PLUNKETT COONEY

UCC Tip of the Month – Security Interests vs. Garnishments

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Questions sometimes arise among secured lenders when a debtor becomes the subject of a garnishment action. Specifically, when a debtor's accounts are garnished to satisfy the judgment of a third-party what can, or should, the secured party do to protect its secured position?

Until recently, this was an unsettled question in Michigan. Some claimed that when faced with a debtor's garnishment the secured creditor was required to foreclose to preserve its secured interest. Creditors, on the other hand, know that despite a default foreclosure may not be the best solution. Rather, if a way can be found to allow the debtor in default to continue operating the default may be cured. At the very least, the collateral may have higher value if sold or liquidated outside of foreclosure.

In *System Soft Technologies, L.L.C. v. Artemis Technologies, Inc,* 301 Mich App 642, --- NW2d ----, 2013 WL 3717753 (2013) the Michigan Court of Appeals ended the debate, concluding that a secured lender need not foreclose to maintain its priority over the garnishment of a junior lien holder or unsecured creditor.

Clearly, if a debtor is not in default of a secured loan the secured lender need not do anything when the debtor's accounts are garnished. However, if the secured loan is delinquent, or if the garnishment can cause a delinquency or other default of the loan, even after *System Soft Technologies,* swift action may be necessary.

Article 9 of the Michigan Uniform Commercial Code, MCL 440.9101 *et seq.,* provides that after a default a secured party "[*m*]*ay* reduce a claim to judgment, foreclose, or otherwise enforce the claim, security interest, or agricultural lien by any available judicial procedure." *See*, MCL 440.9601(1)(a). Similarly, the UCC provides that a secured party may "[n]otify an account debtor or other person obligated on collateral to make payment or otherwise render performance to or for the benefit of the secured party." MCL 440.9607(1)(a).

The *System Soft Technologies* court recognized, in part based on these sections, that the code does not *require* a secured party to (1) foreclose, (2) to order an account debtor to pay the secured party or (3) to enforce the claim by a judicial action merely to preserve its priority interest. While this may seem intuitively correct, only after *System Soft Technologies* is the law clear that once a default is declared,

the secured party can enforce its contract rights in the manner the creditor sees fit. *See*, MCL 440.9601(1). This discretion can include entering into a forbearance agreement to allow the debtor to remain operating while shielded from the garnishment claims of junior lien holders and unsecured creditors.

Put simply, after *System Soft Technologies*, the UCC in Michigan does not require a secured lender to foreclose, to liquidate or to seize a debtors' assets. Since MCL 440.9601(1) authorizes a contractual method of collecting on a secured debt, a secured lender can protect itself from garnishment and even obtain an injunction against other collection activities against the debtor in default with a carefully-worded security agreement.

If you have questions about your rights and obligations as a secured lender when garnishments are filed, do not guess. Plunkett Cooney's attorneys can help.