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**THE CONCEPT OF SELF-HELP ENFORCEMENT OF SECURED
CREDITOR'S RIGHTS: IS THE US MODEL EXPORTABLE TO
SLOVAKIA?**

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Abstract

This thesis focuses on enforcement of secured creditor's rights in collateral via self-help. The main question asked is whether it is feasible to import solutions invented in US to Slovakia. US concept is the example of modern developed enforcement system. Slovakia has recently reformed its secured transactions law, including related enforcement rules. In this paper promptness and efficiency are identified as the desirable features of every credit friendly enforcement system. By means of thorough examination and subsequent comparison of both enforcement regimes it is demonstrated that US system by incorporating self-help enforcement procedures better reflects the need of modern business world. On the other hand Slovak model suffers from slow and inefficient enforcement of secured creditor's rights mainly due to rejection of the self-help repossession. The thesis shows that adopting American solutions to Slovak problems related to enforcement of secured creditor's rights is an option which should be taken into consideration by both legal scholars and legislators.

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List of Abbreviations

Article 9	Article 9 of the Uniform Commercial Code of the United States
Civil Code	Act No. 40/1964 Coll, Civil Code (Slovak Republic)
EBRD	The European Bank for Reconstruction and Development
OC	The Official Comment of the Uniform Commercial Code of the United States
RV	The 1999 Revised Version of Article 9
SC	The Supreme Court of the Slovak Republic
UCC	The Uniform Commercial Code of the United States

Introduction

To build healthy and thriving market economy is undoubtedly the ideal that every country should strive to reach in order to assure prosperity and well-being of its citizens. It is now generally accepted that creating a viable legal framework for granting secured credit is an inevitable precondition of fostering economic development, and thereby increasing growth of general welfare. Therefore, not surprisingly, "due to the ever-growing role of the security idea", the law of secured transactions - a branch of law dealing with granting of secured credit, has "come to the forefront of contemporary commercial law."¹ To produce comfort to creditors and reduce the possibility of non-repaying the loan by debtors, the system needs to provide for strong recognition of enforcement rights of creditors. Without such a "backup" the system would collapse. Hence, as M. R. Umarji emphasized in his article, "the most important part of secured transactions law is rights of enforcement to be conferred on the secured creditors."² And as the viable example of the US enforcement system of secured creditor's rights illustrates, empowering creditors with extrajudicial, i.e. self-help avenues of enforcing their rights is a key to success. Certainly, "the self-help enforcement system of [UCC] Article 9 (...) is the unique American product, which is usually cited as the most venerable enforcement mechanism,"³ especially with respect to non-possessory movable collateral financing.

Following the amendment to the Civil Code⁴ in September 2002, effective since 1st of January 2003, Slovakia joined the "club" of countries with modern, flexible and

¹ See, Tajti, Tibor, *Comparative Secured Transactions Law* 19 (Akadémiai Kiadó, Budapest, 2002)

² See, Umarji, M.R., *Role of Secured Transactions to Mobilize Credit and need for mobilizing law*, 4 (Modern Law for Global Commerce, Vienna, 2007) available at <http://www.uncitral.org/pdf/english/congress/Umarji.pdf>

³ See, Tajti, supra note 1, at 182

⁴ Civil Code, Act No. 40/1964 Coll. (hereinafter referred to as Civil Code); § 151a to § 151md were amended by Act No. 526/2002 Coll., English translation of the amended parts of Civil Code is available at <http://www.ebrd.com/country/sector/law/st/core/civil/slovak.pdf>

simple secured transactions law regimes. Its reformed secured transactions law is characterized as “one of the most advanced legal frameworks for secured credit of any country in Europe, (...) which will greatly strengthen the country’s investment climate.”⁵ The final draft of the reformed law was strongly influenced by EBRD Model Law⁶. And since Article 9 was the single biggest influence on the EBRD Model Law⁷, it is important to note, that through this channel certain American concepts and ideas have been indirectly transformed into the Slovak secured transactions law regime. . And what is of particular importance for the purposes of this paper, the reformed law introduced certain elements of self-help into the enforcement of the rights of secured creditors, though contrary to the EBRD’s proposals, the most important component - self-help repossession, has not been accepted.

The existing literature on secured transactions and on enforcement of the rights of secured creditors in particular is abundant. However, most authors limit the confines of their work to analysis of their “domestic” solutions and refuse to devote a few pages to comparisons with other foreign concepts. Thus, Grant Gilmore’s *Security Interests in Personal Property*⁸ as the most respected piece of art covering US secured transactions law completely ignores other systems. Similarly, Schwartz & Scott in their *Commercial Transactions*,⁹ and Warren & Walt in *Secured Transactions in Personal Property*¹⁰ thoroughly examine US enforcement system without referring to civil law approaches to the problems they tackled. Not being an exception, Jan

⁵ See, *EBRD supports legal reform in Slovakia*, 6.1.2003, available at <http://www.ebrd.com/new/pressrel/2003/01jan06.htm>

⁶ The drafting process was supervised by the Office of Deputy Prime Minister for Economy and EBRD acted as its advisor. Text of the EBRD Model Law is available at <http://www.ebrd.com/country/sector/law/st/core/model/modellaw.pdf>

⁷ See, Simpson, John & Menze, Joachim, *Ten Years of Secured Transactions Reform*, Law in Transition, at 21, (EBRD, Autumn 2000), also available at <http://www.ebrd.com/pubs/legal/lit002.htm>

⁸ Gilmore, Grant, *Security Interests in Personal Property* (Little & Brown, Boston, 1965)

⁹ Schwartz, Alan & Scott, Robert E. *Commercial Transactions* (Foundation Press, 1982)

¹⁰ Warren, William D. & Walt, Steven D., *Secured Transactions in Personal Property* (Foundation Press, 7th edition, 2007)

Lazar in *Základy Občianskeho Hmotného Práva*,¹¹ the leading textbook on Slovak civil law, in the part devoted to secured transactions disregards developments in the field achieved by common law. One of the few treatises, if not the only one, focusing on thorough comparative analysis of all modern secured transactions law regimes is Tibor Tajti's *Comparative Secured Transactions Law*.¹² The unique feature of this book is that it also covers security laws of countries of Central and Eastern Europe such as Hungary and former Yugoslavia. Yet, no relevant literature have dealt with the issue of comparing Slovak reformed secured transactions law with US model, which is the most successful security regime in the world.

The main purpose of this paper is to answer the question whether it is feasible to export solutions to problems related to enforcement of secured creditor's rights from US to Slovakia. Emphasis is put on self-help enforcement, which seems to be the best response to the requirements of modern world of secured credit, based predominantly on utilizing movable assets by means of non-possessory securities. En route to that objective, this paper analyses all relevant features of American self-help enforcement concept based on Article 9. This is followed by examination of recent developments of Slovak secured transactions law regarding enforcement of secured creditor's rights. Through comparative analysis of both systems the paper seeks to offer a new view on the related issues, reveal eventual deficiencies of Slovak reform and propose future changes thereof.

As this paper examines two different legal systems, with terminology that might significantly differ, some explanation of its usage should be given. As to the set of *in rem* rights a secured creditor may have on encumbered assets, the term 'security interest' is used with respect to US law, and the term 'charge' denotes its Slovak

¹¹ Lazar, Ján, *Základy Občianskeho Hmotného Práva* [The Basics of the Substantive Civil Law] (Iura Edition, s.r.o., Bratislava, 2004)

¹² See, supra note 1

equivalent. Terms 'secured creditor' and 'secured party' are used interchangeably to denote the counterparty of the debtor. As to the property involved, the terms 'real' and 'immovable' property are used interchangeably. For the purposes of simplification, terms 'movables' and 'personal property' are used interchangeably, although the term 'personal property' is a broader category. Encumbered property is addressed as 'collateral' or 'security'.

Chapter 1 – The role of self-help within the framework of modern secured transactions law

1.1. Secured transactions law – an essential part of the legal system of countries with market based economies

One of the most important features of the market economy is to ensure a sufficient supply of credit to all segments of the economy. This statement stems from the assumption that credit is a good thing. Businesses use it to raise their capital and consumers enjoy goods and services as they pay for them. The overall effect is the economic growth. This is why modern economists “call credit a blessing, a driving force of the economy and an engine for growth.”¹³ Therefore, not surprisingly one of the major prerequisites to foster economic development is the wide accessibility of credit at minimal costs by all the actors of the commercial life.

The lower is the risk of non-repayment of the debt, the lower are the costs of lending. Thus, in principle secured lending as opposed to unsecured lending increases the accessibility of the credit. Permitting creditors to secure the lending transaction reduces their risk of not being repaid by debtors and expands the volume of available credit in the economy. The creditor should therefore be granted to take an *in rem* right (‘security interest’ if speaking the language of Article 9¹⁴, or ‘charge’

¹³ See, Umarji, supra note 2 at 1

¹⁴ “Security interest means an interest in personal property or fixtures which secures payment or performance of an obligation.” UCC s. 1-201 (b) (35)

according to Civil Code¹⁵) in the debtor's property, an additional right to his *in personam* claim against debtor. The purpose of this *in rem* right is to increase the creditor's chance of recovering the amounts owed by the debtor by taking action against the debtor's encumbered property. Consequently it is essential for a well-functioning secured transactions law regime, to provide for as many types of assets as possible to be utilized in secured transactions as collateral.

In most developed economies, movable assets play a major role in securing financing for businesses. This is particularly important for those business entities that do not own significant real property, but hold inventory and receivables as their primary assets instead.¹⁶ If movable property of any kind, tangible or intangible, presently owned or future-acquired is to be used as collateral, it is necessary to allow the debtor to use it for business purposes during the course of a loan, thus generating further revenue to repay his debt. In order to facilitate this kind of secured financing, the law has to recognize, protect and if necessary enforce the so called non-possessory security. Utilizing immovable property as a security is also important, but its relevance in commercial practice is limited. To sum up, the role of secured transactions law is economic. Its use is to set up the legal framework which enables utilization of possessory as well as non-possessory securities over all types of movable and immovable assets, creates a market for secured credit to operate, and thus stimulates economic activity and growth.

