lien creditor's interest would fare better in Congress remains hard to predict, although some authorities suggest the likelihood is greater in the federal arena.⁹⁹ Since uniform state laws are usually better drafted than federal statutes,¹⁰⁰ a partial preemption, where the federal government only supersedes certain Article 9

97. See, e.g., IDAHO CODE ANN. § 8-506A(b) (1998) (requiring any lien creditor to either obtain the secured creditor's authorization or pay the secured creditor the amount due on the underlying security agreement before seizing encumbered collateral); IOWA CODE ANN. § 626.34 (West 1999) (permitting the lien creditor to seize encumbered collateral so long as the amount due on the underlying security agreement is paid within ten days); N.H. REV. STAT. ANN. § 511:26 (1997) (requiring the lien creditor to pay off the underlying debt).

98. Although U.C.C. § 1-103(a)(3) states uniformity as a UCC goal, the case for uniformity "is not necessarily an obvious goal." Rasmussen, *supra* note 1, at 1129. Although the filing system in Article 9 needs uniformity to work effectively, the reasons for uniformity in other areas of Article 9 remain debatable. See *id.* at 1143-46. Professor Janger asserts that state legislatures are more susceptible to public input than the Article 9 Drafting Committee, and that having states test a few nonuniform rules would give drafters an opportunity to evaluate a rule's potential effectiveness before promulgating it to the nation as a whole. Janger, *supra* note 1, at 626. While this remains plausible in theory, in practice states are unlikely to adopt proposals like the Warren Proposal, see *supra* text accompanying note 84, because of the added "cost of credit for enterprises whose loan transactions are governed by the law of the nonuniform jurisdiction." *Id.* at 626-28. But see Woodward, *supra* note 1, at 1529 n.91 (finding "further proliferation of statutory liens a piecemeal and non-uniform [sic] cure to all-encompassing security interests that may be worse than the disease").

99. "Unsecured creditors and tort claimants will face collective-action problems at the federal level as well, and there is reason to expect their interests to be somewhat underrepresented. Nonetheless, there is a greater likelihood [at the federal level] that they will not be completely overmatched." Janger, *supra* note 1, at 629 n.228; see also Woodward, *supra* note 1, at 1529 ("If the core policy question of secured creditor priority will receive a hearing at all, it will have to be at the federal level."); cf. Edward Rubin, *Efficiency, Equity and the Proposed Revision of Articles 3 and 4*, 42 ALA. L. REV. 551, 586-94 (1991) (discussing how the drafting of the Electronic Fund Transfer Act was superior—in terms of both economic efficiency and social equity—than that of the UCC because a representative group created the former).

100. See Rasmussen, *supra* note 1, at 1144-46; Rubin, *supra* note 99, at 579 ("The quality of [the Expedited Funds Availability Act's] draftsmanship is far inferior to the U.C.C. revisions, but its social policy choices are superior."). The fact that Congress can transfer much of the implementation to a regulatory agency, however, can mitigate poor draftsmanship. See *infra* text accompanying note 103.

provisions, seems preferable to complete preemption.¹⁰¹ And partial preemption already occurs in other parts of the UCC with some success, such as Congress's enactment of the Expedited Funds Availability Act, which trumps much of Article 4 that deals with the bank collection process.¹⁰² Finally, a federal statute can utilize a single regulatory agency to draft supplementary rules and regulations, and thus relieve pressure on the Article 9 drafters to make an exhaustively detailed and potentially more divisive statute.¹⁰³ If the current Article 9 drafters were to do otherwise and leave much of Article 9 to state regulatory agencies, each state could pass a different regulation—destroying uniformity.¹⁰⁴

Despite the apparent benefits of federal preemption, “[g]overnmental actions of this sort do not . . . appear politically likely at this time.”¹⁰⁵ And without federal preemption, the courts become, for the moment, the only viable solution. This result is not without precedent; revised Article 9's drafters left many divisive consumer issues to the courts.¹⁰⁶ For example, when a debtor in a nonconsumer transaction disputes whether a secured creditor conducted a commercially reasonable Article 9 sale, there exists a rebuttable presumption that the collateral would have been equal to the deficiency amount if the sale was done in a commercially reasonable manner.¹⁰⁷ The burden is on the secured creditor to prove otherwise. In a consumer transaction, however, Article 9 defers to the courts.

