

DENIAL OF DEFICIENCY: A PROBLEM OF REASONABLE NOTICE UNDER UCC § 9-504(3)

I. INTRODUCTION

Article 9 of the Uniform Commercial Code¹ details a comprehensive scheme for the regulation of security interests in personal property and fixtures.² More particularly, Part 5 of Article 9 deals with the relative position of parties with respect to collateral after default by the debtor. Upon default a secured party has the right to take possession of the collateral.³ Once the secured party has repossessed the collateral, he may "sell, lease or otherwise dispose of any or all of the collateral in its then condition or following any commercially reasonable preparation or processing"⁴ after giving reasonable notice to the debtor and to any other person who has a filed or known security interest.⁵ Indeed, the secured party must make an effective disposition of the collateral before he may recover any part of the unpaid purchase price from the borrower.⁶ Section 9-504(3) details the requirements to be followed in most cases for providing notice of the sale or other disposition. The UCC requires only that "reasonable notice" be sent and that persons entitled to receive notice have time to protect their interests. Three exceptions to the notice requirement are provided in § 9-504(3). If the collateral is perishable, threatens to decline speedily in value, or is of a type customarily sold on a recognized market, notice is not required.⁷ When the procedures outlined in § 9-504(3) are

¹ Hereinafter referred to as UCC or Code. All citations to UCC or Code, unless otherwise indicated, will be made to the UNIFORM COMMERCIAL CODE, 1962 Official Text with Comments published by the American Law Institute and the National Conference of Commissioners on Uniform State Laws.

² See UCC § 9-101, Comment.

³ UCC § 9-503. *But cf.* *Fuentes v. Shevin*, 407 U.S. 67 (1972).

⁴ UCC § 9-504(1).

⁵ UCC § 9-504(3). The section provides in part:

Unless 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 and place of the public sale or reasonable notification of the time after which any private sale or other intended disposition is to be made shall be sent by the secured party to the debtor, and except in the case of consumer goods to any other person who has a security interest in the collateral and who has duly filed a financing statement indexed in the name of the debtor in this state or who is known by the secured party to have a security interest in the collateral.

A small minority of states deny deficiencies to secured parties who fail to comply with the notice requirements. See, e.g., OHIO REV. CODE ANN. § 1319.07 (Page 1962).

⁶ Compulsory disposition of consumer goods is required where the debtor has paid 60% of the cash price. See UCC § 9-505(1). Not every "transfer" is a "disposition," however. See UCC § 9-504(5); *Universal C.I.T. Credit Corp. v. Beckwith*, 23 Conn. Supp. 362, 183 A.2d 755 (1962).

⁷ The recognized market exception, in particular, has been narrowly construed. This narrow reading is justified in light of the great leeway given to the secured party who sells the collateral within this exception. Notice is excused, § 9-504(3); the secured party can buy at a private disposition, § 9-504(3); and resale is considered to be made in a commercially

not followed, the secured party may incur liability for noncompliance under § 9-507(1) and may possibly lose his right to recover any remaining deficiency from the debtor.

This note will consider the denial of deficiency as a remedial device for failure to give reasonable notice. It is concluded that a secured party should not be free to sell or otherwise dispose of collateral, except after full compliance with the § 9-504(3) notice requirement; that the statutory remedies for noncompliance are, for the most part, inadequate; and that, upon failure to comply with the statutory requirements, the denial of deficiency is the most effective means to prevent abuse of the notice provisions by the secured party.

II. DAMAGES FOR FAILURE TO GIVE REASONABLE NOTICE

Two statutory remedies are potentially applicable when collateral has been sold without adequate notice. First, there is a general damage remedy which is provided by statute to the debtor and any secured party who was entitled to notice. Second, there is a minimum statutory penalty available to the debtor whose consumer-goods collateral was sold without proper notice.

A. Statutory Damages

When a secured party fails to comply with the notice requirement, § 9-507(1) permits the "debtor or any person entitled to notification . . . to recover from the secured party *any loss*"⁸ caused thereby. Since a purchaser after default acquires the collateral free of the debtor's interest, the secured party's interest, and all subordinate interests, provided he has not acted in bad faith,⁹ this protection is necessary.