US law on secured transactions with Article 9 at its core is the example of successful attempt to build up consistent, comprehensive and effective security law regime. On the other hand, Slovak law has not until recently provided creditors with

¹⁵ "A charge is deemed to secure a claim and its appurtenances by entitling the secured creditor to be satisfied, or claim satisfaction from the object of the charge (hereinafter referred to as "collateral") if the debt is not duly and timely paid." § 151a of the Civil Code

¹⁶ See, Su Lin Han, *Secured Transactions Law Reform in China*, (The Secured Lender, July, August, 2007)

effective means of securing their claims in particular it did not recognize non-possessory securities with respect to movables. The following case¹⁷ decided by the Supreme Court of the Slovak Republic (hereinafter referred to as SC) illustrates the problem. The case involved the creation of the charge over the equipment in the debtor's possession. Under the 151b sec 3 of the Civil Code, which was in force until 1.1.2003, the creation of the charge over the movables by a security agreement required delivery of the collateral to the creditor. In the given case the creditor and the debtor stipulated for the delivery of the collateral to the creditor in the written security agreement, but in fact the collateral remained in the debtor's possession. Deciding on the issue of the validity of the charge the SC held:

“According to the security agreement made between plaintiff as a creditor and R.M. [as a debtor], movable property listed in the agreement was taken by the plaintiff. It can be inferred from this fact that pursuant to § 151b sec 3 of the Civil Code, the movable property was delivered to the creditor. This means of delivery is in compliance with the cited provision of the Civil Code and court agrees with plaintiff's opinion on the matter, that such a delivery of the collateral is not precluded by the law. (...) [I]t would not be right, not to allow the debtor to use the collateral, especially to use it for the purpose of developing his business plans, thus helping him to repay his debt.”¹⁸

This somewhat illogical argumentation of the SC shows that, irrespective of lack of legal regulation, Slovak courts recognized the necessity to utilize non-possessory

¹⁷ Rozsudok Najvyššieho súdu Slovenskej republiky, sp. zn. 3 Obo 180/2001 [The Supreme Court of the Slovak Republic decision No. 3 Obo/2001]

¹⁸ The original Slovak text reads as follows: “Z dohody uzavretej medzi R. M.. a žalobcom vyplýva, že hnutelný majetok uvedený v citovanom zozname prevzal žalobca. Z tohto možno vyvodiť, že došlo k odovzdaniu veci záložnému veriteľovi v zmysle § 151b ods. 3 Občianskeho zákonníka. Tento spôsob odovzdania je v súlade s citovaným zákonným ustanovením a treba súhlasiť s právnym názorom žalobcu, že takýto spôsob odovzdania predmetov záložného práva zákon nevylučuje. (...) [B]olo by nesprávne neumožniť užívanie veci záložcovi, najmä, keď ich potrebuje na plnenie svojho výrobného programu, čo môže napomôcť pri splácaní dlhu.”

security and that traditional “possessory” approach cannot meet the needs of the modern business environment.

These dilemmas were left behind after the reformed secured transactions law entered into force. Under the new regime, debtors may retain the possession of the collateralized assets and continue to use them. The significant feature of the reformed regime is the idea that any asset capable of being transferred is available for security purposes. The law provides for simple and quick creation of charges, the requirements are written security agreement and registration in Charges Registry operated by the Slovak Chamber of Notaries¹⁹, thus providing for publicity of the created charge. Creditors are entitled to secure any type of claim, including claims arising in the future.

1.2. Self-help enforcement of the secured creditor’s rights

Enforcement is the ultimate stage of the security right. “Creditor protection through a variety of security devices, affords little actual relief if it is not complemented by sound and effective enforcement mechanisms.”²⁰ Therefore, notwithstanding the fact that in most cases the security right will never reach this stage, due regard has to be given to what happens on enforcement, as the entire value of the security right depends upon it. Thus, one of the main issues for those

¹⁹ Exceptions exist to this rule with respect to certain types of assets. Thus, charges over real property are to be registered in Land Cadastre, ships and aircrafts in respective ship and aircraft registers; trademarks, patents, utility designs and semiconductor topography in the Intellectual Property Office, charges over book entry securities in the Central Depository and charges over participation interests in the Commercial Registry.

²⁰ See, *Principles and Guidelines for Effective Insolvency and Creditor Rights Systems*, 23, (The World Bank, 2001)

States with ambition to enact advanced secured transactions regime is to decide the contours of creditor's rights triggered by the debtor's default.

At this point, the US enforcement model may be used as a valuable illustration of workable solution to problems related to enforcement of secured creditor's rights in the collateral. Under the US law, self-help repossession and disposition are not the only weapons the secured creditor can use. He can also elect to ignore his security interest in the collateral and sue for judgment on the underlying debt. Creditor's position is further enhanced by an efficient bailiff system and available preliminary measures, that even though having been subject to constitutional attacks are still very effective. The primary function of all these collection remedies is to "enable the creditor credibly to convince the debtor that initiative of coercive execution will (...) ensue upon lack of voluntary payment, and (...) would probably cause the debtor serious harm."²¹ Simple and prompt accessibility of fast and effective coercive enforcement methods gives creditors greater leverage in post-breach negotiations with debtors, because of which most post-breach disputes are resolved by negotiation rather than coercive enforcement of the security interest. Secured creditors are able to persuade debtors to pay or surrender property voluntarily because coercive execution is expensive. And because such execution imposes both financial and dignitary losses on debtors, they too are more willing to resolve problems voluntarily or to surrender peacefully.²²

As has been shown, the viability of US enforcement system is based not only on self-help mechanisms regulated by Article 9, but because "it provides the secured creditor with an option entitling him to choose the best way of enforcing his security

²¹ See, Whitford, William C., *A Critique of the Consumer Credit Collection System*, Wis. L. Rev., 1047, 1048 (1979)

²² See, Schwartz & Scott, *supra* note 9, at 814

rights depending on the circumstances of each individual case.”²³ Unfortunately this is not the case of Slovakia. Enforcement through courts is time consuming and costly²⁴, preliminary measures do not function as a quick avenue for the secured creditor seeking to protect his *in rem* rights over movables, and bailiff system, though reformed, lacks flexibility and efficiency. Since judicial enforcement remedies do not reflect the needs of security based financing, in particular the use of movables to secure the debt, the introduction of self-help remedies into the Slovak law offers itself to be the solution. The drafters of the reformed law refused to implement all the elements of self-help enforcement that are present in Article 9 based models. Nevertheless, the introduction of self-help disposition is a giant step forward to achieving the goal of building prompt and efficient enforcement system of security rights.

The reason why self-help plays a central role with respect to effectiveness and promptness of the enforcement system is obvious. Additional costs and delays inherent in any judicial control lead to deterioration of the debtor’s equity in the collateral and to larger deficiency judgments against him, with no corresponding benefit to the secured creditor or to the public as a whole.²⁵

Since self-help is a method of private realization on the security interests of secured creditors, the system has to provide for a fair allocation of rights and duties of the parties to the secured transaction, thus preventing parties from abusing their positions. Here again, Article 9 may serve as a guideline. It provides defaulting debtor with extensive protection. The secured party must exercise reasonable care in the

²³ See, Tajti, *supra* note 1, at 182

²⁴ In the year 2006, the average length of court proceedings in civil law matters was 14,6 months. See, Report of the Ministry of Justice of the Slovak Republic from 11.7.2007, available at <http://www.justice.sk/wfn.aspx?pg=r3&htm=r3/statr.htm>

²⁵ See, Mentschikoff, Soia, *Peaceful Repossession Under the Uniform Commercial Code: A Constitutional and Economic Analysis*, 14 Wm. & Mary L. Rev. 772 (1973)

preservation of the collateral, once it has “peacefully” taken possession of it, and must dispose of it in a “commercially reasonable manner” after the debtor has been notified of the method, time and place of the disposition. Unless waived after the default, the debtor has the right to redeem the collateral at any time prior to foreclosure. The strict foreclosure is available to the secured creditor only if the debtor consents, and in case of consumer transactions, “60 % rule” bans strict foreclosures at all. In all cases of disposition, the debtor is entitled to any surplus as well as being held liable for any deficiency. Debtor is equipped with wide range of remedies in case the secured creditor fails to comply with the standards and rules, including injunctive relief, recovery of the loss suffered and punitive damages. On the other hand secured creditor’s main weapon is the right to privately repossess the collateral if he proceeds “without the breach of peace”. He is also given a wide discretion in disposing of collateral in order to choose the way of realizing on collateral that best suits to the circumstances of the individual case.

Chapter 2 – Default

2.1. Default under American law

The event that triggers a secured creditor's rights to enforce his security interest under Article 9 is the debtor's default. "Default is the event that transforms the secured party from passive observer to the one having the initiative of action."²⁶ In other words, the secured party cannot take action on the debt or move against the security until an event of default has occurred.²⁷ Consequently, it is fundamental for both the secured creditor and the debtor to be able to unequivocally state when and under which conditions the event of default occurs.

Although Part 6 of the 1999 Revised Version of Article 9 (hereinafter referred to as RV) is designated as Default, it is important to note that it does not provide the definition thereof.²⁸ RV Section 9-601, like former Section 9-501, leaves for the parties to define the elements of default.²⁹ On one hand parties are free to omit the definition of default in the security agreement and rely instead on the implicit understanding that nonpayment constitutes a breach of the contract.³⁰ But more often the lack of statutory definition of events of default leads to inclusion of the detailed and sometimes excessive default clauses in security agreements tailored to the circumstances of the commercial transaction. "Security agreements often include default clauses as long as the creditor's arm and as broad as the counsel's

²⁶ See, Tajti, *supra* note 1, at 185

²⁷ See, Gilmore, *supra* note 8, at 1191.

²⁸ Former Article 9 version captured the issue in Part 5 without providing the definition of the default

²⁹ "[T]his Article leaves to the agreement of the parties the circumstances giving rise to a default." See, RV OC point (3) to s. 9-601.

³⁰ This is the case when the creditor's only concern is the failure to pay by the debtor. See, Schwartz & Scott, *supra* note 9, at 815

imagination.”³¹ Debtor’s failure to make payments when due is an obvious, classical event of default. The typical default contractual clause will consist of several other events of default in addition to non-payment of the due debt.³² Therefore, apart from certain limitations³³, it can be said that “default is whatever the security agreement says it is.”³⁴

One of the consequences of the abovementioned freedom of contract approach is the widespread use of the so called “acceleration” clauses in agreements securing monetary claims. Acceleration clause is “a provision or clause in (...) credit agreement, that requires the (...) obligor to pay part or all of the balance sooner than the date or dates specified for payment upon the occurrence of some event or circumstance described in the contract”.³⁵ Usually the acceleration clause gives the secured party the right to demand payment of the total outstanding balance of the debt upon the occurrence of any default on the part of the debtor. The debtor’s primary obligation in an installment contract is to make payments when due. If the installment is due and unpaid the debtor is liable only for that payment and not for the others. Secured creditors insert the acceleration clauses into the security agreements to avoid the expensive procedure of filing a separate lawsuit for each installment payment as it becomes due. The acceleration clause obviates that expensive procedure by making the entire unpaid indebtedness immediately due and payable when the debtor defaults.³⁶ Hence, failure to include an acceleration clause may be very costly to a secured creditor. Further argument in favor of using the acceleration clauses is that they give the creditor the leverage vis-à-vis the debtor, thus

³¹ See, White, James J. & Summers, Robert S., *Uniform Commercial Code* 902 (West Publishing, 4th ed., 1995)

³² “In commercial transactions the debtor will typically covenant (breach of covenant being a default) to pay taxes, to pay property insured, to prevent other liens from attaching to it, to maintain a specified ration of collateral to debt, to furnish additional collateral on request and so on.” See Gilmore, supra note 8, at 1193

³³ E.g., limitations imposed by the unconscionability doctrine, requirement of the good faith, or by UCC s. 1-208

