

CHAPTER 2

ENFORCEMENT OF SECURITY INTERESTS

2.1 IN GENERAL

The rights and remedies of a creditor with a contractually created lien on personal property will generally be governed by part 6 of revised Article 9 of the Uniform Commercial Code (U.C.C.).¹ Article 9 of the U.C.C. will govern contractually created security interests no matter what name the parties give to the transaction.² As between the debtor and the creditor, these rights exist whether the security interest is perfected or not. The creditor may:

1. Exercise rights and remedies provided by agreement or title 8.9A of the Virginia Code;
2. Foreclose;
3. Reduce a claim to judgment;
4. Use any available judicial procedure to enforce the security interest;
5. If the collateral is documents of title, proceed against either the documents or the goods thereby covered (or both);
6. If the collateral is accounts, notify the account debtors or obligors to make payment directly to the secured party;³ or
7. If the security agreement covers both real and personal property, proceed under title 8.9A against the personal property alone or against both the real and personal property

¹ Pursuant to section 8.9A-701 of the Virginia Code, revised Article 9 of the U.C.C. is effective in Virginia as of July 1, 2001. Revised Article 9 is codified in Virginia under title 8.9A of the Virginia Code. References to the U.C.C. in this chapter will generally be to the law as codified in Virginia.

² Section 8.9A-109(a)(1) of the Virginia Code provides that title 8.9A applies to “a transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract.”

³ Va. Code § 8.9A-607(a)(1). A secured party may also proceed against collateral provided by the account debtor. Id. § 8.9A-607(a)(3).

pursuant to rights and remedies respecting the real property, in which case title 8.9A generally does not apply.⁴

2.2 THE IMPORTANCE OF THE PARTIES' AGREEMENT IN ESTABLISHING THE RIGHTS AND REMEDIES OF THE SECURED PARTY AND THE DEBTOR

Many of the rights and remedies of the secured party are provided by the U.C.C. itself. Others flow directly from the terms and conditions of the security agreement. As a result, *many aspects of enforcing a security interest under title 8.9A of the Virginia Code should be dealt with prospectively in the security agreement.* The appendices to this chapter contain suggested provisions for use in a security agreement that may enhance the secured party's rights.

2.201 The Importance of Default. For the most part, the secured party's rights to enforce the lien of a security interest are triggered by "default under a security agreement."⁵ For example, in the case of nonpossessory security interests, the secured party's right to possession of the collateral arises upon "default."⁶ Additionally, certain rights of the debtor may be waived only after default.⁷

Title 8.9A of the Virginia Code does not define "default." It may be inferred that "default under a security agreement" occurs when the debtor fails to pay the indebtedness secured when due. However, the careful practitioner will not rely on such an inference and will define events of default in the security agreement. Moreover, quite often the secured party may want to provide for events of default other than nonpayment in order to be in a position to act at the outset of a debtor's financial difficulties. Usually these are defined as instances where the debtor fails to live up to requirements of the security agreement, for example, failure to provide adequate insurance for the collateral, failure to keep the collateral at the agreed-upon location or in an agreed-upon condition, or, to the extent not set forth in the note or other obligation secured, failure to maintain a specified financial condition.⁸

⁴ Va. Code § 8.9A-109(d)(11); *see also* § 8.9A-604(a) (explaining procedure if security agreement covers real property or fixtures).

⁵ Va. Code § 8.9A-601(a).

⁶ Va. Code § 8.9A-609(a)(1).

⁷ *See infra* ¶ 2.202(D).

⁸ *See* Appendix 2-1 for an example of a default provision.

2.202 Rights and Remedies Arising Only from the Parties' Agreement. In general, the parties may provide in the security agreement for rights and remedies in addition to those set forth in title 8.9A of the Virginia Code. The major limitations on this freedom to create remedies by contract are provided by (i) section 8.1A-302 of the Virginia Code, which provides that obligations of good faith, diligence, reasonableness, and care may not be *disclaimed* by agreement; (ii) section 8.1A-304, which imposes an obligation of good faith in the performance and enforcement of contracts that are subject to the U.C.C.; (iii) section 8.9A-602, which specifies matters that may not be waived or varied even after default;⁹ and (iv) section 8.9A-610(a), which requires each disposition of collateral to be “commercially reasonable.”

