

UNIFORM COMMERCIAL CODE COMMENTARY

ACCELERATION CLAUSES IN SALES AND SECURED TRANSACTIONS: THE DEBTOR'S BURDEN UNDER SECTION 1-208 OF THE U.C.C.

Acceleration clauses are widely used in contracts involving sales on credit and secured transactions. Although clauses which permit a creditor to accelerate payment or to demand additional collateral when he deems himself insecure or when the debtor defaults are necessary to protect a creditor's collateral, the precipitous use of such clauses can force a debtor into default and initiate a chain of similar accelerations thus destroying viable contractual relationships. The drafters of the Uniform Commercial Code,¹ in the light of the courts' experience under both common law and prior uniform statutes, attempted to limit the creditor's power under these clauses without unduly hindering his ability to protect the collateral. The Code established the test which the creditor must meet in order to accelerate, and allocated the burden of proof where the debtor claims that an acceleration was wrongful.² This comment will examine, compare and criticize the common law, pre-Code statutes and Uniform Commercial Code treatment of acceleration clauses in credit sales and secured transactions with respect to the problems of when a creditor may lawfully accelerate, and what is the proper allocation of the burden of proof.

I. ACCELERATION CLAUSES UNDER THE COMMON LAW

Under common law, acceleration clauses were categorized on the basis of the occasion which gave rise to the creditor's right to accelerate. One form of acceleration clause allowed the creditor to accelerate when the debtor defaulted, and enumerated the instances or situations that constituted default.³ Although a default usually occurred upon a non-payment of principal or interest,⁴ other reasons could be enumer-

¹ All Uniform Commercial Code citations are to the 1962 Official Text.

² U.C.C. § 1-208 reads:

A term providing that one party or his successor in interest may accelerate payment on performance or require a collateral or additional collateral "at will" or "when he deems himself insecure" or in words of similar import shall be construed to mean that he shall have power to do so only if he in good faith believes that the prospect of payment or performance is impaired. The burden of establishing lack of good faith is on the party against whom the power has been exercised.

³ See, e.g., *Harris v. Kessler*, 124 Cal. App. 299, 12 P.2d 467 (Dist. Ct. App. 1932).

⁴ 2A G. Bogert, *Uniform Laws Annotated* § 101 (1924) [hereinafter cited as U.L.A.].

ated.⁵ A second form of acceleration clause allowed a creditor to accelerate at will or when he deemed himself insecure.⁶

While the common law generally recognized acceleration clauses as valid,⁷ and found them to be neither a penalty nor a forfeiture but rather an agreement as to when the debt shall be due,⁸ the courts placed two limitations upon them. First, the acceleration clause, although not a penalty, would not be enforced where courts of equity found that the creditor acted in bad faith, or the clause was unconscionable.⁹ Courts also limited clauses which provided that upon acceleration the entire indebtedness became due, including the interest for the full term of the contract. The courts generally held that even if the contract was not usurious, the amount which the creditor received as interest above the maximum statutory limit was uncollectable.¹⁰ The courts reasoned that if the debtor by the terms of his contract could avoid the payment of the larger, usurious sum by prompt performance of his obligation, then the contract was not usurious, even though recovery of any excess over the maximum legal interest rate was generally disallowed as penal.¹¹ The courts also looked to the intent of the parties and not the form of the contract. If a penalty

⁵ Other grounds for acceleration under a default-type acceleration clause are cited in *Parks v. Hallett & Davis Piano Co.*, 145 Ga. 671, 89 S.E. 715 (1916), where acceleration occurred when the debtor sold the collateral; *Morris v. Allen*, 17 Cal. App. 684, 121 P. 690 (Dist. Ct. App. 1911), which allowed acceleration if the other creditors attached the collateral of the debtor; *Flint Wagon Works v. Maloney*, 26 Del. 137, 81 A. 502 (1911), where the acceleration occurred when the buyer suspended the operation of his business; *Huffard v. Akers*, 52 W. Va. 21, 43 S.E. 124 (1902), where the seller could accelerate if the buyer abused the collateral; *Rathbun v. Waters*, 1 City Ct. 36 (N.Y. City Marine Ct. 1876), where the seller could accelerate if the buyer failed to keep the goods insured; *Swain v. Schild*, 66 Ind. App. 156, 117 N.E. 933 (1917), where the seller could accelerate if the buyer lost possession or the goods were removed from his premises.

⁶ *Call v. Seymour*, 40 Ohio St. 670 (1884).

⁷ *Harris v. Kessler*, 124 Cal. App. 299, 12 P.2d 467 (Dist. Ct. App. 1932); *Heath v. Randall*, 58 Mass. (4 Cush.) 195 (1849).

⁸ 124 Cal. App. at 302, 12 P.2d at 468.