³⁴ See, Gilmore, supra note 8, at 1193

³⁵ Black’s law dictionary (West Publishing, 6th ed., 1990)

³⁶ See, Schwartz & Scott, supra note 9, at 816

substantially enhancing creditor's position. American courts routinely uphold and enforce acceleration clauses. However, the insecurity clause³⁷ as the most advanced form of the default clause used in combination with the acceleration clause raises a lot of concern as it can be potentially abused by trigger-happy creditors. Moreover the need for insecurity clause is much less clear than the need for a general acceleration clause. Therefore the UCC s. 1-208 sets forth the limits of using the insecurity clauses to situations where the creditor "in good faith believes that the prospect of payment or performance is impaired". Given the potentially disastrous consequences to the debtor of having his debt accelerated and his collateral seized, the need for preventing the creditor from arbitrarily accelerating the debt is great. Therefore much turns on the meaning of the good faith. Former Article 9 Section 1-201 defined good faith merely as "honesty in fact in the conduct or transaction concerned." The ensuing question that leads itself to be formulated at this point is whether the "good faith" of the creditor invoking insecurity is to be measured subjectively or objectively. The drafters of the Article 9 apparently intended to enact the objective test for the creditor's good faith. Gilmore explicitly rejects the subjective standard and says that the "creditor has the right to accelerate if, under all the circumstances, a reasonable man, motivated by good faith, would have done so. (...) The Code adopts such a rule in § 1-208."³⁸ The pre-revision case law divided on this issue. In *McKay v. Farmers & Stockmens Bank of Clayton*³⁹, New Mexico Court of Appeals reversed the summary judgment granted by the trial court, because good faith of the accelerating creditor was deemed to be a question of the fact. On the contrary, in *Van Horn v. Van de Wol*,

³⁷ An insecurity clause provides that the creditor may accelerate the maturity of the entire debt whenever he deems himself insecure.

³⁸ See, Gilmore, supra note 8, at 1197

³⁹ *McKay v. Farmers & Stockmens Bank of Clayton*, 92 N.M. 181, 585 P 2d 325 (1978)

Inc.,⁴⁰ court held that “honesty in fact” means what the creditor actually knew or believed he knew, not what he should have known. Therefore, the redefinition of “good faith” in RV s. 1-201 (b) (20) as meaning not only “honesty in fact” but also “the observance of reasonable commercial standards of fair dealing” should solve the dilemma and preclude creditors from “whimsical or capricious use of insecurity clauses”⁴¹

2.2. Default under Slovak law

Unlike Article 9, Civil Code defines the event of default as the moment when “the claim secured by the charge is not duly and timely paid.”⁴² The definition stems from the major feature of the Slovak charge, its accessory. In other words, charge functions as an accessory right to the basic right – the claim. This means that with respect to the creation, existence and cessation, charge follows the faith of the creditor’s claim. The independent existence of the charge, i.e. the existence without the corresponding claim is therefore excluded.⁴³ Consequently, default occurs only when the claim exists, and has not been paid in accordance with respective provisions of Civil Code regulating the issues of duly and timely payments. With respect to installment contracts, Civil Code explicitly states that secured creditor cannot accelerate the debt due to the delinquent installment unless parties stipulated therefor in the agreement. Secured creditor can exercise the right to accelerate the

⁴⁰ *Van Horn v. Van de Wol, Inc.*, 497 P2d 252 (Wash. App. 1972)

⁴¹ *See*, Warren & Walt, *supra* note 10, at 251

⁴² *See*, § 151j (1) of the Civil Code

⁴³ *See*, Lazar, *supra* note 11, at 302

debt only until the next installment becomes due.⁴⁴ Apart from this limitation, Civil Code provides contractual parties with a wide contractual flexibility, allowing them to tailor the requirements of duly and timely payment to the conditions of their individual case.⁴⁵ This ensues in common use of Slovak variant of acceleration clauses that equip secured creditor with the entitlement to claim the immediate payment of the debt upon the occurrence of contractually defined events of default. Not surprisingly, taking into account stronger bargaining position of creditors, the wide range of contractual freedom may be potentially abused by creditors tempted to push the debtor into the default. Slovak law deals with the problem by imposing the compliance of the security agreement with general principle of “good morals”. Under § 39 of the Civil Code every legal act which by virtue of its content or purpose is not in accordance with good morals, is declared null and void. Civil Code left the term good morals undefined, and in addition, the legal theory and case law could not agree on its unequivocal definition. In the case No. 5 Cdo 103/2002⁴⁶ SC delivered its opinion on the issue:

*“Good morals is the term not defined by law. The content thereof is based in generally valid and therefore respected norms of morality. It is upon court to determine the content of the term good morals according to the circumstances of each particular case.”*⁴⁷

It follows from the case that SC refused to specify the content of term and gave Slovak courts wide discretion in deciding on compatibility of the legal acts with standards of good morals.

⁴⁴ See, § 565 of the Civil Code

⁴⁵ See, § 559 to § 567 of the Civil Code

⁴⁶ Rozsudok Najvyššieho súdu Slovenskej republiky, sp. zn. 5 Cdo 103/2002 [The Supreme Court of the Slovak Republic decision No. 5 Cdo 103/2002]

⁴⁷ The original text of the decision reads: “Dobré mravy nie sú zákonom definované. Ich obsah spočíva vo všeobecne platných normách morálky, pri ktorých je daný všeobecný záujem ich rešpektovania. Posúdenie konkrétneho obsahu pojmu dobré mravy závisí od konkrétnych okolností každého jednotlivého prípadu a patrí sudcovi.

Therefore due to the lack of legal certainty and predictability, Civil Code's good morals standard does not provide debtors with the same degree of protection against the eventual misuse of acceleration clauses by secured creditors as the standard of good faith redefined in RV s. 1-201 (b) (20) does.

Chapter 3 – Repossession

3.1. Self-help repossession – in general

A view expressed previously in this paper is that the goal of every properly designed, credit facilitating enforcement system of security interests is to provide the secured creditor with prompt and efficient mechanisms of realization on his security interest in collateral after the debtor's default. The physical nature of collateralized movable assets, that play a major role in securing financing for businesses in developed economies, speaks for adopting enforcement measures that would prevent the defaulting debtor from hiding, destroying or disposing of encumbered movables that are in his possession. In other words, the secured creditor has to be granted the right to quickly and inexpensively obtain a control over the collateral at the time when the continued possession of the collateral by the defaulting debtor poses a serious risk for the secured creditor. Therefore self-help repossession, as a quick and inexpensive method of obtaining a possession over the collateral, is undoubtedly the most important element of the concept of self-help enforcement of security interests. By repossessing the collateral the secured creditor protects it from debtor's misuse or concealment and preserves it for the purpose of prospective realization. Furthermore, in significant number of cases the mere threat of repossession alone is sufficient enough to persuade a misguided debtor to mend his ways.⁴⁸ However, it has to be noted, that even though self-help repossession is the most important self-help entitlement of the secured creditor, it is the enforcement device to be least accepted by the civil law systems. Slovakia, not being an exception, did not adopt it when introducing certain other elements of self-help

⁴⁸ See, White & Summers, *supra* note 31, at 911

enforcement concept such as self-help disposition of the collateral by the secured creditor as part of its “advanced” secured transaction law reform. And even in USA itself in some states (e.g. Wisconsin)⁴⁹ the hostility towards self-help repossession led to abolishment thereof, leaving secured creditors the judicial route as the only avenue available for repossessing the collateral.

The grounds for denying self-help repossession may vary. In US the criticism focuses on non-compliance of self-help repossession with the requirements of due process set forth by 14th Amendment of the US Constitution, as it can lead to unfair and mistaken deprivations of property without prior hearing. In Slovakia, like in other civil law countries, the concept of self-help repossession is rejected due to its incompatibility with the state monopoly to provide the legal protection of the subjective rights. Irrespective of reasons for rejecting self-help repossession, the consequences of such an approach speak for adopting it. As the professor Robert Johnson clearly showed in his economic analysis,⁵⁰ abolishing self-help repossession and substituting it with repossession with involvement of courts would lead to substantially increased enforcement costs. As a consequence, creditors will attempt to offset these additional expenses both by raising their incomes, which means most likely to pass some of the costs on to debtors via higher interest rates, and by reducing their expenses through change of contractual terms and denying credit to high risk classes of debtors. Prof. Johnson further argues that for most part, added costs will not be borne by those debtors whose defaults generate the added costs. Instead, the costs will be borne by less wealthy, high risk debtors, either through requiring higher down payments or by denial of credit. Consequently, “from an

⁴⁹ Wisconsin changed the approach towards self-help repossession and introduced self-help repossession of motor vehicle collaterals under 2005 Wisconsin Act 255, which became effective on April 13, 2006

⁵⁰ See, Johnson, Robert W., *Denial of Self-Help Repossession: An Economic Analysis*, 47 S. Cal. L. Rev. 82 (1973) The article measures the incremental costs of denying self-help repossession by using data on motor vehicle financing in California.

economic point of view, denial of self-help repossession (...) imposes a substantial incremental cost on those who can least afford it.” The Wisconsin experience corroborates the results of Prof. Johnson’s analysis. Due to abolished concept of self-help repossession, repossessions became more costly. Creditors refused to lend to less affluent debtors, required higher down payments or shorter payback periods. This resulted in general decline in the amount of credit sold.⁵¹

3.2. Self-help repossession under Article 9

3.2.1. Introduction

According to Gilmore, the normal course for the secured party to follow on default of the debtor is to take the possession of the collateral, unless he already holds it as the possessory pledge. The secured party may also opt for not asserting his security interest immediately and suing the debt for judgment instead.⁵² The latter may seem appealing due to its simplicity and lack of possible legal pitfalls for the secured party. When suing on the debt, secured creditor needs only to prove the existence of the debt, its amount and the fact of the default. The court and its officers take care of the consequent stages of the enforcement procedure.⁵³ “If the debtor appears to be solvent, if other judgment liens have not already attached to his assets, if bankruptcy proceedings do not appear to be imminent, if all these conditions are met, the simple

⁵¹See, Grau, Charles W., & William C. Whitford. *The Impact of Judicializing Repossession: The Wisconsin Consumer Act Revisited*, Wis. L. Rev. 983 (1978)

⁵² See Gilmore, *supra* note 8, at 1211

⁵³ These will include issuing the writ of execution and having a levy made on judgment debtor’s assets, followed by sheriff’s sale thereof.

action on the debt has much to recommend it.”⁵⁴ On the other hand, increased expenses and possible delays that are inherent in judicial system of the United States have to be taken into account. The action on the debt becomes much less attractive for the secured party if the economic situation of the debtor rapidly deteriorates and the need for prompt repayment of the secured debt becomes urgent. Then, the need for prompt protection of secured party’s interests in the collateral outweighs the eventual disadvantages of engaging in self-help repossession by means provided for in respective provisions of Article 9.⁵⁵

The key provision of RV on repossession of personal property is Section 9-609. It authorizes the secured creditor either to take possession of the collateral or without removal, render the equipment unusable and dispose of the collateral on debtor’s premises without judicial process, if he proceeds without the breach of peace. The secured party is not required to give advance notice to the debtor of his intention to repossess the property.

