Show

Part VII Enforcing an Article 9 Security Interest

Chapter 34 Getting Possession of the Collateral

A. Generally

As noted in Chapter 33 (A Secured Party's Options on Default), the first step in enforcing a security interest normally is to get possession of the collateral. A secured party is aided here by the right to seize collateral without judicial process. However, the right of self help is limited in that there can be no breach of the peace. New 9-609(b)(2).

As also noted in Chapter 33, there is collateral that it may not be practicable to physically repossess. In such cases, a secured party is entitled to disable the collateral, subject to the breach of the peace limitation, and dispose of the collateral on the debtor's premises. New 9-609(a)(2). Under new section 9-609(c), after default, or at any time pursuant to agreement, a secured party may require a debtor to assemble collateral and make it available to the secured party at a reasonably convenient place designated by the secured party.

There is valuable collateral as to which repossession simply is not possible. Think about things that cannot be repossessed and why they cannot. Examples include accounts receivables and general intangibles. Other valuable collateral, such as rents and other income from the original collateral and cash proceeds cannot be repossessed, at least not directly. Foreclosure as to such collateral typically implicates the rights of third parties and the subject gets separate treatment in Chapter 37 (Foreclosure as to Intangibles).

Getting possession of collateral is often a first step towards disposing of the collateral, but it is more. It is a means of preserving the collateral to help assure it is available for disposition. Less obviously, but no less important, possession of collateral gives a secured party "leverage" in dealing with a debtor because losing possession of much collateral (such as needed equipment) obviously may have a serious detrimental impact on a debtor.

Due process requires notice and an opportunity to be heard. Self help repossession denies a debtor notice and an opportunity to be heard. However, the due process protection applies only where there is state action. It has been argued that self help repossession provided for in former section 9-503 involves state action. The same argument may be made as to new section 9-609.

The Supreme Court has never ruled directly on whether self help seizure under Article 9 violates due process. *But cf. Flagg Bros., Inc. v. Brooks*, 436 U.S. 149 (1978) (Holding 5-4 that self help foreclosure of a warehouse lien under Article 7 did not violate due process). However, a number of lower federal courts have concluded that Article 9 merely recognizes a right that arises out of the debtor-creditor security arrangement and that self help repossession is private action.

Note that a security agreement that gives a secured parties the remedies provided for in Article 9 runs a greater risk of being subjected to a successful due process challenge than does a security agreement that gives a secured party a right of self help as a matter of contract.

The precise scope of the breach of the peace limitation is both factually and jurisdictionally dependent. The clearest case of a breach of the peace (or threatened breach of the peace, which has been read into the limitation) is that where a debtor physically resists a repossession. Other cases present tougher calls.

There is a good faith requirement, *see* Article 1, section 1-304 (formerly Article 1, section 1-203), that might apply to cases where the breach of the peace limitation does not. You may wish to review the discussion in Chapter 33 (A Secured Party's Options on Default) of this provision and the definition of good faith in new Article 1, section 1-201(b)(20) as to this possibility.

The limitations on self help are the subject of subpart B below.

Where self help is not available, a creditor must get judicial assistance. Such assistance involves state action so due process clearly does attach. In a series of decisions beginning with *Sniadach v. Family Finance Corp.*, 395 U.S. 337 (1969), the United States Supreme Court held that the notice and hearing requirements of due process were satisfied as to a seizure of a debtor's property to satisfy a debt only where the creditor obtained a judgment on the merits before the property was seized (typically pursuant to a writ of replevin).

However, in *Mitchell v. W.T. Grant Co.*, 416 U.S. 600 (1974), the Supreme Court indicated that a state could provide for seizure of a debtor's property prior to a judgment on the merits if certain conditions were met. Many states, including Arizona, took advantage of the opening offered by the Supreme Court and enacted "provisional remedy" statutes. The Arizona law, the Provisional Remedies Act, is at A.R.S. § 12-2401 et seq., and is discussed in subpart C below.

Finally, it must be kept in mind that secured parties in possession have certain rights and responsibilities to care for the collateral and these responsibilities exist in the case of possession by repossession. *See* new 9-207 and Chapter 15 (Perfection by Possession (Including Documents of Title).