The UCC's use of such broad language unfortunately sheds little light on how this provision is to be applied. One commentator has asserted that a strict contractual approach is required.¹⁰ Thus the usual measure of damages would be the difference between the sale price of the collateral and the price for which it would have been sold had notice been given. Presumably this is the market value at the time of the wrongful disposition. This measure of damages ostensibly places the injured party in the same position he would have been in had the notice requirement been fully performed. But the UCC mandates that the remedies incorporated in the

reasonable manner, § 9-507(2). Hogan, *The Secured Party and Default Proceedings Under the UCC*, 47 MINN. L. REV. 205, 222 n.89 (1962); see generally, I P. COOGAN, W. HOGAN & D. VAGTS, SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE § 8.04(2)(d) (i), at 893 (1972).

⁸ Emphasis supplied.

⁹ UCC § 9-504(4).

¹⁰ Comment, *The Damage Award for Improper Disposition of Collateral Under the Uniform Commercial Code*, 49 ORE. L. REV. 65, 74 (1969).

Code be liberally administered.¹¹ Although in the ordinary case the actual "loss" ought to be reflected by compensatory damages,¹² if those damages prove inadequate courts should be free to fashion a remedy which they deem appropriate.¹³ Compensatory damages might prove inadequate when the collateral is such that it is subject to price fluctuations within a relatively short period of time and the market value at the time of disposition reflects the value at one of the low points during such a fluctuation.

In addition, punitive damages ought to be available to the debtor when the facts surrounding the failure to give notice indicate malicious intent. No reported cases, however, have considered punitive damages in conjunction with the narrow issue of proper notice. The lack of precedent indicates the limited availability of punitive damages as a remedy or effective deterrent. One possible case in point, however, is *Skeels v. Universal C.I.T. Credit Corp.*¹⁴ This decision underscores the difficulty involved in proving malicious intent as well as the problem of demonstrating a causal connection between the intent and the act involved.¹⁵ These difficulties multiply when an attempt is made to prove sufficient malicious intent to justify an award of punitive damages based upon factual situations which involve only lack of proper notice and no affirmative act. This discussion is not intended to suggest that punitive damages are not available under § 9-507(1), but only that, because of evidentiary problems, it is unlikely such damages will ever be awarded solely for failure to send adequate notice. Thus, although theoretically justified, punitive damages will prove to be of negligible value to debtors, and will provide only a slight deterrent effect.

B. *Minimum Recovery—Consumer Goods*

Disposal of "consumer goods" without notice to the debtor permits additional recovery under § 9-507(1). The *debtor*¹⁶ may recover an amount not less than the credit service charge plus ten percent of the principal amount of the debt, or the time price differential plus ten percent of the cash price.¹⁷ The adoption of the UCC brought with it this con-

¹¹ UCC § 1-102(1).

¹² *E.g.*, *Fort Knox Nat'l Bank v. Gustafson*, 385 S.W.2d 196 (Ky. Ct. App. 1964).

¹³ One suggestion is to employ the damage remedy used for cases of conversion, the highest intermediate value within a reasonable time after repossession. II G. GILMORE, *SECURITY INTERESTS IN PERSONAL PROPERTY* § 44.9.2, at 1257 (1965) [hereinafter referred to as GILMORE]; *cf.* 1 F. HARPER & F. JAMES, *THE LAW OF TORTS* § 2.38, at 192-97 (1956).

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

¹⁵ *Skeels v. Universal C.I.T. Credit Corp.*, 335 F.2d 846, 852 (3d Cir. 1964).

¹⁶ UCC § 9-504(3). Notice need only be sent to the debtor when there is a sale or other disposition of consumer goods.