Consumer advocates wanted the collateral valued at wholesale when determining a deficiency, regardless of what the secured creditor netted at the Article 9 sale; or alternatively, wanted to bar the deficiency judgment if the sale was not conducted in a commercially reasonable manner.¹⁰⁸ Neither proposal made it into revised Article 9. Instead, the drafters left the issue for the courts to decide in consumer cases, and insofar as a particular jurisdiction recognizes a more pro-consumer approach, such as the “absolute bar” rule,¹⁰⁹ the drafters left it to the courts to apply “established approaches.”¹¹⁰ When the Drafting Committee was asked to explain why they chose

101. See Rasmussen, *supra* note 1, at 1143–46 (“While the observation that certain groups are underrepresented in the Article 9 drafting process is correct, the better solution to this problem is to have the federal government act on a targeted basis against the background of this law rather than to cede primary responsibility for secured transactions to Congress.”).

102. Congress passed the Expedited Funds Availability Act in part because of consumer complaints regarding excessive “float”—the time between the deposit of funds and when those funds became available to the consumer. Rubin, *supra* note 99, at 573.

103. *Id.* at 587–88.

104. *Id.*

105. Steven L. Schwarcz, *Collapsing Corporate Structures: Resolving the Tension Between Form and Substance*, 60 BUS. LAW. 109, 124 n.101 (2004) (noting how government could fix distributional inequalities and give tort claimants preferences in various ways, although it is unlikely to happen soon).

106. See Jean Braucher, *Deadlock: Consumer Transactions Under Revised Article 9*, 73 AM. BANKR. L.J. 83 (1999).

107. *Id.* at 87.

108. *Id.* at 86–88.

109. The absolute-bar rule would prohibit the secured creditor from collecting a deficiency judgment against the debtor. U.C.C. § 9-626 cmt. 4 (2001).

110. *Id.*

this deferential approach, “the [drafters] made hand signals indicating a refusal to touch the question.”¹¹¹

Although the drafters left many divisive issues to the courts, including this Note’s problem, this deference could be for good reason: the courts have traditionally been sensitive to a lien creditor’s rights and skeptical of secured credit. The 1819 Pennsylvania case of *Clow v. Woods*¹¹² is apposite. In *Clow*, the court affirmed a lower court’s ruling that denounced a secret lien, which allowed the creditor to retain possession of the collateral, as being “fraudulent per se, and void against a bona fide creditor without notice, who levied an execution”¹¹³ This common-law hostility, “unequaled in commercial law,” was one of the key reasons for Article 9’s existence.¹¹⁴ Article 9’s purpose was “to do away with technicalities seized on by courts to dislodge security interests.”¹¹⁵

It is wrong, however, to view the courts as protectors of lien creditors’ rights.¹¹⁶ Today the courts are somewhat tied to the rubric of Article 9’s goals of furthering certainty¹¹⁷ and uniformity—even to the point where state courts usually defer to the judgment of their sister courts whenever a sister court’s interpretation is reasonable.¹¹⁸ Moreover, any presupposition that the courts generally look more favorably upon an involuntary creditor, such as a judgment lien creditor, may be flawed. For example, with the corporate law doctrine of “veil piercing,” where a creditor seeks to hold the underlying shareholders liable for the company’s debts, conventional wisdom holds that courts will pierce more often for an involuntary tort creditor rather than for a voluntary contract creditor.¹¹⁹ Empirically the exact opposite occurs.¹²⁰ Perhaps because the equitable veil-piercing doctrine had its roots in protecting the bargaining process,¹²¹ courts are reluctant to judicially impose relief beyond fraud and

111. Braucher, *supra* note 106, at 88.

112. 5 Serg. & Rawle 275 (Pa. 1819).

113. *Id.* at 275.

