Anatomy of a Deficiency Action: A Case of Deficiency Balance After Repossession of an Automobile

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Anatomy of a Deficiency Action:
A Case History in Recovery of Deficiency Balance After Repossession of an Automobile

(Including a Glance at the Federal Trade Commission's Consumer Protection Rules)

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I. Introduction

This article is a study of deficiency judgment rights. A deficiency is the amount due on an obligation after the collateral security for the obligation has been repossessed and sold by a secured creditor. Deficiency recovery is a major factor in the calculus of creditor's remedies. It is significant in direct and indirect consumer and commercial credit. For purposes of this article, a "direct loan" is made by a financial institution to its customer, who acquires personal property with the proceeds and gives the financial institution a security interest in the goods acquired. An "indirect loan" is a transaction in which a buyer purchases goods on installment. He signs a purchase contract and security agreement with his seller. The seller then discounts the contract and security agreement to a financial institution which collects the loan balance from the purchaser. In either case, if the debtor defaults on the underlying obligation, the financial institution causes its collateral to be repossessed. The collateral is then sold or otherwise disposed of. The proceeds of disposition are applied to the balance due the financial institution. The unpaid balance due after applying proceeds of disposition is the deficiency. A creditor's right to recover his deficiency in court is limited by the remedy structure of Part 5 or Article 9 of the Uniform Commercial Code, by the relevant provisions of the Uniform Consumer Credit Code, and by pertinent rules adopted by the Federal Trade Commission, specifically the proposed Rule on Credit Practices of 1975. In order to understand the impact of the legal system for deficiency recovery, it is necessary to discuss common business and consumer installment credit transactions.

A. A Business Installment Credit.

Many small businesses buy all equipment on an installment purchase program financed directly by an equipment seller, or indirectly through commercial or investment banks. The typical line of credit for small businesses includes installment purchase of new equipment. Automotive dealers are the largest users of business installment credit. The auto dealers' floor plan provides for purchase money security for new and used cars on a trust receipt system. The dealer puts up very little cash for his inventory, the balance being advanced by a commercial bank or one of the automotive captive finance companies, such as General Motors Acceptance Corporation. The financing agency holds a blanket master security agreement on all equipment. When individual cars or trucks are sold to consumers, the vehicles are released from the trust receipts. In many cases, the floor plan financing agency also acquires the "dealer paper" from purchasers as part of its package deal. Similar floor plan arrangements are used in small appliance sales, recreational vehicle sales, and in boat and aircraft sales. Business installment credit,
like commercial credit, is based upon the cash flow of the borrower and the value of the collateral. When a business installment borrower is put in receivership or "skips," the installment lender must seize and sell the debtor's inventory and equipment to satisfy the debt. Many marginal business borrowers are over-financed. Their inventory and equipment are inflated on their books to secure more funds than would be justifiable at true value. Upon re-possession and sale, the commercial lender can get a limited return on his investment because such sales are usually at distress sale prices. In order to make up the difference between the debt due and the sale price of the collateral for the debt, the lender must either sue the original obligor or its guarantors for the deficiency or pass the loss along to its other customers.

The deficiency judgment battleground in business installment financing usually involves a contest between the primary holder of security and junior secured parties over proceeds of sale. It can also involve suit by a lender against guarantors who are obliged to pick up the deficiency balance due on sale of the primary obligor's collateral. Naturally, no guarantor wants to pay off his principal's debt. Junior secured creditors expect their collateral to bring more than the debt due to the senior secured creditor. In extreme situations, the debtor's bankruptcy trustee wants to exploit the possibility of recovering additional funds for the debtor's unsecured creditors from a sale of collateral. If the primary secured creditor seizes and sells all the equipment and inventory of a business debtor, then tries to collect a major part of its debt via deficiency suits against the debtor's guarantors, the result will be contested litigation. If a sale does not bring enough to satisfy the bankruptcy trustee of the debtor, the trustee may try to rescind the sale or recover a part of the proceeds of sale. This article will study business installment loan deficiencies in the context of the more serious consumer credit deficiency problem.

B. Consumer Installment Credit.

Most Americans will buy hard goods on installment credit during their lifetime. That sale will be made under a security agreement perfected by appropriate financing statement or endorsement on title under Article 9 of the Uniform Commercial Code. Many installment buyers will not be able to meet their payments when due. The installment lender, in such cases, will accelerate the balance due and seize the collateral for resale to pay part of the balance due. Consumer goods collateral may decline 50% in value when bought and removed from the showroom floor. At any rate, consumer hard goods are not worth the debt due after purchase in many cases. Since consumer installment loans are made on level payments, there will almost always be a deficiency due after seizure and sale of the collateral. The installment lender can pass the loss on to all customers as a cost of doing business. It can collect it, if possible, from the defaulting debtor as a deficiency judgment.

The American consumer credit system is designed to move hard goods, i.e., to increase employment and industrial production by providing a market for hard goods having a short useful life. The system functions because more than 90% of installment buyers make their payments on time. The remainder, the people who cause deficiency balances, are the raison de etre of this article.

The consumer credit market, for purposes of this review, will not include home mortgage financing. It will cover automobile sales, mobile home and recreational vehicle sales, household goods and appliances. These items are the end product of America's major industries. If the industrial climate is to be healthy, then large numbers of these durable goods must be produced, sold, worn out and replaced. The installment sales and lending cycle is a vital part of this economic machinery. The recent sickening economic slide of 1974-75 owes its force to a sharp decline in consumer installment sales of automobiles.

The installment lender looks to his customer's wages, credit history, job stability and position in the community before deciding to loan him money for a consumer installment loan. He knows that his loan must be paid out of the "payability" of his customer. This means that the available income of the customer, after subtracting his current debts and a factor for income tax and living expenses, is the real security for the loan. A good credit man is usually considering how to recover a deficiency after sale of collateral from his customer when he makes the loan.

If American commercial law makes it tougher to recover deficiency judgments from defaulting debtors, the added

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9. **Installment Credit** at 1-12.

10. The Board of Governors of the Federal Reserve System report the aggregate breakdown of consumer installment credit for July, 1975 as:

<table>
<thead>
<tr>
<th>TYPE</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Automobile paper</td>
<td>$50,465,000,000.00</td>
</tr>
<tr>
<td>Other consumer goods</td>
<td>40,329,000,000.00</td>
</tr>
<tr>
<td>Repair &amp; Modernization</td>
<td>7,908,000,000.00</td>
</tr>
<tr>
<td>Personal loans</td>
<td>43,900,000,000.00</td>
</tr>
<tr>
<td><strong>SOURCE</strong></td>
<td><strong>Amount</strong></td>
</tr>
<tr>
<td>Commercial Banks</td>
<td>$70,130,000,000.00</td>
</tr>
<tr>
<td>Finance Companies</td>
<td>37,711,000,000.00</td>
</tr>
<tr>
<td>Credit Unions</td>
<td>22,674,000,000.00</td>
</tr>
<tr>
<td>Retail Sellers</td>
<td>17,852,000,000.00</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>3,243,000,000.00</td>
</tr>
</tbody>
</table>


13. **Installment Credit** at 21-26. The exact characteristics which every young banker learns are:

(a) the character of the borrower;
(b) his vocational stability;
(c) his financial capacity;
(d) his personal qualifications; and
(e) the nature of the loan. *(Id. at 21.)*

Unlike mortgage financing, the collateral is never worth more than the aggregate value of the loan.

14. *Id.* at 193-94.
cost of doing business raises everyone's loan rates. Rising consumer loan costs is one of the factors in the inflationary cycle. Consumer loan rates are a "cost-push" item in the economy. If the losses from deficiencies can be reduced by collecting a larger portion of loss from the debtor, the savings is passed on to all customers.

