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Warranties of Title, Foreclosure, Sales and the Proposed Revision of U.C.C. §9-504: Has the Pendulum Swung Too Far?

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ARTICLES

WARRANTIES OF TITLE, FORECLOSURE SALES, AND THE PROPOSED REVISION OF U.C.C. § 9-504: HAS THE PENDULUM SWUNG TOO FAR?

Robyn L. Meadows*

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INTRODUCTION

HISTORICALLY, purchasers of goods at foreclosure sales generally have done so at their own peril.¹ The purchaser assumed the risk that good title would not be conveyed through the sale due to a defect in the title or as a result of the seller's wrongful acts.² Unlike

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1. See, e.g., U.C.C. § 2-312(2) cmt. 5 (1994) (explaining that foreclosing lienor does not give warranty of title to purchaser); Steve H. Nickles, *Rights and Remedies Between UCC Article 9 Secured Parties with Conflicting Security Interests in Goods*, 68 Iowa L. Rev. 217, 254 (1983) (noting that "[b]uyers at forced sales traditionally have been required to assume the risk that superior encumbrances . . . [would] survive the disposition of the property to them").

2. An example of a seller's wrongful act, the risk of which the purchaser assumes, is wrongful repossession and sale. When the debtor is not in default, a secured

most sales of goods, a party selling goods at a foreclosure sale does not, in any way, warrant title to the goods.³ Excluding the warranty of title from foreclosure transactions, however, could have unjust results. In the event that the foreclosing secured party wrongfully sold the goods, the purchaser would not obtain good title to the property. Because the purchaser assumed the risk of a wrongful sale, however, the seller would be legally entitled to retain the proceeds generated by the sale.⁴ This would be true even when the seller's acts were a contributing factor to the failure of title to pass.

party has no authority to repossess or sell the collateral. U.C.C. §§ 9-501, -504; *see also* *Martens v. Hadley Memorial Hosp.*, 729 F. Supp. 1391, 1393 (D.D.C. 1990) (stating that default is condition to repossession and sale of collateral under U.C.C.); Cynthia Starnes, *U.C.C. Section 9-504 Sales by Junior Secured Parties: Is a Senior Party Entitled to Notice and Proceeds?*, 52 U. Pitt. L. Rev. 563, 581 (1991) (same). In the absence of default, a secured party who repossesses and sells collateral has converted it. *See, e.g., Mitchell v. Ford Motor Credit Co.*, 688 P.2d 42, 47 (Okla. 1984) (stating creditor liable for conversion when creditor repossessed in absence of default). A purchaser from the secured party receives void title. *See, e.g., Swift & Co. v. Jamestown Nat'l Bank*, 426 F.2d 1099, 1103-04 (8th Cir. 1970) (holding that a good faith purchaser from a converter did not receive good title); *Imni-Etti v. Aluisi*, 492 A.2d 917, 923 (Md. Ct. Spec. App. 1985) (same). The debtor has the right to reclaim the collateral or seek damages from the secured party and the purchaser. *See Swift & Co.*, 426 F.2d at 1104 (finding that owner could recover goods from possession of innocent purchaser); Dale A. Oesterle, *Deficiencies of the Restitutionary Right to Trace Misappropriated Property in Equity and in UCC § 9-306*, 68 Cornell L. Rev. 172, 216 (1983) (explaining owner's right to recover damages from innocent purchaser even if wrongdoer is available to be sued). Even though the purchaser's failure to receive good title is due in this instance to the wrongful repossession and sale by the seller, the purchaser is not entitled to recover damages from the seller, under either the U.C.C. or common law, for breach of the warranty of title or in restitution. *See* Robyn L. Meadows, *A Potential Pitfall for the Unsuspecting Purchaser of Repossessed Collateral: The Overlooked Interaction Between Sections 9-504(4) and 2-312(2) of the Uniform Commercial Code*, 44 Am. U. L. Rev. 167, 195-204 (1994) (explaining that failure to convey title through foreclosure sale is not basis for recovery for buyer under either warranty of title or restitution).

3. While U.C.C. § 2-312 generally implies a warranty by the seller of a good that the seller possesses title to the good and has the power to transfer the good to the buyer, subsection (2) limits that warranty in certain transactions, including foreclosure sales. U.C.C. § 2-312 cmt. 5; *see also Vend-A-Matic v. Foothill Capital Corp.*, 37 B.R. 838, 840-41 (Bankr. E.D. Mich. 1984) (finding no warranty of title attached to secured creditor's sale of debtor's collateral); Nickels, *supra* note 1, at 254 (stating that buyers at forced sale were traditionally required to assume risk that superior encumbrances would survive disposition of property to them).

4. *See, e.g., Dixon v. City Nat'l Bank*, 395 N.E.2d 620, 624 (Ill. App. Ct. 1979) (holding that buyer at judicial sale is not entitled to return of purchase price where sale was void because buyer bids at own risk), *aff'd*, 410 N.E.2d 843 (Ill. 1980); *Hutson v. Wood*, 105 N.E. 343, 348 (Ill. 1914) (same); *England v. Clark*, 5 Ill. 487, 490-92 (1843) (finding that caveat emptor applied to execution sales therefore purchaser not entitled to return of money paid where property sold did not belong to debtor); *Diversified, Inc. v. Walker*, 702 S.W.2d 717, 722-23 (Tex. Ct. App. 1986) (holding that a purchaser at a foreclosure sale was not entitled to damages where the sale was conducted by a lender and the title conveyed is void). *But see Basiliko v. Pargo Corp.*, 532 A.2d 1346, 1348 (D.C. 1987) (finding that "a seller who breaches [a] . . . contract for the sale of real property is liable to the would-be purchaser for compensatory damages."); *Bogestad v. Anderson*, 173 N.W. 674, 675 (Minn. 1919) (holding that a pur-

In a previous article,⁵ I discussed this issue based on the interaction between the current provisions in Article 2 of the Uniform Commercial Code (the “U.C.C.” or “Code”)—addressing the warranty of title⁶—and the provisions in Article 9—regarding foreclosure sales⁷—that focuses primarily on the relationship between the debtor and the purchaser of the collateral. In that article, I proposed that the current law, that does not provide protection for purchasers at foreclosure sales from the debtor’s claims or the wrongful actions of the selling secured party, contributed to depressed realization on the sale and, ultimately, the debt. I further argued that the current law is unjust and economically inefficient because it fails to balance the interests of the purchaser and the debtor in the good.

Article 9 is currently under review for possible revision by the American Law Institute (“ALI”) and the National Conference of Commissioners of Uniform State Laws (“NCCUSL”).⁸ The NCCUSL Drafting Committee, charged with revising Article 9, has addressed one aspect of the situation that I discussed in my earlier article. The current proposal to rectify the inequitable treatment of purchasers at foreclosure sales is quite simple. To the section governing foreclosure sales—section 9-504(a)—the Revision proposes to add: “Unless effectively excluded or modified, a contract for sale, lease, license, or other disposition includes the warranties related to title, possession, quiet enjoyment, and the like which by operation of law accompany a voluntary disposition of property of the kind subject to the contract.”⁹

While this language seems to solve the problems raised in my earlier article, to wit, extending warranty of title protection to purchasers at foreclosure sales, this Article will address the significant problems caused by this simple, yet sweeping language. I contend that this revision will result in broader protection for purchasers than is needed or desirable. I further suggest that this change may not solve the problems caused by the current version of Article 9, but will in fact create additional problems which the drafters have not adequately considered. By failing to balance the relevant interests involved, this revision to Article 9 will merely substitute one inequity for another. I

chaser may recover the price paid from a foreclosing seller if the seller failed to convey good title as a result of seller’s own conduct).

5. Meadows, *supra* note 2.

6. U.C.C. § 2-312.

7. In Part 5 of Article 9, the creditor is given the right to repossess and sell collateral subject to a security interest upon the debtor’s default. U.C.C. §§ 9-501, -503, -504.

8. U.C.C. § 9-504 (Proposed Draft 1996) [hereinafter Draft, Article 9]. A more recent draft of U.C.C. article 9 was available on the World Wide Web at <http://www.upenn.edu/library/ulc/ucc9/ml1draft.htm> on March 31, 1997 (on file with the *Fordham Law Review*); however, the substance of the new proposal does not affect this Article. All references to the proposed U.C.C. article 9 are to Draft, Article 9 *supra*.

9. Draft, Article 9, *supra* note 8, § 9-504(a).

propose that a careful balancing of the parties' interests and the equities involved will result in a more workable solution than the current consideration.

I. WARRANTY OF TITLE

Before a thorough analysis of the proposed revision to section 9-504 can be undertaken, it is necessary to consider the warranty of title under Article 2, which the revision has lifted wholesale into 9-504. This section will review the history, underlying premises, and extent of the warranty of title as it has evolved and is currently applied under the Code.

A. Common Law

The evolution of the warranty of title predated the adoption of the Code. At early common law, particularly in England, the seller of personal property did not warrant a good sold, in any respect, even as to title.¹⁰ This early approach was founded on two basic principles of law, *nemo dat* and *caveat emptor*.¹¹ The seller could transfer only such title as it possessed, and the buyer assumed the risk of title deficiency.¹² A fair price paid by the buyer did not guarantee that good title would be transferred.

In the 1800s, the courts in England and the United States gradually began to erode the harshness of this rule. Initially, courts permitted buyers to recover for the seller's failure to convey good title if the seller misrepresented the state of title or concealed title defects.¹³

10. William D. Hawkland & Frederick H. Miller, Uniform Commercial Code Series § 2-312:01 (1994); Irving Mariash, A Treatise on the Law of Sales § 113 (1930) (stating that, at early common law, *caveat emptor* was the rule with respect to title, and parties were presumed to deal at arm's length); see also *Morley v. Attenborough*, 3 Ex. 500 (1849) (stating, in dicta, that no warranty of title implied in sale which is consummated through transfer of specific good).

11. Hawkland & Miller, *supra* note 10, § 2-312:01 (stating lack of warranty of title in sale in early common law based on *nemo dat quod non habet* (he who hath not cannot give) and *caveat emptor* (buyer beware)). This approach is consistent with early court's reluctance to interfere in contractual relationships under a *laissez faire* approach. See Kevin M. Teeven, A History of the Anglo-American Common Law of Contract 288-95 (1990) (explaining that nineteenth century courts were guided by *laissez-faire* ideals); Duncan Kennedy, *Distributive and Paternalist Motives in Contract and Tort Law with Special Reference to Compulsory Terms and Unequal Bargaining Power*, 41 Md. L. Rev. 563, 568-569 (1982) (noting early courts' refusal to interject terms into private contracts based on freedom of contract); Joseph W. Singer, *Legal Realism Now*, 76 Calif. L. Rev. 467, 477-481 (1988) (discussing classical theorists' approach to freedom of contract in the last century which included the state's refusal to regulate the terms of agreements between private parties).

12. Hawkland & Miller, *supra* note 10, § 2-312:01.

13. Edmund H. Bennett & Samuel C. Bennett, Benjamin's Treatise on the Law of Sale of Personal Property § 627, at 583 (6th ed. 1892); 1 Samuel Williston, The Law Governing Sales of Goods at Common Law and Under the Uniform Sales Act § 217, at 561 (rev. ed. 1948); see *Morley v. Attenborough*, 3 Ex. 500 (1849) (noting while

This recovery was grounded in fraud, not in contract.¹⁴ Courts also began to recognize an alternative ground for recovery: an express affirmation by the seller that the seller was the owner of the good.¹⁵ This theory provided recovery under a contractual express warranty.¹⁶ Courts presumed that the parties did not intend for the seller to warrant the title to the good unless the seller expressly assumed that obligation, thus courts required an affirmative act or assumption of liability before the seller would be found to warrant title.¹⁷

The requirement of affirmative conduct on the part of the seller limited a court's ability to protect buyers who paid full price for a good that was subject to a third party's claim. Further extension of the warranty of title would require a court to change its underlying assumption regarding the parties' intentions and the effect of the parties' silence as to title.¹⁸ Consequently, courts first extended the warranty of title by implication to public sales by merchants on the grounds that the open display of the goods for sale was equivalent to a representation that the merchant owned the goods.¹⁹ Later, courts extended the warranty to sales in which the seller had possession of the good.²⁰ These courts viewed a sale coupled with the seller's possession as the equivalent of the seller's representation that the seller had title.²¹ Consistent with the trend of extending the warranty, courts

generally sale alone does not give rise to warranty of title, seller's fraud or affirmation of ownership can amount to warranty).

14. Williston, *supra* note 13, § 217, at 561.

15. See *Starr v. Anderson*, 19 Conn. 338 (1848) (holding that joint owner of horse who sold horse as his own warranted title); *Balte v. Bedemiller*, 60 P. 601, 602 (Or. 1900) (stating, in dicta, affirmation by seller that seller owns good equivalent to warranty of title); see also Joshua Williams, *The Law of Personal Property* 399 (7th ed. 1870) (explaining that vendor who states goods are his own warrants title to the goods); Williston, *supra* note 13, § 217, at 561 (same).

16. Williston, *supra* note 13, § 217.

17. See *Mariash*, *supra* note 10, § 113 (noting that early courts assumed parties dealt at arm's length and therefore courts did not find warranty of title without seller's assumption of the obligation); Williston, *supra* note 13, § 217 (explaining that courts found no warranty of title unless the seller concealed the fact that he lacked title or made express affirmation of title).

18. Frank H. Childs, *Principles of the Law of Personal Property*, § 169, at 202-03 (1914) (explaining implied warranties, including title, arise in the law based on the presumed intent of the parties).

19. See, e.g., *Eichholz v. Bannister*, 144 Eng. Rep. 284 (1864) (implying warranty of title in sale by warehouseman); see also Williams, *supra* note 15, at 399 (explaining that by last quarter of nineteenth century, seller of goods in open shop or warehouse impliedly warranted that seller owned the goods).

20. Williston, *supra* note 13, § 218; see, e.g., *Edwards v. Beard*, 100 So. 101, 103 (Ala. 1924) (stating that the law implies warranty of title when the seller is in possession of the good); *Hafer v. Cole*, 57 So. 757, 759 (Ala. 1912) (same); *Jordan v. Van Duzee*, 165 N.W. 877, 878 (Minn. 1917) (same); *Close v. Crossland*, 50 N.W. 694 (Minn. 1891) (same).

21. See, e.g., *Baker v. McAllister*, 3 P. 581 (Wash. 1881) (holding that both the warranty of good title and against encumbrances is implied in the sale of good in seller's possession); *Burt v. Dewey*, 40 N.Y. 283 (1869) (finding that possession by a seller of a good implies the seller's title to the good); *Eichholz*, 144 Eng. Rep. 284

took a broad view of possession.²² Gradually, the requirement of seller's possession faded away, and courts began to hold that a seller of personal property impliedly warrants good title and the right to sell the good.²³ This rule concerning tangible personal property was ultimately extended to the sales of intangibles.²⁴ By the turn of the century, the doctrine of warranty of title had evolved from the presumption that the parties intended no warranty to the diametrically opposite presumption that the parties intended the seller to warrant title unless circumstances clearly demonstrated the contrary.²⁵

B. *Uniform Sales Act*

By the promulgation of the Uniform Sales Act in 1906, the common law universally recognized the implied warranty of title in the sale of personal property.²⁶ Just as American common law with respect to warranty of title evolved from British common law, section 13 of the Uniform Sales Act was based on the British Sale of Goods Act.²⁷ Sec-

(stating that possession by a seller of a good is equivalent to the affirmation that the seller was the owner of the good).

22. Bennett & Bennett, *supra* note 13, at 633 (explaining that courts construed possession broadly to include constructive possession); North Am. Commercial Co. v. North Am. Transp. & Trading Co., 100 P. 985, 986 (Wash. 1909) (holding that the seller impliedly warranted title to coal that was in seller's constructive possession at time of sale).

23. See, e.g., American Mach. Co. v. Everedy Mach. Co., 35 F.2d 526, 528 (E.D. Pa. 1929) (finding that warranty of title exists in every sale of personal property); Gray v. D.P. Haynes & Bro., 51 So. 416, 417 (Ala. 1909) (holding that in the sale of chattel, warranty of title is implied); Fulwell v. Brown, 121 N.W. 265 (Mich. 1909) (explaining that the modern rule in England and the United States is that sale of personal property implies affirmation by seller that property is his, and therefore, seller warrants title thereto); Spotless Co. v. Commercial Trust Co., 214 N.Y.S. 10 (App. Div. 1926) (holding that the seller of a good warrants title regardless of possession).

24. Jeffers v. Easton, Eldridge & Co., 45 P. 680 (Cal. 1896) (stating that the law views the assignment of a lease as the sale of personalty and thus the warranty of title is implied even without a written agreement to warrant); Ratcliff v. Paul, 220 P. 279, 280 (Kan. 1923) (same); Tomlinson v. Thurmon, 181 So. 458, 460 (La. 1938) (finding an implied warranty of title in the sale of a mineral lease); Wood v. Sheldon, 42 N.J.L. 421 (1880) (extending the warranty of title to the sale of scrip dividend); Singer v. Karron, 294 N.Y.S. 566 (Mun. Ct. 1937) (finding an implied warranty of title in the sale of information as personal property).

25. Hawkland & Miller, *supra* note 10, § 2-312:01; Williston, *supra* note 13, § 218; see, e.g., Motley v. Darling, 98 A. 384 (N.J. 1919) (finding a warranty of title in a sale in which the buyer paid full price and the circumstances showed that absolute title was intended to be transferred, and the intent to sell without a warrant was not proven by seller).

26. U.C.C. § 2-312, official cmt., 1A U.L.A. 88 (1989); Bennett, *supra* note 13, at 631; Mariash, *supra* note 10, § 113.

27. Williston, *supra* note 13, § 216. The Sale of Goods Act, 1893 § 12 provided: [I]n a contract of sale, unless the circumstances of the contract are such as to show a different intention, there is:-

- (1) "An implied condition on the part of the seller that, in the case of a sale, he has a right to sell the goods, and that, in the case of an agreement to

tion 13 of the Uniform Sales Act codified and clarified the law regarding warranty of title in the sales of goods.²⁸ The warranty of title under the Uniform Sales Act had three component warranties: rightful sale, quiet possession, and against encumbrances.²⁹ The warranty of rightful sale insured that the seller had both the power and the right to sell the good.³⁰ The warranty of quiet possession protected the buyer's possession and use of the good from interference from lawful third party claims.³¹ Lastly, the seller warranted that there was no lien or other encumbrance on the property except those about which the buyer had actual knowledge.³² The warranty was implied in most sales of goods, regardless of whether the seller possessed the goods or knew of third party claims.³³ Notably, the Uniform Sales Act, as the

sell, he will have a right to sell the goods at the time when the property is to pass."

