



1976

Liability of the Guarantor of Secured Indebtedness after Default and Repossession under the Uniform Commercial Code: A Walk on the Wild Side by the Secured Party

Rick Sachs
University of Baltimore School of Law

Gloria M. Belgrad
Shapiro & Sachs, P.A.

Follow this and additional works at: <http://scholarworks.law.ubalt.edu/ublr>



Part of the [Law Commons](#)

Recommended Citation

Sachs, Rick and Belgrad, Gloria M. (1976) "Liability of the Guarantor of Secured Indebtedness after Default and Repossession under the Uniform Commercial Code: A Walk on the Wild Side by the Secured Party," *University of Baltimore Law Review*: Vol. 5: Iss. 2, Article 2.

Available at: <http://scholarworks.law.ubalt.edu/ublr/vol5/iss2/2>

This Article is brought to you for free and open access by ScholarWorks@University of Baltimore School of Law. It has been accepted for inclusion in University of Baltimore Law Review by an authorized administrator of ScholarWorks@University of Baltimore School of Law. For more information, please contact snolan@ubalt.edu.

LIABILITY OF THE GUARANTOR OF SECURED INDEBTEDNESS AFTER DEFAULT AND REPOSSESSION UNDER THE UNIFORM COMMERCIAL CODE: A WALK ON THE WILD SIDE BY THE SECURED PARTY

Rick Sachs† and Gloria M. Belgrad††

A lender who obtains security for and a guarantee of its loan may mistakenly presume that recovery in the event of the borrower's default is assured. As the authors point out, however, numerous pitfalls may await the unwary lender who attempts to secure repayment from the guarantor. This article identifies the problems involved, discusses their treatment by the courts, and makes recommendations for reducing the risks of costly mistakes.

INTRODUCTION

A commercial lender often seeks to assure repayment of the money it loans by taking a security interest in the business inventory, accounts receivable or other collateral of the borrowing company. In the commercial financing of small and medium-sized companies, it is common practice for the lender to seek additional assurances of repayment; the lender usually demands and obtains from the company's principals or third persons a guaranty of the indebtedness. Personal guarantees serve two inter-related purposes in the eyes of the lender: first, the personal guarantees represent an independent source of repayment of the indebtedness, so that if the company defaults in repayment, and the collateral in which the lender was granted a security interest proves inadequate to fully discharge the indebtedness, the lender can look to the personal resources of the guarantors for repayment; and, secondly, the lender can usually be assured that the guarantors will exert their best efforts in the operation of the business to liquidate the indebtedness so as to avoid personal liability. Yet, when a loan goes sour, the secured creditor who seeks to realize on the company's collateral and the personal guarantees must proceed with caution and on the most competent legal advice. In this post-default period, the creditor's actions, and, in some instances, failure to act, in respect of the debtor company, the collateral and the guarantors will determine whether the personal guarantees will, in fact, secure repayment of the company's indebtedness if the collateral and other company assets prove insufficient.

†A.B., 1965, LL.B., 1967, University of Maryland; Lecturer in Law, University of Baltimore School of Law, 1969—; Blue Sky Advisory Committee, 1973-75; Partner in Shapiro & Sachs, P.A.; Member of the Maryland Bar.

††B.S., 1959, Johns Hopkins University; J.D., 1970, University of Maryland; Partner in Shapiro & Sachs, P.A.; Member of the Maryland Bar.

A number of threshold questions immediately present themselves. May the secured party, upon default, simply repossess the collateral and peremptorily sell or otherwise dispose of it without notifying the debtor of the intended disposition? If notice is required, will notice to the direct borrower suffice, or is a guarantor entitled to separate notification as well? What type of notice is required to be given? What are the legal consequences, if any, of a failure to comply with the notice requirements?

If the secured party does not wish to sell or otherwise dispose of the repossessed collateral, may it elect to retain the collateral in satisfaction of the debt? If the secured party elects to sell or otherwise dispose of only a part of the collateral and retain the rest, must it notify the defaulting debtor and the guarantor of its election? If the secured party wishes to defer a decision on the disposition of all or part of the collateral while observing the market, how long may it wait? What are the legal consequences of a protracted failure by the secured party to take *any* action with respect to the collateral?

Subtitle Five of Title Nine of the Uniform Commercial Code [hereinafter referred to as the "UCC" or the "Code"]¹ governs the remedies of a secured party and the corresponding rights of the debtor and third persons with respect to the collateral upon default. A secured party's failure to comply with the provisions of the Code can prove to be a very costly mistake.

It is the purpose of this article to explore, in the context of a typical secured transaction under the UCC, the answers to these questions that confront a lender-secured party who, upon default by the direct borrower, seeks to effect repayment of the indebtedness by holding the guarantors liable under their personal guarantees.

FACTUAL BACKGROUND

Let us assume that a Maryland corporation [hereinafter referred to as the "Company" or the "Debtor"], engaged in the business of manufacturing and selling bricks, borrowed \$500,000 [hereinafter referred to as the "Loan"] on January 1, 1973, from a Maryland lending institution [hereinafter referred to as the "Lender" or the "Secured Party"]. The Loan was evidenced by the Company's negotiable promissory note [hereinafter referred to as the "Note"] payable to the order of the Lender. The Note was secured by a security interest granted by the Company to the Lender by a duly executed written security agreement [hereinafter referred to as the "Security Agreement"] in all of the Company's existing and after-acquired brick inventory, accounts, and the proceeds thereof [hereinafter collectively referred to as the "Collateral"]. One or more financing statements were duly executed and filed. Repayment of the Loan and the performance

1. See MD. ANN. CODE, Comm. L. Art., §§ 9-501-07 (1975).

of all the Company's duties and obligations under the Security Agreement were personally guaranteed by an individual third party [hereinafter referred to as the "Guarantor"], who was not affiliated with the Company.

A year later, the Company defaulted under the Security Agreement, and the Lender advised the Company that it was repossessing all of the Collateral. At the time of the Company's default, the Company's inventory consisted of 4,000,000 bricks, and the net total amount of its accounts receivable was \$300,000.

Two months after the default, the Lender gave written notice to the Company and the Guarantor that it proposed to dispose of the repossessed inventory at a public auction to be held at a designated time and place. The public auction was abortive; no bids were accepted and no sales consummated.

Three months after the default, however, the Lender sold the repossessed brick inventory at a private sale for a total purchase price of \$50,000. Although the Company was given prior oral notice of this private sale, neither oral nor written notice was given to the Guarantor. Furthermore, the Guarantor was given no notice of the Lender's intention to retain, sell or otherwise dispose of the repossessed accounts of the Company. For a period of eighteen months after default, the Lender collected, by lawsuit and otherwise, approximately \$50,000 of the \$300,000 net outstanding amount of the accounts; thereafter the Lender made no further collection efforts.

Nineteen months after its default, the Company filed a voluntary petition in bankruptcy in the United States District Court for the District of Maryland. The Lender then filed suit in federal court against the Guarantor on his guarantee of the Note and Security Agreement.

On these facts, what, if any, problems will confront the Lender in connection with its suit against the Guarantor?

ANALYSIS

I. *The Notice Requirements*

The first potential barrier to the Lender's recovery is its failure to give notice to the Guarantor of its intent to sell the Collateral at the private sale. Although Section 9-504(1) of the Code permits a secured party, upon the borrower's default, to "sell, lease or otherwise dispose of any or all of the collateral . . .,"² Section 9-504(3) places certain restrictions on the manner of the disposition. Among these is the requirement that the debtor be given reasonable notice of an intended sale. Section 9-504(3) provides, in pertinent part, that:

Unless collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market

2. *Id.* § 9-504(1).

reasonable notification of the time and place of any public sale or *reasonable notification of the time after which any private sale or other intended disposition is to be made shall be sent by the secured party to the debtor*, 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 of the debtor in this State or who is known by the secured party to have a security interest in the collateral.³

Since the Collateral in our hypothetical is neither "perishable" nor "threatens to decline speedily in value," and is not "of a type customarily sold on a recognized market,"⁴ the Secured Party was required under Section 9-504(3) to give prior notice of its intended private sale to the "debtor." The question then arises whether a guarantor is included within the meaning of the term "debtor" as that term is used in Section 9-504(3).

A. Is a Guarantor a Debtor within the Meaning of Section 9-504(3) of the Code?

An appreciation of the purpose of the notice requirements of Section 9-504(3) is essential to a determination of whether those requirements are applicable to a guarantor. It is almost universally agreed that the purpose of the Section 9-504(3) notice requirements is to give "persons entitled to receive it . . . sufficient time to take appropriate steps to protect their interests by taking part in the sale or other disposition if they so desire."⁵ The holdings of the courts in cases involving the question of whether sufficient notice was given reflect this

3. *Id.* § 9-504(3) (emphasis added). This Section also provides:

Disposition of the collateral may be by public or private proceedings and may be made by way of one or more contracts. Sale or other disposition may be as a unit or in parcels and at any time and place and on any terms but every aspect of the disposition including the method, manner, time, place and terms must be commercially reasonable. *Id.*

This article will not consider certain other defenses which might be available to the guarantor under the Code such as, the lack of commercial reasonableness in the sale of repossessed collateral.

4. Regarding collateral of a type customarily sold on a recognized market, Professor Gilmore has stated:

No one would question that the New York Stock Exchange is a "recognized market" for securities listed on the Exchange. . . . Evidently there is no "market" unless it is possible to say, with objective truth, at 2:00 p.m. on February 3 the market price for steel, soybeans or whatnot was X. . . . If the statement could not be made . . . [there] would not be a "market", so that it would be unnecessary to speculate about whether, if it was a "market," it would be "recognized" one. 2 G. GILMORE, *Security Interests in Personal Property* § 44.5, at 1236 (1965) [hereinafter cited as GILMORE].

See also Norton v. Nat'l Bank of Commerce, 240 Ark. 143, 398 S.W.2d 538 (1966).

5. MD. ANN. CODE, COMM. L. ART., § 9-504, Comment 5 (1975).

view. In *Mallicoat v. Volunteer Finance and Loan Corp.*,⁶ for example, the secured creditor had actually mailed the required prior notice, but the letter had come back marked "unclaimed" prior to the sale. The court held that the prior notice requirements of the Code had not been satisfied, stating:

The purpose of this notice, without doubt, is to *enable the debtor to protect his interest in the property* by paying the debt, finding a buyer or being present at the sale *to bid on the property or have others do so, to the end that it be not sacrificed by a sale at less than its true value.*

....

The requirement of notice is for the benefit and protection of the debtor. This provision of the Act should be construed and applied in a manner to effectuate this salutary purpose⁷

In *Aimonetto v. Keepes*,⁸ the creditor claimed that, as a result of his conversations with the debtor concerning the need to sell the collateral to satisfy the debt, the debtor had received "constructive notice" of the creditor's intentions prior to the time of the actual private sale. The Wyoming court rejected this contention, stating, "[t]he law requires more than a reasonable expectation on the part of the debtor if the notice requirement of the commercial code is to be satisfied."⁹ For similar reasons, the court in *The Morris Plan Co. v. Johnson*,¹⁰ held that even the creditor's advertisement of the sale, coupled with informal notification to the defendants, was insufficient to meet the requirements of Section 9-504(3).¹¹

In *Nelson v. Monarch Investment Plan of Henderson, Inc.*,¹² in which the defendant debtor had actually returned the collateral to the creditor and instructed the creditor to sell it, the court refused to hold that the debtor had been given adequate notice (although the court found it either had waived the right to notice or was estopped from claiming damages resulting from the lender's failure to give notice). The court said:

6. 57 Tenn. App. 106, 415 S.W.2d 347 (1966).

7. *Id.* at 112-13, 415 S.W.2d at 350-51 (emphasis added). See also *Commercial Credit Corp. v. Lloyd*, 12 UCC REP. 15 (D.C. Super. Ct. Small Cl. and Conciliation Br. 1973).

8. 501 P.2d 1017 (Wyo. 1972).

9. *Id.* at 1019.

10. 133 Ill. App. 2d 717, 271 N.E.2d 404 (1971).

11. The court stated:

It is true that the sale was advertised and that the defendants should have expected such action on the part of the plaintiff since the record discloses that plaintiff had advised the defendants of its intentions to effect a sale, but the law requires more than a general advertisement or a reasonable expectation on the part of the debtor if the notice requirement is to be satisfied. *Id.* at 720, 271 N.E.2d at 407.

12. 452 S.W.2d 375 (Ky. Ct. App. 1970).

The debtor is entitled to notification of a specific date after which the creditor may proceed to dispose of the collateral. This would give the debtor a deadline within which to protect himself in whatever manner he saw fit. Knowledge would be brought home to him that if he failed to liquidate his indebtedness, or reach an agreement with respect to the collateral, or failed to take other appropriate action by a specified time, he would be foreclosed from attacking the subsequent sale (provided always that it was "commercially reasonable").¹³

Actual notification has been held insufficient when it was not given within a reasonable time prior to the sale. In *Cities Service Oil Co. v. Ferris*,¹⁴ the court found that the plaintiff creditor had "fulfilled his bare statutory duty"¹⁵ under the Code by giving a form of prior notice to the debtor, but the court held that "the commercial code requires more."¹⁶ The defendant debtor in *Ferris* learned of the intended sale only at 10:30 a.m. on the morning of sale. The court explained its finding that the defendant did not receive reasonable notification as follows:

Had the defendants had more time, when they knew foreclosure was inevitable, they could have perhaps contacted the retail outlets of the plaintiffs and notified them of the sale in order that these individuals could be present to bid in whatever parcels of the collateral they might wish to purchase. Admittedly, the court is dealing in a presumption that the retail dealers of the plaintiff would have been interested in purchasing some of the items. However in view of the short notice, the plaintiff must permit the court to indulge in this presumption.¹⁷

The unmistakable thrust of the opinions is that the debtor must be given the opportunity, by whatever means are available to it in the circumstances, of eliminating altogether or, at least, reducing to a minimum, the amount of any deficiency for which it might be liable. A concern with preserving the debtor's right under Section 9-506 to redeem the collateral "[a]t any time before the secured party has disposed of [it] or entered into a contract for its disposition . . ." is also implicit in the decisions. Sometimes, as in the case of *Skeels v.*

13. *Id.* at 377.

14. 9 UCC REP. 899 (D.C. Mich. 1971).

15. *Id.* at 903.

16. *Id.*

17. *Id.* at 902.

Universal C.I.T. Credit Corp.,¹⁸ the two purposes appear to be ranked of equal importance. There the court stated:

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. . . . A security holder who disposes of collateral without notice denies to the debtor his right of redemption which is provided him in Section 9-506¹⁹

As *Mallicoat, Ferris* and *Skeels* indicate, a debtor who is unable to redeem may yet protect its interests in the collateral by bidding at the sale to drive up the level of competing bids or by "drumming up" interest in the sale. Failing all else, it can at least be present to determine whether the secured party is proceeding in accordance with the requirement of the Code that "every aspect of the disposition including the method, manner, time, place and terms . . . be commercially reasonable."²⁰

Thus, it is perhaps more precise to say that the purpose of the notice requirements of UCC Section 9-504(3) is a dual one: to preserve to the debtor its right to redeem the collateral *and* to give it time to exert efforts to reduce the likelihood and size of any possible deficiency by whatever means available.