C. The Battleground: Debtor vs. Installment Lender.

A defaulting debtor can resist his creditors by any number of tricks or devices. The most common ploy is to hide from the duns, then "skip" to a garnishment free haven such as Florida. More sophisticated creditor-dodgers use the techniques suggested by George Belden's Machiavellian masterpiece, Strategies for the Harassed Bill Payer. The show-down between creditor and debtor is played out in court. The creditor has two options: (a) civil action to recover his loss, or (b) involuntary bankruptcy. The debtor also has options. He can either (a) take a personal bankruptcy, or (b) resist the creditor by defending the creditor's suit. The debtor has a number of defensive weapons in the Uniform Commercial Code and the Uniform Consumer Credit Code. According to current statistics, consumer bankruptcy is the most popular option employed by harassed debtors. However, bankruptcy is a passive remedy. It is good only insofar as the debtor and his attorney understand how to use it. It is a procedure which has many drawbacks. First, a bankrupt may still find it a little harder to get new credit after his discharge. Second, the bankrupt waives his right to recover penalties and damages from his creditors for violating the Uniform Commercial Code and the Uniform Consumer Credit Code. Third, consumer bankruptcy is a passive surrender to creditors. It is emotionally unsatisfying. Most bankrupts generally reaffirm up to 80% of their original indebtedness after bankruptcy, anyway.

The Uniform Commercial Code and the Uniform Consumer Credit Code have draconian penalties with which to drub the unconscionable credit man over the head. The Fair Credit Reporting Act and the Consumer Credit Protection Act have a second series of remedies which can help pay attorney's fees as well. It may be more profitable for an attorney to pick up a $1,000 fee from a successful defense to a deficiency by taxing attorney's fees to the opposite side than to collect $300 for a personal bankruptcy. By assaulting a creditor in his castle, a debtor saves his valuable discharge in bankruptcy for drastic situations such as unanticipated uninsured large medical expense, when it should be used.

Also, most creditors will be willing to "work out" a deficiency balance at no interest to the debtor on extremely reasonable terms. The threat of retaliatory legal action which will require out-of-pocket money from the creditor in addition to his loss may scare the creditor into a reasonable work out of bad debts. Such a lawyer-like compromise may serve the best interest of debtor and creditor. In the mid-1960's economists cheerily predicted that the boom merry-go-round would continue indefinitely. These rosy predictions were wrong. The economic conditions of the mid-1970's indicate that creditors must enforce their rights against debtors in order to keep money costs within limits acceptable to the consumer public. The bad commercial paper of the 1960's and early 1970's cost ordinary credit customers. In order to keep faith with the public, creditors must insist on strict enforcement of consumer credit obligations.

On the other hand, there are social requirements for separating the law of debtor-creditor relations into two branches. The first branch is the law surrounding commercial credit transactions. The second is that surrounding consumer credit transactions. Since the middle 1960's this separation has been made, first by Congress, later by those states adopting the Uniform Consumer Credit Code, finally by the intrusion of the Federal Trade Commission into consumer credit regulation.

The first legislative separation attempt was Truth in Lending. It classified transactions into "consumer credit loans" and "consumer credit sales" for purposes of regulation by the Federal Reserve Board. Truth In Lending made no attempt to regulate commercial credit, other than its assertion of jurisdiction over agricultural credit practices. The second separation was the adoption of Fair Credit Reporting in 1970. The third Congressional intrusion was the passage of Magnuson-Moss in 1972, which authorized the intrusion of the Federal Trade Commission into consumer credit regulation.

At the same time, several states adopted the Uniform

16. The U.S. District Court for the Southern District of Indiana shows a 20% rise in personal bankruptcies in 1975. If current rates hold up, at least 5,000 people will file bankruptcy petitions in 1975 in the District. There were approximately 4,200 bankruptcies in 1974. Interview with Hon. Richard W. VanDier, Bankruptcy Judge, U.S. District Court for the Southern District of Indiana (Indianapolis Division), Richmond, Indiana, June 28, 1975.
17. This has been recognized by creditor's attorneys for decades. One of the principle hard core techniques is harassment of bankrupts into reaffirmation. In most bankruptcies, the bankrupts want to keep their home, household goods and automobile. They will normally reaffirm the debt due on these goods to keep them.
18. See, e.g., Section 9-507 (a) and (b) of the Uniform Commercial Code; Section 5-202 of the Uniform Consumer Credit Code (1968 and 1974); Section 5-203 of the Uniform Consumer Credit Code (1968 and 1974) (Disclosure). Belden refers to this under "unconscionability" as a source of relief from creditors after suit has been filed. Unfortunately, he does not elaborate on the subject sufficiently. (Belden at 85.)
22. As of August 8, 1975, Regulation Z had retreated from attempts to regulate agricultural credit transactions in excess of $25,000.00. 12 CFR 1259-30.
23. 15 U.S.C.
Consumer Credit Code. That Code incorporated many of the provisions of Truth in Lending, plus unique features relating to unconscionable contracts and related remedy rights for injured consumers. All these classification attempts have a common purpose: to separate consumer credit practices from commercial credit practices. The best way to explain the differences is to examine a concrete case history.

II. A Case History

The following case history is taken from an actual consumer credit case tried in Indiana. The names of all parties, witnesses, and places have been changed.

A. The Loan Transaction.

On January 5, 1974 Steve Smith and Sandra Smith bought a 1974 AMC Matador from Gross Rambler, Inc., Salisbury, Indiana. The purchase price was $5,373.72. It was to be paid for by a purchase money security agreement given by the Smiths to Gross Rambler, Inc. and discounted the next day by the Old National Bank of Salisbury. In order to qualify for an indirect loan, the Smiths needed a co-signer. Mr. and Mrs. John Dante, the parents of Mr. and Mrs. Smith, consented to co-sign the purchase money agreement to Gross Rambler, Inc. The agreement was assigned in writing to Old National Bank on January 10, 1974, subject to $500 recourse payable by Gross Rambler, Inc. upon default by the Smiths.

All four signers were obliged to pay the monthly installments of $149.27 due on the Matador. In May, 1974, Mr. and Mrs. Smith got two months behind on the car payments to Old National. The Old National Bank repossessed the Matador. It notified the Smiths of intent to sell and private sale 10 days after repossession. The Dantes were not notified. Mr. and Mrs. Smith went to the Old National Bank with enough cash to make up the missed payments. The bank allowed them to retake the Matador.

B. The Repossession and Sale of the Matador

In August, 1974, Mr. and Mrs. Smith missed a payment on the Matador. On September 13, 1974, the Old National Bank installment loan department decided to accelerate the balance due against Mr. and Mrs. Smith and the Dantes and repossessed the Matador again. On September 11, 1974, Loan Officer John Thomas called Mrs. Smith and told her that the bank would be coming over to repossess the Matador the next day. Swayne Gable, Chief Collection Officer of the installment loan department authorized Thomas to pick up the Matador that day.

On September 13, 1974, Thomas and Samuel Hannah, a second loan officer assigned to collection work, went to the Smith house in Salisbury. Steve Smith came out of the house and gave the keys to the Matador to Mr. Thomas. Mr. Thomas later testified at trial that he did not specifically recall telling Smith that the automobile would be sold at private sale 10 days after pick-up. He did testify that his employers had instructed him to make that oral statement to every customer upon repossession. He said that it was his general policy to do so in each case. Mrs. Smith did not show herself.

According to Old National Bank policy, a mail clerk sent a form notice of intent to sell at private sale by certified mail to Mr. and Mrs. Smith and to Mr. and Mrs. Dante. These notices were retained by the U.S. Postal Service for about two weeks after attempted delivery, then returned to the Old National Bank. No one made any effort to follow up the sale notices by delivering them in person to the Smiths or Dantes.