¹⁷ Special protection without proof of loss is not novel to the Code, nor were such protections limited to consumer sales in prior acts. The UNIFORM CONDITIONAL SALES ACT § 25 [hereinafter referred to as USCA] allowed the buyer to recover "from the seller his actual

sumer-nonconsumer distinction which is based on the theory that the consumer debtor is a non-professional and is therefore less able to protect his interests when dealing with a professional.¹⁸ The inclusion of this remedy provided not only an alternative method of compensatory recovery, but also a method of awarding punitive damages.¹⁹ Consumer transactions are not likely to involve actual damages, but even when they do the amounts recoverable are likely to be consumed by the excessive costs of proving such damages. Thus the potential for abuse of the default provisions was the underlying reason for the adoption of a statutory penalty. The penalty serves as a protective device in many situations in which the consumer would otherwise be left without an adequate remedy. However, the statutory minimum recovery is efficacious only if repossession takes place before the debt has been substantially repaid.²⁰

The UCC does not explicitly indicate when the statutory penalty should be available. Should it be awarded only when actual damages are ascertainable, and only if they are less than the statutory penalty? Section 9-507(1) permits the consumer to recover "in any event an amount not less than" the statutory penalty. A comment to that section further indicates that this provision "states a minimum recovery" in transactions involving consumer goods. The UCC thus dictates that the consumer remedy should be an alternative measure of damages when actual damages are less than the consumer penalty or are nonexistent.²¹

III. DENIAL OF THE DEFICIENCY

After proper sale or disposition of repossessed collateral, the secured party must remit to the debtor any surplus. The secured party may also look to the debtor for any deficiency if the net proceeds of the sale do not equal or exceed the amount of debt and expenses (unless otherwise agreed by the parties).²² The decided cases, however, are split as to whether the secured party may recover a deficiency if he resells but fails to notify the debtor of the resale as required by § 9-504(3).

Many courts deciding this issue have permitted the secured party to

damages, if any, and in no event less than one-fourth of the sum of all payments which have been made under the contract, with interest." This penalty had limited effectiveness. See 2A UNIFORM LAWS, ANNOTATED § 129, at 181 (1924).

¹⁸ TEXAS LEGISLATIVE COUNCIL, ANALYSES OF THE UNIFORM COMMERCIAL CODE 130 (1955).

¹⁹ See *In re Frye*, 9 UCC REP. SERV. 913, 920 (U.S. Dist. Ct. S.D. Ohio 1970).

²⁰ "If repossession took place before much had been paid, the recovery of 10 per cent plus financing charges could perfectly well exceed the payments. In such a case, at least, the Code provision would amount to a real penalty. . . ." GILMORE, *supra* note 13, at 1260.

²¹ Cf. *Crosby v. Basin Motor Co.*, 83 N.M. 77, 79, 488 P.2d 127, 129 (1971).

²² UCC §§ 9-504(2); 9-504(1)(a). Unless the transaction was a sale of accounts, contract rights or chattel paper. UCC § 9-504(2).

recover the deficiency.²³ Although the debtor ordinarily has the burden of proving damages, these courts condition the recovery of the deficiency, notwithstanding the secured party's failure to give proper notice, on his proving that the "reasonable value" of the collateral is credited to the debtor's account. If the secured party fails to meet this burden of proof, the courts presume that the value of the collateral was at least the amount of the debt.²⁴ Shifting the burden of proof as to reasonable value, the courts reason, will adequately prevent creditors from deriving advantage from their own misconduct.²⁵

Other courts deciding this issue have denied recovery of any deficiency in all cases in which the statutory notice requirement has not been met.²⁶ These courts have reached such a conclusion irrespective of the amount of the deficiency or the commercial reasonableness of the resale. It is submitted that this approach achieves a more efficacious result.

Denial of the deficiency, as a penalty for failure to give proper notice of resale or other disposition, has both positive and negative implications. On the positive side, it maintains a more favorable balance of rights in the collateral after default, a balance which is neglected by the default provisions and scarcely recognized in the comments to those provisions. Although Part 5 of Article 9 purports to protect both debtor and creditor rights after default,²⁷ the balance weighs heavily against the debtor. A fundamental example is the UCC's treatment of what constitutes a "default." The drafters intentionally omitted any definition of default, thus leaving the matter up to the parties. This omission has led to inclusion of sweeping contractual terms, such as "any feeling of insecurity,"²⁸ which are unfair to debtors. Although not every debtor is in such a weak bargaining position that he must yield to the imposition of such terms, in many cases the debtor must either accept the terms or look elsewhere for credit. Furthermore, the ease with which the secured party can repossess and resell or otherwise dispose of the collateral tends to create deficiencies,²⁹ particularly since the secured party need not sell at the best possible price.³⁰ A less favorable implication is that denial of any deficiency for failure to give reasonable notice may tend to prolong litigation. Strict

²³ *E.g.*, *Grant County Tractor Co. v. Nuss*, 6 Wash. App. 866, 496 P.2d 966 (1972).