⁹ *Graf v. Hope Bldg. Corp.*, 254 N.Y. 1, 171 N.E. 884 (1930). See also Annot., 70 A.L.R. 993 (1931). This view is in line with the holding of the *Graf* decision. Justice Cardozo, who dissented in *Graf*, desired to extend the majority's rule to situations where the debtor's default was due to a trivial mistake or error on the part of the debtor and where the creditor suffered no damage. He distinguished acceleration clauses as to their effect on the creditor. A failure to pay taxes merely makes the creditor feel insecure but failure to pay an interest installment makes the creditor lose money. He indicated that while both clauses are valid, equity will not enforce the former where the failure to pay taxes is due to the debtor's mistake or accident. See also *Console v. Torchinsky*, 97 Conn. 353, 116 A. 613 (1922).

¹⁰ 6 S. Williston, *Contracts* § 1696 (rev. ed. 1938); *Chicago Title & Trust Co. v. Kearney*, 282 Ill. App. 279 (1935). See also *Restatement of Contracts* § 536, Illustration 2 (1932).

¹¹ For a contrary view see *Restatement of Contracts* § 526, Illustration 5 (1932). See also S. Williston, *supra* note 10, § 1696 n.2 for cases supporting this position. In *Shropshire v. Commerce Farm Credit Co.*, 120 Tex. 400, 30 S.W.2d 282 (1930), the court held that where an acceleration clause makes due the principal plus all the interest for the term, whether accrued or not, and this sum bears interest and total interest is above the nominal statutory rate, the contract is void for illegality.

was intended by using an acceleration clause to exact an interest rate above the maximum statutory rate, then the clause was void.¹²

The common law also regulated the operation of acceleration clauses. Under common law the creditor had the burden of justifying the acceleration.¹³ If the acceleration clause was of the default variety, the creditor had the burden of proving that the default in fact occurred, and if the clause was of the insecurity type, the creditor had the burden of proving that his insecure feeling was reasonable and that he acted in good faith.¹⁴ The common law standard of good faith was subjective.¹⁵ It required that the person acting do so honestly. This standard was often referred to as the rule of "the pure heart and the empty head."¹⁶ With the default type acceleration clause the issue of the creditor's good faith was not present since the creditor's right to accelerate was initiated by the debtor. Although acceleration was allowed when the creditor deemed himself insecure, his good faith could be put in issue, and the debtor could defeat the creditor's right to accelerate by proving that the creditor was motivated by factors other than an insecure feeling about his collateral.¹⁷

Depending on the wording of the acceleration clause, the courts allowed the clause to operate either automatically or at the option of the seller. If the clause was so worded as to be absolute in form, leaving no option to either party, the courts were split as to whether such a provision was self-executing and caused the whole debt to become due automatically, or whether some further action by the seller evidencing the exercise of his option was necessary.¹⁸ Jurisdictions following the former rule generally proceeded on the theory that the acceleration clause exists for the benefit of the buyer as well as the seller, and that the courts may not make a new contract different from the express intent of the parties.¹⁹ On the other hand, jurisdictions following the latter, majority view reasoned that the clause is for the benefit of the creditor, who should be free to decide whether such protection is necessary under the circumstances of default.²⁰ If, how-

¹² *Chicago Title & Trust Co. v. Kearney*, 282 Ill. App. 279, 286 (1935).

¹³ *Leaf v. Reynolds*, 34 Idaho 643, 652, 203 P. 458, 460 (1921); *Spatuzzi v. Star Auto Truck Exch.*, 119 N.J.L. 377, 196 A. 723 (Ct. Err. & App. 1938).

¹⁴ *Jacksonville Tractor Co. v. Nasworthy*, 114 So. 2d 463, 465 (Fla. 1959). See also *Hawyer v. Ball*, 64 Hun 636, 19 N.Y.S. 612 (N.Y. Sup. Ct. 1892).

¹⁵ See 1A A. Corbin, *Contracts*, § 165 (1963). See also Note, *Good Faith Under the Uniform Commercial Code*, 23 U. Pitt. L. Rev. 754 (1962).

¹⁶ Note, *supra* note 15, at 756.

¹⁷ *Graf v. Hope Bldg. Corp.*, 254 N.Y. 1, 6, 171 N.E. 884, 885 (1930).

¹⁸ Annot., 159 A.L.R. 1077 (1945). This annotation provides a complete discussion of whether action by the creditor is required where there is an automatic acceleration clause, an optional acceleration or a variant thereof. For an example of a case which held that such an acceleration clause is self-executing, see *Fischer v. Wood*, 119 S.W.2d 114, 115 (Tex. Civ. App. 1938). For an example of a case holding that such clauses are not self-executing, see *Chase Nat'l Bank v. Burg*, 32 F. Supp. 230, 232 (D. Minn. 1940).

¹⁹ *San Antonio Real Estate, Bldg. & Loan Ass'n v. Stewart*, 94 Tex. 441, 446, 61 S.W. 386, 383 (1901); *Snyder v. Miller*, 71 Kan. 410, 411-12, 80 P. 970 (1905).