Secured creditor enjoys the right to seize the collateral without the judicial process under Article 9 subject to three limitations. First, a secured party can repossess the collateral only if an event of default exists. If there has been no default because of misunderstanding, modification or waiver, no right to repossess exists and creditor pursuing repossession may be held liable for conversion or wrongful repossession.⁵⁶ Here, regarding the waiver of default, an interesting paradox arises. Because the repossession is considerably risky and complex procedure particularly in the consumer finance, secured creditors often prefer to risk the possible allegations of

⁵⁴ *Id.* at 1202

⁵⁵ See UCC s. 9-503. In the RV s. 9-609 (a) states: “After default, a secured party (1) may take possession of the collateral; and (2) without removal, may render equipment unusable and dispose of collateral on debtor’s premises under section 9-610”. In the RV s. 9-609 (b) states: “secured party may proceed under subsection (a): (1) pursuant to judicial process; or (2) without judicial process, if it proceeds without breach of the peace.

⁵⁶ See, e.g. *Warren v. Ford Motor Credit Co.*, 693 F2d 1373, 1376 (11th Cir. 1982), where secured creditor repossessing debtor’s vehicle was held liable in conversion, because evidence indicated that debtor had not yet been in default at the time the repossession had taken place

waiver of default made by the debtor in order to avoid repossession. Whenever possible, creditors rather negotiate with the debtor in default, often even overlook a delinquent payment, accept partial payments and late payments, thereby facing eventual waiver of default claim from the debtor.⁵⁷

Second, even if default exists, the terms of the agreement may limit the secured creditor's entitlement to take possession of the collateral. The UCC permits the secured party and the debtor to contractually modify their behavior, subject to express prohibitions which are not applicable here.⁵⁸ Therefore prior to repossessing any collateral, the creditor should determine that the loan documents neither prohibit self-help nor require satisfaction of any conditions precedent. Otherwise the creditor may be charged with conversion or wrongful repossession.⁵⁹ For example, in *Klingbiel v. Commercial Credit Corp.*,⁶⁰ a secured creditor was held liable in conversion for repossessing collateral without giving contractually required prior notice to the debtor.

Third limitation on the secured creditor's self-help repossession remedy is the requirement that he proceeds without breach of the peace. It is by far the most heavily litigated issue under Article 9.

⁵⁷ See Gilmore, *supra* note 8, at 1214

⁵⁸ See RV s. 9-602

⁵⁹ See Zinnecker, Timothy R., *The Default Provisions of Revised Article 9 of the Uniform Commercial Code*, 35 (American Bar Association, 1999)

⁶⁰ *Klingbiel v. Commercial Credit Corp.*, 439 F2d 1303, 1307 (10th Cir. 1971)

3.2.2. “Without the breach of peace standard”

Article 9 does not contain a definition of the term “breach of peace”. The drafters have deliberately left the term to be determined by case law.⁶¹ Although facts of the cases differ significantly⁶² and courts are not always clear on which conduct constitutes a breach of the peace, the following guidelines can be inferred from the case law.⁶³

- (1) A creditor will breach the peace if the debtor is present and objects to the repossession. In the case *Morris v. First Nat’l Bank & Trust Co.*,⁶⁴ the court held that creditor cannot enter the dwelling on a debtor’s land to repossess if the debtor objects. But as *Williams v. Ford Motor Credit Co.*,⁶⁵ shows, property can be repossessed if the debtor is present but fails to explicitly object.
- (2) A creditor will not breach the peace by removing collateral from parking lot, public street, driveway or open garage.⁶⁶
- (3) A creditor will breach the peace by repossessing collateral from the area with restricted access. In *Martin v. Dorn Equip. Co.*,⁶⁷ the court found that removing collateral from ranch by using bolt cutters to cut padlock on the chained gate was a breach of the peace. On the

⁶¹ “Like former Section 9-503, [Section 9-609] does not define or explain the conduct that will constitute a breach of the peace, leaving that matter for continuing development by the courts.” See, RV OC point (3) to s. 9-609

⁶² The case law reveals that a breach of the peace arises most often when a motor vehicle is being repossessed. There are an estimated 500,000 motor vehicle repossessions each year in United States. See Harrell, Alvin C., *UCC Article 9 Revisions Confront Issues Affecting Consumer Collateral*, 49 Consumer Fin. L.Q. Rep. 256 (1995)

⁶³ See, Zinnecker, supra note 59, at 36

⁶⁴ *Morris v. First Nat’l Bank & Trust Co.*, 254 N.E.2d 683, 686-87 (Ohio 1970)

⁶⁵ *Williams v. Ford Motor Credit Co.*, 674 F2d 717 (8th Cir. 1982)

⁶⁶ See, e.g. *Radge v. Peoples Bank*, 173, 767 P2d 949 (Wash. App. 1989) - where repossession of car from driveway at 5 AM did not constitute a breach of the peace; In *Reno v. General Motors Acceptance Corp.*, 378 So. 2d 1103, 1105 (Ala. 1979) the court upheld the repossession of car from supermarket parking lot.

⁶⁷ *Martin v. Dorn Equip. Co.*, 821 P2d 1025, 1026 (Mont. 1991)

other hand in *Global Casting Indus., Inc. v. Daley-Hodkin Corp.*,⁶⁸ the court held that creditor's use of locksmith to gain access to collateral located on business premises was not a breach of the peace because the security agreement authorized the creditor to enter upon the premises.

The foregoing cases indicate that the breach of the peace limitation purports to balance the interests of creditors and debtors. Therefore the self-help repossession under Article 9 is "far from being a totally one-sided weapon in the hands of secured parties".⁶⁹ The vagueness of the "breach of peace" standard, coupled with potential for significant liability⁷⁰, has severely limited the use of self-help repossession by secured parties. In the great majority of cases in which the secured party retakes possession, it does with the expressed consent of the debtor, who knows he is in default and wants to avoid the heavy costs of judicial actions for possessions.⁷¹

A creditor that cannot seize the collateral without breaching the peace, or who wishes to avoid the risk of liability for violating that duty, enjoys the right to take possession of the collateral with judicial assistance. The creditor may do so by judicial action under Section 9-609 (b) (1). Depending on the state law outside Article 9, he may bring an action in replevin⁷² and obtain a writ of possession. The levying officer may seize the collateral and deliver it to the secured party. Another cause of action for the secured party is to reduce its claim to judgment, levy on the collateral,

⁶⁸ *Global Casting Indus., Inc. v. Daley-Hodkin Corp.*, 432 N.Y.S.2d 453 (Sup Ct. 1980)

⁶⁹ See, Tajti supra note 1, at 188

⁷⁰ The RV section 9-625 (b) subjects the secured party to liability for damages in the amount of any loss suffered by the debtor. Debtors may also seek recovery outside Article 9, wrongful repossession is the tort of conversion and according to OC point 3 to s. 9-625 "principles of tort law supplement" recovery for breach of the peace under section 9-609. Furthermore the debtors can sue for punitive damages if the repossessing party's conduct falls within whatever the law of the jurisdiction requires.

⁷¹ See, Warren & Walt, supra note 10, at 270

⁷² "Replevin is an action whereby the owner or person entitled to repossession of goods and chattels may recover those goods or chattels from one who has wrongfully distrained or taken or who wrongfully detains such goods or chattels." See Black's law dictionary (West Publishing, 6th ed., 1990)

and execute on its judgment by a judicial sale.⁷³ It is also possible for the secured party to render the equipment unusable, which may be attractive when repossessing and storing equipment is expensive, impractical or both, and the creditor is concerned that the debtor may misuse, conceal or dispose of the equipment. Yet this must be done in accordance with the breach of the peace standard.

3.2.3. Repossession companies – independent contractors

One of the unique features of the American self-help enforcement concept is the significant role played in the field by private contractors, known as repossession (or repo) companies. A repo company is the company hired by a secured creditor or his agent to repossess goods that were bought on credit or were pledged as collateral for a loan, mortgage, lease, etc., from a debtor who has fallen behind on his payments. Organizations that utilize repo companies are primarily lending institutions, including banks, savings institutions, finance companies, rental and leasing companies, and automobile, truck, boat, and equipment dealers. Repo companies' employees are known as repossession agents, or repo men.⁷⁴

In debt collection, US creditors are faced with the dilemma whether to collect the debt by their own or whether to contract it out to the independent contractors. This dilemma is even stronger in collection through repossession. The considerations that affect the creditor's choice include the impact on creditor's reputation and the cost factors. As the result the independent repossession sector has grown. With the growth of national creditors, there has been a growth in large local repossession

⁷³ See, subchapter 3.2.1.

⁷⁴ See, Quickrepo.com website, <http://www.quickrepo.com>

companies that have the capital to meet the standards and pay the dues of a national trade organization – American Recovery Association.⁷⁵

The repossession companies can specialize in relatively cheap expert services. They offer secured creditors complete repossession services which can include skip tracing to locate defaulting debtors whose whereabouts are unknown. After the collateral has been recovered, most repo companies are able to securely store it, as well as provide secured creditors with photographs and condition reports. Some repossession companies place the collateral up for auction, thereby obtaining bids and consummating the sale of the collateral, if the secured creditor so desires.

The growth in secured parties' use of independent contractors to carry out repossessions has been followed by significant development in legal treatment of the issues arising there from. In particular, the problem of liability of the secured party for breach of the peace standard if an independent contractor breaches the peace. The response from courts was ambiguous.⁷⁶ The issue has been finally resolved by adoption of RV. Official comment point 3 to section 9-609 clearly says that „in considering whether a secured party has engaged in a breach of the peace, courts should hold the secured party responsible for the actions of the others taken on the secured party's behalf, including independent contractors engaged by the secured party to take possession of the collateral.“

⁷⁵ See, Braucher, Jean, *The Repo Code: A Study of Adjustment to Uncertainty in Commercial Law*, 75 Wash. U. L.Q. 549 (1997)

⁷⁶ See, e.g. *Dixon v. Ford Motor Credit Co.*, 391 N.E.2d 493 (Ill. App. Ct. 1979) where the court found no breach of the peace, but said in dicta that even if a breach of peace had occurred, the creditor would not be liable because the reposessor was an independent contractor. On the other hand in *Clark v. Associates Commercial Corp.*, 877 F.Supp. 1439 (D. Kan. 1994) the court held that even if secured creditor exercised due care in hiring independent contractor to repossess, if statutory duty under UCC to repossess peaceably was violated by employee of the reposessor, secured creditor would be liable.

3.2.4. The constitutionality of self-help repossession

In the 1970's a series of law suits tested the legality of self-help repossession through raising constitutional question of compatibility of this procedure with the requirement of procedural due process for debtors set forth by 14th Amendment of the US Constitution. The constitutional assault launched against self-help repossession has its roots in group of cases where debtors successfully attacked constitutionality of ex parte summary remedies regulated by state law.

