Default Proceedings Under Article 9: Problems, Solutions, and Lessons To Be Learned

Leonard Lakin
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INTRODUCTION

Much of the literature on the subject of secured transactions (Uniform Commercial Code, Article Nine) has been concerned with the creation and perfection of security interests in collateral and with the Uniform Commercial Code's (hereinafter "the Code") provisions which relate to the resolution of the conflicting security interests. The Code, in validating the increasing variety of secured transactions in today's business world, recognizes that collateral is the medium of credit as money is the medium of exchange. Article 9 effectuates the Code's policy which recognizes that the secured transaction is a vital and necessary component in today's credit economy by providing the mechanism that gives to the secured party a definite, special and exclusive interest in the debtor's property to secure the payment of the debtor's obligation. Fortunately for our economy and our lenders, borrowers, sellers, and buyers, the problem of the defaulting debtor and the consequent need of the secured party to make himself "whole" by seizing and disposing of the debtor's collateral occurs relatively infrequently, considering the annual number of secured transactions and the hundreds of billions of dollars of secured transactions concluded each year. Yet, the dollar amount of consumer and commercial secured transactions and the number of consumer and business debtors adjudicated bankrupt each year compel any student of secured transactions to become fully familiar with those Article 9 Code provisions that govern the rights, duties and remedies of the secured party upon the debtor's

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2 Since 1945 the percentage of installment contracts delinquent one month or more has remained at a relatively constant three percent of the total number of outstanding loans. P. McCracken, J. Mao & C. Fricke, CONSUMER INSTALLMENT CREDIT AND PUBLIC POLICY 119 (1965); Note, Consumer Legislation and the Poor, 76 Yale L.J. 745, 761 (1967).
default as well as his liability to the debtor for noncompliance with the Code's requirements.

The Code has two policy objectives in establishing the rules that govern the rights and duties of the secured party and debtor after default. The first objective is to obtain the highest possible price upon the disposition of the collateral. This is accomplished by giving the secured party substantial discretion and flexibility in disposing of the collateral, whether by private or public disposition, provided he acts in a "commercially reasonable" manner. The second objective is to increase the ability of a court of law to review the conduct of the secured party before and after any disposition to insure that the disposition of the collateral will be made, or in fact was made, in a commercially reasonable manner.

This article will explore in detail the relevant Code provisions relating to default proceedings and the impact of the significant court decisions which have interpreted this most important area of secured transactions as well as the changes made by the 1972 Official Text of Article 9, which has already been adopted in ten states as of this writing. ³

WHEN A DEFAULT OCCURS

Article 9 does not specify when a debtor is in default under a security agreement. Nor is the term "default" defined in the Code. Therefore, the security agreement ⁴ must state when the debtor is in default. ⁵ The security agreement will always provide that a default occurs upon the happening of any of certain specified events. The one event universally recited as an event of default is the failure of the debtor to make a payment which is due under the security agreement. Other customary events of default which are generally provided for in the security agreement are: failure to insure the collateral as required under the security agreement; unauthorized removal, sale or disposition of any collateral; legal seizure of any collateral by third parties; the breach of any representation or warranty made by the debtor to the secured party in the security agreement; death or dissolution

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³ In April, 1972, the American Law Institute and the National Conference of Commissioners on Uniform State Laws (the two organizations having responsibility for drafting the UNIFORM COMMERCIAL CODE) published what was called the 1972 Official Text of Article 9. States adopting the 1972 Official Text of Article 9 are Arkansas, Illinois, Iowa, Nevada, North Dakota, Oregon, Texas, Virginia, West Virginia and Wisconsin. For effective dates of adopting states see 1 CCH SEC. TRANS. GUIDE ¶ 4,006 (1974).

⁴ UNIFORM COMMERCIAL CODE § 9-105(1) [hereinafter cited as U.C.C.] defines a "security agreement" as "an agreement which creates or provides for a security interest."

⁵ Since the U.C.C. does not define the term default, the parties are free to do so. Borochoff Properties, Inc. v. Howard Lumber Co., 116 Ga. App. 691, 696, 155 S.E.2d 651, 654 (1967). This accords with the general principle of freedom of contract in U.C.C. § 1-102(3), which allows the parties to define their rights, liabilities and duties subject, however, to the standards of good faith and reasonableness set forth in that section and in sections 1-203 and 1-208.
of the debtor; insolvency of the debtor; appointment of a receiver; assignment for the benefit of creditors, or a bankruptcy proceeding.

Furthermore, when the secured debt is to be repaid in installments, the security agreement will usually contain an acceleration clause which provides that if the debtor defaults by not making any required payment or if any other specified event of default occurs, then all sums due and owing by the debtor under the security agreement become immediately due and payable at the option of the secured party. However, the secured party does not have to exercise his option upon default. There is no concomitant duty owing by the secured party to other creditors of the debtor to declare the debtor in default.

Thus, in a New York case, petitioner, a secured lender, successfully vacated an execution levy made by unsecured creditors of the debtor against the secured lender's collateral. The unsecured creditors contended in a novel argument that a secured lender whose loan is repayable on demand owes a duty to unsecured merchandise creditors to demand repayment and to foreclose on his lien at the first instance the secured lender has cause to believe that the debtor cannot immediately repay the loan. The court rejected this argument and sustained the security interest of the secured lender. While acceleration clauses are commonplace in security agreements, those who loan money secured by a security interest in a debtor's inventory (which might include raw materials and work-in-process) often elect to postpone accelerating the due date of the loan. For example, when the collateral consists of substantial work-in-process, the secured party may elect to postpone declaring a default or accelerating the loan while he continues to advance additional money to the defaulting debtor to enable him to convert relatively valueless work-in-process to much more valuable finished inventory. While the secured party has a right to complete the work-in-process after foreclosing on its security interest, it is often to the secured party's advantage to have the debtor complete the work-in-process since he has the available labor pool, machinery and technical skill.

It is also common practice to provide in the security agreement that the secured party may accelerate payment or performance, or require additional collateral "at will," or "when he deems himself insecure." Obviously, this right could be abused by the secured party. Consequently, under pre-Code law a number of states declared such clauses void as against public policy. However, the Code expressly permits such a clause in a security agreement, but provides in Section 1-208 that the clause

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6 U.C.C. § 9-105(1) (m) defines a secured party as "a lender, seller or other person in whose favor there is a security interest..."  
8 U.C.C. § 9-504(1).
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.

Thus, a debtor who objects to such an acceleration requiring immediate and full payment has the burden of establishing lack of good faith on the part of the secured party. In Code terms the burden of establishing any fact is said to mean "the burden of persuading the triers of fact that the existence of the fact is more probable than its non-existence." The requirement of "good faith" is a golden thread woven into the entire fabric of the Uniform Commercial Code. Good faith is defined as "honesty in fact in the conduct or transaction concerned." To insure that the secured party is acting in "good faith" and not frivolously, the Code provides for judicial review of the conduct of the secured party.

THE SECURED PARTY'S RIGHT TO POSSESS COLLATERAL AFTER THE DEBTOR'S DEFAULT

Upon the debtor's default, the first important right that the secured party usually wants to exercise is to take possession of the collateral as promptly as possible. It is at this time that the risk is greatest that the debtor will wrongfully dispose of the collateral or that other trade creditors or the government will seize the collateral to satisfy their respective claims. Therefore, the right of the secured party to obtain possession of the debtor's collateral after default is the cornerstone of all his subsequent rights. Indeed, the secured party's legal right to possession after default is a meaningless scholasticism if he cannot take possession of the collateral after default. The Code recognizes the historic principle of self-help

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9 U.C.C. § 1-201(8); Fort Knox Nat'l Bank v. Gustafson, 385 S.W.2d 196 (Ky. Ct. App. 1964).
11 U.C.C. § 1-201(19).
12 U.C.C. § 9-507.
13 Supra note 5.
15 Where a debtor has not defaulted under the terms of the security agreement, however, a secured party cannot lawfully seize and dispose of the debtor's collateral. See U.C.C. § 9-501(1).
17 3 W. BLACKSTONE, COMMENTARIES *4, where Blackstone states:
by giving the secured party the right to take possession of the collateral after default without judicial process provided it can be done without breach of the peace.\textsuperscript{18} Moreover, the secured party may take peaceable possession of the collateral on default without the consent, and even over the protest, of the debtor.\textsuperscript{19}

Thus the Code, following the pre-Code law,\textsuperscript{20} provides in Section 9-503: "Unless 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. . . ."

Interestingly, Article 9 does not set forth any standards to determine whether or when a secured party may take possession of the collateral without a breach of the peace. However, the Code does provide that if he takes possession by committing a breach of the peace he not only subjects himself to criminal and to ordinary tort liability\textsuperscript{21} but he also becomes liable to the debtor for "any loss caused by a failure to comply with the provisions of this part."\textsuperscript{22} In this respect the secured party may not exert wrongful pressure against the debtor to obtain possession of the collateral. He has no right to use force or coercion and enjoys no immunity. He acts at his peril, and exposes himself to severe potential liability, including liability for punitive damages.\textsuperscript{23}

Recapture or reprisal is another species of remedy by the mere act of the party injured. This happens when any one hath deprived another of his property in goods or chattels personal, . . . in which case the owner of the goods . . . may lawfully claim and retake them wherever he happens to find them, so it be not in a riotous manner or attended with a breach of the peace.

\textsuperscript{18} U.C.C. § 9-503.

\textsuperscript{19} Ford Motor Credit Co. v. Cole, 503 S.W.2d 853 (Tex. 1973).

\textsuperscript{20} \textit{Uniform Conditional Sales Act} §§ 16, 17; \textit{Uniform Trust Receipts Act} § 6.

\textsuperscript{21} If the secured party repossesses without any claim of right he may be sued for conversion. \textit{W. Prosser, Handbook of the Law of Torts} 79-97 (4th ed. 1971). Moreover, if methods used in self-help repossession are patently offensive to the debtor, he may recover damages from the secured party resulting from defamation, abuse of process or intentional infliction of mental distress. \textit{Id.} at 57. Texas has even recognized the distinct tort of unreasonable collection. \textit{See Note, Effectively Regulating Extrajudicial Collection of Debts}, 20 Me. L. Rev. 261, 271-73 (1968).

\textsuperscript{22} U.C.C. § 9-507(1).