B. Some Specifics Regarding Judicially Supported and Self Help Seizures of Collateral

New section 9-609(a) and (b) track former section 9-503 by permitting a secured party *on default* to take possession of collateral through judicial process (such a writ of replevin) or by self help, if self help can be exercised without a breach of the peace. Under new section 9-609(a)(2), a secured party may forego taking possession and instead disable equipment and dispose of it on the debtor's premises and, under new

section 9-609(c), a secured party may require a debtor to assemble collateral at a reasonably convenient place.

Self help repossession is the procedure of choice because it is faster, reduces the risk that a debtor will make seizure of the collateral difficult and, if successful, avoids the court costs and attorney's fees associated with a seizure effected with court assistance. Recall from Chapter 3 (The Nature of Secured Credit under Article 9) that the law generally looks unfavorably upon self help because of the risk of a breach of the peace and unsecured creditors do not have a right of self help seizure.

An exercise of self help repossession that breaches the peace (or threatens such a breach), violates Article 9 and exposes the secured party to remedies under Part 6 of Article 9 for violations of Article 9 and also tort liability, including damages for wrongful repossession.

"Breach of the peace" is not defined in Article 9 and in general the courts must give the limitation meaning. The limitation is very much fact dependent and generalizations about its meaning are difficult. Decisions under former Article 9, which should be good law under new Article 9 because new section 9-609 parallels former section 9-503 as to the limits on self help, offer some guidance as to the meaning of breach of the peace.

Generally speaking, physical resistance by the debtor will be treated as presenting a sufficient threat of a breach of the peace as to make the exercise of self help impermissible. But, such cases are not always clear-cut. For example, there may be a question of whether the particular debtor could realistically resist.

The case of *Automotive Finance Corp. v. Smart Auto Center, Inc., 334 F.3d 685 (7th Cir. 2003), presented the interesting question of whether a repossession of collateral consisting of several items is divisible in the sense that there could be a problem as to the self-help seizure of certain items but not others. Where collateral is located at different places it makes sense that the seizure at each place should be treated separately. Less clear is the case where the all the collateral is located at one place, but the debtor does not appear and resist until some of the items have been seized.*

In *Automotive Finance* the secured party had a security interest in sixteen vehicles held for sale by the debtor and a repossession agency had seized sixteen of twenty vehicles when the debtor showed up and sought to prevent the taking of the other vehicles. An altercation ensued and the repossession agency eventually seized the remaining four vehicles subject to the security interest. The Seventh Circuit Court of Appeals affirmed a trial court decision that the debtor was entitled to damages for wrongful repossession as to the last four vehicles but not the first sixteen. In so holding, the court concluded that the repossession was complete as to the first sixteen vehicles when the debtor intervened.

The court's holding raises the question of at what point a particular exercise of self help is complete in the sense that an objection by the debtor will be of no effect. There was no discussion in the *Automotive Finance* opinion of why the repossession was complete as to the sixteen vehicles. Apparently, the repossession agency had taken the vehicles off the debtor's lot, but there is no indication that the vehicles had been towed away. If the vehicles had only been loaded on a vehicle carrier it may be argued that the debtor can still prevent self help by physically intervening because it is a breach of the peace or the threat thereof that is controlling.

The question of when an exercise of self help is complete can arise as to single items as well as multiple items. For example, suppose the debtor arrives on the scene after a

vehicle is attached to a tow truck but has not as yet been towed away. Arguably the repossession is not complete even if the vehicle was parked on a public street. On the other hand, if a debtor goes to a secured party's premises (or some storage location) and causes an altercation that constitutes a breach of the peace the exercise of self help was complete and permissible for purposes of the application of new section 9-609.

There was a consensus that "stealth" did not by itself produce a breach of the peace and a debtor did not have to be notified of an impending repossession. Indeed, if a debtor had to be given notice then much of the value of self help could be lost and the risk of confrontations resulting in a breach of the peace would be increased. A self help repossession of a vehicle from a public street in front of a debtor's home was permissible.