- (2) "An implied warranty that the buyer shall have and enjoy quiet possession of the goods."
- (3) "An implied warranty that the goods shall be free from any charge or incumbrance in favour of any third party, not declared or known to the buyer before or at the time when the contract is made."

Harold Potter & A.K. Kiralfy, *Goodeve's Modern Law of Personal Property* 134 (8th ed. 1937) (quoting *The Sales of Goods Act*).

28. The Uniform Sales Act § 13 provided:

In a contract to sell or a sale, unless a contrary intention appears, there is-

- (1) An implied warranty on the part of the seller that in the case of a sale he has a right to sell the goods, and that in the case of a contract to sell he will have a right to sell the goods at the time when the property is to pass.
- (2) An implied warranty that the buyer shall have and enjoy quiet possession of the goods as against any lawful claims existing at the time of the sale.
- (3) An implied warranty that the goods shall be free at the time of the sale from any charge or incumbrance in favor of any third person, not declared or known to the buyer before or at the time when the contract or sale is made.
- (4) This section shall not, however, be held to render liable a sheriff, auctioneer, mortgagee, or other person professing to sell by virtue of authority in fact or law goods in which a third person has a legal or equitable interest.

U.S.A. § 13, *reprinted in* Williston, *supra* note 13 § 216, at 560 [hereinafter U.S.A.].

29. *Id.*

30. *Id.* § 13(1).

31. *Id.* § 13(2); *Martin v. Coffman*, 95 N.E.2d 286 (Ohio Ct. App. 1949) (holding seller warranted buyer's quiet enjoyment against lawful claims).

32. U.S.A., *supra* note 28, § 13(3); *Olson v. Barnick*, 61 N.W.2d 733 (Iowa 1953) (finding that an encumbrance at the time of sale constituted a breach of the seller's warranty of title); Williston, *supra* note 13, § 218 (stating that implied warranty of title means that a seller "has a perfect title free from incumbrances").

33. *See, e.g.,* *Spotless Co. v. Commercial Trust Co.*, 214 N.Y.S. 10 (App. Div. 1926) (holding seller warrants title to good by implication under Uniform Sales Act regardless of possession); *Little v. Fittro*, 54 N.E.2d 311 (Ohio Ct. App. 1943) (finding the seller liable for breach of warranty of title even though the seller honestly but erroneously believed that the seller owned goods); *Bunch v. D.S. Etheridge Co.*, 180 S.W.2d 225, 226 (Tenn. Ct. App. 1943) (explaining that seller of automobile under Uniform Sales Act impliedly warrants title to and quiet possession of good).

common law had before it, excluded sales by foreclosing mortgagees from the warranty of title.³⁴

C. *Uniform Commercial Code*

The policies codified in U.S.A. section 13 were adopted and simplified by the adoption of the U.C.C. in its warranty of title provision, section 2-312.³⁵ Under Article 2 of the Code, the warranty of title is implied in most sales of goods.³⁶ In sales subject to Article 2, the seller warrants to the buyer that the "title conveyed shall be good, and [the good's] transfer rightful."³⁷ The seller also warrants that the good is "delivered free from any security interest or other lien or encumbrance of which the buyer at the time of contracting has no knowledge."³⁸ The warranty of quiet possession was subsumed under the general warranty of title and became merely one way by which a seller could breach the Code warranty of title.³⁹ Sellers who are merchants regarding goods of the kind sold also warrant that the goods are not subject to a rightful infringement claim of another's intellectual property rights.⁴⁰

The law has continued to develop regarding the warranty of title.⁴¹ As with Article 9 of the Code, revisions of Article 2 are also currently under way. In that revision process, changes have been proposed to

34. U.S.A., *supra* note 28, § 13(4).

35. Hawland & Miller, *supra* note 10, § 2:312:01 (explaining that U.C.C. § 2-312 continued policies of Uniform Sales Act § 13 while simplifying language and clarifying requirements for disclaimer of warranty).

36. U.C.C. § 2-312 provides:

- (1) Subject to subsection (2) there is in a contract for sale a warranty by the seller that
 - (a) the title conveyed shall be good, and its transfer rightful; and
 - (b) the goods shall be delivered free from any security interest or other lien or encumbrance of which the buyer at the time of contracting has no knowledge.
- (2) A warranty under subsection (1) will be excluded or modified only by specific language or by circumstances which give the buyer reason to know that the person selling does not claim title in himself or that he is purporting to sell only such right or title as he or a third person may have.
- (3) Unless otherwise agreed a seller who is a merchant regularly dealing in goods of the kind warrants that the goods shall be delivered free of the rightful claim of any third person by way of infringement or the like but a buyer who furnishes specifications to the seller must hold the seller harmless against any such claim which arises out of compliance with the specifications.

U.C.C. § 2-312.

37. *Id.* § 2-312(1)(a).

38. *Id.* § 2-312(1)(b).

39. *Id.* § 2-312 cmt. 1.

40. *Id.* § 2-312(3).

41. The warranty of title has expanded into the international sales context. The Convention on the International Sales of Goods provides that the seller is required to deliver goods "free from any right or claim of a third party" in the absence of an

section 2-312.⁴² While the parameters of the warranty remain essentially unchanged, the revision makes clear that the title and transfer must not only be good and rightful, but also uncontested.⁴³ The revision would also extend seller's liability to a remote buyer, eliminating privity as a defense.⁴⁴

D. *Extent of Warranty of Title*

When the warranty of title attaches, the seller warrants not only its own title and conduct, but that of all its predecessors in interest as

agreement to the contrary. United Nations Convention on the International Sale of Goods Art. 41, *reprinted in* 52 Fed. Reg. 6264, 6270 (1987).

42. The most recent draft of revised U.C.C. § 2-312 provides:

- (a) Subject to subsection (b), a contract for sale contains a warranty by a seller, including an auctioneer or liquidator who fails to disclose its principal, that:
 - (1) the title conveyed is good and uncontested and its transfer is rightful and does not unreasonably expose the buyer to a lawsuit; and
 - (2) the goods will be delivered free from any security interest or other lien or encumbrance of which the buyer at the time of contracting does not have knowledge.
- (b) A warranty under subsection (a) may be excluded or modified only by specific language or by circumstances giving the buyer reason to know that the seller does not claim title or purports to sell only such right or title as the seller or a third party may have. Language in a record is sufficient to exclude warranties under this section if it is conspicuous and states "There is no warranty of title or against infringement in this sale," or words of similar effect.
- (c) Unless otherwise agreed, a seller who deals in goods of the kind sold warrants that the goods will be delivered free of the rightful claim of a third party by way of infringement or the like. However, a buyer who furnishes specifications to the seller holds the seller harmless against any claim that arises out of compliance with the specifications.
- (d) A seller's warranty of title, made to an immediate buyer, extends to any remote buyer who may reasonably be expected to buy the goods and who suffers damage from breach of the warranty. The rights and remedies of a remote buyer against the seller for breach of warranty are determined by the enforceable terms of the contract between the seller and the immediate buyer and this article.

Nat'l Conf. of Comm'rs on Uniform St. Ls., U.C.C. § 2-312 (Proposed Draft 1996) (visited May 6, 1996) <<http://www.law.upenn.edu/library/ulc/ucc2/textm96.htm>> (on file with the *Fordham Law Review*) [hereinafter Draft, Article 2]. A more recent draft of U.C.C. article 2 was available on the World Wide Web at <http://www.upenn.edu/library/ulc/ucc2/ml1draft.htm> on March 31, 1997 (on file with the *Fordham Law Review*), however, the substance of the new proposal does not affect this Article. All references to the proposed U.C.C. article 2 are to Draft, Article 2 *supra*.

43. *Id.* § 2-312 n.2. ("[S]eller also warrants that the title is uncontested. This protects the buyer against various 'cloud's on an otherwise good title that affect the value of the goods.'").

44. *Id.* § 2-312(d); *see also id.* n.7 (explaining that, under revised section, privity will not be a defense against a remote buyer claiming a breach of the warranty of title, however, the remote buyer's rights will be limited by the contract between the seller and its buyer).

well.⁴⁵ Intent or knowledge on the part of the seller regarding the nature of title conveyed is irrelevant.⁴⁶ The warranty is breached unless the seller "transfers to his purchaser 'a good, clean title . . . in a rightful manner so that [the buyer] will not be exposed to a lawsuit in order to protect it.'"⁴⁷ The seller's ignorance of the defect is no defense.⁴⁸ Once the warranty attaches, the seller is strictly liable for any breach thereof.

A seller breaches the warranty of title when transferring a good received from a thief,⁴⁹ or converter,⁵⁰ or subject to a paramount secur-

45. *Crook Motor Co. v. Goolsby*, 703 F. Supp. 511, 518 (N.D. Miss. 1988) (discussing refund of purchaser price to buyer from innocent final seller); *Marvin v. Connelly*, 252 S.E.2d 562 (S.C. 1979) (finding breach of warranty where seller's predecessor in title had stolen trailer from rightful owner); see *Ricklefs v. Clemens*, 531 P.2d 94, 100 (Kan. 1975) (finding defendant seller liable for damages for breach of warranty of title for sale of stolen vehicle although seller was unaware of theft); *Riggs Motor Co. v. Archer*, 240 S.W.2d 75, 76 (Ky. Ct. App. 1951) (awarding damages to buyer where seller unknowingly conveyed a stolen good); James J. White & Robert S. Summers, Uniform Commercial Code, § 9-12, at 422 (3d ed. 1988) (stating that to be liable for breach of warranty of title, "the seller need not be a merchant, and he is not saved by his own ignorance of the defect in his title"); see also *Keller v. Judd*, 671 S.W.2d 604 (Tex. Ct. App. 1984) (holding innocent seller liable for breach of warranty of title where seller unknowingly sold stolen automobile).

46. *White & Summers*, *supra* note 45, § 9-12, at 422 (explaining that seller's knowledge of defect resulting in breach of warranty of title is irrelevant); see, e.g., *Crook*, 703 F. Supp. at 518-20 (holding that a seller of stolen truck is not liable for fraud when a buyer failed to prove that the seller knew that the truck was stolen, however, the seller is still liable for breach of warranty of title); *Brokke v. Williams*, 766 P.2d 1311, 1313 (Mont. 1989) (finding pawn broker liable for breach of warranty of title even though seller did not know that goods sold were stolen); *Marvin*, 252 S.E.2d at 563 (stating, in dicta, seller "not saved by his own ignorance" in action for breach of warranty of title (quoting *White & Summer*, *supra* note 45, at 299-300)); *Colton v. Decker*, 540 N.W.2d 172, 176 (S.D. 1995) (stating neither seller's good faith nor ignorance of defect constitutes defense to breach of warranty of title).

47. *Jefferson v. Jones*, 408 A.2d 1036, 1039 (Md. 1979) (quoting Md. Code Ann. (1975), Commercial Law Act., § 2-312, cmt. 1).

48. See, e.g., *Ricklefs*, 531 P.2d at 99-100 (finding seller liable for breach of warranty even though seller did not know good sold had been stolen); *Riggs Motor Co.*, 240 S.W.2d at 76 (same).

49. *Lawson v. Turner*, 404 So. 2d 424 (Fla. Dist. Ct. App. 1981) (upholding the trial court's finding that the seller breached the warranty of title by delivering a truck that was later determined to be stolen); *Shelly Motors, Inc. v. Bortnick*, 664 P.2d 755, 757 (Haw. Ct. App. 1983) (affirming the judgment that an automobile dealer breached warranty of title when the dealer sold a stolen vehicle to another dealership); *Riggs Motor Co.*, 240 S.W.2d at 76 (finding that an innocent buyer entitled to recover damages under warranty of title from an innocent seller of stolen a good); *John St. Auto Wrecking v. Motors Ins. Corp.*, 288 N.Y.S.2d 281, 284 (Dist. Ct. 1968) (holding that the sale of a stolen car by unknowing seller breached the warranty of title); *Marvin*, 252 S.E.2d at 563 (holding a seller's failure to convey good title because seller's interest in trailer derived from a thief as a breach of the warranty of title).

50. See *Kirby Forest Indus., Inc. v. Dobbs*, 743 S.W.2d 348, 355-57 (Tex. Ct. App. 1987) (permitting buyer of timber to be indemnified under breach of warranty for timber that was innocently taken from land that was improperly described in timber lease); see also *McDonald's Chevrolet, Inc. v. Johnson*, 376 N.E.2d 106 (Ind. Ct. App. 1978). In *McDonald's Chevrolet*, the Indiana Court of Appeals found a breach of the warranty of title when the goods transferred had originally been wrongfully retained

ity interest or lien of which the buyer does not have knowledge.⁵¹ The buyer is protected unless the buyer has actual knowledge of the defect.⁵² Mere record notice is not enough.⁵³ There is no Code requirement that the buyer act reasonably or diligently in protecting her interest.⁵⁴ A buyer who chooses not to inquire into the state of the title or existence of outstanding liens is protected in the same manner as the innocent buyer who does not think about conducting an investigation.

and sold by a lessee after the expiration of the lease. Although the Court refers to the good as “stolen,” it would more appropriately be characterized as “converted” because possession by the lessee/converter had originally been lawful. *Id.* at 108-09; see Daphne D. Sipes, *Effects of Conversion and Trade Custom on Article 2 Titles*, 11 Am. J. Trial Advoc. 277, 280-282 (1987) (discussing difference between theft and conversion); see also *Christensen v. Pugh*, 36 P.2d 100, 102 (Utah 1934) (stating focus of theft is conduct of thief, while “gist of conversion is . . . wrongful deprivation” of rightful owner).

51. U.C.C. § 2-312(1)(b); see, e.g., *Christopher v. McGehee*, 183 S.E.2d 624, 626 (Ga. Ct. App.) (finding that buyer entitled to damages where good conveyed subject to superior security interest of which buyer had no knowledge and under which good was repossessed), *aff’d*, 186 S.E.2d 97, 98 (Ga. 1971); *Elias v. Dobrowolski*, 412 A.2d 1035 (N.H. 1980) (holding seller liable for breach of warranty of title where inventory sold was subject to valid security interest).

52. U.C.C. § 2-312(1)(b) provides that the seller warrants against encumbrances of which buyer has “no knowledge” and U.C.C. § 1-201(25) defines “knows” and “knowledge” as “when [a person] has actual knowledge.” See U.C.C. § 2-312 cmt. 1 (noting the knowledge requirement of § 2-312(1)(b) means “actual knowledge as distinct from notice”); *Elias*, 412 A.2d at 1036-37 (holding that the buyer was entitled to recover under warranty of title where buyer had constructive notice, but not actual knowledge of security interest in goods); *Christopher*, 183 S.E.2d at 626 (holding that warranty of title was breached unless the buyer has actual knowledge of defect, thus buyer’s uncontroverted testimony that he had no actual knowledge of lien sufficient to permit buyer to recover where car was sold subject to recorded lien); William D. Hawkland, *Sales and Bulk Sales* 84 (3d ed. 1976) (explaining that the justification for actual knowledge standard in warranty of title is that buyer will pay less if the buyer knows of any outstanding encumbrance but the price will not reflect the lien if buyer does not have actual knowledge).

53. See, e.g., *Sumner v. Fel-Air, Inc.*, 680 P.2d 1109, 1113 n.8 (Alaska 1984) (dismissing, as irrelevant, seller’s contention that documents of title filed with FAA gave buyer constructive notice of superior interest because UCC requires actual knowledge on the part of the buyer); *Elias*, 412 A.2d at 1036-37 (holding that actual knowledge and not mere notice of outstanding filed security interest are necessary to defeat a claim for breach of warranty of title).

54. Hawkland & Miller, *supra* note 10, § 2-312:03 (explaining that buyer is under no duty to check the filing offices for security interests in goods to be purchased); Sipes, *supra* note 50, at 293 (explaining, in a warranty of title action, the buyer need not prove he acted in good faith to determine whether goods were subject to an encumbrance); see, e.g., *Gary Aircraft Corp. v. General Dynamics Corp.*, 681 F.2d 365, 376 (5th Cir. 1982) (holding that the buyer’s failure to search records for outstanding liens does not constitute bad faith), *cert. denied*, 462 U.S. 1131 (1983); *Northern Illinois Corp. v. Bishop Distrib. Co.*, 284 F. Supp. 121, 125 (W.D. Mich. 1968) (holding that buyer had no duty to search the records for liens before buying an airplane from the dealer); *D’Englere v. Lander Motors, Inc.*, 84 S.E.2d 460, 468 (Ga. Ct. App. 1954) (stating that there was no burden on purchaser to search records throughout the state to determine if goods sold were subject to outstanding liens).

The warranty also protects the buyer from claims against the goods asserted by third parties.⁵⁵ The warranty may also be breached when a third party disturbs the possession of the buyer by raising a colorable claim to the good.⁵⁶ Most courts agree that the warranty is breached if the buyer must defend against a colorable claim, regardless of whether the claim is ultimately determined to be superior to that of the buyer.⁵⁷ A provision in the proposed revision to section 2-312 would codify this majority rule.⁵⁸

55. U.C.C. § 2-312 cmt. 1; *Hawkland & Miller*, *supra* note 10, § 2-312:02 at 387 (explaining that the buyer is entitled to hold goods "in peace, free from concern that substantial claims can be made impugning his ownership rights or disturbing his ability to sell the goods"); *see City Car Sales, Inc. v. McAlpin*, 380 So. 2d 865, 867 (Ala. Civ. App. 1979) (casting of substantial shadow over purchaser's title to automobile is sufficient to violate the warranty of title), *writ denied*, 380 So. 2d 869 (Ala. 1980); *Ricklefs v. Clemens*, 531 P.2d 94, 99-100 (Kan. 1975) (recognizing that a shadow on title was sufficient for finding a breach of the warranty of title); *Mercer v. Braziel*, 746 P.2d 702, 705-06 (Okla. Ct. App. 1987) (holding that seller breached warranty of title where claim of insurance company that vehicle was stolen casted a shadow on title regardless of the validity of the claim).

