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Nonjudicial Disposition Under Louisiana Commercial Law

Chapter Nine

INTRODUCTION

Chapter 9 of the Louisiana Commercial Law,¹ effective January 1, 1990, regulates the creation and effects of security interests in most movables, supplanting the law of pledge and chattel mortgage. Included in Chapter 9 are provisions which allow the creditor to dispose of the collateral nonjudicially in enforcement of all security interests. This lack of restriction on the availability of nonjudicial disposition is new in Louisiana. This comment will provide an overview of the Chapter's sections regulating these nonjudicial dispositions. More detailed discussion is included concerning a few areas of interest in which current and prior Louisiana law may be helpful in predicting how the new procedure will be applied and interpreted.²

POSSESSION OF THE COLLATERAL

Uniform Commercial Code Section 9-503

Upon default U.C.C. section 9-503 allows the secured party, unless otherwise agreed, to take possession of the collateral in enforcement of his security agreement.³ The secured party is not required to utilize judicial process,⁴ and as default is the only prerequisite listed in U.C.C. section 9-503, generally no notice to the debtor is required in utilizing this "self-help" repossession right.⁵ As an alternative to self-help, the secured party may proceed by judicial action,⁶ in accord with U.C.C. section 9-501. The secured party may also render the collateral unusable, or proceed with the sale of the collateral on the debtor's premises.⁷ In

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1. Reference to the Uniform Act will be made as "U.C.C." or "Uniform Commercial Code." Reference to the Chapter as adopted in Louisiana will be made as "Chapter 9" or "Louisiana section 9-50x."

2. For an overview of all of the provisions of Chapter 9 as enacted in Louisiana, see Harrell, *A Guide to the Provisions of Chapter Nine of Louisiana's Commercial Code*, 50 La. L. Rev. 711 (1990). For a detailed look at Chapter 9 and comparison to the Uniform Act, see W. Hawkland, *Hawkland's Handbook on Chapter 9 Louisiana Commercial Law* (1990).

3. U.C.C. § 9-503 (1977).

4. *Id.*

5. W. Hawkland, R. Lord & C. Lewis, *U.C.C. Series § 9-503:02 (Art 9)* (1986).

6. U.C.C. § 9-503 (1977).

7. *Id.*

utilizing his right to self-help repossession, the secured party is not allowed to breach the peace in taking possession;⁸ the consequences of which are possible liability for damages and/or conversion. The line between what is and what is not a breach of the peace has sometimes been difficult for the courts to draw. Generally, any form of protest to the repossession by the debtor or entering of closed premises by the secured party will result in a breach of the peace.⁹

Louisiana Section 9-503

Because of Louisiana's traditional civil law hostility to self-help in all areas of the law, Louisiana section 9-503 does not adopt the U.C.C. Article 9 repossession approach, but does attempt to incorporate the inherent efficiencies of that approach.¹⁰ Louisiana section 9-503 allows the secured party to sell, following the provisions of Louisiana section 9-504, collateral in his possession.¹¹ The secured party can acquire possession either before or after default, and either through pledge or voluntary surrender of the collateral by the debtor.¹² Incorporeals can be sold without delivery in Louisiana,¹³ and thus need not be in the possession of the secured party in order to be sold by the secured party.¹⁴ The secured party has the right to use summary process to obtain the documents, instruments, or endorsements necessary for proceeding with disposal of the incorporeals.¹⁵ Once the secured party is in possession, he proceeds in generally the same manner as secured parties in the other forty-nine states. Louisiana does not provide for the disabling of the collateral, or disposal of the collateral still on the debtor's premises, as is provided in the U.C.C. Article 9.

Policy Behind Louisiana's Version of Section 9-503

The civil law bias against self-help is based on a strong policy of keeping the peace. In *Liner v. Louisiana Land and Exploration Company*,¹⁶ Justice Tate, in expressing the policy behind the law according possessory protection to a possessor evicted by force or fraud no matter how short the duration of possession stated, "[t]his is done in the

8. Id.

9. W. Hawkland, R. Lord & C. Lewis, U.C.C. Series § 9-503:03 (Art 9) (1986).

10. W. Hawkland, Hawkland's Handbook on Chapter 9 Louisiana Commercial Law § 5.03 (1990) [hereinafter Hawkland's Handbook].

11. La. R.S. 10:9-503(1) (Supp. 1990).

12. La. R.S. 10:9-503(1)(a) (Supp. 1990).

13. La. Civ. Code art. 2481.

14. La. R.S. 10:9-503(1)(b) (Supp. 1990).

15. La. R.S. 10:9-503(2) (Supp. 1990).

16. 319 So. 2d 766 (La. 1975) (Tate, J., concurring in denial of reh'g).

interest of preservation of peace in society and as a deterrent against self-help."¹⁷ In *Ryder v. Lacour*,¹⁸ the Louisiana Third Circuit Court of Appeal, in a property dispute involving inconclusive attempts by both parties to establish possession, declined to give legal effect to the last of these corporeal acts of possession, stating that "[t]his would encourage physical confrontations and elevate self help to a status never enjoyed in a civilian jurisdiction."¹⁹ The third circuit also expressed this policy in another instance, "[s]elf-help is generally frowned upon by our courts and is inimical to public order."²⁰ Louisiana courts have enforced this policy against self-help in various other types of legal situations.²¹