114. Woodward, *supra* note 1, at 1516.

115. *Id.* at 1519.

116. Courts in modern times have become quite accustomed to secured credit. *See* *Brescher v. Assocs. Fin. Servs. Co.*, 460 So. 2d 464, 465–67 (Fla. Dist. Ct. App. 1984) (Although permitting a secured creditor to replevy goods from the sheriff insulates the debtor’s equity from all other creditors, “it is an acceptable consequence of a considered legislative decision.”).

117. *Chicago Dist. Council of Carpenters Pension Fund v. Tessio Constr. Corp.*, No. 02-C-4987, 2003 U.S. Dist. LEXIS 9288, at *15 (N.D. Ill. 2003) (“More importantly, the certainty provided to businesses by the UCC enables commercial enterprises to analyze risk and make business decisions with a certain degree of predictability. The [c]ourt is not inclined to abandon this well-established system of relative reliability created by the UCC, simply because it might work a hardship . . .”).

118. *See* HAWKLAND, *supra* note 5, at § 1-103:10. Original Article 9’s § 9-205 was designed to overrule *Benedict v. Ratner*, 268 U.S. 353 (1925), which required a secured creditor to protect against “secret liens” by strictly policing the collateral in the hands of the debtor.

119. Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 CORNELL L. REV. 1036, 1058 (1991).

120. *Id.* at 1058–60, 1068–71 (“These results, more than any other in the project, go against the conventional wisdom.”).

121. *See* David W. Leebron, *Limited Liability, Tort Victims, and Creditors*, 91 COLUM. L. REV. 1565, 1566 (1991); *cf. In re Robert E. Derecktor of Rhode Island, Inc.*, 150 B.R. 296, 300

misrepresentation in the contract setting.¹²² Regardless of the reasoning used, courts look for something more than mere happenstance when imposing equitable relief—even for an involuntary creditor.

II. THE DEVELOPMENT OF A GOOD-FAITH SOLUTION

When asking a court to impose equitable relief, a lien creditor now has another tool at its disposal apart from marshaling. Revised Article 9 contains a revamped good-faith provision that adds an explicit objective component of “observance of reasonable commercial standards of fair dealing” to the prior subjective component of “honesty in fact.”¹²³ This good-faith obligation cannot be waived, although the parties may be able to alter the general standards so long as they are not “manifestly unreasonable.”¹²⁴

When looking to this new solution for relief, a lien creditor must first realize that allegations that the secured creditor did not act in good faith are not independent claims. Instead, the moving party must point to a specific duty that the secured creditor did not perform in good faith.¹²⁵ Courts will not hold that a secured creditor owes an independent duty to a lien creditor; most cite the extra burdens it would impose on creditors and thus lower credit efficiency.¹²⁶ To hold otherwise would destroy the certainty of the priority rules.¹²⁷

A. Subrogation: Finding a Duty Owed Between the Secured and Lien Creditors

Thus, to find a duty between the secured and lien creditor requires one to first look at the relationship between the secured creditor and debtor. For example, assume a lien creditor successfully levies on the collateral, and the secured creditor steps in after declaring a default to stop the execution sale. But instead of selling the collateral in its

(Bankr. D. R.I. 1993) (ensuring the junior creditor receives “the benefit of its bargain” by allowing it to marshal the debtor’s assets to the detriment of unsecured creditors).

122. See Thompson, *supra* note 119, at 1064. “Alter ego,” “instrumentality,” and “dummy” were also factors that often led to veil piercing. *Id.*

123. U.C.C. § 9-102(43) (2001). If the jurisdiction has enacted revised Article 1, this section is deleted since Article 1’s own provisions make this expanded definition applicable throughout the Code (except for Article 5). In those jurisdictions, see U.C.C. § 1-201(20) (2001).

124. U.C.C. § 1-302(b) (2001).

125. See, e.g., Washburn v. Union Nat’l Bank & Trust Co. of Joliet, 502 N.E.2d 739, 743 (Ill. App. Ct. 1986) (“[I]t has been held that allegations of failure to act in good faith in the performance of duties arising under section 1-203 of the Code do not state a claim for relief. In other words, section 1-203 is directive, rather than remedial, and is implemented by such provisions as the ‘commercially reasonable’ requirement of section 9-507(2).” (internal citation omitted)).

