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Uniform Commercial Code -- Constitutionality of Sections 9-503, 9-504 -- Due Process -- Adams v. Egley

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UNIFORM COMMERCIAL CODE COMMENTARY

Uniform Commercial Code—Sections 9-503, 9-504—Due Process— ***Adams v. Egley***[1]—On June 17, 1968, plaintiff Adams obtained a loan of one thousand dollars from the Bank of La Jolla, executing a security agreement and a promissory note in favor of the bank. The security agreement provided that if the debtor defaulted on principal or interest payments, the Secured Party would have "all of the rights and remedies of a Secured Party under the California Uniform Commercial Code. . . ."[2] Included in these rights were the repossession rights under Sections 9-503 and 9-504 of the U.C.C.[3] A short time thereafter, the defendant Southern California First National Bank became the successor in interest to the Bank of La Jolla. The plaintiff failed to make his payments, and the defendant Egley, acting for the bank, repossessed two of the three vehicles described as collateral in the security agreement and sold them at a private sale.

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[1] 388 F. Supp. 614 (S.D.Cal. 1972).

[2] Id. at 616.

[3] U.C.C. § 9-503 provides:

> Unless otherwise agreed a secured party has on default the right to take possession of the collateral. In taking possession a secured party may proceed without judicial process if this can be done without breach of the peace or may proceed by action. If the security agreement so provides the secured party may require the debtor to assemble the collateral and make it available to the secured party at a place to be designated by the secured party which is reasonably convenient to both parties. Without removal a secured party may render equipment unusable, and may dispose of collateral on the debtor's premises under Section 9-504.

U.C.C. § 9-504 provides:

> (1) A secured party after default may sell, lease or otherwise dispose of any or all of the collateral in its then condition or following any commercially reasonable preparation or processing. Any sale of goods is subject to the Article on Sales (Article 2). The proceeds of disposition shall be applied in the order following to
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> (a) the reasonable expenses of retaking, holding, preparing for sale, selling and the like and, to the extent provided for in the agreement and not prohibited by law, the reasonable attorneys' fees and legal expenses incurred by the secured party;
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> (b) the satisfaction of indebtedness secured by the security interest under which the disposition is made;
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> (c) the satisfaction of indebtedness secured by any subordinate security interest in the collateral if written notification of demand thereof is received before distribution of the proceeds is completed. If requested by the secured party, the holder of a subordinate security interest must seasonably furnish reasonable proof of his interest, and unless he does so, the secured party need not comply with his demand.
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> (2) If the security interest secures an indebtedness, the secured party must account to the debtor for any surplus, and, unless otherwise agreed, the debtor is liable for any deficiency. But if the underlying transaction was a sale of ac-

The issue before the United States District Court for the Southern District of California on plaintiffs' motion for partial summary judgment involved the constitutionality of Sections 9503 and 9504 of the California Commerical Code, providing for the secured party's right of repossession and disposition upon the debtor's default.[4] The court

counts, contract rights, or chattel paper, the debtor is entitled to any surplus or is liable for any deficiency only if the security agreement so provides.

(3) Disposition of the collateral may be by public or private proceedings and may be made by way of one or more contracts. Sale or other disposition may be as a unit or in parcels and at any time and place and on any terms but every aspect of the disposition including the method, manner, time, place and terms must be commercially reasonable. Unless collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market, reasonable notification of the time and place of any public sale or reasonable notification of the time after which any private sale or other intended disposition is to be made shall be sent by the secured party to the debtor, and except in the case of consumer goods to any other person who has a security interest in the collateral and who has duly filed a financing statement indexed in the name of the debtor in this state or who is known by the secured party to have a security interest in the collateral. The secured party may buy at any public sale and if the collateral is of a type customarily sold in a recognized market or is of a type which is the subject of widely distributed standard price quotations he may buy at private sale.

(4) When collateral is disposed of by a secured party after default, the disposition transfers to a purchaser for value all of the debtor's rights therein, discharges the security interest under which it is made and any security interest or lien subordinate thereto. The purchaser takes free of all such rights and interests even though the secured party fails to comply with the requirements of this Part or of any judicial proceedings.

(a) in the case of a public sale, if the purchaser has no knowledge of any defects in the sale and if he does not buy in collusion with the secured party, other bidders or the person conducting the sale; or

(b) in any other case, if the purchaser acts in good faith.