Based on this policy against self-help, creditors in Louisiana have had to resort to judicial process in obtaining possession of collateral from debtors upon default, unless the debtor consents to the creditor taking possession. For instance in *Grandeson v. International Harvester Credit Corp.*,²² the creditor repossessed a refrigerator sold to the debtor, supposedly on the authority of a repossession agreement signed with the debtor and the consent of the debtor's wife. The court found the repossession agreement to be ineffective and that, due to the head and master rule in effect at the time, the wife's consent in the husband's absence was also ineffective. The court stated the applicable rule of law as, "[t]his refrigerator was repossessed without resorting to judicial proceedings and in order to avoid the result of legal liability, it must be shown that the plaintiff [debtor] consented to its removal, either orally or in writing."²³

The common law courts have developed a similar rule in cases involving the U.C.C.'s prohibition on breach of the peace by the seizing creditor. In one of the more difficult areas in the interpretation of that prohibition, several courts have held that deception of the debtor by

17. Id. at 781.

18. 322 So. 2d 243 (La. App. 3d Cir. 1975).

19. Id. at 246.

20. Guidry v. Rubin, 425 So. 2d 366, 371 (La. App. 3d Cir. 1982).

21. *Grandeson v. International Harvester Credit Corp.*, 223 La. 504, 66 So. 2d 317 (1953) (no right to self-help repossession by chattel mortgagee's assignee absent consent by the mortgagor); *Ogden v. John Jay Esthetic Salons, Inc.*, 470 So. 2d 521 (La. App. 1st Cir. 1985) (no right to self-help retaking of possession by lessor where lessor is not justified in believing premises to be abandoned by lessee); *Central Fidelity Bank v. Gray*, 422 So. 2d 670 (La. App. 3d Cir. 1982) (no right to repossession of an automobile by a bank as lienholder even from a possessor who may not have been the owner); *Martinez v. Therma-King Sales and Service Division of Transport Refrigeration of La. Inc.*, 346 So. 2d 798, 800-01 (La. App. 1st Cir.), writ denied, 349 So. 2d 884 (La. 1977) (no right to self-help repossession in enforcement of a repairman's privilege); *Vercher v. Toda Enterprises, Inc.*, 216 So. 2d 318, 319 (La. App. 3d Cir. 1968) (no right to self-help repossession by a seller absent consent of the buyer).

22. 223 La. 504, 66 So. 2d 317 (1953).

23. Id. at 506, 66 So. 2d at 318.

the secured party in order to obtain possession violates the intent of the rule.²⁴ In *Ford Motor Credit Company v. Byrd*,²⁵ the debtor prevailed in an action for conversion based on a breach of the peace claim against the creditor. Ford Motor Credit was assigned the retail installment contract on a sale of an automobile to the debtor. The parties disagreed as to whether the debtor's payments were in arrears at the time of the repossession, but neither disputed that the debtor was contacted and asked to drive to the dealer in order to discuss his account. While the debtor was inside, his vehicle was removed from the parking lot and placed in a storage area. The jury concluded that the automobile was obtained without the debtor's consent or knowledge, and on appeal the Alabama Supreme Court held that this supported the debtor's claim of conversion. The supreme court emphasized the debtor's protest against the repossession, which should have forced the secured party to use process. The court stated:

We cannot interpret § 9-503 to permit obtaining possession through trick, without knowledge upon the part of the debtor. To interpret § 9-503 to allow repossession in these circumstances would encourage practices abhorrent to society: fraud, trickery, chicanery, and subterfuge, as alternatives to employment of judicial processes that foster the concept of ours being a government of laws and not of men. If self-help erodes that concept then self-help must be limited as we will limit it here.²⁶

Thus, the common law jurisdictions applying the self-help repossession provisions have expressed a rule very similar to Louisiana's rule, which requires consent by the debtor to the creditor's taking possession.

With the limitations on the self-help repossession right provided in the U.C.C., there are very few situations in which the U.C.C. self-help repossession right differs practically from the Louisiana ban on self-help repossession. The most common of these situations occurs when the collateral is in a non-enclosed area and the debtor does not know that the secured party is repossessing, in which case self-help repossession under the U.C.C. is proper as no breach of the peace occurs. The other way that Louisiana section 9-503 differs from U.C.C. section 9-503 is when the collateral is an incorporeal, in that Louisiana expressly allows the secured party to sell the incorporeals without possession, consistent with Louisiana law, and the U.C.C. does not.

24. *Ford Motor Credit Company v. Byrd*, 351 So. 2d 557 (Ala. 1977); *Quest v. Barnett Bank of Pensacola*, 397 So. 2d 1020, 1024 (Fla. Dist. Ct. App. 1981); *Lane v. John Deere Company*, 767 S.W.2d 138, 142 (Tenn. 1989). But see *Speigle v. Chrysler Credit Corp.*, 56 Ala. App. 469, 473-74, 323 So. 2d 360, 362-63 (Ala. Civ. App.), cert. denied, 295 Ala. 420, 323 So. 2d 367 (1975); *Cox v. Galigher Motor Sales Co.*, 158 W. Va. 685, 213 S.E.2d 475, 478-80 (1975).

25. 351 So. 2d 557 (Ala. 1977).

26. *Id.* at 559.