\textsuperscript{23} The secured party who, during repossession, seizes debtor's property which is not collateral is subject to damages for conversion. Ford Motor Credit Co. v. Cole, 503 S.W.2d 853 (Tex. 1973) (held that waiver of a debtor's claim to contents of repossessed automobile if he made no demand within 24 hours after repossession was void as against public policy). \textit{Cf. Klingbiel v. Commercial Credit Corp.}, 439 F.2d 1303 (10th Cir. 1971) (debtor recovered from secured party $770. as general damages and $7,500. punitive damages for wrongful repossession); \textit{Ferraro v. Pacific Fin. Corp.}, 8 Cal. App. 3d 339, 87 Cal. Rptr. 226 (1970) (debtor recovered from secured parties general damages or $2,812. and punitive damages of $33,000. for wrongful repossession); \textit{Goetz v. Security Indus. Bank}, 508 P.2d 410 (Colo. Ct. App. 1973) (where the court sustained the trial court's award to a third party whose tools and parts were in repossessed truck when bank refused to return them to the third party); \textit{Northside Motors, Inc. v. Brinkley}, 282 So. 2d 617 (Fla. 1973); \textit{Buie v. Barnett First Nat'l Bank}, 266 So. 2d 657 (Fla. 1972).
Since the Code does not define "breach of the peace" the courts have applied common law definitions in the few cases arising under the section.24 Thus, in an interesting New York case25 the secured party, a bank, gained access to the defaulting debtor's business premises by means of a duplicate key made by a locksmith at the bank's request. The security agreement contained the usual provision that in the event of default the bank had the right "to enter the...premises...where any of the collateral may be located and take and carry the same...with or without legal process." At the time of the bank's entry a court order existed for the sale of the debtor's assets. It was argued that the unauthorized entry by the bank's employees was a breach of the peace and the taking of possession of the collateral was, therefore, a conversion. The court dismissed this argument stating that "there was nothing in what they did that disturbed public order by any act of violence, caused consternation or alarm, or disturbed the peace and quiet of the community."26 And when a secured party took possession of an automobile under the terms of the security agreement after the debtor refused permission and informed the secured party to proceed by court action, a court held that there was no wrongful taking or trespass since no breach of the peace occurred.27

However, whatever distinctions Section 9-503 makes between repossession by self-help and by judicial process, the fact is that the remedy of self-help has been subjected to constitutional attack in a large number of jurisdictions following the advent of the well known United States Supreme Court decisions: Sniadach v. Family Finance Corp.28 decided in 1969, and Fuentes v. Shevin29 decided in 1972. The holdings of these two cases and, more importantly, their rationale, became the spearhead in the continuing assault on the constitutionality of the remedy of self-help under Section 9-503.

Sniadach held that the Wisconsin pre-judgment garnishment procedure

26 Id. at 281, 282 N.Y.S.2d at 120. Cf. Wirth v. Heavey, 4 CCH SEC. TRANS. GUIDE ¶ 52,346 (Mo. Ct. App. 1974) (where the court held that the secured party's breaking the lock of the defaulting debtor's door was not a breach of the peace since the secured party was lessor of premises under lease and debtor's default under lease gave secured party the right to forcibly enter premises to which he is entitled to possession).
27 Ford Motor Credit Co. v. Ditton, 4 CCH SEC. TRANS. GUIDE ¶ 52,319 (Ala. 1974).
which permitted garnishment of a defendant's wages prior to trial at the ex-parte request of the creditor's lawyer was a violation of due process under the fourteenth amendment because the garnishment procedure did not afford the debtor notice and hearing prior to garnishment. The significance of *Sniadach* was that for the first time the court established a requirement for a due process hearing before property could be seized by pre-judgment attachment.

In *Fuentes*, Pennsylvania and Florida pre-judgment replevin statutes authorizing the issuance of a writ directing the sheriff to seize secured property were challenged. The Supreme Court stated the issue before them to be "whether procedural due process in the context of these cases requires an opportunity for a hearing before the state authorizes its agents to seize property in the possession of a person upon application of another." The court emphasized the active participation of the state agents and, stating that its holding in *Fuentes* was a very narrow one, declared:

The constitutional right to be heard is a basic aspect of the duty of government to follow a fair process of decision-making when it acts to deprive a person of his possessions. The purpose of this requirement is not only to ensure abstract fair play to the individual. Its purpose, more particularly, is to protect his use and possession from arbitrary encroachment—to minimize substantively unfair or mistaken deprivations of property, a danger that is especially great when the State seizes goods simply upon the application of and for the benefit of a private party. So viewed, the prohibition against the deprivation of property without due process of law reflects the high value, embedded in our constitutional and political history, that we place on a person's right to enjoy what is his, free of governmental interference.

Thus, the Supreme Court held that due process under the fourteenth amendment required that a debtor under such circumstances be given notice and opportunity to be heard before he is deprived of his property interest, even though he does not have full title to the goods at the time of repossession.

In reaching its decision in *Fuentes*, the Court in a four-to-three decision rejected the creditor's view that consideration of the costs in time, effort, and expense imposed by the requirements of a prior hearing should outweigh a constitutional right because, the court said, "the Constitution recognizes higher values than speed and efficiency."

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30 395 U.S. at 342.
31 407 U.S. at 80.
32 *Id.* at 80-81.
33 Justice Stewart wrote for the majority (Justices Douglas, Brennan and Marshall concurring). Justice White wrote a dissenting opinion, concurred in by Chief Justice Burger and Justice Blackmun. Justices Powell and Rehnquist did not participate in the decision.
34 407 U.S. at 90 n.22.
The Court reasoned that the requirements of procedural due process are "not intended to promote efficiency or accommodate all possible interests," but rather "to protect the particular interests of a person whose possessions are about to be taken." 

The Court also rejected the creditor's view that default by a debtor could be considered an "extraordinary situation" that could justify postponing notice and opportunity to be heard. Expanding on the Sniadach interpretation, the Court concluded that outright seizure of a person's property was permitted in only a few limited situations of unusual nature, such as those serving an important governmental or general public interest. This litmus test has been met in situations where the state sought to protect the public from contaminated food, misbranded drugs or to meet war needs.

In the emerging body of case law involving the constitutionality of Sections 9-503 and 9-504 which has developed since the first decision on that issue in 1971, the constitutional validity of the self-help remedy has often been decided on the presence or absence of state action sufficient to invoke the prohibitions of the fourteenth amendment of the Constitution of the United States, which provides in part, "... [N]or shall any state deprive any person of life, liberty, or property without due process of law; ..." While an overwhelming majority of cases have upheld the constitutionality of Sections 9-503 and 9-504 a few examples:

35 Id.
36 Id. at 91.
40 See notes 43-44 infra.
41 See note 43 infra.
42 Northside Motors, Inc. v. Brinkley, 282 So. 2d 617, 620 (Fla. 1973).
courts have declared those sections unconstitutional. Thus, the decisions are in conflict and as one court correctly prophesied, the questions concerning the constitutionality of self-help "are before long going to be placed before the United States Supreme Court." 45

McCormick v. First National Bank, 46 was the first reported case in which a debtor challenged the constitutionality of Section 9-503 under the due process clause of the fourteenth amendment. The debtor purchased an automobile from an auto dealer under a purchase money security agreement which the dealer assigned to the defendant bank. After the debtor allegedly defaulted in his payments the secured party repossessed the automobile without prior notice.

The debtor, relying on Sniadach, claimed, inter alia, that his automobile was repossessed under color of state law and he was thus deprived of his property without due process in violation of the fourteenth amendment. The court rejected this argument by holding the reposssession was a remedy the secured party had under the security agreement and that by exercising this remedy it was acting independently under the agreement and was not acting under color of state law. 47

The most significant case since then was Adams v. Egley, 48 which is now pending before the United States Supreme Court. 49 That decision declared the California statute embodying Sections 9-503 and 9-504 unconstitutional as a violation of the due process clause under the fourteenth amendment. In that case pursuant to the security agreement the debtors' cars were seized and sold by the secured party without notice or an opportunity to be heard before the seizure. The debtors urged the court to take federal court civil rights jurisdiction under 28 U.S.C. Section 1343(3) 50 and to grant substantive relief under 42 U.S.C. Section 1983. 51

Automatic Employees Credit Union, 363 F. Supp. 143 (N.D. Ill. 1973); (court dismissed the action because plaintiffs were found, on the facts, not to have standing to raise the issue of constitutionality of sections 9-503 and 9-504; inasmuch as plaintiffs alleged repossessin in violation of the state's statutes).


47 Id. at 606.


49 Cert. docketed, No. 73-1842 (June 7, 1974).

50 See note 51 infra.

51 To establish jurisdiction in federal court under § 1343(3) and § 1983 the plaintiff must show "that the action in question was 'under color of state law' and also that
They claimed that the constitutional right of due process under the fourteenth amendment entitled them to have their rights judicially determined before being deprived of a significant property interest. The secured party argued that the repossession was accomplished by private parties pursuant to a contract clause in the security agreement and that no state action was involved. The court rejected the secured party's argument holding that the presence of Sections 9-503 and 9-504 has a "significant impact" on the contents of the contract provisions because one contract made specific reference to the Code and another granted the secured party "immediate possession... according to law" upon default. The court found that secured parties were "persuaded or induced to include" repossession clauses by the fact that repossession was authorized by statute and concluded that Sections 9-503 and 9-504 set forth the state's authorization of self-help by repossession and the cited contract clauses "are merely an embodiment of the policy.

On appeal, the Ninth Circuit, in a 2-1 decision, reversed. The court stated that the two controlling questions of law are: (1) whether the repossession of collateral by self-help on default under a contract providing for such repossession is an act accomplished under color of state law, and thus state action within the meaning of the fourteenth amendment, and (2) whether Sections 9-503 and 9-504 are unconstitutional as state action which authorizes summary repossession without affording due process.

The court, in holding that there was no significant state action involved when the secured party exercised its right of self-help, stated:

The objective finding that the creditors in part acted with knowledge of and pursuant to state law is but one element of the action taken under color of state law requirement; alone it is not sufficient. The test is not state involvement, but rather is significant state involvement. Statutes and laws regulate many forms of purely private activity, such as contractual relations and gifts, and subjecting all behavior that conforms to state law to the Fourteenth Amendment could emasculate the state action concept. Further inquiry needs to be made into the relationship between creditors and the State to see whether the State is significantly involved or entangled in the challenged repossessions or whether mutual benefits are conferred.


52 338 F. Supp. at 617.
53 Id. at 617.
54 Id.
55 Id. at 618.
56 Adams v. S. Cal. First Nat'l Bank, 492 F.2d 324 (9th Cir. 1974) (as modified on denial of rehearing).
57 Id. at 328.
which would lead to a finding of a "symbiotic relationship" between creditors and the State. . . .\textsuperscript{58} (emphasis added).

The court in finding no "significant state involvement" reasoned that in self-help cases the enactment of Sections 9-503 and 9-504 did not reverse the law as it had been prior to the enactment of the Code but merely codified existing law for the most part, noting that this is particularly true for the creditor's remedy of self-help repossession. Furthermore, the court recognized that these creditors' remedies were based on economically reasoned grounds of very long standing, "which appear to have been the topic of extensive research and legislative investigation."\textsuperscript{59}

The court rejected the debtor's contention that "the Code provisions clothe secured parties with the authority of state law" stating that the creditors were not "working in active concert with state officials"\textsuperscript{60} in the course of self-help repossession. Moreover, the court also rejected the debtor's contention that the creditors were performing a function or service that would otherwise in all likelihood be performed by the state by noting that "a strong case can be made that it is a tradition that repossession is not a state function, and that the creditor was invoking a private remedy rather than a state power which has been delegated to him."\textsuperscript{61}

The circuit court decision in Adams was explicitly relied upon by a United States District Court in a different circuit in Johnson v. Associates Finance Inc.,\textsuperscript{62} which held that repossession by private parties was not "state action" giving federal court civil rights jurisdiction. The court based its decision on its recognition that:

[S]tates have authorized self-help repossession in deference to historical continuity and because the practice is adjudged to be economically beneficial for the bulk of creditors and debtors alike. The persons who thoughtfully and meticulously drafted the Uniform Commercial Code were not attempting to circumvent constitutional guarantees. Rather, they intended to permit private persons to decide whether or not to continue the practice of self-help repossession and thereby leave to them the ability to regulate, in some small degree, the cost of borrowing money. Thus, state power, in a sense, was withdrawn and private decision-making substituted therefor by Section 9-503 and Section 9-504. Under these circumstances, this court can perceive no action in this case. . . .\textsuperscript{63}

A review of all the cases involving the constitutionality of self-help repossession reveals that many courts upholding constitutionality have

\textsuperscript{58} Id. at 330-31.
\textsuperscript{59} Id. at 333.
\textsuperscript{60} Id. at 338.
\textsuperscript{61} Id. at 336.
\textsuperscript{63} Id. at 1381-82.
postulated their decision on a finding that the state's involvement is only passive and therefore there is no "color of law" under which the secured party acts. 64

It is submitted that the Supreme Court will declare self-help repossession constitutional in view of the compelling combination of reasons cited in the various cases upholding constitutionality.

