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U.C.C. Article 9—Disposition of Repossessed Collateral Notice and Deficiency—New Rule in Arkansas

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U.C.C. ARTICLE 9—DISPOSITION OF REPOSSESSED COLLATERAL NOTICE AND DEFICIENCY—A NEW RULE IN ARKANSAS, *Rhodes v. Oaklawn Bank*, 279 Ark. 51, 648 S.W.2d 470 (1983).

In early 1978 the defendant, Jerry Rhodes, executed a promissory note for $20,592.02 to the plaintiff, Oaklawn Bank.[1] The note was secured by restaurant equipment and a portable building.[2] Late in 1978 Rhodes defaulted and Oaklawn repossessed the collateral.[3] In July of 1979, Oaklawn sold the various items for $1,400 without giving Rhodes specific notice of the sale.[4] Oaklawn then sued for a deficiency of $21,516.32 plus costs, interest and attorney's fees.[5] Rhodes defended on the ground that Oaklawn's failure to notify made the sale commercially unreasonable.[6] The circuit court granted a deficiency judgment of $21,516.32 without making specific findings of fact or conclusions of law.[7] The Arkansas Court of Appeals affirmed.[8] On review, the Arkansas Supreme Court held that Oaklawn's failure to notify Rhodes of the sale as required by section 9-504 of the Uniform Commercial Code[9] precluded Oaklawn from recovering a deficiency judgment.[10] *Rhodes v. Oaklawn Bank*, 279 Ark. 51, 648 S.W.2d 470 (1983).

Prior to enactment of the Uniform Commercial Code in Arkansas,[11] a secured party had two principal alternative remedies after default by the debtor: (1) recovery of the collateral or (2) action on the debt.[12] As early as 1887, Arkansas courts allowed a secured party to recover collateral securing a debt by an action of replevin at common law.[13] The action is now codified[14] and generally entitles a

1. Rhodes v. Oaklawn Bank, 279 Ark. 51, 53, 648 S.W.2d 470 (1983).
2. *Id.*
3. *Rhodes*, 279 Ark, at 53, 648 S.W.2d at 471.
4. *Id.*
5. *Id.*
6. ARK. STAT. ANN. § 85-9-504(3) (1961 & Supp. 1983).
7. *Rhodes*, 279 Ark. at 53, 648 S.W.2d at 470.
8. Rhodes v. Oaklawn Bank, No. 82-412 (Ark. Ct. App. 1982), *rev'd* 279 Ark. 51, 648 S.W.2d 470 (1983).
9. ARK. STAT. ANN. § 85-9-504(3) (1961 & Supp. 1983).
10. *Rhodes*, 279 Ark. at 53, 648 S.W.2d at 472.
11. Arkansas enacted the Uniform Commercial Code (UCC) in 1961, effective December 31. The Uniform Commercial Code, 1961 Ark. Acts 185 (codified at ARK. STAT. ANN. §§ 85-1-101 to 9-507) (1961 & Supp. 1983).
12. Anderson & Hale, *Conditional Sales in Arkansas*, 4 ARK. L. REV. 19, 27 (1949).
13. Kirby v. Tompkins, 48 Ark. 273, 3 S.W. 363 (1887).

secured party to a judgment for the return of the property,[15] or in the alternative, payment of the value of the property.[16] The secured party could also peaceably reposses the collateral[17] without judicial process, where the contract so provided.[18]

Alternatively, the creditor could allow the defaulting debtor to retain possession of the collateral and sue in contract for the unpaid balance of the debt.[19] Upon obtaining judgment, the secured party obtained a writ of execution[20] authorizing the sheriff to sell the property of the debtor at public auction.[21] The proceeds of the sale were used to satisfy the debt.[22] One of the major advantages of this procedure was that after obtaining judgment, the secured party could attach the collateral and any other property held by the debtor to satisfy that judgment.[23] However, under the doctrine of election of remedies,[24] recovery of the collateral, either by replevin or peaceable repossession, precluded the secured party from instituting an action to recover on the debt.[25] The secured party's repossession was said to be inconsistent with his action to recover on the debt.[26]

Adoption of the U.C.C. in Arkansas eliminated the election of remedies problem.[27] However, a closer examination of the U.C.C. provisions reveals some new pitfalls for the conditional seller seeking to take advantage of this new found right to dispose of repossessed collateral and recover on the remaining contract debt.