In *Sniadach v. Family Finance Corp.*,⁷⁷ the US Supreme Court held that Wisconsin's prejudgment garnishment of wages procedure, with its obvious taking of property without notice and prior hearing, violates the fundamental principles of procedural due process. As a consequence, state statutes relating to wage garnishment were widely revised. In *Fuentes v. Shevin*,⁷⁸ the US Supreme Court went even further as it overthrew the Florida and Pennsylvania prejudgment replevin statutes that authorized the secured party, through the sheriff, to repossess various consumer goods under installment contract without any prior notice and hearing for the debtor. The Supreme Court held that such a summary proceeding denied the debtor due process by depriving him of substantial property interest without prior notice and hearing. In response to *Fuentes*, many states modified their replevin procedures to require prior notice and an adversary probable cause hearing before a judge, rather than a clerk as before. In the next case of *Mitchell v. W.T. Grant Co.*,⁷⁹ Supreme Court softened its stand somewhat by upholding the Louisiana statute that authorized the secured party to obtain an *ex parte* order of repossession, because the Louisiana summary procedure

⁷⁷ *Sniadach v. Family Finance Corp.*, 395 U.S. 397 (1969)

⁷⁸ *Fuentes v. Shevin*, 407 U.S. 67 reh'g denied, 409 U.S. 902 (1972)

⁷⁹ *Mitchell v. W.T. Grant Co.*, 416 U.S. 600 (1974)

provided for immediate hearing and for the possibility of immediate dissolution of the *ex parte* order.

Since the *ex parte* replevin statutes were declared unconstitutional in the absence of procedural safeguards, it is absolutely logical that self-help repossession under Article 9, which aims at the same results as summary procedures, was being tested as well. Since creditor groups praised the self-help remedy as one of their most important weapons, and debtor groups disliked it as being subject to abuse, both sides threw maximum resources into a series of test cases that followed *Sniadach* case and its progenies. Almost without exception the courts upheld self-help repossession, because the courts could find no state action in self-help repossession.⁸⁰ When the secured party obtains a writ of replevin to seize the collateral, the machinery of the state is clearly set in motion. With self-help, however, the creditor is not invoking the assistance of the state, the action is private. Although the US Supreme Court has not ruled directly on the constitutionality of the self-help repossession, its consistent denial of certiorari from the lower courts is a signal that self-help repossession is safe under the U.S. Constitution.

3.3. Repossession under Slovak law

Although Slovak reformed secured transactions law provides for certain elements of self-help enforcement of charges, the reformers did not accept the proposal from

⁸⁰ See, Warren & Walt, *supra* note 10, at 269

EBRD and did not introduce self-help repossession into the Slovak law. The reluctance to do so stems from a strong civil law tradition, which restricts the use of self-help as a means of interfering in another person's rights to circumstances of bare necessity. The restriction on use of self-help is expressed in § 6 of the Civil Code. The provision reads:

*“If a person is imminently threatened with an unjustifiable interference with his right, the person so threatened may himself avert such violation in an appropriate manner”*⁸¹

This means that only a person whose rights are immediately threatened may obviate the threat in an appropriate manner. In other circumstances such conduct could be considered as an unlawful interference with another person's right. SC rendered the following decision on the issue:⁸²

*“A form of protection of the subjective right alongside the judicial protection thereof may be, in extraordinary circumstances, the self-help, meaning a possibility of the endangered to prevent by own force the immediate unlawful interference of a third person with his right under the conditions set forth by the law. Nevertheless, our law under no circumstances allows the aggressive, so-called possessory self-help which purports to take the right from a third person to whom this right does not belong.”*⁸³

⁸¹ The Slovak text of § 6 of the Civil Code reads: „ Ak hrozí neoprávnený zásah do práva bezprostredne, môže ten, kto je takto ohrozený, primeraným spôsobom zásah sám odvrátiť..”

⁸² Rozsudok Najvyššieho súdu Slovenskej republiky, sp. zn. 2 Obo 33/2000 [The Supreme Court of the Slovak Republic decision No. 2 Obo 33/2000]

⁸³ The original text reads: “Formou ochrany subjektívnych práv popri súdnej ochrane môže byť výnimočne svojpomoc, teda možnosť ohrozeného vlastnými silami bezprostredne hroziaci neoprávnený zásah inej osoby do svojho práva sám odvrátiť, a to za splnenia v zákone uvedených podmienok. Naše právo však v žiadnom prípade nepripúšťa útočnú, tzv. uchopovaciú svojpomoc, za účelom zmocniť sa svojho práva od osoby, ktorej toto právo nepatrí”

According to the court, judicial protection is a dominant form of protection of subjective rights. In the explanatory note⁸⁴ SC further explains that doctrine of rule of law requires state to provide legal protection of rights of individuals. The right for the legal protection is the subjective right of every individual vis – a – vis the state. Consequently, the judicial protection is not only a duty of the state towards individuals, but also the exclusive right of the state. Only state and its authorized bodies are entitled to provide the legal protection of subjective rights. Therefore, one can say that in Slovakia there is a state monopoly to the legal protection. As a corollary, apart from exceptional circumstances set forth in § 6 of the Civil Code, self-help in Slovakia is generally prohibited.

The interesting question that lends itself to be asked at this point is, how then is the collateral, in particular movable collateral, protected during enforcement against destroying, concealing or unauthorized disposing thereof by the debtor? The drafters chose to replace the secured creditor's right to take possession of the collateral by self-help with the debtor's duty to hand it over. Pursuant to § 151m (4) debtor is obliged to hand over to the secured creditor the collateral and all documents necessary for the taking over, transfer and enjoyment of the collateral. Debtor is also obliged to further co-operate with the secured creditor according to the standards of co-operation stipulated for in the security agreement. The same duty is imposed on any third person which is in possession of the collateral or any such documents. The major weakness of this solution is that it doesn't work with dishonest debtors. In case the debtor refuses to hand over the collateral or the related documents, secured creditor needs to go to court and bring a so called revendication action.⁸⁵ The

⁸⁴ It is usual practice of the Supreme Court of the Slovak Republic to attach to certain decisions, which are considered to be of major importance an explanatory note, where the court further elaborates on the issue.

⁸⁵ The purpose of the revendication action is to gain possession of the things that are unlawfully detained or possessed by others. Thus it serves as a Slovak equivalent of action in replevin.

judgment or any other type of the executory title can be then enforced through executors (bailiffs) under the Execution Act.⁸⁶ As the general experience shows, this procedure can take months and in some cases even years and therefore cannot fulfil the needs of modern secured financing based on movable assets.⁸⁷

Slovak law⁸⁸ provides the secured creditor seeking to protect collateralized assets in debtor's possession with another remedy. The secured creditor may apply for the *ex parte* preliminary measure to be issued by the court. Preliminary measure is the temporary pre-judgment remedy, which purports to guarantee that any judgment subsequently issued by the court can be effectively enforced. If the creditor sufficiently demonstrates that it is necessary to temporarily freeze the status quo between the parties or that there are fears that the enforcement of the judgment may be frustrated, the court is obliged to issue the preliminary measure without undue delay, but not later than 30 days from the day the application was filled with court. Prior hearing of the parties is not required.⁸⁹ Slovak courts are given a wide discretion in tailoring the content of the preliminary measure to best suit the conditions of the particular case, in order to achieve the purpose of temporary protection.⁹⁰ Thus, secured creditor may apply for the interim measure preventing the debtor from any disposal of collateralized assets in his possession. Following the issuing of the preliminary measure, creditor's position is significantly enhanced, since any violation of the conditions set forth therein is deemed to be an act of crime. It is therefore difficult to understand strong reluctance of Slovak courts to issue preliminary measure in favor of secured creditors. The decision No. 2 Obo

⁸⁶ Execution Act No. 233/1995 Coll.

⁸⁷ See, supra note 24

⁸⁸ Act No. 99/1963 Coll. (hereinafter referred to as Code of Civil Procedure)

⁸⁹ See, § 74 and § 75 of the Code of Civil Procedure

⁹⁰ § 76 of the Code of Civil Procedure contains open list of types of preliminary measures, thus court may order the defendant for example: to deposit an amount of money or an object in court custody; to pay maintenance of the required amount; to do something, to refrain from doing something or allow something to be done, etc.

312/1994⁹¹ is an example of such an approach. Here, SC refused to grant ex parte preliminary measure to the creditor which has already secured his claim by charge SC based on the following reasoning:

*“In case the claim of the plaintiff is secured by the charge, there is usually no imminent and real danger of the frustration of the judicial decision and therefore normally the conditions of such case do not suffice the issuance of the preliminary measure.”*⁹²

SC did not exclude secured creditors from the possibility of being granted the preliminary measure freezing the assets in the debtor’s possession. What follows from the case is that the mere existence of the charge is considered to be sufficient means of securing the claim; therefore the issuance of the preliminary measure in such case has to be justified by demonstration of “not ordinary” conditions of the case. The corollary to such an approach of Slovak courts is the significant reduction of the availability of ex parte preliminary measures for secured creditors.

As has been shown, Slovak law does not provide for prompt and efficient protection of the secured creditors’ rights in collateral - the *sine qua non* of every viable enforcement system. As Professor Lazar pointed out, insufficient protection of the secured creditor’s rights in the collateral which is in possession of the debtor, is the major flaw of the reformed secured transactions regime and can considerably undermine the achievement of the goal of the reform – building the effective system of granting secured credit, thus further fostering the growth of economy.⁹³ The solution he proposed is stricter and more detailed regulation of the debtor’s duties

⁹¹ Uznesenie Najvyššieho súdu Slovenskej republiky, sp. zn. 2 Obo 312/1994 [The Supreme Court of the Slovak Republic decision No. 2 Obo 312/1994]

⁹² The original text of the decision reads as follows: “Ak je nárok žalobcu zabezpečený záložným právom, obvykle nebezpečie zmarenia výkonu rozhodnutia bezprostredne a reálne nehrozí, a preto spravidla nie je daný dôvod na nariadenie predbežného opatrenia.”

⁹³ See, Lazar, supra note 11, at 322

with respect to disposition of the collateral. It is questionable whether this typical “civil law” approach would yield in desirable results. The thesis of this work is that, following the example of the Article 9 based self-help repossession concept would be a panacea to the problem. American concept offers well-functioning, properly regulated system, which fairly balances interests of creditors and debtors involved in the transaction. Creditors are equipped with strong entitlement to repossess the collateral. They are offered professional repossession services of repossession companies, an independent industry that through self-regulation ensures that the possibility of unlawful repossession is minimized. On the other hand, debtors may recover any loss caused by wrongful repossession, especially when creditor repossesses in breach of peace. The possibility of imposing punitive damages functions as an additional balance preventing creditors from abusing self-help. Even though drafters of the reformed law were offered the option to implement at least certain American solutions via adopting EBRD’s Model Law provisions on self-help repossession, strong civil law tradition prevailed and the idea was turned down. The consequence is considerably impaired position of secured creditors, who are thus much less attracted to the idea of securing their loans through taking movable property as a security for their loans. This debtor protective feature of Slovak enforcement laws also leads to expansion of activities of “illegal” nature. It’s a fact that some creditors in desperate effort to prevent defaulting debtors from hiding or disposing of collateral use services of organized crime. Therefore at the end of the day, the system does not guarantee the protection of debtors, nor does it provide the comfort for secured creditors seeking for prompt realisation on the collateral.

