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September 14, 2015

Representative Charles "Chuck" Kleckley
Speaker of the House of Representatives
P.O. Box 94062
Baton Rouge, Louisiana 70804-9062

Senator John A. Alario
President of the Senate
P.O. Box 94183
Baton Rouge, Louisiana 70804

RE: HCR NO. 93 OF 2012

Dear Mr. Speaker and Mr. President:

The Louisiana State Law Institute respectfully submits herewith its report to the legislature in response to 2012 House Concurrent Resolution No. 93, relative to repossession of collateral by sureties.

Sincerely,

William E. Crawford
Director

cc: Representative Robert Billiot

email cc: David R. Pointer Legislative Research Library
drplibrary@legis.la.us
Secretary of State, Tom Schedler
admin@sos.louisiana.gov

LOUISIANA STATE LAW INSTITUTE

REPORT TO THE LOUISIANA LEGISLATURE IN RESPONSE TO HCR NO. 93 OF 2012 REGULAR SESSION

Repossession of Collateral by Sureties

Prepared for the Louisiana Legislature on

September 14, 2015
Baton Rouge, Louisiana

L. David Cromwell, Reporter
Claire Popovich, Staff Attorney

ENROLLED

Regular Session, 2012

HOUSE CONCURRENT RESOLUTION NO. 93

BY REPRESENTATIVE BILLIOT

A CONCURRENT RESOLUTION

To urge and request the Louisiana State Law Institute to study creating procedures that would enable a surety to take possession of collateral in certain circumstances and to report its findings on or after January 1, 2014.

WHEREAS, many people obligate themselves as surety of debts for the purchase of movables; and

WHEREAS, the purchased movables are the primary collateral of the debt incurred:

and

WHEREAS, if the principal obligor of the debt fails or refuses to make required payments, the surety is then required to make the payments in order to prevent default on the debt and seizure of the collateral; and

WHEREAS, while the surety is making payments on the debt, he frequently does not have possession or control of the collateral; and

WHEREAS, the principal obligor who has failed or refused to make payments retains possession and control of the movable and may cause damage to or destruction of the movable; and

WHEREAS, it would be beneficial to the surety, in addition to his rights of subrogation and reimbursement, if he were able to take possession of the movable in order to protect his interest in the collateral before it is damaged or destroyed.

THEREFORE, BE IT RESOLVED that the Legislature of Louisiana does hereby urge and request the Louisiana State Law Institute to study creating procedures that would enable a surety to take possession of collateral in certain circumstances and to report its findings and recommendations in the form of specific proposed legislation to the Legislature of Louisiana on or before January 1, 2014.

BE IT FURTHER RESOLVED that a suitable copy of this Resolution be transmitted to the director of the Louisiana State Law Institute.

SPEAKER OF THE HOUSE OF REPRESENTATIVES

PRESIDENT OF THE SENATE

REPORT TO THE LOUISIANA LEGISLATURE ON REPOSSESSION OF COLLATERAL BY SURETIES

HCR NO. 93 OF THE 2012 REGULAR SESSION

HCR No. 93 of the 2012 regular session requested the Louisiana State Law Institute "to study creating procedures that would enable a surety to take possession of collateral in certain circumstances." The resolution was assigned for study to the Law Institute's Security Devices Committee.

The recitals of the resolution make clear that it is directed to transactions in which a surety obligates himself for an obligation incurred for the purchase of a movable. Likely, what the Legislature has in mind is the very common situation in which a person co-signs a loan made to finance the purchase price of a motor vehicle. The resolution observes that, in certain cases, the surety is called upon to make payments on the debt while the principal obligor retains possession of the movable, thereby retaining the ability to cause possible damage to or destruction of the movable. The recitals to the resolution also observe that it would be beneficial to the surety if he were able to take possession of the movable in order to reduce the risk that the collateral might be damaged or destroyed.