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14. ARK. STAT. ANN. §§ 34-2101 to -2126 (1962 Repl. & Supp. 1983).

15. ARK. STAT. ANN. § 34-2116 (1962 Repl. & Supp. 1983). *See also* Anderson & Hale, *supra* note 12, at 36 (debtor in possession of property must surrender it, if debtor is not in possession then the secured party is entitled to execution on his money judgment).

16. *See* Anderson & Hale, *supra* note 12, at 37, 38 (for a discussion of the amount a debtor must pay in lieu of surrendering the collateral).

17. *Id.* at 30-34 (the secured party's property interest will support the retaking).

18. American Can Co. v. White, 130 Ark. 381, 197 S.W. 695 (1917).

19. *Id. See also* Anderson & Hale, *supra* note 12, at 39 (discussion of action for the price).

20. ARK. STAT. ANN. § 30-101 (1979 Repl. & Supp. 1983). For property subject to execution *see* ARK. STAT. ANN. §§ 3-201 to -220 (1979 Repl. & Supp. 1983).

21. ARK. STAT. ANN. § 30-106 (1979 Repl. & Supp. 1983). ARK. STAT. ANN. § 30-411, 419 (1979 Repl.).

22. ARK. STAT. ANN. § 30-411 (1979 Repl.).

23. J. WHITE & R. SUMMERS, UNIFORM COMMERCIAL CODE § 26-4 (2d. ed. 1980).

24. McRae v. Merrifield, 48 Ark. 160, 2 S.W. 780 (1887).

25. *Id.*

26. McCain v. Fender, 188 Ark. 1139, 69 S.W.2d 867 (1934).

27. Mooney, *The Old and the New: Article IX*, 16 ARK. L. REV. 145 (1961). The author states, "The most significant change . . . is the final and conclusive eradication of the doctrine of election of remedies. . . ." *Id.* at 151.

Under the U.C.C., unless otherewise agreed, a secured party may peaceably repossess collateral held by a debtor in default without judicial process.[28] Furthermore, there is no requirement that the debtor be notified prior to repossession by the secured party.[29] In addition to peaceable repossession, the statutory action of replevin remains available to the secured party.[30]

Upon either method of repossession, the secured party has two options with respect to disposition of the collateral. The first is strict foreclosure; the retention of the collateral in full satisfaction of the debt.[31] Except in the case of consumer goods, where the debtor has paid sixty percent of either the cash price or the loan amount, a secured party may propose to retain the collateral in full satisfaction of the debt by simply notifying th debtor and any other secured party from whom the secured party has received written notice of a claim of an interest in the collateral of his intention to do so.[32] The second option available to a secured party in possession of the collateral is disposition by sale.[33] However, a secured party must comply with two requirements in conducting this sale: (1) the debtor must be given reasonable notice of the disposition, and (2) the sale must be "commercially reasonable."[34]

The reasonable notification requirement was designed to allow the debtor and other interested parties adequate opportunity to redeem the collateral,[35] or to procure financing to purchase at the sale.[36] The notice must contain, at a minimum, the time and place

28. Teeter Motor Co. v. First Nat'l Bank of Hot Springs, 260 Ark. 764, 543 S.W.2d 938 (1976). ARK. STAT. ANN. § 85-9-503 (1961 & Supp. 1983). *See also* J. WHITE & R. SUMMERS, *supra* note 23, at § 26-6 for a general discussion of what may constitute breach of peace.

29. *Teeter Motor Co.*, 260 Ark. at 766, 543 S.W.2d at 940.

30. *See* ARK. STAT. ANN. § 85-9-501(1) (1961 & Supp. 1983) which provides that the secured party "may reduce his claim to judgment, foreclose or otherwise enforce the security interest by any available judicial procedure."