²⁴ *See Norton v. National Bank of Commerce*, 240 Ark. 143, 149-50, 398 S.W.2d 538, 542 (1966); *Leasing Assoc., Inc. v. Slaughter & Son, Inc.*, 450 F.2d 174, 177 (8th Cir. 1971).

²⁵ *Id.*

²⁶ *E.g.*, *Leasco Data Proces. Equip. Corp. v. Atlas Shirt Co.*, 66 Misc. 2d 1098, 323 N.Y.S.2d 13 (1971).

²⁷ *See* UCC § 9-501, Comment 1.

²⁸ *See Clark, Default, Repossession, Foreclosure, and Deficiency: A Journey to the Underworld and a Proposed Salvation*, 51 ORE. L. REV. 302, 308 (1972).

²⁹ *Compare* UCC § 9-503 *with* *Fuentes v. Shevin*, 407 U.S. 67 (1972).

³⁰ UCC § 9-508(2). Additionally the secured party can recover certain expenses. UCC § 9-504(1),

construction of the notice requirement will encourage debtors' attorneys to complicate litigation with defenses of technical breaches.³¹ A broader construction of the notice requirement, however, will mitigate these effects.³²

On the negative side, denial of any deficiency may give a "windfall" to the debtor. The deficiency might be considered a windfall if there are no statutory damages or if the debtor recovers the consumer-debtor damages. But regardless of its characterization as a windfall, courts should continue to deny recovery of any deficiency when the secured party fails to comply with the notice provision. Denial of the deficiency is a measure of punitive damages, necessary because of the failure to provide any substantial protection for the debtor in the default provisions of the UCC. The rights of the debtor in the collateral after default are interests which warrant protection. The UCC's damage provision, § 9-507(1), does not adequately protect the debtor's interest; thus, denial of the deficiency is the most effective means to assure compliance with the notice provision.

However, courts will not find support for their decisions in any specific language in the UCC or its comments regarding the availability of a deficiency when a secured party has failed to comply with the notice provision.³³ Consequently, some courts have turned to pre-Code law as authority to deny recovery of any deficiency,³⁴ while others have bypassed pre-Code precedent in the course of permitting complete recovery.³⁵ Since the UCC is silent with respect to the availability of deficiencies when the notice requirement has not been met, the argument can be made that the Code implicitly adopted the practices prevalent under prior statutes.³⁶

³¹ Cf. Clark, *supra* note 30, at 321.

³² An approach such as that taken in *Mallicoat v. Volunteer Fin. & Loan Corp.*, 57 Tenn. App. 106, 415 S.W.2d 347 (1966), is preferable. In *Mallicoat*, the secured party attempted to send notice by registered mail, ordinarily an acceptable method. This attempt, however, was held unreasonable under the circumstances because the secured party was aware that the debtor had not received the notice. In spite of this, the secured party made no further attempt to notify the debtor, although he possessed additional information as to where the debtor was employed and where the debtor's parents lived. The court emphasized the effect which that failure had upon the rights of the debtor in the collateral. *Id.* at 113-14, 415 S.W.2d at 350. But see White, *Representing the Low Income Consumer in Repossessions, Resales and Deficiency Judgment Cases*, 64 NW. U. L. REV. 808 (1970), where the author contends that "[n]othing in the Code mentions an additional requirement of a second contact when the creditor learns that the first has failed, but debtors' lawyers will wish to build upon the judicial gloss which *Mallicoat* has deposited on section 9-504." *Id.* at 820.

³³ GILMORE, *supra* note 12, § 44.9.4, at 1264.

³⁴ *E.g.*, *Leasco Data Process. Equip. Corp. v. Atlas Shirt Co.*, 66 Misc. 2d 1089, 323 N.Y.S.2d 13 (1971).

³⁵ *E.g.*, *Conti Causeway Ford v. Jarossy*, 114 N.J. Super. 382, 276 A.2d 402 (1971), *aff'd mem.*, 118 N.J. Super. 521, 288 A.2d 872 (1972); noted in 76 DICK. L. REV. 394 (1971).