However, if the repossession was undertaken at 2 A.M. then a court might conclude there was a threatened or actual breach of the peace. Likewise, a seizure of a vehicle from an open carport attached to a debtor's home likely would not violate the breach of the peace limitation, but such a repossession done in the early morning hours likely would.

Courts have been consistent in holding that intrusions into a debtor's home or attached structures such as a closed garage, breach the peace. Any type of forcible entry could well constitute a breach of the peace. However, entry into a place of business, by contrast to a debtor's home, might well be permitted, especially if the debtor agreed to such entry in the security agreement. An entry onto premises or into structures that was not consented to in an enforceable agreement is a trespass. However, a trespass alone does not necessarily result in a breach of the peace.

In *Salisbury Livestock Co. v. Colorado Central Credit Union*, 793 P.2d 470 (Wyo. 1990), the court was faced with the question of whether a trespass onto the property of a third party to effect a self help repossession was a privileged trespass or resulted in a breach of the peace that rendered the self help repossession impermissible. The court ultimately remanded the case for a jury determination of whether there was a breach of the peace under all the circumstances, but in its opinion the court makes a number of important points and the opinion warrants a close reading. You may do so by clicking on the case name above.

Among the points made by the court were that:

> Self help repossession has economic advantages that benefit both creditors and debtors, but self help is subject to abuse and the risks of confrontation and physical injury are real;
>
> Where a secured party enters property without consent there is a trespass that may be privileged depending on whether or not the peace is breached or threatened;
>
> Whether or not a breach of the peace has resulted or was threatened can be a jury question, especially where residential property is involved.

As noted in Chapter 33 (A Secured Party's Options on Default), an agreement by a debtor to waive the breach of the peace limitation is not be enforceable under new section 9-602(6) and an agreement to allow an entry into the debtor's home likewise would be ineffective.

It is important to keep in mind that a secured party has a right to possession of the collateral only after default. A seizure, especially a self help repossession, done

without a default can have disastrous consequences for a secured party by way of damages under Part 6 of Article 9 or for wrongful repossession, which could include punitive damages. A review of the discussion of default in Chapter 33 (A Secured Party's Options on Default) is in order here.

The question arose under former Article 9 as to whether a secured party could be liable for improper self help action by a person hired by the secured party to recover property. Early on, there was a tendency to allow the secured party to escape liability on the theory that the person engaging in the wrongful action, typically referred to as a "repo agent," was an independent contractor and not a true agent.

Eventually, however, courts began to hold secured parties liable, for example, because self help repossession was inherently dangerous and a secured party could not delegate responsible for avoiding a breach of the peace or because the secured party was negligent in selecting the particular repo agent. Of course, the latter ground would require proof of negligent action by the secured party.

As noted in subpart A and in Chapter 33 (A Secured Party's Options on Default), the duty of good faith imposed by Article 1, section 1-304 (formerly Article 1, section 203) attaches to actions under Article 9 and under Article 1, section 1-302(b) (formerly Article 1, section 1-102(3)) cannot be contracted away by the debtor. Therefore, a secured party who fails to act in good faith, as measured by the honesty in fact and reasonable standards of fair dealing test in Article 1, section 1-201(b)(20), could be held accountable even in circumstances where there is no breach of the peace.

As pointed out in Chapters 27 (Secured Party Versus Buyer) and 33 (A Secured Party's Options on Default), under Article 1, section 1-201(b)(20), as proposed for adoption by the states, good faith requires honesty in fact and the observance of reasonable standards of fair dealing but some states have chosen to retain the narrower honesty in fact definition of good faith in Article 1. As also pointed out, however, new section 9-102(a)(43), contains the expanded definition of good faith and, arguably, that definition should control in Article 9 disputes.

You may explore the right under new Article 9 of a secured party to get possession of collateral through the exercise of self help in the next problem.

Problem 34.1 (INTERACTIVE)

Jane (in Chapter 3 (The Nature of Secured Credit under Article 9)) purchases a used Toyota from Dream Machine, Inc. (DM) (also from Chapter 3). Jane has signed an agreement giving DM an interest in the Toyota to secure Jane's debt to DM. Jane defaults. DM hires Big Mac, a "repo agent," to seize the Toyota. Big Mac locates the Toyota parked on the street in front of Jane's home.