The draftsmen of the Code deemed these purposes of the prior notice requirements of Section 9-504(3) to be so fundamentally and vitally important that they departed from their avowed devotion to freedom of contract principles²¹ and provided, in Section 9-501(3), that the rights of the debtor to prior notice under Section 9-504(3) may not be waived or varied prior to the default.²² This protective reasoning of the Code draftsmen is also exhibited in the requirement of

18. 222 F. Supp. 696 (W.D. Pa. 1963), *modified on other grounds*, 335 F.2d 846 (3d Cir. 1964).

19. *Id.* at 702. *See also* *Camden Nat'l. Bank v. St. Clair*, 309 A.2d 329 (Me. 1973).

20. MD. ANN. CODE, Comm. L. Art., § 9-504(3) (1975).

21. MD. ANN. CODE, Comm. L. Art., § 9-101, Comment (1975), provides:

Except for procedure on default, freedom of contract prevails between the immediate parties to the security transaction.

22. The Official Comment explains the concern of the draftsmen:

In general, provisions which relate to matters which come up between immediate parties may be varied by agreement. In the area of rights after default our legal system has traditionally looked with suspicion on agreements designed to cut down the debtor's rights and free the secured party of his duties: no mortgage clause has ever been allowed to clog the equity of redemption. The default situation offers great scope for overreaching; the suspicious attitude of the courts has been grounded in common sense. MD. ANN. CODE, Comm. L. Art., § 9-501, Comment 4 (1975).

See, e.g., C.I.T. Corp. v. Haynes, 161 Me. 353, 212 A.2d 436 (1965) (secured party's sale, without notice, pursuant to debtor's antecedent waiver of notice of resale of repossessed collateral is void as against public policy of protecting "improvident and impecunious" debtors from unfair dealing and imposition, and of preserving the debtor's long-established right of redemption). *But see* note 127 *infra* and accompanying text.

Section 9-504(3) that "except in the case of consumer goods," the secured party must give prior notice of disposition "to any person who has a security interest in the collateral and who has duly filed a financing statement indexed in the name of the debtor in this State or who is known by the secured party to have a security interest in the collateral."²³

It is evident from the importance ascribed to them by the draftsmen of the Code, and from the solicitude with which they are treated by the courts, that these prior notice requirements lie at the heart of a social and economic policy that embraces more than vindication of the merely technical rights of individual defaulting debtors. The secured party's compliance with these notice provisions, together with the other procedures for disposition of collateral upon default is clearly deemed to be vital "for the protection not only of the defaulting debtor but of other creditors" as well.²⁴ Like the defaulting debtor, the holder of a junior security interest, for example, has vital interests in the repossessed collateral which can be similarly safeguarded. It may be willing and able to redeem the collateral or procure interested buyers to drive up the level of competitive bidding at the sale or, at the very least, scrutinize the conduct of the sale for indicia of unfairness or commercial unreasonableness. Aside from equitable considerations, it is virtually indispensable to the rational functioning of the entire regulatory scheme envisaged by Article Nine of the UCC that some mechanism be provided, whereby, without unduly burdening the secured party, those with the closest and most substantial interests in the collateral can be provided with the opportunity to protect these interests. In the case of these designated creditors, this function is served by the prior notice mandate of UCC Section 9-504(3).

The same policy considerations would seem to apply with equal force to the *owner of collateral* who merely permits his property to be "pledged" by another as security for the latter's debt. Pursuant to Section 9-112, an owner of collateral is immune from the threat of liability "for the debt or for any deficiency after resale" that hangs over the individual actually indebted in the secured transaction. Yet, while the owner's interest in the collateral is readily distinguishable from that of a junior secured creditor, its interest is, nevertheless, sufficiently close and substantial to be embraced within the protective prior notice mandate of UCC Section 9-504(3). This conclusion is reached indirectly; one searches in vain for any express reference to the owner of the collateral in Section 9-504. However, the definitional cross reference appended to the Official Comment to Section 9-504 directs attention to Section 9-105 for the meaning and scope of the term "debtor," as that term is employed within the context of Section 9-504. Section 9-105(1)(d) provides, in pertinent part, that:

23. MD. ANN. CODE, Comm. L. Art., § 9-504(3) (1975) (emphasis added).

24. MD. ANN. CODE, Comm. L. Art., § 9-501, Comment 1 (1975).

“Debtor” means the person who owes payment or other performance of the obligation secured. . . . Where the debtor and the owner of the collateral are not the same person, the term “debtor” means the owner of the collateral in any provision of the [Article] dealing with the collateral, the obligor in any provision dealing with the obligation, and may include both where the context so requires.²⁵

Since a section dealing with disposition of collateral upon default is, manifestly, a “provision of the [Article] dealing with the collateral,” the conclusion is irresistible that the owner of the collateral is a “debtor” entitled to notice within the meaning of Section 9-504(3).

Section 9-504(3) is as devoid of any reference to a guarantor as it is of any reference to an owner of collateral. Guidance on this point must again be sought in the definition of “debtor” as set forth in Section 9-105(1)(d). The language of that Section providing that “debtor” means the person “*who owes payment or other performance of the obligation secured . . .*”²⁶ can be readily construed to embrace a guarantor. This is particularly true of a guarantor who, like the one in our hypothetical, guarantees not only repayment of the indebtedness under the note, but also performance of the obligations and duties of the debtor under the security agreement, and, therefore, patently owes the secured party “payment or other performance of the obligation secured” within the meaning of Section 9-105(1)(d). The very measure of that payment or other performance due the secured party hinges upon the secured party’s disposition of the repossessed collateral after default. A closer and more substantial interest in the collateral is hard to imagine. To read Section 9-105 as including within the definition of “debtor” an owner of collateral who owes no payment or other performance whatsoever, but excluding the guarantor with all of its exposure to a deficiency judgment, would appear to be extremely arbitrary and capricious. It would certainly be at variance with the cautionary advice of the draftsmen of Article Nine that “[t]he scheme of the [Article] is to *make distinctions*, where distinctions are necessary, *along functional rather than formal lines*.”²⁷

The question of whether the guarantor of secured indebtedness, or someone in a closely analogous position, is a “debtor” entitled to notice within the meaning of Section 9-504(3) has rarely arisen in the

25. See, e.g., Kripke and Felsenfeld, *Secured Transactions: A Practical Approach to Article 9 of the Uniform Commercial Code*, 17 *U.T. L. REV.* 168 (1962), who state:

As Article 9 is concerned with the treatment of security, it affects owners of collateral whether or not they have personal liability on the obligation secured. For convenience, Article 9 defines “debtor” as both the individual personally liable and the owner of the collateral, where they are different. In this way, Article 9 prescribes the rules relating to collateral for a debt, regardless of who owns the collateral. *Id.* at 169.

26. *MD. ANN. CODE*, *Comm. L. Art.*, § 9-105(1)(d) (1975) (emphasis added).

27. *MD. ANN. CODE*, *Comm. L. Art.*, § 9-101, *Comment* (1975) (emphasis added).

reported decisions. On those scant occasions when the courts have been called upon to consider the question, however, they have answered it in the affirmative.

A leading case in this area is *Norton v. National Bank of Commerce*.²⁸ Norton, an automobile dealer, sold a used car to Goldsmith, who executed a promissory note and a conditional sales contract for the unpaid purchase price. Norton sold the note and contract to the plaintiff bank, endorsing the note and executing a written assignment of the contract, which provided that if Goldsmith should default in his obligation Norton would repurchase the contract for the amount due. Goldsmith shortly defaulted, the bank repossessed the car, and, without notice to either Goldsmith or Norton, sold the car to one of its customers in a private sale. The proceeds of sale were insufficient to wipe out the debt, and when Norton refused the bank's demand for payment of the outstanding balance, the bank brought suit against him to recover a deficiency judgment. On these facts, the court held that "Norton was a debtor . . . entitled to notice that a private sale was impending,"²⁹ explaining that:

the controlling definition appears in [Section 9-105(1)(d)], . . .

Norton had promised to repurchase the contract for the amount due. He was a person who owed "other performance" of the obligation.³⁰

It is also significant that the court arrived at this conclusion only after weighing and rejecting narrow conceptual distinctions urged upon it in amicus curiae briefs submitted at its own request. Clearly adopting the functional approach intended by the UCC, the court stated:

Norton . . . was directly affected by the sale of the [repossessed collateral]; the amount obtained in that sale fixed his pecuniary liability. In simple fairness he should have had notice—a requirement entailing no real inconvenience or hardship to the bank.³¹

The same functional approach led the court in *T&W Ice Cream, Inc. v. Carriage Barn, Inc.*,³² to hold that the *accommodation endorsers* of a corporate note secured by a security interest in furniture and equipment used in the corporate debtor's business were "debtors" within the meaning of Section 9-105(1)(d) and, as such, entitled to prior notice of a private sale under UCC Section 9-504(3):

28. 240 Ark. 143, 398 S.W.2d 538 (1966).

29. *Id.* at 145, 398 S.W.2d at 540.

30. *Id.* at 146-47, 398 S.W.2d at 540.

31. *Id.* at 148, 398 S.W.2d at 541.

32. 107 N.J. Super. 328, 258 A.2d 162 (1969).

The exact words of the guarantee signed by the individual guarantors in the security agreement between Carriage Barn and plaintiff's assignors was [sic.]: "Payment and performance of the above obligation absolutely, unconditionally and continuously guaranteed."

This language of the guarantee is almost exactly the same as that of the definition of a debtor (a debtor being a person who "owes payment or other performance of the obligation secured"). Therefore, the court finds that the accommodation endorsers in this case are debtors under [Section] 9-105(1)(d) and are thus entitled to notice.³³

Significantly, the court observed that the secured party was "in effect" proceeding against the individual guarantors after the default of the corporate debtor.³⁴ By virtue of the ubiquitous acceleration clause, default typically converts the guarantor's theretofore contingent liability into a direct and primary liability for full performance of the entire secured obligation. When the secured party is confident that the value of the collateral equals or exceeds the amount of the debt, or that the defaulting debtor can secure new financing, it is likely to regard the additional security of the guarantee as largely superfluous. When the probability of a deficiency looms, the situation is altered sharply: the guarantor will appear to be a much safer "bet" for payment than the insolvent or "defunct" original debtor. This is particularly likely to be the case when the language of the guarantee is highly reassuring to the secured party, that is, when absolute and unconditional payment or other performance is guaranteed in language which "is almost exactly the same as that of the definition of a debtor."³⁵ The guarantor, in short, is likely to be made the real target of the secured party's anticipated collection efforts. The sale will merely fix the exact amount of its pecuniary liability. Thus, in a very real sense, when the secured party prepares to dispose of the collateral by sale, it is taking the first step toward ultimate recovery under the guarantee, and is, in effect proceeding against the guarantor rather than against the original debtor. It can be argued strongly that the secured party, who is taking comfort in its foresight in obtaining additional security, should not be permitted to deny that the very individual to whom it looks foremost for payment or other performance is, in fact, its debtor, and, as such, entitled to all of the procedural and other safeguards provided for debtors in the Code.

This type of assessment of the underlying realities of the commercial situation apparently led the court in *Third National Bank & Trust Co. v. Stagnaro*³⁶ to hold that, since the maker of a corporate note secured

33. *Id.* at 332-33, 258 A.2d at 165.

34. *Id.*

35. *Id.*

36. 25 Mass. App. Dec. 58 (1962).

by a chattel mortgage had dishonored it, the president of the debtor corporation, who had endorsed the note, was a debtor within the meaning of UCC Section 9-504(3).³⁷

This functional approach has also been followed when the issue of prior notice has been raised in the context of bankruptcy proceedings. In *In re Frye*,³⁸ for example, the court concluded that the trustee in bankruptcy was the debtor "under the statutory definition of . . . UCC 9-105(1)(d) . . ." ³⁹ and, therefore, entitled to notice of any intended disposition. Curiously, neither the trustee nor the secured party made any reference to Section 9-105(1)(d), but the court, indicating that the "language of this section . . . [threw] considerable light"⁴⁰ on the issue, turned to it sua sponte.

Two apparently contrary cases do not, upon close analysis, lend themselves as strong precedential authority for the proposition that a guarantor should not be treated as a debtor under Section 9-504(3). In *A. J. Armstrong Co., Inc. v. Janburt Embroidery Corp.*,⁴¹ the court held that the accommodation endorsers of the debtor corporation's note were personally liable for a deficiency judgment. The issue of

37. *Id.* at 66. The court went on to find, however, that the collateral there sold was a type customarily sold on a recognized market so as to bring the plaintiff bank within the exception to the notice requirements of Section 9-504(3). The court further found that, from undisputed evidence in the case, the defendant actually had received a letter of notice addressed to the corporation but flagged to his attention. Substance similarly prevailed over form in *Atlas Thrift Co. v. Horan*, 27 Cal. App. 3d 999, 104 Cal. Rptr. 315 (1972). In that case, it was conceded that the defendant, who had orally assured the plaintiff loan company that he was backing the primary debtor and was a silent partner in the latter's business, was a "debtor" within the meaning of UCC Section 9-105(1)(d) and, therefore, entitled to notice under UCC Section 9-504(3).

See also *Foundation Discounts Inc. v. Serna*, 81 N.M. 474, 468 P.2d 875 (1970), which, although not strictly decided on the basis of the Code, contains persuasive dicta in support of the proposition that a guarantor is a debtor under 9-504(3).

38. 9 UCC REP. 913 (S.D. Ohio 1970).

39. *Id.* at 919.

40. *Id.* at 918. It should be noted that the court in *Frye* did not rest its conclusion upon the technical consideration that, by virtue of the "relation back" doctrine, title to the automobile had vested in the trustee prior to the sale so that the trustee was an owner-of-collateral-debtor within the meaning of Section 9-105(1)(d). The court summarily dismissed the argument as follows:

These statutory duties and interests of the trustee in bankruptcy are not relevant to the issues raised on a purely functional basis. It must be emphasized that the Uniform Commercial Code very properly, and expressly, incorporates all of "the principles of law and equity, . . ." as a supplement to its provisions . . . [UCC Section 1-103]. Any right or obligation declared in the Uniform Commercial Code is enforceable by action unless the provision declaring it specifies a different and limited effect. *Id.* at 920.

Cf. In re Senters, 9 UCC REP. 922 (S.D. Ohio 1970), which provides an interesting and illuminating example of how a court's evenhanded concern with commercial realities and with commercial fairness rather than with formal and technical distinctions, can work to the advantage of the secured party rather than that of the debtor. Although the court held that the trustee was not a debtor entitled to notice, its expressed concern with functional results fairly implies that upon a proper showing of facts, the court would treat the "additional monetary loss" potentially visited on a guarantor deprived of notice of disposition with no less solicitude than was shown to the secured party therein, threatened with losses by virtue of a delayed sale.

41. 97 N.J. Super. 246, 234 A.2d 737 (1967).

notice to the defendants appeared to be raised, almost as an afterthought, as one element of one of several defenses asserted. The court devoted only a single sentence in the entire lengthy opinion to this subject, stating: "Section 9-504(3) provides that only the debtor [the corporate maker of the note] or other secured party need receive notice."⁴² The statement was totally unsupported by citation of authority. Significantly, a later decision from the same jurisdiction, *T&W Ice Cream, Inc. v. Carriage Barn, Inc.*,⁴³ distinguished and refused to follow the *Janburt* case.