56. Although Comment 1 to U.C.C. § 2-312 states that the common law warranty of quiet possession was abolished under the Code, the Comment goes on to explain that "[d]isturbance of quiet possession, although not mentioned specifically, is one way, among many, in which the breach of the warranty of title may be established." U.C.C. § 2-312 cmt. 1. The Comment also emphasizes that the buyer should receive good title, rightfully transferred, "so that he will not be exposed to a lawsuit in order to protect it." *Id.*; *see Wright v. Vickaryous*, 611 P.2d 20, 22 (Alaska 1980) (holding that failure of seller to disclose to buyer that security interests in goods were released resulted in a cloud on buyer's title sufficient to constitute a breach of the warranty of title); *American Container Corp. v. Hanley Trucking Corp.*, 268 A.2d 313, 317-318 (N.J. Super. Ct. Ch. Div. 1970) (stating that a purchaser of goods "has a right to rely on the fact that he will not be required, at some later time, to enter into a contest over the validity of his ownership"); *Saenz Motors v. Big H. Auto Auction, Inc.* 653 S.W.2d 521, 525 (Tex. Ct. App. 1983) (holding that confiscation by government agency of automobile was a breach of warranty of title regardless of whether the automobile was actually stolen), *aff'd*, 665 S.W.2d 756 (Tex. 1984).

57. *See, e.g., Frank Arnold Contractors, Inc. v. Vilsmeier Auction Co.*, 806 F.2d 462, 464 (3d Cir. 1986) (stating that the majority of courts find a breach of warranty of title where buyer demonstrated cloud on title regardless of whether third party claimant's title was ultimately proved as superior); *Jefferson v. Jones*, 408 A.2d 1036, 1039-40 (Md. Ct. App. 1979) (holding that the buyer was entitled to recover damages for breach of warranty of title when the buyer was subjected to third party's claim to goods, even if third party's claim ultimately determined to be inferior to buyer's title); *Colton v. Decker*, 540 N.W.2d 172, 175-176 (S.D. 1995) (holding that a better rule was that the initiation of a colorable, non-spurious claim against title was sufficient to establish a breach of warranty of title regardless of whether the claim was ultimately determined to be superior to the buyer's title); *Horta v. Tennison*, 671 S.W.2d 720, 723 (Tex. Ct. App. 1984) (upholding the trial court's finding of a breach of warranty of title where the buyer's "quiet possession" had been disturbed by one claiming to be the owner); *White & Summers*, *supra* note 45, § 9-12, at 488-89 (stating that the rule that seller is liable for damages to a buyer who must defend title to goods is the "better" rule).

58. Draft, Article 2, *supra* note 42, § 2-312(a)(1) (providing that the seller warrants that the "transfer is rightful and does not unreasonably expose the buyer to a lawsuit").

If the seller breaches the warranty of title, the seller is liable to the buyer for damages.⁵⁹ The buyer, generally, is entitled to more than the return of the purchase price paid.⁶⁰ As damages for a breach of the warranty of title, the seller must pay the buyer damages for loss of the good plus incidental and consequential damages.⁶¹ When the seller has breached a Code warranty, the buyer's measure of damages is the difference between the value of the goods as accepted and as warranted at the time and place of acceptance.⁶² This is also the measure of damages for a breach of the warranty of title⁶³ unless the court finds special circumstances which justify damages of a different amount.⁶⁴ If a buyer purchases a good without receiving good title,

59. U.C.C. § 2-711.

60. See, e.g., *Jerry Parks Equip. Co. v. Southeast Equip. Co.*, 817 F.2d 340, 343 (5th Cir. 1987) (finding that the appropriate measure of damages for a breach of warranty is the value of the goods at the place of acceptance, and not return of the purchase price); *Metalcraft, Inc. v. Pratt*, 500 A.2d 329, 336 (Md. Ct. Spec. App. 1985) (noting that the courts have "uniformly rejected" purchase price as proper measure of damages in warranty of title actions); *Bremen Elevator Co. v. Farmers & Merchants Bank*, 216 N.W. 203, 205-06 (N.D. 1927) (holding that the buyer's damages in suit for breach of warranty of title was not limited to purchase price); *Colton*, 540 N.W.2d at 176 (holding that the measure of damages for breach of warranty of title is the value of the goods at time of dispossession). But see *Landmark Motors, Inc. v. Chrysler Credit Corp.*, 662 N.E.2d 971, 976 (Ind. Ct. App. 1996) (stating, in dicta, that under Kentucky law, the buyer was only entitled to recover the purchase price paid, not fair market value of good, for breach of warranty of title).

61. U.C.C. § 2-714; see, e.g., *Crook Motor Co. v. Goolsby*, 703 F. Supp. 511, 521-523 (N.D. Miss. 1988) (explaining buyer entitled to damages under U.C.C. § 2-714, including incidental and consequential damages, for breach of warranty of title); *Colton*, 540 N.W.2d at 176-177 (same); see also *Peel v. St. Ann*, 3 La. App. 447 (1926) (holding, in pre-UCC case, buyer may recover actual loss suffered not purchase price in warranty of title action).

U.C.C. § 2-714 (2) and (3) provide:

- (2) The measure of damages for breach of warranty is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount.
- (3) In a proper case any incidental and consequential damages under [section 2-715] may also be recovered.

U.C.C. § 2-714(2)-(3).

62. U.C.C. § 2-714(2).

63. See *Jerry Parks*, 817 F.2d at 343 (finding that under U.C.C. § 2-714(2), the appropriate measure of damages for breach of warranty is the value of the goods at a place of acceptance); *Metalcraft*, 500 A.2d at 336 (explaining that provisions of U.C.C. § 2-714(2) with respect to damages for breach of warranty also apply to breaches of warranty of title). See generally Roy R. Anderson, *Buyer's Damages for Breach in Regard to Accepted Goods*, 57 Miss. L.J. 317, 365-68 (1987) (discussing the measure of damages for breach of warranty of title under the U.C.C.); Jane M. Draper, Annotation, *Measure of Damages in Action for Breach of Warranty of Title to Personal Property Under U.C.C. § 2-714*, 94 A.L.R.3d 583, 583-93 (1979).

64. U.C.C. § 2-714(2); see *Jeanneret v. Vichey*, 541 F. Supp. 80, 85 (S.D.N.Y.) (noting that the New York courts have used special circumstances exception to U.C.C. § 2-714(2) when determining breach of warranty of title involving unique goods), *rev'd on other grounds*, 693 F.2d 259 (2d Cir. 1982); *Metalcraft*, 500 A.2d at 336 (finding damages may be different than value of goods at time of acceptance if special

the value of the good as accepted is zero.⁶⁵ The value of the good as accepted with good title, would be the fair market value of the goods. The buyer, therefore, will be entitled to recover—as damages for the seller's failure to convey good title—the fair market value of the goods. This amount may be greater or less than the purchase price paid.⁶⁶

The buyer, in appropriate cases, may also recover incidental and consequential damages. Recoverable incidental damages include expenses which are "reasonably incurred in inspection, receipt, transportation and care and custody" of the goods.⁶⁷ These expenses generally arise from the buyer's need to deal with the goods or obtain their replacements.⁶⁸ Consequential damages arise not from the buyer-seller relationship, but from the special needs of the buyer which the seller may reasonably foresee.⁶⁹ Examples of consequential damages which may be recoverable include damages for loss of use of the good, finance charges, sales and use taxes paid on the good, and repair

circumstances exist); *Schneidt v. Absey Motors, Inc.*, 248 N.W.2d 792, 798 (N.D. 1976) (using date of dispossession as date for determining damages where good had appreciated since purchase).

65. See *Jerry Parks*, 817 F.2d at 343 (explaining calculation of value of goods in determining damages for breach of contract).

66. One example of when the fair market value of the goods may exceed the purchase price is when the good is purchased at a foreclosure sale. *Meadows*, *supra* note 2, at 203-04, 206 (noting that the price of good at foreclosure sale is generally below the fair market value); see also Craig H. Averch & Michael J. Collins, *Avoidance of Foreclosure Sales as Preferential Transfers: Another Serious Threat to Secured Creditors?*, 24 Tex. Tech. L. Rev. 985, 989-90 (1993) (arguing that foreclosure sales often do not generate even liquidation value of collateral sold); William H. Henning, *An Analysis of Durrett and Its Impact on Real and Personal Property Foreclosures: Some Proposed Modifications*, 63 N.C. L. Rev. 257, 258 (1985) (noting that courts may sustain foreclosure sales even though the collateral was sold for far less than market value).

67. U.C.C. § 2-715(1) provides:

Incidental damages resulting from the seller's breach include expenses reasonably incurred in inspection, receipt, transportation and care and custody of goods rightfully rejected, any commercially reasonable charges, expenses or commissions in connection with effecting cover and any other reasonable expense incident to the delay or other breach.

U.C.C. § 2-715(1).

68. See *Colton v. Decker*, 540 N.W.2d 172, 176-77 (S.D. 1995) (finding that costs associated with the impoundment and retrieval of a truck confiscated by government officials were recoverable as incidental damages—reasonable expenses in dealing with the truck resulting from the breach of warranty of title). See generally *Petroleo Brasileiro, S.A., Petrobras v. Ameropan Oil Corp.*, 372 F. Supp. 503, 508 (E.D.N.Y. 1974) (discussing plaintiff's right to recover incidental damages).

69. *Petroleo Brasileiro*, 372 F. Supp. at 508 (explaining consequential damages do not arise from buyer-seller relationship but from buyer's special requirements for the goods). U.C.C. § 2-715(2)(a) provides:

(2) Consequential damages resulting from the seller's breach include (a) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise.

U.C.C. § 2-715(2)(a).

costs.⁷⁰ If the buyer has incurred expenses in defending title to the good, the buyer is entitled to indemnification for these amounts, including reasonable attorney fees.⁷¹ A buyer who has paid damages to the true owner of the good is also entitled to indemnification from the seller for the damages paid.⁷²

Additionally, the seller may be liable for the damages not only to its immediate buyer but also to remote buyers who purchase the good later. While courts are currently split on whether a remote buyer can recover from a seller,⁷³ the proposed revision to section 2-312 would make it clear that the warranty does extend to remote buyers.⁷⁴

II. POTENTIAL PROBLEMS WITH EXTENDING WARRANTY OF TITLE COMPLETELY TO FORECLOSURE SALES

As previously stated, secured parties who sell collateral at foreclosure sales do not warrant title. The proposed revision to Article 9

70. See Anderson, *supra* note 63, at 354-62 (discussing the categories of consequential damages); see also *Riggs Motor Co. v. Archer*, 240 S.W.2d 75, 76 (Ky. 1951) (holding that the buyer was entitled to recover the costs of repairs and improvements to the vehicle as consequential damages in warranty of title action); *Rex Auto Exchange v. Hoffman, Inc.*, 84 Pa. Super. 369 (1925) (holding that where the seller knew that the buyer was a dealer of used cars, the court could reasonably assume that the seller knew that the buyer would refurbish car, and, therefore, the buyer was entitled to recover the costs of repairs to vehicle as damages for breach of warranty of title).

71. See, e.g., *Universal C.I.T. Credit Corp. v. State Farm Mut. Auto. Ins. Co.*, 493 S.W.2d 385, 391 (Mo. Ct. App. 1973) (holding that a buyer in a warranty of title action may recover expenses incurred in defense of title to good, including attorney fees); *Colton*, 540 N.W.2d at 178 (holding that attorney fees incurred to clear title were recoverable, while attorney fees incurred in litigation between buyer and seller were not); *Murray v. Holiday Rambler, Inc.*, 265 N.W.2d 513, 527 (Wis. 1978) (finding that attorney fees and costs incurred in defense of third party claim recoverable as consequential damages in warranty of title action unless specifically included in the statute or contract of the parties); see also *Alterman Foods, Inc. v. G.C.C. Beverages, Inc.*, 310 S.E.2d 755, 757-58 (Ga. Ct. App. 1983) (holding that a buyer was entitled to recover as consequential damages attorney fees incurred in defense of a third party claim in a warranty action); *Noel v. Wheatly*, 30 Miss. 181, 192-93 (1855) (holding, in early common law case, buyer entitled to recover cost of defending title from seller in warranty of title action). See generally David T. Schaefer, Note, *Attorney's Fees for Consumers in Warranty Actions—An Expanding Role for the U.C.C.?*, 61 Ind. L.J. 495 (1986) (discussing recovery of attorney fees in breach of warranty actions).

72. U.C.C. § 2-607(5)(a) binds a seller, who, after receiving notice of a claim against its buyer, refuses to defend warranty action brought by third party, to the outcome of the litigation between the buyer and third party. See *Universal C.I.T. Credit Corp.*, 493 S.W.2d at 392 (discussing a buyer's right to indemnification in warranty of title action).

73. See David Frisch & John D. Wladis, *General Provisions, Sales, Bulk Transfers, and Documents of Title*, 45 Bus. Law. 2289, 2300-01 n.62 (1990) (discussing the current division of the courts regarding whether seller is liable to a remote buyer for a breach of the warranty of title under the current version of U.C.C. §§ 2-312 and 2-318). Compare *Mitchell v. Webb*, 591 S.W.2d 547, 550 (Tex. Civ. App. 1979) (holding lack of privity between remote buyer and seller no defense to suit for breach of warranty of title) with *Crook Motor Co. v. Goolsby*, 703 F. Supp. 511, 519 (N.D. Miss. 1988) (rejecting lack of privity as defense in action by remote buyer).

74. See *supra* notes 41-42 and accompanying text.

would change this by extending full Article 2 warranty of title protection to purchasers at foreclosure sales. While the goal of the drafters of the revisions to Article 9—to protect purchasers at foreclosure sale—is a laudable one, the manner in which the drafters have chosen to accomplish this goal is faulty. The wholesale adoption of the Article 2 warranties of title into a foreclosure sale will result in a number of potential problems, which, at a minimum, will result in litigation, and at worst, will create more harm than that which it was intended to remedy. This section will look at several problems created by imposing the warranty of title under Article 2 to its fullest extent to a selling secured party.

A. *Warranty of Title and Foreclosure Sales*

The theory behind holding a seller liable for defects in the title, even when the seller has no knowledge or notice and has at all times acted reasonably and honestly, rests on a basic assumption: that the current seller by dealing with the former owner is in a better position to determine potential problems with the title.⁷⁵ Each buyer and seller in the chain of title to a good is assumed to have this capability thus requiring each to investigate and not purchase blindly. The seller has special knowledge with respect to the circumstances under which it obtained and used the good, and has greater knowledge about prior owners and potential claimants. The seller, because of its greater knowledge or access to the history of the good, assumes the risk of a prior defect in the title, even if the seller has no knowledge of the defect.⁷⁶ In a voluntary sale under Article 2 in which the warranty of title is implied,⁷⁷ the seller generally represents that it owns the goods

75. See, e.g., *Basiliko v. Pargo Corp.*, 532 A.2d 1346, 1349 (D.C. 1987) (stating where sale failed due to circumstances with knowledge of seller, it would be unfair to require buyer to suffer loss due to mistake); *Trans World Airlines, Inc. v. Skyline Air Parts, Inc.*, 193 A.2d 72, 74 (D.C. 1963) (noting that the seller, because of his ownership, has superior knowledge of potential claims against a good by third parties; he must bear risk of its inability to convey title to buyer because of a third party claim).

76. See, e.g., *Crook Motor Co.*, 703 F. Supp. at 520 (holding a seller of stolen truck liable for breach of warranty of title, but not fraud, when the buyer failed to prove that the seller knew that the vehicle was stolen); *Ricklefs v. Clemens*, 531 P.2d 94, 99-100 (Kan. 1975) (same); *Riggs Motor Co. v. Archer*, 240 S.W.2d 75, 75-76 (Ky. 1951) (finding innocent seller liable for breach of warranty in sale of stolen good); *Brokke v. Williams*, 766 P.2d 1311, 1313 (Mont. 1988) (finding pawn broker liable for breach of warranty of title even though seller did not know that goods sold were stolen); *Marvin v. Connelly*, 252 S.E.2d 562, 563 (S.C. 1979) (stating, in dicta, that a seller is "not saved by his own ignorance" in action for breach of warranty of title").

77. Article 2 generally governs voluntary transactions regarding sales of goods. See U.C.C. § 1-102 & cmts. 1-2 (describing purpose of U.C.C. to promote expansion of commercial practices); U.C.C. § 1-201(3) (defining agreement as "bargain of the parties in fact"); U.C.C. § 2-102 (providing Article 2 applies to transactions in goods); U.C.C. § 2-106(1) (defining sale as "passing of title from the seller to the buyer for a price").

and is selling its interest.⁷⁸ These general assumptions coupled with the seller's representation to the buyer that the seller owns the goods provides ample justification for imposing strict liability on the seller if the title to the good is defective.

Neither of these underlying premises are valid, however, with respect to a secured creditor's position at foreclosure sales. The selling secured party does not represent to the buyer that it owns the good. Buyers at a properly conducted foreclosure sale know that the seller holds a security interest in the good, and that the seller is selling the debtor's interest in the good.⁷⁹ Recognizing the distinct nature of sales by a party other than the owner, the drafters of the Code provided that the warranty of title does not attach to a sale when the buyer has reason to know that the seller does not claim title or is only selling a limited interest.⁸⁰ Historically, sales of this type, in which the warranty of title did not attach, included judicial sales and foreclosure sales, including those conducted under Article 9.⁸¹ This exemption

78. See U.C.C. § 2-312(2) (limiting warranty of title if seller purports not to be the owner or to be selling only a limited interest); see also *Fulwell v. Brown*, 121 N.W. 265, 267 (Mich. 1909) (stating that modern rule in England and United States is that sale of personal property implies affirmation by seller that he owns property and has right to sell it); *Motley v. Darling*, 98 A. 384 (N.J. 1916) (finding warranty of title in sale in which buyer paid full price and circumstances showed intent to transfer absolute title).