126. See, e.g., Nat’l Acceptance Co. v. Mitsubishi Int’l Corp., 491 F. Supp. 1269, 1276 (E.D. Va. 1980) (“A secured creditor does not owe any duty to those holding subordinate interests to proceed to enforce his remedies. To hold otherwise would place an undue burden, not imposed under the UCC, upon debtors and creditors alike.” (internal citation omitted)); Yamaha Motor Corp. v. Tri-City Motors & Sports, Inc., 429 N.W.2d 871, 878 (Mich. Ct. App. 1988) (“If we were to impose additional responsibilities upon a secured creditor, such as requiring it to act in the best interests of all other creditors, this would increase costs and decrease certainty.”); Color Leasing 3 v. FDIC, 975 F. Supp. 177, 186–89 (D.R.I. 1997).

127. *Id.*

own Article 9 sale, the secured creditor holds the collateral indefinitely. At this point, the lien creditor is stuck, yet the debtor still has rights in the collateral,¹²⁸ including: the right to redeem the collateral (upon payment of the underlying obligation),¹²⁹ the right to receive any surplus from any eventual disposition of the collateral,¹³⁰ the right to force a mandatory Article 9 sale if sixty percent of the obligation secured has been paid,¹³¹ and the right to have the sale of the collateral done in a “commercially reasonable” manner.¹³²

Moreover, through subrogation or general equitable assignment principles,¹³³ all these rights transfer to the lien creditor the moment the lien creditor levies on the collateral. Under revised Article 9 section 9-401(b), official comment five, “the debtor has rights in [the] collateral (whether legal title or equitable) which it can transfer and which its creditors can reach.” Thus, since the lien creditor has levied on the collateral, it has become linked to the secured creditor in more ways than “merely by coincidence” or from a completely separate security arrangement, an argument upon which some courts have seized to deny relief.¹³⁴ Instead, the lien creditor can compel the secured creditor to recognize its interest in the collateral not as a subordinate junior lienholder, but as an assignee of the debtor with rights under the original security agreement.

B. Crafting a Working Definition of Good Faith

Once a court finds a duty that flows from the secured creditor to the lien creditor, the court must then decide on a working definition of good faith. Even before the promulgation of revised Article 9, this has been no easy task.¹³⁵ Indeed, some courts actually implied an objective element of good faith into the purely subjective standard of prior Article 9. Their argument: in order to understand whether the secured creditor acted reasonably, one must determine whether it is reasonable for the secured creditor to believe as it did. Other courts more explicitly added an objective element, but only when the controversy involved a general insecurity clause.¹³⁶ Unfortunately, recent decisions under revised Article 9 provide little definitional guidance.¹³⁷

128. U.C.C. § 9-401 cmt. 5 (2001).

129. U.C.C. § 9-623 (2001).

130. U.C.C. § 9-615 (2001).

131. U.C.C. § 9-620(e) (2001).

132. U.C.C. § 9-610(b) (2001) (“*Every aspect* of a disposition of collateral, including the method, manner, *time, place, and other terms*, must be commercially reasonable.”) (emphasis added). *See also* Solfanelli v. CoreStates Bank, 203 F.3d 197, 201 (3d Cir. 2000) (“In particular, we have held previously that despite agreements between the parties, [the collateral] must be liquidated in good faith and in a commercially reasonable manner.”).

133. *See generally* DAN B. DOBBS, LAW OF REMEDIES § 4.3(4) (2d ed. 1993).

134. *Yamaha Motor Corp. v. Tri-City Motors & Sports, Inc.*, 429 N.W.2d 871, 877 (Mich. Ct. App. 1988).

135. Denise R. Boklach, Comment, *U.C.C. Section 1-201(19) Good Faith—Is Now the Time to Abandon the Pure Heart/Empty Head Test?*, 45 OKLA. L. REV. 647, 655 (1992) (“Many courts make only conclusory statements of the good faith duty required without specifically defining good faith.”).