Chapter 4 – Post repossession avenues for the secured creditor

4.1. In general

Upon debtor's default and repossession of the collateral (or as is the case of Slovakia, after debtor has handed over the collateral) the secured creditor's main objective is to promptly realize on collateral and gain maximum satisfaction of the outstanding debt. On the other hand debtor's interest is to have the real value of the collateral credited against the outstanding debt. Therefore, the secured creditor realizing on collateral must take into consideration the debtor's equity therein.⁹⁴ Thus, the role of the legislature should be to provide for the fair resolution of debtor-creditor relationship and to achieve the dual goal of assuring to the largest degree possible that the secured creditor will be paid the money owed him and that the debtor will suffer the least possible loss of the property in the process.⁹⁵

As it will be described in following subchapters, drafters of Article 9 more or less successfully dealt with the problem how to strike this balance. Slovak reformed secured transactions law at least in this part reached similar results. Nevertheless, Article 9 could still serve as a valuable guidance for future advances of Slovak law in this field. Article 9 offers secured creditors following default and repossession several avenues in order to realize on the collateral. Creditor can either take the collateral in full satisfaction of the debt (strict foreclosure) or he can satisfy the indebtedness out

⁹⁴ See, Gilmore, *supra* note 8, at 1216

⁹⁵ See, Yearbook of the United Nations Commission on International Trade Law, 229, Volume VIII, 1977, available at http://www.uncitral.org/pdf/english/yearbooks/yb-1977-e/yb_1977_e.pdf

of the proceeds of sale of the collateral (foreclosure by sale)⁹⁶. The alternative the creditor selects is subject to “commercial reasonableness” test. The strategy drafters chose was designed to result in higher realization on collateral for the benefit of all parties.⁹⁷ If the commercially reasonable disposition leads to the deficiency, the creditor is entitled to recover it. On the other hand, debtor holds the right for any surplus resulting from disposition. In case the strict foreclosure is the chosen option, debtor’s equity in collateral is protected by statutory requirement of debtor’s consent to strict foreclosure or by compulsory disposition under 60% rule applicable to consumer financing.

The debtor’s right of redemption, originally the product of mortgage law,⁹⁸ purported to be one of the major debtor-protective devices in the process of realization on collateral, needs to be mentioned here as well. The purpose of redemption is to give the debtor one last opportunity to recover the collateral. The debtor may have strong incentive to acquire enough money to redeem the collateral, either because he fears that the collateral will not be sold for a good price, or because there is sentimental attachment irrespective of price. On the other hand, the existence of the debtor’s right to redeem causes controversy, and some scholars contest the justification therefor. Gilmore says that “debtor [almost] never does in fact cure the default and redeem his property, so that the preservation of his right to do so merely adds complication and expense to the secured party’s attempt to devote the collateral to payment of the debt.”⁹⁹ In fact, the debtor probably doesn’t need the statute to force the secured creditor to take payment of the debt. Creditors will always

⁹⁶ RV section 9-610 (a) allows the foreclosing creditor to “sell, lease, license or otherwise dispose” of the collateral, yet the sale of the collateral is the most common form of disposition

⁹⁷ See, Schwartz & Scott, *supra* note 9, at 847

⁹⁸ Redemption is “the right to have the title of property restored free and clear of the mortgage.” See, Black’s law dictionary (West Publishing, 6th ed., 1990)

⁹⁹ See, Gilmore, *supra* note 8, at 1216

make this deal. But if the debtor can afford to pay the debt owed, he probably wouldn't have defaulted at all.¹⁰⁰

This ancient common law right is recognized by RV section 9-623, whereby the debtor can redeem the collateral by paying the secured party before foreclosure the full amount owing on the debt plus reasonable expenses incurred by secured party. Redemption may occur at any time before the secured creditor has collected receivables, disposed of collateral in foreclosure or accepted collateral in a strict foreclosure.

Although not expressly stated, Slovak law recognizes the idea of redemption. It is corollary to the accessory nature of the charge. The charge ceases to exist if the secured claim does so. Thus, the debtor may exercise the right of redemption by paying the amount of outstanding debt before secured creditor sold the collateral or accepted collateral in satisfaction of the debt by acquiring of ownership thereto. This right is protected by ban on predefault strict foreclosure agreements and by mandatory 30 days period preceding the self-help disposition of the collateral by the secured creditor.

4.2. Strict foreclosure

4.2.1. Strict foreclosure: US approach

A handy option for the secured creditor to holding a foreclosure sale is “to keep the collateral as his own free of the debtor's equity, waiving any claim to a

¹⁰⁰ See, Warren & Walt, *supra* note 10, at 321

deficiency judgment.”¹⁰¹ This procedure is known as strict foreclosure and is authorized by RV sections 9-620 – 9-622. This strict foreclosure approach has historical roots in the law of real property, particularly the mortgage law.¹⁰² Strict foreclosure may be mutually advantageous to both secured creditor and debtor. Under this procedure, the secured party receives the collateral without the delay and expense, shortcomings inherent in foreclosure sale. In addition, secured party can forestall the risk of non-complying with the commercially reasonable standard when disposing of the collateral.¹⁰³ The secured creditor can then dispose of the collateral in any manner he wishes. The defaulting debtor, who acknowledges that he cannot pay the secured debt, escapes any further liability for a deficiency, which might be even greater with additional expenses of disposition.¹⁰⁴ Thus, strict foreclosure is promoted by drafters of Article 9 as a cheaper and quicker way of realizing on the collateral.¹⁰⁵

Presumably, the strict foreclosure is especially attractive measure for both creditor and debtor, when the value of the collateral is roughly equivalent to the amount of the outstanding debt. If the value of the collateral is less than the amount of the secured obligation plus the predictable expenses of foreclosure, the secured creditor holds the right to a deficiency judgment in addition to his security rights. When the situation is reversed and the amount of secured obligation is lower than the value of the collateral, “the debtor has an equity which should be preserved, either for

¹⁰¹ See, Gilmore, *supra* note 8, at 1220

¹⁰² Under the mortgage law, after the mortgagor’s default the mortgagee could bring the action for foreclosure, obtain a decree of strict foreclosure, which finds the amount due under the mortgage, orders its payment within specified time, and provides that, in default of such payment the mortgagor’s right and equity of redemption shall be forever barred and foreclosed.

¹⁰³ See, subchapters 4.3.1 and 4.3.2.

¹⁰⁴ See, Warren & Walt, *supra* note 10, at 305

¹⁰⁵ “(Section 9-620) reflects the belief that strict foreclosures should be encouraged and often will produce better results than a disposition for all concerned.” See RV OC point (2) to s. 9-620

the debtor himself or, if he is insolvent, for his other creditors.”¹⁰⁶ Since all lenders have obviously stronger bargaining position and can dictate the terms of the security agreement to borrowers, the objective of the legislature should be to “preserve (this) useful technique of letting parties liquidate the (secured) transaction by agreement but to preserve it without opening the freedom of contract door so wide that oppressive forfeiture agreements (under which the debtor’s equity could be sacrificed) can slip through”¹⁰⁷ Drafters of the Article 9 effectuated this aim by imposing two limitations on the use of the strict foreclosure.

First, secured party can enjoy the benefits of strict foreclosure only if the debtor after default consents to the acceptance of collateral in satisfaction of the debt. The debtor may consent either by expressly agreeing to the terms of the acceptance in a record authenticated after default. Alternatively the debtor may consent by mere silence. It means that if the secured creditor sent the debtor a proposal¹⁰⁸ to accept the collateral in full satisfaction of the secured obligation and has not received authenticated notification of the debtor’s objection within 20 days after the proposal had been sent, the debtor is deemed to have accepted the secured creditor’s proposal. Acceptance by silence is not allowed if the debtor purports to accept the collateral in partial satisfaction. The protection of other secured creditors holding security interest in the same collateral is provided by mandatory notification requirement set forth in section 9-621. If the foreclosing creditor fails to notify them, he is held liable for any loss resulting from noncompliance with this section.¹⁰⁹ The

¹⁰⁶ See, Gilmore, *supra* note 8, at 1221

¹⁰⁷ See *id.*

¹⁰⁸ RV section 9-620 eliminates the “proposal-and-objection” rule of the former section 9-505. Under former section 9-505, the secured party must always make a proposal to retain and the debtor has a fixed period to respond. Allowing the simple acceptance option without a formal proposal eliminates an element of awkwardness under the old law. It is necessary to send a proposal to the debtor only if the debtor does not agree to an acceptance in an authenticated record. It is also necessary to send the proposal to every secured creditor with security interest over the same collateral. See RV OC point (2), point (4) to s. 9-620.

¹⁰⁹ See, RV OC point (2) to s.9-621

proposed strict foreclosure can be effectuated only if the notified creditors do not object within 20 days after the notification has been sent.

Second, Article 9 imposes compulsory disposition of the collateral by the secured party under the “60% rule”, which is applicable only in consumer finance. The belief is that if the debtor has paid this much, there is a chance that he has built up equity, and he should be entitled to have the possibility of a surplus tested by the disposition.¹¹⁰

On the other hand, secured creditors’ interests are protected by non recognition of “constructive” strict foreclosure in the RV section 9-620. The policy behind is to protect secured creditors against involuntary strict foreclosures depriving them of any right to a deficiency. In pre-RV case law in the area of strict foreclosure, the most litigated issue was whether secured party’s retention of possession of repossessed collateral for a commercially unreasonable period of time without either disposing of the collateral or proposing the acceptance in satisfaction amounted to constructive acceptance in satisfaction.¹¹¹ The RV clearly does away with constructive strict foreclosure as a theory by which deficiencies may be eliminated.¹¹² On a related point, the debtor’s voluntary surrender of the collateral to the secured party and the secured party’s acceptance of the possession of the collateral do not imply that the secured party intends or is proposing strict foreclosure.¹¹³

¹¹⁰ See, Gilmore, *supra* note 8, at 1222

¹¹¹ See, Warren & Walt, *supra* note 10, at 308

¹¹² “To ensure that the debtor cannot unilaterally cause an acceptance of collateral (by secured party), (...) under subsection (b), acceptance does not occur unless, in addition, the secured party consents to the acceptance in an authenticated record or sends to the debtor a proposal.” See, RV OC point (5) to s.9-620

¹¹³ See *id.*

4.2.2. Strict foreclosure: Slovak approach

The traditional approach of the Slovak jurisprudence to the strict foreclosure idea was hostile. It was emphasized that the main function of the charge is to secure the creditor's claim and only after the claim was not duly and timely paid, the charge may be realized by means provided for in Code of Civil Procedure, which did not allow secured creditor to satisfy himself by acquiring the ownership of the collateral. The decision of SC in the case No. 2 MCdo 2/2006¹¹⁴ illustrates this approach. The case involved credit transaction secured by charge disguised in the form of sales agreement. SC held that:

“The sales agreement is invalid and void, because the parties entered into the agreement with intention to secure the obligation arising from the credit agreement, and because realization of the security would have caused conveyance of the ownership right to the collateral from debtor to creditor, i.e. the forfeiture of the ownership right to the collateral. Taking into account the security function of the charge, the forfeiture effect thereof is not allowed. (...) The agreement which purports to satisfy the secured claim of the creditor through conveyance of the ownership right to the collateral from debtor to creditor is inconsistent with the purpose of the charge, thus the agreement is declared invalid and null because it circumvents the law.”¹¹⁵

This changed after the adoption of the reformed secured transactions law. The relevant provision of the Civil Code states:

¹¹⁴ Rozsudok Najvyššieho súdu Slovenskej republiky, sp. zn. 2 MCdo 2/2006 [The Supreme Court of the Slovak Republic decision No. 2 MCdo 2/2006]

¹¹⁵ The original text reads: “[K]úpna zmluva je neplatná, pretože túto jej účastníci uzatvorili za účelom zabezpečenia zmluvy o pôžičke, a že realizáciou dohodnutého zabezpečenia malo dôjsť k prevodu vlastníckeho práva k zálohu na zástavného veriteľa, teda k prepadnutiu zálohu. So zreteľom na zabezpečovaciu funkciu záložného práva sa nepripúšťa prepadný účinok záložného práva. (...) Zmluva, ktorej skutočným zmyslom je uspokojenie pohľadávky záložného veriteľa tým, že založená vec prechádza do jeho vlastníctva, je v rozpore s účelom záložného práva a je neplatná, pretože obchádza zákon.”