The holding of the other case, *Mutual Finance Co. v. Politzer*,⁴⁴ that the guarantors of a secured corporate debt were liable for a deficiency, is difficult to apply to our hypothetical factual scenario for numerous reasons. First, the thrust of the defendants' argument was that they, as guarantors, were discharged by virtue of the plaintiff's failure to give notice to and consequent discharge of their principal, the corporate debtor. Secondly, in *Poltizer* the guarantors were a husband, his wife and his mother, who had individually executed guarantees on behalf of the corporation in which the husband was the sole stockholder. Inasmuch as the guarantors represented the total ownership interest in the closely held corporation, the holding of the court may have been motivated by the conviction that they should be liable for the corporation's debt. Thirdly, there were strong estoppel facts in *Poltizer* based on an agreement between the guarantors and the plaintiff after repossession which induced the plaintiff to resell the collateral without giving the debtor the required notice. Fourthly, the decision was largely based on technical distinctions between the liability of sureties and that of guarantors, which are frowned upon by the UCC. It is arguable, therefore, that *Poltizer* has no application beyond similarly narrow factual situations.⁴⁵

On the basis of the foregoing analysis of the authorities and the relevant underlying policy considerations, a secured party would be best advised to deem a guarantor a "debtor" within the meaning of Section 9-504(3), entitled to notice of the intended disposition of repossessed collateral. To require a secured party to give notice of disposition to a guarantor of the indebtedness secured is "a requirement entailing no real inconvenience or hardship to the [secured party]."⁴⁶ This requirement would seem incomparably less burdensome than the requirement to give notice to other secured creditors designated in

42. *Id.* at 263, 234 A.2d at 746. *But see* Camden Nat'l Bank v. St. Clair, 309 A.2d 329 (Me. 1973), in which an accommodation maker of a notice was deemed to be entitled to notice.

43. 107 N.J. Super. 328, 258 A.2d 162 (1969).

44. 21 Ohio St. 2d 177, 50 Ohio Op. 2d 397, 256 N.E.2d 606 (1970), *aff'g* 16 Ohio App. 2d 83, 241 N.E.2d 906 (1968).

45. For a discussion highly critical of the decision in *Poltizer*, see 20 CASE W. RES. L. REV. 874 (1969).

46. Norton v. Nat'l Bank of Commerce, 240 Ark. 143, 148, 398 S.W.2d 538, 541 (1966).

Section 9-504(3),⁴⁷ the secured party need not be put to the trouble of searching through various state records, since the identity of its guarantor is already known and available from its own files. In view of the guarantor's serious and substantial interests in the sale of the collateral, it would seem little enough to demand that the secured party be required to provide the guarantor with reasonable prior notice thereof.

Assuming, therefore, that the Guarantor in our hypothetical was a debtor entitled to notice of disposition under Section 9-504(3), the next issue that must be examined is the effect, if any, of the Lender's failure to give prior notice upon its right to recover a deficiency judgment against the Guarantor.

B. The Effect of Failure to Give Notice on the Secured Party's Right to Recover a Deficiency Judgment

A majority of the courts [hereinafter referred to as the "Majority"] that have considered the problem of the secured party's non-compliance with the default provisions of the UCC have concluded that non-compliance extinguishes the secured party's right to recover a deficiency as a matter of law. This view has also attracted considerable support from the textual commentators and authors of articles on the subject.⁴⁸

A number of other jurisdictions [hereinafter referred to as the "Minority"], however, have adopted the rule that lack of notice is not an absolute defense to a suit for recovery of a deficiency. Apparently, the courts that have reached this conclusion have felt impelled to it more by their superficial reading of the statutory language of the

47. See text of Section 9-504(3) at note 3 *supra*.

48. Professor Gilmore, for example, describes this result as "eminently reasonable." 2 GILMORE § 44.9.10, at 1264 (1965). See White, *Representing the Low Income Consumer in Repossessions, Resales and Deficiency Judgment Cases*, 64 NW. U.L. REV. 808 (1970), who states:

In sum, the weight of authority may well be that the failure to comply with Part 5 of Article 9 precludes a creditor's recovery of a deficiency None of the cases which are cited for the proposition that a misbehaving creditor retains a right to a deficiency is strong authority. . . . [The cases which deny recovery.] constitute a body of case law which is enjoying both rapid growth and acceptance. Moreover, there is every indication that this doctrine can be successfully cultivated in all but the most barren judicial soil. *Id.* at 832-33.

See, e.g., Clark, *Default, Repossession, Foreclosure, and Deficiency: A Journey to the Underworld and a Proposed Salvation*, 51 U. ORE. L. REV. 302, 317 (1972); Shuchman, *Profit on Default: An Archival Study of Automobile Repossession and Resale*, 22 STAN. L. REV. 20 (1969); Comment, *Defending Deficiency Judgment Suits in Kentucky: Article Nine, Part 5 of the Uniform Commercial Code*, 61 KY. L.J. 578, 588 (1973).

A similar growing concern with the possibilities for creditors' abuse of the deficiency decree appears to be invading the ranks of the lawmakers; for example, legislatures in a number of states, including Arizona, California, Colorado, Hawaii, Idaho, Illinois, Indiana, Oklahoma, Oregon, Utah and Wyoming, have passed some form of supplementary anti-deficiency judgment legislation.

default provisions than by any firm conviction as to its wisdom and desirability. This is evidenced by the fact that these courts have made

strenuous judicial efforts . . . to mitigate [the] harsh and unfair consequences [to the debtor that may result from this approach]. The most common formula was to create a presumption that the value of the repossessed [collateral] had the value of the outstanding debt and to place upon the secured party the burden of proving a different value.⁴⁹

1. The Majority Rule Cases

The courts holding that creditor compliance with the default provisions of Article Nine is a prerequisite to recovery of a deficiency judgment have taken a variety of routes, both legal and equitable, to arrive at that decision.

The case of *Leasco Data Processing Equipment Corp. v. Atlas Shirt Co.*,⁵⁰ is, perhaps, the most incisive and lucid of all of the cases barring recovery of a deficiency for failure to give notice. Three aspects of the court's opinion are worthy of preliminary comment. First, the court denied recovery solely and exclusively on the basis of the creditor's failure to give notice; there were no other infractions of the rules, no other indications of commercial unreasonableness to cloud the issue or deflect attention from the court's clear holding.⁵¹ Secondly, the court went to special pains to articulate the basis for its opinion, not merely because "of the importance of the question"⁵² but because a split of authority in the only three reported New York cases involving the question appeared to make "a careful examination of the problem . . . appropriate."⁵³ The court's reasoning is thus fully open to scrutiny. Thirdly, in formulating its opinion, the court had the benefit of ample precedent from other jurisdictions. It had closely examined contrary decisions so that its rejection of their authority and persuasiveness must be seen as both well-informed and deliberate.

The background facts in *Leasco* were, by the court's own description, "both simple and familiar."⁵⁴ The defendant defaulted on a secured transaction involving a lease-with-reservations-of-title to certain

49. *Leasco Data Processing Equip. Corp. v. Atlas Shirt Co.*, 66 Misc. 2d 1089, 1093, 323 N.Y.S.2d 13, 17 (Civ. Ct. N.Y. 1971).

50. 66 Misc. 2d 1089, 323 N.Y.S.2d 13 (Civ. Ct. N.Y. 1971).

51. *Id.* at 1089, 323 N.Y.S.2d at 14. The creditor solicited bids on the collateral from dealers, sold it for the highest of the three bids received, and apparently was not the actual purchaser at his own sale so as to raise implications of overreaching. There was uncontroverted evidence in the case from which the court found as a fact that the price received at the sale was the fair market value of the equipment at that time. The issue of lack of notice was thus presented for decision in stark relief.

52. *Id.* at 1089, 323 N.Y.S.2d at 14.

53. *Id.* Two New York cases had barred recovery: *Jefferson City Credit Corp. v. Marcono*, 60 Misc. 2d 138, 302 N.Y.S.2d 390 (Civ. Ct. N.Y. 1969) and *Associates Discount Corp. v. Cary*, 47 Misc. 2d 369, 262 N.Y.S.2d 646 (Civ. Ct. N.Y. 1965).

54. 66 Misc. 2d 1089, 323 N.Y.S.2d 14.

equipment. The entire outstanding balance of the debt became due under an acceleration clause. The secured party repossessed the equipment and sold it at private sale without giving any prior notice to the debtor. In the subsequent suit to recover a deficiency judgment, the court held that the secured creditor's recovery was barred as a matter of law.

The creditor in *Leasco* raised the statutory construction argument that provides the real impetus to the standard Minority rationale; namely that, inasmuch as Section 9-504(3) does not expressly preclude recovery of a deficiency for non-compliance with its notice provisions, the right to recover a deficiency is limited only by the remedies set forth in Section 9-507; that is, that non-compliance cannot be used as an *absolute* defense, since Section 9-507 constitutes the debtor's *exclusive remedy* for secured creditor non-compliance.

Section 9-507(1) provides as follows:

If it is established that the secured party is not proceeding in accordance with the provisions of this [Part] disposition may be ordered or restrained on appropriate terms and conditions. If the disposition has occurred 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].⁵⁵

The court quickly exposed what it considered the threshold inconsistency in the creditor's position—that if there is no express bar to a deficiency judgment in Section 9-504(3) neither is there any mention in Section 9-507 of “the circumstances under which a right to a deficiency may arise.”⁵⁶ The words “exclusive remedy” are absent from the text of either Section and neither Section expressly sanctions a presumption of any kind. As the *Leasco* court readily perceived, the absence of an express sanction for either approach does not call for hasty or superficial conclusions; it merely warrants a more detailed textual analysis of the relevant statutory provisions in order to ascertain the true intent of the draftsmen in light of the purpose, policy and history of the default provisions of the UCC. The court proceeded to undertake a more thorough analysis of the statutory language than is to be found in any of the other cases that have considered this question.

The court began by indicating that a natural and unrestrained reading of Section 9-504(3) must lead to the conclusion that creditor compliance with the notice provisions of that Section is a condition precedent to recovery of a deficiency judgment:

55. MD. ANN. CODE, Comm. L. Art., § 9-507(1) (1975).

56. 66 Misc. 2d at 1091, 323 N.Y.S.2d at 16.

It surely has meaning that the very section that affirms the right to a deficiency judgment after sale of a repossessed article also describes in simple and practical terms the rules governing dispositions as well as the pertinent notice requirements. If a secured creditor's right to a deficiency judgment were intended to be independent of compliance with those rules, one would surely expect that unusual concept to be delineated with clarity. *The natural inference that the right depends upon compliance is forcefully underlined by the joining of the two provisions in one section.*⁵⁷

If creditor compliance is not a condition precedent, and the creditor's right to recover a deficiency is limited only by the remedies provided for the debtor in Section 9-507, then the language of Section 9-507 should be reasonably appropriate to, and consistent with the purpose of establishing a defense to the deficiency action. The *Leasco* court pointed out, however, that Section 9-507 speaks only in terms of an affirmative action against the creditor to recover damages; it does not sound in defense at all:

More significant is the special nature of the language used: "the debtor or any person entitled to notification . . . has a right to recover from the secured party any loss caused by a failure to comply with the provisions of this Part." If this were intended to authorize a defense to an action for a deficiency judgment it is hard to envisage language less apt to that purpose. The words used plainly contemplate an affirmative action to recover for a loss that has already been sustained—not a defense to an action for a deficiency. The distinction between an affirmative action and a defense is a familiar one, phrases that articulate the different concepts are familiar in the law, and it is unlikely that the experienced authors of the U.C.C. intended the above language to provide a limited defense to an action for a deficiency judgment based on a sale that had violated the simple and flexible statutory procedure.⁵⁸

The court, therefore, concluded that:

It seems far more probable that [Section 9-507] has nothing whatever to do with defenses to an action for a deficiency, since it was never contemplated that a secured party could recover such a judgment after violating the statutory command as to notice.⁵⁹

57. *Id.* (emphasis added).

58. *Id.* at 1092, 323 N.Y.S.2d at 16.

59. *Id.*

The *Leasco* court then indicated that, quite apart from textual analysis of the relevant sections of the UCC, the same conclusion appeared to be dictated by judicial experience with similar provisions of the Uniform Conditional Sales Act [hereinafter referred to as the "UCSA"], one of the statutory predecessors of the UCC. As Professor Gilmore has expressed it, the UCSA "treated the question of the buyer's liability for a deficiency and the seller's liability for failure to comply with the resale requirements in a sequence of sections which is almost exactly comparable with the sequence of [Section] 9-504(2) and [Section] 9-507(1)."⁶⁰ Section 19 of the UCSA required that notice of an intended resale be published in a newspaper for five days prior to the sale.⁶¹ Section 22 of the UCSA provided that: "If the proceeds of the resale are not sufficient to defray the expenses thereof . . . and the balance due upon the purchase price, the seller may recover the deficiency from the buyer or from anyone who has succeeded to the obligations of the buyer."⁶² Section 25 of the UCSA provided that:

If the seller fails to comply with the [resale] provisions [of the Act] . . . the buyer may 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.⁶³

Almost without exception, the courts held that a creditor's compliance with these resale provisions of the UCSA was a condition precedent to his recovery of a deficiency judgment.⁶⁴

Despite the fact that the sections of the UCC dealing with disposition of repossessed collateral have altered the UCSA in a number of ways and are substantially more flexible than those of the older act, the significance of a nearly-uniform judicial response to the UCSA sections was not lost on the *Leasco* court:

This rule [barring recovery of a deficiency for non-compliance] was adopted even though (1), the statutory language did not specifically link the right to secure a deficiency judgment with such notice and (2) [Section 25] specifically declared the debtor's right to recover actual damages in the event of a violation of the sections regulating sale and notice of sale.

. . . .

If the authors of the [UCC] proposed to overthrow the firmly established and generally accepted construction of the

60. GILMORE § 44.9.4, at 1262 (1965).

61. UNIFORM CONDITIONAL SALES ACT § 19 (repealed 1964).

62. *Id.*, § 22 (repealed 1964).

63. *Id.*, § 25 (repealed 1964).

64. *See, e.g.*, 49 A.L.R.2d 15, 82 (1956).

older statute denying recovery for a deficiency where there was not precise compliance with the notice requirement, they surely would have manifested that intent in clear and unambiguous language. In fact, there is not the slightest intimation of any such purpose to be found in the [UCC]. The conclusion is inescapable that the prior interpretation continues to be applicable under the [UCC]⁶⁵

Professor Gilmore makes precisely the same point, stressing that:

It would have been quite as possible to conclude that the seller's recovery under [Section] 22 and the buyer's recovery under [Section] 25 were offsetting claims as it would be to make the same argument under the comparable Article 9 provisions. Nevertheless, the courts, with only a few exceptions, held that a literal compliance with the complicated UCSA resale provisions was a condition precedent to the seller's recovery of a deficiency.⁶⁶

Finally, the court in the *Leasco* case gave its assessment of the persuasiveness of the Minority rule opinions which it had studied. It found them wanting in at least three major respects: (1) none undertook "a detailed textual analysis of the relevant statutory language;"⁶⁷ (2) none referred to the "settled interpretation of the corresponding provisions of the [UCSA]" nor "describe[d] how it had been changed by the new statutory language"⁶⁸ and (3) all of the opinions were forced to devise fictional presumptions in order to mitigate the "harsh and unfair consequences"⁶⁹ of their holdings, when these consequences could be eliminated without resort to artificial contrivances if a more direct and forthright approach to the fundamental question of liability in the absence of notice were taken. As the court forcefully put it:

I am persuaded that this kind of judicial fiction is not necessary to reach a sensible and fair result. The most natural construction of the statutory language, the legal background, the realities of the relationships between secured creditors and debtors who have defaulted and their respective resources for prosecuting lawsuits, all point unmistakably to the conclusion that the right to a deficiency judgment depends on compliance with the statutory requirements concerning dispositions and notice.