79. See, e.g., *Niland v. Deason*, 825 F.2d 801, 811 (5th Cir. 1987) (explaining that a secured creditor only has security interest in collateral—title never vests in creditor; therefore, in foreclosure sale, the debtor's interest is transferred directly to purchaser); *Sandel v. Burney*, 714 S.W.2d 40, 41 (Tex. Ct. App. 1986) (same).

80. U.C.C. § 2-312(2); see also *Bank of Nova Scotia v. Equitable Fin. Management*, 708 F. Supp. 678, 683 (W.D. Pa.) (holding that suspicious circumstances should have put buyer on notice of potential claims against machinery), *aff'd*, 882 F.2d 81 (3d Cir. 1989); *Simmons Mach. Co. v. M & M Brokerage, Inc.*, 409 So. 2d 743, 752-53 (Ala. 1981) (finding warranty of title did not attach to transfer where buyer knew of possible security interest in good); *Landmark Motors, Inc. v. Chrysler Credit Corp.*, 662 N.E.2d 971, 975 (Ind. Ct. App. 1996) (finding, under Kentucky law, buyer knew or should have known that title to good was questionable and that seller was selling only interest it had at foreclosure auction, thus making no warranty of title to buyer).

81. U.C.C. § 2-312 cmt. 5. The comment provides that:

Subsection (2) recognizes that sales by sheriffs, executors, foreclosing lienors and persons similarly situated are so out of the ordinary commercial course that their peculiar character is immediately apparent to the buyer and therefore no personal obligation is imposed upon the seller who is purporting to sell only an unknown or limited right.

Id.; *Vend-A-Matic, Inc. v. Foothill Capital Corp.*, 37 B.R. 838, 841-42 (Bankr. E.D. Mich. 1984) (finding that no warranty of title attached to secured creditor's sale of bankrupt debtor's assets); *Harris Intertype Corp. v. Robertson*, 16 Cal. Rptr. 159, 165 (Dist. Ct. App. 1961) (declining to find secured party liable for breach of warranty of title in resale of collateral after debtor's default); *Stuart v. American Sec. Bank*, 494 A.2d 1333, 1338 (D.C. Ct. App. 1985) (stating that caveat emptor applies to foreclosure sales); *Marvin v. Connelly*, 252 S.E.2d 562, 563 (S.C. 1979) (explaining the law is "well settled that where property is sold at a judicial sale, there is no warranty of title flowing to the purchaser and he buys only the interest which the debtor . . . had in the property"). But see *Russell A. Hakes, A Quest for Justice in the Conversion of Security Interests*, 82 Ky. L.J. 837, 898-99 (1993-94) (questioning whether the provisions of

from the warranty of title extended to protect a seller even from liability for defects which were caused by the seller's actions.⁸²

The greater knowledge that is assumed ordinarily on the part of the seller is not present in a foreclosure sale. Accordingly, courts have long rejected extending warranty of title liability to foreclosing secured creditors and reasoned that the creditor and purchaser were in equal positions to determine defects in the chain of title because the seller, who was not the owner of the good, did not deal with previous sellers.⁸³ In obtaining its interest in the good to be sold, the foreclosing secured party dealt with the debtor who is now losing the good involuntarily. The seller, a secured creditor, rather than the owner, neither purchased the good initially, dealt with prior owners, nor has any special knowledge regarding the circumstances surrounding the debtor's acquisition of the good. The seller and purchaser are on almost equal footing in this regard. Because the seller was in no better position to determine the existence of title defects than the purchaser, the purchaser was left to do her own search to determine if there were

U.C.C. § 9-504 that require the application of Article 2 to sales may result in the application of warranty of title liability in foreclosure sales). The National Conference of Commissioners on Uniform State Laws suggests that no warranty of title attaches to Article 9 foreclosure sales under the current versions of U.C.C. §§ 2-312 and 9-504. *See* U.C.C. § 9-504(a) cmt. 1 (Discussion Draft, Sept. 2, 1993) [hereinafter 1993 Draft, Article 9]. The Committee has proposed to change this by revising § 9-504(a) of the Code. Draft, Article 9, *supra* note 8, § 9-504(a).

82. *See, e.g.,* *Hutson v. Wood*, 105 N.E. 343, 348 (Ill. 1914) (holding that a purchaser at an execution or judgment sale is not entitled to the return of the price paid even if the sale is void because of a seller's lack of power to sell); *Diversified, Inc. v. Walker*, 702 S.W.2d 717, 720-23 (Tex. Ct. App. 1985) (holding that a foreclosure purchaser is not entitled to recover lost profits or purchase price paid from a secured party even where the sale is void due to secured party's wrongful conduct). *But see* *Basiliko v. Pargo Corp.*, 532 A.2d 1346, 1349 (D.C. 1987) (holding that in foreclosure sale, the seller, at least, warranted that it had the right to sell); *Bogestad v. Anderson*, 173 N.W. 674, 675 (Minn. 1919) (holding that a seller who knowingly sold collateral after mortgage had been discharged was liable to the purchaser for damages).

83. *See* *Stuart*, 494 A.2d at 1338 (explaining that a trustee selling at a foreclosure sale is under no duty to investigate or to notify a buyer of outstanding encumbrances); *Barnard v. Duncan*, 38 Mo. 170, 186 (1866) (stating that "[w]here the facts, or means of information, concerning the condition and value of the thing sold are equally accessible to both parties," a seller is under no greater duty than a purchaser to ascertain validity of title); *Diversified*, 702 S.W.2d at 722 (stating that the law does not require a foreclosing creditor to investigate or otherwise act reasonably to protect a purchaser from a void foreclosure sale).

title problems.⁸⁴ Thus at common law,⁸⁵ under the U.S.A.⁸⁶ and the Code,⁸⁷ there was no implied warranty of title in a foreclosure sale. This, of course, would change if the current proposal to amend section 9-504 is adopted by the NCCUSL and enacted by the states.

Under the proposed revision, the warranty of title will be implied in Article 9 foreclosure sales providing purchasers of repossessed collateral with title protection heretofore limited to Article 2 buyers. This change reflects the drafters' desire to extend the benefits of title warranties to these purchasers.⁸⁸ The drafters' belief that foreclosure sales were not so out-of-the ordinary as to warrant the different treatment of purchasers in these sales also contributed to the desire to extend the warranties.⁸⁹ The Study Group which initially reviewed Article 9 for possible revision recognized that foreclosure purchasers received no protection if title failed to pass as a result of the foreclosure sale.⁹⁰ Only a revision to the Code could accomplish this change.⁹¹

The current proposal will accomplish a complete about-face from current Code and common law and impose liability on the seller not only for defects caused by the seller, but also for those which predated its interest in the good.⁹² The seller will not only warrant its

84. See *Stuart*, 494 A.2d at 1338 (stating that purchaser at foreclosure sale can and should make his own investigation into the title to the good prior to purchase); *Diversified*, 702 S.W.2d at 722 (holding that a purchaser at foreclosure sale does so "at [his] own risk," and that the obligation to investigate is on purchaser not secured creditor).

85. See *Harris v. Lynn*, 25 Kan. 281 (1881) (finding no warranty of title in judicial sale pursuant to mortgage); *Cohn v. Amidown*, 24 N.E. 944 (N.Y. 1890) (denying purchaser recovery under warranty of title in sale by mortgagee); see also *Williston*, *supra* note 13, § 220 (explaining that at common law those who sold under authority of law or fact, including foreclosing mortgagees, did not warrant title).

86. See U.S.A., *supra* note 28, § 216(4) (stating that the section providing for warranty of title in sale of good "shall not, however, be held to render liable a sheriff, auctioneer, mortgagee, or other person professing to sell by virtue of authority in fact or law goods in which a third person has a legal or equitable interest.").

87. U.C.C. § 2-312 cmt. 5; see also *Vend-A-Matic, Inc. v. Foothill Capital Corp.* 37 B.R. 838, 841-42 (Bankr. E.D. Mich. 1984) (finding no warranty of title in sale of bankrupt debtor's assets by secured lender); *Harris Intertype Corp. v. Robertson*, 16 Cal. Rptr. 159, 165 (1961) (holding that no warranty of title is implied in the sale of collateral by secured party after debtor's default).

88. See Draft, Article 9, *supra* note 8, § 9-504 reporter's cmt. 2.

89. *Id.* § 9-504 reporter's cmt. 2 (explaining draft rejects assumption that foreclosure sales are "out of the ordinary course" or "peculiar").

90. See *id.* § 9-504(4) reporter's cmt. 3 (recognizing that under current U.C.C. § 2-312 and the comments thereto no warranty of title attaches to judicial or foreclosure sale).

91. *Id.*; *id.* § 9-504 reporter's cmt. 2 (explaining draft conflicts with current law as explained in official comment 5 to U.C.C. § 2-312, which clarifies that no warranty of title attaches to judicial or foreclosure sales).

92. U.C.C. § 2-312(4) provides for an additional warranty given in certain transactions, the warranty against infringement. Sellers who are merchants with respect to goods of the kind sold warrant that the goods "shall be delivered free of the rightful claim of any third person by way of infringement or the like." U.C.C. § 2-312(4) (quoting unnamed source). Although generally a secured party will not be a

right to transfer the goods under a valid security interest, but will also warrant both that the debtor's title is good and that no unknown encumbrances exist.⁹³

Under the warranty of title as extended to foreclosure sales, if the seller does not transfer good, unencumbered title to the purchaser, it will have breached the warranty. If the good is subject to any encumbrances which survive the sale,⁹⁴ the seller will be responsible for curing the defect, or incur liability for damages.⁹⁵ If the seller fails to convey good title to the purchaser, the seller will also be liable to the purchaser for damages, generally equal to the fair market value of the

merchant with respect to the good sold, a financing seller who reposes and sells the collateral may be. This warranty, however, will generally not apply to a typical foreclosure sale. For discussions of the warranty against infringement under this section, see William F. Dudine, Jr., *Warranties Against Infringement Under the Uniform Commercial Code*, 36 N.Y. St. B.J. 214 (1964) and Joseph J. Schwerha IV, *Warranties Against Infringement in the Sale of Goods: A Comparison of U.C.C. § 2-312(3) and Article 42 of the U.N. Convention on Contracts for the International Sale of Goods*, 16 Mich. J. Int'l L. 441 (1995).

93. U.C.C. § 2-312(1).

94. U.C.C. § 9-504(4) provides that the sale by the secured creditor after default discharges the debtor's interest, the interest of the selling secured party and any interest subordinate to the seller. Interests which have priority over that of the seller survive. *E.g.*, *Continental Bank v. Krebs*, 540 N.E.2d 1023, 1026 (Ill. App. Ct. 1989) (finding that the senior secured party retains a security interest in the collateral notwithstanding junior creditor's sale of collateral after debtor's default); *Chadron Energy Corp. v. First Nat'l Bank of Omaha*, 459 N.W.2d 718, 732-33 (Neb. 1990) (explaining that under the U.C.C., a senior secured party's lien is not discharged by junior creditor's foreclosure sale of collateral); *see also* David Frisch, *The Implicit "Takings" Jurisprudence of Article 9 of the Uniform Commercial Code*, 64 Fordham L. Rev. 11, 23-24 (1995) (noting that a buyer at foreclosure sale takes collateral subject to any lien superior to that of the seller); Lynn M. LoPucki, *The Unsecured Creditor's Bargain*, 80 Va. L. Rev. 1887, 1939-40 (1994) (stating that a senior lien survives the sale of collateral after default); Luize E. Zubrow, *Rethinking Article 9 Remedies: Economic and Fiduciary Perspectives*, 42 UCLA L. Rev. 445, 457 (1994) (explaining the interest acquired by a foreclosure purchaser from a junior secured creditor subordinate to a senior creditor's lien).

95. *Catlin Aviation Co. v. Equilease Corp.*, 626 P.2d 857, 860-61 (Okla. 1981) (holding that a seller breached warranty of title when seller refused to clear filed lien on good); *see* U.C.C. § 2-312(1)(b); *Dugdale of Nebraska, Inc. v. First State Bank*, 420 N.W.2d 273, 276-77 (Neb. 1988) (holding that a seller not only warranted title but was obligated to transfer title free from encumbrances); *State v. DeBaca*, 487 P.2d 155, 158 (N.M. Ct. App. 1971) (finding that a buyer was entitled to rescind contract and recover damages where a seller warranted, but failed to deliver, unencumbered title to automobile); *Seymour v. W.S. Boyd Sales Co.*, 127 S.E.2d 265, 268-69 (N.C. 1962) (holding that a buyer was entitled to recover for breach of warranty of title where a seller failed to discharge lien on good sold); *White v. Mid-City Motor Co.*, 284 S.W.2d 689, 692 (Tenn. Ct. App. 1955) (holding that seller's failure to deliver automobile clear of liens constituted breach of warranty of title under the Uniform Sales Act); *see also* *Old Pueblo Motors, Inc. v. Ysias Abarca*, 288 P. 666, 667 (Ariz. 1930) (holding that a seller was entitled an opportunity to defend title before being held liable for breach of warranty of title); *Hawkland & Miller*, *supra* note 10, § 2-312:07 (explaining that a seller should generally be permitted to cure defect in title under U.C.C. § 2-508 to avoid liability for breach of warranty of title).

good.⁹⁶ The fair market value will generally be significantly higher than the purchase price paid at the foreclosure sale because the price paid for collateral sold through foreclosure sales is often well below fair market value.⁹⁷ In addition, the seller may be liable for incidental and consequential damages that can include costs and attorney fees incurred by the purchaser in defending the title,⁹⁸ damages for losing use of the good, costs of repairs, taxes, and finance charges paid.⁹⁹ The Code damages for which the seller will be liable are likely to greatly exceed the amount realized at the foreclosure sale.

To protect itself against this potential liability, a prudent secured creditor will feel compelled to investigate the validity of debtor's title to the collateral. Investigating at the time of default would be useless because the creditor already has taken an interest in the good at the time of the granting of the security interest. Thus to protect itself, a secured creditor would have to do a title investigation at the time of the granting of the security interest with the expectation that any defects or potential clouds on the title would prevent the creditor from lending. This investigation would be different than that which is currently conducted—a search of the filing records to see if there are prior outstanding security interests or liens. The creditor would have to identify the debtor's predecessors in interest to determine the valid-

96. See *Jerry Parks Equip. Co. v. Southeast Equip. Co.*, 817 F.2d 340, 343 (5th Cir. 1987) (finding that in the absence of other proof the measure of damages in warranty of title action is fair market value of good as measured by bargain price); *Itoh v. Kimi Sales, Ltd.*, 345 N.Y.S.2d 416, 419-20 (Civ. Ct. 1973) (holding that the amount of damages recoverable in warranty of title action is the value of property when the buyer dispossessed). See generally *Draper*, *supra* note 63, at 583-93 (discussing cases applying U.C.C. § 2-714 measure of damages to warranty of title actions).

97. See *Thornton v. Citibank*, 640 N.Y.S.2d 110, 111 (App. Div. 1996) (noting foreclosure sale often grosses substantially less than fair market value of collateral sold); *Averch & Collins*, *supra* note 66, at 989-90 (observing foreclosure sales, generally conducted swiftly and without sufficient opportunity for competitive bidding, typically yield amount less than liquidation value); Alex M. Johnson, Jr., *Critiquing the Foreclosure Process: An Economic Approach Based on the Paradigmatic Norms of Bankruptcy*, 79 Va. L. Rev. 959, 959-60 (1993) (noting prices paid at foreclosure sales typically substantially below market value); see, e.g., *Sierra Fin. Corp. v. Brooks-Farrer Co.*, 93 Cal. Rptr. 422, 426 (Ct. App. 1971) (holding a sale commercially reasonable even though winning bid was \$500 for collateral with fair market value in excess of \$27,600); *School Supply Co. v. First Nat'l Bank*, 685 S.W.2d 200, 203-04 (Ky. Ct. App. 1984) (finding that the sale for \$20,564 of collateral worth over \$163,000 was commercially reasonable).

98. *Universal C.I.T. Credit Corp. v. State Farm Mut. Auto. Ins. Co.*, 493 S.W.2d 385, 391 (Mo. Ct. App. 1973) (holding buyer, in warranty of title action, may collect costs and attorney fees incurred in defending title after giving seller of notice of potential third party claim); see also *Chemco Indus. Applicators Co. v. E.I. du Pont de Nemours & Co.*, 366 F. Supp. 278, 286 (E.D. Mo. 1973) (holding seller liable for attorney fees expended on defense of third-party claim). See generally *Schaefer*, *supra* note 71, at 496-97 (discussing a buyer's right to recover attorney's fees in breach of warranty actions).

99. *Roy R. Anderson, Incidental and Consequential Damages*, 7 J.L. & Com. 327, 360-364 (1987) (discussing types of incidental and consequential damages recoverable in warranty actions).

ity of each of their titles and the potential for outstanding claims against these earlier owners. While there may be some advantages to this approach, it would complicate and add expense to the secured transaction with little resulting benefit. Most debts do not result in foreclosure, and of those that do, many will not involve potential third party claims to the collateral. The creditor will have to weigh the risk, the potential liability, the chance of default, and the likelihood of a third party claim to the collateral. In order to fully protect the seller's interests, these factors will need to be considered before the granting of the security interest. This added step in the granting of the security interest will increase cost and complicate the consummation of the secured transaction, which will, in turn, increase the cost of secured credit.¹⁰⁰

While providing for a complete warranty of title in a foreclosure sale should increase the amount paid in foreclosure sales by providing additional protection for purchasers, it comes at significant cost. If creditors must determine the adequacy of the debtor's title prior to the granting of the security interest in order to minimize the risk of lending against the collateral, the increased realization may be wholly or partially offset by the transaction costs incurred in every secured transaction.

This provision, which completely shifts the risk of title defect from the purchaser to the seller, runs counter to the central goals of the Code. When Article 9 of the Code was adopted, it was intended to simplify secured lending.¹⁰¹ Unlike lending under the Code's predecessors, financing in compliance with the Code and its requirements was intended to be simple, easy, and predictable.¹⁰² By making secured lending simple, it also made credit less costly and more readily available.¹⁰³ Enacting a provision that increases the risks, complexity, and costs associated with secured lending is inconsistent with the goals of Article 9.