“Any agreement that is made before the claim secured by charge becomes due and that provides for the satisfaction of the [secured creditor] by acquiring of ownership to a [collateral] shall be void, unless otherwise provided for by the law.”¹¹⁶

On one hand the law strictly invalidates any agreement, made before the secured claim becomes due, that automatically upon default forecloses debtor’s ownership rights in collateral. Obviously, the underlying idea is the protection of the debtor’s right to redeem the collateral. On the other hand after the claim becomes due, parties are left to agree on satisfying the creditor’s claim by means of strict foreclosure. This resembles American model, whereby secured creditor may accept collateral in satisfaction of the debt after the debtor’s consent. Slovak drafters didn’t go further and did not provide for special protection of consumer debtors by means of mandatory disposition. However, it is questionable whether American more paternalistic approach leads to better protection of consumer groups.

At this point, one specific feature of Slovak civil law has to be stressed - the widespread use and often even abuse of the security transfers by creditors. This legal device has been adopted into the Czechoslovak civil law regime as a part of Austro – German heritage. In Germany security transfer evolved into a unique security device. German security transfer is based on the transfer of the ownership on the collateral onto the transferee in trust, but only for a limited period of time and for the very purpose of the security. The common feature of German security transfers “is that they always involve fiduciary ownership. The transferee is not to be absolutely entitled to the right transferred to him. He may in law be the “full owner of the right” but this is only temporary and in trust, for the purposes of security.”¹¹⁷ It is a product of customary law, though based on statutory principles of *constitutum*

¹¹⁶ See, § 151j (3) of the Civil Code

¹¹⁷ See, Serick, Rolf, *Securities in Movables in German Law, an outline*, 23, (Kluwer Law and Taxation Publishers, 1990)

possessorum and the rules of trust law. Nevertheless, it has been recognized by German courts as a security device, which led to its extensive utilization mainly by banks to secure their loans.¹¹⁸

In Slovakia, due to deficiencies in former secured transactions law regime, mainly the non-recognition of non-possessory securities, and due to very brief statutory regulation of this device¹¹⁹ providing parties with wide contractual flexibility, security transfers gained popularity among creditors seeking to secure their claims. Security transfers entitled debtors to retain the possession of the encumbered assets while providing creditors with sufficient security through transfer of the ownership rights. However, in practice creditors frequently misused this device to circumvent the restrictions that law imposed on automatic strict foreclosure effect of the charge. In other words, the agreement on security transfer of ownership enabled the creditor to gain unrestricted ownership to the encumbered assets automatically upon the debtor's default, thus depriving the debtor of any protection of his equity in collateral. This feature of the security transfer caused many debtors to lose ownership rights to property of much greater value than the secured claim. The abovementioned undesired effects led to the amendment of the respective provisions of Civil Code on security transfers.¹²⁰ The new law copies the concept adopted with respect to charges. Thus, any agreement on security transfer, made before the secured claim becomes due, that leads to automatic foreclosing of the debtor's ownership rights in collateral is declared void and null. Moreover, the law requires creditor to notify the debtor of his intention to execute the security transfer at least 30 days in advance, thereby giving debtor enough time to pay back the secured claim.

¹¹⁸ See, Tajti, *supra* note 1, at 277, 278, 279

¹¹⁹ Civil Code devoted to security transfer only one paragraph 553. "(1) The performance of the obligation may be secured by transfer of a debtor's right in favor of the creditor. (2) A contract on transfer of a right securing an obligation must be in writing."

¹²⁰ § 153 to § 153e as amended by Act No. 568/2007 Coll.

4.3. Disposition of the collateral

4.3.1. US law on self-help disposition of the collateral – introduction

In case strict foreclosure, suing on debt or foreclosing secured creditor's security interest under respective judicial procedure provided by state law is not possible or convenient for any reason, the Article 9 secured creditor's only option of satisfying his debt is disposition of the collateral.¹²¹ Repossession and subsequent disposition of the collateral is the usual method to satisfy debtor's obligation upon default. The striking feature of the resale provisions of the Part 6 of Article 9 "is the great latitude they grant to the secured party."¹²² The secured creditor may "sell, lease, license, or otherwise dispose of any or all of the collateral in its present condition or following any commercially reasonable preparation or processing."¹²³ The drafters of the Article 9 purported to loosen up the disposition process and make it more businesslike in order to get better return. They encourage the secured creditor to resell in private sales at market prices, thus bringing profit for both the creditor and the debtor.¹²⁴

But as a balance to the abovementioned freedom of action, the secured creditor is required to send a reasonable notice stating the method, time and place of disposition to specified interested persons, and to adhere to the standard of "commercial reasonableness" in all aspects of the realization process with strict accountability for failure to comply with the standard.

¹²¹ "In case the security agreement covers both real and personal property, the secured party may foreclose or realize on his collateral, both real and personal, in a single proceeding under the law applicable to real estate." *See*, Tajti, *supra* note 1, at 191

¹²² *See*, White & Summers, *supra* note 31, at 918

¹²³ *See*, RV s. 9-610 (a)

¹²⁴ "This section encourages private dispositions on the assumption that they frequently will result in higher realization on collateral for the benefit of all concerned."

The notification requirement is easy to understand and to apply. It has to be sent in the form of authenticated document at a reasonable time before the date of the disposition. There are several reasons that justify this requirement. The primary one is to inform the debtor how long he has to redeem the collateral. It also permits the debtor to actively participate in prospective public sale of the collateral and allows him to contact other potential buyers. Furthermore, it gives the debtor an opportunity to monitor the compliance of the disposition with commercial reasonableness standard.¹²⁵ The notice is excused if the collateral “is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market.”¹²⁶ The justification for the two first exceptions is to avoid the harm resulting from a decrease in potential proceeds, and a corresponding increase in the size of the deficiency, that would follow after postponement of the disposition until after the notice is given. If the collateral is sold in a recognized market, independent market forces specify the market price of the collateral against which the commercial reasonableness of the price received by the creditor is easily measured¹²⁷, thus the debtor’s interests are sufficiently protected. Apart from the debtor, secured creditor is required to notify of the disposition any secondary obligors and other secured parties. Apparently, the reason for this requirement is the same as with respect to the debtor, to protect their interests in the collateral.

4.3.2. “Commercial reasonableness” standard

The price that the secured creditor receives from sale of the collateral is of crucial importance to the debtor, because any claim for deficiency is determined by

¹²⁵ See, Zinnecker, *supra* note 59, at 59

¹²⁶ RV s. 9-611 (d)

¹²⁷ See, Zinnecker, *supra* note 59, at 60

deducting the proceeds of sale from the outstanding debt.¹²⁸ Therefore, not surprisingly, one of the principal goals of the drafters of the Article 9 was to maximize the return on dispositions of collateral. Their intention was to make the disposition process more “business-like” and to get away from rigidities and inflexibilities of the old “sale on the courthouse steps” methods of foreclosing on collateral. The thrust was to have the collateral disposed of in the same manner as other property of the same kind so that something approaching market value could be obtained.¹²⁹ The problem drafters faced was how to achieve the flexibility needed to sell the collateral in a business-like manner at near market prices without giving up the protection of the debtor’s equity in the collateral. Solution chosen by drafters was the introduction of the concept of “commercial reasonableness”. Instead of providing for the detailed procedural requirements for the foreclosure sale, Article 9 equipped the secured party with a great amount of discretion and relied upon her to select the appropriate means of sale¹³⁰, which would be most suited to maximize the resale price of the collateral. To counterbalance the secured party’s somewhat extraordinary freedom in disposing of the collateral, Article 9 relies on the courts’ ex post review of the sale’s commercial reasonableness.¹³¹

Since the term commercial reasonableness was intentionally left undefined, it has been the subject of an overwhelming amount of litigation. In their commercial reasonableness assessment under Article 9, courts typically review a variety of aspects in determining a sale's commercial reasonableness, including the type and nature of the collateral, whether the sale was at a public auction or private sale, the

¹²⁸ See, White & Summers, *supra* note 31, at 919

¹²⁹ See, Warren & Walt, *supra* note 10, at 288

¹³⁰ Under Article 9 the secured creditor is allowed to dispose of the collateral in almost any manner so long as “every aspect of a disposition of collateral, including the method, manner, time, place, and other terms must be commercially reasonable.” See, RV s. 9-610 (b)

¹³¹ See Gilmore, *supra* note 8, at 1183: “Part 5 of Article 9 (...) rejecting the UCSA approach of detailed statutory regulation, opts for a loosely organized, informal, anything-goes type of foreclosure pattern, subject to ultimate judicial supervision and control which is explicitly provided for.”

nature of advertising and notice, the place and time of sale, the number of bids, and whether the sale was through the wholesale or retail market.¹³² Not surprisingly, the most controversial issue in court's reviewing the disposal of the collateral by the secured creditor became the price received at the foreclosure sale. However, on this point it has to be noted, that under RV low price itself is not sufficient to establish commercially unreasonable disposition, it only "suggests that a court should scrutinize carefully all aspects of a disposition to ensure that each aspect was commercially reasonable."¹³³

The concept of ex-post court review of the disposition of the collateral means, that possibly every disposition is open to attack. Therefore RV offers secured creditors a safe harbor by providing that a disposition is commercially reasonable if it has been approved in advance by a court, by a bona fide creditor's committee or by creditor's representative.¹³⁴ Other safe harbor is provided for the protection of the secured creditors against debtor's nuisance allegations by defining the methods of disposition which are *per se* commercially reasonable.¹³⁵

4.3.3. Liability of the secured party for noncompliance

It has been mentioned before, that after disposition of the collateral by the secured creditor, any surplus from the sale goes to the debtor, or the debtor is liable for any deficiency, if that is the result thereof. Here, an interesting issue arises: what

¹³² See, Korybut, Michael, *Searching for Commercial Reasonableness under the Revised Article 9*, 87 Iowa L. Rev. 1383 (2002);

¹³³ See, RV OC point (10) to s. 9-610; see, also RV OC point (2) to s. 9-627

¹³⁴ See, RV s. 9-627 (b)

¹³⁵ "A disposition of collateral is made in a commercially reasonable manner if the disposition is made: (1) in the usual manner on any recognized market; (2) at the price current in any recognized market at the time of the disposition; or (3) otherwise in conformity with reasonable commercial practices among dealers in the type of property that was the subject of the disposition." See, RV s. 9-627 (b)

is the effect of secured creditor's noncompliance with the commercially reasonable standard on his deficiency claim?