(5) A person who is liable to a secured party under a guaranty, indorsement, repurchase agreement or the like and who receives a transfer of collateral from the secured party or is subrogated to his rights has thereafter the rights and duties of the secured party. Such a transfer of collateral is not a sale or disposition of the collateral under this Article.

[All citations to the Uniform Commercial Code will be to the 1962 Official Text.]

[4] Cal. Commercial Code §§ 9503-9504 (West 1964). These sections are verbatim adoptions of Sections 9-503 and 9-504 of the Uniform Commercial Code, supra note 3, except that subsection (3) of section 9-504 has been expanded in the California statute to read as follows:

A sale or lease of collateral may be as a unit or in parcels, at wholesale or retail and at any time and place and on any terms, provided the secured party acts in good faith and in a commercially reasonable manner. Unless collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market, the secured party must give to the debtor, and to any other person who has a security interest in the collateral and who has filed with the secured party a written request for notice giving his address, a notice in writing of the time and place of any public sale or of the time on or after which any private sale or other intended disposition is to be made. Such notice must be delivered personally or be deposited in the United States mail postage prepaid addressed to the debtor at his address as set forth in the financing statement or as set forth in the security agreement or at such other address as may have been furnished to the secured party in writing for this

had to decide whether the repossessions which occurred represented "takings without due process of law, thus denying plaintiffs their constitutional rights."[5] The District Court for the Southern District of California HELD: Sections 9503 and 9504 of the California Commerical Code, which authorize such takings, violate the due process clause of the Fourteenth Amendment. The impact of the court's holding is that the once powerful creditor remedy of non-judicial repossession is no longer available in California. This note will examine the *Adams* holding in light of other recent cases dealing with prejudgment remedies.

In reaching its decision, the *Adams* court relied heavily on the Supreme Court's decision of *Sniadach v. Family Finance Corp.*[6] In *Sniadach*, the Court held that the Wisconsin prejudgment wage garnishment procedure, which permitted a taking of property without prior notice and a fair hearing, lacked the procedural due process required by the Fourteenth Amendment.[7] Never before had the Court found that due process required a prior hearing in the case of prejudgment attachments. Earlier decision either ignored or considered insignificant the temporary loss of the property attached.[8]

Although the *Sniadach* decision turned on due process issues, as was recognized in *Adams*, it may be interpreted as possessing strong equal

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purpose, or, if no address has been so set forth or furnished, at his last known address, and to any other secured party at the address set forth in his request for notice, at least five days before the date fixed for any public sale or before the day on or after which any private sale or other disposition is to be made. Notice of the time and place of a public sale shall also be given at least five days before the date of sale by publication once in a newspaper of general circulation published in the county in which the sale is to be held. Any public sale shall be held in the county or place specified in the security agreement, or if no county or place is specified in the security agreement, in the county in which the collateral or any part thereof is located or in the county in which the debtor has his residence or chief place of business, or in the county in which the secured party has his residence or a place of business if the debtor does not have a residence or chief place of business within this State. If the collateral is located outside of this State or has been removed from this State, a public sale may be held in the locality in which the collateral is located. Any public sale may be postponed from time to time by public announcement at the time and place last scheduled for the sale. The secured party may buy at any public sale and if the collateral is customarily sold in a recognized market or is the subject of widely or regularly distributed standard price quotations he may buy at private sale. Any sale of which notice is delivered or mailed and published as herein provided and which is held as herein provided is a public sale.

[5] 338 F. Supp. at 618. The case also involved important jurisdictional issues, i.e., whether the acts of repossession were made "under color of state law" as required under the Civil Rights Act, 28 U.S.C. § 1343 (1970) and 42 U.S.C. § 1983 (1970), and whether the enactment of sections 9503 and 9504, authorizing such acts, constitutes sufficient state action to raise a federal question. The court resolved both questions in the affirmative. For a relevant discussion of these jurisdictional problems, see Black, Foreward: "State Action," Equal Protection, and California's Proposition 14, 81 Harv. L. Rev. 69 (1967).

[6] 395 U.S. 337 (1969).

[7] Id. at 342.