May Big Mac seize the Toyota without judicial process and without notifying Jane in advance?

Would your answer change if Jane appeared and physically resisted the seizure?

Would it matter at what point in the exercise of self help Jane appeared?

Would self help repossession of the Toyota from the driveway of the home of a friend of Jane's be permissible?

Would self help repossession by Big Mac from a carport attached to Jane's house be permissible?

If the self help repossession from Jane's attached carport took place at 2 a.m., would the repossession be permissible?

Would a self help repossession by Big Mac from a locked garage attached to Jane's house be permissible?

Would consent by Jane in the security agreement to a forcible entry into her home change the answer to the question whether self repossession from the locked garage is permissible?

Could DM be held liable for actions by Big Mac that violated the breach of the peace limitation on self help repossession?

Suppose that DM's credit manager asked Jane to come to his office so that they could work out there differences and while Jane was in the credit manager's office the Toyota was repossessed. Would the repossession be permissible?

An oft-litigated issue under former Article 9 was whether a self help repossession done with the assistance of an off duty peace officer or one who was not acting pursuant to legal process was permissible. The argument in favor of permitting a peace officer to assist is that it would reduce the likelihood of a breach of the peace. However, a number of courts concluded that the presence of a peace officer denied a debtor the right to resist self help and thereby force a secured party to get legal process. The decisions sometimes turned on the degree to which the peace officer was actively or passively involved.

In *Walker v. Walthal*, 588 P.2d 863 (Ariz. App. 1978), the court addressed the question of whether a repossession assisted by a peace officer impermissibly interfered with a debtor's right to resist self help and considered further whether such assistance of the peace officer meant the repossession was "under color of law" and involved state action. You should read the court's opinion by clicking on the case name above.

You may test your understanding of the peace officer limitation on self help in the next problem.

Problem 34.2 (INTERACTIVE)

Assume the facts of Problem 34.1. On default, DM goes to Jane's home and demands possession of the Toyota. Jane refuses. The next day DM returns with a personal friend who is an off duty deputy sheriff. Jane turns the Toyota over to DM. Is the repossession "legal"? Why or why not?

Recall from Chapter 11 (Enforceability and Attachment of Security Interests in Consumer Transactions) that there are laws outside Article 9 that can limit the enforceability of security interests in consumer goods. Section 44-5501 of the Arizona Revised Statutes was examined in Chapter 11. A.R.S. § 44-5501(B) and (C) qualify the right of a secured party to seize the collateral in consumer credit cases as follows:

> B. *Notwithstanding any agreement to the contrary, if the seller or his assignee retakes goods which were the subject of the sale, the buyer shall not be personally liable for the unpaid balance of the price if the sales price were one thousand dollars or less.* * * * [Emphasis added.]
>
> C. * * * *If the seller or assignee elects not to retake the goods, but brings an action for the unpaid balance, the goods may not thereafter be retaken and are not subject to judicial process to enforce any judgment obtained therein.* [Emphasis added.]

You may consider the application of A.R.S. 44-5501(B) and (C) in the next problem.

Problem 34.3 (INTERACTIVE)

Donald Debtor, who resides in Tucson, Arizona, buys a stereo from Selma Seller, an Arizona retailer. Donald agrees to pay the $500 purchase price in twelve equal monthly installments. Donald signs an agreement giving Selma an interest in the stereo to secure the unpaid price. Donald defaults without having made a single payment.

May Selma repossess the stereo?

If Selma repossesses the stereo, may it recover any resulting deficiency from Donald?

If Selma chose to get a judgment and a writ of execution, putting aside the question of whether the stereo is exempt, could the sheriff levy on the stereo?

Suppose Donald paid cash for the stereo using the proceeds of a loan from Lisa Lender that is secured by an interest in the stereo. If Lisa repossessed the stereo, could Lisa recover any resulting deficiency from Donald?