The Old National Bank of Salisbury has a repossession lot across from its main offices. Swayne Gable testified at trial that he was responsible for managing the lot. The Bank did not have a prominent billboard or sign marking the sales lot. Gable said that “For Sale” signs were put in the windows of most of the cars on the lot, with a telephone number shown on each sign. The public was permitted to walk through the lot to and from the Bank. The dealers who originally sold each repossession, Gable testified, were called by the Old National Bank and asked to buy back their cars. No other notice to used car dealers was given by the Bank. It did not have a list of repossessions posted on the Bank premises for customers to see. It did not advertise its repossessions in the local media.

The Matador was sold November 12, 1974 for $2,500 to Gross Rambler, Inc. No other bids were ever received on the car. Gross Rambler, Inc. paid $500 recourse to the Bank. The net return to the Old National Bank was such that after expense of repossession and sale, the Bank had a deficiency balance of $689.42. Swayne Gable testified that he had appraised the Matador shortly before sale. He stated the fair market value of the car was $2,560 wholesale. He relied upon the National Auto Research Association, Inc. “Black Book” of wholesale prices for Indiana to appraise the car.

C. The Deficiency Action.

The Old National Bank dunned the Smiths and Dantes for several months without success. The Bank then turned the account over to its collection attorneys who brought suit in the Superior Court for Salisbury County against the Smiths and Dantes. Mr. and Mrs. Smith and Mr. and Mrs. Dante hired Melvin Miracle attorney at law to present their case. Miracle filed a two paragraph answer, the first paragraph denying the claims of the Bank for a deficiency. The second paragraph stated two affirmative defenses: (a) the Bank was not entitled to a deficiency because it did not serve notice on all defendants, and (b) the Bank did not sell the car in a commercially reasonable manner. Miracle did not file a counterclaim for 10% of the cash price plus the credit service charge.

26. Those states are: (1968 version only)
- Colorado—C.R.S. 1973 §5-1-101 to 5-9-103 (1971)
- Indiana—E.C. 1971 §24-4.5-1-101 to 24-4.5-9-103 (1971)

27. See e.g. §5-101 et seq. (1968 version).

28. The facts of this case have been taken from the untranscribed record of proceedings in Second National Bank of Richmond v. Ogborn et al., Wayne Superior Court #1, Cause 51-74-8361-C, Wayne County, Indiana.
The case was tried before Judge Fairless. At the close of the plaintiff's case, Miracle moved for judgment on the evidence (directed verdict) for the defendants on the grounds that the plaintiff had failed to prove that each and every defendant received notice of sale and that the plaintiff failed to make a prima facie case that its sale of the 1974 Matador was commercially reasonable.

D. Hypothetical Alternatives.

For purposes of this article, suppose the case had been brought in 1977 after the adoption of the Federal Trade Commission Rule on Preservation of Consumer Claims and Defenses. Would the defendants have additional defenses to liability arising out of the required notice imposed by the Federal Trade Commission by that rule? If the proposed Federal Trade Commission Rule on Credit Practices became a final rule, would that rule's provisions relating to "fair retail market value" credit for repossessed goods mean the defendants would automatically win?

The remainder of this article will take up this case and apply the three integers of deficiency recovery law to the facts of the Smith-Dante defenses.

III. Deficiency Law Applied to the Case of Old National Bank v. Smith

A. Statutory Provisions for Deficiency Judgments.

1. Pre-Uniform Commercial Code Background in Indiana.

Since Old National Bank of Salisbury v. Smith et al. was an Indiana case, Indiana's history of commercial credit sales law prior to 1963 helps to illustrate the problem. Indiana's history is not materially different from most states (New York and Louisiana excepted).

Prior to 1963, Indiana had several statutes describing ways of retaining a security interest in personal property. First there was the Chattel Mortgage Act of 1935. Under the Chattel Mortgage Act a creditor holding a mortgagee's interest in personal property could repossess collateral. If the mortgage contained a power of sale, he could sell the collateral at public sale. After such a sale, if the mortgage provided for a deficiency clause, the creditor could collect a deficiency judgment from the debtor. Section Fourteen of the Conditional Sales Act gave the conditional seller the right to repossess his collateral upon default. Section 15 permitted a seller to make notice of intention to retake not less than 10 days prior to retaking. If he did so, the collateral could be sold according to Section 17 (compulsory sale if 50% of the purchase price or more had been paid) by public sale with notice delivered to the buyer by registered mail or in person stating that the sale would take place 10 days after the date of delivery, plus three notices posted in public places in the county in which the collateral was to be sold. If $500 or more had been paid on the purchase price, the conditional seller would have to advertise the sale of collateral in a local paper. Under Section 18, a conditional seller had no obligation to sell repossessed collateral unless the conditional buyer demanded a sale. If the seller elected to make a sale, it would be done as described above. Indiana also had the Retail Installment Sales Act. Although that act contained no express provisions about retaking and selling collateral, it did refer to the Conditional Sales Act, which was to be the guide for repossession and sale. Indiana case law held that a conditional seller could repossess collateral and sell it without notice to the buyer, if a "deficiency clause" in the original contract provided for such procedure. The buyer was liable for the deficiency in any case.

The Uniform Commercial Code was adopted in 1963 to do away with the mess described above. Under pre-Code law, a conditional seller had a clear right to obtain a deficiency judgment against the conditional buyer after sale. He was not obliged to give the buyer notice of sale. Any sale would be reviewed by the courts with a jaundiced eye. If the conditional seller proved that he got a fair market price for the collateral, he could get a deficiency judgment. Indiana was one of many states which ultimately looked to the outcome of the sale to determine whether the conditional seller could claim a deficiency judgment against the conditional buyer.

2. The Uniform Commercial Code Deficiency System.

The provisions of Article 9 of the Uniform Commercial Code permit any secured creditor to recover a deficiency

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31. Id. § 444.2 (a) (7).
31a. The facts of this illustration are taken from Wayne Superior Court # 1, Docket Number S1-75-8361-C tried August 8, 1975.
33. Lee v. Fox, 113 Ind. 98, 14 NE 899,890 (1888).
35. §51-606.
37. §58-814.
38. §58-815.
39. §58-817.
40. Id.
41. Id.
42. §58-818.
43. Id.
45. §58-930.
48. Id.
49. Id.
judgment by following the steps of Section 9-504. Section 9-504(3) describes the method of conducting a sale. The Uniform Commercial Code does not provide for any election of remedies or for any special rights of defense against a deficiency action.

a. Secured Creditor's Remedies Under Article 9 of the Code.

Section 9-501 of the Uniform Commercial Code describes the remedies which a secured creditor has after the debtor defaults. Those remedies include all the remedies described in Part 5 of Article 9 of the Code as well as those described in the security agreement. The remedies of the creditor are cumulative. Section 9-502 states the collection rights of the secured creditor. The most important part of this section is:

(2) A secured party who by agreement is entitled to charge back uncollected collateral or otherwise to full or limited recourse against the debtor and who undertakes to collect from the account debtors or obligors must proceed in a commercially reasonable manner, and may deduct his reasonable expense of realization from the collections. If the security agreement secured an indebtedness, the secured party must account to the debtor for any surplus, and unless otherwise agreed, the debtor is liable for any deficiency. This means that the Uniform Commercial Code specifically grants secured creditors the right to press deficiency remedies against debtors after sale of collateral. The courts seem to fail to notice this provision of the Code in conjunction with Sections 9-504, 506 and 507.

Section 9-503 provides that the secured party can take possession of its collateral upon default by self-help without breach of the peace. It can also take possession by replevin or similar procedures. It can also dispose of the collateral from the debtor's premises if it wishes to do so.