31. ARK. STAT. ANN. § 85-9-505 (1961 & Supp. 1983).

32. *Id.* But *cf.* UNIF. COMMERCIAL CODE (U.L.A.) § 9-505 (1981) (debtor may surrender the collateral and upon acceptance by the secured party claim satisfaction of the indebtedness).

33. ARK. STAT. ANN. § 85-9-504(1) (1961 & Supp. 1983). A secured party has the right "to sell, lease or otherwise dispose of any or all of the collateral. . . ." *Id.* ARK. STAT. ANN. § 85-9-505 (1961 & Supp. 1983) (Disposition by sale is compulsory in the case of consumer goods, debtor having paid sixty percent of loan amount or cash price).

34. ARK. STAT. ANN. § 85-9-504(3) (1961 & Supp. 1983).

35. *See* ARK. STAT. ANN. § 85-9-506 (1961 & Supp. 1983) which provides for redemption by the debtor at any time prior to disposition by the secured party.

36. ARK. STAT. ANN. § 85-9-504, Comment 5 (1961 & Supp. 1983).

of the disposition[37] and is effective when sent.[38] Notice of repossession by the secured party is not sufficient as notice of an intent to dispose of the collateral at sale.[39] In addition, oral notice of prospective disposition by the secured party has been held insufficient.[40] On the other hand, the notice requirement may be waived by the debtor after default[41] and is subject to two exceptions: notice need not be given with respect to collateral that is perishable or likely "to decline speedily in value . . .,"[42] and collateral "of a type customarily sold on a recognized market."[43]

The requirements that the debtor be notified and that the sale be commercially reasonable are viewed by some authors as serving to protect the debtor from creditor abuse, while simultaneously affording the creditor the benefit of the liberal disposition provisions of section 9-504.[44] Since the U.C.C. permits private sales[45] and specifically provides for a deficiency judgment on the contract debt in the event the sale proceeds are not sufficient,[46] the secured party is held to the "commercially reasonable" disposition sale standard in order that deficiencies be minimized. This includes method, manner, time, place and terms of sale.[47] The price obtained at a disposition sale alone is not determinative of commercial reasonableness,[48] but price may be a significant factor.[49] Notice may also figure into the commercial reasonableness determination, rendering the sale

37. ARK. STAT. ANN. § 85-9-504(3) (1961 & Supp. 1983).

38. Hudspeth Motors Inc. v. Wilkinson, 238 Ark. 410, 382 S.W.2d 191 (1964) (overruled 257 Ark. 263, 516 S.W.2d 379 (1974) (notice by certified mail not received by the debtor upheld as reasonable). *See also* ARK. STAT. ANN. § 85-1-201(26) (1961 & Supp. 1983) where notice is defined as "taking such steps as may be reasonably required to inform the other in ordinary course whether or not such other actually comes to know of it."

39. Wheeless v. Eudora Bank, 256 Ark. 644, 509 S.W.2d 432 (1974).

40. Barker v. Horn, 245 Ark. 315, 432 S.W.2d 21 (1968) (verbal notice by secured party stating the repossessed collateral would be sold to the highest bidder held insufficient).

41. Teeter Motor Co. v. First Nat'l Bank of Hot Springs, 260 Ark. at 767, 543 S.W.2d at 940 (1976) ARK. STAT. ANN. § 85-9-504(3) (Supp. 1983).

42. ARK. STAT. ANN. § 85-9-504(3) (1961 & Supp. 1983).

43. *Id. See also* J. WHITE & R. SUMMERS, *supra* note 23, at § 26-10 (discussion of types of goods customarily sold on a recognized market).

44. *See generally* R. HENSON, *Secured Transactions Under the Uniform Commercial Code* § 10-10 (2d. ed. 1979). *See also* J. WHITE & R. SUMMERS, *supra* note 23, at § 26-9.

45. *See* ARK. STAT. ANN. § 85-9-504, Comment 1 (Supp. 1983) which says, "it is hoped that private sale will be encouraged where, . . . [it] will result in higher realization on collateral for the benefit of all parties."

46. ARK. STAT. ANN. § 85-9-504(2) (1961 & Supp. 1983).

47. *Id.* at § 85-9-504(3).