For the reasons that follow, the Law Institute believes that existing law is sufficient to protect the rights of the surety and recommends against any legislation that would allow the surety to exercise self-help to repossess the motor vehicle after the principal obligor has stopped making payment.

RIGHTS OF SURETIES UNDER EXISTING LAW

Suretyship, which is a form of personal security,[1] is an accessory contract by which a person binds himself to a creditor to fulfill the obligation of another upon the failure of the latter to do so.[2] There are three kinds of suretyship in Louisiana law: commercial suretyship, legal suretyship, and ordinary suretyship.[3] Generally speaking, commercial suretyship arises when a commercial transaction is involved, the principal obligor or the surety is a business organization, or the surety is engaged in the surety business.[4] Legal suretyship is one given pursuant to legislation, administrative act or regulation, or court order.[5] Examples of legal suretyship include bonds required of tutors and curators,[6] bail bonds,[7] and bonds given by a construction surety under either the Private Works Act[8] or the Public Works Act.[9] Any suretyship that is

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[1] C.C. Art. 3137.
[2] C.C. Art. 3035.
[3] C.C. Art. 3041.
[4] C.C. Art. 3042.
[5] C.C. Art. 3043.
[6] *See* C.C.P. Art. 4132.
[7] C.Cr.P. Art. 313.
[8] R.S. 9:4801, *et seq.*
[9] R.S. 38:2241 *et seq.*

neither a commercial suretyship nor a legal suretyship is classified under the Civil Code as an ordinary suretyship.[10] Unlike a commercial suretyship or legal suretyship, an ordinary suretyship is strictly construed in favor of the surety.[11] In addition to this rule of strict construction, the law favors an ordinary surety in certain other ways over a commercial surety or legal surety. For instance, the creditor's agreement to a modification or amendment of the principal obligation or an action of the creditor that impairs any real security held for the obligation, in any material manner and without the consent of the surety, extinguishes an ordinary suretyship.[12] Under these circumstances, a commercial or legal suretyship is in most cases extinguished only to the extent the surety is prejudiced by the creditor's action.[13] Though the recitals of HCR No. 93 of 2012 do not specifically exclude commercial or legal suretyship from the scope of the study resolution, it is likely that the Legislature had in mind only ordinary suretyships in the adoption of the resolution, specifically those suretyships that arise when a person co-signs a purchase money loan made to finance a consumer's acquisition of a motor vehicle or other movable.

As the resolution's recitals observe, existing law accords the surety the twin rights of subrogation and reimbursement.[14] The right of subrogation means that, upon payment of the principal obligation, all the rights initially held by the creditor pass to the surety.[15] This subrogation occurs by operation of law without the necessity of any specific agreement to that effect. In many cases, the most important right to which the surety becomes subrogated is the creditor's rights in any real security, that is, in any collateral that was given by the principal obligor as security for the debt.[16] Thus, when the surety pays the debt, the mere fact of payment entitles the surety to "stand in the shoes" of the creditor in enforcing the creditor's rights in any collateral securing the loan. For instance, if a loan is secured by security interest in a motor vehicle that was financed with proceeds of the loan, the co-signer, upon paying the loan, becomes entitled to enforce the security interest, just as the original creditor could have.

A different right given to the surety under existing law is the right of reimbursement. A surety who pays the creditor is entitled to reimbursement from the principal obligor.[17] To a large extent, the right of reimbursement overlaps the right of subrogation. However, in certain cases, the right of reimbursement allows the surety to recover from the principal obligor even when subrogation would not have allowed such recovery. For instance, if the surety in good faith pays the creditor when the principal obligation has already been extinguished, the surety is nevertheless entitled to reimbursement from the principal obligor if the surety made a reasonable effort to notify the principal obligor that the creditor was insisting on payment.[18] Another reason why the right of reimbursement is sometimes more valuable to the surety than the right of subrogation is that it is a personal action governed by a liberative prescriptive period of ten years