³⁶ The decisions which have rejected pre-Code precedent do not provide sufficient analysis of this argument. *E.g.*, *Conti Causeway Ford v. Jarossy*, 114 N.J. Super. 382, 176 A.2d 402 (1971).

Under the Uniform Conditional Sales Act³⁷ some courts asserted that, since the right to bring suit for a deficiency was created by statute, compliance with the provisions of the statute was a prerequisite to the maintenance of a suit for any deficiency.³⁸ Thus most UCSA courts held that adequate notice, *i.e.*, literal compliance with the notice provision, was a condition precedent to recovery of any deficiency. An argument advanced by one commentator³⁹ against applying the "condition precedent" rationale of pre-Code cases to transactions under the UCC is that this rule *was more appropriate* to suits brought under the UCSA than the UCC. The UCC only requires "reasonable notice" while the UCSA precisely described the manner of the notice. Thus, he asserts "[i]t would appear that the flexibility of the notice provisions under the Code leaves too much room for honest error"⁴⁰ The difficulty with this argument is revealed by a comparison of the notice provisions of the two statutes. It is more reasonable to deny recovery of a deficiency under the UCC than under the UCSA, in light of the less restrictive requirements for notice in the UCC;⁴¹ the chances of a technical breach resulting in a failure to meet the notice requirement, as often occurred under the UCSA, are greatly diminished by the "reasonable notice" requirement of the UCC.

Analogizing to the pre-Code case law does, however, have weaknesses. Since the UCC has altered so much of the prior law, the premise that the drafters' failure to comment on pre-Code practices indicates tacit acceptance of those practices is not necessarily valid. Thus the UCC itself must be looked to as authority. Courts need not rely on pre-Code cases, as some have, to deny recovery of a deficiency, since the UCC and its comments can be interpreted as supporting the conclusion that denial of any deficiency is an appropriate remedy available to the debtor, in addition to the remedies provided in § 9-507(1), when the secured party fails to give notice of the sale under § 9-504(3).

Courts have touched on ideas which are basic to including the denial of deficiency among the debtor's remedies. According to one theory, denial of recovery of any deficiency is proper since failure to give notice impairs the right to redeem the collateral.⁴² The second theory is that denial is proper for the reason that § 9-504(3) was passed to protect the interest of the debtor in the collateral, and failure to give notice destroys the ability to protect that interest.⁴³

³⁷ UCSA §§ 19-22.

³⁸ *Bergen Auto Co. v. Mattarochio*, 58 N.J. Super. 161, 165, 155 A.2d 787, 789 (1959).
See, *e.g.*, *Commercial Credit Corp. v. Swiderski*, 195 A.2d 546 (Del. Super. Ct. 1963).

³⁹ Note, 5 B.C. IND. & COM. L. REV. 831, 835 (1964).

⁴⁰ *Id.* at 836.

⁴¹ See I GILMORE, *supra* note 13, § 44.9.4, at 1264.

⁴² *Braswell v. American Nat'l Bank*, 117 Ga. App. 699, 701, 161 S.E.2d 420, 422 (1968).

⁴³ See *One Twenty Credit Union v. Darcy*, 5 UCC REP. SER. 792 (Mass. App.Div. 1968).

Under the UCC collateral may be redeemed by tendering payment of all obligations as well as expenses incurred by the secured party.⁴⁴ Indeed, even if part of the collateral has been sold or contracted to be sold, the debtor may redeem the remainder.⁴⁵ Thus the debtor has the opportunity to protect his equity in the collateral. Failure to notify the debtor of resale impairs the right of redemption since good faith purchasers take free of the debtor's interest in the collateral in spite of defects in the sale.⁴⁶ In addition, resale generates expenses for preparation of the collateral and legal fees, both of which increase the amount of the deficiency. Thus the right of redemption is essential to the debtor in order to enable him to retain his interest in the collateral as well as to minimize the expenses after default. Some commentators question the efficacy of the redemption right, suggesting that it is more important in theory than in practice because it is seldom exercised.⁴⁷ The challenge is appropriate in many instances since debtors often will not have the funds or immediate financing necessary to the exercise of the right. The inability to redeem will occur primarily in consumer transactions. In such transactions resale value is not great; it is likely that the secured party will include an acceleration clause in the security agreement, thereby making it extremely difficult to redeem.⁴⁸