²⁰ *Keene Five Cent Sav. Bank v. Reid*, 123 F. 221, 224 (8th Cir. 1903), cert. denied,

ever, the clause provided that on default the total amount under the contract would become due at the option of the seller, the courts uniformly held that such a clause was not self-executing and required some action on the part of the seller.²¹ In reaching this decision the courts either followed the express words of the clause, or reasoned that the clause was for the benefit of the creditor who may take advantage of it at his discretion.²² Based on this reasoning, insecurity type acceleration clauses require the exercise of the creditor's option to become operative.

Once the creditor had established his right to accelerate, the common law determined the rights and duties of the creditor and debtor. The clause usually provided that the creditor had a right to the entire amount due under the contract plus interest.²³ In order to recover this amount, the common law rule on conditional sales required the creditor to elect between remedies to determine the manner of recovery.²⁴ The creditor could exercise his right of possession under the theory that title was reserved in him by the conditional sales contract, or he could sue the debtor for the debt owed.²⁵ Whichever election the creditor made, it would act as a bar to the use of the other remedy.²⁶ This put the creditor in a difficult position, since he had the choice of retaking his collateral and thus being barred from obtaining a deficiency judgment, or proceeding against a possibly insolvent debtor.

The debtor under common law could vest title in himself by payment of the balance due any time before repossession,²⁷ but once the creditor had taken possession of the collateral the common law normally did not recognize the right to redeem the collateral by payment or tender of either the amount in default or the full contract price.²⁸ There is some judicial support for an equitable right to redeem after

191 U.S. 567 (1903). For a modern decision using this reasoning, see *Peter Fuller Enterprises, Inc. v. Manchester Sav. Bank*, 102 N.H. 117, 121, 152 A.2d 179 (1959), where the buyer defaulted in order to make the debt due so as to pay the debt off immediately. The court held that the clause was operative only upon the creditor's election.

²¹ *Schumacher v. Miller*, 111 Conn. 568, 571, 150 A. 524, 526 (1930); Annot., 159 A.L.R. 1077 (1945).

²² *California Sav. & Loan Soc'y v. Culver*, 127 Cal. 107, 112-13, 59 P. 292, 294 (1899); Annot., 159 A.L.R. 1077 (1945).

²³ E.g., *Harris v. Kessler*, 124 Cal. App. 299, 300-01, 128 P.2d 467 (Dist. Ct. App. 1932).

²⁴ 2 G. Gilmore, *Security Interests in Personal Property* § 43.1 (1965) [hereinafter cited as *Gilmore*]. For an extensive treatment of the development of the common law concept of chattel mortgages and its comparison to that of conditional sales and pledges, see *Gilmore* § 43.2.

²⁵ *Id.* § 43.2.

²⁶ *Id.* § 43.1.

²⁷ *Vaughan v. McFadyen*, 110 Mich. 234, 235, 68 N.W. 135, 136 (1896).

²⁸ *Franklin Motor Car Co. v. Hamilton*, 113 Me. 63, 65, 92 A. 1001, 1002 (1915). There seems to be some support for the view that there is a right of redemption in the area of chattel mortgages. See *Bogert, The Evolution of the Conditional Sales Law in New York*, 8 Cornell L.Q. 303, 305 (1923).

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repossession by a tender of the balance due upon default, however this right arose only when the acceleration was due to some trivial default or excusable negligence on the part of the debtor.²⁹ But if the contract indicated that the parties did not contemplate the existence of such a right, as where the acceleration clause contained the phrase, "time is of the essence," the debtor lost even this equitable right.³⁰

Thus, common law did not provide a satisfactory means for redeeming collateral. It is suggested that a short period during which the debtor may redeem his collateral after repossession, by payment of the amount by which he is in default, would protect the debtor without unduly harming the creditor. Such a common law right of redemption was provided under the Uniform Conditional Sales Act (U.C.S.A.).³¹ This procedure would eliminate requiring the debtor to rely on a court of equity to determine if the default was due to an accident or mistake, or if the creditor acted unreasonably.

II. ACCELERATION CLAUSES UNDER THE UNIFORM CONDITIONAL SALES ACT

The provision of the U.C.S.A.³² most concerned with acceleration clauses was section 16,³³ which allowed the creditor-seller to retake the goods either when the buyer defaulted or when some other condition existed which the parties agreed would give rise to the right to retake. Thus, default type acceleration clauses were expressly allowed under the U.C.S.A.³⁴ However, the U.C.S.A. and the courts were silent as to the validity of an insecurity type acceleration clause. Since the common law applied to those situations not statutorily provided for,³⁵ security type acceleration clauses were impliedly allowed under the U.C.S.A.³⁶ The creditor was also allowed to

²⁹ *Graf v. Hope Bldg. Corp.*, 254 N.Y. 1, 7, 171 N.E. 884, 886 (1930) (Cardozo, J., dissenting). There is also some support for the proposition that the buyer has a right to redemption, which is exercised by paying the entire amount due after a default and repossession. *Liver v. Mills*, 155 Cal. 459, 462, 101 P. 299, 300 (1909); *Miller v. Stein*, 30 Cal. 402, 407 (1866).

