

BUSINESS LAW TODAY

When to Contract for Remedies

By [Stephen L. Sepinuck](#)

Contracting parties often include in their written agreement provisions on remedies for breach. Occasionally, these provisions simply restate what the law already provides. For example, it is not unusual for a security agreement to authorize the secured party to repossess and sell the collateral after default, rights that Article 9 expressly grants. While superfluity alone might not justify omitting or excising such a provision from a written agreement – after all, careful transactional lawyers seek comfort in the safety blanket of redundancy – there are reasons to avoid this practice. Expressly providing for remedies obviously available under the law lengthens the written agreement. More important, unless the agreement mentions every remedy that the law makes available, the clause might create a negative implication that the parties are not entitled to any of the unreferenced remedies.

So, when should an agreement expressly provide for a remedy? When any one of the following six reasons applies.

1. To Comply with the Law

Some transactions, particularly those involving a consumer, might require that a remedy be expressly stated to be available or for the transaction to be valid and unavoidable. If so, then obviously the agreement should expressly provide for the remedy.

2. To Create or Expand a Remedy

Some statutory remedies are expressly made available only in limited situations, but the law allows parties to make those remedies available in other situations. U.C.C. § 9-601(a), for example, provides for certain basic remedies after default, but permits the parties to provide for additional remedies. As a result, a well-drafted security agreement will, depending on the type of collateral involved, cover the following:

Disabling Non-equipment

U.C.C. § 9-609(a)(2) authorizes a secured party after default to disable equipment. The agreement should expand this authorization to cover non-equipment collateral, such as inventory, consumer goods, and software. Of course, the secured party should be aware that some state and federal laws might limit a secured party's rights in this regard. For example, Connecticut requires 15-day's advance notification of any electronic self-help, prohibits electronic self-help entirely if the secured party has reason to know it will result in grave harm to the public interest, and provides for nonwaivable consequential damages for its wrongful use. Conn. Gen. Stat. § 42a-9-609(d).

Voting Collateral

Authorize the secured party to exercise the voting rights of the debtor with respect to

collateralized stock, partnership interests, and LLC interests. Bear in mind, however, it remains unclear whether such a clause will in fact work, particularly with respect to LLC membership interests. Colorado law, for example, apparently requires a secured party to enforce the security agreement and become admitted as a member before the secured party may exercise voting rights associated with a membership interest pledged as collateral. *In re Crossover Fin. I, LLC*, 477 B.R. 196 (Bankr. D. Colo. 2012). Moreover, concerns about liability might impel a secured party to either omit such a clause from the security agreement or refrain from exercising the authority such a clause grants.

Entering Premises

Expressly authorize the secured party and its representatives to enter the debtor's property after default to repossess collateral. U.C.C. § 9-609 grants a secured party the right to take possession of collateral after default, provided it acts without a breach of the peace. One factor relevant to whether a breach of the peace occurs is the existence and extent of a trespass. While a secured party probably has a license to enter the debtor's driveway or carport even without express authorization, entering a garage or other structure is more problematic. If the security agreement authorizes the secured

party to enter the debtor's premises, it may help avoid any trespass claim. This authorization will not, by itself, be sufficient to prevent a breach of the peace and will be irrelevant if the debtor does not own or rent the premises where the collateral is located, but might nevertheless be helpful.

Taking Non-collateral

Authorize the secured party, when repossessing the collateral, to repossess things in or attached to the collateral. For example, a consumer who has granted a security interest in a motor vehicle will typically keep in the vehicle items of personal property that are not and by law cannot be encumbered by the security interest. While a secured party might not need express authorization to temporarily take such property during a repossession, see *Terra Partners v. Rabo Agrifinance, Inc.*, 2010 WL 3270225 (N.D. Tex. 2010), such authorization should help insulate the secured party from conversion and trespass claims with respect to such property.

Retaining Surplus to Cover Unliquidated and Contingent Secured Obligations

Indicate what the secured party may do with the proceeds of a collection or disposition if there are non-monetary or contingent obligations that remain outstanding. For example, the secured party should, after satisfying the noncontingent monetary secured obligations, be permitted to hold onto additional proceeds until such time as the debtor's non-monetary and contingent obligations are satisfied or discharged. While a secured party has nonwaivable duties to account for surplus proceeds of collateral and to remit them to either a junior lienor or the debtor, the security agreement would presumably be relevant to determining whether a surplus exists and should be able to specify – at least with respect to the debtor – how quickly the secured party must act in remitting any surplus.