The vast area of non-consumer transactions, however, *does* involve many different situations and circumstances in which redemption can prove useful. These include transactions secured with many items of collateral worth more than the debt and collateral which has a tendency to appreciate in value. A hypothetical set of facts will illustrate this point:⁴⁹ A debtor purchases restaurant equipment for \$33,000, approximately one half of which is evidenced by a note and a security interest in the equipment. The debtor later defaults on the note and the secured party repossesses the collateral. Subsequently, the secured party purchases the collateral at an otherwise proper public sale without having sent notice of the sale to the debtor. After expenses and legal fees are deducted, there remains a deficiency of \$2,000. Less than a year later the same equipment is resold to the debtor for \$22,000. Assuming all other aspects of the resale were commercially reasonable, this hypothetical suggests that the

⁴⁴ UCC § 9-506.

⁴⁵ UCC § 9-506, Comment.

⁴⁶ UCC § 9-504(4).

⁴⁷ GILMORE, *supra* note 13, § 44.2, at 1216; White, *Representing the Low Income Consumer in Repossessions, Resales and Deficiency Judgment Cases*, 64 NW. U.L. REV. 808, 821 n.40 (1970).

⁴⁸ "[I]f the agreement contains a clause accelerating the entire balance due on default in one installment, the entire balance would have to be tendered." UCC § 9-506, Comment. Courts may find the acceleration clauses unconscionable, however, and not enforce them. *Robinson v. Jefferson Credit Corp.*, 4 UCC REP. SERV. 15, 16 (Sup. Ct. N.Y. 1967).

⁴⁹ The facts for the hypothetical were suggested by those in *Crest Investment Trust, Inc. v. Alatzas*, 264 Md. 571, 287 A.2d 261 (1972).

right to redeem has more than just a theoretical justification. The debtor's right to redeem the collateral was valuable to him because the value of the collateral was substantially more than the amount of the debt. The debtor could redeem the collateral himself. Once refinanced, the debtor can minimize his losses by either resuming his operation or selling the collateral to realize his equity.

Closely related to this discussion is the fact that not every debtor who will be liable for a deficiency owns the collateral which secures his debt. Thus the intervention of a third party who is also a debtor for purposes of notice increases the likelihood of redemption. The third party may be in a better position to secure financing or pay cash than the person liable for the deficiency. Moreover, the expenses incurred during resale would be substantially decreased by early redemption. Indeed, barring the deficiency judgment will encourage more efficient dispositions of the collateral. The secured party who has not met the notice requirement will be less willing to increase his out-of-pocket expenses incident to the disposition of the collateral when he knows that failure to meet the notice requirement may result in his inability to recapture those expenses.

The second theory, that the notice provision was adopted with the intent of protecting the interests of the debtor in the collateral, is supported by the following rationale: (1) notice of a public sale gives the debtor an opportunity to bid himself or to secure the attendance of other bidders at the sale, and (2) attendance of the debtor militates against collusive practices or defects in the sale which affect its commercial reasonableness. The effect, then, is to give the debtor a means of protecting his interest in the collateral.

Additionally, the possibility exists that the secured party will attempt to unload the collateral while the market is low. In many situations the sale would meet Code standards of commercial reasonableness, but would result in an increased deficiency since the Code does not require that the secured party obtain the best price.⁵⁰ The drafters recognized that this problem could be especially troublesome in sales of accounts, contract rights and chattel paper.⁵¹ In those transactions the debtor is not liable for any deficiency unless so provided in the agreement.⁵² Apparently the risks inherent in transactions which involve intangibles were thought to be so one-sided that the drafters felt impelled to even the balance by statute.⁵³ Conversely, the risks inherent in other transactions would remain in parity, thus giving a partial rationale for different treatment by the UCC. We must assume, however, that the drafters presupposed that this parity would be maintained; the other sections of Part 5 would prevent

⁵⁰ See UCC § 9-507(2).

⁵¹ See UCC § 9-502, Comment 2.

⁵² UCC § 9-504(2).