³⁰ In *Miller v. Stein*, 30 Cal. 402, 407 (1866); *Liver v. Mills*, 155 Cal. 459, 462, 101 P. 299, 300 (1909) (dictum).

³¹ See pp. 536-37 *infra*. All references to the Uniform Conditional Sales Act [hereinafter cited as U.C.S.A.] may be found in 2 U.L.A. (H. Greene ed. 1922).

³² The U.C.S.A. was adopted in 14 jurisdictions: Alaska, Arizona, Delaware, Hawaii, Indiana, New Hampshire, New Jersey, New York, Panama Canal Zone, Pennsylvania, South Dakota, Virgin Islands, West Virginia, Wisconsin. 2 U.L.A. 9 (Supp. 1967).

³³ U.C.S.A. § 16 provides:

When the buyer shall be in default in the payment of any sum due under the contract, or in the performance of any other condition which the contract requires him to perform in order to obtain the property in the goods, or in the performance of any promise the breach of which is by the contract expressly made a ground for the retaking of the goods, the seller may retake possession thereof

³⁴ *Contra, Harlee v. Federal Fin. Corp.*, 34 Del. 345, 354, 152 A. 596, 600 (1930), which ignored § 16 in holding that the U.C.S.A. invalidated acceleration clauses.

³⁵ U.C.S.A. § 29 provides that "[i]n any case not provided for in this act the rules of law and equity shall continue to apply to conditional sales."

³⁶ G. Bogert, *Commentaries on Conditional Sales*, in 2 U.L.A. § 101 (Supp. 1959).

retake when there was no acceleration clause in the contract. The implied right to retake arose when the buyer was in default of any payment or in default of any performance under contract which was necessary to pass title to the buyer. Dean Bogert, one of the drafters of the U.C.S.A., stated in his commentary on the Act that this implied right to retake also arose where the breach was of such importance as to threaten the seller's security.³⁷ Since creating a feeling of insecurity is not a breach of a contract term, there would have been no implied right of acceleration in such an instance. The theoretical basis of this right was that, under conditional sales law, title to the goods remained in the seller until the buyer had fully performed,³⁸ and that title carried with it the right of possession.³⁹

Sections 17 and 18 of the U.C.S.A.⁴⁰ imposed some limitations on acceleration clauses and the right to retake. The buyer had the right to redeem the collateral only if the seller failed to provide notice to the buyer 20 to 40 days prior to retaking the goods. In such a case the buyer had a non-waivable right to redeem the goods for ten days after repossession.⁴¹ The drafters proceeded on the theory that a conditional sale was equivalent to a chattel mortgage and should therefore have attached to it the equivalent of a right of redemption. They felt

³⁷ 2A U.L.A. § 102.

³⁸ S. Eager, *The Law of Chattel Mortgages and Conditional Sales and Trust Receipts* § 301 (1941).

³⁹ *Liver v. Mills*, 155 Cal. 459, 460, 101 P. 299, 300 (1909).

⁴⁰ U.C.S.A. § 17 provides:

Not more than forty nor less than twenty days prior to retaking, the seller, if he so desires, may serve upon the buyer . . . notice of intention to retake the goods on account of the buyer's default If the notice is so served and the buyer does not perform the obligations in which he has made default before the day set for retaking, the seller may retake . . . but without any right of redemption.

U.C.S.A. § 18 provides:

If the seller does not give notice of his intention to retake described in section 17, he shall retain the goods for ten days . . . during which period the buyer, upon payment or tender of amount due under the contract at time of retaking and interest, or upon performance or tender of performance of such other condition as may be named in the contract as precedent to passage of the property in goods, or performance or upon tender of performance or any other promise for the breach of which goods were retaken, upon payment of the expenses of retaking, keeping and storing may redeem goods and become entitled to take possession of them and to continue in performance of the contract as if no default had occurred If the goods are perishable . . . the provisions of this section shall not apply, and the seller may resell the goods immediately upon the retaking.

A retaking by the seller within 4 months of the buyer's bankruptcy was not a voidable preference under the bankruptcy acts. *Thomas Roberts & Co. v. Robinson*, 141 Md. 37, 118 A. 198 (1922).