Section 9-504 is the heart of this remedy system. It provides that any secured creditor can sell, lease or otherwise dispose of any repossessed collateral in a commercially reasonable manner. The creditor may apply the amount recovered to (1) the cost of retaking, preparation and the like; (2) payment of the debt due; (3) payment of any subordinate security interest or levy. The creditor's right to get a deficiency judgment against the debtor is reasserted by Subsection (2). Subsection (3) is the principal part of this scheme:

(3) Disposition of the collateral may be by public or private proceedings and may be made by way of one or more contracts. Sale or other disposition may be as a unit or in parcels and at any time and place and on any terms but every aspect of the disposition including the method, manner, time, place and terms must be commercially reasonable. Unless the collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market, reasonable notification of the time after which any private sale or other intended disposition is to be made shall be sent by the secured party to the debtor.

Subsection (4) provides that a purchaser at public or private sale of the collateral get the collateral free and clear of the secured party's security interest. It is a foreclosure and power of sale provision, which must be read into all security agreements drawn after the adoption of the Code. Subsection (5) deals with the creditor's right to proceed against recourse sellers or repurchase agreement paper. It says that the secured party can pass repossessed collateral to a recourse seller under a repurchase agreement which maintains all the rights he has. That act is not a sale or disposition of collateral under the Uniform Commercial Code.

Section 9-505 tells creditors that they must make compulsory disposition of any collateral held within 90 days of repossession if the debtor has paid 60% of the purchase price. The second subsection allows secured creditors to take the old conditional sales act remedy of repossession in satisfaction of the debt due. This is the only election of remedies provision in this Article of the Code.

Section 9-506 is the redemption portion of the program. It says:

At any time before the secured party has disposed of collateral or entered into a contract for its disposition under this section, or before the obligation has been discharged under section 9-505(2) the debtor or any other secured party may unless otherwise agreed in writing after default redeem the collateral by tendering fulfillment of all obligations secured by the collateral as well as the expenses reasonably incurred by the secured party in retaking, holding and preparing the collateral for disposition, in arranging for the sale and to the extent provided for in the agreement and not prohibited by law, his reasonable attorney's fees and legal expenses.

From time to time, appellate courts have confused this provision with Section 16 of the old Conditional Sales Act. Section 16 barred deficiency judgments. It was an election of remedies. Section 9-506 is not that type of provision.

Section 9-507 makes secured creditors liable to their debtors for failure to comply with Part 5 of Article 9 of the Code. A debtor or any junior secured party can enjoin a commercially unreasonable sale. After sale the injured parties have the following remedy:

... the debtor or any person entitled to notification or whose security interest has been made known to the secured party prior to the disposition has a right to recover from the secured party any loss caused by the failure to comply with the provisions of this Part. If the collateral is consumer goods, the debtor has a right to recover in any event an amount not less than the credit service charge plus ten (10%) per cent of the principal amount of the debt, or the time price differential plus ten per cent (10%) of the cash price.

This section resembles Section 23 of the Conditional Sales

50. IC 26-1-9-504. All citations to the text of the Uniform Commercial Code and the Uniform Consumer Credit Code (1968 Edition) are to the versions adopted by Indiana.
51. IC 26-1-9-501.
52. IC 26-1-9-502.
53. Id.
54. IC 26-1-9-503.
55. IC 26-1-9-504 (1).
Act, traditionally viewed by the courts as a counterclaim provision. The second part of this section clearly tells debtors that another method of sale for the collateral, a different time of sale, or any other factor which might have brought a higher price for the collateral doesn't defeat a deficiency. It says that if the secured party follows reasonable commercial practices among dealers in the type of property sold, the secured party is acting reasonably. Any disposition approved by court order or by creditor's meeting or trustee for benefit of creditors is commercially reasonable, no matter how bad the result may be.


The definitions of terms used in Part 5 of Article 9 control the meaning of the remedy structure of the Code. One of the most important such definitions is that of "debtor." A "debtor" . . . means the person who owes payment or other performance of the obligation secured, whether or not he owns or has rights in the collateral and includes the seller of accounts, contract rights or chattel paper. Where the debtor and the owner of the collateral are not the same person, the term "debtor" means the owner of the collateral in any provision of the article, the obligor in any provision dealing with the obligation and may include both where the context so requires.

The Code also provides a significant definition of notice. Section 1-210(26) says:

(26) A person "notifies" or "gives" notice or notification to another by taking such steps as may be reasonably required to inform the other by ordinary course whether or not such other actually comes to know of it. A person "receives" notice or notification when (a) it comes to his attention; or (b) it is duly delivered at the place of business through which the contract was made or at any other place held out by him as the place for receipt of such communication.

"Send" has a special meaning under the Code. Section 1-201(38) says:

(38) "Send" in connection with any writing or notice means to deposit in the mail or deliver for transmission by any other usual means of communication with postage or cost of transmission provided for and properly addressed and in the case of an instrument to an addressee specified thereon or otherwise agreed or if there be none to any address reasonable under the circumstances. The receipt of any writing or notice within the time at which it would have arrived if properly sent has the effect of a proper sending.

The Uniform Commercial Code should be first read before any decisions are made on what it means. The Code contains its own set of rules and definitions. Many courts refuse to grant the Uniform Commercial Code its right to define its own terms and make its own rules on deficiency judgments.

3. The Uniform Consumer Credit Code of Deficiency Judgments.

The Uniform Consumer Credit Code has altered the deficiency judgment structure of the Uniform Commercial Code. Article 5, parts 1 and 2, are the remedy and enforcement provisions of the Uniform Consumer Credit Code. Section 5-106 says that deficiency rights after re-possession or surrender of collateral to a creditor are waived for goods having a cash price or loan amount of $1,000 or less. This re-establishes, in part, the familiar election of remedies doctrine of Section 22 of the Uniform Conditional Sales Act. Section 5-105 provides that an "unconscionable agreement" may not be enforced by the courts, or may be severely limited in scope, in a consumer credit sale or loan. Section 5-202 prescribes a number of monetary penalties which an injured debtor can collect from a creditor for violation of the disclosure and refund provisions of the Consumer Credit Code. The Consumer Credit Code does permit an injured debtor to tax his attorney's fees to his creditor if he wins. None of these remedies allow a debtor to recover damages for an "unconscionable sale" of repossessed collateral. The Uniform Consumer Credit Code creates no affirmative defense for a debtor being sued on a deficiency arising from the sale of goods having a cash price or loan value of more than $1,000.

However, the provision for collection of attorney's fees and for relief from "unconscionable" clauses in contracts gives debtors significant weapons against deficiencies.

The statutory framework set out above is necessary to know what to make of the case law on deficiency judgments since 1961. The courts have mangled the Uniform Commercial Code by reading into it all sorts of game-rules taken from pre-Code law. Each state seems to develop its own little rules. The result is that there is no uniform deficiency judgment law in the United States.

B. Were the Defendants Entitled to Judgment on the Evidence Because the Old National Bank Failed to Serve Notice on Defendants of the Private Sale of the Collateral?

1. Were Mr. and Mrs. Dante Protected by Section 9-504(3)?

The evidence at trial showed that neither Mr. nor Mrs. Dante received notice of sale. It did show they were sent notice, but did not accept or receive it. The Dantes did not change residence and the letter was properly addressed. Section 9-504(3) of the Uniform Commercial Code requires notice to be sent to the "debtor" or to any person having a security interest or lien on the collateral. Under Connecticut law, Mr. and Mrs. Dante were not "debtors" and could not assert that they were entitled to

66. IC 26-1-9-507 (2).
67. Id.
68. IC 26-1-9-501 (d). (Emphasis added.)
69. IC 26-1-1-201 (26). (Emphasis added.)
70. IC 26-1-1-201 (38). (Emphasis added.)
71. IC 24-4.5-5-104 defines "consumer credit sale" as a sale of goods, services or interest in lands in which credit is granted by a person who regularly engages as a seller in credit transactions, and the buyer is other than an organization, the goods being purchased are primarily for personal, family, household or agricultural purposes, the debt being payable in installments.
72. IC 24-4.5-5-103.
73. IC 24-4.5-5-103 (3).
75. IC 24-4.5-5-108.
76. IC 24-4.5-5-108 (1).
77. IC 24-4.5-5-202.
78. Currently, the Indiana limitation is $1,100 as set by the Department of Financial Institutions. The 1974 revision of the Uniform Consumer Credit Code would revise this figure to $1,750. That sum is much less than the amount financed in most new or used car sales transactions.
79. IC 26-1-9-504.
be sent notice of sale. Under Maine law, as stated in *Camden National Bank v. St. Clair*, the Dantes would be entitled to be sent notice of sale because “debtor” includes co-makers on a retail installment contract for purchase of a car, even though the car is titled in the name of the other maker. This result recognizes the latent ambiguity of Section 1-105(d) of the Uniform Commercial Code, and finds that “debtor” means a co-maker or accommodation party as opposed to Section 9-504(3) as required. The Maine result is better law than the Connecticut result. Ordinary suretyship law would excuse the Dantes from liability for impairment of recourse or collateral. Therefore, Mr. and Mrs. Dante were entitled to be sent notice of the impending sale of the Matador.