RIGHT TO DISPOSE OF THE COLLATERAL

U.C.C. and Louisiana Section 9-504(1) and (2)

After default, the secured party has the right to sell, lease or otherwise dispose of the collateral.²⁷ Louisiana section 9-503 adds the prerequisite that the secured party must be in possession of the collateral in order to proceed under section 9-504,²⁸ unless the collateral is an incorporeal.²⁹ Although the courts have not often decided the meaning of the term "otherwise dispose,"³⁰ they have provided some indication of what it is not. In *Maxl Sales Co. v. Critiques, Inc.*,³¹ the court decided that appointment of a receiver in bankruptcy in order to continue the debtor's business before liquidation was not a disposition within the meaning of the term "otherwise dispose." In *Cordova v. Lee Galles Oldsmobile*,³² the court held that a loan of a repossessed vehicle to police for use in undercover operations was likewise not a disposition within the meaning of the term "otherwise dispose." It has been suggested that the drafters intended a lack of restriction on the secured party and that the term ought to be interpreted to allow the secured party to best realize on the collateral, including using or operating the collateral or the carrying on of the debtor's business by the secured party.³³

In Louisiana, should the secured party decide to lease the collateral, it is clear that he will have the obligations of a lessor to his lessee.³⁴ Although the secured party can lease the property owned by the debtor, he is limited to leasing it for its usual use.³⁵ In addition to the usual obligations of the lessor, the secured party also warrants his lessee's enjoyment of the property from claims by the debtor.³⁶

*Distribution of the Proceeds of the Disposition**U.C.C. and Louisiana Section 9-504(2)*

After the disposition, section 9-504 provides for the distribution of the proceeds. There is little difference in the provisions of the U.C.C.

27. U.C.C. § 9-504(1) (1977); La. R.S. 10:9-504(1) (Supp. 1990).

28. La. R.S. 10:9-503(1)(a) (Supp. 1990).

29. La. R.S. 10:9-503(1)(b) (Supp. 1990).

30. *Hawkland's Handbook*, supra note 10, § 5:05, at 13.

31. 796 F.2d 1293, 1297 n.2 (10th Cir. 1986).

32. 100 N.M. 204, 668 P.2d 320 (N.M. Ct. App. 1983).

33. *Hawkland's Handbook*, supra note 10, § 5:05, at 13.

34. *Id.* at 14.

35. La. Civ. Code art. 2681.

36. La. Civ. Code art. 2682.

and Louisiana Chapter 9 on this matter. First, the expenses of the sale are paid. Second, the indebtedness covered by the security agreement is satisfied. Third, subordinate security interests in the collateral are satisfied. Finally, the secured party may be responsible for a surplus, or the debtor may be responsible for a deficiency.

First, the reasonable expenses of the disposition, retaking, holding, sale or lease preparation, and legal expenses and attorney fees if provided for in the security agreement and not prohibited by law are deducted from the sale proceeds.³⁷ Regarding the matter of whether attorney fees are prohibited by law, Louisiana Civil Code article 2000 provides in pertinent part "[i]f the parties, by written contract, have expressly agreed that the obligor shall . . . be liable for the obligee's attorney fees in a fixed or determinable amount, the obligee is entitled to that amount."³⁸ In *Central Progressive Bank v. Bradley*,³⁹ the Louisiana Supreme Court held that article 2000 will not be enforced by the courts when the attorney fees fixed in the contract are excessive and unreasonable, and the courts have authority to inquire into the reasonableness of the fee. The court in *Central* cited its decision in *Leenerts Farms, Inc. v. Rogers*⁴⁰ in which the court quoted Code of Professional Responsibility Disciplinary Rule 2-106,⁴¹ which prohibits excessive attorney fees and provides a list of factors to use in determining whether a fee is excessive.

Second, the debt secured by the security agreement is satisfied from the proceeds of the disposition.⁴² One should note that cross-collateralization is still possible under section 9-504(1)(b).⁴³ Senior security interests are not discharged or satisfied in the disposition under the section 9-504 procedure; the purchaser acquires subject to any senior security interest. This procedure differs from the Louisiana procedure governing judicial sales, which provides that if the price offered by the highest bidder is insufficient to discharge the senior interests, the property will not be sold.⁴⁴ Also, the Louisiana judicial sales procedure provides that the purchaser will only pay to the sheriff that part of the purchase price exceeding the amount of the senior interest.⁴⁵ The amount of the senior

37. La. R.S. 10:9-504(1)(a) (Supp. 1990); U.C.C. § 9-504(1)(a) (1977).

38. La. Civ. Code art. 2000.

39. 502 So. 2d 1017 (La. 1987).

40. 421 So. 2d 216 (La. 1982).

41. The Code of Professional Responsibility has since been replaced by the Rules of Professional Conduct. The provision discussed is now found at La. R.S. Title 37, art. 16, Rule 1.5 (a-d).