⁴¹ U.C.S.A. § 26 provides:

No act or agreement of the buyer before or at the time of the making of the contract, nor any agreement or statement by the buyer in such contract, shall constitute a valid waiver of the provisions of Sections 18, 19, 20, 21 and 25

that default should not be final because it may be due to a mistake of the debtor or to causes beyond his control.⁴²

However, the statute did not clearly indicate whether the buyer had to tender the full amount of the contract plus interest and expenses, or merely the amount by which he was in default, in order to redeem the collateral. Courts have held that payment or tender of the amount by which the debtor is in default is all that is required.⁴³ In so holding these courts rejected the contention that an acceleration clause in a contract is a waiver of this right of redemption in section 18.⁴⁴

Justification for acceleration was dependent upon the type of acceleration clause contained in the contract. If the clause was of the default type, justification depended, as under common law, upon its wording. There was usually little problem where the clause enumerated the conditions which constituted a default, for justification then depended upon the occurrence of a specific act. If the clause permitted acceleration when the creditor deemed himself insecure, courts were divided as to the standard for determining whether the creditor's insecurity was justified. Some courts adopted a subjective test whereby the creditor was the sole judge of whether the security was endangered, and no proof was needed beyond the fact that he had actually deemed himself unsafe and proceeded upon that belief.⁴⁵ Other courts applied a completely objective test, and required that the insecurity rest in "facts of actual ultimate existence, disregarding appearances, however indicative of probable cause the appearances may be."⁴⁶ The best and most prevalent approach is where the courts applied the reasonable man test, and considered whether under all facts and circumstances a prudent man would have deemed himself insecure.⁴⁷ Such circumstances usually included changes in the debtor's financial situation and deterioration of the state of the collateral.

The burden of proof also depended upon the type of acceleration clause. In a default type clause, where the creditor accelerated and repossessed upon an alleged default of the debtor, the debtor would bring suit for conversion against the creditor and would therefore have to prove that the alleged default in fact had not occurred, or that such a default was not provided for in the acceleration clause. In this case good faith was irrelevant. However if the acceleration was occasioned

⁴² 2A U.L.A. § 113.

⁴³ *Harlee v. Federal Fin. Corp.*, 34 Del. 345, 351-52, 152 A. 596, 599 (1930); *Street v. Commercial Credit Co.*, 35 Ariz. 479, 487-88, 281 P. 46, 49 (1929). See also Annot., 67 ALR 1554 (1930). These courts construe the words "amount due under the contract at time of retaking" in the light of the words "upon performance or tender of performance of any other promise for the breach of which goods were retaken" to mean the amount due under the contract absent an acceleration clause, i.e., the unpaid installments.

⁴⁴ *Harlee v. Federal Fin. Corp.*, 34 Del. 345, 352, 152 A. 596, 600 (1930).

⁴⁵ *Commercial Credit Co. v. Cain*, 190 Miss. 866, 871, 1 So. 2d 776, 777 (1941).

⁴⁶ *Id.*

⁴⁷ *Id.*; *Jacksonville Tractor Co. v. Nasworthy*, 114 So. 2d 463, 465 (Fla. 1959). See also *S. Eager*, *supra* note 38, § 176.

by the creditor's insecurity, there was confusion as to who had the burden of proof. In jurisdictions which followed the reasonable man test as a justification for acceleration, the courts placed the burden of proof on the creditor, the one who exercised the contractual prerogative, and required him to present facts which would justify acceleration by a reasonable man.⁴⁸ In jurisdictions which applied the subjective good faith test, the burden of proof was on the person attacking the operation of the acceleration clause, the debtor, to show that the creditor acted in bad faith.⁴⁹ These courts proceeded on the theory that this type of acceleration clause was for the benefit of the creditor, and authorized the creditor to take advantage of it when he deemed it necessary to protect the collateral. If the creditor considered the collateral insecure, then the presumption would arise that such was the fact.⁵⁰

While the U.C.S.A. protected a defaulting debtor by providing a right of redemption for ten days after a retaking,⁵¹ its provisions regulating resale of the collateral by a foreclosure sale⁵² were criticized as being too rigid.⁵³ The debtor could require the creditor to resell the collateral,⁵⁴ and in so doing the creditor had to comply with certain safeguards or lose the right to a deficiency judgment.⁵⁵ The U.C.S.A. provisions regarding disposal of collateral were only partially effective, since in practice the debtor often would allow the creditor to retake without exercising his right of redemption, hoping that when the creditor sold the collateral at a foreclosure sale he would violate one of the technical safeguards. This violation would then bar a deficiency judgment by the creditor, and could even give the buyer a cause of action for damages.⁵⁶

The drafters of Article 9 of the Code rejected the technical safe-

⁴⁸ *Jacksonville Tractor Co. v. Nasworthy*, 114 So. 2d 463, 465 (Fla. 1959). But see *S. Eager*, *supra* note 38, § 176, showing that in New York, a state which adopted the U.C.S.A., the chattel mortgagor, or the debtor, had the burden of proving bad faith or unreasonableness.

⁴⁹ *Stage v. Van Leuven*, 77 App. Div. 646, 78 N.Y.S. 960, 960-61 (1902).

⁵⁰ *Smith v. Post*, 1 Hun 516, 518 (N.Y. Sup. Ct. 1874).

⁵¹ U.C.S.A. § 18.

⁵² U.C.S.A. § 19 requires that the sale take place within 30 days of retaking, that the buyer be afforded 10 days written or personal notice of the sale, that 3 notices of the sale be posted within the billing district where the sale is to take place and that the sale be in a public auction in the state of the retaking.