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[10] C.C. Art. 3044.
[11] *Id.*
[12] C.C. Art. 3062.
[13] *Id.*; C.C. Art. 3063.
[14] C.C. Art. 3047.
[15] C.C. Art. 1826; C.C. Art. 3048. *See also* C.C. Art. 1829(3).
[16] C.C. Art. 1826.
[17] C.C. Art. 3049.
[18] C.C. Art. 3050.

and accordingly can be asserted even if prescription has accrued on the rights that the surety would have acquired by subrogation from the creditor.[19]

Subrogation and reimbursement are not, however, the only rights afforded to a surety by existing law. When the surety has been sued by the creditor, he has the right, even before making payment, to demand security from the principal obligor to guarantee his reimbursement.[20] He has the same right when the principal obligor is insolvent, when the principal obligor has failed to perform an act promised in return for the suretyship, or when the principal obligation is due.[21] If the principal fails to provide security or obtain the discharge of the surety within ten days after the surety demands security, then the surety has an action to require the principal obligor to deposit into the registry of the court funds sufficient to satisfy the surety's obligation.[22] Thus, under existing law, if the surety has paid the creditor, he enjoys rights of subrogation and reimbursement. In certain cases the surety has the right to require security from the principal obligor even before making payment.

SHOULD THE LAW GRANT A SURETY A SPECIAL RIGHT OF REPOSSESSION?

As pointed out above, if the surety has paid the creditor, he has the ability under existing law, by exercise of his right of subrogation, to enforce the creditor's rights in the collateral that secures the loan. Typically, this would be done by arranging for the sheriff to seize the property in a foreclosure brought under either executory process[23] or ordinary process.[24] Thus, where the surety has paid the debt, existing law grants him the means, through proper judicial procedures, of regaining possession of the collateral from the debtor and a means of enforcing the security interest by exposing the collateral to sheriff's sale. In those rare instances in which the creditor already has physical possession of the collateral, the surety, as subrogee, has the right to exercise the remedy of a non-judicial disposition by public or private sale to the extent permitted by Chapter 9 of the Louisiana Uniform Commercial Code.[25] The question thus becomes whether the law should afford the surety the right to repossess the collateral *before* the surety has paid the debt. A related question is whether the law should allow this repossession to occur through extra-judicial means, such as self-help repossession.

From the recitals of the study resolution, it appears that the case for granting a surety a special right of repossession is predicated upon a desire to protect sureties against the risk that a debtor might allow the collateral to be damaged, thus potentially increasing the surety's exposure to the creditor. If the law permitted the surety to take possession of the collateral, then he might

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[19] C.C. Art. 3499. *Cleveland v. Comstock,* 22 La. Ann. 597(1870); *Smith v. Taylor,* 14 La. Ann. 663 (1859).
[20] C.C. Art. 3053.
[21] *Id.*
[22] C.C. Art. 3054.
[23] C.C.P. Art. 2631 *et seq.*
[24] Ordinary process involves an ordinary lawsuit resulting in a money judgment that, after expiration of the delays for taking a suspensive appeal, is enforced by seizure of the collateral under C.C.P. Art. 2291 *et seq.* Upon posting a bond, the plaintiff in the suit is entitled to pre-judgment seizure pursuant to a writ of sequestration issued under C.C.P. Art. 3501 *et seq.* For a discussion of the constitutionality of pre-judgment seizure under a Louisiana writ of sequestration, *see* Mitchell v. W. T. Grant Co., 416 U.S. 600 (1974).
[25] R.S. 10:9-610.

be better equipped to mitigate this risk.