[8] Note, 83 Harv. L. Rev. 113, 114 (1969).

protection implications as well.[9] A concern for the inequities in the area of consumer credit manifests itself throughout the Court's due process discussion. The author of *Sniadach*, Mr. Justice Douglas, viewed prejudgment statutes as imposing a "tremendous hardship" on "wage earners with families to support" and placed considerable weight on the injustice of the process.[10]

The *Sniadach* Court further indicated certain limitations inherent in the application of due process standards to prejudgment remedies:

> [Although the] summary procedure [established by the Wisconsin statute] may well meet the requirements of due process in extraordinary situations. . . , in the present case no situation requiring special protection to a state or creditor interest is presented. . . ; nor is the Wisconsin statute narrowly drawn to meet any unusual condition.[11]

Even though the *Sniadach* Court did not elaborate on what would constitute an "extraordinary situation," the cases cited in the opinion indicate the determinative factors. In *Ownbey v. Morgan*,[12] a resident creditor's prejudgment attachment of a nonresident's property was allowed in order to obtain "quasi-in-rem" jurisdiction. The seizure of nonresident assets is frequently the only effective remedy for injuries inflicted by nonresidents. Furthermore, the resulting hardship to the debtor is minimal since his "necessities" are within his home state.[13] Two other cases, *Fahey v. Mallonee*[14] and *Coffin Bros. & Co. v. Bennet*,[15] involved the imminent failure of banking institutions and the immediate need for specialized government personnel to seize operational control of banking assets. Considering the public danger inherent in the situation and the regulated nature of the industry, an "extraordinary" problem was presented, and summary procedures were justified. An even more compelling case for the elimination of due process requirements was *Ewing v. Mytinger & Casselberry, Inc.*,[16] which involved multiple seizures by the Federal Food and Drug Administrator of misbranded articles found to be materially misleading to the con-

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[9] Comment, 70 Colum. L. Rev. 942, 954 (1970).

[10] 395 U.S. at 340. In his opinion, Justice Douglas quotes Congressman Sullivan's Subcommittee on Consumer Affairs:

> What we know from our study of this problem is that in a vast number of cases the debt is a fraudulent one, saddled on a poor ignorant person who is trapped in an easy credit nightmare in which he is charged double for something he could not pay for even if the proper price was called for, and then hounded into giving up his pound of flesh, and being fired besides.

Id. at 341.

[11] Id. at 339.

[12] 256 U.S. 94 (1921).

[13] Randone v. Appellate Dep't of Sup. Ct. of Sacramento Co., 5 Cal. 3d 536, 555, 488 P.2d 13, 25, 96 Cal. Rptr. 709, 721 (1971).

[14] 332 U.S. 245 (1947).

[15] 277 U.S. 29 (1928).

[16] 339 U.S. 594, 595-96 (1950).

sumer. The *Ewing* Court held that because of the "injurious consequences of protracted proceedings," the "speedy, preventive device of multiple seizures" was necessary.[17]

Thus *Fahey*, *Coffin*, and *Ewing* all possess certain distinguishing features. First, the seizures were initiated to benefit the general public and not to serve the interests of a private creditor. Second, authorized public officials, bound to act in furtherance of the general welfare, were charged with responsibility for the seizures. Third, the risk of potential harm demanded immediate action. Fourth, the goods appropriated were not "necessities." Finally, the statutes providing for the "takings" were narrowly drawn and permitted summary procedures only when necessary.[18]

Under the *Sniadach* test, then, the constitutionality of an attachment statute depends on the following variables: hardship, the existence of an extraordinary situation, the narrowness of the statute in question, and provision made in the statute for adequate notice and a prior hearing.[19] For a statute to pass constitutional muster, each of the aforementioned criteria must be satisfied. In setting forth for the first time the due process requirements of prejudgment remedies, the *Sniadach* decision laid the groundwork for major constitutional reform in this area.

The district court decision in *Adams v. Egley* follows as a logical extension of the Supreme Court's opinion in *Sniadach*. In declaring unconstitutional Sections 9-503 and 9-504 of the Uniform Commercial Code, the *Adams* court invalidated the powerful creditor remedy of self-help. Past decisions had struck down statutes authorizing the taking of collateral upon the issuance of judicial process,[20] but never before had the secured party's private right to non-judicial repossession been affected.

Under Section 9-503 of the Code, "[u]nless otherwise agreed a secured party has on default the right to take possession of the collateral. . .without judicial process if this can be done without breach of the peace. . . ."[21] The advantages of this right are enormous: costly legal fees are avoided,[22] immediate unofficial repossession protects the goods from loss or destruction, and the threat of repossession gives the creditor added leverage vis-á-vis the debtor. In view of the importance of this creditor remedy, the court's requirement of prior notice and hearing is bound to have a far-reaching effect on the extension of consumer credit.