⁵³ *Gilmore* § 43.1.

⁵⁴ U.C.S.A. § 20.

⁵⁵ *Gilmore* § 44.9.4 & n. 5.

⁵⁶ U.C.S.A. § 25 provides:

If the seller fails to comply with the provisions of Sections 18, 19, 20, 21 and 23 after retaking the goods, the buyer may recover from the seller his actual damages, if any, and in no event less than one third of the sum of all payments which have been made under the contract, with interest.

As originally framed the section would have provided for the recovery of all of the part payments. 2A U.L.A. § 129. This would have worked an even greater injustice on good faith creditors, for then the debtor could in all probability not only avoid a deficiency judgment but also recover any payments made under the contract.

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guards imposed on a foreclosure sale by the U.C.S.A.⁵⁷ Under Article 9 the debtor may require the creditor to dispose of the collateral,⁵⁸ but the Code avoids the unjust situation which arose under the U.C.S.A. by merely requiring the sale to be "commercially reasonable."⁵⁹

III. ACCELERATION CLAUSES UNDER THE UNIFORM COMMERCIAL CODE

Clauses which allow acceleration on the occasion of the insecurity of the creditor are expressly allowed under Section 1-208 of the Code. Section 1-208 is not concerned with default type acceleration clauses. The Code implicitly allows a default type acceleration clause since on default a secured party has the right to repossession of the collateral without judicial intervention;⁶⁰ the creditor need only enumerate the occasions of default within the contract.

Section 1-208 adopts a good faith standard in order to determine whether the occasion of the creditor's insecurity was justified. The section provides that when the contract allows a party to accelerate "at will," or "when he deems himself insecure," the party must in good faith believe that the prospect for payment is impaired. Like the common law rule,⁶¹ but unlike the reasonable man test of the U.C.S.A.,⁶² the Code merely requires that the creditor be "honest in fact."⁶³ This preference for the more subjective standard rather than the reasonable man test allows the creditor to be the sole judge of whether the security is endangered; his honest belief is the only prerequisite for acceleration and it need not be supported by objective facts.⁶⁴

⁵⁷ Gilmore §§ 43.1, 43.2.

⁵⁸ U.C.C. § 9-505(2).

⁵⁹ U.C.C. § 9-504(3).

⁶⁰ U.C.C. § 9-503 provides that "[u]nless otherwise agreed a secured party has on default the right to take possession of the collateral. In taking possession a secured party may proceed without judicial process if this can be done without breach of the peace or may proceed by action"

⁶¹ See p. 533 *supra*.

⁶² See p. 537 *supra*.

⁶³ U.C.C. § 1-201(19) defines "good faith" as "honesty in fact in the conduct or transaction concerned."

⁶⁴ Only six cases have cited § 1-208. In *Sheppard Fed. Credit Union v. Palmer*, 408 F.2d 1369 (5th Cir. 1969), the court held that the trial court was in error in instructing the jury that the burden of proof was on the creditor to show that he acted in good faith. *Id.* at 1371. The court also stated that mere error by the creditor as to a debtor's security is insufficient to establish bad faith. *Id.* at 1373. *Fort Knox Nat'l Bank v. Gustafson*, 385 S.W.2d 196, 200 (Ky. 1964), held that the issue of the creditor's good faith must go to the jury unless the evidence relating to it is no more than a scintilla. *Seay v. Davis*, 246 Ark. 198, 438 S.W.2d 479, 481 (1969), held that the creditor acted in bad faith in accelerating where assurances were given that payment would be made within three hours after the debtor's default. *Merchant v. Worley*, 79 N.M. 771, 774, 449 P.2d 787, 790 (1969), held that the debtor has the burden of proving the creditor's bad faith.

The Code's adoption of "the pure heart and empty head"⁶⁵ approach, which was a minority view under the U.C.S.A.,⁶⁶ is subject to abuse because it is too subjective and arbitrary. This test allows the creditor to be unreasonable, since as long as the creditor is honest he is protected by the literal wording of the Code. It puts the debtor in an unjust position since the creditor may at any time call in the entire debt.⁶⁷ This is especially true in light of the Code's allocation of the burden of proof.

Under the Code the debtor has the "burden of establishing" the creditor's lack of good faith under an insecurity type clause.⁶⁸ Where a creditor retakes the collateral upon a debtor's default pursuant to section 9-503, the burden of proof is also on the debtor. Since the creditor retakes and the debtor must bring suit for conversion, the burden of proof falls on the debtor to prove that in fact no default occurred.

