

PEB COMMENTARY NO. 22
STATUS OF A DISPOSITION UNDER SECTION 9-610 OF THE UNIFORM
COMMERCIAL CODE IF THE TRANSFEREE DOES NOT ACT IN GOOD FAITH
(August 24, 2020)

By the Permanent Editorial Board for the Uniform Commercial Code*

PREFACE TO PEB COMMENTARY

The Permanent Editorial Board for the Uniform Commercial Code acts under the authority of the American Law Institute and the Uniform Law Commission (also known as the National Conference of Commissioners on Uniform State Laws). In March 1987, the Permanent Editorial Board resolved to issue from time to time supplementary commentary on the Uniform Commercial Code to be known as *PEB Commentary*. These *PEB Commentaries* seek to further the underlying policies of the Uniform Commercial Code by affording guidance in interpreting and resolving issues raised by the Uniform Commercial Code and/or the Official Comments. The Resolution states that:

A *PEB Commentary* should come within one or more of the following specific purposes, which should be made apparent at the inception of the Commentary: (1) to resolve an ambiguity in the Uniform Commercial Code by restating more clearly what the PEB considers to be the legal rule; (2) to state a preferred resolution of an issue on which judicial opinion or scholarly writing diverges; (3) to elaborate on the application of the Uniform Commercial Code where the statute and/or the Official Comment leaves doubt as to inclusion or exclusion of, or application to, particular circumstances or transactions; (4) consistent with U.C.C. § 1-102(2)(b),[†] to apply the principles of the Uniform Commercial Code to new or changed circumstances; (5) to clarify or elaborate upon the operation of the Uniform Commercial Code as it relates to other statutes (such as the Bankruptcy Code and various federal and state consumer protection statutes) and general principles of law and equity pursuant to U.C.C. § 1-103;[‡] or (6) to otherwise improve the operation of the Uniform Commercial Code.

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[†] Current U.C.C. § 1-103(a)(2).

[‡] Current U.C.C. § 1-103(b).

INTRODUCTION

Article 9 of the Uniform Commercial Code provides several statutory rights available to a secured party if the debtor defaults on obligations secured by a security interest in collateral within the scope of Article 9.¹ One of those rights is the right of the secured party to dispose of the collateral under Section 9-610. That section is supplemented by Section 9-617, which describes the rights in the collateral that a transferee obtains following a disposition of the collateral to the transferee under Section 9-610. A “transferee that acts in good faith takes free”² of “all of the debtor’s rights in the collateral.”³ Among other things, Section 9-617(c)(1) states that a transferee that does not act in good faith takes subject to “the debtor’s rights in the collateral.”

This Commentary explains the effect of a transferee taking subject to the debtor’s rights in the collateral.

DISCUSSION

The debtor’s “rights” include whatever ownership rights that the debtor has in the collateral, along with statutory rights under Article 9.⁴ The debtor has certain rights under Article 9 when a secured party seeks to enforce its statutory remedy of disposition under Section 9-610. One of those rights is the right of the debtor to redeem the collateral under Section 9-623 by satisfying the obligations secured by the secured party’s security interest in the collateral. The right of redemption enables the debtor to “buy back” the secured party’s security interest in the collateral by paying the secured party what it is owed on the secured obligations or by otherwise performing the secured obligations.

The importance of the debtor’s right of redemption in particular is reflected in Article 9’s limits on the debtor’s ability to waive the right. In a transaction other than a consumer-goods transaction, the debtor’s right of redemption may be waived only by the debtor’s agreement to that effect entered into and authenticated by the debtor after default.⁵ In a consumer-goods transaction, the debtor’s right of redemption may not be waived at all.⁶

Even so, Sections 9-617(a) and (b) provide that a “transferee that acts in good faith”⁷ in connection with a “secured party’s disposition of collateral after default”⁸ “takes free of”⁹ “all of

¹ See, e.g., U.C.C. §§ 9-609 (peaceful possession), 9-607 (collection), 9-610 (disposition), and 9-620 (acceptance of collateral).

² U.C.C. § 9-617(b).

³ U.C.C. § 9-617(a)(1).

⁴ See U.C.C. § 9-203(b)(2).

⁵ U.C.C. § 9-624(c).

⁶ See U.C.C. § 9-602(11).

⁷ U.C.C. § 9-617(b).

⁸ U.C.C. § 9-617(a).