136. *See, e.g.*, *Mitchell v. Ford Motor Credit Co.*, 688 P.2d 42, 45 n.5 (Okla. 1984).

137. *See, e.g.*, *Pride Hyundai, Inc. v. Chrysler Fin. Co.*, 369 F.3d 603, 616–19 (1st Cir.

One author, who analyzed the new good-faith definition in relation to another article of the UCC, posited that the “fair dealing” aspect of the objective component implies that a party should not only act honestly in fact and in a “fair manner,” but the party should also “consider the other party’s expectations.”¹³⁸ The author concluded that there is “no doubt . . . that an objective test will require some comparison between a particular creditor’s activities and those of a similarly situated creditor.”¹³⁹

In the Article 3 negotiable instruments context, one court devised a solution that follows a similar line of reasoning. First, the trier of fact must determine whether the party comported with commercial standards.¹⁴⁰ Then, the fact finder should determine whether those standards in and of themselves were reasonably related to achieving fair dealing.¹⁴¹ A secured creditor can comport with the good-faith standard even if it acts negligently,¹⁴² but the secured creditor will probably not meet this standard if it fails to act “fairly.” “Fairly” in the secured transactions context should mean that the secured creditor cannot deliberately prejudice the lien creditor’s position when the collateral is clearly oversecured and the secured creditor can fully recover on its claim.

Assuming the lien creditor achieves standing through subrogation, the lien creditor should then tailor its good faith argument to the case’s particular circumstances. If the secured creditor holds onto the collateral for an extended period of time without disposition, the lien creditor could assert commercial unreasonableness or lack of good faith. If the secured creditor returns the collateral to the debtor, the lien creditor could assert lack of good faith in declaring default, since the lien creditor is now arguably part of the security agreement and must be dealt with fairly. And if the secured creditor accepts the collateral in satisfaction of the obligation, despite the collateral being oversecured, the lien creditor could argue a lack of good faith in consummating the transaction. In other words, as a subrogee of the debtor’s equity, the lien creditor should be treated akin to a debtor in a similar situation; thus, the secured creditor must comply with Article 9’s provision concerning strict foreclosure.¹⁴³

CONCLUSION

An inability for a lien creditor to obtain the debtor’s equity in oversecured collateral has plagued Article 9 since its first promulgation. Although the original drafters and later scholars proposed a sensible solution, premised on the lien creditor giving the secured creditor notice before being authorized to proceed with a sale, it has not been enacted. The inability to enact a sensible solution results primarily from the Article 9 drafting process: in order to secure uniformity and the Article’s eventual passage in states’ legislatures, the drafters cannot allow divisive proposals to succeed. Thus, as with most controversial proposals, the courts are left to strike a balance between Article 9’s goals of certainty and uniformity and the reality that if the Article were

2004).

138. Boklach, *supra* note 135, at 674 (suggesting how the new objective good-faith standard in Articles 3 and 4 should be interpreted).

139. *Id.* at 683.

140. *Maine Family Fed. Credit Union v. Sun Life Assurance Co.*, 727 A.2d 335, 343 (Me. 1999).

141. *Id.*

142. *See* Boklach, *supra* note 135, at 687.

143. U.C.C. § 9-620 (2001).

taken to its literal extreme, a lien creditor might never be able to obtain its share in the debtor's equity if the courts did not invoke some of the UCC's built-in safeguards.

Among these safeguards is the new good faith provision contained in revised Article 9, which adds an explicit objective standard to prior Article 9's subjective standard. After levying on the collateral, a lien creditor has a stake in the debtor's equity, regardless of whether this act triggered the default provision on the underlying agreement between the secured creditor and debtor. This stake in the debtor's equity, coupled with the equitable principle of subrogation, means the secured creditor owes the lien creditor an obligation of good faith when disposing of the collateral. This good faith argument should provide a lien creditor with enough leverage to force an Article 9 sale from a holdout secured creditor. In the end, the courts do not have to become saviors of lien creditors' rights, just more cognizant of them.