48. Goodin v. Farmers Tractor & Equipment Co., 249 Ark. 30, 458 S.W.2d 419 (1970). ARK. STAT. ANN. § 85-9-507(2) (1961 & Supp. 1983).

49. Farmers Equipment Co. v. Miller, 252 Ark. 1092, 482 S.W.2d 805 (1972).

unreasonable due to misleading notice.[50] Although the U.C.C. is silent on public sale requirements,[51] adequate notice, an accurate description of the collateral to be sold, date, place, and terms of the sale are likely to be required in order to comply with the "commercially reasonable" standard.[52]

Section 9-507 of the Code imposes liability on a secured party for failure to comply with the aforementioned requirements of notice and commercial reasonableness. The debtor, or any person entitled to notice of proposed disposition, has a right to recover from the secured party any loss suffered due to the secured party's failure to comply with the statutory requirements of disposition. If disposition of the collateral is not proceeding in compliance with the statutory requirements the debtor may seek an order restraining sale or providing specific terms and conditions governing sale.[53] According to *Harrell Motors, Inc. v. Sweeten*, if disposition has occurred, a debtor may recover his loss by showing a surplus would have been generated at a sale conducted in compliance with the U.C.C.[54] In addition, where disposition has occurred, debtors have used a secured party's failure to notify and the 9-507 damages provision to prevent recovery of any deficiency by the secured party.

The first case decided by the Arkansas Supreme Court dealing with a secured party's failure to meet statutory disposition requirements was *Baber v. Williams Ford Co.*, decided in 1965.[55] In *Baber* the supreme court, dealing with a question of sufficiency of a notice of resale, indicated that in order for a secured party "to hold the debtor . . . liable for any deficiency, . . . [he] must give the debtor 'reasonable notice' . . . ." The rationale used in *Baber* did not employ the 9-507(1) damages provision, but simply conditioned the debtor's liability for a deficiency on proper notice by the secured party. The same court, in *Norton v. National Bank of Commerce*,[56] in addressing a case of insufficient notice stated the following rule:

> Upon the issue of Norton's damages simple considerations of fair play cast a burden of proof upon the bank. It was the bank which wrongfully disposed of the car without notice to the debt-

50. *Id.*

51. *See* R. HENSON, *supra* note 44, at § 10-10.

52. Wilkerson Motor Co., Inc. v. Johnson, 580 P.2d 505 (Okla. 1978). *See also* 49 OKLA. BAR ASS'N J. 115; Annot., 4 A.L.R.2d 575 (discussion of public sale requirements).

53. ARK. STAT. ANN. § 85-9-507 (1961 & Supp. 1983).

54. 4 Ark. App. 230, 628 S.W.2d 878 (1982).

55. 239 Ark. 1054, 396 S.W.2d 302 (1965).

56. 240 Ark. 143, 398 S.W.2d 538 (1966).

> ors. . . . It would be manifestly unfair for the creditor to derive an advantage from its own misconduct. We think the just solution is to indulge the presumption in the first instance that the collateral was worth at least the amount of the debt, thereby shifting to the creditor the burden of proving the amount that should reasonably have been obtained through a sale conducted according to law.[57]

Thus, unlike *Harrell Motors, Inc. v. Sweeten*,[58] the debtor, when faced with a deficiency, did not have to show that a commercially reasonable sale would have produced a surplus. In *Norton* the creditor, after being found to have conducted a commercially unreasonable sale, had to show that there would have been a deficiency even if the sale had been commercially reasonable. Upon such a showing, however, a secured party may still recover a deficiency after failing to conduct disposition in accordance with statute. This rule was followed in *Universal C.I.T. Credit Corp. v. Rone*,[59] where the supreme court reversed and remanded a judgment due to an instruction that "failed to allow for the fact that, when commercial code requirements for disposition of collateral have not been followed, judgment for a secured party can be rendered for the amount by which its deficiency exceeds the amount the collateral reasonably should have brought if code requirements had been followed."[60] The most recent case upholding the *Norton* approach, *Harper v. Wheatley Implement Co., Inc.*,[61] put it in somewhat different terms. "The real issue on this point is whether the [debtors] were given proper credit for the proceeds of the sale . . . had the private sale been conducted according to law."[62] The results of these cases clearly indicated that a secured party could recover a deficiency even though disposition of repossessed collateral did not meet the requirements of notice and/or commercial reasonableness. The court would simply require the creditor to show additional proof as to the reasonable value of the collateral.[63] However, in *Rhodes v. Oaklawn Bank*,[64] failure to meet the notice requirement operated to bar a deficiency judgment altogether.