At least two persuasive arguments stand in opposition to this proposal. First, it is far from certain that a personal surety would have any greater incentive, or be in any better position, to safeguard the collateral than would the debtor. Allowing the surety to take possession of the collateral on the theory that doing so will reduce his risk would have the obvious result of subjecting the debtor—who is the owner of the collateral—to the risk that the surety might somehow damage the debtor's property to the debtor's prejudice. Secondly, and perhaps even more compelling, is the fact that the creditor is exposed to the very same risk that the debtor might permit the collateral to be damaged. Nevertheless, the law does not permit a creditor, under the guise of having concerns for the safety of the collateral, to simply repossess it and exercise a continuing right of retention.[26] If the creditor, who has already parted with money in funding the loan, is not permitted to dispossess the debtor on the fear that the debtor might harm the collateral, why should the surety, who has not yet paid the debt and is only secondarily liable on it, be granted greater rights than the creditor? Non-possessory security interests inherently involve the risk that harm will come to the collateral while in the debtor's hands. By agreeing to make a loan on the security of a non-possessory security interest, the creditor knowingly subjects himself to this risk. By guaranteeing a loan that is secured by a non-possessory security interest, knowing that the debtor will have possession of the collateral, a surety implicitly assumes the identical risk.

Though the resolution does not mention it, another reason that might be given for allowing a surety to take possession of the collateral when he is called upon to make payments on the loan is the apparent unfairness of allowing the debtor to have unbridled use of the collateral while the surety is having to pay for it. Though on the surface this may seem unfair, it is simply a consequence of the differing rights of owners and creditors. Ownership confers upon the owner "direct, immediate, and exclusive authority over a thing," coupled with the right to "use, enjoy and dispose of it within the limits of the law and under the conditions established by law."[27] No such rights are granted to a creditor, even a creditor holding rights of security in a thing. If a creditor is unpaid, his remedy is to cause the collateral to be sold to satisfy the debt due to him; he cannot appropriate to himself ownership of the collateral or its enjoyment.[28] A surety, who holds only the possibility of becoming subrogated to the creditor's rights in the collateral, has, and should have, no such ability either.

There is also the question of fairness *vis-à-vis* the debtor. In many cases, through his down payment and by making installment payments over a substantial period of time before defaulting, the debtor himself may have already invested much more money than the surety. Should the surety, upon paying only an installment or two, have the right to dispossess the debtor? If so, what then occurs if the surety stops making payments? At what point would the

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[26] It is true that, as a matter of contract, security agreements typically provide that certain actions by a debtor endangering the collateral will constitute a default entitling the creditor to accelerate the loan and institute proceedings to enforce its security interest in the collateral. However, even then, the creditor cannot simply hold on to the collateral on the theory that he is safeguarding it. He must enforce his security interest by sheriff's sale or, where permitted by law, by public or private disposition under the Uniform Commercial Code.

[27] C.C. Art. 477.

[28] C.C. Art. 3140.

debtor then be permitted to regain possession of the collateral and how would he do so? Even if the surety were to continue making all of the remaining payments, should he have the ability to deprive the debtor of possession and use of his property, particularly in those cases where the debtor has substantial equity in the property? Granting such rights to the surety would run the risk of unfairly depriving the debtor of his own rights. It is, of course, true under existing law that if the debtor defaults, he may ultimately lose ownership of the collateral; however, that loss will occur only after the creditor has followed lawful procedures that are designed to balance the competing interests of the debtor and creditor in the collateral. This balancing would be lost if either the original creditor or a surety could simply dispossess the debtor whenever a default occurs.

Again, however, if the surety actually pays the debt, he becomes subrogated to the creditor's rights and can exercise essentially the same remedies that were available to the original creditor.[29] Among those remedies is the right to enforce the security interest in the collateral in order to obtain payment of the balance of the debt that was owed before the surety was required to make payment. Under these circumstances, there is no risk that the surety will pay for a short period and then stop; he will already have paid the entire remaining balance. There is no risk that the debtor's rights in the collateral will be prejudiced by the surety's actions; the debtor's rights and obligations will be precisely the same as though the original creditor still held the debt.

SHOULD SURETIES HAVE THE RIGHT TO USE SELF-HELP?

If the law were amended to grant a surety a special right of repossession, it would be necessary also to address whether this right of repossession could be exercised only through judicial procedures or whether the surety would be authorized to repossess the collateral on his own without judicial oversight.