A. Rights and Remedies of a Secured Party. Certain rights and remedies of the secured party exist only if the parties so agree. Often they must be set forth *in the security agreement itself*, but in other cases they may be established simply “by agreement.” Under title 8.9A of the Virginia Code, “[a]greement,” means the bargain of the parties in fact as found in their language or inferred from other circumstances,” for example, trade usage, course of dealing, or course of performance.¹⁰

1. Direct Collection. Although the general rule is that a secured party’s right to enforce a security interest arises only upon default, the secured party may begin direct collection of accounts or other obligations in the absence of default if there is “agreement” to that effect.¹¹ Financiers of chattel paper, such as retail installment contracts and accounts, are well-advised to retain the right of direct collection because of the highly liquid nature of the collateral, the heightened possibility of double financing in these cases, and the ever-present problem of commingling. On the other hand, many debtors (and lenders) do not wish to have their financing relationship known to the debtor’s customers. These interests may be accommodated by use of a “lock box,” which is no more than a device whereby payment is mailed to the borrower, care of a post office box controlled by the lender, who deposits the proceeds in a special account controlled as provided in the parties’ agreement. Alternatively, a lender may require the debtor to

⁹ See *infra* ¶ 2.202(C). Section 8.9A-624 of the Virginia Code provides a limited exception to the prohibition on post-default variance set forth in section 8.9-602. Section 8.9A-624 allows for (a) waiver of disposition notification by a debtor or secondary obligor, (b) waiver of mandatory disposition by a debtor, and (c) except in a consumer-goods transaction, waiver of redemption rights by a debtor or secondary obligor. All waivers permissible under section 8.9A-624 must be accomplished by agreements entered into and authenticated after default.

¹⁰ Va. Code § 8.1A-201(b)(3).

¹¹ Va. Code § 8.9A-607(a).

remit payments on accounts and chattel paper directly to the lender in the form received, duly endorsed to the lender, to ensure that the account obligors (and thus the accounts as collateral) really exist and are not being double-financed or fabricated by the borrower.¹²

Before engaging in direct collection, the secured party should take note of *Tazewell Oil Co. v. United Virginia Bank*¹³ and the hostility to direct collection remedies evidenced in Justice Lacy's opinion.

2. Assembling the Collateral. The secured party may require the debtor to assemble the collateral and make it available at a mutually convenient location, but only if the *security agreement* so provides.¹⁴

3. Legal Expenses. The secured party may not apply proceeds of a foreclosure sale to attorney fees and legal expenses unless the security agreement so provides.¹⁵

4. Deficiency After Sale. In most instances, the debtor is liable for any deficiency existing after sale of the collateral.¹⁶ If the underlying transaction was a sale of accounts or chattel paper, the debtor is not liable for the deficiency after sale by the secured party unless the security agreement so provides.¹⁷ In many instances, difficulty arises in determining whether chattel paper or accounts financing is a sale or a lending transaction. This is the very reason for bringing both into Article 9 of the U.C.C. The lender who desires recourse should make his or her rights clear in the security agreement if there is any possibility that the transactions may be characterized as sales.

B. Rights of the Debtor. Certain rights and remedies of the debtor exist only if there is agreement.

¹² See Appendix 2-2 for an example of a provision that should be included in a security agreement covering accounts, chattel paper, or instruments.

¹³ 243 Va. 94, 413 S.E.2d 611 (1992) (finding evidence sufficient to demonstrate that two lien creditors engaged in a conspiracy to injure debtor's business by virtue of their agreement to seize debtor's accounts receivable and inventory, and upholding compensatory damages awarded by a jury for conspiracy and tortious interference).