C. Getting Possession of the Collateral When Self Help Is Not Possible

If self help repossession is not permissible, a secured party must seek judicial assistance. Doing so requires filing a lawsuit and obtaining legal process, typically replevin, that provides for seizure of the collateral. Due process clearly attaches when judicial assistance is invoked.

As noted in subpart A, under the *Sniadach* line of decisions, *see* B & S (cited in Chapter 3), Ch. 15, due process initially required that a creditor get a judgment on the merits against a debtor before the debtor's property could be seized. However, as also noted there, in its decision in *Mitchell v. W.T. Grant Co.*, 416 U.S. 600 (1974), the Supreme Court permitted states to enact provisional remedy statutes under which collateral can be seized prior to judgment if certain conditions are met.

Simply stated, pre-judgment seizure of collateral is permissible if a creditor has to apply for a special writ and in the application the creditor has to plead with particularity the facts giving rise to the claim, the writ can be issued only by a judicial officer, the creditor has to post a bond indemnifying the debtor against a wrongful seizure and, perhaps most importantly, the debtor has to be accorded the right to demand a prompt hearing on whether a seizure was rightful.

Taking its cue from *Mitchell*, Arizona enacted the Provisional Remedies Act (PRA), A.R.S. § 12-2401 *et seq*. To examine its provisions click on its title.

It is not obvious from the PRA, but to get a provisional remedy a creditor must file a law suit seeking to recover an unpaid debt. Moreover, provisional remedies work in conjunction with conventional collection remedies that are the subject of separate statutes and the requirements of these statutes must be satisfied along with the PRA.

Replevin is the remedy most often used where a creditor has an interest in property that is the target of a provisional remedy request. In the case of secured credit, a creditor will ask for a provisional remedy *in the nature of replevin*. *See* B & S (cited in Chapter 3), Ch. 15.

A.R.S. §12-2402(A) provides for a provisional remedy *without notice*. There still must be notice of the right to demand a prompt hearing, but as provided for in A.R.S. § 12-2402(D), the notice need not be given until after the debtor's property has been seized. A "without notice" provisional remedy gives a creditor many of the advantages of self help repossession. In particular, a creditor who can seize property prior to notice enjoys the "leverage" that goes with divesting the debtor of possession and placing on the debtor the burden of forcing a hearing to recover the property.

The key section for secured parties is A.R.S. § 12-2402(A)(2) is the key section for secured parties because a secured party is a party "otherwise lawfully entitled to the possession of the property claimed" and is entitled to a provisional remedy in the

nature of replevin without prior notice. To avail itself of the right conferred by A.R.S. § 12-2402(A)(2), a secured party must file a lawsuit and apply for a provisional remedy in the nature of replevin without notice by satisfying the specific requirements set forth in A.R.S. § 12-2402(A)(2).

Under A.R.S. § 12-2402(B), a secured party must by affidavit establish with particularity to the court's satisfaction facts sufficient to support the secured party's claim that the secured party has a right to a without notice provisional remedy under A.R.S. § 12-2402(A)(2) and that the requirements of other statutes have or will be met. The last includes the need to post a bond as demanded by the replevin statute.

A "without notice" provisional remedy is not available under A.R.S. § 12-2402(A)(2) to get possession of consumer goods unless the security interest in the goods is purchase money. *See* *Searles v. First National Bank*, 619 P.2d 749 (Ariz. App. 1980) (Upholding the constitutionality of the PRA and the limitation as to consumer goods). The content of the notice given to a debtor is prescribed by A.R.S. § 12-2402(E).

The most important right of a debtor whose property has been taken pursuant to the PRA is to move to quash the provisional remedy and force a prompt hearing as provided for in A.R.S. § 12-2402(C). Under A.R.S. § 12-2402(C), the issues at the hearing are limited to the probable validity of the secured party's claim and any defenses available to the debtor (such as that the debt has been paid or there was no default) and whether the requirements of A.R.S. § 12-2402(A)(2) and (B) have been satisfied. If a debtor is successful at a hearing on the motion to quash the secured party must return the property and could be liable for damages for wrongful seizure of the collateral as well.