100. The cost of credit to the debtor depends on both the transaction costs and risk associated with the loan to the creditor. See F. Stephen Knippenberg, *Debtor Name Changes and Collateral Transfers Under 9-402(7): Drafting from the Outside-In*, 52 Mo. L. Rev. 57, 81-83 (1987) (explaining that the effect of risk and transaction costs on the cost of loans to debtors); see also Steven L. Schwarcz, *A Fundamental Inquiry into the Statutory Rulemaking Process of Private Legislatures*, 29 Ga. L. Rev. 909, 939 (1995) (commenting that commercial law should be cost-effective).

101. See U.C.C. § 1-102(2); *id.* § 9-101 cmt., at 822.

102. The official comment to U.C.C. § 9-101 explains that "[t]he aim of this Article [9] is to provide a simple and unified structure within which the immense variety of present-day secured financing transactions can go forward with less cost and with greater certainty." U.C.C. § 9-101 cmt., at 822; see Schwarcz, *supra* note 100, at 939 (noting that "commercial law should be practical and cost-effective").

103. U.C.C. § 9-101 cmt.; Robert E. Scott, *The Politics of Article 9*, 80 Va. L. Rev. 1783, 1795 (1994) (explaining that Article 9 is designed to decrease the cost of secured lending).

The effects of enacting such provisions may be felt the most by those who can least afford it—small businesses and individuals. Small or occasional lenders are an important source of credit for these types of debtors.¹⁰⁴ These lenders are also the most susceptible to increased risk and costs.¹⁰⁵ Without the resources available to large financial institutions and commercial lenders, these smaller entities are less likely to decide to lend when the risks and costs of lending increase, because these lenders do not have the resources necessary to minimize the risk.¹⁰⁶ If these lenders do lend, the cost of credit to their customers will rise to reflect the increased risk and costs imposed by the extension of the warranty of title.¹⁰⁷ While this extension of the warranty of title may help foreclosure purchasers and some debtors, small businesses and individual debtors may be faced with tighter and more expensive credit, a result inconsistent with the goals of the Code.¹⁰⁸

B. Warranty Disclaimers

A potential response to these concerns could be that the seller may simply disclaim the warranty of title. The Code warranty of title can be disclaimed. The process of disclaiming, however, is not simple. This warranty may only be excluded or modified by specific language referencing the warranty of title.¹⁰⁹ Unlike the Code warranties of quality, the warranty of title is not disclaimed by language such as “as

104. See Robert M. Lloyd, *The Absolute Bar Rule in UCC Foreclosure Sales: A Prescription for Waste*, 40 UCLA L. Rev. 695, 741-43 (1993).

105. See *id.*

106. See *id.*

107. See Knippenberg, *supra* note 100, at 81.

108. The increased expense and risk for smaller lenders and the tightening of credit for their clients is inconsistent with the goals of Article 9—to make secured transactions less costly and less risky. U.C.C. § 9-101 cmt. 2 (noting that the goals of Article 9 are to decrease expense and increase certainty associated with secured lending). Additionally, the principal drafter of Article 9 has noted that it was intended to make lending safe for all lenders, including smaller ones. Grant Gilmore, *The Good Faith Purchase Idea and the Uniform Commercial Code: Confessions of a Repentant Draftsman*, 15 Ga. L. Rev. 605, 620 (1981) (noting that Article 9 intended to make secured lending safe for smaller lenders).

109. U.C.C. 2-312(2); *Lawson v. Turner*, 404 So. 2d 424, 425 (Fla. Dist. Ct. App. 1981) (holding that seller must use “very precise and unambiguous language” to exclude the warranty of title); *Shelly Motors, Inc. v. Bortnick*, 631 P.2d 594, 596 (Haw. Ct. App. 1981) (stating that the UCC requires strict compliance with the method by which the warranty of title can be excluded), *aff’d*, 664 P.2d 755 (Haw. Ct. App. 1983); *Jones v. Linebaugh*, 191 N.W.2d 142, 144 (Mich. Ct. App. 1971) (same); *Sunseri v. RKO-Stanley Warner Theatres, Inc.*, 374 A.2d 1342, 1344-45 (Pa. Super. Ct. 1977) (holding that the language in the bill of sale—which stated “[s]eller shall in nowise be deemed or held to be obligated, liable or accountable upon or under any guarant[e]es or warranties, in any manner or form including, but not limited to, the implied warranties of title”—was not sufficiently specific to disclaim warranty of title under U.C.C. § 2-312). The proposed revisions to Article 2 will also clarify the steps necessary to disclaim the warranty of title. The revision would add the following language to U.C.C. § 2-312:

is" or "with all defects."¹¹⁰ To be effective, the disclaimer should be conspicuous and clarify to the purchaser that the seller assumes no obligation with respect to title.¹¹¹

The proposed revision to section 9-504 recognizes that the warranty can be disclaimed.¹¹² The most recent draft provides:

Warranties under this section may be excluded or modified in the contract for disposition by giving a purchaser a written statement that contains specific language excluding or modifying the warranties. Language in a written statement is sufficient to exclude warranties under this section if it states "There is no warranty relating to title, possession, quiet enjoyment, or the like in this disposition," or words of similar effect.¹¹³

Thus it appears that a creditor who complies with this language may disclaim the warranty and thereby avoid liability for breach of warranty of title. The revision drafters intend for this to be an option for the creditor.¹¹⁴

Experienced secured creditors may choose to disclaim liability. While disclaiming the warranty of title is difficult, it is not impossible, particularly for sophisticated lenders. Thus, the creditor disclaims liability even for defects caused by its wrongful actions.¹¹⁵ While this

A warranty under subsection (a) may be excluded or modified only by specific language or by circumstances giving the buyer reason to know that the seller does not claim title or purports to sell only such right or title as the seller or a third party may have. Language in a record is sufficient to exclude warranties under this section if it is conspicuous and states "There is no warranty of title or against infringement in this sale," or words of similar effect.

Draft, Article 2, *supra* note 42, § 2-312(b).

110. See, e.g., *Brokke v. Williams*, 766 P.2d 1311, 1313 (Mont. 1989) (holding that warranty of title is not disclaimed by the posting of large fluorescent signs on seller's premises which stated merchandise sold "as is"). U.C.C. § 2-316(3)(a) recognizes that general language such as "as is" or "with all faults" can be used to effectively disclaim all implied warranties. U.C.C. § 2-312 cmt. 6 notes, however, that the warranty of title is not designated as an "implied" warranty, therefore a disclaimer of the warranty of title is governed by U.C.C. § 2-312(2) which requires specific language and not the more general provisions of § 2-316. See *Hawkland & Miller*, *supra* note 10, § 2-312:05 (explaining that specific language referencing warranty of title is necessary in the disclaimer because general disclaiming language suggests risk with respect to good's quality not title).

111. *Hudson v. Gaines*, 403 S.E.2d 852, 853-54 (Ga. Ct. App. 1991) (finding issuance of certificate of title stating title "may be subject to undisclosed liens" insufficient to disclaim warranty of title); *Hawkland & Miller*, *supra* note 10, § 2-312:05 (stating that a disclaimer should "make it brutally clear to the buyer that the seller is undertaking no responsibility for the title"); see *Sunseri*, 374 A.2d at 1345 (finding attempted disclaimer of warranty of title ineffective where it was unlikely to "catch the eye of an unsophisticated buyer").

112. Draft, Article 9, *supra* note 8, § 9-504(a).

113. *Id.*

114. *Id.* § 9-504 reporter's cmt. 2.

115. A creditor who knowingly and wrongfully transfers an asset to which it does not have title or the right to transfer may be guilty of fraud. See *Cady v. Pitts*, 625 P.2d 1089, 1092 (Idaho 1981) (holding a seller liable for fraud when the seller failed to

does have the benefit over current law of ensuring that the purchaser knows that she is assuming all risks, it may further deflate the price of the collateral. It may be that only infrequent, or smaller lenders will actually give the warranty because large lenders, having participated in the process and knowing what the sale involves, will have sufficient information to know to disclaim the warranty.¹¹⁶

The question remains whether a secured creditor should be allowed to disclaim the warranty at all. The revision makes it clear that a creditor should give notice of the disclaimer to the purchaser. The proposed revision, however, ignores the interest of an important party—the debtor. At least as currently drafted, the provision does not require either notice to or the debtor's consent when the creditor exercises its right to disclaim this warranty.

A disclaimer, however, will directly affect the debtor's interests. Assuming that the warranty of title is valuable to a purchaser, a disclaimer would lower the price paid by the purchaser, and thus either increase the deficiency owed by the debtor or decrease the surplus to which the debtor is entitled.¹¹⁷ An important consideration is whether the creditor should be allowed to affect the rights of the debtor in this significant manner without notice and consent. While the proposed version acknowledges the right to disclaim, there is no indication that the Committee has considered the question as it relates to the debtor's interests in the outcome of the sale.¹¹⁸ Comment 2 discusses the Article's approach to the disclaimer focusing on the seller's obligations and the transferee's protection. The comments completely ignore the debtor's interest in the conduct of the sale regarding the warranty issue.¹¹⁹ During the revision process, the drafters should consider the

disclose a lien on goods sold and sold goods in contravention of an agreement with another party); *see also* Levin v. Nielsen, 306 N.E.2d 173, 185-87 (Ohio Ct. App. 1973) (affirming that the secured creditor's acts in wrongfully withholding title to a motor vehicle from buyer in the ordinary course of business was fraudulent). The Code expressly permits the use of common law, including fraud, to supplement its provisions. U.C.C. § 1-103 (providing that unless supplanted by provisions of Code, principles of law and equity, including fraud, supplement the Code). Thus, there may be, in limited circumstances which amount to fraud, some remedy for a purchaser whose title fails due to the wrongful conduct of its seller.

116. Lloyd, *supra* note 104, at 740 (noting small and inexperienced lenders most likely to make mistakes in the repossession and resale of collateral); Alan Schwartz & Robert E. Scott, *The Political Economy of Private Legislatures*, 143 U. Pa. L. Rev. 595, 644-45 (1995) (noting Article 9 product of process captured by lending industry); Scott, *supra* note 103, at 1808 (explaining that counsel for large banks and finance companies has provided important input into the proposed revisions to Article 9).

117. U.C.C. § 9-504 provides that a debtor is entitled to any monies and obligated to pay for any debt remaining after payment of the interest secured, costs of sale, and subordinate interests of creditors who have provided notice to the seller. U.C.C. § 9-504.

118. Draft, Article 9, *supra* note 8, § 9-504, reporter's cmt. 2.

119. *Id.*

effect that a warranty disclaimer may have on the debtor's interest in the collateral and the debt.¹²⁰

Because the conduct of the sale, and the secured party's actions significantly affect the debtor's interests, secured parties conducting sales under Article 9 have significant constraints on their actions compared to sellers under Article 2. Both Article 2 and Article 9 sellers must act in good faith.¹²¹ Article 9 sellers must also, prior to the sale, provide notice of the proposed sale to the debtor, guarantors, and certain secured parties.¹²² The secured creditor is also obligated to conduct the sale in a "commercially reasonable" manner.¹²³ These limitations on the seller's actions exist in Article 9 to protect the debtor and her interest in the collateral and the debt. Because the debtor is losing her interest in the property¹²⁴ and will remain liable on any unsatisfied portion of the debt,¹²⁵ insuring fairness to the debtor is an important goal of the default provisions of Article 9.¹²⁶ Consistent with the need to protect the debtor, any attempt by a secured creditor to disclaim the warranty of title in a foreclosure sale should not only satisfy the Code's specific requirements regarding disclaimers, but it should also be made in good faith and be commercially reasonable.

If the creditor is required to act in good faith and reasonably, the creditor may be limited in its ability to disclaim. If disclaimers of the warranty of title are uncommon in the trade for the sale of goods similar to the collateral, a creditor who attempts to disclaim may run the risk of having a court find that the sale was not commercially reason-

120. Scott, *supra* note 103, at 1806 (noting that debtors as a group have less cohesive interests than secured parties, thus resulting in less debtor's participation in and influence over the drafting of Article 9); Schwarcz, *supra* note 100, at 938 (observing that fairness requires consideration of law's effect on affected parties who may not be fully represented in rulemaking process).

121. U.C.C. § 1-203 provides:

Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement.

U.C.C. § 1-203.

This section applies to both Article 2 and Article 9 sales. *See, e.g.,* Sons of Thunder, Inc. v. Borden, No. A-37, 1997 WL 104592, at *14 (N.J. 1997) (stating that both parties to a contract for the sale of goods have the duty to act in good faith in the performance of the contract); Kruse v. Voyager Ins. Cos., 648 N.E.2d 814, 816 (Ohio 1995) (noting the primary Code restraints on secured party's conduct of foreclosure sale are good faith and commercial reasonableness). Additionally, under Article 2, the sales contract and its terms must not be unconscionable. U.C.C. § 2-302. This section is also under consideration for revision. The revision may extend the unconscionability proscription to conduct as well. Draft, Article 2, *supra* note 42, § 2-105 (proposed as revision to current U.C.C. § 2-302).

122. U.C.C. § 9-504(3).

123. *Id.*

124. *Id.* § 9-504(4) (providing that debtor's interest in collateral is extinguished by sale of collateral after default).

125. U.C.C. § 9-504(2) (providing that debtor remains liable for any deficiency after sale of collateral).

126. Lloyd, *supra* note 104, at 704, 709-10.

able. A creditor's good faith obligation and the commercial reasonableness requirements compel the creditor to act in a manner which will maximize, to the extent possible, the amount received for the collateral.¹²⁷ The creditor can only conduct a sale, which is designed to maximize price, or face potential liability.¹²⁸

The Code gives a secured creditor great latitude in the conduct of the foreclosure sale.¹²⁹ The creditor may determine the method, manner, time, place, terms, and other aspects of the conduct of the sale with one restriction: the sale, in all respects, must be commercially reasonable.¹³⁰ This includes the terms of the contract under which the good is sold.¹³¹

The Code does not define commercial reasonableness.¹³² The parties may do so, but the obligation of commercial reasonableness may

127. See *Crosby v. Reed*, 176 B.R. 189, 195 (Bankr. 9th Cir. 1994) (noting secured party must use reasonable care and diligence in disposing of collateral after default to obtain "reasonable price"), *aff'd*, 85 F.3d 634 (Bankr. 9th Cir. 1996); *Brunswick Corp. v. J & P, Inc.*, 424 F.2d 100, 105 (10th Cir. 1970) (noting that the policy of the U.C.C. providing flexibility to a secured party's conduct in a foreclosure sale was intended to produce maximum amount on disposition of collateral); *A to Z Rental, Inc. v. Wilson*, 413 F.2d 899, 909 (10th Cir. 1969) (finding that the secured creditor should exercise due diligence to obtain the best price possible for collateral at a foreclosure sale); *Lloyd*, *supra* note 104, at 711.

128. The creditor need not, however, actually maximize price. U.C.C. § 9-507(2) specifically provides that "[t]he fact that a better price could have been obtained by a sale at a different time or in a different method from that selected by the secured party is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner."

129. After repossession, the Code permits a secured party to sell the collateral by public or private sale. U.C.C. § 9-504(3). The collateral may be sold as a single unit or in parcels. *Id.* The creditor can choose any manner, method, time, place, and terms so long as the disposition is commercially reasonable. *Id.*

130. *Id.*; see also *id.* § 9-504 cmt. 1 (stating the "only restriction placed on the secured party's method of disposition is that it must be commercially reasonable."); *id.* § 9-507(1) (providing debtor with a remedy for the secured party's failure to comply with the requirements of Part 5 of Article 9, including the commercial reasonableness requirement); *id.* § 9-507 cmt. 1 (stating that the "principal limitation of the secured party's right to dispose of collateral" is commercial reasonableness and good faith); *id.* § 9-507(2) (providing guidelines to be considered when determining commercial reasonableness of secured party's disposition of collateral). The parties may delineate what they mean by "commercial reasonableness" but the requirement may not be waived. *Id.* § 1-102(3) (providing parties may not waive, but may determine standards by which reasonableness may be judged if the standards are not manifestly unreasonable.); *id.* § 9-501(3) (providing that the rights of the debtor and duties of the secured party in Part 5 of Article 9 may not be waived but the standards may be agreed to if not manifestly unreasonable).

131. *Id.* § 9-504(3) (requiring that all aspects of disposition, including terms, must be commercially reasonable); *id.* § 9-504 cmt. 6 (stating "specifically . . . method, manner, time, place and terms" must be commercially reasonable).

132. The Code, however, does provide guidelines in U.C.C. § 9-507(2), which state:

The fact that a better price could have been obtained by a sale at a different time or in a different method from that selected by the secured party is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner. If the secured party either sells the collateral in the usual manner in any recognized market therefor or if he sells at the price

not be waived.¹³³ Courts generally consider a number of factors to determine if all aspects of the sale are commercially reasonable, however, the facts of each individual case are the most important.¹³⁴ When determining the reasonableness of a sale, courts will look at the totality of the circumstances surrounding the sale to determine whether the overall transaction was fair and reasonable.¹³⁵ In conducting a reasonable sale, the creditor is expected to use every advantage in time, place, and manner on the debtor's behalf.¹³⁶ While the

current in such market at the time of his sale or if he has otherwise sold in conformity with reasonable commercial practices among dealers in the type of property sold he has sold in a commercially reasonable manner.

Id. § 9-507(2).

133. *Id.* § 1-102(3) (providing parties may not waive, but may determine standards by which reasonableness may be judged if the standards are not manifestly unreasonable); *id.* § 9-501(3) (providing that the rights of the debtor and duties of the secured party in Part 5 of Article 9 may not be waived but the standards may be agreed to if not manifestly unreasonable); *id.* § 9-501(3)(b) (providing that standards for § 9-504(3), which include the commercial reasonableness requirement, may be determined by agreement of parties); *see also* *United States v. Conrad Publishing Co.*, 589 F.2d 949, 952 (8th Cir. 1978) (noting under U.C.C., commercial reasonableness requirement may not be waived by the debtor).