2. Must Notice of Sale Be Written?

The evidence in the case showed that Steve Smith met Loan Officer Thomas when his car was repossessed. Thomas said that he could not recall telling Smith that the car would be sold within ten days, but that it was his policy to tell all customers upon repossession. The Old National Bank is entitled to the inference that Smith was informed of the sale, because evidence of its usual custom, policy or practice is competent to prove that an act was done. The court had to accept the inference upon a motion for judgment on the evidence (directed verdict). If the Uniform Commercial Code does not require written “notice” the oral statement to Smith may be sufficient notice to him. Maryland has held that oral notice of a proposed public sale of collateral made to the attorney for the holder of a second security interest in the collateral was sufficient notice under Maryland law to satisfy Section 9-504(3). Arkansas has determined that oral notice which properly identified the time and place of sale would suffice under the Uniform Commercial Code in *Barker v. Horn*.

3. Since Mrs. Smith and the Dantes Did Not Receive Notice of Sale, Is the Old National Bank Denied Recovery as a Matter of Law?

The leading case preceding the annotation in 59 ALR 3rd 401 on the subject of notice to debtors is *Atlas Thrift Co. v. Horan*, a California case denied in 1972. That case says that the defendant cannot plead failure to receive notice of sale as an affirmative defense to deficiency judgment liability. California has accurately stated a rule followed by ten other states in varying forms, which says that if the debtor does not receive notice of sale, the creditor is barred from recovering a deficiency judgment as a matter of law. The ten states besides California which subscribe to this rule include: District of Columbia, Florida, Iowa, Maine, Michigan, Nebraska, New Mexico, Pennsylvania, South Dakota, and Wyoming.

The following states have adopted a contrary rule which

92. Id. at 309 A2d 331.
93. Id.
94. See IC 26-1-3-405 which says that any signature in an ambiguous capacity must be construed as an endorsement. IC 26-1-3-415 spells out the contract of an accommodation party. IC 26-1-3-601 provides that any party to an instrument is discharged to the extent that the holder without the party’s consent unjustifiably impairs any collateral for the instrument. Sale of the collateral without notice to accommodation parties at wholesale is an impairment of collateral which may be sufficient to discharge the accommodation party.
95. See 1 Jones, *Evidence* §4.10 at 401-03 (1972).
96. Indiana’s Rules of Trial Procedure are essentially the same as the Federal Rules of Civil Procedure. Under Trial Rule 50, as under Rule 50 of the Federal Rules, the party against whom a directed verdict or judgment upon the evidence is sought is entitled to all favorable inferences and presumptions. *Miller v. Grisell*, Ind., 308 N.E.2d 701, 707 (1974).
101. Id. at 104 Cal. Rptr. 318.
107. *Bank of Gering v. Glover*, 192 Neb. 575, 223 NW2d 56 (1974). *Associates Finance Co. of Nebraska v. Teske*, 190 Neb. 747, 212 NW2d 572 (1973) was not directly overruled, although it was a “no notice” case also. In Teske, the debtor did not receive notice of sale. Sale was private. The debtor counterclaimed under Section 9-507 for the statutory penalty of the credit service charge plus 10% of the cash price of the goods. The debtor sold the sale for $200 was for much less than the fair market value of the goods. The Teske decision talks about the plaintiff’s burden of proof of commercially reasonable sale and the fact that Teske got no notice of sale is ignored. Perhaps Teske’s attorney forgot to plead “no notice” as an affirmative defense.
says that failure to receive notice of a sale does not deprive the creditor of its deficiency rights, but is one factor in determining whether the creditor's sale was commercially unreasonable: Arkansas, 102 Alaska, 103 Colorado, 104 Illinois, 105 Montana, 106 New Jersey, 107 Tennessee, 108 Texas, 109 and Washington, 110

The following states have divided lower appellate court precedent on the issue of the "no-notice" defense and must be classified as doubtful: Georgia, 111 New York, 112 and Massachusetts. 113

The real question presented by the cases is whether the provisions of Section 9-504(3) of the Uniform Commercial Code require the debtor to get notice. An internal interpretation of the Code suggests that this is not the case. The following schematic outline restates the Code's provisions for sale and notice:

(a) A secured party may sell, lease or otherwise dispose of collateral upon default in a commercially reasonable manner; 114

(b) If the secured party chooses to sell he may make either public or private sale in units or in parcels; 115

(c) Unless the collateral is perishable or threatens to decline speedily in value, or is of a type customarily sold on a recognized market, the creditor must send reasonable notice to the debtor or any junior lienholder or secured party stating when public sale will take place, or the date after which private sale will be had. 116

(d) The debtor has the right to redeem the collateral before sale by paying off the balance due the creditor plus expense of retaking. 117

(e) If the secured party does not comply with these provisions, it may be restrained. If the collateral has been disposed of, the injured party may recover any loss by failure to comply with the Code; 118

(f) If the collateral is consumer goods, the debtor has the right to recover 10% of the purchase price plus all interest charged from the secured party; 119

(g) To recover for loss or for penalty, the debtor will have to show that the sale was commercially unreasonable as to method, manner, notice and purchase price. 120

Otherwise the creditor wins.

The cases cited in support of the "no-notice" defense are neither uniform nor consistent. For example, several cases follow Leasco Data Processing Equipment Corp. v. Atlas Shirt Co. 121 and the early case of Skeels v. Universal CIT Credit Corp. 122 They say that the Uniform Commercial Code does not disturb the strict notice requirements of the old Conditional Sales Act. It is cumulative, rather than a supplanting provision. Therefore, unless a creditor strictly follows the old notice requirements, which act like service of process, he loses. 123 Atlas Thrift Co. v. Horan follows this line of thought. 124 California, however, altered Section 9-504(3) by requiring service by registered mail or in person upon the debtor as was true under Section 17 of the Conditional Sales Act. 125 This result is not good law. It places an unwarranted priority on receipt of notice of sale, without examining whether the entire transaction was commercially reasonable.

Other "no-notice" states appear to misread the Uniform Commercial Code itself. The leading offender is Iowa. Twin Bridges Truck City v. Halling 126 somehow concludes that Section 9-504(3) requires the creditor to plead and prove it sent notice of sale which was received. 127 The court ignores the operative word "send" and substitutes consumer transactions. However, Steelman v. Associates Discount Corp., 121 Ga. App. 649, 175 SE2d 62 (1970) clearly holds that notice to debtor of private sale of a repossessed car is not condition precedent to recovery of a deficiency. In that case, the debtor never got notice. Notice was misdirected to another person having a similar name. The Court allowed a deficiency judgment to stand. These cases cannot be reconciled.


Massachusetts is also split. One Twenty Credit Union v. Darcy, 40 Mass.App. Dec. 64, 5 U.C.C.R.S. 792 (1968) says that notice to the debtor is condition precedent to recovery. Abbott Motors, Inc. v. Ralston, 28 Mass.App. Dec. 35 (1964) says that it is not.