The court decisions on the issue divided among three rules.¹³⁶ The "absolute bar" rule denied the noncomplying secured creditor a deficiency judgment altogether. It was grossly unfair in cases in which secured party's breach was minor and the amount of deficiency was large. Other courts followed the "set off" rule. It allows the debtor to deduct from deficiency the amount of all the damages suffered due to the secured party's transgression. In the third line of cases courts applied the "rebuttable presumption" rule. The presumption was that compliance with the Article 9 disposition rules would have yielded an amount sufficient to satisfy the secured debt, thus leaving no deficiency. In response to the three "rules", the drafters of RV placed great emphasis on clarifying the issue. For non-consumer foreclosures RV adopts the rebuttable presumption rule that most courts favored under former Article 9.¹³⁷ The new rule is explained in RV OC point (3) to s. 9-626: "Unless the secured party proves that compliance with the relevant provisions would have yielded a smaller amount, (...) the amount that a complying collection, enforcement, or disposition would have yielded is deemed to be equal to the amount of the secured obligation (...) Thus, the secured party may not recover any deficiency unless it meets this burden." This rule eliminates unfair situations where a small technical failure of the foreclosing creditor may lead to denial of multimillion dollar deficiency.¹³⁸

On the other hand, the sanction for creditor misbehavior in consumer transactions is left to the courts to decide. The exclusion of consumer transactions was done at the request of consumer advocates, in order to allow courts to continue

¹³⁶ See, RV OC point (4) to s. 9-626

¹³⁷ See, RV s. 9-626 (a)

¹³⁸ See, *In re Kirkland*, 915 F2d 1236 (9th Cir. 1990), where for want of mere technical compliance, a deficiency claim in the amount of \$1,303,882.78 was denied

to apply the absolute bar rule in those jurisdictions that applied that rule before RV was enacted. One of the reasons why courts are willing to limit deficiencies is “the harshness of deficiency judgments in cases in which there is no ready secondhand market for the goods”.¹³⁹ This is particularly true in case of used consumer goods, with respect to which the price gained on resale may be too low, and given the fact that expenses of resale are relatively high, “debtor ends up without the property but owing a deficiency in excess of the original price”¹⁴⁰

Other sanctions for creditor’s misbehavior include: (i) an injunction, available if the debtor can move quickly enough.¹⁴¹ For example, in *Cox v. Galigher Motor Sales Co.*,¹⁴² the debtor got an injunction against a foreclosure sale of the truck, on the ground that the repossession undertaken by secured creditor was wrongful. (ii) Recovery of any loss caused by a secured creditor’s failure to comply with the standards of disposition set forth by RV Part 6¹⁴³ is available for the debtor when the disposition has already occurred. In case of consumer-goods transactions, a minimum¹⁴⁴ statutory damage recovery is guaranteed to the debtor. (iii) Although not expressly provided for in the Article 9, some courts awarded debtors even with punitive damages. For example, in *Davidson v. First Bank & Trust Co.*, a creditor bank rightfully repossessed the collateral at issue, yet subsequently failed to proceed in a commercially reasonable manner. The debtor sued for conversion, and the Oklahoma Supreme Court upheld a stipulation of actual damages, and affirmed an

¹³⁹ See, Warren & Walt, supra note 10, at 299

¹⁴⁰ See, id at 298

¹⁴¹ See, RV s. 9-625 (a)

¹⁴² *Cox v. Galigher Motor Sales Co.*, 213 SE2d 475 (W. Va. 1975)

¹⁴³ See, RV s. 9-625 (b)

¹⁴⁴ “(...) an amount not less than the credit service charge plus 10 percent of the principal amount of the obligation or the time-price differential plus 10 percent of the cash price.” See, RV s. 9-625 (c) (2)

award of punitive damages because “bank’s acts in private sale of property for less than stipulated value were malicious and willful.”¹⁴⁵

4.3.4. Slovak law on self-help disposition of the collateral

Following foreclosure, Article 9 offers a secured creditor a choice of actions as long as he implements his choice in compliance with standard of commercial reasonableness. “This choice is explained by the assumption that the creditor is in the best position to select the foreclosure method that is most likely to maximize the value of the collateral.”¹⁴⁶ Provisions of Civil Code on realization of the collateral follow this idea. The reformed law provides secured creditor with wide discretion on selecting the best option thereof, including self-help disposition of the collateral. This is a one of the major achievements of the security reform that significantly contributes to its success.

After the debtor’s default secured creditor can satisfy the secured claim by acquiring of an ownership to the collateral¹⁴⁷, disposing of the collateral in private sale or public auction, or by enforcing the charge via executors after obtaining the judgment on the secured debt, or on the basis of an enforceable notarial deed.¹⁴⁸

Before any disposition of the collateral, secured creditor is obliged to send a written notification of the commencement of the enforcement of the charge to the debtor and any third party holding right in collateral, including other secured creditors, with the specification of the mode of out-of court disposition or of the judicial enforcement. In addition, commencement of the enforcement has to be registered in

¹⁴⁵ See. *Davidson v. First Bank & Trust Co., Yale*, 609 P2d 1259 (Okla. 1976)

¹⁴⁶ See, Schwartz & Scott, *supra* note 9, at 860

¹⁴⁷ See, subchapter 4.2.2.

¹⁴⁸ Notarial deed is directly enforceable, therefore is often used by creditors to obviate the lengthy and costly court proceedings

the respective registry. The delivery of the notification to the debtor has two effects. First, following the delivery of the notification the debtor is not allowed to dispose of the collateral in his possession. Second, it triggers the 30 days period, when the debtor can repay the debt, since the secured creditor can sell the collateral only after this time period has lapsed.

The private sale of the collateral by the secured creditor requires the stipulation thereof in the security agreement. The other form of out-of-court disposition of collateral available to secured creditor is the sale thereof through public auction under the Act on Voluntary Auctions.¹⁴⁹ For the purposes of the private or public sale of the collateral, secured creditor acts in the name of the debtor. This means that even though secured creditor does not hold the ownership right in the collateral, he is by operation of law entitled to sell the collateral with the same effect as if it had been sold by debtor himself.¹⁵⁰ To protect the debtor's interests and to maximize the return on creditor's disposition of collateral, § 151m (8) of the Civil Code imposes on the secured creditor duty to "proceed with the sale of the collateral with due care so that the collateral is sold for a price for which the collateral or a similar asset is normally traded under comparable circumstances at the time and place of sale of the collateral". Drafters were apparently inspired by Article 9 based standard of "commercially reasonable" disposition of the collateral by the secured creditor. They went even further and obliged secured creditor to inform the debtor about the process of sale, in particular about the price received therefrom.

Depending on the amount of the proceeds of sale, secured creditor is either required to hand over any surplus to the debtor, or sue for deficiency. In order to equip the debtor with additional controlling mechanism, secured creditor is required

¹⁴⁹ Act No. 527/2002 Coll. on Voluntary Auctions

¹⁵⁰ See, Lazar, *supra* note 11, at 323

to serve him with written report about the sale of the collateral without undue delay thereafter. The report should include the relevant information on time, place and mode of sale, the proceeds of sale, expenses incurred by the secured creditor and use of proceeds of sale of the collateral. As the practice shows, both forms of out-of-court disposition of the collateral have gained broad popularity with secured creditors.

On the other hand, enforcement through courts and subsequent execution are rarely used. As has been previously mentioned, court procedures in Slovakia tend to take an unreasonable long time therefore this avenue is left as the last resort, only if self-help disposition of the collateral is from various reasons unavailable. This fact further corroborates the argument presented in this paper that methods of self-help enforcement of secured creditor's right, if properly regulated by law, serve as a faster and cheaper alternative to the judicial route.

Conclusion

The major goal of any modern system which intends to regulate enforcement of secured creditor's rights in the collateral after debtor's default can be stated simply: "Disposition of the collateral at a fair price with the least possible delay and at the lowest possible cost."¹⁵¹ To the extent that this aim is achieved, the debtor's equity in the collateral is protected and the possibility of a deficiency judgment is minimized, while secured creditor's right to get the satisfaction of the debt is maintained. Legislators in countries with advanced secured transactions law regimes have been trying to tackle the issue of building fair, quick and efficient enforcement system by using different approaches.

The examination of the US enforcement model pointed out, that a movement from judicial supervision and control to self-help enforcement is the workable answer. This tendency seems obvious even in Slovakia. Drafters of the reformed law, certainly under the indirect influence of Article 9, made a major step forward and introduced certain elements of self-help into the enforcement system. The success and popularity of the newly introduced self-help disposition of the collateral among creditors corroborates this opinion. Undoubtedly, alongside other major improvements, the implementation of self-help disposition into the enforcement scheme is what makes Slovak secured transactions law one of the most advanced in the region.

However, analysis of Slovak enforcement rules unveiled one major shortcoming thereof. The system does not provide for prompt protection of the collateral which is in debtor's possession. Legislators refused to accept the idea of secured creditors repossessing the movable collateral without judicial assistance.

¹⁵¹ See, Mentschikoff, *supra* note 25, at 772

Instead, they imposed the duty to hand over the collateral on debtors. Yet, due to deficiencies in related body of law, this duty is hardly enforceable, which means that this part of reformed secured transactions law remains a dead letter and the system as such is heavily debtor protective.

The opinion expressed in this paper is that strict rejection of self-help repossession concept ensued in significant disfunctioning of the enforcement system, thus affecting the viability of the whole, otherwise advanced and workable secured transactions law regime. In the country like Slovakia, where rule of law is still not a reality, introduction of fairly balanced, properly regulated model of self-help repossession might yield in considerable improvement of the enforcement efficiency. Here, the American concept might serve as the valuable guidance. The thorough examination showed that it offers feasible solutions to all dilemmas arising from use of this enforcing device. As Warren & Walt sarcastically note, “Europeans tend to see [self-help] as another example of American barbarism.”¹⁵² This paper illustrates that such an approach lacks justification.

¹⁵² See, Warren & Walt, *supra* note 10, at 269

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