42. La. R.S. 10:9-504(1)(b) (Supp. 1990); U.C.C. § 9-504(1)(b) (1977).

43. Hawkland's Handbook, *supra* note 10, § 5:08, at 26.

44. La. Code Civ. P. art. 2337.

45. La. Code Civ. P. art. 2374.

interest is owed to the senior creditor by the purchaser, thus this amount is withheld from the amount paid to the sheriff. Little practical difference exists here between these two procedures, however, as it would be commercially unreasonable for a subordinate security interest holder to sell the collateral for a total price less than the senior indebtedness, as he would be receiving no value towards the reduction of the debt he is owed. In other words, no sale can occur under either Chapter 9 or the Louisiana procedure for judicial sales unless the buyer agrees that the collateral is worth more than the senior security interest's debt amount. It should also be noted that the subordinate security interest proceeding under section 9-504 is likely to activate default clauses in the senior security agreement,⁴⁶ further reducing the practical effect of any procedural differences in this area.

Third, subordinate interests are satisfied if written demand is received from these creditors before distribution of the proceeds is complete.⁴⁷ The secured party disposing of the collateral is allowed to request proof of the subordinate security interest's validity, and failure by the subordinate interest holder to provide this proof relieves the disposing secured party from his duty to comply with the demand for payment.⁴⁸ This provision is necessary as the disposing creditor can be liable to the debtor for paying a bad claim, but he is also required by the law to pay valid subordinate claims.

A related problem exists when more than one subordinate interest holder makes a claim. The secured party is faced with the difficult task of determining the priority, in addition to the validity, of the competing claims. The Louisiana procedural rules governing concursus proceedings⁴⁹ should be applied to provide the secured party protection in this situation. In *Asian International v. Merrill, Lynch, Pierce, Etc.*,⁵⁰ the Code of Civil Procedure rules governing concursus proceedings were applied to Merrill Lynch holding an account claimed by two parties. The court analyzed the purpose behind the concursus proceeding provision. "The primary purpose of this remedial proceeding is to protect the stakeholder from multiple liability, from conflicting claims, and from the vexation attending involvement in multiple litigation in which the stakeholder may have no direct interest."⁵¹ The court also observed that "[t]he articles of the Louisiana Code of Civil Procedure governing concursus suits are to be construed liberally and given broad application."⁵² There is no doubt that the secured party should have the benefit of the concursus

46. Hawkland's Handbook, supra note 10, § 5:08, at 27-28.

47. La. R.S. 10:9-504(1)(c) (Supp. 1990); U.C.C. § 9-504(1)(c) (1977).

48. La. R.S. 10:9-504(1)(c) (Supp. 1990); U.C.C. § 9-504(1)(c) (1977).

49. La. Code Civ. P. arts. 4651-4662.

50. 435 So. 2d 1064 (La. App. 1st Cir. 1983).

51. Id. at 1067.

52. Id. at 1067.

proceeding when confronted with two or more competing claims from subordinate interests.

Finally, the debtor, unless otherwise agreed, is liable to the secured party for any deficiency after the disposition, and is entitled to any surplus.⁵³ An exception to this provision exists if the underlying transaction is a sale of accounts or chattel paper, in which case the debtor is neither liable for a deficiency nor entitled to a surplus, unless the security agreement provides otherwise.⁵⁴

THE DISPOSITION PROCEEDINGS

U.C.C. and Louisiana Section 9-504(3)

The U.C.C.'s only limitation on the conduct of the right of disposition by the secured party is that it must be done in a commercially reasonable manner.⁵⁵ Louisiana Chapter 9 adds an additional requirement that the disposition be conducted in good faith.⁵⁶ These requirements apply to the manner, method, time, place, and terms of the disposition.⁵⁷ The disposition can be at public or private proceedings, and as a unit or in parcels.⁵⁸ Louisiana Chapter 9 also states that the disposition can be made with or without appraisal.⁵⁹ Both public and private proceedings are nonjudicial in nature. Although the terms public and private are not defined in the U.C.C. or Chapter 9, it is suggested that a public sale is one in which the public is invited to attend and effective publication of when and where the sale is to occur is made.⁶⁰

Commercial reasonableness is likewise not defined by the U.C.C., and the definition of that term is of utmost importance as it is the only limitation imposed on the process of disposition. "The draftsmen felt that it would be unwise to try to place finite limits on the overriding standard of fair play that was to circumscribe all dispositions by the secured party under Chapter 9."⁶¹ Professor Hawkland suggests commercial reasonableness is a general standard similar to the "reasonable

53. La. R.S. 10:9-504(2) (Supp. 1990); U.C.C. § 9-504(2) (1977).

54. La. R.S. 10:9-504(2) (Supp. 1990); U.C.C. § 9-504(2) (1977). For a discussion of the potential difficulty in determining whether the underlying transaction is a sale or a security interest, see W. Hawkland, R. Lord & C. Lewis, U.C.C. Series § 9-504:03 (Art. 9), at 585-86 (1986).

55. U.C.C. § 9-504(3) (1977); La. R.S. 10:9-504(3) (Supp. 1990).

56. La. R.S. 10:9-504(3) (Supp. 1990).

57. U.C.C. § 9-504(3) (1977); La. R.S. 10:9-504(3) (Supp. 1990).

58. U.C.C. § 9-504(3) (1977); La. R.S. 10:9-504(3) (Supp. 1990).

59. La. R.S. 10:9-504(3) (Supp. 1990).

60. Hawkland's Handbook, *supra* note 10, § 5:06, at 23.

61. *Id.* at 16.

man" and "good faith" standards which pervade the Anglo-American legal system.⁶² More specifically, jurisprudence, U.C.C. section 9-507, and the official Comments are to flesh out the standard.⁶³ The case law has generally suggested that the secured party must "use his best efforts to see that the highest possible price is received for the collateral."⁶⁴

Prior to enactment of Chapter 9, Louisiana allowed nonjudicial proceedings by a creditor in the pledge relationship. The pledger/debtor was allowed to authorize a sale or other disposition of movable property without the intervention of the courts.⁶⁵ The jurisprudence establishing the standards imposed on the pledgee/creditor actions in these nonjudicial dispositions in the pledge context may indicate how the courts will define commercial reasonableness in Louisiana under Chapter 9.