134. *See In re Zsa Zsa Ltd.*, 352 F. Supp. 665, 670 (S.D.N.Y. 1972), *aff'd*, 475 F.2d 1393 (2d Cir. 1973) (noting that the "aggregate of circumstances in each case" should be considered when reviewing commercial reasonableness of foreclosure sale); *Sierra Fin. Corp. v. Brooks-Farrer Co.*, 93 Cal. Rptr. 422, 425-26 (Ct. App. 1971) (upholding trial court's finding, based on facts of case, that foreclosure sale was commercially reasonable); *Westgate State Bank v. Clark*, 642 P.2d 961, 971 (Kan. 1982) (holding whether foreclosure sale is commercially reasonable depends on particular facts of each case). Factors which courts consider in determining the commercial reasonableness of a foreclosure sale include:

1. Choice of public or private sale; 2. Sale at wholesale or retail price; 3. Sale as unit or in parcels; 4. Price realized on foreclosure sale; 5. Price realized on subsequent sale; 6. Time of sale; 7. Place of sale; 8. Solicitation and receipt of bids; 9. Publicity; 10. Appraisal; 11. Sale with or without repair; 12. Familiarity with type of property; 13. Judicial approval of disposition; 14. Secured party's purchase of collateral; 15. Sale of bankruptcy debtor's property; 16. Sale on or at price current in recognized market or in accordance with reasonable commercial practices; or 17. Other factors.

Crosby v. Reed, 176 B.R. 189, 195-96 (Bankr. 9th Cir. 1994), *aff'd*, 85 F.3d 634 (Bankr. 9th Cir. 1996); *see also* Richard C. Tinney, Annotation, *What Is "Commercially Reasonable" Disposition of Collateral Required by UCC § 9-504(3)*, 7 A.L.R. 4th 308, 316 (1981) (discussing factors relevant to court's determination of commercial reasonableness of foreclosure sale).

135. *Bezanson v. Fleet Bank*, 29 F.3d 16, 20 (1st Cir. 1994) (noting commercial reasonableness depends on all circumstances of sale, not one particular factor); *Van Dorn Retail Mgmt. v. Jim's Oxford Shop, Inc.*, 874 F. Supp. 476, 484 (D.N.H. 1994) (discussing totality of circumstances as proper method to determine reasonableness of foreclosure sale), *aff'd*, 45 F.3d 424 (1st Cir. 1995); *In re Zsa Zsa Ltd.*, 352 F. Supp. at 670-71 (stating reasonableness of sale must be determined by viewing transaction as a whole). *See First Bank v. VonEYE*, 425 N.W.2d 630, 636 (S.D. 1988), and *Westgate State Bank*, 642 P.2d at 969, for discussions of the totality of the circumstances standard.

136. *Estate of Kiamie v. Colonial Trust Co.*, 130 N.E.2d 745, 747 (N.Y. 1955); *see Vic Hansen & Sons, Inc. v. Crowley*, 203 N.W.2d 728, 731 (Wis. 1973) (holding se-

Code does not require the price to be maximized,¹³⁷ the creditor is expected to make choices regarding the conduct of the sale with the expectation that they will result in a fair price.¹³⁸

The purpose behind the commercial reasonableness requirement is to provide a selling secured party with flexibility in the sale of the collateral, and thereby permit the creditor to choose an appropriate method to maximize the price obtainable.¹³⁹ Maximizing the price will ultimately benefit both the secured party and the debtor by either minimizing the deficiency for which the debtor is liable or maximizing the surplus to which the debtor is entitled.¹⁴⁰ Fairness to the debtor in the conduct of the sale and regarding price are important concerns of section 9-504.¹⁴¹

Even though the revision to section 9-504 recognizes disclaimers as an option,¹⁴² the creditor's exercise of this option is still limited by the commercial reasonableness requirement.¹⁴³ While Article 9 gives a secured party flexibility in conducting the sale, courts have recognized that the secured party's choice among options authorized by the Code is not absolute; the choice itself must be commercially reasonable.¹⁴⁴

cured party has duty to use all fair and reasonable means to obtain best price for collateral on disposition).

137. See U.C.C. § 9-507(2) (providing that the "fact that a better price could have been obtained" by a different manner of sale "is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner").

138. See, e.g., *Crosby*, 176 B.R. at 195 (noting foreclosing secured creditor must exercise reasonable care and diligence to obtain reasonable price for collateral); *Brunswick Corp. v. J & P, Inc.*, 424 F.2d 100, 105 (10th Cir. 1970) (noting policy of U.C.C. is to give secured party flexibility in disposition of collateral to maximize amount received on sale).

139. Barkley Clark, *The Law of Secured Transactions Under the Uniform Commercial Code* ¶ 4.07, at 4-107 (rev. ed. 1993); Lloyd, *supra* note 104, at 711 (noting major goal of Article 9 provisions regulating foreclosure sales is to obtain fair price on debtor's behalf).

140. Clark, *supra* note 139, ¶ 4.07.

141. Lloyd, *supra* note 104, at 711.

142. Draft, Article 9, *supra* note 8, § 9-504 cmt. 2 (stating that § 9-504 "explicitly contemplates that these warranties [of title, possession and quiet enjoyment] can be disclaimed").

143. See *First State Bank v. Keilman*, 851 S.W.2d 914, 924 (Tex. Ct. App. 1993) (suggesting common law foreclosure sale is not unreasonable where other U.C.C. warranties disclaimed, but warranty of title was not).

144. E.g., *Aspen Enters. v. Bodge*, 44 Cal. Rptr. 2d 763, 768-69 (Ct. App. 1995) (noting, that although the U.C.C. gives the secured party the choice to sell the collateral consisting of real estate and personal property as unit, the secured party may only do so if the joint sale is commercially reasonable); *Trimble v. Sonitrol of Memphis, Inc.*, 723 S.W.2d 633, 641 (Tenn. Ct. App. 1986) (noting that the U.C.C. gives the secured party a choice to dispose of collateral by either public or private sale, whichever is more commercially reasonable); *Old Colony Trust Co. v. Penrose Indus. Corp.*, 280 F. Supp. 698, 712 (E.D. Pa. 1968) (finding, that although the language of U.C.C. § 9-504(3) appears to give the secured creditor unfettered choice between a public or private sale, the requirement that all aspects of sale must be commercially reasonable applies to that choice; therefore, the creditor must choose the type of sale according to which is more commercially reasonable), *aff'd*, 398 F.2d 310 (3d Cir. 1968); see also

While the Code permits a creditor to sell the collateral at either a public or private sale, courts have generally required that the choice between these two methods be commercially reasonable.¹⁴⁵ For example, secured parties who have conducted public sales when a private sale would have been more reasonable, and likely to result in a higher realization on the collateral, may be held liable for failing to conduct a commercially reasonable sale.¹⁴⁶ The Code also recognizes that a secured party may choose to sell the collateral "in its then condition or following any commercially reasonable preparation or processing."¹⁴⁷ This language seems to give the creditor an unrestrained option to decide whether to prepare the collateral for resale. Most courts which have addressed this issue, however, have held that the commercial reasonableness may require the creditor to prepare the collateral prior to sale if selling the collateral in its existing condition would not be commercially reasonable.¹⁴⁸ Commentators, includ-

White & Summers, *supra* note 45, § 25-10, at 1217-18 (noting secured creditor's choice of one method of sale over another must be commercially reasonable).

145. *United States v. Willis*, 593 F.2d 247, 258-59 (6th Cir. 1979) (holding that the secured party's choice as to method of sale, public or private, must be commercially reasonable); *John Deere Leasing Co. v. Fraker*, 395 N.W.2d 885, 887 (Iowa 1986) (noting that the secured party's choice between public and private sale itself may be fact relevant to commercial reasonableness of sale); *Ridley v. First Nat'l Bank*, 531 P.2d 607, 610 (N.M. Ct. App. 1974) (noting that the method of resale, including whether it should occur through public or private sale, was an element for determining commercial reasonableness), *cert. denied*, 521 P.2d 602 (N.H. 1975); *Appleton State Bank v. Van Dyke Ford, Inc.*, 279 N.W.2d 443, 446 (Wi. 1979) (stating that the choice of method of sale must be reasonable); *cf.* U.C.C. § 2-706 cmt. 4 (providing that in resale by seller after buyer's breach "[i]n choosing between a public and private sale the character of the goods must be considered and relevant trade practices and usages must be observed").

146. *See, e.g., Willis*, 593 F.2d at 259-60 (holding that the government, as a secured lender, is not entitled to recover a deficiency where the government's choice of a public sale was not commercially reasonable). In *Willis*, the Sixth Circuit Court of Appeals found a public foreclosure sale by the Small Business Administration unreasonable. *Id.* at 249-59. The government had received offers from private parties to purchase the collateral for \$200,000 and \$210,000. *Id.* at 250. The auctioneer who conducted the public sale of the collateral estimated the value of the collateral if sold at auction to be \$45,000. *Id.* at 259. Despite this information, the S.B.A. proceeded to sell the collateral through a public sale. *Id.* This choice, the court held, was unreasonable and rendered the sale commercially unreasonable. *Id.* As a result, the government lost its right to a deficiency judgment. *Id.* at 260; *see also* U.C.C. § 9-507 (providing creditor liable for damages to debtor for failure to comply with the requirements of Part 5 of Article 9, which include conducting a commercially reasonable sale).

147. U.C.C. § 9-504(1).

148. *E.g., Ingersoll-Rand Fin. Corp. v. Miller Mining Co.*, 817 F.2d 1424, 1428 (9th Cir. 1987) (holding that the failure to inspect collateral and make the necessary minor repairs prior to the foreclosure sale was commercially unreasonable); *Liberty Nat'l Bank & Trust Co. v. Acme Tool*, 540 F.2d 1375, 1382 (10th Cir. 1976) (finding that the commercial reasonableness standard applied to the preparation of collateral for sale as well as to the conduct of foreclosure sale); *Farmers & Merchants Bank v. Barnes*, 705 S.W.2d 450, 452-53 (Ark. Ct. App. 1986) (upholding the chancellor's finding that the sale was not commercially reasonable when the secured creditor failed to make

ing drafters involved in the current revision process, have agreed that commercial reasonableness constrains choices of the creditor, even where the choice is permitted by the Code.¹⁴⁹

Thus the mere fact that the Code authorizes the creditor to disclaim the warranty of title does not mean that courts will find that such disclaimers are, in all instances, commercially reasonable. If a court determines that, in a particular case, the disclaimer of the warranty unfairly deflates the price and therefore is unreasonable, the secured party would be liable to the debtor for violating the requirements of Article 9.¹⁵⁰ The creditor's choice to disclaim the warranty in light of the Code's requirement that all aspects and terms of the sale be commercially reasonable will give debtors a further avenue to attack the validity of the foreclosure sale. This issue, which has not been considered in the Article 9 revision process, will result in increased litigation by debtors challenging foreclosure sales, which in turn will increase the costs and uncertainty associated with foreclosure sales.

Another issue that courts will need to resolve will be the proper industry against which the secured party's actions will be judged re-

reasonable repairs that could have resulted in higher price); *Franklin State Bank v. Parker*, 346 A.2d 632, 635 (N.J. Union County Ct. 1975) (holding that the secured party's failure to make minor repairs before sale that resulted in a grossly inadequate price realized at the foreclosure sale was not commercially reasonable); *see also In re Severance Truck Line, Inc.*, 35 B.R. 332, 333 (Bankr. M.D. Fla. 1983) (finding sale commercially unreasonable where condition of collateral deteriorated in secured party's possession and secured party failed to repair collateral before foreclosure sale); *cf. In re Deephouse Equip. Co. v. Knapp*, 38 B.R. 400, 405 (Bankr. D. Conn. 1984) (finding that secured creditor's retention of collateral without making repairs, which resulted in reduced value of collateral, was commercially unreasonable). *But see C.I.T. Corp. v. Duncan Grading & Constr., Inc.*, 739 F.2d 359, 361 (8th Cir. 1984) (holding that a creditor is not required to repair or prepare collateral prior to a foreclosure sale).

149. In the comments to the spring 1996 draft of the revisions to Article 9, the drafters recognize that, while the Code "appears to give the secured party the choice of disposing of collateral" with or without reasonable preparation, many courts have found that the commercial reasonableness standard may require the secured creditor to prepare or process the collateral prior to the foreclosure sale. Draft, Article 9, *supra* note 8, § 9-504 cmt. 3. The comment goes on to acknowledge that the secured party does not, in all circumstances, have the right to sell without preparation, despite the Code language, if it would be commercially unreasonable to do so. *Id.* at 213. This is a recognition that even acts authorized by the Code must be commercially reasonable in the context of the particular foreclosure sale being conducted by the secured party. An act, although authorized by the Code, which is not commercially reasonable in a particular context can render the sale of the collateral unreasonable and subject the creditor to liability. *White & Summers*, *supra* note 45, § 25-13, at 1231 (explaining even though words of Code which indicate secured party can sell collateral "in its then condition," a majority of courts require secured party to prepare collateral for sale if failing to do so is commercially unreasonable); Draft, Article 9, *supra* note 81, § 9-504 cmts. 1-3, at 212-13 (noting that the drafters agreed that, despite language of Code which appears to give creditor choice, secured party should not be allowed to sell collateral without preparation or processing if to do so would be commercially unreasonable).

150. U.C.C. § 9-507(1).

garding the reasonableness of the disclaimer. Secured creditors will argue that the appropriate industry should be the foreclosure industry. Creditors may argue that because imposition of the warranty of title is in contravention of common law and prior uniform laws, it is reasonable for the secured creditor to disclaim the warranty. Additionally, although under the current Code it is unnecessary, it has not been uncommon for foreclosing creditors to provide in the contract of sale that no warranty of title is given.¹⁵¹ Creditors can find support for analogous situations where courts have judged the reasonableness of actions against the conduct of similarly situated creditors in foreclosure sales.¹⁵²

Debtors will press for comparison of the creditor's actions to sales of similar goods in the market for goods of that kind, where disclaimers of the warranty of title are less common. The Code recognizes that a sale consistent with the practices found in the general market for the type of property sold will be commercially reasonable.¹⁵³ Relying on this provision of the Code, courts have judged the creditor's actions with respect to a foreclosure sale against the norm of the market in which similar goods are generally sold.¹⁵⁴ Using the general market as the standard against which the creditor's actions will be judged will more likely result in a finding that the disclaimer of the warranty is unusual and therefore, commercially unreasonable. Discouraging the disclaimer of the warranty of title would be consistent with the goals of the default provisions of Article 9—to insure fairness to the debtor and maximize price. Once the Code has provided for warranties in foreclosure sales, protecting the debtor's interest from a disclaimer of the warranty, when such disclaimers are uncommon in sales of property similar to the collateral, will increase the realization on the collateral. This should be an important consideration, particularly when the debtor has not consented to this term.

It has been noted that unsophisticated lenders are the most likely to make mistakes that result in a finding that a sale was not commercially

151. Hakes, *supra* note 81, at 898-99.

152. See, e.g., *Piper Acceptance Corp. v. Yarbrough*, 702 F.2d 733, 735 (8th Cir. 1983) (comparing the creditor's actions to the standard in the foreclosure industry to determine commercial reasonableness of sale).

153. U.C.C. § 9-507(2) provides that a secured party who sells "in conformity with reasonable commercial practices among dealers in the type of property sold he has sold in a commercially reasonable manner."

154. See, e.g., *United States v. Conrad Publishing Co.*, 589 F.2d 949, 954 (8th Cir. 1978) (upholding the District Court finding that the sale was commercially unreasonable when the collateral at issue was the standard type of collateral sold at a regional or national level, yet the seller made no effort to reach this market); *Connecticut Bank & Trust Co. v. Incendy*, 540 A.2d 32, 39-40 (Conn. 1988) (noting sale is commercially reasonable if it conforms to reasonable commercial practices of dealers in that type of property); *Franklin State Bank v. Parker*, 346 A.2d 632, 635 (N.J. Union County Ct. 1975) (stating that a secured party has an affirmative duty to dispose of collateral in a manner consistent with the trade practices among responsible business in same or similar business).

reasonable.¹⁵⁵ The imposition of another area of uncertainty will open up further sales to attack by debtors and cause further problems for these small lenders. It was never the intent of the drafters of Article 9 that only large, sophisticated lenders with the assistance of counsel could comply with Article 9.¹⁵⁶ The more complicated the drafters make foreclosure sales, the more the Code contravenes its own goals.¹⁵⁷

If a court finds the creditor conducted a sale which was not commercially reasonable, the creditor, at a minimum, is liable to the debtor for any damages that result from the creditor's failure to comply with the Code.¹⁵⁸ The creditor may also lose the right to a deficiency judgment.¹⁵⁹ Thus, the creditor is not only subject to the time

155. Lloyd, *supra* note 104, at 740 (explaining it is unsophisticated lenders, such as rural banks, local credit unions and small businesses, which are most likely to run afoul of the commercial reasonableness requirements).

156. *Id.*; see Gilmore, *supra* note 108, at 620 (noting that Article 9 intended to make secured lending safe for "widows[,] orphans[,] and country bankers").

157. See U.C.C. § 1-102(2) (providing purpose of U.C.C. is to simplify and clarify commercial law); *id.* § 9-101 cmt. (stating that the aim of Article 9 is to simplify secured transactions); *United States v. Willis*, 593 F.2d 247, 258 (6th Cir. 1979) (noting policy of Article 9 to provide simple, efficient and flexible method for disposition of secured collateral); Schwarcz, *supra* note 100, at 924-25 (suggesting that clarity and simplicity should be purposes which influence the drafters as they revise U.C.C.).

158. U.C.C. § 9-507(1) gives the debtor a right to recover damages from a secured party that does not comply with Part 5 (Default Provisions) of Article 9. See, e.g., *Georgia Cent. Credit Union v. Coleman*, 271 S.E.2d 681, 684 (Ga. Ct. App. 1980) (finding that a debtor has a right to recover any losses suffered due to the creditor's failure to comply with the commercial code); *Peoples Acceptance Corp. v. Van Epps*, 395 N.E.2d 912, 916-17 (Ohio Ct. App. 1978) (holding that the debtor is entitled to damages when a creditor failed to sell collateral in a commercially reasonable manner in violation of the U.C.C.); *First Nat'l Bank & Trust Co. v. Holston*, 559 P.2d 440, 443 (Okla. 1976) (noting debtor entitled to damages for commercially unreasonable sale conducted by secured creditor).