⁵³ See UCC § 9-502, Comment 2.

risk-shifting. They do not. Although the drafters created an exception for sales of certain intangibles, availability of the deficiency was not made absolute in other transactions. To the extent that a secured party may act without regard for the debtor's right to notice, yet still act within the bounds of commercial reasonableness, the denial of the deficiency serves as the only effective check on the indiscriminate exercise of the secured party's rights. A look at a recent case, however, discloses that some courts have not recognized this problem.

In *Conti Causeway Ford v. Jarossy*,⁵⁴ a case that involved consumer goods, the court based its decision to allow recovery of a deficiency on a determination of the commercial reasonableness of the resale. The court said:

It therefore must be decided whether the sale was so commercially unreasonable as to bar recovery of the deficiency.

. . . .

[W]here reasonable notice of sale has not been given, the spirit of commercial reasonableness requires that the secured party not be arbitrarily deprived of his deficiency⁵⁵

The court seemed to acknowledge the punitive nature of the denial of deficiency, but its decision turned on the commercial reasonableness of the resale. This result is an unnecessary blend of two different concepts.

Although related to the notice requirement, the inclusion of a commercial reasonableness requirement in § 9-504(3) is principally to protect interests different from those which the notice requirement protects. The statute itself states that "every aspect of the disposition including the method, manner, time, place and terms must be commercially reasonable" This indicates that the purpose of commercial reasonableness is to set standards of propriety at the time of disposition of the collateral. Notice, on the other hand, was included to insure that the debtor (and other secured parties) could protect his interest in the collateral itself *after default and before disposition*.⁵⁶ Notwithstanding these differences, *Conti* neglected this distinction when it suggested that the proper test of the secured party's right to recover a deficiency was whether the reasonable value of the collateral was credited to the debtor's account.⁵⁷ The damage award in *Conti* indicates how the "commercially reasonable" test undercuts the intended effect of the statute. The secured party had disposed of the collateral in a commercially reasonable manner and the failure to give notice caused no injury to the debtor so there was no claim for actual damages under § 9-507(1). But the debtor was a consumer, which entitled him to re-

⁵⁴ 114 N.J. Super. 382, 276 A.2d 402 (1971).

⁵⁵ *Id.* at 385-86, 276 A.2d at 404.

⁵⁶ See UCC § 9-504, Comment 5.

⁵⁷ *Conti Causeway Ford v. Jarossy*, 114 N.J. Super. 382, 386, 276 A.2d 402, 404-05 (1971).

cover the statutory penalty. The court then offset that penalty (\$872.00) by the amount of the deficiency (\$258.12) and awarded a judgment for the difference (\$613.88) to the debtor. This result at first seems equitable. But if the debtor were not a consumer, he would be liable for the deficiency despite the secured party's failure to give notice, because the sale was commercially reasonable and caused no other damages. Such a result seems inescapable unless the court meant to suggest a "line-drawing" test. It is unlikely that the court had this in mind, however, since use of a line-drawing approach would depend upon making artificial distinctions within the same transaction. The decision indicates that a secured party could recover the deficiency if a "reasonable amount" is credited to the debtor's account. But the best possible price is not required to meet the tests of commercial reasonableness under § 9-507(2). Thus in order to maintain the integrity of the requirement of notice and the requirement of commercial reasonableness as two different, although related, concepts, a factual distinction would have to be drawn. The distinction would be made between the amount realized at resale adequate to meet the UCC requirements of commercial reasonableness and an amount realized at resale sufficient to be the reasonable amount necessary to enable the secured party to recover any deficiency. If no distinction is drawn, the notice provision otherwise becomes dependent upon, rather than exclusive of, the commercial reasonableness requirement. Perhaps the court's reluctance to deny the deficiency was in part based on the fact that the debtor recovered the statutory penalty, but the decision indicates that the court would have ignored this distinction also. The opinion cites *Norton v. National Bank of Commerce*⁵⁸ as authority which indicates that the same conclusion would have been reached if consumer goods were not involved. Thus the notice requirement is rendered meaningless in situations in which the debtor suffers no actual damage and the disposition was carried out in a commercially reasonable manner.