*Elmer v. Elmer*⁶⁶ is an excellent example of a court reviewing the actions of a creditor in a nonjudicial sale. The debtor borrowed \$70,000 from the creditor secured by 700 shares of stock in the Elmer Candy Corporation. The promissory note evidencing the debt stated that upon non-payment of the note the creditor was authorized to sell the stock "at public or private sale without recourse to judicial proceedings, and without either demand, appraisal, advertisement or notice of any kind."⁶⁷ The creditor was also authorized to purchase the shares himself at a public or private sale, or to acquire the shares himself at market value.

The debtor did not pay the first installment, and the creditor proceeded to acquire the collateral, refusing the debtor's attempts to obtain an extension. The creditor, the president of Elmer Candy, and the creditor's attorney met at the attorney's office. The president informed the attorney of the book value of the shares,⁶⁸ and the creditor gave the attorney a signed document instructing the attorney to acquire the shares. An attempt to notify the debtor's attorney was unsuccessful. The attorney prepared three documents, including a letter of notice to the debtor, which were signed by the three parties present and the wife of the president. These actions constituted the sale of the stock to the

62. *Id.* at 16.

63. *Id.* at 16.

64. *Id.* at 16.

65. La. Civ. Code art. 3165.

66. 203 So. 2d 391 (La. App. 4th Cir. 1967).

67. *Id.* at 394.

68. The president gave a per share book value of \$100 to \$110. Testimony at the trial by a Hibernia National Bank officer gave a loan value of \$154 per share. Review of the books of the Elmer Candy Company at the end of the fiscal year ended 3 weeks prior to the "sale" revealed a \$126 per share value. As the company was closely held, unlisted, and untraded, a "market value" as referred to in the pledge agreement was indeterminable. 203 So. 2d at 396.

creditor. The debtor then filed suit seeking to set aside the sale, and seeking return of the pledged stock upon his payment of the amount of the loan.

The court stated the standard to be applied in this situation as follows:

A mere literal compliance with the terms of the pledge is not in itself sufficient to render valid the sale and purchase by the pledgee of the subject of the pledge, since the pledgee occupies a fiduciary relation to the pledgor, being regarded as a trustee or agent of the pledgor in making the sale, owing the pledgor the duty of acting fairly and in good faith.⁶⁹

The pledgee must attempt to realize the amount of the debt by the sale. He must not merely attempt to acquire title to the property at the lowest possible price.⁷⁰

In its review of the facts, the fourth circuit found "an utter disregard by the pledgee of the rights of the pledgor."⁷¹ The creditor's motivation was solely the acquisition of the stock, which he expressed even before the first installment was due, and he also testified to that effect.⁷² The court found the sale amounted to no more than an appropriation of the stock by the pledgee and set aside the sale.

A similar conclusion was reached in the earlier case of *Dibert v. Wernicke*,⁷³ a case decided by the United States Sixth Circuit Court of Appeals applying Louisiana pledge law. The pledge agreement authorized the creditor to nonjudicially sell the pledged bonds similar to the agreement in *Elmer*, specifically providing, "If said sale or sales shall be public or at any broker's board or stock exchange * * * [the creditor] * * * may purchase said property."⁷⁴ After maturity of the note secured and some negotiation with the debtor, the creditor proceeded to sell the bonds on the New Orleans Stock Exchange. No notice of the sale was given to the debtor or its sureties, no advertisement or posting of notice of the sale was made, and the broker provided very little information concerning the bonds to those present at the time of the sale. All of these practices conformed with the customary manner of doing business on the exchange. The creditor then bid two cents on the dollar for the bonds, no higher bid was made, and the "sale" was complete.

The court found literal compliance with the terms of the pledge agreement was not enough. Reasonable care and due diligence in securing

69. *Id.* at 394.

70. *Id.* at 395.

71. *Id.* at 396.

72. *Id.* at 396-97.

73. 214 F. 673 (6th Cir. 1914).

74. *Id.* at 675.

a just price, taking into account both the creditor's and the debtor's interest, were to be exercised by the creditor.

In other words, it was the duty of the [creditor], in selling the bonds as pledgee, to conduct the sale in a fair and diligent manner, tending to secure a reasonable price for the bonds for the benefit of all concerned, and not in such manner as to enable it, under color of a sale, to purchase the bonds at a sacrifice; it was a "trustee to sell," not to buy, though with the privilege of buying, if fairly sold.⁷⁵

The court found the creditor's motive to be acquiring ownership of the bonds. Even though the sale was technically conducted within the creditor's authority, and within the custom of the Stock Exchange, the unfair use of the authority and the resulting grossly inadequate price made the sale invalid.