65. 66 Misc. 2d at 1090-91, 323 N.Y.S.2d at 15-16 (footnotes omitted).

66. GILMORE § 44.9.4, at 1263 (1965).

67. 66 Misc. 2d at 1092, 323 N.Y.S.2d at 17.

68. *Id.*

69. *Id.* at 1093, 323 N.Y.S.2d at 17.

The burden on the secured creditor is by no means onerous. If he wishes a deficiency judgment he must obey the law, the relevant provisions of which are now simpler and more flexible than before. If he does not obey the law he may not secure a deficiency judgment.⁷⁰

Professor Gilmore also concludes that creditor compliance with the notice provisions of the Code was intended to operate as a condition precedent to the recovery of a deficiency, notwithstanding the absence of express statutory language to this effect, and endorses this position as both fair and reasonable in light of the minimal burden imposed upon the creditor by the default provisions of the Code:

[T]hat a proper resale was a condition precedent to the recovery of a deficiency [in UCSA litigation] seemed too obvious to require either a reasoned analysis or the citation of precedent. What was obvious under UCSA may be equally obvious under Article 9. The relationship between the debtor's liability for a deficiency and the secured party's liability for non-compliance with the required default procedures seems to have escaped the conscious attention of the Article 9 Draftsmen as it escaped that of the UCSA draftsman. Nevertheless, the conclusion [barring recovery of a deficiency for non-compliance] is eminently reasonable. In light of the minimal formal requirements which Article 9 prescribes for disposition of collateral, the conclusion may be more reasonable under Article 9 than it was under the enormously complicated procedure required by UCSA. We may conclude that the secured party's compliance with the default provisions of Part 5—both the formal requirements of notice and the like and the substantial requirement of a "commercially reasonable" sale—is a condition precedent to the recovery of a deficiency.⁷¹

One of the earliest decisions barring recovery of a deficiency for non-compliance with the notice provisions of the Code, *Skeels v. Universal C.I.T. Credit Corp.*,⁷² is noteworthy in several respects. First, it is a case in which a federal district judge sitting in Pennsylvania felt free to disregard two lower state court decisions⁷³ that were in apparent disagreement with its position. Secondly, it was one of the rare cases in which the repossessed collateral was neither a consumer-debtor's motor vehicle nor some type of business equipment, but rather

70. *Id.*

71. GILMORE § 44.9.4, at 1263-64 (1965) (footnotes omitted).

72. 222 F. Supp. 696 (W.D. Pa. 1963), *modified on other grounds*, 335 F.2d 846 (3d Cir. 1964).

73. *Alliance Discount v. Shaw*, 195 Pa. Super 601, 171 A.2d 548 (1961) and *Atlas Credit Corp. v. Dolbow*, 192 Pa. Super. 649, 165 A.2d 704 (1960).

consisted of the debtor's entire business inventory of new and used cars. In this respect, the facts of *Skeels* bring it especially close to our hypothetical, in which the entire brick inventory of the Company was repossessed and sold. While there are doubtless special considerations that warrant greater protection against deficiencies for consumer debtors, the utter finality of a business inventory repossession and resale, and the fact that creditor action effectively puts the debtor out of business, would seem to militate in favor of a particular solicitude for the rights of the business debtor and the guarantors upon default.

This fact does not appear to have escaped the conscious attention of the *Skeels* court, since its opinion emphasizes a determined effort to implement the real purpose and policy of the notice requirements of the Code. The *Skeels* case arose as a debtor's suit against its secured creditor for an unlawful conversion of its auto-dealer business. The defendant creditor then brought a counter-claim seeking a deficiency judgment for the losses and expenses incurred upon resale of the repossessed collateral. It was "conceded . . . that no notice whatsoever was given to Skeels at the time the cars, new or used, were sold. There was simply no compliance by defendant with [Section 9-504(3)] of the . . . Code."⁷⁴ The court's holding barring recovery of the deficiency would thus seem to be of singular precedential significance to our hypothetical Guarantor. In a much quoted passage from the opinion, Judge Willson explained the basis of the court's holding:

It seems to this [court], however, that to 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. . . . 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.⁷⁵

Other courts have displayed an understanding of commercial realities and a perception of the peculiar relevance of the notice requirements in the context of the business debtor's situation.⁷⁶ A business debtor may be, *arguendo*, better situated than the consumer debtor with respect to obtaining new financing after default so as to exercise its right of redemption. However, it is also, because of contacts in the business and a knowledge of customers, dealers and others likely to be interested in

74. 222 F. Supp. at 702.

75. *Id.*

76. *E.g.*, *Cities Service Oil Co. v. Ferris*, 9 UCC REP. 899 (D.C. Mich. 1971).

purchasing the collateral, in a better position than the consumer debtor (or, for that matter, the secured creditor) to drum up interest in the sale so as to drive up the level of bids on a bona fide basis.⁷⁷

Conscientious examination of precedents from analogous areas of the law has provided courts with insights into the requirements of a sound public policy on the deficiency problem. In *C.I.T. Corp. v. Haynes*,⁷⁸ the court scrutinized the law of mortgages, as well as judicial treatment of deficiencies under pre-Code statutes governing conditional sales contracts, in order to accomplish this end. Although the facts of this case, involving a conditional sales contract, arose long before the effective date of the Maine UCC and the statute referred to was one governing conditional sales, the court pointed out in a footnote that Section 9-504 of the UCC similarly requires "reasonable notification" of resale.⁷⁹ After an historical survey similar to that made in *Leasco*, the *Haynes* court concluded that the creditor was barred, stating:

[A]t common law the terms of the contract controlled and, absent appropriate provision for redemption upon default, the vendee was without remedy unless he performed as agreed. . . . [S]tatutes soon were enacted to protect the improvident and impecunious vendee from unfair dealing and imposition . . . some of which have been embodied within the . . . Uniform Commercial Code.

While neither our statute nor the contract under discussion requires a resale, the rule that the provisions of a statute prescribing manner of resale must be observed as a condition precedent to holding the [debtor] for a deficiency judgment, is by weight of authority enforced.⁸⁰

Still other courts have resorted to analogous areas of the law at some point in their treatment of the deficiency judgment issue. For example,

77. As the *Ferris* court stated:

The court holds that the defendants did not receive reasonable notification. Had the defendants had more time, when they knew foreclosure was inevitable, they could have perhaps contacted the retail outlets of the plaintiff and notified them of the sale in order that these individuals could be present to bid in whatever parcels of the collateral they might wish to purchase. Admittedly, the court is dealing in a presumption that the retail dealers of the plaintiff would have been interested in purchasing some of the items. However, in view of the short notice, the plaintiff must permit the court to indulge in this presumption.

. . . .

The court feels that the duty of the creditor in this instance was to obtain the best possible price it could obtain for the collateral for the benefit of the debtor [without using] "extraordinary means" to accomplish this result. . . . *Id.* at 902-03.

78. 161 Me. 353, 212 A.2d 436 (Me. 1965).

79. *Id.* at 437, n. 1.

80. *Id.* at 438-39 (emphasis added) (footnotes omitted), *accord*, *Camden Nat'l Bank v. St. Clair*, 309 A.2d 329 (Me. 1973).

the Georgia Court of Appeals appears to have approached the issue of the creditor's entitlement to a deficiency in the absence of notice to the debtor very tentatively at first; "like a skater testing March ice, [it] showed great hesitance to base its decision on the UCC Having tested the ice . . . , however, [it] was finally willing to rest its conclusion exclusively on the UCC" ⁸¹ In *Moody v. Nides Finance Co.*, ⁸² the court held that the creditor's repossession and resale without notice amounted to an accord and satisfaction, ⁸³ and stated, without explanation, that it was "not necessary [to] deal with the Code provisions in deciding this case We are content to rest the matter on the accord and satisfaction . . . though it appears that we would likely have reached the same result by applying UCC provisions."⁸⁴

A short time later, however, in *Braswell v. American National Bank*, ⁸⁵ the Georgia court was prepared to base its decision squarely on the notice provisions of the UCC, perhaps because "the repossession [there] . . . seems to have been lawful so as to possibly preclude the application of the doctrine of accord and satisfaction. . . ." ⁸⁶ Finding that "neither the notice alleged nor the notice proved [by the secured party] complied with [Section 9-504(3) of the Code]," ⁸⁷ the court held that the creditor was barred from recovery of a deficiency, stating:

[T]he majority of the courts in this country in applying these provisions . . . have reached the conclusion that *the act of the secured party, in selling the collateral without strict compliance with the notice of sale provisions, precludes the [debtor] from exercising his right of redemption* under Section . . . 9-506, and for that reason the secured party cannot recover for the deficiency. . . . We concur with this view. ⁸⁸

Some courts have resorted to sections of the UCC outside of Article Nine for additional guidance and support of their decisions. A good example is *Atlas Thrift Co. v. Horan*. ⁸⁹ In this case of first impression, the California Court of Appeals held that a "failure [to give notice was] a bar to a deficiency judgement where . . . such failure was raised as an affirmative defense."⁹⁰ The court pointed out that UCC Sec-

81. White, *Representing the Low Income Consumer in Repossessions, Resales and Deficiency Judgment Cases*, 64 Nw. U.L. Rev. 808, 831 (1970).

82. 115 Ga. App. 859, 156 S.E.2d 310 (1967).

83. *Id.* at 861, 156 S.E.2d at 311-12. See also *Johnson v. Commercial Credit Corp.*, 117 Ga. App. 131, 159 S.E.2d 290 (1968).

84. *Id.* at 861, 156 S.E.2d at 312 (footnotes omitted).

85. 117 Ga. App. 699, 161 S.E.2d 420 (1968).

86. *Id.* at 700, 161 S.E.2d at 422.

87. *Id.*

88. *Id.* at 701, 161 S.E.2d at 422 (emphasis added).

89. 27 Cal. App. 3d 999, 104 Cal. Rptr. 315 (1972).

90. *Id.* at 1009, 104 Cal. Rptr. at 321. The court expressed the basis for its decision as follows:

We are persuaded that the better reasoning and the ends of justice require the

tion 1-102(1) provides that: "This code shall be liberally construed and applied to promote its underlying purposes and policies."⁹¹ More centrally, however, the court looked to Section 1-103 of the UCC in order to evaluate the defendant's argument that Section 9-507 must be a cumulative remedy since it is not expressly stated to be the exclusive remedy, and state law relating to the consequences of failure to give notice of the sale could thus provide guidance.⁹² Section 1-103 of the UCC provides as follows:

Unless displaced by the particular provisions of this Code, the principles of law and equity . . . shall supplement its provisions.

Examining California law prior to the enactment of the UCC, the court found what the *Leasco* court had found to be the almost universal result—that "a creditor who disposed of property after default without following the notice requirements of the mortgage agreement, ha[d] extinguished the mortgage lien and [was] thus *barred* from recovering a deficiency judgment."⁹³ The court, therefore, agreed with the defendant that the debtor's remedy under UCC Section 9-507 is not exclusive but cumulative, and held that lack of notice pursuant to 9-504(3) is available as an absolute defense in the suit for a deficiency.⁹⁴

The Supreme Court of Iowa very recently turned to still another section of the Code for guidance and support of its decision to bar a deficiency for lack of notice. In *Twin Bridges Truck City, Inc. v. Halling*,⁹⁵ the court relied on the analogy provided by the notice requirements of Section 2-706(3) in sustaining the trial court's direction of a verdict in favor of the defendant debtor. The Official Comments to Section 9-504 draw attention to the similarities between a secured party's resale of repossessed collateral after default and a seller's resale of goods pursuant to a default by the buyer. Section 2-706, dealing with the latter situation, requires in Subsection (3) that: "Where the resale is a private sale the seller must give the buyer reasonable notification of his intention to resell." Official Comment Eight to

acceptance of defendant's contention and reversal of the judgment [of the trial court in favor of the secured party].

. . . .
The most natural and reasonable construction of the statutory language, in the light of the legal background, the realities of the relationships involved between secured creditors and debtors who have defaulted and their respective financial resources for engaging in litigation, all lead to the conclusion that *the right to a deficiency judgment depends on compliance with the statutory requirements concerning dispositions and notice. Id.* at 1008-09, 104 Cal. Rptr. at 321.

See also Turk v. St. Petersburg Bank & Trust Co., 281 So. 2d 534 (Fla. Dist. Ct. App. 1973), and *Bank of Gering v. Glover*, 192 Neb. 575, 223 N.W.2d 56 (1974).

91. 27 Cal. App. 3d at 1004, 104 Cal. Rptr. at 318.

92. *Id.* at 1005, 104 Cal. Rptr. at 318.

93. *Id.*

94. *Id.* at 1009, 104 Cal. Rptr. at 321.

95. 205 N.W.2d 736 (Iowa 1973).

Section 2-706 makes it clear that reasonable notification in this context exactly parallels the notice provisions of Section 9-504(3) with respect to private sales, that is, that “[n]otification of the [precise] time and place of this type of sale is not required;” what is required, is notification of intention to resell, or in the language of Section 9-504(3), “notification of the time after which any private sale . . . is to be made”⁹⁶

The foregoing cases furnish a representative sample of the sources, reasoning and policy of the Majority approach to the issue presently under examination. Numerous other jurisdictions are in accord.⁹⁷ The opinions vary as to the emphasis which is placed upon any given factor, but, clearly, all of these courts have concluded that barring the deficiency as a matter of law is supported by:

(a) A reasonable statutory construction of the relevant provisions of the UCC;

(b) Extensive judicial experience with interpretation of similar provisions of the UCCSA;

(c) Insights gained from legislative and judicial treatment of analogous problems in the law of mortgages and judicial sales; and

(d) The dictates of justice and of a sound social and economic policy.

2. The Minority Rule Cases

The Minority approach to the problem of the secured party's failure to give notice as required by Section 9-504(3) apparently originated with the opinion of the Supreme Court of Arkansas in *Norton v. National Bank of Commerce*.⁹⁸ The effect of lack of notice on the defendant's liability for a deficiency was discussed only in the last two paragraphs of the opinion, in which the court merely concluded that “[w]e do not agree with [Norton's] contention that the bank's failure to give him notice of the intended sale completely discharged his

96. In the absence of the notice required by the above-cited sections of the Code, the Iowa court in *Twin Bridges* sustained the trial court by holding that the plaintiff was not entitled to recover a deficiency judgment.