The Code defines "burden of establishing" as the "burden of persuading the triers of fact that the existence of the fact is more probable than its non-existence."⁶⁹ The cases which have construed section 1-208 unsuccessfully attempted to alleviate the burden placed on the debtor. Thus, one court construed this burden to require "submission to the jury of the issue of good faith unless the evidence relating to it is no more than a scintilla, or lacks probative value having fitness to induce conviction in the minds of reasonable men."⁷⁰ At least one other court was bound unwillingly by this provision, and said that it was "not at liberty to accept or reject the legislative policy of the state."⁷¹

The Code's allocation upon the debtor of the burden of proving the creditor's bad faith is clearly unreasonable. This burden is practically impossible to meet unless the creditor outwardly manifests bad faith, since the debtor is unable to probe the mind of the creditor to establish his intention. Thus, the Code in effect allows a creditor to destroy a possible viable contractual relationship without requiring

Fay v. Marina Inc., 6 UCC Rep. Serv. 516 (N.Y. Sup. Ct. 1969), which held that § 1-208 was inapplicable to a default type acceleration clause.

⁶⁵ The Code's definition of "good faith" is an exemplification of the subjective test of honesty in fact which is sometimes referred to as the rule of "the pure heart and empty head." This subjective test relates back more than one hundred years in the law of negotiable instruments to the case of *Gill v. Cupitt* and is an abandonment of the objective standard of reasonable prudence there enunciated. Note, *supra* note 15, at 756.

⁶⁶ *Jacksonville Tractor Co. v. Nasworthy*, 114 So. 2d 463, 465 (Fla. 1958). See p. 537 *supra*.

⁶⁷ In 14 Sw. L.J. 516, 518 (1960), the commentator concluded that a good faith determination is not sufficient to protect stable debtors.

⁶⁸ U.C.C. § 1-208.

⁶⁹ U.C.C. § 1-201(8). For a general criticism of the Code's method of presenting evidence, see Bigham, *Presumptions, Burden of Proof and the Uniform Commercial Code*, 21 Vand. L. Rev. 177 (1968).

⁷⁰ *Fort Knox Nat'l Bank v. Gustafson*, 385 S.W.2d 196, 200 (Ky. 1964).

⁷¹ *Sheppard Fed. Credit Union v. Palmer*, 408 F.2d 1369, 1372 (5th Cir. 1969).

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him to justify his actions. For these reasons the courts prior to the Code placed the burden of proving good faith upon the creditor.⁷²

Once the creditor has legitimately accelerated under the Code, Article 9 determines the rights of the debtor and creditor. Section 9-506⁷³ gives a debtor a right to redeem the collateral at any time before the creditor has disposed of it by "tendering fulfillment of all obligations." The Comment to section 9-506 provides that if the agreement contains an acceleration clause which expressly makes the entire balance due on the default of one installment, the debtor may redeem only by tendering the entire balance.⁷⁴

Where the debtor fails to redeem the collateral, the question arises as to the procedure allowed by the Code for disposing of the collateral. The drafters rejected the strict procedure of the U.C.S.A. and chose to follow Section 6.3 of the Uniform Trusts Receipts Act,⁷⁵ which provided broad guidelines allowing the marketplace to most

⁷² *Jacksonville Tractor Co. v. Nasworthy*, 114 So. 2d 463, 465 (Fla. 1959). *Commercial Credit Co. v. Cain*, 190 Miss. 866, 871, 1 So. 2d 776, 777 (1941).

⁷³ U.C.C. § 9-506 provides:

At any time before the secured party has disposed of collateral or entered into a contract for its disposition under Section 9-504 or before the obligation has been discharged under Section 9-505(2) the debtor or any other secured party may unless otherwise agreed in writing after default redeem the collateral by tendering fulfillment of all obligations secured by the collateral as well as the expenses reasonably incurred by the secured party in retaking, holding and preparing the collateral for disposition, in arranging for the sale, and to the extent provided in the agreement and not prohibited by law, his reasonable attorney's fees and legal expenses.

⁷⁴ U.C.C. § 9-506, Comment. No case has construed what the debtor must do to redeem where the agreement does not contain an acceleration clause; thus, the debtor's requirement for redemption is unclear. By negative implication, in such a case the debtor may redeem by paying only the missed installment. But if the debtor fails to redeem, the question arises as to what the debtor owes the creditor—the missed payment or the entire balance. If the debtor merely owes the missed installment when the collateral is sold, the proceeds over and beyond the missed installments would have to be paid to the debtor, thus leaving the balance of the contract unsecured. This situation is completely unacceptable, and if the courts followed such a course few creditors would repossess and even fewer debtors would redeem the collateral. See *Gilmore* § 43.5.

⁷⁵ *Gilmore* § 44.2. The Uniform Trust Receipts Act § 6.3 provides:

(a) After possession taken, the entruster shall, subject to subdivision (b) and Subsection 5, hold such goods, documents or instruments with the rights and duties of a pledgee.