THE SECURED PARTY'S RIGHT TO COLLECTIONS

Possession of the collateral after the debtor defaults is easy to accomplish when the collateral is tangible property, such as equipment, inventory and consumer goods. However, when the collateral is intangible personal property, such as accounts receivable and chattel paper, the secured party has nothing tangible to take into his possession. Therefore, his ability to realize on intangible collateral depends on his right to collect the proceeds of such intangible collateral. When the secured party and debtor use accounts receivable as collateral they will almost always use a security agreement which will provide for a "non-notification accounts receivable financing arrangement." 65 Under the arrangement the secured party will not notify the debtor's customers of the debtor's assignment of the customers' accounts receivable. Moreover, the secured party will allow the debtor to collect these accounts receivable, which is permitted by Section 9-205, and then remit the collections (usually in original specie) to the secured party which represents the proceeds of the collateral to which the secured party is entitled. 66

After default, the secured party may be able to take possession of all mail received by the debtor pursuant to the standard provision contained in such security agreements. In that way he takes possession of all payments received by the debtor from his account debtors 67 and can endorse all checks to his own order pursuant to the security agreement. However, for obvious reasons, he will generally prefer to notify the account debtors directly and inform them that their accounts have been previously assigned to him and that payment should therefore be mailed directly to him. To enable him to do so, the Code gives him this extremely


66 U.C.C. § 9-306.

67 An "account debtor" is defined under U.C.C. § 9-105(1)(a) as "the person who is obligated on an account, chattel paper or general intangible." The words "contract right" were deleted by the 1972 amendments.
important right to obtain collections by giving him the right to notify the account debtor to make payment to him after the debtor’s default even if he has not reserved this right in the security agreement.

Thus, Section 9-502(1) provides:
When so agreed and in any event on default the secured party is entitled to notify an account debtor or the obligor on an instrument to make payment to him whether or not the assignor was theretofore making collections on the collateral, and also to take control of any proceeds to which he is entitled under section 9-306.

Furthermore, under the standard “non-notification accounts receivable financing arrangement” and this Code section the secured party is given the right to compromise and settle claims against the account debtors as well as charge back to the debtor any uncollectible accounts. The debtor remains liable for any deficiency if the total collections are not sufficient to repay the loan.68 Thus, what the secured party does when he settles and collects these various accounts may adversely affect the debtor because the debtor will continue to be liable for any deficiency as well as be entitled to any surplus.69 Therefore, to protect the debtor’s interest during this most important phase, the Code provides that when the secured party collects the proceeds of such collateral, either before or after default, he must do so in a “commercially reasonable manner.” Thus, Section 9-502(2) provides:

A secured party who by agreement is entitled to charge back uncollected collateral or otherwise to full or limited recourse against the debtor and who undertakes to collect from the account debtors or obligors must proceed in a commercially reasonable manner and may deduct his reasonable expenses of realization from the collections. If the security agreement secures an indebtedness, the secured party must account to the debtor for any surplus, and unless otherwise agreed, the debtor is liable for any deficiency. But, if the underlying transaction was a sale of accounts, contract rights, or chattel paper, the debtor is entitled to any surplus or is liable for any deficiency only if the security agreement so provides.

The “reasonable expenses of realization” which the secured party may deduct from the collections will generally include reasonable attorney’s fees and other costs reasonably incurred in enforcing collection against the account debtors.70 In requiring the secured party who undertakes to collect from the account debtors or obligors to proceed “in a commercially reasonable manner,” the Code imposes a fair standard of conduct for the protection of the debtor.

The paucity of cases challenging the right of the secured party to assert his rights under Section 9-502(1) after the debtor defaults, with

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68 Id. at 330-31.
69 Id.
respect to notifying account debtors to make payment directly to him and taking control of proceeds, suggests that this section is working well in actual practice.

THE SECURED PARTY'S RIGHT TO RETAIN THE COLLATERAL

Once the secured party has taken possession of the collateral by self-help or through judicial process, he must comply with other provisions of the Code.71

The Code provides, with one important exception (relating to certain consumer transactions discussed hereafter), that the secured party may propose to retain the collateral in complete satisfaction of the debtor's obligation by giving written notice of such proposal to the debtor and, except in the case of consumer goods, to any other secured party who has a security interest in the collateral evidenced by a financing statement or who is known by the secured party to have a security interest in the collateral.72 In such a case, Section 9-505(2) provides that if the debtor or other secured party does not object within 30 days from the receipt of notification, the secured party may retain the collateral in addition to all payments previously received. If the debtor or certain other secured parties having a security interest in the same collateral make timely objection to the secured party's retention of the collateral then the secured party must dispose of the property.73 This section is frequently employed, according to one writer,74 to dispose of unregistered securities when public sale under Section 9-504(3) would be difficult.

The reason for this rule is set forth in the Official Code Comment to this section:

Experience has shown that the parties are frequently better off without a resale of the collateral; hence this section sanctions an alternative arrangement. In lieu of resale or other disposition, the secured party may propose under subsection (2) that he keep the collateral as his own, thus discharging the obligation and abandoning any claim for a deficiency. . . .75

The 1972 Official Text has made some important and useful changes in this area. First, the waiting period is reduced to a maximum of 21 days calculated from the time written notice of proposal to retain the collateral is “sent” (not when it is received) until written objection is “received” (not when it is dispatched). Secondly, the new Text requires that notice

72 U.C.C. § 9-505(2). This section has been revised by the 1972 Official Text of Article 9 and is discussed infra.
73 Id.
75 U.C.C. § 9-505, Comment 1.
of the proposal to retain the collateral be sent only to other secured parties from whom the secured party has received written notice of a claim of an interest in the collateral, before the secured party has sent notice of his proposal to the debtor, or before the debtor's renunciation or modification of his rights, whichever occurs first. Thus, the time for objection is shortened and the period for giving an objection is stated in terms of being received by the creditor, rather than the date the person was notified of the intention to retain the collateral.

Under Revised Section 9-505(2), if the secured party proposing to retain the collateral in satisfaction of the obligation receives a written objection within the 21-day period, from a person entitled to receive notification, he must dispose of the collateral under Section 9-504. Otherwise, his proposal is deemed accepted and he becomes the owner of the collateral.

However, the exception to the rule which allows the secured party at his option to retain the collateral in full satisfaction of his claim against the debtor, in the absence of written objection from the debtor and other secured parties, occurs when a debtor has purchased consumer goods and has paid 60 percent of the price or 60 percent of the debt. In this case Section 9-505(1) provides for compulsory disposition of the goods.

The obligation of the secured party to make a compulsory disposition of the consumer goods cannot be disclaimed or avoided in the security agreement. However, the Code recognizes that after default the debtor may agree in writing to modify or renounce his right to compulsory disposition of the consumer goods. The rationale of this rule is that it is frequently in the debtor's interest to make this agreement after default because it permits the secured party to retain the consumer goods in full satisfaction of his claim while discharging the debtor from any liability for any deficiency. Otherwise, compulsory disposition may not produce sufficient net proceeds to satisfy the obligation and the debtor would be liable for the deficiency. Of course, if there is compulsory disposition then the secured party must deliver any resulting surplus of money or collateral to the debtor. Compulsory disposition of consumer goods must be made within 90 days after the secured party has taken possession of the consumer goods. The disposition may be by public or private sale and must, like all dispositions, be made in a commercially reasonable manner.

While there appear to be no reported decisions contesting the secured party's right to retain the collateral in full satisfaction, a number of cases have raised the question whether and under what circumstances a secured party's delay in disposing of the collateral after repossession might be

76 The policy reasons for this important change are discussed in detail in the text accompanying notes 98-100 infra.

77 See note 134 infra.

78 U.C.C. § 9-504(2).

79 U.C.C. § 9-504(3).
judicially held to be a proposal to retain the collateral in full satisfaction—
over the objections of the secured party. An examination of these cases
reveals that courts answering this question have concluded without
difficulty that unreasonable delay in disposition constitutes retention of
the collateral in full satisfaction.80

THE SECURED PARTY'S RIGHT TO DISPOSE OF THE COLLATERAL

As noted in the previous section, the secured party may retain the
collateral in full satisfaction of his claim against the debtor unless the Code
compels disposition of the collateral, or the debtor, or other secured party
having a security interest in the collateral, duly objects in writing.81

However, when disposition of collateral is made, whether mandated
or voluntarily made, Section 9-504 prescribes the judicial parameters
within which the secured party must act. That section provides in part:

(1) A secured party after default may sell, lease or otherwise dispose
of any or all of the collateral in its then condition or following any
commercially reasonable preparation or processing. . . .

(3) 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 including the method, manner, time, place and terms
must be commercially reasonable. . . .

The theme of this entire provision is to afford the secured party
the widest possible discretion and flexibility in disposing of the collateral
to insure that the maximum amount of money will be realized from
the disposition, as long as the secured party acts in a commercially
reasonable manner.82

In setting forth the framework of disposition, Article 9 rejects the
common pre-Code requirement that all dispositions be by public sale

(retention of repossessed car without sale, without excuse for not selling, and without
demand for payment under contract for a period of approximately 50 days before suit
on the contract and for over 16 months from the time of filing suit to the time of
trial); Brownstein v. Fiberonics Indus., Inc., 110 N.J. Super. 43, 264 A.2d 262 (1970);
Northern Fin. Corp. v. Chatwood Coffee Shop, Inc., 4 U.C.C. REP. SERV. 674 (Sup.
1972) (the court recognized the principle, noting that "Some courts . . . seem to have
held that a written proposal may not be absolutely essential, especially where the
secured party conducts himself in a manner so unfair or so unreasonable as to
amount to a retention of the collateral on satisfaction of the obligation." However, the
court did not allow full satisfaction but rather allowed the debtor a credit equal to
the fair market value of the security when repossessed.).

81 See text accompanying notes 73-80 supra.

82 U.C.C. § 9-504, Comment 1. See, e.g., Old Colony Trust Co. v. Penrose Indus, Corp.,
280 F. Supp. 698 (E.D. Pa. 1968), aff'd, 398 F.2d 310 (3d Cir. 1968),
after giving notice of the time and place of the sale.\textsuperscript{83} Moreover, under this section there is no required waiting period before the collateral can be disposed of.\textsuperscript{84} The reason for abandoning this pre-Code policy is set forth in the Official Code Comment to this section:

\ldots Although public sale is recognized, it is hoped that private sale will be encouraged where, as is frequently the case, private sale through commercial channels will result in higher realization on collateral for the benefit of all parties. The only restriction placed on the secured party's method of disposition is that it must be commercially reasonable.\ldots \textsuperscript{85}

Private dispositions, as expected, are sometimes challenged as commercially unreasonable in view of the supposedly advantageous benefits of a public sale. Thus, in a leading case\textsuperscript{86} the debtor objected to a private sale of collateral consisting of the stock of a radio station, arguing that a private sale was not commercially reasonable. The court approved the sale over the debtor's objections stating that such a sale was "amply justified in view of the evidence concerning the unique nature of the assets underlying the collateral, \textit{i.e.}, a radio station."\textsuperscript{87} The court noted that the secured parties expressly relied upon thoroughly experienced advice from a large media broker that "a private or negotiated" sale would produce the highest price for the stock of a radio station. A public or "semi-private" sale of limited bidding was rejected by the secured parties because of S.E.C. problems.