Left only with the syntax of § 9-504(3), one might well conclude that the drafters did not intend to blur the distinction between the tests of reasonable notice and commercial reasonableness. Indeed, it is difficult to impute to the drafters an intention that failure to comply with certain requirements would go unpunished. By making the notice requirement non-waivable⁵⁹ the drafters have implicitly indicated that this requirement

⁵⁸ *Norton v. National Bank of Commerce*, 240 Ark. 143, 398 S.W.2d 58 (1966). In *Norton*, the court did not expressly characterize the goods. The issue was raised because counsel assumed the goods were consumer goods, but since the court found that Norton was a debtor it did not feel compelled to decide the issue. When the court considered the damages, however, it made no mention of the statutory penalty, which leads to the conclusion that the court would not have considered the collateral involved to be consumer goods for the purpose of awarding damages. *Id.* at 149, 398 S.W.2d at 541.

⁵⁹ See UCC § 9-501(3)(b). In 1972 the Permanent Editorial Board for the UCC adopted amendments to Article 9. The amendments, if adopted, will permit the debtor to remove or modify his right to notification after default. UCC § 9-504(3) (1972 version).

is not one to be taken lightly. Thus when a secured party sells or disposes of the collateral on his own behalf, he should be required to act in a manner which is to the debtor's benefit as well as his own.⁶⁰ The secured party should not be afforded the opportunity to realize all his rights in the collateral at the expense of the debtor's rights. The secured parties who commit these breaches do not do so under impulse or chance. They have ample opportunity to weigh the risks involved against advantages and calculate their courses of action.

By permitting recovery of deficiencies when there has been a breach of the duty to give notice of resale, the courts have given a great deal of discretion to the secured party, subject only to the remedies contained in § 9-507(1). The natural outgrowth of cases such as *Conti*, in which the secured party may recover a deficiency, is a continued abuse of the debtor's right to notice since withdrawal of the penalty leaves no incentive to comply with the notice requirement if the secured party acts in a commercially reasonable manner.

In addition, the denial of deficiency is available as an affirmative defense in a claim for a deficiency by a secured party. Thus the pervasiveness of the penalty is likely to give it a greater deterrent effect. Although it is difficult to assess its effectiveness until the Code is amended to provide more realistic remedies for abuse, the denial of any deficiency for failure to give notice appears to be the only remedy that will adequately deter improper conduct by secured parties.

Two interpretive problems remain. Should the deficiency be denied only in consumer transactions, only in nonconsumer transactions, or in both? Should it be denied if the debtor suffers provable actual damages or if the debtor recovers the statutory penalty? Denial of the deficiency is a means of awarding punitive damages. It serves the salutary purpose of deterring creditors from abuse of this preferred position at the expense of the debtor's interest. It also enables the debtor to recover, albeit indirectly, many of his intangible losses to the extent of the deficiency, such as his loss of equity and litigation expenses which ordinarily are not recoverable as compensatory damages. Therefore, it is submitted that the deficiency be denied in all cases where the secured party fails to send notice, in addition to any award of compensatory damages.

III. CONCLUSION

The notice provision can only be as effective as the means by which it is enforced. The statutory scheme creates liability for failure to give reasonable notice. In transactions involving nonconsumer goods it allows recovery of losses, which should include compensatory damages as well as punitive damages. In transactions involving consumer goods an alterna-

⁶⁰ Cf. UCC § 2-706; UCC § 2-706, Comment 2.

tive remedy is provided which permits a specified minimum recovery without proof of loss. These remedies, however, have proved inadequate. Thus some jurisdictions impose a non-Code penalty by denying recovery of any deficiency if the notice requirement is not met.

The secured transaction places the secured party in a preferred position compared to unsecured lenders since he can repossess the collateral and resell it to pay the debt owed him without court intervention. In doing so, however, the UCC has attempted to protect the debtor from dealings inimical to his interests. Since the UCC has minimized the formal requirements of the disposition it should be incumbent upon the secured party to comply with § 9-504(1) which is aimed at protecting these interests. To this end, denial of the deficiency serves as the most effective means of policing this provision. Because it is a punitive measure it has a deterrent effect upon secured parties who recklessly disregard the rights of debtors in the repossessed collateral. Therefore recovery of any deficiency should be denied in all cases where the secured party fails to send reasonable notice of resale or other disposition.

Douglas M. Mancino