3. To Enhance Availability of a Discretionary Remedy

Some remedies, particularly equitable remedies, are within the court's discretion. For example, the appointment of a receiver to

manage collateral before final judgment is subject to a variety of factors, the most critical of which are whether the creditor is undersecured and whether the debtor is insolvent. To enhance the likelihood that a court will appoint a receiver, the mortgage or security agreement might provide for such an appointment upon the lender's application therefor after the borrower's default. Courts will not be bound by such a contractual provision, but the provision may help. It may also permit such an appointment to occur on an *ex parte* basis.

Similarly, an award of specific performance is subject to court discretion and will not be ordered if, among other reasons, an award of damages would be adequate or the remedy would be unfair. See Restatement (Second) of Contracts §§ 357(a), 359(1), 364(1). Because courts regularly regard equitable relief as jurisdictional and beyond the competence of private contracting parties, they are unlikely to treat a clause expressly declaring damages to be inadequate or expressly authorizing specific performance as binding or even as relevant. This certainly appears to be the approach taken by federal courts. Nevertheless, a contractual clause declaring damages in certain instances to be inadequate – such as for breach of a covenant not to compete – might enhance the prospect that a court would conclude similarly. Moreover, in some states – Delaware, for example – courts regard a clause stipulating to the existence of irreparable harm in the event of breach as binding. See *Martin Marietta Materials, Inc. v. Vulcan Materials Co.*, 2012 WL 2783101 (Del. 2012). A clause declaring goods to be sold as “unique” or indicating that the buyer will not be able to cover quickly enough to avoid irreparable injury might also be helpful because the U.C.C. authorizes specific performance when the goods are unique or in other proper circumstances. See U.C.C. § 2-716(1).

Another set of remedies is available only following a material breach. Under modern contract law, the contracting parties' main promises to each other are regarded as dependent – rather than independent – covenants. As a result, one condition to a

party's duty to perform is that there be no “uncured material failure” by the other party to perform. See Restatement (Second) of Contracts § 237. In short, any breach gives rise to a claim for damages but only a material breach excuses the nonbreaching party from the duty to perform.

Unfortunately, it is not always clear what constitutes a material breach. As a result, when a dispute arises, a game of chicken may ensue. For example, a contractor renovating a home might, in violation of its agreement with the owners, leave them without running water for several days. The owners might respond by withholding the next installment payment. The contractor might then walk off the job. Who wins in the resulting lawsuit will depend on who was the first to materially breach. If the contractor's initial breach was material, the owners were permitted to withhold payment. If not, the owners had a duty to pay. If their failure to pay was a material breach, then the contractor was justified in refusing to complete the work. If their failure to pay was not material, then the contractor's refusal to finish was a further breach, and no doubt a material one. Needless to say, it is difficult to predict in advance how a court or jury will rule.

To clarify the parties' rights, the agreement might expressly provide under what circumstances a breach by one party will excuse the other. Such a clause need not – and probably should not – be exhaustive. That is, it should not purport to identify all the breaches that suspend the other party's duty to perform, unless the drafter is confident that nothing else should so qualify.

One caveat is in order. Some written agreements purport to do this by simply declaring a particular type of breach to be “material.” For example, one standard purchase agreement for the sale of grapes from a vineyard to a winery provides “[b]uyer's failure to make payment within sixty (60) days of due dates constitutes material breach of this agreement.” There are at least two problems with this clause. First, outside Louisiana, the contract would be governed by U.C.C. Article 2, which does not use the phrase “material breach.” Thus, it is not clear what purpose such a declara-

tion would serve in an agreement governed by that law. Second, payment by the buyer was the last act called for under the agreement; the seller would necessarily have shipped the grapes months before and have no duties remaining. As a result, the seller would have no performance to suspend if the buyer failed to pay, and the declaration of materiality would be meaningless.

4. To Negate or Limit a Remedy

Contracting parties occasionally wish to make unavailable a remedy to which one or both of them would otherwise be entitled or to limit the extent or duration of a remedy that is to remain available. Common examples of this are disclaimers of consequential damages, liquidated damages clauses, limits on the time or grounds for rejecting tendered goods, clauses shortening the applicable limitations period, and terms conditioning a right to recovery on prompt notice of the claim. Secured lending on a nonrecourse basis can also be viewed as a negation of personal liability for any deficiency. Any intention to negate or limit a remedy must be stated in the parties' agreement.