While the overwhelming number of dispositions will be by outright sale of the repossessed collateral, the Code expressly provides that the secured party may also "lease or otherwise dispose" of the collateral.\textsuperscript{88} While no reported cases have construed the term "otherwise" or challenged a disposition by "lease" litigation may be expected in this area.

Finally, it should be noted that under this section the secured party may dispose of collateral "in its then condition." Thus, in a leading case,\textsuperscript{89} the secured party sold the repossessed collateral consisting of trucks and parts which were "in exactly the same condition in which they had been repossessed from [debtors]."\textsuperscript{90} The debtors complained that some trucks were in need of repair which was not performed. Although the inference was that a higher price would have been realized after repair, the court, in the absence of proof, rejected the debtor's claim

\textsuperscript{83}U.C.C. § 9-504. The pre-Code decisions relating to notice and posting in public places are collected in 90 A.L.R.2d 1210 (1963) and supplemental material.
\textsuperscript{84}U.C.C. § 9-504(3).
\textsuperscript{85}U.C.C. § 9-504, Comment I.
\textsuperscript{86}Old Colony Trust Co. v. Penrose Indus. Corp., 398 F.2d 310 (3d Cir. 1968).
\textsuperscript{87}Id. at 312.
\textsuperscript{88}U.C.C. § 9-504(1).
\textsuperscript{90}Id. at 444.
stating that the secured party was entitled to sell the repossessed equipment at public auction in the condition in which it was repossessed, and it had no obligation to repair or repaint.\textsuperscript{91}

Yet, the secured party while in possession of repossessed collateral and pending disposition may not do any affirmative act which might depress the value of the collateral,\textsuperscript{92} and where he does so he may be held to be acting in a commercially unreasonable manner.\textsuperscript{93}

In making disposition of the collateral the secured party must act in a commercially reasonable manner. What the standard means and how the secured party complies with this essential requirement will be discussed in the sections that follow.

THE SECURED PARTY'S DUTY TO GIVE REASONABLE NOTICE OF DISPOSITION OF THE COLLATERAL

The pre-Code law frequently required that elaborate public notice of sale be given one or more times in newspapers of general circulation or that notice be posted on the courthouse bulletin-board in the area where the public sale was to be held.\textsuperscript{94} This requirement served no useful purpose in a largely urban society since few interested persons attended such public sales and those who did frequently were professional buyers who generally did not compete with each other. The Code, in recognition of the deficiencies inherent in a mandatory public sale, provides that the secured party may, at his election, dispose of the collateral by public or private disposition. Thus, in giving the secured party the right to proceed, at his election, by private or public disposition, the Code gives him flexibility and discretion, subject to the litmus test that the chosen method of disposition must be "commercially reasonable."\textsuperscript{95}

However, when a secured party disposes of the collateral by private disposition he must comply with Section 9-504(3):

[R]easonable 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, and except in the case of consumer goods to any other person who has a security interest in the collateral and who has duly filed a financing statement indexed in the name

\textsuperscript{91} Id. at 445.
\textsuperscript{92} Finance, Inc., v. Haltiwanger, 258 S.C. 330, 188 S.E.2d 472 (1972) (jury held that secured party decreased value of repossessed machine prior to sale by replacing winch and other parts of machine with defective parts).
\textsuperscript{93} Harris v. Bower, 266 Md. 579, 295 A.2d 870 (1972) (where court said that repossessed yachts "if not carefully and constantly maintained, depreciate at a ruinously progressive rate. [secured party] permitted this to happen [over period embracing two full boating seasons] and this seems to us to be not only not commercially reasonable but to be also utterly lacking in common sense.") See also U.C.C. 9-504, Comment 6.
\textsuperscript{94} Annot., 90 A.L.R.2d 1210 (1963) and supplemental material.
\textsuperscript{95} U.C.C. § 9-504(3).
of the debtor in this state or who is known by the secured party to have a security interest in the collateral. . . .

The notice of any intended private disposition is not required to state the date of disposition but only the date after which the private disposition will be made. Moreover, the notice must be sent not only to the debtor but also to other persons having a security interest in the collateral who have filed a financing statement or are known to the secured party, except where the collateral is consumer goods. In this respect the 1972 Official Text substantially changes the rule concerning the persons entitled to notice of a proposed disposition under Section 9-504(3). Under Revised Section 9-504(3) the junior secured party who wishes to receive notice of disposition of collateral must inform the senior secured party of his interest in writing before the senior secured party sends notice to the debtor of the proposed disposition or the debtor waives or renounces his own right to be sent notification. If the junior secured party does not so before either event occurs he is not entitled to notice of disposition. The effect of this important change is to shift the burden of giving notice to other secured parties from the secured party to the debtor.

The policy reason for this important change was set forth by the Editorial Board for the Uniform Commercial Code in its "Reasons for 1972 Change" which stated:

[The original 1962 text of 9-504] meant that the secured party had to search the records in every case of notice of sale, to ascertain whether there were any other secured parties with financing statements that might be deemed to cover the collateral in question. Moreover, he ran the risk that some informal communication by letter, or even orally, might be deemed to have given him knowledge of the interest of that other party. These burdens of searching the record and of checking the secured party's files were greater than the circumstances called for because as a practical matter there would seldom be a junior secured party who really has an interest needing protection in the case of a foreclosure sale. Therefore, a change is made requiring notice to persons other than the debtor only if such persons had notified the secured party in writing of their claim of an interest in the collateral before he sent his notification to the debtor or before the debtor's renunciation of his rights. . . .

96 Id. Wheless v. Eudora Bank, 4 CCH SEC. TRANS. GUIDE ¶ 52,384 (Ark. 1974) (where court held that knowledge of repossession does not equate with notice of sale, nor does knowledge that an automobile will eventually be sold.)
97 U.C.C. § 9-504(3). Usually borrower is the "debtor." Where, however, the borrower obtained a loan from secured party and offered as collateral an automobile owned by a third party, it was held that borrower was not a "debtor" within meaning of 9-105(d) and, therefore, was not entitled to the notice of disposition of the collateral as provided in 9-504(3). See, e.g., New Haven Water Co. Employees Credit Union v. Burroughs, 6 Conn. Cir. 709, 313 A.2d 82 (1973). For an interesting case involving effect of failure to give notice to lienholders see note 129 infra.
98 U.C.C. § 9-504(3) (1972 revision).
When the secured party disposes of the collateral by public sale, Section 9-504(3) requires that he give "reasonable notification of the time and place of any public sale" to the same parties as in the case of a private disposition.\(^{100}\)

The Code defines "notification" as "taking such steps as may be reasonably required to inform... in the ordinary course,"\(^{101}\) whether or not the notice is actually received.

Assuming, however, the secured party gives the debtor notice of the intended disposition of the collateral, the question remains whether the notice meets the Code's requirement of "reasonable notification." This is a question of fact, not of law.\(^{102}\)

Although the Code states the conditions under which a person "notifies"\(^{103}\) another, or "gives"\(^{104}\) or "sends"\(^{105}\) a notice, and when a person "receives"\(^{106}\) a notice\(^{107}\) it does not define "reasonable notification." However, Section 9-504, Comment 5 states:

"Reasonable notification" is not defined in this Article [Secured Transactions]; at a minimum it must be sent in such time that persons entitled to receive it will have sufficient time to take appropriate steps to protect their interests by taking part in the sale or other disposition if they so desire.

Thus, the secured party who allows too little time between the sending of notice and the disposition of the collateral does not give "reasonable notification." In a recent case\(^{108}\) notice of a private sale to be held on April 10, 1971, was mailed to the debtor on April 7, and received by him on April 8. April 9 was a holiday. The collateral was sold on April 10. The court affirmed the trial court's decision that the secured party failed to give reasonable notification as required in Section 9-504(3).\(^{109}\)

Although security agreements frequently provide that five days'...
notice of disposition may be given it is submitted that this may be too short a time especially where a Saturday or Sunday or holiday fall within the five-day period. To avoid the potentially successful claim that such five-day notice is not "reasonable notification" the secured party would be well advised to extend the time to ten days or at a minimum to seven days.

Assuming reasonable notification of disposition is given, the question remains whether such notice must be received by the debtor or other appropriate secured party to be effective notice. There is no Code requirement that the debtor receive the notice.110 Consistent with this rule, the Supreme Court of Arkansas held111 that the secured party satisfied the Code's requirement that "reasonable notification...shall be sent by the secured party to the debtor..." when the secured party sent notice by certified mail to the debtor even though the debtor did not read the notice until after the sale. The court held that more than a week's notice of the proposed sale was reasonable notification even though the mail was held for the debtor by the post office until about two weeks after the sale when the debtor finally called for his mail. The court correctly stated: "Notification is defined as the taking of such steps as may be reasonably required to inform the person to be notified, 'whether or not such other actually comes to know of it.'"112

However, a secured party who sends notice of sale of repossessed collateral to a debtor by certified or registered mail will have a legal problem in satisfying the Code's notice requirements if the letter is returned "unclaimed."

The problem was presented in an interesting 1974 Georgia case.113 The secured party's letter setting forth notice of sale of repossessed collateral was addressed to the debtor at his last known address and was sent by certified mail with return receipt requested. The letter was returned to the secured party marked "unclaimed" by United States Postal Service. The sale took place almost four months after the notice was mailed.114 The secured party moved for summary judgment for the deficiency after the sale was held. The trial court granted the motion, but it was reversed on appeal because there was no indication as to whether the unclaimed letter was returned before the sale. The court held that if the letter was returned before the sale, then the secured party did not act in good faith in holding the sale. The court rejected the secured party's contention that the requirement of reasonable notification was met when it wrote the letter regardless of whether or not it was received, saying that once the secured party had notice that the letter was not received by the debtor, it had the obligation

110 U.C.C. § 1-201 (38). See note 105 supra.
112 Id. at 411, 382 S.W.2d at 192.
114 Id. at 829, 204 S.E.2d at 786.
to act in good faith in the enforcement of its rights. The court stated:

The documents in the record show that the notice was returned marked "unclaimed" rather than "refused," but we cannot determine from the record whether the notice was returned prior to or after the sale. If returned prior to the sale, as would appear to be the case from the length of time elapsing between mailing and the sale, we would be constrained to hold that [secured party] had not in good faith performed its obligation in disposing of the collateral.\(^{115}\)

Unfortunately, the court did not state what the secured party should have then done under the circumstances to give "reasonable notification" of the sale of the repossessed collateral. It is submitted, however, that when the secured party sends notice of disposition by certified mail or registered mail, he should send a copy of his notice by regular mail at the same time. If the certified mail or registered mail is returned "unclaimed" or "refused" but the copy sent by regular mail is not returned then the secured party has satisfied the Code's requirement of sending reasonable notification, since the secured party does not have to prove that the notice was received. However, if all letters are returned by the Postal Service marked "unclaimed" or "refused" then the secured party has a problem for which the Code does not provide a solution since no provision is made for constructive notice. No reported cases on this question have been found.

Although the Code requires "reasonable notification" of the sale or other disposition of the collateral to be given to the debtor, under Section 9-504(3) the secured party must also inform the debtor of the "time and place of any public sale or . . . the time after which any private sale or other intended disposition is to be made . . . ." The failure of the secured party to comply with this simple requirement of stating the time, date and place of the intended disposition resulted in the only reported decision on this point that the sale was not commercially reasonable.\(^{116}\) In that case the secured party's letter to the debtor stated "This is to notify you that your repossessed car will be put up for bids and sold to the highest bidder. If you wish to make arrangements or bid on the car, call us immediately."\(^{117}\) Thereafter, the secured party advertised the sale of the automobile in the local newspaper and sold the automobile to the highest bidder. The court in holding that the notice was defective stated:

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\(^{116}\) Beneficial Fin. Co. v. Reed, 4 CCH SEC. TRANS. GUIDE ¶ 52,244 (Iowa 1973).