⁹ U.C.C. § 9-617(b).

the debtor's rights in the collateral.”¹⁰ This is the case “even if the secured party fails to comply with [Article 9] or the requirements of any judicial proceeding.”¹¹

The transferee will not “take free” if the transferee fails to “act in good faith.”¹² In that case, subsection (c) of Section 9-617 makes explicit the negative implication of subsections (a) and (b): “the transferee [not acting in good faith] takes the collateral subject to . . . the debtor's rights in the collateral”¹³

To be sure, Section 9-623 cuts off the debtor's right of redemption when the secured party “has disposed of collateral or entered into a contract for its disposition under Section 9-610”¹⁴ The question then arises whether, if the secured party disposes of collateral, a transferee who is not acting in good faith takes the collateral subject to the debtor's right of redemption in the collateral or, alternatively, whether, because the right of redemption is cut off by a Section 9-610 disposition, the transferee takes the collateral free of the right.

This Commentary concludes that a transferee who has not acted in good faith does take subject to the debtor's right of redemption in addition to other rights of the debtor in the collateral. Section 9-617(c)(1) states that the transferee in a Section 9-610 disposition who is not acting in good faith takes subject to the debtor's rights in the collateral. A natural reading of the phrase “debtor's rights in the collateral” is that those rights include the debtor's right of redemption. Indeed, nothing in Article 9 suggests that “the debtor's rights in the collateral” do not include the debtor's right of redemption. It follows that the right of redemption is not cut off if the transferee does not act in good faith. It would be anomalous in that circumstance for Section 9-617(c)(1) to provide that a transferee not acting in good faith takes the collateral subject to the debtor's rights in the collateral if the disposition cuts off one of the debtor's key rights in the collateral, the right of redemption.

If the debtor retains the debtor's right of redemption and other rights in the collateral on account of the transferee not acting in good faith, those rights could not have been transferred to the transferee nor would the transferee take free of those rights (as would have been the case had the transferee acted in good faith).¹⁵ In other words, the disposition is ineffective to the extent that it would otherwise have cut off the debtor's right of redemption¹⁶ and other rights in the collateral. Absent a permitted and effective waiver by the debtor, the debtor retains whatever rights the debtor had in the collateral before the disposition including the right of redemption,

¹⁰ U.C.C. § 9-617(a).

¹¹ U.C.C. § 9-617(b). The policy rationale for “taking free” is to incentivize prospective transferees to bid for the collateral and to do so at prices that minimize economic loss to the secured party, the debtor, and others who have an interest in the collateral.

¹² See U.C.C. § 9-617(b) and cmt. 4 to U.C.C. § 9-617. “Good faith” requires that the transferee act with honesty in fact and in the observance of reasonable commercial standards of fair dealing. U.C.C. § 1-201(b)(20).

¹³ U.C.C. § 9-617(c)(1). This Commentary does not address under what circumstances a transferee, such as a transferee who knows that the secured party is failing to comply with Article 9, is still considered to be acting in good faith. The resolution of that matter may depend on the specific facts and circumstances of the disposition and on the transferee's relationship to the secured party and is best left to the courts.

¹⁴ U.C.C. § 9-623(c)(2).

¹⁵ U.C.C. § 9-617(a)(1).

¹⁶ See U.C.C. § 9-623(c)(2).

albeit subject to the security interest under which the disposition was made and any other security interest or other lien.¹⁷

For this reason, this Commentary disagrees with the decision in *Atlas MF Mezzanine Borrower, LLC v. Macquarie Texas Loan Holder LLC*, 174 A.D.3d 150 (2019). In that case the debtor alleged that the disposition transferee had not acted in good faith and that therefore the disposition should be set aside. The court, citing a policy against disturbing foreclosure sales in the interest of commercial certainty, rejected the debtor's argument that the sale should be set aside and instead explained its view that the debtor's remedy was to seek monetary damages. Although the debtor may indeed be entitled to seek monetary damages for a disposition that did not comply with Section 9-610,¹⁸ the debtor is also entitled to the debtor's right of redemption and other rights in the collateral when the transferee has not acted in good faith. A bad faith transferee may not rely on the "take free" rule. Any policy based on commercial certainty is subordinate to the policy of not rewarding those that do not act in good faith.

AMENDMENTS TO OFFICIAL COMMENTS

With the discussion in this Commentary in mind, Official Comment 4 to Section 9-617 is amended as follows:

4. **Title Taken by Nonqualifying Transferee.** Subsection (c) specifies the consequences for a transferee who does not qualify for protection under subsections (a) and (b) (i.e., a transferee who does not act in good faith). The transferee takes subject to the rights of the debtor, the enforcing secured party, and other security interests or other liens. In such a case the disposition is ineffective to the extent that it would otherwise have cut off the debtor's rights in the collateral, and the debtor retains those rights, including the debtor's right of redemption under Section 9-623, albeit subject to the security interest under which the disposition was made and any other security interests or liens. See PEB Commentary No. 22, dated August 24, 2020. The Commentary is available at <https://www.ali.org/peb-ucc>.

¹⁷ See U.C.C. § 9-617(c).

¹⁸ See U.C.C. § 9-625(b).