You may explore the application of the PRA scheme for allowing a secured party to get possession of collateral where self help is unavailable in the next problem.

Problem 34.4 (INTERACTIVE)

Assume the facts of Problem 34.1. Assume further that when Big Mac attempts self help repossession and Jane physically resists.

Must DM get a judgment on the merits before it is permitted to seize the Toyota?

May DM get a provisional remedy (PR)?

What must DM do to obtain a PR in the nature of replevin?

Is DM entitled to a PR without notice (even though the collateral constitutes consumer goods)?

Does getting a PR in the nature of replevin mean that no notice need be given to Jane?

What is the benefit to DM of a without notice PR?

What rights does Jane have in response to a seizure of the Toyota pursuant to a PR in the nature of replevin without notice?

D. The Secured Party's Duty of Care as to Property in the Secured Party's Possession (Including Property Other Than Collateral)

As noted several times, under new section 9-207(a) a secured party in possession of the debtor's property must act reasonably with regard to the care and custody of that property and this duty of care is imposed upon a secured party who is in possession of property seized in an exercise of self help or with judicial assistance.

Under Article 1, section 1-302(b) (formerly Article 1, section 1-102(3)) this duty of care cannot be contracted away by the debtor. However, Article 1, section 1-302(b) standards of care that are "not manifestly unreasonable" may be defined in the security agreement. The meaning of the quoted language is unclear at best, but should be understood to preclude the fixing of standards that effectively do away with the duty of care.

What it means to act reasonably is necessarily fact dependent, but at a minimum should require that recovered property be stored in a manner that preserves the property and protects it against unreasonable risk of loss or damage.

It can happen in the course of a seizure of collateral that property that is not subject to a security interest is incidentally seized. For example, some of the contents of a repossessed vehicle may well not be collateral. Courts have recognized that this is to some extent unavoidable (but the baby in the car case), but because a secured party technically has not right of possession as to non-collateral it is especially important for the secured party to use special care to account for non-collateral and return it to the debtor as expeditiously as possible. *See*, *e.g.*, *National Bank v. Huff*, 582 P.2d 364 (Nev. 1978).

The application of new section 9-207 and Article 1, section 1-302(b) (formerly Article 1, section 1-102(3)) are considered in the next problem.

Problem 34.5 (INTERACTIVE)

Donald Debtor defaulted on a loan secured by an interest in his Dodge Pickup on which was a factory-installed camper shell. Big Mac, on behalf of the lender, Southwestern Bank, repossessed the vehicle without incident. Big Mac then towed the vehicle to a storage lot where other repossessed vehicles were kept until disposed of. The lot was fenced and lighted. Access to the lot was through a gate that was kept locked at night but not during the daylight hours. When Big Mac employees were out repossessing vehicles there was no one at the lot.

Three days after the vehicle was seized, Donald went to Southwestern and informed the bank that there were several expensive hunting guns and fishing rods stored in the camper. Southwestern immediately called Big Mac and inquired about the guns and fishing rods.

When Big Mac employees looked inside the camper they did not find any guns or fishing rods. There was no sign of any breaking and entering, but it was apparent that someone had gone into the camper because several items, including a propane stove and refrigerator that came with the vehicle had been taken. In the course of removal of the stove and refrigerator the camper interior had been badly damaged. Donald is prepared to describe the guns and rods in detail and prove that he kept them in the camper at all times.

Is Southwestern Bank liable for converting the missing hunting guns and fishing rods? If not, does Donald Debtor have any other recourse regarding these items of property?

Does Donald Debtor have any recourse regarding the theft of the stove and refrigerator and the damage to the interior of the camper?

Would your answers be different if the security agreement contained a provision under which Southwestern was relieved of any responsibility for any losses that in its judgment are not its responsibility?

CASE COMMENTARY

Ace Equipment Sales, Inc. v. H.O. Penn Machinery Co., Inc., 871 A.2d 402 (Conn. App. 2005)

Thompson v. First State Bank, 709 N.W.2d 307 (Minn. App. 2006)

Davenport v. Bates, 2006 WL 367875 (Tenn. App. 2006)

2009-02-01 update