\(^{117}\) Id. Cf. Commercial Credit Corp. v. Wallgast, 4 CCH SEC. TRANS. GUIDE ¶ 52,382 (Wash. App. Div. 1974) (court held that notification of private disposition was insufficient "since the notification did not specify the time after which the private sale was to be made." However, court held that sale made in a "commercially reasonable manner" and therefore did not bar secured party from recovering the deficiency from the debtor.).
The trial court determined the letter indicated a prospective private sale thereby necessitating reasonable notification of the time after which the sale would occur. Yet [secured party] in fact conducted a public sale as the car allegedly was advertised in the local newspaper. Accordingly, reasonable notification of the time and place of the sale should have been sent to [debtor].

While "reasonable notification" of disposition is mandated by the Code, some courts have held that a debtor has waived his right to reasonable notice of disposition or is estopped from claiming a violation of the Code where a debtor has voluntarily surrendered the collateral to the secured party and given written notice of election to rescind the secured transaction.

WHEN THE SECURED PARTY IS NOT REQUIRED TO GIVE NOTICE OF DISPOSITION

It is not always practical or wise to require that the secured party give notice to the debtor and other appropriate secured parties of his intended disposition of the collateral. The Code recognizes this and thus provides that such notice is not required if: "...collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market...."

Thus, when any of the three conditions apply to the collateral the secured party may dispose of the collateral without notice immediately or at any other time. Whether any of the conditions apply to the collateral is a question of fact.

An extremely important commercial question coming before the courts frequently is whether collateral consisting of used cars "is of a type customarily sold on a recognized market" within the meaning of Section 9-504(3). If so, then the Code requirement of notice to the debtor is dispensed with and the secured party may buy the used cars at private sale. All courts presented with this issue to date have held that used cars are not "a type customarily sold on a recognized market," and thus the

118 Beneficial Fin. Co. v. Reed, 4 CCH SEC. TRANS. GUIDE ¶ 52,244 (Iowa 1973).
120 U.C.C. § 9-504(3).
121 See, e.g., Wheeless v. Eudora Bank, 4 CCH SEC. TRANS. GUIDE ¶ 52,384 (Ark. 1974.).
122 U.C.C. § 9-504(3).
secured party must send the debtor reasonable notification of the intended disposition. One court, in contrasting the used car market with a "recognized market" stated:

We cannot approve the bank's contention that a used car falls in this category. [A type customarily sold on a recognized market]. Obviously the Code dispenses with notice in this situation only because the debtor would not be prejudiced by the want of notice. Thus a "recognized market" might well be a stock market or a commodity market, where sales involve many items so similar that individual differences are nonexistent or immaterial, where haggling and competitive bidding are not primary factors in each sale, and where the prices paid in actual sale of comparable property are currently available by quotation....what one 1957 Oldsmobile sells for does not fix the amount a different one may bring....

And another court rejecting the application of "recognized market" to used cars stated:

The observation by the court below, in its opinion, is well put. "It is indeed questionable whether there is a 'recognized market' for used automobiles. No other article of commerce is subject to more erratic vacillation in pricing procedures. The so-called 'redbook' purporting to fix prices of various makes and models of automobiles in accordance with their year of manufacture is adopted for the convenience and benefit of dealers and is not based on market prices which are arrived at in the open, based on asking prices of sellers and bids of prospective buyers." Notice, as required by the [Code], should have been given.

The question of whether the sale of automobiles, repossessed from a defaulting automobile dealer, at an "automobile auction" was a "recognized market" was raised in a recent case. The court held that automobile auctions should not be construed as a "recognized market" under Section 9-504(3). The court stated:

Although such auctions do not present some of the evils intended to be prevented by the statute, it seems reasonable to limit the definition of "recognized market" to widely recognized stock and commodity exchanges which are regulated in some substantial way. This will prevent nearly all of the evils while imposing only a slight notice burden on creditors in order to obtain their deficiency judgments.

And in one of the few reported cases involving perishable collateral, where a secured party repossessed and disposed of collateral consisting of


Id. at 536.
meat processed from carcasses without giving any notice to the debtor, a
court held that the collateral was "perishable" and thus excused the
secured party from complying with the notice requirements.128

Yet, in another case129 when the secured party attempted to excuse
itself from giving notice of disposition to a junior lienholder when it sold
cattle, by claiming that the cattle were "perishable" or threatened "to
decline speedily in value," the court rejected the argument. The court
noted that the cattle were reported to be in "good general condition" by a
veterinarian who tested them for disease, and that the lapse of two weeks
between repossession and sale would have been ample time for notification
to be given to the junior lienholder. As a result of its failure to give notice
of disposition to the junior lienholder the secured party lost its priority.130

EFFECT OF FAILURE TO GIVE REASONABLE NOTIFICATION
UPON SECURED PARTY'S LIABILITY TO DEBTOR

Section 9-507(1) sets forth the secured party's liability to the debtor
when he fails to comply with any of the Code's requirements. In such
event, the debtor's rights are determined by whether or not the secured
party has disposed of the collateral. Where disposition of the collateral
by the secured party has not yet occurred and it is judicially established
that the secured party is not proceeding in accordance with the Code, the
debtor may initiate legal proceedings wherein "disposition may be ordered
or restrained on appropriate terms and conditions."131

The Official Code Comment to this section explains the rationale
of this rule by stating:

The principal limitation on the secured party's right to dispose of
collateral is the requirement that he proceed in good faith (Section
1-203) and in a commercially reasonable manner. See Section 9-504.
In the case where he proceeds, or is about to proceed, in a contrary
manner, it is vital both to the debtor and other creditors to provide a
remedy for the failure to comply with the statutory duty. This remedy
will be of particular importance when it is applied prospectively
before the unreasonable disposition has been concluded. This Section
therefore provides that a secured party proposing to dispose of
collateral in an unreasonable manner, may, by court order, be
restrained from doing so, and such an order might appropriately
provide either that he proceed with the sale or other disposition

128 United States v. Wyoming Nat'l Bank, 4 CCH SEC. TRANS. GUIDE § 52,273 (D.C.
130 Id. at 1104.
131 U.C.C. § 9-507(1). See, e.g., Dopp v. First Nat'l Bank, 461 F.2d 873 (2d Cir.
1972); Riblet Tramway Co. v. Monte Verde Corp., 453 F.2d 313 (10th Cir. 1972);
(1972); Peoples Nat'l Bank v. Peterson, 7 Wash. App. 196, 498 P.2d 884 (1972);
under specified terms and conditions, or that the sale be made by a representative of creditors where insolvency proceedings have been instituted.\textsuperscript{132}

However, when disposition has already occurred without Code compliance, it is too late to obtain a court order restraining or ordering the disposition on appropriate terms and conditions. In that event the Code affords relief to the injured party by expressly providing that:

\ldots the debtor or any person entitled to notification or whose security interest has been made known to the secured party prior to the disposition has a right to recover from the secured party any loss caused by a failure to comply with the provisions of this Part.\textsuperscript{133}

There have been few reported decisions where a debtor has recovered from a secured party "any loss" which exceeded the balance owed by the debtor to the secured party. However a substantial jury award given to a debtor against a secured party was affirmed on appeal in the leading case of Skeels v. Universal C.I.T. Credit Corporation.\textsuperscript{134}

In that case the secured party repossessed the defaulting debtor's entire automobile inventory and sold it without the required notice of sale being given to the debtor. Although he was in default, the debtor claimed that the secured party gave him reason to believe that an additional loan would be made despite the existing default. The debtor claimed he relied on this assurance and did nothing further to cure the default. The court sustained a jury award of $55,000 as compensatory damages stating that the jury's evaluation of the loss caused by the secured party's failure to give notice of sale was justified since the debtor's automobile dealership was destroyed.\textsuperscript{135}

In every case where the debtor seeks to recover "any loss" caused by the secured party's noncompliance with Code requirements the debtor has the burden of proving his loss.\textsuperscript{136} Furthermore, in cases where the collateral is consumer goods,\textsuperscript{137} the Code provided the debtor with an additional remedy against a secured party who fails to comply with the Code's requirements. Thus, in such cases, even though the debtor has not incurred any loss he "has a right to recover in any event not less than the credit service charge plus ten percent of the principal amount of the debt or the

\begin{footnotesize}
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\item[132] U.C.C. § 9-507, Comment 1.
\item[133] U.C.C. § 9-507(1).
\item[134] 222 F. Supp. 696 (W.D. Pa. 1963), modified on other grounds, 335 F.2d 846 (3d Cir. 1964).
\item[135] Id. at 700.
\item[137] U.C.C. § 9-109(1) states that goods are "consumer goods" if they are used or bought for use "for personal, family or household purposes." Thus, ordinary household products would be classified by the Code as consumer goods. An automobile would also be a consumer good if its intended use was for personal or family purposes.
\end{itemize}
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time/price differential plus ten percent of the cash price. . . ."138 This additional remedy is provided because in consumer transactions a consumer-debtor is not likely to have actual damages. Even when he does, the amount recoverable is likely to be consumed by the excessive costs of proving such damages. The potential for abuse of the default provisions was the underlying reason for the adoption of a statutory penalty. This penalty affords a protective remedy in many situations in which the consumer-debtor would otherwise be without a meaningful remedy.

In one reported case the interesting question was raised whether a consumer-debtor could recover a double penalty in an action against a secured party who failed to sell the repossessed automobile within 90 days after repossession and failed to give the debtor notice of the disposition. The secured party's noncompliance violated both Section 9-504(3) and Section 9-505(1). The court held that the debtor could not recover a double penalty.139

The Code's inclusion of this additional remedy awarding punitive damages to a consumer-debtor was intended to be a deterrent to secured parties who might otherwise escape liability for noncompliance with the Code's requirements because of the consumer-debtor's difficulty in proving actual loss. Thus, the statutory minimum penalty serves as a prophylactic device affording the debtor protection and encouraging Code compliance by the secured party.140

EFFECT OF FAILURE TO GIVE REASONABLE NOTIFICATION UPON SECURED PARTY'S RIGHT TO RECOVER DEFICIENCY FROM DEBTOR

The more frequently reported Code decisions involving the legal effect of the secured party's failure to give the debtor reasonable notification of the disposition of collateral have arisen in actions by the secured party against a debtor to recover a deficiency judgment.141

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138 U.C.C. § 9-507(1). Under this provision the debtor could recover a substantial amount where default occurs after only a few payments. Concerning this possibility Gilmore has noted: "If repossession took place before much has been paid the recovery of 10 per cent plus the financing charges could perfectly well exceed the payments. In such a case, at least, the Code provision would amount to a real penalty." 2 G. GILMORE, SECURITY INTEREST IN PERSONAL PROPERTY § 44.9.3 (1965).

139 Special protection without proof of loss is not novel to the Code, nor were such benefits limited to consumer sales in prior acts. The UNIFORM CONDITIONAL SALES ACT, Section 25, allowed the buyer to recover "from the seller his actual damages, if any, and in no event less than one-fourth of the sum of all payments which have been made under the contract, with interest." This penalty had limited effectiveness. See 2A UNIFORM LAWS ANNOT. § 129, at 181 (1924).

140 2 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY, § 44.9.3 (1965).