¹⁴ Va. Code § 8.9A-609(C). See Appendix 2-3 for a sample provision requiring the collateral to be assembled at a given location.

¹⁵ Va. Code § 8.9A-615(a)(1).

¹⁶ Va. Code § 8.9A-615(d).

¹⁷ Va. Code §§ 8.9A-602, -615(e).

1. Surplus After Sale. In most instances, the secured party must account to the debtor or holders of junior security interests for any surplus proceeds after sale.¹⁸ However, if the underlying transaction was a *sale* of accounts or chattel paper, the debtor is not entitled to any surplus remaining after sale by the secured party unless the security agreement so provides.¹⁹

2. Deficiency. In cases involving other types of collateral, the debtor is liable for any deficiency after sale of collateral unless there is “agreement” to the contrary.²⁰

3. Possession. The debtor and the secured party may agree that the secured party will not have the right to possession of collateral after default, but in the absence of such agreement the right automatically arises under title 8.9A of the Virginia Code.²¹

C. Matters That May Not Be Varied by Agreement.

1. Relevant Statutory Provisions. There are exceptions to the general rule that a security agreement may supplement or alter statutory provisions. In addition to the general limitations of sections 8.1A-302 and 8.1A-304 of the Virginia Code,²² title 8.9A of the Virginia Code imposes its own specific limitations on the contractual powers of the parties. To the extent they give rights to the debtor and impose duties on the secured party, certain provisions of title 8.9A may not be waived or varied in the security agreement.²³ These provisions include the following:

- a. Sections 8.9A-608(a) and 8.9A-615(d), insofar as they require accounting for and payment of surplus proceeds of collateral;
- b. Sections 8.9A-610, 8.9A-611, 8.9A-613, and 8.9A-614, which address disposition of collateral;
- c. Sections 8.9A-620, 8.9A-621, and 8.9A-614, which address acceptance of collateral in satisfaction of the obligation;

¹⁸ Va. Code § 8.9A-615(d).

¹⁹ Va. Code § 8.9A-602, -615(e).

²⁰ Va. Code § 8.9A-615(d).

²¹ Va. Code §§ 8.9A-602(6), -609(a)(1).

²² See *supra* ¶ 2.202.

²³ Va. Code § 8.9A-602(1)-(13).

- d. Section 8.9A-623, which addresses redemption of collateral; and
- e. Sections 8.9A-625, 8.9A-626, and 8.9A-628, which address the secured party's liability (and limitation on damages) for failure to comply with part 6 of Article 9 of the U.C.C.

2. When Variance or Waiver Is Allowed. The limitations on which sections may be varied or waived in the security agreement are provided in section 8.9A-602(1)-(13). Additionally, “[t]he parties may determine by agreement the standards measuring the fulfillment of the rights of a debtor or obligor and the duties of a secured party under a rule stated in § 8.9A-602 if the standards are not manifestly unreasonable.”²⁴

D. Rights That May Be Waived Only After Default.

1. Notice of Sale. The debtor may waive certain rights only after default.²⁵ Under section 8.9A-624(a) of the Virginia Code, the debtor can waive notice of disposition of collateral only by an agreement entered into and authenticated after default. Otherwise, the secured party must notify the debtor of:

- a. The method of intended disposition;
- b. The time and place of a public sale or other disposition;
- c. The date after which a private sale or other disposition will be made; and
- d. The debtor's entitlement to an accounting of unpaid indebtedness; and
- e. The description of the debtor, the secured party, and the collateral that is the subject of the intended disposition.²⁶

²⁴ Va. Code § 8.9A-603(a) (emphasis added). However, the parties can never contract around the secured party's duty to refrain from breaching the peace under section 8.9A-609.

²⁵ See Appendix 2-4 for an acknowledgment of default and waiver of rights of redemption and notification of sale form.

²⁶ Va. Code § 8.9A-613(1). Section 8.9A-614 provides for the content of notification before disposition in a consumer-goods transaction and a “safe harbor” form for this notification.