97. *Accord*, *In re Bro Cliff Inc.*, 8 UCC REP. 1144 (W.D. Mich. 1971); *Commercial Credit Corp. v. Lloyd*, 12 UCC REP. 15 (Super. Ct. D.C. 1973); *Edmondson v. Air Serv. Co.*, 123 Ga. App. 263, 180 S.E.2d 589 (1971); *Prairie Vista, Inc. v. Casella*, 12 Ill. App. 3d 34, 297 N.E.2d 385 (1973); *Morris Plan Co. v. Johnson*, 133 Ill. App. 2d 717, 271 N.E.2d 404 (1971); *Nelson v. Monarch Inv. Plan of Henderson, Inc.*, 542 S.W.2d 375 (Ky. 1970); *Camden Nat'l Bank v. St. Clair*, 309 A.2d 329 (Me. 1973); *One Twenty Credit Union v. Darcy*, 40 Mass. App. Dec. 64 (1968); *Foundation Discounts, Inc. v. Serna*, 81 N.M. 474, 468 P.2d 875 (1970); *Jefferson Credit Corp. v. Marcano*, 60 Misc. 2d 138, 302 N.Y.S.2d 390 (1969); *Associates Discount Corp. v. Cary*, 47 Misc. 2d 369, 262 N.Y.S.2d 646 (1965); *Aimonetto v. Keepes*, 501 P.2d 1017 (Wyo. 1972). *Cf.* *United States v. Mid-States Sales Co.*, 336 F. Supp. 1099 (D. Neb. 1971).

98. 240 Ark. 143, 398 S.W.2d 538 (1966). The primary question was whether Norton, who had assigned a conditional sales contract to the bank with a provision to repurchase if the conditional vendee defaulted, was a “debtor” under UCC Section 9-504(3), entitled to notice of the disposition of a repossessed automobile. The court held that he was.

obligation.”⁹⁹ The basis for the court’s conclusion and the nature of its reasoning are left largely to speculation. Some insight may be gleaned from the court’s observation that “[f]or the most part [Section 9-504(3) of] the Code follows the theory formerly applicable to mortgages, by which the debtor was entitled to any surplus realized upon foreclosure and was liable for any deficiency.”¹⁰⁰ Following this observation, the court recited the provisions of Section 9-507(1) that give the debtor a right to recover from the secured party any loss caused by a failure to comply with the default provisions of the Code. The relationship of these two provisions was, however, never explained.

In the final paragraph of the opinion, the court expressed its concern with preventing the non-compliant creditor from benefiting from its own misconduct:

Upon the issue of Norton’s damages simple considerations of fair play cast the burden of proof upon the bank. It was the bank which wrongfully disposed of the car without notice to the debtors. Thus it was the bank’s action that made it at least difficult, if not impossible, for Norton to prove the extent of his loss with reasonable certainty. . . . It would be manifestly unfair for the creditor to derive an advantage from its own misconduct.¹⁰¹

Having thus set out what might reasonably serve as a sufficient justification for a total bar to recovery of a deficiency judgment, the court, without further elaboration held that a fictional presumption was the best way to handle the problem, stating:

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 conducted according to law. The extent to which the penalty set out in [9-507(1)] may be applicable in the case at bar is an issue that may depend upon the further development of the proof.¹⁰²

The presumption which was to spawn the Minority line of cases thus sprang into being. Courts adhering to this view have adopted, more or less uncritically, this presumption as their solution to the problem of lack of notice. With one possible exception,¹⁰³ the Minority rule was

99. *Id.* at 149, 398 S.W.2d at 541-42.

100. *Id.* at 149, 398 S.W.2d at 542.

101. *Id.* at 149-50, 398 S.W.2d at 542.

102. *Id.* at 150, 398 S.W.2d at 542.

103. *Investors Acceptance Co. of Livingston, Inc. v. James Talcott, Inc.*, 61 Tenn. App. 307, 454 S.W.2d 130 (1969) (resale of unspecified portion of debtor’s accounts receivable). In

apparently fashioned exclusively in factual contexts which, like *Norton*, involved the repossession and resale of motor vehicles or business equipment and fixtures. In none of these cases did the repossessed collateral consist of the entire business inventory and accounts receivable of the debtor as it did in our hypothetical.

Three frequently cited opinions, contributing to the inaccurate impression that a long and growing body of precedents supports the Minority position are Arkansas cases decided largely on the authority of *Norton: Barker v. Horn*,¹⁰⁴ *Carter v. Ryburn Ford Sales, Inc.*¹⁰⁵ and *Universal C.I.T. Credit Co. v. Rone*.¹⁰⁶ A fourth, *Leasing Associates, Inc. v. Slaughter & Son, Inc.*,¹⁰⁷ is a federal court decision applying Arkansas law as embodied in the decisions of *Norton* and *Barker*. None of these cases undertakes an independent evaluation of the *Norton* rule or betrays any hint of awareness of the competing Majority rule or discusses its comparative merits. The *Norton* rule is simply stated to be the established law of Arkansas on the subject; the provisions of the rule are reiterated, and then applied to the facts at hand. This lack of independent analysis substantially detracts from the precedential value of these decisions.

Weaver v. O'Meara Motor Co.,¹⁰⁸ another frequently cited Minority case, is largely unpersuasive for the same reason. The issue of lack of notice, one of several issues arising out of the repossession and sale of certain trucks, was summarily disposed of by the court on the basis of a terse, three-line recitation of the Minority rule. The statement was supported only by a footnote reference to *Norton*.¹⁰⁹

The Tennessee Court of Appeals took a Minority approach in *Mallicoat v. Volunteer Finance & Loan Corp.*¹¹⁰ Although the court emphasized that the purpose of the notice requirements was "for the benefit and protection of the debtor" and that "[t]his provision of the Act should be construed and applied in a manner to effectuate this salutary purpose . . .,"¹¹¹ its consideration of the possible remedies for

another Minority case, *Lincoln Rochester Trust Co. v. Howard*, 75 Misc. 2d 181, 347 N.Y.S.2d 306 (1973), there is no reference to the nature of the collateral involved.

104. 245 Ark. 315, 432 S.W.2d 21 (1968).

105. 248 Ark. 236, 451 S.W.2d 199 (1970).

106. 248 Ark. 665, 453 S.W.2d 37 (1970).

107. 450 F.2d 174 (8th Cir. 1971).

108. 452 P.2d 87 (Alas. 1969).

109. The court said:

Where non-compliance with the notice of sale provisions of [UCC Section 9-504(3)] has been shown, the burden of proving that the market value of the collateral was received at sale is upon the secured party. *Id.* at 91-92.

In re Thomas, 12 UCC REP. 578 (W.D. Va. 1973), is a more recent example of this same genre of uncritical authority. In that case, notice had in fact been sent, but the sale was conducted in a commercially unreasonable manner. The court, without giving its reasoning, and with no citation of precedent other than *Barker v. Horn*, merely reiterated the presumption rule approach, and applied it to the facts at hand.

110. 57 Tenn. App. 106, 415 S.W.2d 347 (1966).

111. *Id.* at 113, 415 S.W.2d at 350-51.

creditor non-compliance was singularly circumscribed. Without reason, explanation, or justification, the court simply leaped from a definition of the repossessed car as "consumer goods" to the conclusion that the minimum recovery provisions of Section 9-507 pre-empted the field. Any further analysis was apparently deemed foreclosed by that part of Section 9-507 that provides:

If the collateral is consumer goods, the debtor has a right to recover *in any event* an amount not less than the credit service charge plus ten per cent of the principal amount of the debt or the time price differential plus ten per cent of the cash price.

Although the *Norton* presumption is not expressly mentioned, the court's order that an "off-set" from the judgment should be allowed the defendants for the amount due them¹¹² would seem to place *Mallicoat* in the ranks of the Minority. The court never even considered the possibility that recovery of the deficiency could be barred. The mere existence of the provision for a minimum recovery apparently impressed the court as reason enough to warrant an "off-set." The real import of the court's decision, whether intended or not, is that recovery of damages (in an amount not less than the minimum prescribed) is the debtor's sole remedy for the secured party's non-compliance with the default provisions of the Code.

This conclusion does not hold up under close analysis. A provision for minimum recovery and a provision for exclusive recovery are two entirely different concepts. As previously noted, Section 1-103 of the UCC precludes implications of exclusivity unless expressly designated in the relevant sections of the UCC. Furthermore, a provision granting the right to seek affirmative recovery, whether a minimal recovery is mentioned or not, in no way precludes the right to assert all available and relevant defenses. There would thus seem to be no sanction either in the UCC or in logic for the conclusion that an off-set of damages is the only possible consequence of creditor misconduct. Inasmuch as the court did not entertain, let alone refute, the possibility of barring the secured party's deficiency as a potential remedy for non-compliance, *Mallicoat*, too, may be properly characterized as weak or unpersuasive authority.¹¹³

T&W Ice Cream, Inc. v. Carriage Barn, Inc.,¹¹⁴ probably ranks as a co-equal with *Norton* in inspiring Minority rule decisions. Having

112. 57 Tenn. App. at 115, 415 S.W.2d at 351-52.

113. See also *Investor's Acceptance Co. of Livingston, Inc. v. James Talcott, Inc.*, 61 Tenn. App. 307, 454 S.W.2d 130 (1968), in which the court referred to the existence of authorities in other jurisdictions, but contented itself with merely quoting from *Mallicoat* and *Norton*.

114. 107 N.J. Super. 328, 258 A.2d 162 (1969). In an opinion which cut through formal distinctions to achieve the functional results advocated by the draftsmen of the UCC, the court held that the accommodation endorers of the defendant corporation's note were

decided the plaintiff had not complied with Section 9-504(3) of the UCC, the court briefly turned to the question of the consequences. Again, the familiar Minority pattern emerged. Apparently, the mere existence of an affirmative right to recovery in Section 9-507 impressed the court as dispositive of the issue. Citing only *Norton, Barker* and *Weaver*, the court held:

The presumption is that where a secured party repossesses and resells collateral, and notice of the resale is required and not given, the burden of proving the value of the collateral in a deficiency action is on the secured party. Failing this, the value is presumed to be at least the amount of the debt. *The court will indulge in this presumption because it would be manifestly unjust to allow plaintiff to profit by its own wrongdoing.*¹¹⁵

What is significant about the court's decision, however, is not so much what it said as what it actually did; it denied the secured party any further opportunity to present evidence to rebut the presumption peremptorily raised. Moreover, unlike the *Mallicoat* case, there was to be no re-hearing on the question of damages. After asserting that it

debtors within the meaning of Section 9-504(3) of the Code entitled to notice of a private sale of the repossessed collateral.

115. *Id.* at 337, 258 A.2d at 167 (emphasis added) (footnotes omitted). *Accord*, *Abbott Motors, Inc. v. Ralston*, 28 Mass. App. Dec. 35 (1964). *Contra*, *One Twenty Credit Union v. Darcy*, 40 Mass. App. Dec. 64 (1968), which did not follow *Abbott*. It barred the deficiency on the grounds that "[Section 9-504(3)] was passed with a view to protecting the interest of the borrower . . . [and] the provisions of the statute must be followed." *Id.* at 65-66.

Two early Pennsylvania superior court decisions, *Alliance Discount Corp. v. Shaw*, 195 Pa. Super. 601, 171 A.2d 548 (1961), and *Atlas Credit Corp. v. Dolbow*, 192, Pa. Super. 649, 165 A.2d 704 (1960), frequently cited in support of the Minority rule, were not followed by the federal district court in Pennsylvania in the later case of *Skeels v. Universal C.I.T. Credit Corp.*, 222 F. Supp. 696 (W.D. Pa. 1963), *modified on other grounds*, 335 F.2d 846 (3d Cir. 1969). Furthermore, the narrow holding in the *Shaw* case actually consisted of an order affirming the trial court's order making absolute a rule to open a judgment entered by confession against the defendants on grounds that lack of notice of the sale of the repossessed automobile was a "prima facie meritorious defense . . . [enabling the court] in the exercise of its discretion, [to] open the judgment." 195 Pa. Super. at 605, 171 A.2d at 550-51. At best, Minority thinking was *implied* in the result of the court's action which was to give the debtor a chance upon rehearing, "to have the reasonable value of the automobile determined upon resale as required by the [Pennsylvania] Motor Vehicle Sales Finance Act . . ." *Id.* at 604, 171 A.2d at 550. There is nothing in the opinion to even suggest that the debtor raised, or that the court considered, the argument that non-compliance with the notice provisions should be an absolute defense to a suit for a deficiency.

Similarly, the *Dolbow* case merely affirmed the action of the trial court in reopening a judgment secured by the creditor. It allowed the debtor to file a counterclaim for damages under the consumer goods recovery portion of Section 9-507, permitting the case to be tried before a jury and refusing to grant a new trial or judgment n.o.v. after the jury brought in a verdict for the debtor on the counterclaim. At best, the Minority rule approach with respect to off-sets may be hidden in the arithmetic of the jury's verdict thus affirmed by the court, but the opinion does not consider the argument that non-compliance should result in a bar to a claim for a deficiency.

would be unfair to allow a plaintiff to benefit from his wrong, the court unceremoniously found that the collateral was worth at least the amount of the debt and discharged the accommodation endorsers on both the note and security agreement. The practical result of the court's action was thus indistinguishable from the effect that would have followed a ruling that compliance with the notice provisions of the Code was a condition precedent to recovery of a deficiency. While apparently lulled into such indirection by its reliance on the *Norton*, *Barker* and *Weaver* precedents, the court's handling of the matter of liability in this case was, in fact, entirely consistent with its avowed devotion to fair and functional results.¹¹⁶

In *Conti-Causeway Ford v. Jarossy*,¹¹⁷ the plaintiff car dealer assigned the retail installment security agreement covering the car to a bank. Upon default, the bank repossessed and resold after sending notice which the debtor never received. The bank then reassigned its right to a deficiency to the dealer who brought suit against the defaulting purchasers. They, in turn, asserted a counterclaim against the bank for damages pursuant to Section 9-507(1). Equating lack of receipt of notice with failure to send notice, the court proceeded to survey some of the authorities on both sides of the question of entitlement to a deficiency judgment in the absence of prior notice, and concluded that "the better rule is the one enumerated in the *T&W* and *Norton* cases. . . ."¹¹⁸

Applying this rule to the facts of the case, however, the court came up with results that positively defy the "spirit of commercial reasonableness" which it was avowedly pursuing. The entire amount of

Additionally, in *Community Management Ass'n. of Colorado Springs, Inc. v. Tousley*, 32 Colo. App. 33, 505 P.2d 1314 (1973), a case involving repossession and resale of an automobile, the court simply stated, after citing authority on both sides of the question, that it adopted the "reasoning" of the Minority line of authority. No basis for this choice is expressed, so it is impossible to analyze the court's reasoning. *See also*, *Lincoln Rochester Trust Co. v. Howard*, 75 Misc. 2d 181, 347 N.Y.S.2d 306 (1973); *Chase Manhattan Bank v. Lyon Air, Inc.*, 8 UCC REP. 1121 (N.Y. Sup. Ct. 1971). *Accord*, *United States v. Whitehouse Plastics*, 501 F.2d 692 (5th Cir. 1974) (predicting that the Texas Courts would adopt the Minority rule that the existence of a remedy under Section 9-507 negates the inference that the draftsmen of the Code intended the harsher remedy of barring a deficiency judgment as well).