Based on "the civil law's abhorrence of self-help,"[30] Louisiana courts have over the last two centuries developed a strong public policy against a creditor's resort to self-help enforcement of his rights.[31] One early case condemned a party's decision to "resort to force and violence" rather than making "an application to the courts of justice, in redressing their grievances."[32] Another case emphasized "the jealous care with which our law guards the sacredness of every man's house and his lawful possession of property against invasion or disturbance, otherwise than by proceedings taken under the sanction and through the agency of the public justice."[33] Louisiana courts have not hesitated to award damages where a creditor has unlawfully exercised self-help.[34]

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[29] As discussed below, certain self-help rights of repossession of motor vehicles are available only to licensed lenders.

[30] *See* Bruce Schewe, *Civilian Thoughts on U.C.C. Section 9-503 Self-Help Repossession: Reasoning in a Historical Vacuum,* 42 LA. L. REV. 239 (1981).

[31] *See* James A. Stuckey, *Louisiana's Non-Uniform Variations in U.C.C. Chapter 9*, 62 LA. L. REV. 793, 854–59 (2002).

[32] *Thayer v. Littlejohn*, 1 Rob. 140 (La. 1841).

[33] *Wren v. Flynn*, 34 La. Ann. 1158 (1882).

[34] *See Grandeson v. International Harvester Credit Corp.*, 66 So.2d 317 (La. 1953); *Lewis v. Burglass*, 172 So. 807

When Louisiana adopted Chapter 9 of the Uniform Commercial Code, effective January 1, 1990,[35] the Legislature purposely deleted those provisions of Section 9-503 of the model Uniform Commercial Code that would have allowed a creditor to exercise self-help to regain possession of collateral.[36] Instead, the Legislature allowed a creditor to exercise the right of disposition under the Uniform Commercial Code only if the collateral was already lawfully in his possession. When the Legislature substantially revised Chapter 9 in 2001 in keeping with a nationwide revision of Article 9 of the Uniform Commercial Code, it chose to retain the existing prohibition on self-help, allowing a creditor to take possession of collateral only after the debtor's abandonment or surrender or with the debtor's consent given after default.[37]

Nevertheless, the Legislature has enacted special legislation, known as the Additional Default Remedies Act, allowing certain types of creditors to repossess motor vehicles through a licensed repossession agent when the debtor has defaulted on a minimum of two consecutive payments.[38] Notably, however, this remedy is not granted to all secured parties but only to financial institutions licensed and regulated by the commissioner of financial institutions or licensed and regulated under the laws of the United States.[39] Originally, the law required filing of a summary proceeding against the debtor before the secured party could obtain possession, but a 2004 amendment allows the secured party to take possession without judicial process if repossession can be accomplished without a breach of the peace,[40] which is defined to include an unauthorized entry into a closed dwelling or an oral protest by the debtor.[41] The same amendment allows the secured party to avail itself of the right of self-help repossession without loss of its deficiency judgment rights.

It can be readily seen that the remedy of self-help afforded by R.S. 6:965 *et seq.* is narrow indeed. It is available only with certain types of collateral and is available only to certain types of licensed creditors holding a security interest in the collateral. Repossession can occur only if it can be achieved without a breach of the peace. The repossession must be made only by a licensed repossession agent.[42]

Under existing law, even if a personal surety pays a motor vehicle loan in full thereby becoming subrogated to the creditor's rights, the surety is nonetheless not entitled to exercise self-help under the Additional Default Remedies Act, because the personal surety is not a licensed financial institution. For that matter, if the original creditor is an individual, he, too, is

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(La. 1937). Noting Louisiana's strong and long-standing abhorrence of self-help, one case had no difficulty finding an out-of-state lender liable in damages when it entered upon the debtor's property to disable equipment in which the creditor held a security interest, notwithstanding arguments that such actions would have been lawful under the law of the creditor's domicile. *Pelican Point Operations, L.L.C. v. Carroll Childers Company*, 807 So. 2d 1171 (La. App. 1st Cir. 2002).