141 In general, "deficiency" is that part of a secured obligation which remains after the original debt is credited with net proceeds realized from the sale of the collateral by the secured party. Thus, a deficiency judgment is a judgment or decree for that part of a secured debt not realized from the sale of the collateral. See Okmulgee Motor Sales Co. v. Prentice, 371 P.2d 723 (Okla. 1962).
This type of action is more common than an action by a debtor to recover "any loss" which involves the debtor meeting the difficult burden of proof of loss imposed by Section 9-507.

The question, succinctly stated, is whether a secured party can recover a deficiency judgment from a debtor when he has not complied with Code requirements concerning notice of disposition of collateral. The Code does not expressly answer the question nor is this question discussed in the Code comments or in its unofficial commentaries. Rather, a careful reading of Section 9-507(1) discloses that the injured debtor can recover "any loss" from the secured party when the latter does not comply with the Code's notice requirements. Of course, the debtor would have the burden of proving his loss. Yet, despite the absence of express Code authority on the specific question, a majority of courts have reasoned that the secured party who fails to comply with the Code's notice requirements is subject not only to the liability provided by Section 9-507(1) of paying the "any loss" incurred by the debtor but also to an additional penalty, the loss of the right to recover any deficiency from the debtor.

Some courts have embraced the majority view by simply concluding that Code compliance is a condition precedent to recovery of any deficiency. Other courts have followed the majority view based on the rationale that the secured party's noncompliance with the Code's notice requirements has precluded the debtor's exercise of his right of redemption. As stated in the leading case of Skeels v. Universal C.I.T. Credit Corp.:

... It is conceded in this case that no notice whatsoever was given to [debtor] at the time the cars, new and used were sold. There was simply no compliance by defendant with this Section [9-504] of the Uniform Commercial Code... [T]o permit recovery by the security holder of a loss in disposing of collateral when no notice has been given, permits a continuation of the evil which the Commercial Code sought to correct. The owner should have an opportunity to bid at the sale. It was the secret disposition of collateral by chattel mortgage owners and others which was an evil which the Code sought to correct.

143 Vic Hansen & Sons, Inc. v. Crowley, 57 Wis. 2d 106, 203 N.W.2d 728 (1973).
correct. It is important to note in the instant case that there was no waiver of the right to notice on disposition of collateral. A security holder who disposes of collateral without notice denies to the debtor his right of redemption which is provided him in Section 9-506. In my view, it must be held that a security holder who sells without notice may not look to the debtor for any loss...\textsuperscript{147}

Yet, other courts following the majority rule have reasoned that there is a rebuttable presumption that the collateral was equal in value to any deficiency when the secured party does not comply with the Code’s notice requirements.\textsuperscript{148} This reasoning was expressed in a leading case\textsuperscript{149} where the court stated:

\begin{quote}
We think the just solution is to indulge the presumption in the first instance that the collateral was worth at least the amount of the debt; thereby shifting to the creditor the burden of proving the amount that should reasonably have been obtained through a sale according to law.\textsuperscript{150}
\end{quote}

Thus, under this reasoning unless the secured party rebuts this presumption by proving what he obtained without notice was what he would have obtained by a disposition with notice, he cannot recover any claimed deficiency.\textsuperscript{151} In almost all of the reported cases the secured party who failed to give notice did not rebut the presumption and therefore could not recover his claimed deficiency.\textsuperscript{152}

The minority view, however, permits the secured party to obtain a deficiency judgment against a debtor even though the secured party did not comply with the Code’s notice requirements.\textsuperscript{153} The courts following


\textsuperscript{150}Id. at 150, 398 S.W.2d at 542.

\textsuperscript{151}See note 152 infra.

\textsuperscript{152}Barker v. Horn, 245 Ark. 315, 432 S.W.2d 21 (1968); Norton v. Nat’l Bank, 240 Ark. 143, 398 S.W.2d 538 (1966); Johnson v. Commercial Credit Corp., 117 Ga. App. 131, 159 S.E.2d 290 (1968); Gallatin Trust and Savings Bank v. Darrah, 152 Mont. 256, 448 P.2d 734 (1968); Jefferson Credit Corp. v. Marciano, 60 Misc. 2d 138, 302 N.Y.S. 2d 390 (Civ. Ct. 1969); Alliance Discount Corp. v. Shaw, 195 Pa. Super. 601, 171 A.2d 548 (1961). See also Weaver v. O’Meara Motor Co. 452 P.2d 87 (Alaska 1969) (court held that secured party rebutted the presumption when it established that it received “the best available current price for the four dump trucks after they were sold upon repossession and that the sale was made in a commercially reasonable manner.”). In that case the court was influenced by the fact that the secured party had obtained written appraisals from Alaskan appraisers, and thereafter obtained prices from sources in Washington, Oregon and California and finally sold the dump trucks to the firm making the best offer. The court concluded that the secured party was entitled to a deficiency judgment against the debtor.

\textsuperscript{153}Weaver v. O’Meara Motor Co., 452 P.2d 87 (Alaska 1969); Universal C.I.T. Credit
the minority view often consider the commercial reasonableness of the transaction, noting that lack of notice is one factor to determine whether the sale was commercially reasonable. They usually hold that the debtor's sole remedy where reasonable notification is not given is a separate action by the debtor to recover "any loss" under Section 9-507(1).^{154}

Thus, in a case of first impression in Washington,\textsuperscript{155} the court in electing to follow the minority view stated:

Under [Section 9-507(1)] if the creditor fails to give notice to the debtor as required by [Section 9-504(3)], the debtor has a right to recover from the creditor any loss caused by the failure to give that notice. Thus, in the instant case if the sale of the tractor without notice had resulted in a loss to the [debtor], the [debtors] would have a right in the instant proceeding to claim that loss against the deficiency sought by the [secured party]. In view of this remedy, we are of the opinion the writers of the Uniform Commercial Code did not intend that the creditor's failure to give notice would result in a forfeiture of the creditor's right to a deficiency...\textsuperscript{156}

In analyzing the merits of the two opposing views, it should be recognized that the secured transaction places the secured party in a preferred position compared to unsecured creditors since he can repossess and sell the collateral for his own benefit without court intervention. In granting the secured party this invaluable right the Code has attempted to protect the debtor's interests by requiring that reasonable notification be sent to the debtor of the intended disposition of the collateral. Since the Code has validated self-help and minimized the formal requirements of the disposition it should be incumbent upon the secured party to comply with Section 9-504(1) relating to reasonable notification. Denial of the deficiency judgment serves as the most effective means of insuring Code compliance by the secured party and protecting the debtor's interests because it has a deterrent effect upon secured parties who disregard Co. v. Rone, 248 Ark. 665, 453 S.W.2d 37 (1970); Community Management Ass'n v. Tousley, 505 P.2d 1314 (Colo. App. 1973); Cornett v. White Motor Corp., 190 Neb. 496, 501, 209 N.W.2d 341, 344 (1973) ("No sound policy requires us to inject a drastic punitive element into a commercial context."); T. & W. Ice Cream, Inc. v. Carriage Barn, Inc., 107 N.J. Super. 328, 258 A.2d 162 (1969); Mallicoat v. Volunteer Finance & Loan Corp., 415 S.W.2d 347 (C.A. Tenn. 1966); Grant County Tractor Co. v. Nuss, 6 Wash. App. 866, 496 P.2d 966 (1972).

\textsuperscript{154} See, e.g., Lincoln Rochester Trust Co. v. Howard, 4 CCH SEC. TRANS. GUIDE ¶ 52, 308 (City Ct. N.Y. 1973) ("A meritorious defense against a deficiency judgment gained under section 9-504 [subd. (3)] as stated is precluded by relief under the proper sections of the Uniform Commercial Code.").

\textsuperscript{155} Grant County Tractor Co. v. Nuss, 6 Wash. App. 866, 496 P.2d 966 (1972).

\textsuperscript{156} Id. at 869, 496 P.2d at 969. The court cited with approval one commentator's analysis that the injured debtor's remedy is provided in 9-507. See Hogan, Pitfalls in Default Procedures, 86 BANKING L.J. 965, 978 (1969) [hereinafter cited as Hogan]. See also Posel, Sales and Sales Financing, 16 RUTGERS L. REV. 329, 346 (1962) [hereinafter cited as Posel].
debtor's rights in repossessed collateral. Therefore, recovery of any deficiency, it is submitted, should be denied in all cases where the secured party fails to send the debtor reasonable notice of intended disposition. On this important question, two of the leading commentators on secured transactions have reached opposite viewpoints.

WHAT CONSTITUTES A COMMERCIALY REASONABLE DISPOSITION OF COLLATERAL AND THE PENALTY FOR NONCOMPLIANCE

The Code deliberately provides wide latitude, discretion and flexibility to the secured party engaged in the disposition of collateral in an effort to achieve maximum economic benefit. However, the Code mandates that "every aspect of the disposition including the method, manner, time, place and terms must be commercially reasonable..." Commercially reasonable, although a repeated term in the Code, is not specifically defined. Rather, the Code defers to case law for the development of a precise meaning.

Since the Code subjects the secured party to liability to the debtor for "any loss" incurred by the debtor if the secured party does not comply with the Code, the draftsmen of Article 9 set forth some tests to help determine whether the disposition of the collateral is made in a "commercially reasonable" manner. Thus, Section 9-507(2) amplifies the meaning of "commercially reasonable manner" by providing:

The fact that a better price could have been obtained by a sale at a different time or in a different method from that selected by the secured party is not of itself sufficient to establish that the same was not made in a commercially reasonable manner. If the secured party either sells the collateral in the usual manner in any recognized market thereof or if he sells at the price current in such market at the time of his sale or if he has otherwise sold in conformity with reasonable commercial practices among dealers in the type of property sold he has sold in a commercially reasonable manner. The


158 Compare Hogan, supra note 156 with 2 G. Gilmore, Security Interests in Personal Property § 44.9.4 (1965).

159 See, e.g., Hogan, The Secured Party and Default Proceedings Under the Uniform Commercial Code, 47 Minn. L. Rev. 205, 219-220 (1962) ("the policy of Article 9 is to provide a simple, efficient and flexible tool to produce the maximum amount from the disposition of the collateral.").

160 U.C.C. § 9-504(3). The provisions of the Code do not apply when a sale of the collateral is made in execution on a judgment against the debtor since the Code applies only when collateral is sold under the Code. See, e.g., Citizens Bank v. Perrin & Sons, Inc., 253 Ark. 639, 488 S.W.2d 14 (1973).


162 U.C.C. § 9-507(1).
principle stated in the two preceding sentences with respect to sales also apply as may be appropriate to other types of disposition. A disposition which has been approved in any judicial proceeding or by any bona fide creditors' committee or representative of creditors shall conclusively be deemed to be commercially reasonable, but this sentence does not indicate that any such approval must be obtained in any case nor does it indicate that any disposition not so approved is not commercially reasonable.