105. Tauber v. Johnson, 8 Ill.App.3rd 789, 219 NE2d 180 (1972). Morris Plan of Bettendorf v. Johnson, 133 Ill. App. 3rd 717, 217 NE2d 404 (1971) does not contradict Tauber. It applied ordinary suretyship law to the original obligor on a note incorporating security agreement on a truck, which was repossessed and resold to a second buyer who assumed the payments. The second buyer defaulted, the Morris Plan repossessed again and resold the collateral to a third buyer without notice to the original obligor. The original maker was a surety, and entitled to the usual protection of discharge by reason of impairment of recourse on collateral.


111. The following cases seem to indicate that Georgia has adopted a "no notice-no deficiency" rule: Edmonson v. Air Service Co., 123 Ga. App. 263, 180 SE2d 589 (1971); Braswell v. American Natl Bank, 117 Ga. App. 699, 161 SE2d 420 (1963); Gurwitch v. Luxvest Furniture Mfg. Co., 124 Ga. App. 314, 314 SE2d 373 (Ga. 1973) applies the "no notice-no deficiency" rule to a commercial case as well as consumer transactions. However, Steelman v. Associates Discount Corp., 121 Ga. App. 649, 175 SE2d 62 (1970) clearly holds that notice to debtor of private sale of a repossessed car is not condition precedent to recovery of a deficiency. In that case, the debtor never got notice. Notice was misdirected to another person having a similar name. The Court allowed a deficiency judgment to stand. These cases cannot be reconciled.

112. IC 26-1-9-504.

113. IC 26-1-9-504 (3).

114. IC 26-1-9-506.

115. IC 26-1-9-507.

116. IC 26-1-9-504 (3).

117. IC 26-1-9-506.

118. IC 26-1-9-507.

119. IC 26-1-9-504 (3).

120. IC 26-1-9-506.

121. IC 26-1-9-507.

122. IC 26-1-9-504 (3).

123. IC 26-1-9-506.

124. IC 26-1-9-507.

125. IC 26-1-9-504 (3).

126. IC 26-1-9-506.

127. IC 26-1-9-507.
“receive” in its place. *Aimonetto v. Keepes* commits a similar error in Wyoming. That case required the plaintiff creditor to comply strictly with Section 9-504(3) by making sure the debtor received notice.

The common note among the cases supporting the “no-notice” rule is the idea that debtors have to be served with notice like service of process. If service is not made, the debtors should win. Such notions are not found in the Uniform Commercial Code. They are relics of the Conditional Sales Act. The effect of the “no-notice” rule is to make it hard to recover a deficiency if the debtors dodge notice sent by the creditor.

The cases which say that failing to serve the debtor with notice is one of many factors in analyzing a sale usually talk about lack of notice creating a rebuttable presumption that the collateral was worth the amount of the debt. This was the rule stated in *Norton v. National Bank of Pine Bluff*, the first case in which deficiency judgment liability under the Code was really tested. That rule really says nothing more than the plaintiff has the burden of proof that his sale was commercially reasonable. Arkansas has adopted this rule in *Carter v. Ryburn Ford Sales, Inc.* This latter rule makes more sense and is in line with the liberal construction of the Uniform Commercial Code described in this article. Therefore, Judge Fairless should conclude that the plaintiff cannot be denied a deficiency judgment as a matter of law because three of the defendants did not receive notice of sale.

C. Was the Old National Bank’s Sale of the Collateral Commercially Unreasonable as a Matter of Law?


The case is on motion for judgment on the evidence (Directed Verdict). The defendants have offered no evidence contradicting plaintiff’s case. If the plaintiff has failed to carry the burden of making a prima facie case of liability, it loses.

2. Analysis of Sale.

This article has insisted that the entire transaction must be reviewed before any court can say a repossession sale was reasonable or unreasonable.

a. Notice of Sale.

Three of four defendants did not receive notice of intent to sell from the Old National Bank. They could not exercise their rights to redeem the collateral under Section 9-506. Had the defendants filed a counterclaim, they could initiate proof of such a claim for penalty by starting with ineffective notice of sale which denied them redemption rights. The evidence at trial showed that notice was sent to each defendant. Therefore, the Old National Bank substantially complied with Section 9-504(3) of the Uniform Commercial Code. It sent notice in a manner reasonably calculated to let the defendants know what had become of the collateral and how they could redeem it.

b. Advertising.

The evidence discussed earlier shows that Old National did not advertise its repossessed vehicles in the media nor post a list on its premises. It maintained a lot on which the public could get a look at the cars. The advertising of repossession sales is very important to the eventual sale of the same. Without effective advertising, repossessions will be sold in a haphazard fashion. Therefore, the Old National Bank did not advertise sales conspicuously.

c. Sales Technique.

According to the evidence, one loan officer at Old National is in charge of repossession sales. He appraises the repossessed vehicles by physical inspection and by resort to the ADA Blue Book and the NARA Black Book, standard appraisal guides for automobile sales. Swayne Gable appraised the 1974 Matador of the Smiths as “clean” or “average.” The Old National Bank likes to make sales on bids, but in this case, no one other than Gross Ramble, Inc. ever was interested enough in the car to make a bid. Swayne Gable testified that the Old National always appraises its repossessed cars and trucks at wholesale because in their experience no one would pay more than wholesale price for “as is” automobiles that were not reconditioned. The Matador was appraised for $2,560 wholesale. The manner of taking bids and appraisal appeared to be fair and regular.

d. Sales Price.

The Matador sold for $2,500, $50.00 less than the wholesale price. In order to have a better sale, the Old National Bank would have had to have had another bidder. There were no other bidders in two months. As automobile prices decline rapidly as cars get older, the Old National Bank would not be justified in holding up the sale of the Matador more than 60 days. A wholesale sale of a repossessed vehicle is not commercially unreasonable as a matter of law. The fair market value of the repossessed vehicle may be wholesale value. The pricing guides used by the Old National Bank in establishing its sales price are competent evidence of car value.

3. What the Courts Have Said on Commercially Reasonable Sales.

Section 9-504(3) requires the entire transaction between repossession creditor, third party buyer and the debtors be analyzed to see if the sale was commercially reasonable. This result is approved by the best discussion of commercially reasonable sales, *In re Zsa Zsa, Ltd.* In *Zsa Zsa*, a bankrupt corporation’s assets were turned over to its primary secured creditor for liquidation. No notice of sale was given to the trustee in bankruptcy of the corporation. Sale was public. It was advertised in the *New York Times* three or four times. The sale was held by an experienced auctioneer in the warehouse in which the corporation’s inventory was stored. Bidders were allowed to examine the goods before sale day. The sale was well attended. The inventory sold for $300,000—more than

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$500,000 less than the debt due. After a thorough and exhaustive analysis of the sale, the U.S. District Court for the Southern District of New York approved the sale as commercially reasonable. The court said that it was obliged to review the entire sale, not merely the outcome. This is a restatement of the provisions of Section 9-507(2) of the Code. But not all courts have been as liberal and fair-minded. The commercially reasonable sale is by nature not something that can be established by ironclad rules of law. However, several state appellate courts have tried to go back to the outcome-determination rule of pre-Code law.

In *Eaton, Yale & Town, Inc. v. Sherman Industrial Equipment Co.*, the repossessing creditor sold its collateral at public sale without reconditioning or preparation. The debtor's lawyers argued that the sale was commercially unreasonable because ordinary public sales would have been made after the machinery repossessed from Sherman Industries had been reconditioned, bringing a better price. The district judge properly ruled that it was not commercially unreasonable as a matter of law to sell the collateral in an "as is" condition. This case parallels in most respects *In re Zsa-Zsa, Ltd.*

On the other hand, *Mercantile Finance Corp. v. Miller*, which allegedly follows Pennsylvania law, reviewed a sale of inventory repossessed from Mercantile Finance Corp. It was sold for $19,000. That price was substantially less than the appraised value of the goods sold. The district judge said that such a sale raised a rebuttable presumption that the sale was commercially unreasonable. In this case, the judge held that the creditor had not rebutted the presumption. This case flies in the face of Section 9-507(2). There isn't anything in the Code which establishes presumptions or rules about the outcome of sale. The true meaning of this case is that the creditor has the burden of proving that its sale was commercially reasonable. If the evidence put on by the creditor shows that the sale was substantially below fair market value, it has failed to make its burden of proof as a matter of law.