[35] Acts 1989, No. 137, effective January 1, 1990.

[36] *See Price v. U-Haul Company of Louisiana*, 745 So. 2d 583, 599 n. 9 (La. 1999).

[37] R.S. 10: 9-609. *See* Stuckey, note 31 *supra* at 856.

[38] R.S. 6:965 *et seq.*

[39] R.S. 6:966(C).

[40] Acts 2004, No. 191.

[41] R.S. 6:965(C)(1).

[42] R.S. 6:966(D).

precluded from using self-help for the same reason. Thus, to grant a personal surety a special right of repossession exercisable through self-help would be to grant him a remedy that he cannot acquire by subrogation and that even the original creditor himself could not exercise if he, like the personal surety, is an individual. The Legislature has already made the policy choice that self-help rights should be limited to creditors that are licensed financial institutions and that employ licensed repossession agents. Not only does this choice further the likelihood that self-help will be exercised only by creditors that are engaged in the business of making automobile loans and presumably know the governing rules, but it also means that a presumably solvent financial institution will be accountable in the event that the debtor's rights are violated. Changing the law to allow personal sureties to exercise self-help repossession, whether by virtue of subrogation to the original creditor's rights or by virtue of a special right of repossession that might be enacted, would run counter to this policy choice. Apart from the fact that most personal sureties are not engaged in the business of motor vehicle financing and are likely unfamiliar with the governing rules, allowing individuals to take the law into their own hands in this manner would risk the very "frontier justice" that the Supreme Court railed against nearly two centuries ago.[43]

SHOULD THE LAW REQUIRE WARNINGS TO SURETIES BEFORE THEY SIGN?

One might argue that a better solution would be to approach the problem at its inception by educating sureties, before they become obligated, of the very real risks that are involved when they choose to guarantee a consumer loan made to another person. Federal law already imposes such a requirement by making it an unfair act for a bank[44] or a retail installment seller or lender within the jurisdiction of the Federal Trade Commission[45] to obligate a co-signer unless the co-signer is informed of the co-signer's liability prior to becoming obligated. The disclosure must be clear and conspicuous and must be substantially similar to the following:

> Notice to Cosigner
>
> You are being asked to guarantee this debt. Think carefully before you do. If the borrower doesn't pay the debt, you will have to. Be sure you can afford to pay if you have to, and that you want to accept this responsibility.
>
> You may have to pay up to the full amount of the debt if the borrower does not pay. You may also have to pay late fees or collection costs, which increase this amount.
>
> The bank can collect this debt from you without first trying to collect from the borrower. The bank can use the same collection methods against you that can be

[43] There might also be constitutional problems with granting a surety a right of self-help. In *Price*, note 36 *supra*, the Supreme Court upheld self-help provisions of the Self-Storage Facility Act against federal and state constitutional challenges. Nevertheless, the Court was careful to observe that "[t]his does not necessarily mean that private self-help can be utilized in every creditor-debtor relationship, even if authorized by statute. Such matters are to be decided on a case-by-case basis." 745 So. 2d 600.

[44] 12 C.F.R. Section 227.14(a).

[45] 16 C.F.R. Section 444.3(a).

used against the borrower, such as suing you, garnishing your wages, etc. If this debt is ever in default, that fact may become a part of *your* credit record.

This notice is not the contract that makes you liable for the debt.[46]

Since federal law has already mandated these very specific disclosures that apply in nearly all cases of consumer lending, little point would be served by adding yet another layer of state-mandated disclosures to co-signers.

CONCLUSION

For the foregoing reasons, the Law Institute believes that existing law affords sureties ample remedies against principal obligors. The Law Institute recommends against adoption of legislation that would create a special right of repossession in favor of sureties and would caution against granting sureties any rights of self-help.

[46] 12 C.F.R. Section 227.14(b); 16 C.F.R. Section 444.3(c).