The duty to make a disposition of the collateral within a reasonable time and in a reasonable manner is imposed on the secured party to require him to act diligently to protect the interest of the debtor. The duty of the secured party who disposes of the collateral is to obtain the best possible price the secured party could obtain for the collateral, for the benefit of the debtor.\(^{163}\)

In all cases the overriding factual test is whether the disposition made or about to be made by the secured party is commercially reasonable.\(^{164}\) The answer depends on all the facts and circumstances of each case.\(^{165}\)

Since disposition may be by public or private sale, a preliminary question is what constitutes a public sale. That question was decided in an interesting case\(^{166}\) where the debtor contended that the secured party's sale of the collateral was not a public one. The Code does not define "public sale" but the court applied the definition of that term as found in the Restatement of Security as "one to which the public is invited by advertisement to appear and bid at auction for the goods to be sold."\(^{167}\) The court held that the secured party did not conduct a public sale as required by the Code after it gave the debtor notice of public sale. The evidence disclosed that the sale of the collateral was not advertised in any newspaper and no signs were posted announcing the public sale. Moreover, no one passing the lot where the collateral was kept could have known an auction was taking place. The court concluded that the sale "was neither lawful nor commercially reasonable."\(^{168}\) The court then concluded that the

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\(^{163}\) A to Z Rental, Inc. v. Wilson, 413 F.2d 899, 909 (10th Cir. 1969); Vic Hansen & Sons, Inc. v. Crowley, 57 Wis. 2d 106, 203 N.W.2d 728 (1973); 2 G. Gilmore, SECURITY INTERESTS IN PERSONAL PROPERTY, § 44.5, at 1234 (1965) ("The obligation on the secured party is to use his best efforts to see that the highest possible price is received for the collateral.").

\(^{164}\) The fact that particular conduct is authorized by the contract of the parties does not excuse the secured party from acting with commercial reasonableness in disposing of the collateral. See, e.g., Empire Life Ins. Co. v. Valdak Corp., 468 F.2d 330 (5th Cir. 1972).

\(^{165}\) See, e.g., Farmers Equipment Co. v. Miller, 252 Ark. 1092, 482 S.W.2d 805 (1972). The fact that the sale of the collateral to a buyer is approved by a receivership court does not in itself establish that the sale was conducted in a commercially reasonable manner. See also Frontier Inv. Corp. v. Belleville Nat'l Sav. Bank, 119 Ill. App. 2d 2, 254 N.E.2d 295 (1969).

\(^{166}\) In Re Bishop, 482 F.2d 381 (4th Cir. 1973).

\(^{167}\) Id. at 385, quoting RESTATEMENT OF SECURITY § 48, comment c at 140 (1949).

\(^{168}\) Id. at 386.
secured party was barred from recovering a deficiency judgment. In doing so the court reasoned that even if the minority rule was followed the same result would be reached as under the majority rule. The court stated:

Courts that allow a secured creditor to recover a deficiency although he has not fully complied with the law hold that the debt is not to be credited with the proceeds of sale; instead, the debtor must be credited with the amount that reasonably should have been obtained through a lawful sale—that is, the credit must be equal to the market value. Logically, the amount of the proceeds is not evidence of the market value, and a creditor who has not complied with the law has the burden of proving by other evidence that the market value is less than the balance due...

The court held that the secured party did not meet that burden because it did not introduce an appraisal of the property or even evidence of sales of comparable property. The fact that the collateral, after being bought in by the secured party, was thereafter sold for $500 more did not prove that the disposition of the collateral was commercially reasonable or that the aggregate credit of both sales represented the market value of the collateral. The court was influenced by the fact that the resale for $500 more did not appear to have been made through a broker or dealer, or in the usual manner in any recognized market and that the circumstances of the resale, including advertising, were not disclosed.

Other cases have considered the question of whether the public sale was conducted in a commercially reasonable manner as required by the Code. The method, manner, time, place and terms of a public sale are often challenged by the debtor who claims that the conduct of the public sale was not commercially reasonable. Thus, debtors frequently claim that the public sale was not adequately advertised, and that the public sale was not therefore commercially reasonable, and thus bars the secured party from recovering a deficiency judgment as well as entitling the debtor to recover "any loss" from the secured party. Courts have said that the secured party must advertise in a manner likely to come to the attention of the class of buyers who would be interested in buying the collateral. Thus, when a secured party repossessed a yacht and, during the course of two full boating seasons before selling it, advertised one time in a newspaper of general circulation and did not list the yacht with a yacht broker or advertise the sale in a publication read by persons interested in boating, the court held that the secured party did not act in a commercially reasonable manner.

169 Id. at 385.
170 Id.
171 Id. at 385-86.
172 Id. at 386.
173 See notes 174-75 infra.
Perhaps the most thorough judicial analysis of what constitutes commercial reasonableness in disposition of collateral by public sale is found in the leading case of In Re Zsa Zsa Limited. The public sale produced only one bidder whose $300,000. bid for the collateral was accepted. The collateral had an estimated retail value of 3.5 million dollars, wholesale value of 1.5 million dollars and cost value of $500,000. When a hearing was held before the referee in bankruptcy to determine whether the sale should be confirmed, the trustee in bankruptcy contended that the advertisement in The New York Times was insufficient in terms of timing and content; that the size of the lots was too large and their composition too varied to attract a large buying public; that the boxes containing the inventory should have been opened for full inspection, and that the failure of the auctioneer to represent that the inventory lists shown to the bidders were accurate in all respects discouraged active bidding.

The secured party argued that the well-displayed advertisements in the Times, the provision of eight days' notice before sale, the availability of inspection for five days, the use of lot bidding as an alternative method, and the situs of the sale at the warehouse where inventory was stored were indicators of commercial reasonableness. The court affirmed the referee's order confirming the sale although the amount received was “only about 10 cents on the dollar.” The court stated:

It is the aggregate of circumstances in each case—rather than specific details of the sale taken in isolation—that should be emphasized in a review of the sale. The facets of manner, method, time, place and terms cited by the Code are to be viewed as necessary and interrelated parts of the whole transaction. . . .

The language of section 9-507 reveals that the primary focus of commercial reasonableness is not the proceeds received from the sale but rather the procedures employed for the sale. If the secured creditor makes certain that conditions of the sale, in terms of the aggregate effect of the manner, method, time, place and terms employed conform to commercially accepted standards, he should be shielded from the sanctions contained in Article 9. . . .

The price received, $300,000, falls substantially short of the estimated alleged retail value in a going concern context, placed in excess of 3.5 million. A wide discrepancy between the sale price and the value of the collateral signals a need for close scrutiny. . . . even though a seemingly low return is usually not dispositive on the public notice was given, a professional auctioneer conducted the sale, and the collateral, consisting of trucks and truck parts and accessories, were sold as individual trucks and as a bulk of accessories.).

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177 Id. at 669.
178 Id.
179 Id. at 671.
question of commercial reasonableness. Section 9-507. Such scrutiny
is especially appropriate where self-dealing is alleged.180

Sometimes, rather than a too hasty sale, the secured party, after
repossession, delays the disposition. In such a case the question arises as
to when a delayed disposition becomes a commercially unreasonable
disposition which bars the secured party from recovering any deficiency
as well as subjects him to liability for any loss caused by such delay. Since
the Code does not compel disposition by a specified date after repossession,
except in the case of consumer goods,181 case law must be examined.
Thus, one case held that where a secured party retained collateral without
sale and without excuse for not selling and without demand for payment
on the contract, for a period of 50 days before suit on the contract and for
over 16 months from the time of filing suit, the delayed disposition was
commercially unreasonable and the secured party was barred from recov-
ering a deficiency judgment.182 Other cases have reached the same result.183

When a disposition is challenged by the debtor as not being
commercially reasonable he will often assert that the price realized at
the public or private disposition was so inadequate as to constitute a
commercially unreasonable disposition.

Section 9-507(2) anticipates this challenge and affords some, but
not absolute, protection by providing, in part, that: "The fact that a better
price could have been obtained by a sale at a different time or in a different
method from that selected by the secured party is not of itself sufficient to
establish that the sale was not made in a commercially reasonable
manner." (Emphasis added).

While a discrepancy between a price received at a sale and fair market
value is not alone sufficient for a determination of unreasonableness such
a discrepancy, if substantial, is relevant to a determination of whether a
challenged sale was commercially reasonable.184

Yet, a substantial discrepancy is not a commercially unreasonable
disposition per se. Thus, when collateral having a fair market value of
approximately $28,000 was sold on a bid for $500 the court said that fact
did not in itself establish that the sale was not conducted in a commercially
reasonable manner.185 The court relied on the evidence that proper notice

180 Id. at 670, 671 (emphasis by the court).
181 U.C.C. § 9-505(1).
183 Farmers State Bank v. Otten, 204 N.W.2d 178 (S.D. 1973) (where secured
did not sell until approximately 15 months after repossession); Brownstein v.
Fiberonics Indus., Inc., 110 N.J. Super. 43, 264 A.2d 262 (1970); Northern Fin. Corp.
422 (1973).
was given, no fraud or wrongdoing of any kind existed, and the goods were "distressed" goods, in that the manufacturer had gone out of business and the exact quantity and condition of the goods could not be determined at the time, because the objecting party who claimed the collateral would not release it for purpose of sale.186

The question of whether the secured party may sell repossessed collateral at "wholesale" rather than "retail" is another related question in testing the commercial reasonableness of the disposition. This question was answered in a recent case187 where the court correctly noted that while there is no Code requirement or prohibition that the secured party sell at "wholesale" or "retail" the secured party has a duty to obtain the best possible price under the circumstances. Thus, when the secured party, an automobile dealer, purchased the repossessed automobile at "wholesale" and credited the debtor with the proceeds and sued the debtors for the deficiency, the court held that the sale was not commercially reasonable and barred recovery of a deficiency judgment. The court rejected the secured party's argument that it "took used automobiles in at wholesale to sell at retail and make money." The court stated:

Such a practice has no place in a private sale of debtor's collateral in that the plaintiff, as secured party, owes the duty to the defendant to use reasonable efforts to obtain the best price to protect the debtors' interests. The secured party should not "make money" from the sale of the debtors' collateral.188

In cases where a debtor challenges, by affirmative defense, the commercial reasonableness of the disposition, there is some conflict as to who has the burden of proof. The majority of cases hold that the secured party must establish that every aspect of the disposition was commercially reasonable.189

Courts may be expected to further define the commercially reasonable disposition on a case-by-case basis since a survey of the case law reveals that no hard and fast rules can be laid down. Consequently, the prudent secured party will strive to do everything reasonable as to the method, manner, time, place and terms of every disposition he makes after he repossesses the collateral.

THE RIGHTS OF THE PURCHASER OF THE COLLATERAL

Successful disposition of the collateral requires that the purchaser acquire valid title at the time he buys the collateral at public or private sale. This desired effect is achieved under Section 9-504(4) which provides:

186 Id.
187 Vic Hansen & Sons, Inc. v. Crowley, 57 Wis. 2d 106, 203 N.W.2d 728 (1973).
188 Id. at 111, 203 N.W.2d at 733.
When collateral is disposed of by a secured party after default, the disposition transfers to a purchaser for value all of the debtor's rights therein, discharges the security interest under which it is made and any security interest or lien subordinate thereto. The purchaser takes free of all such rights and interests even though the secured party fails to comply with the requirements of this part or of any judicial proceedings:

(a) in the case of a public sale, if the purchaser has no knowledge of any defects in the sale and if he does not buy in collusion with the secured party, other bidders or the person conducting the sale; or

(b) in any other case, if the purchaser acts in good faith.

Thus, we see a double standard imposed. The purchaser at a public sale is protected as long as he is not acting in bad faith and is under no duty to inquire into the circumstances of the sale. However, at a private sale, where the possibility of collusion between the secured party and the purchaser is greatest, the purchaser must qualify in all respects as a purchaser in good faith (honest in fact) to be protected.190

The Code recognizes that the secured party may wish to buy the collateral and provides that he may do so pursuant to Section 9-504(3):

"...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."