159. Generally, the creditor is entitled to collect from the debtor any deficiency between the amount of the debt and the proceeds generated from the sale after deduction of the costs of sale. U.C.C. § 9-504(2). However, if a creditor fails to comply with the requirements of U.C.C. § 9-504 in conducting the foreclosure sale, it may lose this right. See *Topeka Datsun Motor Co. v. Stratton*, 736 P.2d 82, 86-87 (Kan. Ct. App. 1987) (holding that the consumer debtor was relieved of liability for deficiency judgment when the creditor violated the U.C.C. in disposition of the collateral); *Whirlybirds Leasing Co. v. Aerospatiale Helicopter Corp.*, 749 S.W.2d 915, 919 (Tex. Ct. App. 1988) (holding that when a creditor violates the Commercial Code, the creditor is barred from a deficiency judgment). But see *In re Excello Press, Inc.*, 890 F.2d 896, 902-06 (7th Cir. 1989) (holding that a secured creditor's failure to comply with the default provisions of Article 9 merely raises a rebuttable presumption that the fair market value of the collateral at a proper sale would have equaled the debt); *Barbour v. United States*, 562 F.2d 19, 21-22 (10th Cir. 1977) (holding that a debtor's damages under U.C.C. § 9-507(1) are merely a set-off against secured creditor's deficiency judgment); *Westgate State Bank v. Clark*, 642 P.2d 961, 972 (Kan. 1982) (holding that in a non-consumer commercial transaction, a secured party's failure to comply with the provisions of the U.C.C. are not an absolute bar to deficiency judgment). For an overview of the various approaches to this remedy, see Lloyd, *supra* note 104, at 702-21 and Kathryn Page, *A Secured Party's Right to a Deficiency Judgment After Non-compliance with the Resale Provisions of Article 9*, 60 N.D. L. Rev. 531 (1984). The

and expense involved with a lawsuit defending the sale, but also the creditor may be liable for damages if it loses. If the proposed revision is ultimately adopted, lenders may be faced with a Hobson's choice: warrant the debtor's title to the collateral or risk a battle with the debtor over the reasonableness of the sale. Forcing lenders into this dilemma runs counter to the Code's goals of simplicity and certainty.¹⁶⁰

In most instances, a secured party who is selling the collateral after a repossession is an involuntary seller.¹⁶¹ If complying with the requirements of section 9-504 in conducting a commercially reasonable sale prevents or limits the effective disclaimer of the warranty to title without risking potential liability to the debtor, as suggested above, these involuntary sellers only choice may be to warrant their right to sell the goods, the debtor's title, and the title of all the debtor's predecessors-in-interest. Voluntary sellers under Article 2, on the other hand, can disclaim the warranty with minimal concern for potential liability. There is nothing in the principles behind the imposition of warranty of title liability that would justify the imposition of greater liability on a seller who is selling reluctantly. It is one issue to require a seller of goods who has voluntarily undertaken to enter the commercial arena to warrant that the chain of title is valid. It is another, however, to require one who has not entered the sales arena voluntarily to do so. The potential challenges to the commercial reasonableness of foreclosure sales could result in voluntary sellers—under Article 2—having more latitude to protect themselves by disclaiming the war-

NCCUSL Drafting Committee proposes to resolve the split among the courts with respect to this issue by adopting the rebuttable presumption rule in commercial transactions. See Draft, Article 9, *supra* note 8, § 9-507(c) & reporter's cmt. 3. Under this rule, the selling secured party's failure to comply with the default provisions of Article 9 raises a rebuttable presumption that a sale in compliance with the Code would have realized an amount equal to the debt. *Tennant Co. v. Martin's Landscaping, Inc.*, 515 A.2d 665, 669 (Conn. Super. Ct. 1986) (requiring that where creditor sells repossessed collateral without giving necessary statutory notice, rebuttable presumption arises that proper sale would have been at amount equal to the outstanding debt).

160. See U.C.C. § 9-101 cmt. (stating that the purpose of Article 9 is to simplify secured transactions and to permit these transactions to proceed in a less costly and more certain manner); Steven L. Harris & Charles W. Mooney, Jr., *A Property-Based Theory of Security Interests: Taking Debtors' Choices Seriously*, 80 Va. L. Rev. 2021, 2021 (1994) (stating Article 9 should "facilitate the creation of security interests" and therefore, transfers of security interests should be "easy, inexpensive, and reliable").

161. There are, of course, instances where a secured party, who is the original financing seller of the good, has repossessed and will resell the good. Alternatively, the secured party may have a repurchase agreement with the original seller whereby upon default, the original seller will be responsible for payment of the debt to the creditor and resale of the collateral. For a discussion of repurchase agreements, see Donald J. Rapson, *Repurchase (of Collateral?) Agreements and the Larger Issue of Deficiency Actions: What Does Section 9-504(5) Mean?*, 29 Idaho L. Rev. 649 (1992). These secured parties are in the business of selling goods of the same type as the collateral; while perhaps involuntary sellers of the particular collateral at the time of default, they are hardly involuntary sellers in a larger sense. It is not with these types of sellers, who are in the business of selling goods, with which this Article is concerned.

ranty of title than an involuntary Article 9 seller. There is no justification in history, law, or equity for such disparate treatment.

At this early juncture, it is difficult to predict how courts will view disclaimers of the warranty of title made without consent of the debtor. It is likely that courts will go both ways on this issue. One thing is for certain: the revision's approach to warranty of titles and foreclosure sales will give debtors and their counsel additional ammunition to challenge the conduct of foreclosure sales, thus increasing the risk and cost of commercial transactions. If the Code's goals are to promote simplicity, certainty, and cost-effective secured transactions,¹⁶² this change, as currently drafted, will not do so.

C. *Junior Secured Creditors*

This proposed change runs counter to another proposed revision to section 9-504 regarding to junior secured creditors. A proposed revision to U.C.C. section 9-504 provides that the proceeds received from a sale by a junior creditor are not subject to the claims of the selling senior creditor.¹⁶³ The imposition of the warranty of title is in fact worse for the junior creditor than if the junior creditor only was held liable to the senior creditor for the proceeds of the sale. One who purchases at a foreclosure sale takes subject to liens that have priority over that of the selling secured party.¹⁶⁴ If there is a senior lien and the purchaser does not know about the senior lien at the time of sale, the selling creditor has breached the warranty of title by selling the goods subject to an encumbrance of which the buyer does not have knowledge.¹⁶⁵ That the superior interest may be on record is not enough to defeat liability.¹⁶⁶ Having breached the warranty of title, the junior creditor will be liable to the buyer for damages. The amount of the purchaser's damages will likely exceed the purchase price.¹⁶⁷ As we have seen, the junior creditor will be liable even if it

162. U.C.C. § 9-101 cmt.; *see also* Harris & Mooney, *supra* note 160, at 2021 (stating that Article 9 should expedite the simple and dependable creation of security interests).

163. Draft, Article 9, *supra* note 8, § 9-504(e). The proposed revision provides:

- (e) A secured party that receives cash proceeds of disposition in good faith and without knowledge that the receipt violates the rights of the holder of a security interest or other lien that is not subordinate to the security interest or agricultural lien under which the collection or enforcement is made:
 - (1) takes the cash proceeds free of the security interest or other lien;
 - (2) is not obligated to apply the proceeds of disposition to the satisfaction of obligations secured by a security interest or other lien; and
 - (3) is not obligated to account to or pay the holder of the security interest or other lien for any surplus.

Id.

164. U.C.C. § 9-504(4).

165. *Id.* § 2-312(1)(b); *see also supra* notes 49-54 and accompanying text.

166. *See supra* notes 49-54 and accompanying text.

167. *See supra* notes 94-97 and accompanying text.

did not know of the superior interest.¹⁶⁸ If a creditor mistakenly believes that it has a superior interest, repossesses and sells the collateral, and is later determined to be in error,¹⁶⁹ the selling creditor will be liable to the purchaser for compensatory, incidental, and consequential damages. If the junior creditor did not give the warranty of title, but was merely liable to the senior creditor for the proceeds of the sale, the creditor would never be liable for more than the money it received through the sale.¹⁷⁰ Thus, the junior creditor is worse off under this version of U.C.C. section 9-504 than if it were liable to the senior creditor for the proceeds. This is inconsistent with the purported purpose of protecting the interests of junior creditors.¹⁷¹

The Code permits the junior secured creditor to sell, but now it does so at its own peril. The purpose behind sheltering proceeds received by junior creditors is to protect the interests of the junior creditors and thus give them the ability to recover their debt from the collateral. Yet, the warranty of title provisions counteracts this purpose by subjecting the junior creditor to liability for breach of the warranty of title. The warranty of title provision makes the protection afforded junior creditors by the proposed revision merely illusory. Again, the revisions to U.C.C. section 9-504 create conflicts that are likely unintentional, but still must be addressed before this version is adopted.¹⁷²

168. See *supra* notes 49-54 and accompanying text.

169. A creditor may not be aware that it does not have the security interest with priority. A creditor with priority may lose that priority to a later creditor who has obtained super-priority of a purchase money security interest. See U.C.C. § 9-312(4). A junior creditor may have inadvertently failed to properly perfect its interest, thus having the interest subordinated to a later perfecting secured creditor or judgment lienholder. See *id.* § 9-301(1).

170. U.C.C. § 9-504(1) provides a method for the distribution of proceeds. Under this section, the proceeds of disposition are applied in the following order:

- (a) the reasonable expenses of retaking, holding, preparing for sale or lease, selling, leasing and the like and, to the extent provided for in the agreement and not prohibited by law, the reasonable attorney's fees and legal expenses incurred by the secured party;
- (b) the satisfaction of indebtedness secured by the security interest under which the disposition is made;
- (c) the satisfaction of indebtedness secured by any subordinate security interest in the collateral if written notification of demand therefor is received before distribution of the proceeds is completed.

Id. § 9-504(1).

171. Draft, Article 9, *supra* note 8, § 9-504 reporter's cmt. 7 (stating that this revision makes clear that a junior secured party owes no duty to a senior secured party to apply proceeds to senior interest and is intended to protect interests of junior creditors).

172. Furthermore, this revision to section 9-504 rewards those purchasers who fail to search the filing records. If a purchaser does not search the record of title and, therefore, fails to discover a superior recorded lien, the purchaser is entitled to Code damages from the seller for breach of the warranty of title because the purchaser does not have actual knowledge of the superior interest. See *Elias v. Dobrowolski*, 412 A.2d 1035, 1037 (N.H. 1980) (holding that a buyer was entitled to recover for breach

III. PROPOSED SOLUTIONS

This Article has identified several potential problems with the proposed revision to U.C.C. section 9-504: (1) the extent of the creditor's potential liability; (2) the commercial reasonableness restraint on the creditor's right to disclaim; and (3) the inconsistent treatment of junior creditors. These demonstrate a larger problem with the revision process—its piecemeal nature.¹⁷³ Each of these problems is caused by the lack of careful review of the problems created by the current Code and the failure to address those difficulties in light of the purposes and policies of the Code as a unified statute.¹⁷⁴ The current review process results in inconsistencies, which will increase litigation and uncertainty, each an anathema to the commercial world.¹⁷⁵

A. *Inconsistencies Between Warranty of Title in Foreclosure Sales and Policies of the Code*

The current proposal to revise section 9-504 is fraught with inconsistencies. In one section of U.C.C. section 9-504, the Code protects junior creditors,¹⁷⁶ then within the same section, it exposes these creditors to substantially more liability than under current law.¹⁷⁷ The drafters justify grafting Article 2 warranties onto foreclosure sales because such sales are not “out of the ordinary.”¹⁷⁸ Recognizing the unique circumstances surrounding these types of sales,¹⁷⁹ the Code,

of warranty of title because the buyer had mere constructive notice, but not actual knowledge of outstanding security interest in goods); Hawkland, *supra* note 10, § 2-312:03 (explaining buyer has no duty to search records for outstanding interests in goods subject to sales contract). If the purchaser searches and gains knowledge of the lien, there is no protection. If there is no superior interest, the purchaser is in the same position regardless of whether it conducted a search. The purchaser gains nothing by searching the records. Thus, purchasers at foreclosure sales, have no incentive to take the steps necessary to protect their interests.

173. See Scott, *supra* note 103, at 1812 (noting that the drafters working on revisions to the U.C.C. work on only one project and each project is presented for separate consideration as an independent entity).

174. See John L. Gedid, *U.C.C. Methodology: Taking a Realistic Look at the Code*, 29 Wm. & Mary L. Rev. 341, 342, 384 (1988) (explaining that the Code was drafted as unified law and suggesting that inconsistency and lack of uniformity in application of the Code results from failure of scholars, lawyers, and judges to interpret the Code as an integrated entity).

175. *Id.* at 355 (explaining the one of the most important attributes of a code is “maintenance of consistency among various sections of the statute relative to the subject area covered”); Harris & Mooney, *supra* note 160, at 2021 (stating that creation of security interests should be simple and inexpensive).

176. See discussion *supra* part II.C.

177. See discussion *supra* part II.C.

178. Draft, Article 9, *supra* note 8, § 9-504, cmt. 2.

179. Commentators agree that foreclosure sales rarely yield an amount even close to the fair market value. See, e.g., Averch & Collins, *supra* note 66, at 990 (observing that foreclosure sales typically yield amounts less than liquidation value); Johnson, *supra* note 97, at 959-60 (explaining that prices paid at foreclosure sales are typically substantially below the value of the collateral). Courts have also long recognized that

however, still provides that insufficient price is not enough to support a finding that a foreclosure sale is not commercially reasonable.¹⁸⁰ The revision purports to give the creditor the right to disclaim the warranty by giving notice to the purchaser while ignoring the debtor's interests in the terms of the sale. At the same time, the Code requires the creditor to conduct a reasonable sale for the protection of the debtor. These inconsistencies will make commercial transactions more costly and unpredictable, cardinal sins for commercial entities.¹⁸¹

Predictability and stability are two of the prime motivating factors behind the U.C.C.¹⁸² In the commercial arena, often a correct result is less important than a predictable one.¹⁸³ As the uncertainty surrounding foreclosure sales increases, the availability and affordability of credit decreases.¹⁸⁴ The problems with the current proposed revision, even if ultimately resolved by the courts, will result in costly and needless litigation. The drafters should consider possible solutions that protect the purchaser without increasing the costs and uncertainty associated with secured lending.

Having demonstrated that the revision of U.C.C. § 9-504 is flawed, the more important question is whether there is a better approach to resolving this issue. Such an approach should consider the dimensions of the problem identified, examine the Code as an integrated statute, and seek to draft a solution which is consistent with the policies and

foreclosure sales are out of the ordinary and sufficiently "peculiar" in nature to warrant treatment different than that accorded Article 2 sales. *See* Landmark Motors, Inc. v. Chrysler Credit Corp., 662 N.E.2d 971, 977 (Ind. Ct. App. 1996) (affirming trial court's finding that foreclosure sale out of ordinary course and peculiar in nature should be apparent to prospective buyer); *see also* U.C.C. § 2-312 cmt. 5 (reflecting drafters belief that sales by foreclosing lienors "are so out of the ordinary commercial course that their peculiar character is immediately apparent to the buyer"); Thornton v. Citibank, 640 N.Y.S.2d 110, 111 (App. Div. 1996) (noting foreclosure sale often grosses substantially less than fair market value of collateral sold). In "ordinary sales," the seller seeks to maximize price, yet in these foreclosure ordinary sales, everyone agrees maximization of price is unlikely.

180. U.C.C. § 9-507(2).

181. *See* David G. Carlson, *Rationality, Accident and Priority Under Article 9 of the Uniform Commercial Code*, 71 Minn. L. Rev. 207, 235 (1986) (stating that the U.C.C. was drafted to give business what it wanted: simplicity, uniformity, and certainty); Gedid, *supra* note 174, at 384-85 (explaining that proper Code methodology requires an issue to be considered within its own context, the context of related issues, and the context of the Code as a whole); Howard Ruda, *Article 9 Works—How Come?*, 28 Loy. L.A. L. Rev. 309, 310 (1994) (noting that Article 9's purpose is to minimize transaction costs and uncertainty in secured transactions).

182. Carlson, *supra* note 181, at 235 (observing that the purpose of the U.C.C. is to provide as much certainty as possible in the commercial arena); Ruda, *supra* note 181, at 319 (noting that predictability is an important goal of Article 9).

183. Ruda, *supra* note 181, at 319 (noting that the ability to predict and plan based on a certain rule provides equity in commercial law).

184. *See* William M. Burke et al., *Interim Report on the Activities of the Article 9 Study Committee*, 46 Bus. Law. 1883, 1884 (1991).

purposes of the Code. The first step is to identify the purpose behind this revision.

What are the drafters attempting to accomplish by inserting the standard liens into these out of the ordinary sales? As my previous article demonstrated, there are problems with section 9-504 as it currently exists—in particular, its failure to protect a foreclosure purchaser from a wrongful sale by a secured creditor.¹⁸⁵ A selling creditor can wrongfully transfer the collateral; thereby, the purchaser will lose both the collateral (to the debtor) and its money (to the creditor) under the current law. The proposed revision of section 9-504 ignores the debtor/purchaser dispute, focusing instead on the purchaser/seller relationship. This proposed solution goes beyond the problem of protecting purchasers from the wrongful acts of the seller to make the selling secured party an insurer of the purchaser's title. While ignoring one aspect of the problem—the debtor/purchaser dispute—the drafters have gone beyond what is necessary in another. The drafters of revised Article 9 have failed to tailor the cure to the ailment and have crafted a broad remedy for a narrow problem and created further difficulties that have not been considered or addressed.

The comments explain that the imposition of Article 2 warranties to foreclosure sales recognizes that these sales are not out of the ordinary stream of commerce.¹⁸⁶ This stated purpose does not comport with the realities of the commercial world. Foreclosure sales are not the same as “ordinary” sales. The seller is not selling merely its interest in the good, but also that of the debtor and subordinate creditors.¹⁸⁷ Because the seller is transferring the interest of another in the good, it cannot conduct the sale on whatever terms it chooses; it must act reasonably on the debtor's behalf. The seller does not reap the profits of the sale.¹⁸⁸ Unlike a typical sale where the seller is the owner of the good, the seller is not always motivated to expend the effort necessary to realize the highest price possible.¹⁸⁹ Without the

185. See Meadows, *supra* note 2. The Code does not clearly provide an answer to the dispute between the debtor and purchaser after a wrongful repossession and sale. In my previous article, I proposed resolving this aspect of the problem by balancing the interests of the debtor and purchaser by shifting focus from who has title to the equities of the particular situation before the court. See *id.* at 210-17. Unfortunately, the current revision does not address this issue, but rather leaves the resolution to the common law and its rigid adherence to title theory.