Although these cases involve situations in which the creditor acquired the pledged property, the fiduciary duty imposed upon the creditor applies in any disposition by the pledgee. The analogy to the creditor under Louisiana Chapter 9 is an easy one. In both instances the creditor is in possession of the debtor's property and is attempting to dispose of collateral in order to realize on the credit extended to the debtor. It is plausible that courts in Chapter 9 disposition situations will find a fiduciary duty owed by the creditor to the debtor, since the creditor is selling the debtor's property both for the debtor's and the creditor's benefit, in establishing what commercial reasonableness means under Chapter 9.

Louisiana Deficiency Judgment Act

Another body of Louisiana law may prove helpful in fleshing out the commercial reasonableness standard to be applied under Chapter 9. The Louisiana Deficiency Judgment Act⁷⁶ provides procedures to be followed in judicial sales in order for the mortgagee or creditor to be entitled to a deficiency judgment after the sale if the sales proceeds are insufficient to satisfy the debt. The Act was passed in 1934 to address the prevalent practice of including waiver of appraisal clauses in mortgages.⁷⁷ As the mortgagee can bid up to the full mortgage indebtedness amount without incurring any cash outlay other than a minor sales commission and fees, in times of depressed economic values other bidders are discouraged from bidding and the mortgagee can acquire

75. Id. at 681.

76. La. R.S. 13:4106-4108.3 (1968 and Supp. 1990).

77. McMahon, *The Historical Development of Executory Procedure in Louisiana*, 32 Tul. L. Rev. 555, 567 (1958).

the property very cheaply.⁷⁸ The creditor would then be entitled to a significant deficiency judgment against the debtor. The Act effectively eliminated these waivers by protecting the debtor with strict procedural requirements imposed on the sale, and failure of the mortgagee to comply with the procedures defeated the mortgagee's right to a deficiency judgment.⁷⁹ The Act attempted to assure proper appraisal of the debtor's property, making the deficiency judgment a true representation of the difference in the market value of the property and the value of the debt.⁸⁰

There are both legislative and scholarly expressions to the effect that the strict procedural requirements of the Deficiency Judgment Act will not apply to dispositions under Chapter 9. 1989 Louisiana Act Number 137 section 8⁸¹ amended the Deficiency Judgment Act, adding Louisiana Revised Statutes 13:4108.3 which provides:

The rights or absence thereof of a secured creditor to pursue and collect a deficiency from a debtor, guarantor, or surety in connection with a secured transaction subject to Chapter 9 of the Louisiana Commercial Laws (R.S. 10:9-101, et seq.) shall be exclusively subject to the provisions of Chapter 9.⁸²

Again, the only express protection for the debtor in Chapter 9 is the requirement of conducting every aspect of the sale in a commercially reasonable manner and in good faith.⁸³ One should also note that Chapter 9 expressly states that the sale can be conducted with or without appraisal, which is contrary to the Deficiency Judgment Act.⁸⁴

Professor Hawkland writes, "[t]he limitations imposed by the Deficiency Judgment Act are entirely eliminated when [a Chapter] 9 security interest is foreclosed."⁸⁵ The debtor is protected by the commercial reasonableness standard without need to resort to the formal requirements of the Deficiency Judgment Act, and new formal procedures need not be imposed to replace those that have been "discredited and discarded."⁸⁶ "[T]he idea is to see to it that the secured party does not play fast and loose with the debtor's property when disposing of it at a foreclosure sale."⁸⁷

78. *Id.*

79. *Id.*

80. Comment, *Deficiency Judgments in Louisiana*, 49 *Tul. L. Rev.* 1094, 1096 (1975).

81. 1989 La. Acts No. 137, § 8.

82. La. R.S. 13:4108.3 (Supp. 1990).

83. La. R.S. 10:9-504(3) (Supp. 1990).

84. *Id.*

85. Hawkland's Handbook, *supra* note 10, § 5:03, at 10.

86. *Id.* at 31.

87. *Id.* at 31.

In spite of these express provisions and assertions to the contrary, the Deficiency Judgment Act, or more specifically the jurisprudence applying it, may still have relevance in dispositions under Chapter 9. The policies underlying the Deficiency Judgment Act are sound, and the Louisiana courts have been enforcing these policies in a diligent manner for over five decades. Certainly some guidance as to how these same courts will construe what is or is not commercially reasonable conduct can be gleaned from a review of this jurisprudence.

Soon after enactment of the Deficiency Judgment Act, the courts applied the Act to nonjudicial sales, even though the Act only expressly covered judicial sales. In *Home Finance Service v. Walmsley*,⁸⁸ the court denied a creditor's action for a deficiency judgment after nonjudicial sale without appraisal in enforcement of a chattel mortgage. After noting that the Act specifically referred to judicial sales, the court stated:

we are of the opinion that the statement of the public policy therein is sufficiently broad to disclose that it was the intention of the lawmakers to place a stamp of disapproval on any practice whereby encumbered property is sold without judicial appraisal, and to sanction the type of agreement, such as the one before us, would be to allow the employment of a device calculated to defeat the underlying purposes which prompted the passage of the law.⁸⁹

The Act was subsequently applied in the case of a nonjudicial sale without appraisal to which the debtor had agreed.⁹⁰ Even in an action for a deficiency judgment in which the debtor failed to make an appearance, the court of appeal reversed the default judgment against the debtor as the creditor failed to allege his nonjudicial sale was made with appraisal.⁹¹ The court decided this even though there was an agreement between the parties allowing the sale.⁹² Clearly the courts did not stay within the express provisions of the Act when strong public policy supported decisions beyond those express provisions.