The foregoing rule is salutary because at a public sale the secured party is often willing to bid for the collateral if the other bids are insufficient or if there are no other bidders, as is frequently the fact. This inures to the benefit of the debtor since he continues liable for any deficiency and also to the secured party who may choose to own the collateral rather than receive the meager proceeds resulting from the public sale. Of course, where the secured party is the only bidder at the public sale the price he bids will often by challenged by the debtor as a price which is inadequate. The debtor's claim will usually be raised as a defense or counterclaim when the secured party seeks to recover a claimed deficiency. In such cases the fact question to be resolved will be whether the secured party's disposition of the collateral at the resultant price was commercially reasonable.191

The Code also permits the secured party to buy the collateral in a

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190 See, e.g., Cooper v. Klopfenstein, 29 Mich. App. 569, 185 N.W.2d 604 (1971) (court held purchaser acted in good faith and noted that good faith purchaser holds title to collateral clear of the debtor's right of redemption); 2 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 44.7 (1965) (Professor Gilmore criticizes the double standard); Hogan, The Secured Party and Default Proceedings Under the U.C.C., 47 MINN. L. REV. 205, 233 (Hogan criticizes the distinction made between purchasers at public sales and those at private sales.)

191 U.C.C. § 9-504(3).
private sale provided the collateral is one of the two types enumerated in the section.\textsuperscript{192} Thus, a purchase made by the secured party of collateral consisting of registered securities at the price at which such securities were concurrently sold on the New York Stock Exchange would qualify under either exception. The rationale of this Code provision is that since there is a recognized market or standard price quotation for the collateral the secured party cannot successfully make a bid lower than the market value since he buys at the "going price." However, in all other instances the secured party may not purchase the collateral at private sale.

Finally, it should be noted that in any disposition made by the secured party, the test of commercial reasonableness must be met no matter who the purchaser is.

**APPLICATION OF THE PROCEEDS OF THE DISPOSITION OF COLLATERAL**

The Code provides in Section 9-504(1):...

\begin{itemize}
  \item [a)] the reasonable expenses of retaking, holding, preparing for sale, selling and the like and, to the extent provided for in the agreement and not prohibited by law, the reasonable attorney's fees and legal expenses incurred by the secured party;
  \item [b)] the satisfaction of indebtedness secured by the security interest under which the disposition is made;
  \item [c)] the satisfaction of indebtedness secured by any subordinate security interest in the collateral if written notification of demand therefor is received before distribution of the proceeds is completed. If requested by the secured party, the holder of a subordinate security interest must seasonably furnish reasonable proof of his interest, and unless he does so, the secured party need not comply with his demand.
\end{itemize}

Under this section the secured party is authorized to prepare or process the collateral prior to disposition and to recover the reasonable expenses of preparing the collateral for sale. Thus, a secured party is entitled to recover his reasonable expenses if he completes the manufacturing of work-in-process in a "commercially reasonable" manner.

It should be noted that the secured party shall turn over to the holder of a subordinate security interest in the same collateral the amount necessary to satisfy the claim of such subordinated secured party "if written notification of demand therefor is received before distribution of the proceeds is completed."\textsuperscript{193} And, if the senior secured party requests, the junior secured party must furnish reasonable proof of his interest. If he

\textsuperscript{192} Id.
\textsuperscript{193} U.C.C. § 9-504(1) (c).
fails to do so, the senior secured party may ignore his demand for payment. Reasonable proof would include, at a minimum, a copy of the security agreement signed by the debtor together with a sworn proof of claim.

The secured party must then account to the debtor for any surplus, and, unless otherwise provided in the security agreement, the debtor is liable for any deficiency. However, if the transaction covered by the agreement between the parties was an outright sale of accounts or chattel paper, then the debtor will not be entitled to any surplus or be liable for any deficiency unless the agreement provides for such liability.

THE DEBTOR'S RIGHTS OF REDEMPTION

It was the philosophy of most pre-Code secured transactions to give the debtor the right to pay his debt and secure the return of his collateral if he has previously defaulted and lost possession of the collateral to the secured party. The rationale of this rule is that no harm is done to the secured party who receives what is owed to him, while the debtor is entitled to the return of his property once he has paid his debt. Under pre-Code law, the Uniform Conditional Sales Act gave the buyer the right to redeem for only ten days after the conditional seller repossessed the goods. Other pre-Code security devices had different time periods after which the debtor could not redeem. The Code has not set any time limit within which the debtor or another secured party having an interest in the collateral must exercise his right to redeem the collateral. However, those pre-Code security devices which gave the debtor the right of redemption also provided that the right would be cut off in specified cases. The Code has similar provisions. Thus, Section 9-506, unchanged by the 1972 amendments, 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 attorneys' fees and legal expenses. (Emphasis added).

Thus, the debtor or any other secured party having any interest in the collateral can redeem the collateral at any time unless the secured

194 U.C.C. § 9-504(3).
195 U.C.C. § 9-504(2). For a discussion of the problems that can arise when subordinated secured parties claim proceeds, see 2 GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 44.8 (1965).
196 UNIFORM CONDITIONAL SALES ACT, § 18.
197 Id.
party has effectively cut off that right by: (1) disposing of the collateral; (2) making a contract of disposition; (3) retaining the collateral in satisfaction of the secured obligation; (4) making a written agreement with the debtor or other appropriate secured parties after default.\footnote{198 U.C.C. § 9-506.}

Obviously, protection of the debtor's right of redemption requires that he be sent notice of disposition of the collateral by the secured party. Moreover, since the Code specifically provides that a good faith purchaser for value takes all of the debtor's rights in the collateral whether or not the secured party has complied with the Code's provisions concerning disposition,\footnote{199 Id.} notification is essential to preserve the debtor's rights in the collateral.\footnote{200 Notice of disposition, however, is excused where the collateral is perishable, where it threatens to decline substantially in value, or where it is of a type customarily sold on a recognized market. \textit{See} U.C.C. § 9-504(3).} While redemption is a right "devoutly to be wished" by the debtor, most debtors who are in default because of nonpayment of one or more installments are usually unable to pay the full amount of the debt which is declared due at such time under the standard acceleration clause contained in the security agreement and any accompanying installment promissory note.\footnote{201 \textit{See} Clark, \textit{Default, Repossession, Foreclosure and Deficiency: A Journey to the Underworld and a Proposed Salvation}, 51 \textit{ORE. L. REV.} 302, 315-316 (1972) (the author criticizes the Code requirement that the defaulting debtor pay the entire debt if the secured party exercises his right to accelerate under the usual acceleration clause).} Yet, notification will afford the debtor an opportunity to seek refinancing even if he is not able to redeem.

What constitutes a "contract of disposition" was discussed in a leading case,\footnote{202 Old Colony Trust Co. v. Penrose Indus. Corp., 280 F. Supp. 698 (E.D. Pa. 1968), aff'd, 398 F.2d 310 (3d Cir. 1968).} where the novel argument was made by a debtor that since a secured party's contract for the disposition of the collateral could be avoided by the failure of a condition stated in the contract, the debtor's right to redeem should not be cut off by Section 9-506. The court noted that the secured party's contract for disposition of the collateral contained specific provisions which, had they become operative, would have permitted the parties to avoid the contract. However, the court stated:

> But the provisions in question were not "conditions precedent" in the sense that either party was equally free to withdraw from the contract without reason. We are satisfied that prior to the time the petition for redemption of the collateral was filed the secured parties had "entered into a contract for its disposition" within the meaning of that provision of Section 9-504 of the Code.\footnote{203 398 F.2d at 313.}

In accordance with Section 9-506, if a security agreement contains an acceleration clause which provides that upon default all sums
become due and payable at the option of the secured party, then the
right of the debtor to redeem his property is conditioned upon his
making the following tender:

(a) the amount representing the sum due under the acceleration
clause; and

(b) the amount sufficient to reimburse the secured party for his
reasonable expenses incurred in retaking, holding and preparing
the collateral for disposition, in arranging for the sale and his
reasonable attorneys' fees and legal expenses.

Yet, in one case\textsuperscript{204} where the secured party repossessed the debtor's
automobile upon default, and declared the entire unpaid balance due
amounting to $1180.71, the court held that the secured party's refusal of
$900 from the debtor and its subsequent sale of the automobile for $275
was unconscionable and therefore denied the secured party its claim for
da deficiency judgment. And in another case\textsuperscript{205} where the secured party
after repossession of the debtor's automobile accepted past due payments,
late charges and a repossession fee, it was held that the debtor was entitled
to the return of the automobile and the secured party's refusal to return
the automobile was not commercially reasonable conduct and amounted
to unconscionable conduct proscribed
by the Code.\textsuperscript{206}

It will be remembered that under Section 9-504(3) the secured party
may dispose of the collateral "by way of one or more contracts" and that
the sale or other disposition of the collateral may be as a unit or in parcels.
Thus, the secured party may make successive sales or other dispositions of
different parts of the collateral in his possession. The fact that he may have
sold or contracted to sell part of the collateral will not affect the debtor's
right under this section to redeem the remaining collateral. In calculating
the amount required to be tendered in "fulfillment of all obligations
secured by the collateral" in addition to the enumerated expenses, the
debtor will receive credit for the net proceeds of the collateral sold.

It should be noted that a debtor may agree in writing to waive
his right of redemption "after default." Although no reported cases
have involved the validity of the debtor's waiver of his right of
redemption before default, it is submitted that any pre-default waiver
would be declared void.\textsuperscript{207} In one reported case, however, the court said

\textsuperscript{206} In allowing the debtor to redeem the collateral, the court ignored 9-506 entirely. By comparison, courts construing Section 18 of the UNIFORM CONDITIONAL SALES ACT (repealed by the Code) have held that a defaulting debtor could redeem by paying past due installments, plus interest, late charges and expenses instead of the entire unpaid balance. See, e.g., Mfrs. Hanover Trust Co. v. Nascarella, 39 Misc. 2d 971, 242 N.Y.S.2d 326 (Sup. Ct. 1963). The Code thus changes this rule to the debtor's disadvantage.
that a guarantor of a debtor in a secured transaction could validly waive his right of redemption, as guarantor, before default.\textsuperscript{208}

Although there are very few reported cases where the right of redemption was sought to be exercised, courts have zealously guarded this right and have frequently denied a deficiency judgment to a secured party who has failed to comply with the Code's notice requirements by holding that failure to give reasonable notification prevented the debtor from exercising his right of redemption.\textsuperscript{209}

\section*{CONCLUSION}

We have seen that the Code through its provisions affords the secured party the flexibility and convenience he requires (1) to swiftly move to possess his collateral from a debtor in default, (2) to collect from account debtors and obligors the proceeds of the collateral when the collateral is accounts receivable or chattel paper, and (3) to dispose of the collateral by public or private disposition or retain it in satisfaction of the debtor's obligations. At the same time the interests of the defaulting debtor are carefully safeguarded by requiring the secured party to give the debtor reasonable notification of the disposition and an opportunity to redeem. Moreover, the economic interests of other secured parties who have a subordinated security interest in the same collateral are also protected by the Code's provisions. Finally, the provisions for judicial review of past and future dispositions of collateral by the secured party is the ultimate safeguard afforded to the debtor and other subordinated secured parties who believe the secured party has not proceeded in every respect in a commercially reasonable manner.

An examination of the reported cases illustrates that some secured parties have been careless in complying with the Code requirements and have thereby incurred the penalties the Code prescribes for noncompliance. Yet, we have seen that not every challenge by a debtor to the secured party's conduct has met with success. We may conclude that when a secured party acts in a commercially reasonable manner, measured by what a reasonable party acting in good faith should do in the market place, he will successfully meet the challenge of objecting debtors and other specified parties. The Code, improved by the 1972 amendments, has given the secured party flexibility in possessing and disposing of the collateral while at the same time protecting the economic interests of the debtor and other subordinated secured parties. Thus, the Code has balanced the equities fairly and has thereby made an extremely valuable contribution to the business community it seeks to serve.