116. *Tauber v. Johnson*, 8 Ill. App. 3d 789, 291 N.E.2d 180 (1972), similarly sounds in the language of the Minority, yet acts with the purpose and results of the Majority. Indeed, in this case, there is room for reasonable doubt as to which rule the court actually thought it was applying. Despite much talk about presumptions, the court stated: "If the secured party cannot sustain his burden of proving a commercially reasonable resale, he may be denied the amount of the deficiency." *Id.* at 794, 291 N.E.2d at 184. *Skeels v. Universal C.I.T. Credit Corp.*, 222 F. Supp. 696 (W.D. Pa. 1963), *modified on other grounds*, 335 F.2d 846 (3d Cir. 1969), a leading Majority rule exponent, was cited as authority for the foregoing quote. Ultimately, however, the court achieved a Majority rule result equivalent to a holding that compliance with the statutory mandate of notice was a condition precedent to recovery of a deficiency. Like the court in *T&W*, it precluded the creditor from offering further evidence to rebut the presumption, by reversing and remanding with directions simply to enter judgment in favor of defendants.

117. 8 UCC REP. 1348 (D.C. N.J. 1971).

118. *Id.* at 1351.

the deficiency sued for by the dealer, Conti, was \$258.12. The court allowed a judgment in the amount of the deficiency subject to any defense that was available to the Jarossys against the bank.¹¹⁹ The court then proceeded to look to the affirmative remedies set out in Section 9-507(1). Seizing upon the minimum recovery provisions, the court determined that the Jarossys were entitled to recover a total of \$872.00 on their counterclaim, representing the time-price differential plus ten percent of the cash price. The court then set off the \$258.12 deficiency judgment against Jarossy's \$872 recovery, thereby eliminating the deficiency.¹²⁰ The Jarossys, who had suffered no provable harm beyond exposure to Conti's deficiency action, wound up with an award of damages amounting to more than twice the amount of the claimed deficiency. The bank, which had shown good faith at least to the extent of sending a prior notice, wound up having to pay what was, in effect, punitive damages. All this occurred in a case in which everybody concerned had *stipulated* that the resale price of the car was its fair and reasonable value.

That a court may be goaded into the Minority camp by the egregious behavior of the debtor, is evident from the case of *Grant County Tractor Co. v. Nuss*.¹²¹ This is particularly unfortunate since the case came up as one of first impression in the State of Washington. From the court's careful recitation of the facts as well as from some of its comments, it is difficult to escape the conclusion that estoppel was the real impetus behind the court's decision.

In August of 1968, the defendants in *Nuss* purchased a tractor, a rotovator and a packer from the plaintiff under a written security agreement. Approximately one year later, the defendants decided to exchange the tractor for a different model. To consummate this exchange a new contract and security agreement were executed replacing the prior agreement. The first annual payment thereunder was due and payable by the defendants on September 1, 1969. The defendants defaulted, but kept and continued to use the equipment until January 9, 1970. On that day, they "unilaterally and without request delivered the tractor, rotovator and packer to plaintiff's sales yard,"¹²² and a week later, notified the plaintiff in writing that they had elected to rescind the contract. In April 1970, the plaintiff sold the tractor without first giving notice of the sale to the defendants, and then brought suit to recover a deficiency judgment. The defendants counterclaimed, seeking rescission of the contract and damages by reason of the alleged defective condition of the equipment.

It should be noted that at the time the defendants returned the equipment and elected to rescind the contract, they had enjoyed the use of the allegedly defective rotovator and packer for approximately

119. *Id.* at 1352.

120. *Id.*

121. 6 Wash. App. 866, 496 P.2d 966 (1972).

122. *Id.* at 867, 496 P.2d at 967.

one and a half years and the tractor for approximately six months. The trial court found as a fact that the defendant's use of the rotovator and packer had depreciated their value to \$300 and \$50, respectively, so that they were fit only for salvage. Of greatest importance is the fact that the alleged deficiency did not come about as a result of the sale of the tractor. Apparently, the plaintiff had been able to sell the tractor for the full contract price, since the deficiency sought to be recovered, \$3,507, represented only the purchase price of the rotovator and packer less their salvage value.¹²³ The court specifically pointed out that "[d]efendants [did] not contest this amount . . . but argue[d] that the plaintiff [was] not entitled to a judgment for that amount because it failed to give notice of the sale of the tractor."¹²⁴

To bar the secured party's deficiency under these circumstances would have been tantamount to granting rescission of the contract for two pieces of equipment that the defendants had reduced to mere salvage. This the appellate court apparently could not bring itself to do. Stating tersely that it adopted the "reasoning" of the Minority line of cases, the court demonstrated how foremost in its thoughts was the fact that the defendants had suffered no loss by the sale of the tractor. Citing the affirmative remedy available in Section 9-507(1), the court stated that:

[I]n the instant case if the sale of the tractor without notice had resulted in a loss to the defendants, the defendants would have a right in the instant proceeding to claim that loss against the deficiency sought by the plaintiff.¹²⁵

The court then proceeded to articulate what was probably the real rationale behind its holding and upon which it might have disposed more forthrightly of the issue:

[I]t should be noted that defendants unilaterally and voluntarily delivered to plaintiff complete control of the security and gave written notice of their election to rescind the transaction. It has been held that such conduct constitutes a waiver of the debtor's right to reasonable notice of an impending sale or estops the debtor from claiming a violation of the statute.¹²⁶

It can be argued with some force that the Majority approach should not be rejected on the authority of a decision such as *Nuss*, tailored, as it obviously was, to the non-meritorious defense of a singularly unsympathetic debtor.

123. *Id.* at 871, 496 P.2d at 969-70.

124. *Id.* at 869, 496 P.2d at 968.

125. *Id.* at 870, 496 P.2d at 969.

126. *Id.*

One feature that readily distinguishes the Minority rule cases from our hypothetical is that, almost invariably, they involved disposition of repossessed motor vehicles or business equipment and fixtures, rather than collateral consisting of the debtor's inventory and accounts receivable. While there are, doubtless, special considerations that should govern deficiencies in the consumer-debtor area, not the least of which may be the widespread incidence of the problem, there also are, or ought to be, special considerations governing deficiencies in the kind of business default situation presented by our hypothetical. A consumer-debtor who loses his car does not necessarily lose his means of livelihood. A business that loses some or even all of its fixtures and equipment, while in a patently more serious situation, may be able to recoup somewhat, borrow or buy new equipment, or possibly even secure new financing if it is allowed to retain its inventory and receivables. On the other hand, a manufacturing firm, with no inventory or receivables at all, is effectively out of business and the livelihood of all those who depended upon it is lost. All that is left to the debtor in this predicament is the protection afforded by the notice requirements: the opportunity of redeeming, or, more substantially, the opportunity of minimizing the amount of indebtedness by taking steps to drive up, on a bona fide basis, the level of bids at the sale. If the purposes and policy of the notice requirements are to have any tangible meaning for this debtor they will have to provide a defense to its creditor's action for a deficiency, rather than an affirmative action for damages. The creditor has the power not only to protect fully his own interests, but also to foreclose all challenge and complaint by the debtor by simply adhering to the flexible and liberalized procedures of the UCC.

In view of the slight onus placed upon the creditor, as opposed to the irrevocable consequences to the business debtor if the creditor elects to follow a course that deprives the debtor of its only realistic protection in the post-default situation, the Majority position that the creditor's breach provides the debtor with an absolute defense to the creditor's suit for a deficiency would appear to be the better rule. Yet, all such reflections are absent from the consumer-debtor-oriented Minority opinions. This failure to consider important matters of policy together with the lack of reasoning and uncritical adherence to precedent typical of the Minority decisions undermines their persuasiveness and limits the degree to which they could be relied upon by our hypothetical Lender.

C. The Law in Maryland

The precise issues under consideration herein appear never to have arisen in Maryland. Nevertheless, the approaches taken by the Maryland courts on closely analogous questions as well as their citation of Majority rule cases indicate that, given the opportunity to decide the matter, Maryland would probably align itself with the Majority; deem

the Guarantor in our hypothetical a debtor within the meaning of Section 9-504(3), who is entitled to the notice provided for in that Section, and hold that the Secured Party's failure to give notice would bar a deficiency decree as a matter of law.

A recent Court of Appeals opinion by Judge McWilliams, *Crest Investment Trust, Inc. v. Alatzas*,¹²⁷ is instructive. Although the precise question for determination in *Alatzas* was whether oral notification satisfied the reasonable notification mandate of UCC Section 9-504(3) or whether only written notice would suffice,¹²⁸ the court's approach to the issue displays all of the hallmarks of the best of the Majority rule decisions on deficiency judgments. The court looked first to the purpose of the notice requirements, and then examined the relevant statutory language of Section 9-504(3) in light of the Official Comment.¹²⁹ Finding that "reasonable notification" was not defined in Article Nine, the court looked to other sections of the Code for guidance.¹³⁰ It held, on the basis of a functional analysis of the results, that the giving of actual notice was what counted, not whether the notice was given in written or verbal form.¹³¹ Not content to rest matters there, the court carefully considered the authority available to it from textwriters and other jurisdictions. It pointedly disregarded the one case it found that required formal written notice as having been incorrectly decided on the basis of a misinterpretation of *Barker v. Horn*.¹³²

The Maryland Court of Appeals case of *Harris v. Bower*,¹³³ is also significant because the court's heavy reliance on a leading Majority rule

127. 264 Md. 571, 287 A.2d 261 (1972).

128. The senior secured party allegedly repossessed and resold the collateral without adequate notice to the junior secured party.

129. The Comment provides:

Reasonable notification is not defined in this subtitle; 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. MD. ANN. CODE, COMM. L. ART., § 9-504, COMMENT 5 (1975).

130. 264 Md. at 575-76, 287 A.2d at 263, citing MD. ANN. CODE, COMM. L. ART., § 9-504, COMMENT 5 (1975), quoting from §§ 1-201 (38) and 1-201 (25), in which the terms "send" and "notice," respectively, are defined.

131. 264 Md. at 576, 287 A.2d at 264.

132. 245 Ark. 315, 432 S.W.2d 21 (1968).

133. 266 Md. 579, 295 A.2d 870 (1972). In *Harris*, the plaintiff filed a bill of complaint for an accounting, damages and other equitable relief in March, 1973, based upon the defendant's conduct following repossession of a boat purchased by plaintiff and her deceased husband from the defendant in 1966. The purchase price of the boat, \$17,000, was evidenced entirely by the promissory note of the plaintiff and her husband and was payable over a period of two years from its date. The note was secured by a security interest in the boat granted by the plaintiff and her husband to the defendant. Following default under the note, the defendant obtained a summary judgment in the amount of approximately \$22,000 against the plaintiff and her husband's estate (the husband died and his estate was insolvent) in December, 1969. The defendant repossessed the boat in March, 1970, when it had an uncontroverted fair market value of \$13,900, and had still not resold it by the time the *Harris* case was tried in September, 1971. The lower court found that the value of the boat did not then equal the amount of the judgment

case, *Dynalectron Corp. v. Jack Richards Aircraft Co.*,¹³⁴ in deciding closely analogous issues of law may indicate its thinking on the issues posed by our hypothetical. In determining whether a secured party's post-repossession acts and omissions in respect of the collateral were commercially reasonable, and the proper consequences that should be visited on commercially unreasonable conduct, the court relied *solely* on *Dynalectron*, quoting the following statement from that case:

As the Court finds that the sale of the aircraft by the Plaintiff was not accomplished in a commercially reasonable manner, the Plaintiff is not entitled to a deficiency judgment against either Defendant. 4 Anderson Uniform Commercial Code § 9-502:28 states, "The creditor is not entitled to a deficiency judgment unless the sale of the collateral was conducted in a manner which was commercially reasonable."¹³⁵

While both the facts and the procedural posture of *Harris* were readily distinguishable from *Dynalectron* so that the above-quoted language may not even measure up to the status of dictum, the *Dynalectron* holding regarding the effect of the secured party's conduct—no compliance with Section 9-504(3), no deficiency judgment—must have been looked upon with favor by the court and may well be prophetic of its approach to a secured creditor who fails to give notice under Section 9-504(3).¹³⁶

previously obtained by the defendant against the plaintiff, and, therefore, it was "not reasonable to expect the defendant to retain the boat in complete satisfaction of the [plaintiff's] obligation." *Id.* at 586, 295 A.2d at 873. See MD. ANN. CODE, Comm. L. Art., § 9-505(2) (1975). Denying the relief requested by the plaintiff, the trial court ordered that the boat be sold by judicial sale, and that the proceeds be applied in accordance with Section 9-504(1). If the proceeds were less than the amount of the judgment previously obtained by the defendant, the provisions of UCC Section 9-504(3) as to deficiency would control. 266 Md. at 586, 295 A.2d at 873.

On appeal, the plaintiff made two contentions. First, she argued that under Section 9-505(2), the defendant had accepted and retained possession of the boat in full satisfaction of her obligation to him. Secondly, it was contended that the defendant, in not reselling the boat during the period of time that had elapsed since repossession, had acted in a commercially unreasonable manner and that the loss resulting therefrom, namely, any decrease in value of the boat from the date of its repossession, should be set off against the defendant's judgment against the plaintiff.

The court rejected the plaintiff's former contention, but agreed with the latter, stating that any "shrinking in value [of the boat from its uncontroverted \$13,900 fair market value on its date of repossession] must be attributed to [the defendant's] conduct which we are persuaded to categorize as not commercially reasonable." *Id.* at 592, 295 A.2d at 876. The case was then remanded with instructions to the lower court to determine the amount that the plaintiff should receive as a "credit" against the summary judgment entered against her: "We think the chancellor could very well find that the [plaintiff] is entitled to a credit of \$13,900." *Id.*

134. 337 F. Supp. 659 (W.D. Okla. 1972).

135. 266 Md. at 591, 295 A.2d at 875-76, (emphasis added), quoting from 337 F. Supp. at 663.

136. Similar inclinations towards the Majority rule view are evidenced by the decisions of lower courts in Maryland, such as the decision of the late Judge Gilbert Prendergast in

Maryland's approach to notice requirements in connection with real estate foreclosure sales may also provide a useful analogy. In *Fleisher Co. v. Grice*,¹³⁷ the Maryland Court of Appeals reversed the findings of the trial judge and refused to confirm the real estate foreclosure sale, *solely* on the basis that the publication of the advertisement of sale was not in strict accordance with the notice provisions of Maryland Rule W74(a)(2)(1).¹³⁸ Citing a considerable number of precedents in Mary-

the nisi-prius case of *Ford Motor Credit Co. v. Lilly*, File No. 15480 (Ct. C.P. for Supreme Bench of Baltimore City, 1970). The *Lilly* case arose as a suit for a deficiency under the MARYLAND RETAIL INSTALLMENT SALES ACT (the "Act"). MD. ANN. CODE art. 83, §§ 128 *et. seq.* (1957), as *recodified*, MD. ANN. CODE, Comm. L. Art., §§ 12-601 *et. seq.* (1975), but Judge Prendergast's comments on Section 9-504 of the UCC and his citations of authority in the course of his opinion leave little doubt that he would have reached the same conclusion had he been called upon to decide the case under the UCC. Section 141(c) of the Act requires that the creditor send written notice to the debtor after repossession, advising him, *inter alia*, of his right to redeem and his "rights as to a resale and his liability for a deficiency . . ."

Section 142(a) of the Act provides that:

The holder shall retain repossessed goods for fifteen days after notice has been delivered pursuant to Section 141(c) . . .