Of course, parties must be very careful when negating remedies. If they limit one party to a single remedy, and the law makes that remedy unavailable, the party might find itself without any recourse for breach.

5. To Set Standards

Some remedies are subject to vague standards that the parties cannot waive or disclaim but which they can help clarify. For example, Article 9 requires that every aspect of a disposition of collateral be commercially reasonable. U.C.C. § 9-610(b). The parties cannot by agreement alter this requirement, § 9-602(7), but they can set the standards for what is reasonable, as long as those standards are not themselves "manifestly" unreasonable. *See* §§ 1-302(b), 9-603(a).

Accordingly, the security agreement should contain a clause on how the secured party may dispose of the collateral. Such a clause is particularly important when the parties anticipate no ready market for the collateral, such as closely-held stock. When dealing with such collateral, the agreement

ADDITIONAL RESOURCES
For other materials related to this topic, please refer to the following.

Business Law Today
Remedies Outside the Box: Enforcing Security Interests Under Article 9 of the Uniform Commercial Code
By Kathy Cabral and Teresa Wilton Harmon
August 2012

BLS Programs Material Library
Time to Play the Name Game: A Practical Guide to UCC Filing Under the 2010 Amendments to Article 9 (PDF) (Audio)
2013 Spring Meeting

ABA Web Store
Practice under Article 9 of the UCC, Second Edition
Practice under Article 9 of the UCC, Second Edition is a comprehensive guide for lawyers facilitating secured transactions. This updated edition summarizes the provisions of Article 9 as it was revised and as it is contained in the 2010 Official Text of the UCC. The 2010 Official Text includes the 2002 revision of Article 1 of the UCC and the 2003 revision of Article 7 of the UCC, with conforming amendments to Article 9. The 2010 Official Text also includes the amendments to Article 9 promulgated in 2010 (the "2010 amendments"). The "2010 amendments" address a narrow set of issues, but do not change the basic structure of Article 9.

The ABCs of the UCC Article 9: Secured Transactions, Third Edition
The ABCs of the UCC Article 9: Secured Transactions, Third Edition provides an introduction to the law governing security interests in personal property; this book explains the terminology, structure, and methodology of security interests governed by Article 9.

CLE Products
A Primer on UCC Articles 8 & 9 by Steve Weise (Audio CD ROM)
Recording Date: Sep 18, 2013
Running Time: 90 minutes
To a general practitioner, the UCC and its commercial laws are frequently encountered and may seem mysterious. This program is designed for attorneys with a general practice that need to keep current with substantive changes and developments in the UCC that affect daily business practices. Expert panelist and member of the Permanent Editorial Board for the Uniform Commercial Code, Steve Weise discusses common issues, recent developments, and updates to Articles 8 and 9 with specific attention given to real-world examples and best practice guidelines. This audio CD-ROM includes full program audio and PDF course materials.

should, at a minimum, disclaim any obligation by the secured party to engage in a public offering of privately held securities. For collateral consisting of goods, particularly equipment, the security agreement should provide either that the secured party has no responsibility to clean, prepare, or repair the collateral before sale or limit any such duty to a specified dollar amount. *Cf.* § 9-610 cmt. 4. If there is a reasonable chance that

the secured party will receive noncash proceeds of a collateral disposition, the security agreement should provide standards on whether or when the secured party must apply noncash proceeds to the secured obligation. *Cf.* §§ 9608(a)(4), 9-615(c).

6. To Preserve a Remedy the Law Might Eliminate

A cautious lawyer might be concerned that the law will change to make unavailable a remedy for which the law currently provides. To such a lawyer, it is desirable to

expressly provide for all remedies in every agreement. Yet consider all the assumptions underlying this rationale: (1) that the law will or might change so as to eliminate a remedy currently available, (2) the change will apply to contracts already entered into, and (3) parties will be permitted to contract around that change by agreement. This combination seems a remarkably unlikely and would probably be restricted to consumer transactions for which a legislature may wish to require that the remedy be expressly stated as a form of notice. In

general, this is not a sufficient justification for expressly stating remedies that the law currently makes available.

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