(b) An entruster in possession may, on or after default, give notice to the trustee of intention to sell, and may, not less than five days after the serving or sending of such notice, sell the goods, documents or instruments for the trustee's account at public or private sale, and may at a public sale himself become a purchaser. The proceeds of any such sale, whether public or private, shall be applied (i) to the payment of the expenses thereof, (ii) to the payment of the expenses of retaking, keeping and storing the goods, documents or instruments, (iii) to the satisfaction of the trustee's indebtedness. The trustee shall receive any surplus and shall be liable to the entruster for any deficiency. Notice of sale shall be deemed sufficiently given if in writing, and either (i) personally served on the trustee, or (ii) sent by postpaid ordinary mail to the trustee's last known business address.

effectively and fairly dispose of collateral in order to satisfy the obligation. The only requirement was that the disposition be "commercially reasonable."⁷⁶ To protect the consumers' interest in sales transactions, the drafters relied on the local Retail Installment Sales Act.⁷⁷ Professor Gilmore states:

In some Code states the default provisions of the Retail Installment Sales Act have been repealed with the enactment of the Code or amended to mesh with Article 9 default provisions. In states where that has not been done, the default provisions of the local RISA will prevail over the Article 9 provisions by virtue of the saving clause in section 9-203(2).⁷⁸

There are several provisions of the Code which alleviate the burden placed on the debtor. Courts have applied Article 2 to transactions which involve elements of sales and secured transactions.⁷⁹ Section 2-302⁸⁰ permits the courts to refuse enforcement of a contract or term which is found to be unconscionable. Thus, if an acceleration clause is so one-sided as to be unreasonable, the debtor may have a remedy under section 2-302. Since section 1-208 expressly validates clauses which permit acceleration at will or when the creditor feels insecure, the mere existence of such a clause would not be evidence of unconscionability. Section 2-302 may be applicable where a clause provides a right of acceleration arising out of an enumerated trivial occasion. Another provision which may alleviate the burden upon the debtor under section 1-208 is section 2-103(1)(b),⁸¹ which imposes

⁷⁶ U.C.C. § 9-504(3) provides:

Disposition of the collateral may be by public or private proceedings and may be made by way of one or more contracts. Sale or other disposition may be as a unit or in parcels and at any time and place and on any terms but every aspect of the disposition . . . must be commercially reasonable. Unless collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market, reasonable notification of the time and place of any public sale or reasonable notification of the time after which any private sale or other intended disposition is to be made shall be sent by the secured party to the debtor. . . . The secured party may buy at any public sale and if the collateral is of a type customarily sold in a recognized market or is of a type which is the subject of widely distributed standard price quotations he may buy at private sale.

⁷⁷ Gilmore § 43.1.

⁷⁸ *Id.*

⁷⁹ See *Unico v. Owen*, 50 N.J. 101, 232 A.2d 405 (1967), discussed in Comment, Unconscionable Security Agreements: Application of Section 2-302 to Article 9, 11 B.C. Ind. & Com. L. Rev. 128 (1969).

⁸⁰ U.C.C. § 2-302(1) provides:

If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause so as to avoid any unconscionable result.

⁸¹ U.C.C. § 2-103(1)(b) defines "good faith" in the case of a merchant as meaning

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the general obligations of honesty in fact and the observance of reasonable commercial standards in contracts under Article 2. Thus, if the creditor is a "merchant" under section 2-104(1)⁸² an objective standard must be met in order to justify acceleration.

While the above provisions may be beneficial to the debtor, the Code could be revised in order to further protect the debtor from arbitrary acceleration. Section 1-208 could be rewritten to provide a reasonable man test as a standard for justifying acceleration at will or when the creditor feels insecure. This would be similar to the tests provided under the common law and the U.C.S.A. The burden of proof should be shifted to the creditor since he is the party who feels "insecure" and is in the best position to present evidence to establish the reasonableness of this alleged "insecurity." However, where the clause allows acceleration when the debtor defaults, the burden of proof should remain on the debtor.

The Code should also be modified so as to include a right of redemption by payment of the amount by which the debtor is in default. Thus, a provision similar to the ten-day period provided by the U.C.S.A. during which the debtor could redeem the collateral by tender of missed payments should be included in Article 9. It should also be specified that if the debtor does not redeem, the creditor may satisfy the entire balance due under the contract. Where the collateral consists of perishable goods or the contract specifically provides that "time is of the essence," the debtor's right to redeem should be for a reasonable period up to ten days. In a suit by the debtor for conversion where the debtor claims that the creditor has resold the goods before the ten-day redemption period has expired, the burden of proof should be on the creditor to establish that his early resale was reasonable.

CONCLUSION

It is evident that the Code, in attempting to improve on the U.C.S.A.'s provisions on foreclosure, has removed the basic protection owed the debtor in order to protect the creditor's right to a deficiency judgment. The Code places the harsh burden of proving subjective intent on the party least able to establish it, while providing only a minimal right of redemption. The Code incorporates the most unworkable provisions of prior statutory and case law in its attempt to insulate the creditor. It is submitted that fundamental revisions of

"honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade."

⁸² U.C.C. § 2-104(1) defines "merchant" as:

[A] person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction or to whom such knowledge or skill may be attributed by his employment of an agent or broker or other intermediary who by his occupation holds himself out as having such knowledge or skill.

the Code are necessary to provide balanced protection to both the debtor and creditor.

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