The Louisiana Fourth Circuit Court of Appeal, in *General Motors Acceptance Corp. v. Smith*,⁹³ prohibited a deficiency judgment against the debtor's surety, despite the surety's agreement not to be held to a discharge of the debtor. The court concluded that allowing the judgment against the surety would allow the surety to agree to something the

88. 176 So. 415 (La. App. Orl. 1937).

89. Id. at 417.

90. *David Investment Company v. Wright*, 89 So. 2d 442 (La. App. 1st Cir. 1956).

91. *Atlas Finance Corporation v. Whitehead*, 99 So. 2d 481 (La. App. Orl. 1958).

92. Id.

93. 399 So. 2d 1285 (La. App. 4th Cir. 1981).

debtor could not have agreed to, circumventing the strong policy behind the Act. The case is more interesting, however, for its insight into the goal behind rigid enforcement of the Act. The court stated that the reason for insisting on appraisal is to insure the seeking of a price which provides an acceptable measure for a deduction from the debt.⁹⁴ The court believed that the legislature determined that sale without appraisal, providing no acceptable measure to deduct from the debt, would be treated as if the proceeds were sufficient to pay the entire debt.⁹⁵

The fourth circuit showed similar insight in an earlier case in which the Deficiency Judgment Act was found not to apply. In *International City Bank & Trust Company v. Zander*,⁹⁶ the creditor sold pledged stock on the New York Stock Exchange without appraisal pursuant to the authorization in the pledge agreement. The court held that the creditor was entitled to a deficiency judgment despite failing to follow the express requirement of the Deficiency Judgment Act to obtain an appraisal. The policy behind the Act would not be furthered by requiring appraisal here, as an accurate market value could be easily obtained from reviewing the stock listings in the newspaper. Thus, in a situation where the goal of the Act, obtaining an accurate value with which to reduce the debt after the sale, was obtained without resort to the strict procedures of the Act, strict compliance with the Act was found unnecessary.

Even though the procedures required by the Deficiency Judgment Act are inapplicable in enforcing a Chapter 9 security agreement, the policies and goals of that Act can still guide the courts in their determination of a standard of commercial reasonableness. The creditor's conduct should always be viewed with the objective of obtaining a fair price for the debtor's property. This objective is especially vital in light of the debtor's liability under section 9-504(2) for any deficiency of the price obtained when applied against the debt. The Louisiana courts have been enforcing this policy for over 50 years, and these courts have displayed diligence in that enforcement. One has to wonder how much these courts will actually adjust their decision-making process even with the passage of Chapter 9.

Notice to the Debtor and Other Parties

The secured party also must reasonably notify the debtor of the time and place of a public sale, or the time after which a private sale will be made.⁹⁷ The debtor can waive or modify his right to notice after

94. *Id.* at 1287.

95. *Id.* at 1287.

96. 378 So. 2d 506 (La. App. 4th Cir. 1979).

97. La. R.S. 10:9-504(3) (Supp. 1990); U.C.C. § 9-504(3) (1977).

default occurs.⁹⁸ No notice is necessary when the collateral is perishable, rapidly depreciating, or customarily sold on a recognized market.⁹⁹ If the collateral is not consumer goods, the secured party must notify others with security interests in the collateral who have filed a financing statement or whose written notice has been received by the secured party.¹⁰⁰

Right of the Secured Party to Buy

In a public sale, the secured party may purchase the collateral.¹⁰¹ In a private sale, the secured party may not buy unless for a price established in widely distributed price quotations or in a recognized market.¹⁰² This differs from the prior law in Louisiana governing pledge nonjudicial sales. The creditor and debtor were allowed to provide in the pledge agreement that the creditor could acquire the collateral at any type of nonjudicial sale, even without notice to the debtor.¹⁰³

RIGHTS AFTER THE DISPOSITION

U.C.C. and Louisiana Section 9-504(4)

The purchaser of the collateral receives all the rights of the debtor in the collateral, with the security interest and the subordinate interests discharged.¹⁰⁴ The sale is good to that effect even if the secured party fails to follow Part 5 of Chapter 9, if the buyer has no knowledge of the defects and, in a public sale, there is no collusion.¹⁰⁵ In a private sale, lease, or other disposition, the buyer need only have acted in good faith.¹⁰⁶

Right to Retain the Collateral in Satisfaction of the Debt

U.C.C. and Louisiana Section 9-505

Under section 9-505 the secured party can retain the collateral in

98. La. R.S. 10:9-504(3) (Supp. 1990); U.C.C. § 9-504(3) (1977).

99. La. R.S. 10:9-504(3) (Supp. 1990); U.C.C. § 9-504(3) (1977).

100. La. R.S. 10:9-504(3) (Supp. 1990); U.C.C. § 9-504(3) (1977). The U.C.C. does not provide for notice to those who have filed a financing statement.