The conditional vendor in *Lilly* had sent the written notice required by Section 141(c) of the Act, but had resold the repossessed automobile on the fourteenth day thereafter, or one day too early. The trial court was of the opinion that:

[A] secured creditor who fails to conduct a re-sale properly and timely after repossession, has lost his claim for deficiency because he has foreclosed any right of redemption on the buyer's part and has not complied with the statutes.

Accordingly, Judge Prendergast overruled the plaintiff's motion for a new trial or judgment *n.o.v.* Commenting on the fifteen-day retention of repossessed collateral required by the Act, the court said:

This is confirmed in principle, though not specifically, by the provisions of Article 95B, Section 9-504 of the Uniform Commercial Code, setting forth the procedure to be followed by the secured parties exercising their right to dispose of collateral after default. . . . While plaintiff may rationalize that Mr. Lilly did not show any disposition to redeem the automobile after repossession . . . it would seem to be immaterial under the strict requirements of the statutes.

The court then cited a number of precedents construing similar acts in other jurisdictions, including *Associates Discount Corp. v. Carey*, 47 N.Y. Misc. 2d 369, 262 N.Y.S.2d 646 (1965), all of which held that non-compliance barred the recovery of a deficiency as a matter of law.

Of significance, however, was the express analogy drawn by the court between the notice requirements of the Act and those of the Code. The court stated:

In cases where no notice at all was given, the effect was held to be the same as that where invalid notice was afforded the debtor. In other words, if there is a non-compliance with the Code, there ceases to be any right to a deficiency judgment.

As if to drive home this point, the court cited not only the opinion of Judge Willson in the *Skeels* case, but Professor Gilmore's conclusion that "the secured party's compliance with the default provisions . . . both the formal requirements of notice and substantial requirement of 'commercially reasonable' sale—is a *condition precedent* to the recovery of a deficiency." GILMORE § 44.9.4, at 1264 (1965) (emphasis added) (footnotes omitted).

137. 245 Md. 248, 226 A.2d 153 (1967).

138. That rule provides:

(i) For the sale of real estate or chattels real—at least once in each week for three successive weeks, the first such publication to be not less than fifteen days prior to sale and the last such publication to be not more than one week prior to sale. MD. RULES OF PROCEDURE R.W.74(a)(2).

land law holding that statutory notice provisions are mandatory, not directory, and, therefore, must be strictly observed, the court explained its unyielding response to even slight technical non-compliance in terms of the *purpose* for which the rule had been formulated. In language reminiscent of that used by Judge Willson in the *Skeels* case with respect to the enactment of the notice provisions of Article Nine of the UCC, the court observed with respect to Rule W74:

That the interdiction of this kind of shenanigan was the reason for the rule scarcely needs saying.¹³⁹

While there are undoubtedly relevant distinctions to be made between a real estate foreclosure sale and a resale of repossessed collateral under the UCC, the situations are so analogous, particularly with respect to the purpose designed to be served by the prior notice requirements, that the implications of the court's decision for the question being discussed cannot be safely overlooked. It is difficult to conceive how the same court that so firmly turned away the partially-compliant creditor in *Fleisher* could be induced to greet with greater sympathy the totally non-compliant creditor under Article Nine, whose burdens with respect to notice are manifestly less onerous.

It may be that the unspoken premise in all this judicial concern with notice provisions is that which was articulated by the court in *Litteral v. Houser*,¹⁴⁰ a case dealing with questions of pre-UCC pledge law:

The Maryland cases make it plain that a pledgee is a *fiduciary* as to the pledgor and owes him a *duty of fairness*. They have laid down the rule that in case of default the pledgee must *notify* the pledgor and give a right to redeem. . . .¹⁴¹

The foregoing Maryland cases appear to be stamped with the Majority rule approach. The opinions have conscientiously analyzed the statutory construction of relevant Code provisions, and have refused to be deflected from functional reasoning by purely technical distinctions. Unlike the characteristic Minority opinions, the Maryland courts have displayed the same readiness to disavow weak or unpersuasive authority as did the *Leasco* court. Given the Maryland Court of Appeal's reliance upon *Dynalectron* in deciding *Harris*, and its approach to notice provisions in analogous areas of the law, it would appear that Maryland

Although the advertisement in *Fleisher* had been published a total of *six times* prior to the sale, there was a one week gap between publications so that the "three successive weeks" requirement of subsection (a)(2)(1) had not been satisfied. The court stated:

Our inquiry is limited to the requirements of the rule and it is now firmly settled that there must be strict compliance. 245 Md. at 251, 226 A.2d at 155.

139. 245 Md. at 251, 226 A.2d at 155.

140. 221 Md. 403, 158 A.2d 75 (1960).

141. *Id.* at 412, 158 A.2d at 79 (emphasis added).

would hold that strict compliance with the notice provisions of Section 9-504(3) is a condition precedent to the recovery of a deficiency judgment by the Secured Party in our hypothetical.

II. *Retention of Collateral in Satisfaction of the Obligation Under UCC Section 9-505(2)*

In our hypothetical transaction, the Lender had three possible courses of action with respect to the repossessed brick inventory and accounts receivable of the Company: (1) it could have sold or otherwise disposed of all the bricks and accounts and sued for any resultant deficiency; (2) it could have retained all the bricks and accounts in satisfaction of the obligation, foregoing any suit for a deficiency or (3) it could have sold or otherwise disposed of any part of the collateral and retained the rest in satisfaction of the obligation. Our Lender, however, attempted all three—sold part of the collateral (the bricks), retained part (the accounts) *and* sued for a deficiency.¹⁴² Professor Gilmore has stated that retention of collateral “must . . . discharge the *entire* obligation. . . .”¹⁴³ Should our Lender’s retention of the accounts for one and one-half years amount to an “election,” *as a matter of law*, to retain the accounts receivable in full satisfaction of the Company’s obligation so as to discharge the Guarantor from all liability?

While the result of a holding effectively discharging the initial indebtedness of \$500,000 for total collateral proceeds of \$100,000 (\$50,000 from the sale of the brick inventory and \$50,000 in collections on the accounts receivable) would, admittedly, be hard on the Secured Party, it is a result that manifestly was within the power of a secured party to prevent, since the decision to indulge in inaction was its alone. It is, moreover, a result that can be supported by the UCC and one that has been upheld in analogous situations in the scant relevant cases that exist.

UCC Section 9-505(2) provides that:

In any other case involving consumer goods or any other collateral *a secured party in possession may, after default, propose to retain the collateral in satisfaction of the obligation.* Written notice of such proposal shall be sent to the debtor and except in the case of consumer goods to any other secured party who has a security interest in the collateral and who has duly filed a financing statement indexed in the name of the debtor in this State or is known by the secured party in possession to have a security interest in it. If the debtor or other

142. See pp. 154-55 *supra*. It should be noted that the UCC Section governing collection rights of a secured party on default, contains no prescribed time limit within which the secured party must undertake to collect from the account debtors. See MD. ANN. CODE, Comm. L. Art., § 9-502 (1975).

143. 2 GILMORE, § 44.3 at 1223, n.2 (1965) (emphasis added).

person entitled to receive notification objects in writing within thirty days from the receipt of the notification or if any other secured party objects in writing within thirty days after the secured party obtains possession the secured party must dispose of the collateral under § 9-504. *In the absence of such written objection the secured party may retain the collateral in satisfaction of the debtor's obligation.*¹⁴⁴

The Official Comment to this Section explains that:

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.*¹⁴⁵

This "alternative arrangement," frequently referred to as "strict foreclosure" is, like the other provisions of Title Nine governing secured transactions, animated by an impulse to foster commercial reasonableness. The Section does not commit the secured party to an all-or-nothing course; it is entirely free to dispose of a part of the repossessed collateral if it deems that wise, while electing to retain the remaining collateral in satisfaction of the outstanding balance of the obligation. From a practical business point of view, it might make better sense, for example, for a lending institution like the Secured Party in our hypothetical to get out of the brick business in which it lacks expertise by promptly selling off the brick inventory. On the other hand, an election to retain the receivables for future collection or sale might be more practical since these activities are much closer to the sphere of competence and experience of the Secured Party. Section 9-505(2) preserves this option for the secured party. As Professor Gilmore explains:

The statutory text refers to "the collateral" and "the obligation". This may be taken to mean "*all or part of the collateral*". With respect to the obligation, however, *the proposal must be to discharge the entire obligation. Otherwise, the provision would open up a short cut, which would soon become a broad highway, to informal deficiency judgments.*¹⁴⁶

Preliminarily, it may also be observed that the right given to the debtor and other designated creditors to object to the proposal to

144. MD. ANN. CODE, COMM. L. ART., § 9-505(2) (1975) (emphasis added).

145. *Id.* Comment 1 (emphasis added).

146. 2 GILMORE, § 44.3 at 1223, n.2 (1965) (emphasis added).

retain the collateral and to force its disposition under Section 9-504 was an attempt by the draftsmen to balance the equities. This option defuses the possibility that a secured creditor might "elect" to retain a million dollar chattel in satisfaction of a hundred dollar debt. As Professor Gilmore has stated:

It is by no means true that all lenders have the economic power to dictate terms to their borrowers or that, if they have the power, they will misuse it to impose unfair terms. And yet it is obvious that over a broad range of situations the lender is in control and will naturally be tempted to exercise his power in his own self-interest which, however enlightened, is not necessarily the same thing as the interest of the debtor or of competing creditors.¹⁴⁷

The initiative to proceed with retention under Section 9-502(2) clearly belongs to the secured party: its written proposal compels a decision by the debtor and other creditors. It will be noted instantly that, in a departure from the standard practice in Title Nine of avoiding the UCSA's imposition of inflexible dates and deadlines, the UCC provided that the debtor, if it wishes to object to the secured party's proposal, must do so "in writing within thirty days from the receipt of the notification."¹⁴⁸ No corresponding deadline is expressly put on the secured party; the Code does not specify a definite date by which the secured party must notify the debtor of its proposed election. Are there, therefore, no outer time limits on the secured party's choice? Could the Code have intended to place in the secured party the power to keep the debtor and other creditors dangling indefinitely in a state of suspension by the sheer expedient of withholding its proposal? Though relatively few courts have been confronted with the issue, most have said no. In the spirit of commercial reasonableness, there must come a time when the secured party's option to elect retention has run out. His failure to act will, at some time, cross the boundary between omission and commission and amount to a positive election as a matter of law.

In *Cox Motor Car Co. v. Castle*,¹⁴⁹ no specific dates are given with respect to the period of time that elapsed between repossession and the filing of suit in either the trial court or the appellate court, but some of the basic principles in this area were clearly enunciated in the court's opinion. The decision was tantamount to a holding that the creditor had retained the collateral in satisfaction of the debt. The purchaser of a Chevrolet truck under a conditional sale contract brought suit against his vendor for breach of warranty and was granted an award of damages. The vendor counterclaimed for the unpaid balance of the

147. *Id.* at 1221.

148. MD. ANN. CODE, Comm. L. Art., § 9-505(2) (1975).

149. 402 S.W.2d 429 (Ky. Ct. App. 1966).

purchase price of the truck, but was denied recovery. In affirming the lower court's decision, the appellate court stated:

But still another obstacle stands in the way [of successful appeal]. According to the evidence the truck was repossessed. . . . However, we find nothing in the record to show that there was a sale and an insufficiency of the proceeds thereof to cover the balance due on the conditional sale contract. Certainly Cox could not keep the truck and still make a claim for the amount of the unpaid balance on the contract. Having repossessed the truck, Cox was required to liquidate it at [a] reasonable . . . sale, as a condition of seeking further recovery from Castle and Castle's obligation became limited to whatever deficiency remained after such a sale.

In the absence of evidence that there was a sale and a deficiency we think Cox did not make out a valid claim.¹⁵⁰

Whatever our hypothetical Lender's subjective intention may have been at any point during the one and one-half years, an intention to retain the receivables in satisfaction of the obligation could, arguably, be imputed to it on the basis of its objective behavior. This is scarcely a novel idea in the law. Whether couched in terms of imputed intent, waiver or estoppel, as the context may require, legal consequences are attached to what parties have *actually done* regardless of what the parties may have hoped, intended or thought they were doing.

Thus, for example, in that short period of time before it was ready to embrace the UCC openly, the Georgia Appellate Court carefully scrutinized the objective behavior of a repossessing creditor in order to determine whether the circumstances surrounding his repossession amounted—in law—to an “accord and satisfaction,” or, in the language of the Code, an election to “retain the collateral in satisfaction of the obligation.” In *Johnson v. Commercial Credit Corp.*,¹⁵¹ in which the creditor took the car, telling the debtor, “You can't afford to turn it in, it's worth more than you owe on it,”¹⁵² the court found an accord and satisfaction. On the facts of *Barnes v. Reliable Tractor Co.*,¹⁵³ however, where the objective facts supported an attempt by the debtor to unilaterally impose an accord on an unconsenting creditor at the time of repossession, the court refused to do so.

In *Bradford v. Lindsey Chevrolet Co., Inc.*,¹⁵⁴ the issue arose in the context of a suit by the vendor of an automobile against the guarantor of the conditional sales contract for recovery of the outstanding balance due on the contract. The defendant guarantor inartfully

150. *Id.* at 432.

151. 117 Ga. App. 131, 159 S.E.2d 290 (1968).

152. *Id.* at 131, 159 S.E.2d at 291.

153. 117 Ga. App. 777, 161 S.E.2d 918 (1968).

154. 117 Ga. App. 781, 161 S.E.2d 904 (1968).

“defended on the grounds that the repossession and retention of the automobile was a ‘waiver’ of the right to collect on the conditional sale contract.”¹⁵⁵ The Georgia Appellate Court, in a transitional stage between its desire to rely on familiar common law doctrine and its later willingness to rest squarely on the provisions of the Code, held that:

*Irrespective of whether the law prior to the Georgia Uniform Commercial Code . . . or the Commercial Code itself applies here, the result is the same. See . . . § 9-501 et seq. of the Georgia Uniform Commercial Code. The action of the holder in legally repossessing the security under a conditional sale contract, the retention of the same without sale and without excuse for not selling . . . 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, constituted a rescission and satisfaction of the contract and no recovery could be had thereon.*¹⁵⁶

A secured creditor’s threshold argument would logically be that the entire subject of an election under Section 9-505(2) may not be considered unless and until he has first served a written proposal of retention, that is, that the proposal is a pre-requisite to any defense based on Section 9-505(2). This argument, however, was flatly rejected by the court in *Northern Financial Corp. v. Chatwood Coffee Shop, Inc.*¹⁵⁷ It should be noted that the court in that case was not being asked to decide that, as a matter of law, the creditor had made an election. On the contrary, the defendant debtor’s only purpose was to raise the election as a triable issue of fact in order to overcome the plaintiff’s motion for summary judgment. In denying the plaintiff’s motion, the court stated:

*In this connection, the plaintiff’s failure to serve a proposal to retain the collateral in full satisfaction of the debt pursuant to § 9-505(2) of the Uniform Commercial Code is not a bar to the defendants’ claiming that plaintiff actually adopted such course of conduct with respect to that property. This type of notice serves only to relieve a secured creditor from being required to dispose of the property in accordance with § 9-504 of the Uniform Commercial Code.*¹⁵⁸

155. *Id.* at 782, 161 S.E.2d at 905-06.