186. Draft, Article 9, *supra* note 8, § 9-504 cmt. 2.

187. U.C.C. § 9-504(4).

188. The debtor is entitled to any surplus (profit) on the sale after payment of the costs of sale, the debt secured, and certain junior interests. See *id.* § 9-504(1).

189. Zubrow, *supra* note 94, at 449 (explaining that because Article 9 permits a secured party to purchase collateral after default in certain situations, a secured party has a conflict of interest between wanting to increase competitive bidding and therefore price to reduce deficiency and wanting to decrease bidding and price as purchaser so it can realize profit upon resale of collateral).

consent of the debtor, the seller does not have the option to refuse to sell.¹⁹⁰ If the seller wrongfully declares a default and repossesses, the seller cannot even transfer the good.¹⁹¹ Even if the seller conducts the sale in full compliance with the Code and in all ways acts reasonably and in good faith, it is unlikely that the good will yield market price. If foreclosure sales were truly "not out of the ordinary," then the reasonableness of the sale should be judged by the same standards as one would expect from a seller selling its own goods, yet no one is proposing that approach. The solution to the problem of providing purchasers protection cannot ignore the reality of the seller's limited interest in the good and the actual conduct of foreclosure sales. The solution should provide purchasers with some protection, yet acknowledge the seller's more limited rights and powers.

B. *Similar Warranties Within Article 2A*

In one type of transaction within the scope of the U.C.C., the lease of goods, a transfer of a more limited interest is accomplished. In a lease, the lessor transfers to the lessee the right to possession and use of the goods for a period of time.¹⁹² In this type of transaction, the lessee also needs some protection against claims which may interfere with its more limited interest in the goods. In consideration of the more limited nature of the interests involved, Article 2A of the U.C.C., which applies to leases of personal property,¹⁹³ provides a more modified approach to protecting the transferee's rights to use of the goods. Article 2A provides that lessors warrant that they have done nothing to cause an interference with the lessee's interest.¹⁹⁴

190. U.C.C. § 9-505 permits the creditor to retain the collateral in satisfaction of the debt unless the debtor objects. This right may be extended to permit retention in partial satisfaction of the debt in the revised Article 9. *See* Draft, Article 9, *supra* note 8, § 9-505.

191. *See* Meadows, *supra* note 2, at 172-90 (explaining that a purchaser at foreclosure sale held when the debtor is not in default receives void title, has converted the good, and cannot transfer good title even to a good faith purchaser for value).

192. *See* U.C.C. § 2A-103(1)(j) defining lease as "a transfer of the right to possession and use of goods for a term in return for consideration." U.C.C. § 2A-103(i)(j).

193. *Id.* § 2A-102.

194. *Id.* § 2A-211(1). U.C.C. § 2A-211 provides:

- (1) There is in a lease contract a warranty that for the lease term no person holds a claim to or interest in the goods that arose from an act or omission of the lessor, other than a claim by way of infringement or the like, which will interfere with the lessee's enjoyment of its leasehold interest.
- (2) Except in a finance lease there is in a lease contract by a lessor who is a merchant regularly dealing in goods of the kind a warranty that the goods are delivered free of the rightful claim of any person by way of infringement or the like.
- (3) A lessee who furnishes specifications to a lessor or a supplier shall hold the lessor and the supplier harmless against any claim by way of infringement or the like that arises out of compliance with the specifications.

Id. § 2A-211.

Article 2A has its basis in Article 2.¹⁹⁵ In particular, Article 2 was a model for the provisions of Article 2A dealing with lease formation, warranties and remedies.¹⁹⁶ The warranty of title provision from Article 2, § 2-312, could not be adopted wholesale in Article 2A because title is not transferred in a lease.¹⁹⁷ However, the drafters of Article 2A did provide protection for the lessee's transferred interest through the warranty against interference.¹⁹⁸ The warranty against interference is similar to the warranty of quiet enjoyment under common law and the Uniform Sales Act.¹⁹⁹ The warranty protects the lessee's enjoyment of the leasehold interest, the lessee's possession and use against interference.²⁰⁰ This warranty differs in one important respect from the warranty of quiet possession under the Uniform Sales Act and the warranty of title under the Code. The warranty only protects the lessee against third party claims which arise from "an act or omission of the lessor."²⁰¹

This warranty is clearly more circumscribed than that given by a seller of goods. A seller under the Code, as it was at common law and under the Uniform Sales Acts, warrants not only defects in the title caused by its actions, but also those of which it has no knowledge.²⁰² The seller is liable, under the warranty of title, for defects in the title which arose prior to the seller's interest, even if the seller had no knowledge of the defect and at all times acted in good faith.²⁰³ Under Article 2A, the lessor is not liable for claims that arise through no fault of the lessor, even if the claim interferes or entirely defeats the lessee's possession.²⁰⁴

The justification for this distinction is two-fold. In a lease transaction, only a limited interest, possession and use for a specified term, is transferred.²⁰⁵ The more limited nature of the interest transferred justifies more limited liability on the part of the lessor. Because the lessor is only liable for claims that arise through its acts or omissions, the lessor will be in a better position to weigh the potential costs associ-

195. Amelia H. Boss, *The History of Article 2A: A Lesson for Practitioner and Scholar Alike*, 39 Ala. L. Rev. 575, 600 (1988).

196. Edwin E. Huddleson, III., *Old Wine in New Bottles: UCC Article 2A-Leases*, 39 Ala. L. Rev. 615, 618-21 (1988).

197. See Boss, *supra* note 195, at 600. Compare U.C.C. § 2-106(1) (defining sale as "passing of title from the seller to the buyer for a price") with U.C.C. § 2A-103(1)(j) (defining lease as "transfer of the right to possession and use of goods for a term in return for consideration").

198. *Id.* § 2A-211(1).

199. *Id.* § 2A-211 cmt.

200. *Id.* § 2A-211(1).

201. *Id.*

202. See generally discussion *supra* part I.D.

203. See discussion *supra* notes 49-54 and accompanying text.

204. Hawkland & Miller, *supra* note 10, § 231.

205. U.C.C. § 2A-211 cmt. (stating modifications in Article 2A to extent of warranty of title from Article 2 reflect limited interest that is transferred under lease).

ated with the warranty.²⁰⁶ If a lessee desires more protection from hidden interests, it can negotiate for that protection.²⁰⁷ By weighing the interest of the lessee to receive unrestricted possession and use of the good with that of the lessor in minimizing the risks and costs involved with the transaction, the drafters of Article 2A struck a balance which provides lessees with protection and lessors with predictability.

Selling secured parties are transferring more limited interests as do lessors. Selling secured parties can transfer the debtor's interest, its interests and any interest in the collateral subordinate to the seller's, but the interest of any creditor which is superior to that of the seller is not transferred.²⁰⁸ Furthermore, the creditor's right to convey this interest is conditioned on the debtor's default.²⁰⁹ Historically, selling secured parties did not warrant title because of this more limited transfer and the fact that the seller was not and was known not to be the owner of the good.²¹⁰ An approach similar to that adopted for leases in Article 2A would result in the selling secured party warranting that no claims, which are caused by an act or omission on the part of the seller, will arise to defeat the purchaser's interest in the good. The selling secured party would essentially warrant its own conduct with respect to the collateral and the foreclosure sale.

At least two cases have suggested that the distinction between warranting the debtor's title and warranting the seller's own conduct in foreclosure sales is a legitimate one. These two courts which have considered the issue of a purchaser's rights against a selling lienholder when the lienholder sells without authority to do so have adopted an

206. *Id.* (explaining that because "the scope of the protection is limited to claims or interests that arose from acts or omissions of the lessor, the lessor will be in position to evaluate the potential cost, certainly a far better position than that enjoyed by the lessee").

207. *Id.*

208. *Id.* § 9-504(4).

209. *Id.* § 9-501 (providing that after debtor is in default, the secured party has rights under Part 5 of Article 9); *id.* § 9-504 (providing that a seller may dispose of collateral after default); see 2 Grant Gilmore, *Security Interests in Personal Property* § 43.3, at 1190-91 (1965) (noting that a secured party cannot act against collateral to collect on a debt unless the debtor is in default); Meadows, *supra* note 2, at 168 (explaining the creditor's right to repossess and resell collateral conditioned on debtor's default); see also *Mitchell v. Ford Motor Credit Co.*, 688 P.2d 42, 46-47 (Okla. 1984) (holding that repossession of collateral where debtor not in default constitutes conversion on the part of the secured creditor); *Trimble v. Sonitrol of Memphis, Inc.*, 723 S.W.2d 633, 642-43 (Tenn. Ct. App. 1986) (finding the secured creditor in possession of collateral only has conditional right to sell collateral after debtor's default).

210. See *Stuart v. American Sec. Bank*, 494 A.2d 1333, 1338 (D.C. 1985) (explaining *caveat emptor* applies to foreclosure sales because selling creditor is known to be transferring debtor's interest, thus has no duty to investigate and disclose potential outstanding claims); *Cohn v. Amidown*, 24 N.E. 944, 944 (N.Y. 1890) (holding no warranty of title existed where circumstances clear that seller only conveying limited interest); see also U.C.C. § 2-312(2) (providing that the warranty of title is excluded or modified when buyer knows seller "does not claim title in himself").

approach similar to that found in Article 2A. These courts permitted recovery by foreclosure sale purchasers where title to the good sold did not pass because of the selling lienholder's conduct. Early this century, the Minnesota Supreme Court permitted recovery under a warranty theory when a lienholder sold a team of horses under an invalid mortgage.²¹¹ The Court distinguished between warranting title against preexisting claims and encumbrances and warranting that the sale was conducted under a valid mortgage.²¹² While the Court found that the seller made no warranty as to the former, the seller at least warranted the right to sell exists.²¹³

The District of Columbia Court of Appeals reached a similar result in *Basiliko v. Pargo Corp.*²¹⁴ In this case, the debtor had cured its default prior to the foreclosure sale, however the lienholder, unaware of the cure, conducted the sale anyway.²¹⁵ When the lienholder refused to conclude the sale after learning of the cure, the purchaser sued to recover damages for breach of contract.²¹⁶ The court permitted the purchaser to recover because the failure to convey good title was a result of the seller's wrongful conduct in proceeding with the sale.²¹⁷ The court stated "the rule of *caveat emptor* can provide no basis for exempting the foreclosure sale vendor from the usual obligation that 'a vendor is bound to know that he can deliver that which he professes to sell.'"²¹⁸ The court found that liability on the seller was justified in that to do otherwise would place the burden of seller's mistake on the purchaser.²¹⁹ Both of these courts, while recognizing the general rule that there is no warranty of title in foreclosure actions, were willing to impose liability on the seller when its failure to convey title to the foreclosure purchaser was due to the actions of the seller. Both cases provide a more reasoned approach to the warranties a selling secured party should give its purchaser than that currently proposed for inclusion in 9-504.

Under this type of approach, the selling secured party would not only warrant its right to sell as in *Basiliko* and *Bogestad*, but also that it has not done anything to give rise to a superior claim to the collateral. Additionally, because the warranty would extend to claims caused by an omission of the transferor, any superior interest which

211. *Bogestad v. Anderson*, 173 N.W. 674, 675 (Minn. 1919).

212. *Id.*

213. *Id.*

214. 532 A.2d 1346 (D.C. 1987).

215. *Id.* at 1347.

216. *Id.* at 1347-50.

217. *Id.* at 1349-50.

218. *Id.* (quoting *Trans World Airlines v. Skyline Air Parts, Inc.*, 193 A.2d 72, 75 (D.C. 1963)).

219. *Id.* For a further discussion of the *Bogestad* and *Basiliko* cases, see Meadows, *supra* note 2, at 198-200.

would survive the sale and was known to the selling secured party would also be covered under the warranty.

C. *Consistent Solutions*

Purchasers at foreclosure sales need some protection from receiving goods with little value, however sellers at these sales are doing so involuntarily and should not be saddled with the burdens of trying to ascertain the validity of debtor's title. Requiring sellers to warrant their own actions, but not that of the debtor or its predecessors-in-title, strikes such a balance.

An approach similar to that found in Article 2A and used by the courts in *Bogestad* and *Basiliko* balances the interests of the parties involved. With respect to title defects caused by its own acts or omissions, the seller has superior knowledge and the ability to cure these deficiencies. The risk of these defects, therefore, should fall on the seller.²²⁰ The seller, however, does not have superior knowledge or ability to prevent loss where the claim against the collateral preexisted the seller's interest. The seller is in no better position than the purchaser. In light of the relatively low amount paid in a typical foreclosure sale, there appears to be no reason to shift the risk to the seller from where it currently resides, with the purchaser,²²¹ who is generally acquiring property at less than market value. Each party to the sale assumes some risk, commensurate with its position and the advantages the sale provides to it.

The issue of warranties and foreclosure sales can be resolved in a number of ways which are not inconsistent with the policies of the Code. The Code can balance the interests of all three parties involved, requiring each to act diligently and placing the loss on the party who does not, as I suggested in my earlier article. It can adopt a more limited approach, similar to that adopted for leases in Article 2A and the *Bogestad* and *Basiliko* cases, leaving the debtor's interests unaltered, but providing purchasers with protection from defects in title caused by the wrongful acts of the seller. Either of these will avoid the problems inherent in the revision currently under consideration.

These approaches, which limit a creditor's liability to claims caused by its own acts or omissions, would not be plagued by the problems and potential challenges, to which the approach found in the current proposed revisions. If the secured creditor only warrants its own actions, the incentive to disclaim, limiting unknown and unpredictable liability, will not be present. The creditor will not have the need to

220. See Menachem Mautner, "The Eternal Triangles of the Law": *Toward a Theory of Priorities in Conflicts Involving Remote Parties*, 90 Mich. L. Rev. 95, 104 (1991) (suggesting that in a situation where one party who can avoid loss, the other should be protected).

221. See generally discussion *supra* part II.A.

disclaim the warranty because its potential liability is circumscribed and within its control. Without the incentive to disclaim, a reasonable creditor will not disclaim, thus taking away a potential challenge to the reasonableness of the sale. Depriving a creditor of the right to disclaim in order to protect the debtor and the reasonableness of the sale will also not be unjust. The creditor is only guaranteeing that there is no claim against the title which it caused; it is not subject to the greater liability of a voluntary seller under Article 2. Taking away this issue as a potential area of dispute between creditor and debtor will promote certainty and predictability in foreclosure sales, consistent with the goals of Article 9.

Similarly, junior creditors will not be exposed to large potential claims unless their act or omission resulted in the claim against the title which caused the purchaser's loss. This should permit junior creditors to reap the benefits of the proposed revision, which will make clear their entitlement to proceeds even as against senior secured parties. Article 9 will not take away with the prefatory language in section 9-504(1) what section 9-504(1)(e) will give. Creditors are clearly better off with this more limited approach.

Purchasers will be protected against the wrongful acts of the creditor. The lack of protection of foreclosure purchasers from claims arising from the acts of the creditor is the most inequitable aspect of current law. These approaches solve this most egregious omission from Article 9. Additionally, the risk of a defect in or lien against the debtor's title remains with the purchaser. Purchasers, therefore, will still have the incentive to inquire as to the state of the debtor's title and potential claims against it, but will be protected against potentially hidden claims caused by the selling secured party, which would be difficult for purchasers to discover. Purchasers are better off than under current law. Furthermore, the purchaser's power to avoid the loss coupled with the protection against the creditor's actions should encourage higher prices at foreclosure sales, a definite benefit to debtors.

Overall transaction costs will be minimized. In every transaction, the secured creditor will not have the need to do an exhaustive search as to the debtor's title, beyond that which it would be likely to conduct under current law. Only when there is a default and resale of the collateral will a search as to the state of the debtor's title by the purchaser be warranted. Unnecessary searches by the creditor in each and every secured transaction will be avoided, thus reducing costs to debtors as a group.

Secured transactions will also be subject to less risk under this approach. Creditors will only warrant their own actions. Thus a creditor who acts reasonably and in good faith will have little to fear under these proposals. The risk to the creditor will be little more than the risk currently present in secured lending. This reduction in risk also

benefits debtors by making lending more available and less expensive. These are consistent with the Code goals of simplicity, certainty and cost-effectiveness.

Both approaches balance the needs of the purchaser and the creditor. The creditor is in the best position to prevent defects caused by its actions, but cannot do so with respect to past defects. The purchaser is given protection from claims caused by the seller's actions, but more limited protection, in recognition of the smaller purchaser price paid at a foreclosure sale. The transaction will be more certain because the seller must insure that transfer to the purchaser is rightful and potential challenges to the validity of the sale on the part of the debtor should be minimized. Transaction costs over all will be minimized, while purchasers will be protected from wrongful actions of the secured creditor. A proper balance will be struck.

Perhaps more important than the adoption of one particular approach is the need for the drafters to carefully consider the problem a Code revision is designed to address in light of the purposes and policies of the Code and all the ramifications of any proposed change.²²² Such an approach should result in a narrowly tailored solution to the actual problem and avoid unnecessary time and expense involved in litigating unresolved issues. While an expectation that the drafters can consider every ramification of each proposed change may be unrealistic, the result, if they do not, will be with the commercial world well into the next century.²²³

222. See Gedid, *supra* note 174, at 372 (suggesting Karl Llewellyn, principal drafter of the Code "consciously included reason, purpose, and policy" in drafting the U.C.C.); Allen R. Kamp, *Between-the-Wars Social Thought: Karl Llewellyn, Legal Realism, and the Uniform Commercial Code in Context*, 59 Alb. L. Rev. 325, 333 (1995) (noting that Llewellyn's jurisprudence which influenced the U.C.C. was to set goals, enact law to reach goals, then monitor its success).

223. The last major revision of Article 9 occurred over two decades ago in 1972. Schwartz & Scott, *supra* note 116, at 596. It is reasonable to expect that the next revision will have similar longevity.