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57. *Id.* at 149-50, 398 S.W.2d at 542.
58. 4 Ark. App. 230, 628 S.W.2d 878 (1982).
59. 248 Ark. 665, 453 S.W.2d 37 (1970).
60. *Id.* at 672, 453 S.W.2d at 41.
61. 278 Ark. 27, 643 S.W.2d 537 (1982).
62. *Id.* at 34, 643 S.W.2d at 539-40 (citing Universal C.I.T. Credit Corp. v. Rone, 248 Ark. 665, 453 S.W.2d 37 (1970)).
63. *See* J. WHITE & R. SUMMERS, *supra* note 23, at § 26-15.
64. 279 Ark. 51, 648 S.W.2d 470 (1983).

> When a creditor repossesses chattles and sells them without sending the debtor notice as to the time and date of sale, or as to a date after which the collateral will be sold, he is not entitled to a deficiency judgment, unless the debtor has specifically waived his rights to such notice.[65]

In arriving at this conclusion, the supreme court purported to follow precedent, citing *Harper* and *Rone*.[66] However, an examination of these cases indicates language directly contrary to that used in the preceding quotation from *Rhodes*.[67] For instance, the following language appears in *Rone*: "The failure to give the notice required by the code cannot constitute an absolute defense to an action for a deficiency judgment."[68] In *Harper*,[69] the supreme court reversed and remanded a lower court judgment against a secured party who had failed to notify the debtor in accordance with Section 9-504.[70] The court held the lower court "erred in prohibiting the [secured party] from producing evidence as to the commercial reasonableness of the sale. . . ."[71] Although *Harper* was not perceived by the *Rhodes*[72] court to have dealt with the notice issue, it would seem fruitless to reverse and remand a case in favor of a party against whom an absolute defense could be asserted—the result if *Rhodes*, decided just four months after *Harper*, is applied to the *Harper* facts.

As a result of the holding *Rhodes*, a secured party who repossesses collateral after default by the debtor must either notify the debtor of a proposed disposition or obtain a written waiver of notice from the debtor in order to retain his right to a deficiency judgment. The practical significance of the new absolute defense against a deficiency judgment is indicated by studies showing that disposition sales may produce an average yield of only fifty percent of the outstanding debt.[73] Hence, in many cases, the deficiency judgment will amount to a major portion of the secured party's recovery. Conversely, the availability of deficiency judgments may discourage attempts by the secured party to obtain maximum value for the

65. *Id.* at 55, 648 S.W.2d at 471.
66. *Id.* at 54, 648 S.W.2d at 470.
67. *Id.* at 55, 648 S.W.2d at 471.
68. 248 Ark. at 669, 453 S.W.2d at 39. (The supreme court cited Norton v. Nat'l Bank of Commerce, 240 Ark. 143, 398 S.W.2d 538 (1966), in support of the quoted statement.)
69. 278 Ark. 27, 643 S.W.2d 537 (1982) (Justice Purtle writing for the court).
70. ARK. STAT. ANN. § 85-9-504(3) (1961 & Supp. 1983).
71. *Harper*, 278 Ark. at 36, 643 S.W.2d at 541.
72. 279 Ark. at 55, 648 S.W.2d at 471.
73. *See*, J. WHITE & R. SUMMERS, *supra* note 23, at § 26-9.

collateral on sale.[74] Further, if a secured party may not recover any deficiency, for whatever the reason, the loss occuring on disposition may result in increased costs of lending to high risk debtors, causing a corresponding decreased availability of credit to those in this group.

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74. *Id.*