In consumer credit transactions, New Jersey may have created a new hydra: the unconscionable disposition of collateral. *Urdang v. Muse* denied recovery to a creditor trying to recover a $771.25 deficiency after resale of a Plymouth. After repossession and before sale, Muse borrowed $900 on an open note. Muse went to Chrysler Credit Corporation, the noteholder, and offered to pay it $900 for the return of the car. The $900 exceeded the amount of his missed payments, repossession costs and incidental expense of $319.16. It was approximately $300 less than the balance due on the car. Instead of taking the $900 and returning the Plymouth to Muse, Chrysler Credit sold the car at private sale, generating a deficiency of $771.25. The account was assigned to plaintiff for collection. The court found the sale was unconscionable because Muse had made tender of $900 leaving a deficiency of $280.71 secured by the car. The court said that the automobile should have been returned to Muse because the car was worth more than $280.71. The sale was therefore unreasonable and the deficiency should not be collected from Muse. The result is not justified by the reasoning of the court. Muse had missed three payments and had "skipped" to Washington, D.C. with the collateral. The loan was accelerated by Chrysler Credit Corporation to prevent Muse from skipping with the collateral again. The court invoked Section 2-302 of the Uniform Commercial Code and its general equity power to relieve the debtor from default because it felt he had been unfairly treated.

What the court really says is that a consumer debtor has unlimited redemption rights, despite the express requirement of Section 9-506 about paying off all the debt due. If a debtor comes to his creditor after repossession and offers him a substantial part of the debt due, the creditor must surrender the collateral to the debtor. That is not a just result.

*Vic Hansen & Sons, Inc. v. Crowley* is another difficult consumer resale case. A car was repossessed and appraised at $700-$800 wholesale or $995-$1,595 retail according to the NADA Blue Book of Prices for that part of Wisconsin. The car was "sold" by transferring the wholesale value of the car to the creditor's charge-off ledger. The car was later marketed by the creditor as a used car and sold for a good retail price. The court looked at this transaction with disgust. The court correctly denied a deficiency judgment because the "sale" was unreasonable. The "disposition" of the car in this case was without any justification, said the court. Although a wholesale sale is not commercially unreasonable as a matter of

135. Id. at 669-71.
137. Id.
140. Id. at 801.
141. Id.
142. Id. The decision is an interlocutory ruling permitting Miller to reopen a default judgment under Rule 55 and put on evidence to show that the case was commercially unreasonable. It was unnecessary for the district judge to make any findings about the value of the collateral to determine if the Rule 60 Motion filed by Miller presented a meritorious defense.
144. Id. at 276 A2d 398.
145. Id.
146. Id. at 276 A2d 402.
147. Id.
148. Id. at 276 A2d 398.
149. Judge Yanoff fastens on to the idea that somehow the defaulting debtor should be relieved of the acceleration clause in the dealer contract from Monarch Chrysler-Plymouth. He tries to tie in *Henning vs. Bloomfield Motors, Inc.* 32 N.J. 358, 161 A2d 69 (1960) by stating that if a dealer contract is an adhesion contract, then the court can relieve the weaker party from the strict words of the contract. Judge Yanoff doesn't like the idea that Philip Muse signed an agreement by which he agreed to surrender his car upon default, or have it repossessed by the credit agency holding the paper. Muse did not read the contract. (276 A2d 405.) Therefore, the creditor cannot refuse redemption even if the debtor tenders about ½ of the balance due, instead of the balance due plus expense of retaking. The payoff was $1180.71 (Id. at 276 A2d 404).
150. 57 Wis. 2d 106, 203 NW2d 341 (1973).
151. Id. at 203 NW2d 734.
152. Id. at 732.

On November 14, 1975, the Federal Trade Commission promulgated its Rule on Preservation of Consumers' Claims and Defenses. This rule made an "unfair and deceptive trade practice" the taking or receiving of a "consumer credit contract" which failed to include the following language in ten point bold-face type:

NOTICE

ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED PURSUANT HERETO OR WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.

This rule became binding May 14, 1976. It prohibits any "creditor" from accepting an assigned "consumer credit contract" which does not contain the required notice. Since the required notice becomes part of the original credit transaction, it creates debtor's rights to make any defense or counterclaim which the debtor may have against the original seller of the goods against the holder of the contract. The limitation on this right is the sum already paid to the creditor by the debtor.

On August 16, 1976, the Federal Trade Commission issued a "Statement of Enforcement Policy" in which the Commission described its intention to apply the notice rule to direct and indirect consumer credit loans. The Commission intends to make the consumer's duty to pay dependent upon the seller's duty to meet all his legal commitments to the consumer-debtor. The Commission indicates it will enforce the notice requirements against direct lenders as well as upon discount purchasers of sales contracts. If the seller "refers" customers to the direct lender, or if the direct lender is an "affiliate" of the seller, then the required disclosure must appear on the direct loan documents of the lender. The Federal Trade Commission gives the following list of what constitutes "affiliation":

1) Maintenance of loan application forms of the lender in the office of the seller;
2) Seller agrees with creditor to prepare loan documents;
3) Creditor's referrals of customers to a sales outlet;
4) Payment of consideration to a seller for furnishing loan customers, or to a creditor for furnishing sales prospects;
5) The assignment of indirect paper or the referral of loan customers to a creditor;
6) Active creditor participation in a sales program;
7) Joint advertising efforts;
8) An agreement to purchase paper on an indirect basis.

153. Id. at 733.
157. Section 5 of the Federal Trade Commission Act (15 U.S.C. §45(a)). That section forbids and declares unlawful "unfair methods of competition in commerce and unfair or deceptive acts or practices in commerce." Magnuson-Moss adds to the basic framework of Section 5 the power to issue consumer protection regulations. See 15 U.S.C. §57 (d) (1).
The Commission makes its meaning clearer in the following hypothetical examples:

1) Suppose a seller puts a creditor’s application forms in its sales office? The creditor must insert the required notice in its direct loan paper, because this practice is an affiliation.166

2) If a creditor agrees to process both direct and indirect loan applications for a seller on an expedited basis, so long as the seller routinely refers customers to the creditor for direct loans, then the creditor must put the required notice in his direct paper. It is both an affiliation and a referral, whether or not the seller and creditor have a written agreement.167

3) Suppose the seller suggests that his customers go to a particular creditor, and the creditor becomes aware that the seller made the suggestion: but seller and creditor do not cooperate beyond the steps necessary after the decision to loan is made, to perfect the creditor’s security interest in the collateral. This is not an affiliation, if the creditor had no prior knowledge of the informal referrals. However, the creditor who had antecedent knowledge of the informal suggestions of the seller may be affiliated.168

4) A buyer asks for help in finding credit. The seller calls up a creditor to determine whether the creditor will lend money to the buyer, then the seller sends the customer to the creditor. The seller and creditor have no agreement. However, the Federal Trade Commission will find the creditor to be an affiliate, and require that the prescribed notice appear in all the creditor’s direct loan paper.169

5) A buyer asks for credit information. Seller gives buyer a list of creditors, but seller makes no contact with any creditor for the buyer’s benefit. Seller has no other arrangement with the creditor. There is no affiliation and no notice is required.170 The general principle is that so long as the seller and the creditor have no contact prior to the creditor’s decision to make the loan, they will not be deemed affiliated.171