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17 Id. at 601.

18 5 Cal. 3d at 554, 488 P.2d at 24-25, 96 Cal. Rptr. at 720-21.

19 Note, 22 Stan. L. Rev. 1254, 1266 (1970).

20 Swarb v. Lennox, 314 F. Supp. 1091, 1094 (E.D. Pa. 1970), aff'd, ___ U.S. ___, 92 S. Ct. 767 (1972). Randone v. Appellate Dep't of Sup. Ct. of Sacramento Co., 5 Cal. 3d 536, 544, 488 P.2d 13, 17, 96 Cal. Rptr. 709, 713 (1971).

21 See note 3 supra.

22 Hogan, The Secured Party and Default Proceedings Under the UCC, 47 Minn. L. Rev. 205, 211 (1962); Comment, 11 B.C. Ind. & Com. L. Rev. 435 (1969).

Yet, given the scope of the applicable law, the decision to declare sections 9-503 and 9-504 unconstitutional was almost incumbent on the court. The cases cited in the opinion constitute a solid foundation upon which the court's conclusions are based. *Santiago v. McElroy*[23] and *Swarb v. Lennox*[24] furnish sufficient precedent for the court's conclusion that the contractual waiver is ineffective and that the debtor's rights under *Sniadach* are enforceable. *Laprease v. Raymours Furniture Co.*[25] and *Blair v. Pitchess*[26] support the court's position that procedural due process requires prior notice and hearing despite the presence of a security agreement.

Of paramount significance in the *Adams* opinion are the nature of the parties to the security agreement and the type of collateral involved. In distinguishing among different types of debtors and collateral, *Adams* also finds support in prior case law. The Tenth Circuit, in *Brunswick Corp. v. J.P., Inc.*,[27] indicated its willingness to uphold a security agreement between commercial parties of equal bargaining strength where the collateral is of a non-essential nature. In *Swarb v. Lennox*,[28] a three-judge district court panel held that confession of judgment clauses in consumer credit agreements did not constitute a waiver of the right to notice and hearing as to those debtors with incomes under ten thousand dollars. As to this class, the court ruled that the plaintiffs had established that there had been no "intentional relinquishment or abandonment of a known right or privilege."[29] Moreover, the district court in *Swarb* added important dicta relevant to the facts in *Adams*. The court said that where the debtor is an attorney, all that may be necessary to establish his understanding of the terms of the agreement is an affidavit of his profession. On the other hand, where the debtor is a non-high school graduate, far greater proof is needed.[30] The Supreme Court, while affirming the judgment, did not deal with this line of reasoning.

In *Santiago v. McElroy*,[31] the United States District Court for the Eastern District of Pennsylvania went even further than did the *Swarb* court in rejecting the claimed waiver of the right to prior notice and hearing. In *Santiago*, the court considered the issue of whether the distress sales under the distraint procedures of the Pennsylvania Landlord and Tenant Act violated due process inasmuch as the statute made no provision for notice and hearing prior to sale.[32] The court discussed the defendant's contention that the taking was accomplished

[23] 319 F. Supp. 284, 294 (E.D. Pa. 1970).
[24] 314 F. Supp. at 1100-01.
[25] 315 F. Supp. 716, 723 (N.D.N.Y. 1970).
[26] 5 Cal. 3d 258, 281, 486 P.2d 1242, 1259, 96 Cal. Rptr. 42, 59 (1971).
[27] 424 F.2d 100 (10th Cir. 1970). See also 338 F. Supp. at 619.
[28] 314 F. Supp. 1091 (E.D. Pa. 1970).
[29] Id. at 1100.
[30] Id. at 1101.
[31] 319 F. Supp. 284 (E.D. Pa. 1970).
[32] Id. at 285.

pursuant to a lease agreement between private parties and ruled that the lease provision providing for levies and sales did not create an independent right in the landlord to distrain; instead, the provision meant that the landlord would have the right to act pursuant to the statute, and that the tenant would not object to the use of the statutory distress procedure.[33] The court went on to hold that the waiver was ineffective and that the statutory procedure amounted to a taking of property without due process of law.[34]