101. La. R.S. 10:9-504(3) (Supp. 1990); U.C.C. § 9-504(3) (1977).

102. La. R.S. 10:9-504(3) (Supp. 1990); U.C.C. § 9-504(3) (1977).

103. See, e.g., *Elmer v. Elmer*, 203 So. 2d 391, 394 (La. App. 4th Cir. 1967).

104. La. R.S. 10:9-504(4) (Supp. 1990); U.C.C. § 9-504(4) (1977).

105. La. R.S. 10:9-504(4)(a) (Supp. 1990); U.C.C. § 9-504(4)(a) (1977).

106. La. R.S. 10:9-504(4)(b) (Supp. 1990); U.C.C. § 9-504(4)(b) (1977).

complete satisfaction of the debt.¹⁰⁷ This procedure is called strict foreclosure by the U.C.C. The debtor is not liable for any deficiency or costs, nor is he entitled to any surplus.¹⁰⁸ Strict foreclosure is not available if sixty percent of the cash price or loan amount is paid on consumer goods, but the debtor may renounce or modify this limitation after default.¹⁰⁹

The secured party can propose strict foreclosure after he, under the provisions of section 9-503, is in possession.¹¹⁰ Written notice of this proposal must be sent to the debtor, unless the debtor has renounced or modified his rights.¹¹¹ In the case of non-consumer goods under Louisiana Chapter 9, notice must also be sent to other secured parties holding security interests in the collateral who have filed financing statements.¹¹² The parties entitled to receive notice are given twenty-one days to respond, and if such party objects, the secured party must proceed under 9-504.¹¹³ If no objection is received, the secured party has acquired the collateral in satisfaction of the debt.¹¹⁴

Louisiana adds two presumptions to the strict foreclosure scenario not included in the U.C.C. Upon voluntary surrender or abandonment of the collateral by the debtor upon default or in contemplation of default, if the collateral is consumer goods, the surrender is presumed to be for strict foreclosure unless the secured party notifies the debtor within twenty days that he rejects the offer of strict foreclosure.¹¹⁵ If the collateral is not consumer goods, the surrender is presumed to be for disposition pursuant to section 9-503 unless there is written agreement contemporaneous to or after the surrender to the contrary.¹¹⁶

It is worth noting that, under the law of pledge in Louisiana, stipulations in the pledge agreement providing that the object of the pledge becomes the property of the creditor upon default with no further action on his part were prohibited. In fact, in *Alcolea v. Smith*¹¹⁷ the Louisiana Supreme Court stated that the practice had been prohibited for 1,400 years in civil law jurisdictions, since an edict of Constantine,¹¹⁸ "and of which nothing better has since been said than that they were

107. La. R.S. 10:9-505 (Supp. 1990); U.C.C. § 9-505 (1977).

108. Hawkland's Handbook, *supra* note 10, § 5:10, at 34.

109. La. R.S. 10:9-505(2) (Supp. 1990); U.C.C. § 9-505(1) (1977).

110. La. R.S. 10:9-505(2) (Supp. 1990); U.C.C. § 9-505(2) (1977).

111. La. R.S. 10:9-505(2) (Supp. 1990); U.C.C. § 9-505(2) (1977).

112. La. R.S. 10:9-505(2) (Supp. 1990).

113. La. R.S. 10:9-505(2) (Supp. 1990); U.C.C. § 9-505(2) (1977).

114. La. R.S. 10:9-505(2) (Supp. 1990); U.C.C. § 9-505(2) (1977).

115. La. R.S. 10:9-505(3) (Supp. 1990).

116. La. R.S. 10:9-505(4) (Supp. 1990).

117. 150 La. 482, 90 So. 769 (1922).

118. *Id.* at 488, 90 So. at 771.

obnoxious to good morals, odious, oppressive, and unconscionable."¹¹⁹ The fourth circuit in *Elmer* basically decided that the creditor's actions in that case amounted to an attempt at just such an appropriation.¹²⁰ There is dicta in *Alcolea* to the effect that the parties may agree after the debt is due that the pledgee can retain the pledge in satisfaction of the debt.¹²¹

Section 9-505 clearly contemplates this situation referred to in the dicta in *Alcolea*. The secured party is only allowed to propose strict foreclosure after default, and he must also get consent from the debtor, in the form of no objection by the debtor, to be deemed to have acquired the collateral. Secured parties should be wary of any action on their part which has the appearance of bargaining for this sort of consequence prior to default, due to the strong policy against it in the pre-Chapter 9 Louisiana law, and the express terms of the Chapter requiring the proposal to be after default.

CONCLUSION

The procedures by which the secured party enforces his security agreement under Chapter 9 upon the default of the debtor are not radically different from procedures which already existed in Louisiana law. Under Chapter 9 the secured party needs the consent of the debtor in order to obtain possession of the collateral, as was the case prior to its enactment. Louisiana law allowed nonjudicial disposition by the secured party if agreed to by the parties in a pledge agreement, and now the law under Chapter 9 allows it in all security relationships involving movables. Finally, under prior Louisiana practice the creditor was allowed to keep the pledge in complete satisfaction of the debt if the parties agreed after the debt came due, and this is substantially the rule under Chapter 9 for all security interests involving movables. As a result of these similarities, the prior Louisiana jurisprudence, and especially the policies underlying it, can be very useful in applying Chapter 9 in Louisiana.

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119. *Id.* at 490, 90 So. at 772.

120. *Elmer v. Elmer*, 203 So. 2d 391, 397 (La. App. 4th Cir. 1967).

121. 150 La. at 492, 90 So. at 772.