156. *Id.* at 782, 161 S.E.2d at 906 (emphasis added).

157. 4 UCC REP. 674 (N.Y. Sup. Ct. 1967).

158. *Id.* at 675 (emphasis added). There is nothing to conflict with this in the holding of *Priggen Steel Buildings Co. v. Parsons*, 350 Mass. 62, 213 N.E.2d 252 (1966), which is sometimes cited for the proposition that strict foreclosure is ruled out in the absence of a proposal pursuant to Section 9-505(2). While there was no proposal in *Priggen*, neither was there a retention of collateral; the repossessed portable metal building there involved

Similarly, in *Brownstein v. Fiberonics Industries, Inc.*,¹⁵⁹ the court held that despite the failure of one of the creditors to serve a proposal of retention, the receiver of the insolvent debtor corporation had the option, much to his advantage, of treating the creditor's repossession and retention of certain machinery during the four-month period preceding the insolvency action as an election to retain the collateral in full satisfaction of the obligation.

Thus, it can fairly be said that (1) the creditor's failure to serve a proposal of retention is not fatal to the debtor's claiming that the creditor actually adopted this course of conduct with respect to the property and (2) that in a proper case, this course of conduct may be found to have been adopted as a matter of law.¹⁶⁰

There is also strong dictum to this effect in *Harris v. Bower*,¹⁶¹ where the court cited *Bradford*, *Fiberonics* and *Chatwood* as authority for the position that:

[A] *written proposal may not be absolutely essential*, especially where the secured party conducts himself in a manner so unfair

had been sold, and the resultant deficiency formed the basis of the plaintiff's suit. There is, thus, no real similarity between the facts of that case and our hypothetical facts.

159. 110 N.J. Super. 43, 264 A.2d 262 (1970).

160. See *Michigan Nat'l. Bank v. Marston*, 29 Mich. App. 99, 185 N.W.2d 47 (1970). The background of this case is significant. The issue of retention was raised as a defense under Section 9-505(1), which required the creditor under a purchase money security interest in consumer goods to dispose of the collateral under Section 9-504, within ninety days after he takes possession "if the debtor has paid sixty percent of the cash price. . . ." The creditor had made strong and commercially reasonable efforts to resell the car, which was not only in a badly-damaged condition but also subject to a garageman's lien for storage charges. Having received no viable offers, it sued instead on the underlying promissory note. The debtor argued that the creditor was required to dispose of the collateral under Section 9-504 before bringing suit on the note, the analogy by implication being that the failure to do so amounts to an election to retain the collateral in satisfaction of the obligation. The issue of whether a proposal of retention is prerequisite to a finding of retention-in-fact thus never arose, since there is no requirement for such a proposal to be made under the terms of Section 9-505(1). The court dismissed the debtor's defense under Section 9-505(1) as totally inapplicable for the reason, *inter alia*, that the debtor had not paid 60 percent of the purchase price. In affirming the judgment of the trial court for the plaintiff, the court went on to say:

This does not mean, however, that the bank owes no duties to defendant with respect to the collateral. . . . *It would be unfair to allow a creditor to deprive the debtor of the possession and use of the collateral for an unreasonable length of time and not apply the asset or the proceeds from its sale toward liquidation of the debt.* Moreover, it would be equally unfair to allow a creditor to take possession at all, if the creditor never intended to dispose of the security. For *during the period that the debtor is deprived of possession he may have been able to make profitable use of the asset or may have gone to far greater lengths than the creditor to sell.* Once a creditor has possession he must act in a commercially reasonable manner toward sale, lease, *proposed retention* where permissible, or other disposition. *Id.* at 108, 185 N.W.2d at 51 (emphasis added).

The court found that the plaintiff had acted in a "commercially reasonable manner;" and that the defendant had suffered "[no] loss by the plaintiff's failure to sell or return title." *Id.* at 109, 185 N.W.2d at 52.

161. 266 Md. 579, 295 A.2d 870 (1972).

or unreasonable as to amount to a retention of the collateral in satisfaction of the obligation.¹⁶²

Speaking for the court, Judge McWilliams indicated that in a proper case the court might find an election as a matter of law. He stated that the creditor in *Harris* had "come perilously close to painting himself into a corner in this regard."¹⁶³ In the circumstances of *Harris*, however, the court was "unwilling . . . to hold that what [the creditor had done] extinguishe[d] the entire debt."¹⁶⁴

The circumstances in *Harris* differ from those in our hypothetical in several ways. First, the collateral consisted of a pleasure boat rather than the accounts receivable of a business. Secondly, there was uncontroverted testimony to show that the debtor's attorney had specifically proposed to the creditor that he "accept the return of the boat in exchange for the cancellation of the note" and that the creditor's reaction was a resounding rejection, in that, approximately one month later, he sued on the note and reduced it to a judgment.¹⁶⁵ Thirdly, the creditor's behavior toward the collateral after gaining his judgment, while not commercially reasonable, nevertheless further served to support his contention that he had not factually made an election of retention, inasmuch as he had actually *advertised the boat for sale* and sent copies of the bids to the debtor's widow. On these facts it is not difficult to understand why Judge McWilliams felt that although the creditor had come "perilously close" to an election at law, he had not quite crossed the line. Fourthly, the issue of retention as a matter of law, did not reach the court until after there had been a full hearing on the merits. Therefore, the court had available to it all the facts in the case upon which to base a finding of commercial unreasonableness in the event that it could not find a retention as a matter of law.

Finally, *Harris* arose as a suit by the debtor for an accounting and other equitable relief, and not as a creditor's suit for a deficiency. This makes it necessary to transpose and analogize what occurred with respect to recovery in the context of an affirmative action to the defensive posture of a guarantor. The debtor's claim that the creditor factually elected to retain the boat in satisfaction of the obligation must be seen for purposes of the analogy, as an absolute defense which, upon the facts in *Harris*, failed to hold up. Consequently, the "deficiency" was not barred as a matter of law. The debtor was then in the position of any other debtor seeking, by counterclaim or separate action, an affirmative recovery for damages under Section 9-507(1). In that situation, he is entitled only to provable damages which, in *Harris*,

162. *Id.* at 587, 295 A.2d at 874 (emphasis added).

163. *Id.* at 588, 295 A.2d at 874.

164. *Id.*

165. *Id.* at 581, 295 A.2d at 871.

amounted to the usual measure of damages for conversion: the amount of the debt less the fair market value of the boat at the time of repossession.

There is nothing in this measure of damages to suggest that the Maryland Court of Appeals has adopted the "off-set" theory of the Minority courts in the lack of notice cases discussed earlier. On the contrary, had the "absolute defense" held up, had the facts in *Harris* been such as to warrant a finding of retention at law (thereby extinguishing the "deficiency") and had the value of the boat exceeded the amount of the debt, the Maryland court might demonstrably have shown that it was thinking along affirmative recovery rather than defensive lines, by granting an award of damages for the amount of the excess. In short, on the basis of *Harris* it may be said that, in a proper case, the Maryland Court of Appeals might be disposed to find an election to retain the collateral in satisfaction of the obligation as a matter of law despite the creditor's failure to serve a written proposal thereof on the debtor.

Stronger authority, however, is furnished by the recent decision in *Farmers State Bank v. Otten*.¹⁶⁶ There, Otten and Weiss borrowed \$2,200 from the plaintiff bank and both signed the note. Otten also executed a security agreement to the bank on a tractor and trailer. As the court recited the facts,

On April 4, 1969 Otten was in default in payment of the loan, whereupon the bank, under its security agreement, and Weiss (without any right) took physical possession of the collateral and thereafter retained possession of it. No proceedings were ever taken for sale or other disposition of the collateral under our Uniform Commercial Code. . . .¹⁶⁷

Some three months later the bank commenced action on the note against Otten, who made Weiss a party defendant. Weiss, as co-signer of the note, thereupon paid off the bank and made a claim against Otten for this amount. Otten cross-claimed against Weiss and the bank for damages resulting from the failure to make any disposition of the collateral. At the time of the trial, eleven months after repossession, the bank and Weiss were still in possession of the collateral. More than thirteen months after the date of repossession, the trial court entered a general judgment for Weiss against Otten based on the note "without any mention of a lien on any property of the security agreement," and dismissed Otten's cross-claim for damages.¹⁶⁸ Some fourteen and one-half months after repossession the collateral was sold to satisfy the

166. 87 S.D. 161, 204 N.W.2d 178 (1973).

167. *Id.* at 163, 204 N.W.2d at 179.

168. *Id.* at 164, 204 N.W.2d at 179.

judgment, which, with costs, totalled \$2,132.49. Otten appealed, assigning as error the trial court's dismissal of the cross-claim for damages.

Again, the issue of retention arose within the context of an affirmative attempt to recover damages. In this case, however, unlike *Harris*, the evidence showed that the value of the collateral (\$2,500) exceeded the amount of the debt (\$1,898.64). The court remanded, with instructions to enter judgment in favor of Otten on his cross-claim against the bank and Weiss in the amount of \$601.36 with interest and costs from April 4, 1969. The effect of this decision was obviously indistinguishable from a finding that the debt had been extinguished by the unreasonable retention as a matter of law, coupled with a further finding of losses over and above the debt for which Otten was entitled to be compensated.

The court's thinking in terms of Section 9-507(1) was spelled out. Furthermore, the court made it quite clear why it did not feel free to simply reverse the trial court's judgment in favor of Weiss:

Weiss obtained record title to the tractor and trailer as purchaser at the sheriff's sale under execution of the judgment on the note originally made to the bank. Otten did not deny that debt, and in this state of the record it is inappropriate to alter that judgment.

The failure of the bank and Weiss to proceed in a reasonable time and manner to comply with the statutes with reference to disposition of the collateral resulted in a loss to Otten for which he is entitled to damages. This is consistent with recovery of loss provided for when there is failure to comply with the UCC under the circumstances set out in . . . [§ 9-507(1)].¹⁶⁹

Looking first to the language of UCC Section 9-504(3) and its requirement that reasonable notification be given "of the time after which any private sale or other intended disposition is to be made," the court said:

The other "intended disposition" in this section must include that mentioned in . . . [UCC § 9-505(2)], . . . which permits a secured party in possession to propose to retain the collateral in satisfaction of the obligation. . . .

We believe the intent of these sections is that the secured creditor has two options—he may proceed initially to sell the property after giving the notice, etc. as provided by . . . [UCC § 9-504(3)] . . . or propose to retain the collateral in satisfaction of the obligation. . . . *A creditor who takes possession*

169. *Id.* at 170, 204 N.W.2d at 183.

*under . . . [UCC § 9-504(3)] must pursue his claim under one of the above-described options, and failure so to do subjects him to damages.*¹⁷⁰

The court then quoted extensively from *Marston and Bradford*, emphasizing that:

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 interests of the debtor.¹⁷¹

The court specifically pointed out that any excuses of the creditors for their long failure to act

[could not] be charged to Otten when he did nothing to prevent the enforcement of any rights under the security agreement.¹⁷²

Coming to the crux of the matter (for purposes of guidance in our hypothetical case), the court turned to two of the leading cases expounding the Majority rule position that failure to give prior notice of intended disposition barred the secured creditor's recovery of a deficiency as a matter of law, *Braswell v. American Nat'l Bank*,¹⁷³ and *Atlas Thrift Co. v. Horan*,¹⁷⁴ stating:

We equate failure to give notice as required by law where a sale is held to be of the same legal effect as where the creditor retains possession of the property for an unreasonable time (as the bank and Weiss did here) and takes no proceeding to conduct a sale. The resulting damage to the debtor is the same.¹⁷⁵

If retention of approximately fourteen months is so unreasonable as to extinguish the debt as a matter of law and bar the recovery of a deficiency, then should not the delay of eighteen months in our

170. *Id.* at 165, 204 N.W.2d at 180 (emphasis added).

171. *Id.* at 166, 204 N.W.2d at 181.

172. *Id.* at 167, 204 N.W.2d at 181.

173. 117 Ga. App. 699, 161 S.E.2d 420.

174. 27 Cal. App. 3d 999, 104 Cal. Rptr. 315.

175. 87 S.D. at 168, 204 N.W.2d at 182. *See also* *Moran v. Holman*, 514 P.2d 817 (Alas. 1973) (secured party who retained truck for four months after repossession and used it in a manner inconsistent with its preservation before bringing suit, held to have retained the collateral in satisfaction of the indebtedness). *But see* *People's Nat'l. Bank of Washington v. Peterson*, 82 Wash. 2d 822, 514 P.2d 159 (1973), wherein the Supreme Court of Washington refused to find such an election when the debtor's attorney had requested the creditor bank to cancel a proposed public sale and the bank had acceded to this request.

hypothetical have the same effect? If the Lender had doubts about the value or collectibility of the receivables, should it not have hastened to seek to liquidate all of them by sale, even if it would be nothing more than a futile gesture, before bringing suit for the total deficiency? Its failure to do so might, arguably, support the inference that it never intended to do so, since it desired to retain the receivables in satisfaction of the obligation still outstanding after the sale of the brick inventory. Even if the Lender had some excuse for its failure to act a court might be unwilling to hold the Guarantor liable since, in the words of the *Otten* court, the Lender's "inaction should not be charged to [the guarantor herein] when [he] did nothing to prevent the enforcement of any rights under the security agreement."¹⁷⁶

On the basis of the foregoing analysis it would appear to be prudent for the secured party in possession of collateral following default to make a prompt decision, and to notify the debtor and any guarantor of its intention to retain or dispose of the collateral. Procrastination might take the matter out of the lender's hands and compel it, as a matter of law, to be satisfied with the collateral, the value of which might be substantially lower than the amount of the outstanding indebtedness.

CONCLUSION

As the body of case law considered in this article attests, there are a number of pitfalls to catch the unwary secured creditor on the far side of default. Failure to comply with the provisions of Title Nine of the Code governing disposition of repossessed collateral on default can negate all of the foresight and business planning exercised at the inception of the transaction. In Maryland there is, perhaps, need for a somewhat higher degree of caution, since the Maryland Court of Appeals has yet to rule directly on most of the relevant issues. Consequently, there are no definitive answers to many of the questions posed herein, particularly with respect to the nature and extent of the consequences to be visited on the secured party for non-compliance.

Fortunately, however, the burdens placed on the secured party by the Code are far from onerous so that, with competent legal advice and a measure of prudence, it is possible to obviate or substantially minimize the risks of non-compliance. Unless and until the Court of Appeals holds otherwise, the secured party would be best advised to regard any guarantor of the secured obligation as a debtor within the meaning of Section 9-504(3), entitled to receive the notice provided for therein. Similarly, the secured party should not unduly temporize with respect to the option provided by the Code to retain all or part of the collateral in satisfaction of the outstanding indebtedness, lest procrastination result in an unwelcome choice being imputed to it as a matter of

176. 87 S.D. 167, 204 N.W.2d at 181.

law. Beyond this, nothing more is required of the secured party than that it act in good faith and with commercial reasonableness.

If it complies with these requirements, the secured party can substantially reduce the risk of forfeiting its entitlement to a deficiency judgment against the guarantor, or of assuming the equally costly burden of rebutting a presumption that the value of the repossessed collateral is equal to the amount of the obligation. In short, the secured party has it within its power to avoid a walk on the wild side and, to the extent that it is possible to speak of it as such, assure that its walk is on the secure side of default.