An even stronger authority for the *Adams* decision is *Laprease v. Raymours Furniture Co.*,[35] where a three-judge district court panel held that procedural due process demands that notice and an opportunity to be heard be afforded the debtor before his property is taken pursuant to Article 71 of the New York Civil Practice Law and Rules, or at least that the creditor present the facts allegedly justifying summary repossession to a "judicial officer."[36] Article 71 gave the creditor the right to summary repossession of his collateral upon delivery to the sheriff of an affidavit identifying the chattel to be seized and the value thereof.[37] In invalidating the statute, the court noted that the fact that *Sniadach* involved an unsecured interest and in this case the vendors' interests were secured was immaterial since the replevin action was not limited to secured transactions.[38] The court also doubted whether the "fine print in the usual consumers conditional sales contract gives rise to a competent and intelligent waiver of a constitutional right."[39]

Further support comes from the California Supreme Court decision in *Blair v. Pitchess*,[40] an action brought by resident taxpayers to enjoin the enforcement of California's claim and delivery procedures. The court held that the state's claim and delivery law violated due process despite the presence of retained title security agreements which purported to give the seller the authority to enter and repossess on default.[41] In summary, both *Blair* and *Laprease* stand for the proposition that due process requires prior notice and an opportunity to be heard in the case of prejudgment remedies whether or not a purported waiver has been signed.

In light of the aforementioned decisions, the court's holding in *Adams v. Egley* lies within the ambit of *Sniadach*. Recent Supreme Court cases have seen in *Sniadach* not a special constitutional rule for wages but an important source for the general principle that absent some compelling state interest, a person must be given the right to

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33 Id. at 294.
34 Id. at 294-95.
35 315 F. Supp. 716 (N.D.N.Y. 1970).
36 Id. at 724.
37 Id. at 719.
38 Id. at 723.
39 Id. at 724.
40 5 Cal 3d 258, 486 P.2d 1242, 96 Cal. Rptr. 42 (1971).
41 5 Cal. 3d at 275-77, 486 P.2d at 1254-55, 96 Cal. Rptr. at 54-55.

notice and hearing before being deprived of some significant interest by operation of law.[42] Other state and federal court cases have extended the scope of *Sniadach* to encompass other "necessities"[43] as well as other prejudgment remedies,[44] to secured as well as unsecured creditors.[45] The debtor's rights also withstood unknowing waivers in unconscionable conditional sales contracts.[46] Thus, there was ample precedent available for the application of the *Sniadach* constitutional tests to the facts in *Adams v. Egley*.

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[42] Boddie v. Connecticut, 401 U.S. 371 (1971); California Department of Human Resources v. Java, 402 U.S. 121 (1971); Bell v. Burson, 402 U.S. 535 (1971); Goldberg v. Kelly, 397 U.S. 254 (1970). *Goldberg* and *Java* require an evidentiary hearing before welfare benefits can be terminated. *Bell* extends the requirement of prior notice and hearing to the suspension of the license and registration of a motorist. *Boddie* applies due process principles to individuals seeking judicial dissolution of their marriages.

[43] Blair v. Pitchess, 5 Cal. 3d at 279, 486 P.2d at 1257, 96 Cal. Rptr. at 57; Randone v. Appellate Dep't of Sup. Ct. of Sacramento Co., 5 Cal. 3d at 560, 488 P.2d at 29, 96 Cal. Rptr. at 725; Laprease v. Raymours Furniture Co., 315 F. Supp. at 723; Jones Press, Inc. v. Motor Travel Services, Inc., 286 Minn. 205, 210, 176 N.W.2d 87, 90-91 (1970); Larson v. Fetherston, 44 Wis.2d 712, 718, 172 N.W.2d 20, 23 (1969); Klim v. Jones, 315 F. Supp. 109, 123 (N.D. Cal. 1970).

[44] Klim v. Jones, 315 F. Supp. at 124; Laprease v. Raymours Furniture Co., 315 F. Supp. at 723; Randone v. Appellate Dep't of Sup. Ct. of Sacramento Co., 5 Cal. 3d at 563, 488 P.2d at 32, 96 Cal. Rptr. at 728; Blair v. Pitchess, 5 Cal. 3d at 281, 486 P.2d at 1259, 96 Cal. Rptr. at 59; Santiago v. McElroy, 319 F. Supp. at 294.

[45] Laprease v. Raymours Furniture Co., 315 F. Supp. at 723; Blair v. Pitchess, 5 Cal. 3d at 281, 486 P.2d at 1258-59, 96 Cal. Rptr. at 58-59.

[46] Santiago v. McElroy, 319 F. Supp. at 294; Swarb v. Lennox, 314 F. Supp. at 1100.