Since four of the six examples shown above are common consumer credit practices in direct financing of consumer purchases, the Rule will require creditors to insert in practically all their direct loan paper, the required notice. Since the seller is subject to direct Federal Trade Commiss-

ion Regulation, the effect of this rule is to require banks to comply with the Federal Trade Commission’s dictates despite the specific exemption of banks under Section 5 of the Federal Trade Commission Act.172

Additionally, the proposed Rule on Credit Practices promulgated in 1975 would require that each creditor apply the “fair retail market value” of any repossessed collateral to the balance due on any consumer credit contract.173 This provision, of course, would alter the creditor’s right to obtain a deficiency judgment in any action against a consumer.174 The Uniform Commercial Code requirement for a “commercially reasonable sale” as condition precedent to deficiency recovery would remain as an alternative, supplemental standard. However, the courts would first apply the federal standard before reaching the Uniform Commercial Code standard for deficiency determination. Thus, a consumer-debtor would receive an automatic credit of the “fair retail market value” of his collateral, whether or not a commercially reasonable sale of the collateral produced that result.175

Since the notice requirements of the Rule on Preservation of Consumer Defenses creates an additional contractual obligation between consumer-debtor and direct lender, he can receive a “credit” of fair retail market value on the sum due him,176 and a contractual recovery of what he has already paid in under several theories of law, such as breach of express and implied warranties.177 This will put the debtor in a better position than the direct lender. This overrules the law in those states which would make independent actions out of claims of breach of warranty, noncompliance with Truth in Lending disclosures and other collateral issues arising out of the credit transaction. The notice requirements of the Federal Trade Commission make all these matters part of the underlying obligation at issue in deficiency recovery. Creative attorneys will find ways to include provision for recovery of attorney’s fees as part of the consumer-debtor’s counterclaim, using one or more of the collateral issue defenses to liability.178


To return to the original issues before Judge Fairless—should he grant the defendants’ motion for judgment on the evidence (directed verdict)?

First, Mr. and Mrs. Dante may not have been entitled to

impact on small-loan type deficiencies in Hartford, Connecticut may be very slight.

175. 40 Fed. Reg. 16347 (1975). The ordinary state court judge, before granting judgment to the plaintiff in a deficiency action, will first apply the Federal Trade Commission doctrine in consumer cases. He will then apply the usual Uniform Commercial Code standard.


177. Id. The preamble says that:

178. The proposed Rule on Credit Practices would not permit direct recovery of attorney’s fees. But see n. 78 for the impact of the Uniform Consumer Credit Code on attorney’s fees.
be sent notice under one legal theory. However, the better rule is that they should be sent notice of sale. Mrs. Smith received no notice nor did Mr. and Mrs. Dante. Mr. Smith received clumsy oral notice of impending sale on the day the Matador was repossessed. The Old National Bank conducted an indifferent sales procedure for its repossessed collateral. The low price which Old National got for the Matador may be charged to Old National's half-hearted sales effort. It sold the Matador for $60 under wholesale price to the dealer who made the original sale to the Smiths. If the Smiths and Dantes had filed a counterclaim to recover the statutory penalty provided by Section 9-507(1), the resale to Gross Rambler, Inc. at a below-wholesale price would be one touchstone for recovery.

Since Old National Bank had the burden of proof of a commercially reasonable sale of collateral, it should lose. It had the duty to sell the collateral in a manner that would, in ordinary course of business, bring the best results. The debtors had no opportunity to protect themselves by bidding for the car before sale. Section 3-402 of the Uniform Commercial Code would excuse the Dantes from liability since the conduct of Old National impaired recourse on collateral.

If the original dealer contract had been made under current Federal Trade Commission regulations, it would have contained the required preservation notice. That notice would not change the outcome of the case. First, the right to file a counterclaim under Section 9-507(1) of the Uniform Commercial Code was not exercised by the defendants, even though under Indiana practice it would have been a mandatory counterclaim.179 Second, there were no other infirmities in the paper or the transaction according to the testimony in the trial. The defendants waived their right to a counterclaim through their attorney.

Had the proposed Credit Practice Rule been in effect, however, the result might have been different. First, the burden of proof on Old National would have been to first show the "fair retail market value" of the collateral had been applied to the balance due from defendants on the day of repossession. Then, Old National, under state law, would be required to prove it conducted a commercially reasonable disposition of the Matador. If it failed to prove a commercially reasonable disposition of collateral, then it would lose even if it gave a "fair retail market value" credit to the defendants on repossession. Last, if Old National Bank issued commercial paper which did not contain the 10 required statements relating to credit practices contained in the Rule on Credit Practices, a private right of action under the Federal Trade Commission Act may be asserted by the defendants.180 In short, application of the new Federal Trade Commission Rules to deficiency collection may make deficiency judgments an uneconomical goal for lenders.

Conclusion

When consumers are involved in the repossession and sale of collateral, the courts must recognize that the consumer-debtor generally signs an adhesion contract prepared by the creditor. The credit instrument is the result of a transaction in which the creditor has a stronger bargaining position. Consequently, consumer credit contracts should be carefully reviewed by the courts for irregularity or overreaching in negotiations and in subsequent actions taken to enforce the contract. Creditors are able to protect themselves by drafting good credit instruments which define default and remedies available to the creditor upon default. Creditors can establish fair sales procedures to protect themselves against unfair losses on deficiency judgment liabilities resulting from indifferent sales techniques. The courts and legislatures have been attempting to establish a balance of power between consumer-debtors and creditors for the past decade. Debtors and creditors play games over deficiency judgment liabilities. Courts wrestle with expressions of public consciousness on the relative strength of debtor and creditor in society. The Federal Trade Commission has expanded its efforts into the area of consumer credit protection by legislating to supersede Uniform Commercial Code doctrines on commercially reasonable disposition of collateral repossessed. It threatens to expand the assertion of consumer-debtor claims and defenses to innocent third parties. Yet the cardinal policy issues involved in the deficiency judgment mess have not been resolved.

The two policy questions which have to be settled are:

1. Should the law make a distinction between consumer credit and commercial credit, enforcing deficiency liabilities against commercial debtors, but not against consumer debtors?

2. Is it economically sound to permit consumer-debtors to escape deficiency judgment liability after repossession and sale of collateral, passing on the cost of losses to other consumer-debtors in the form of higher money costs?

These questions haven't been solved by the judicial handling of deficiency judgment liabilities. The Federal Trade Commission has not provided an answer. It has assumed the two questions to be answered by Congressional fiat.181
But Magnun-Moss does not answer the fundamental issues raised by deficiency judgment collection. The application of the Federal Trade Commission rules on Preservation of Claims and Defenses and Credit Practices to deficiency judgment collection may extinguish the deficiency judgment as a creditor's remedy. If so, the increased losses will be passed on to all customers by financial institutions. The present judicial doctrines on deficiency judgment liabilities do not express any consistent policies. The Federal Trade Commission has superseded its judgment for that of the several state legislatures and judges. The Uniform Commercial Code and the Uniform Consumer Credit Code provide excellent vehicles for judicial creation of a deficiency judgment policy. If the remedies scheme in part 5 of Article 9 of the Uniform Commercial Code were followed by judges, and the relevant provisions of the Uniform Consumer Credit Code were applied to provide for awarding attorneys' fees to successful litigants who resisted an unfair deficiency, a uniform policy on deficiency judgments would emerge by judicial decision-making.

The present judicial doctrines on deficiency judgment liabilities of a federal regulatory agency that it can regulate consumer credit practices more effectively than the judiciary. Until the judiciary reasserts its position of leadership in law-making, such attempts will be increased. Vigorous judicial law-making in deficiency judgment actions will defeat the extension of federal regulation in consumer credit law. □

180. Id. Section 444.2 (a) (8) (first alternative).