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Secured Transactions - Notice, Deficiency and Personal Liability - Creditor Required to Furnish Debtor Notice of Repossession Sale of Livestock and Farm Machinery or in Subsequent Suit for Deficiency Judgment It Is Presumed the Value of the Collateral Equals the Indebtedness

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CASE COMMENT

SECURED TRANSACTIONS — NOTICE, DEFICIENCY AND PERSONAL LIABILITY — CREDITOR REQUIRED TO FURNISH DEBTOR NOTICE OF REPOSSESSION SALE OF LIVESTOCK AND FARM MACHINERY OR IN SUBSEQUENT SUIT FOR DEFICIENCY JUDGMENT, IT IS PRESUMED THE VALUE OF THE COLLATERAL EQUALS THE INDEBTEDNESS

Debtor had executed security agreements and mortgages placing as collateral his livestock, farm machinery, and certain real property.[1] After the debtor defaulted, the secured creditor repossessed the pledged personal property and sold the collateral at various farm machinery and livestock auction sales[2] and applied the sales proceeds against the debt.[3] Subsequently, the creditor obtained a deficiency judgment and foreclosed on the mortgaged real property.[4] Debtor appealed the judgment and foreclosure to the North Dakota Supreme Court,[5] alleging the creditor failed to

1. State Bank of Towner v. Hansen, 302 N.W.2d 760 (N.D. 1981). *Hansen* was a consolidated appeal of two separate judgments. Hansen, the debtor, appealed a deficiency judgment in the amount of $242,366.20 and a foreclosure of mortgaged real property to satisfy the deficiency. *Id.* at 763.

Hansen had borrowed money from Pioneer State Bank in Towner, North Dakota, to finance his ranching operations. Pioneer State Bank subsequently was put into receivership and the State Bank of Towner received the loans through a receivership transfer. *Id.* at 763 n.1.

Between Hansen and his widowed mother, the livestock owned totaled about 750 head and the land was listed at about 1040 acres. Brief for Appellant at 2, 47, State Bank of Towner v. Hansen, 302 N.W.2d 760 (N.D. 1981).

2. 302 N.W.2d at 763-64. The Bank used a total of three auction sales to dispose of the repossessed collateral, which had been obtained under court order. Two separate and distinct sales were used to sell the farm machinery. The third auction was strictly for sale of the livestock. The repossession of the personal property occurred prior to the filing of suit for a deficiency judgment. *Id.*

3. Brief for Appellant at 4, 6, State Bank of Towner v. Hansen, 302 N.W.2d 760 (N.D. 1981). The Bank, in seeking to repossess the collateral, stated in an affidavit that the actual value was $150,000. After the collateral was sold, Hansen received a credit of $45,109 against his debt. *Id.*

4. 302 N.W.2d at 760-61. The district court of McKenzie County entered judgment in creditor's favor. *Id.*

5. N.D.R. APP. P. 1. North Dakota lacks an intermediate level of appellate courts, thus all appeals from district courts and county courts of increased jurisdiction go directly to the North Dakota Supreme Court. *Id. See* N.D. CONST. art. VI, §§ 1-3.

provide notice[6] of sale of the repossessed collateral,[7] and therefore should be absolutely barred from obtaining a deficiency judgment.[8] Creditor raised as a defense the perishable collateral and customary sales market exceptions to the notice requirement found in section 41-09-50 of the North Dakota Century Code.[9] The North Dakota Supreme Court reversed the district court and *held* that the debtor was entitled to notice.[10] The court further stated that in the subsequent action for deficiency judgment, the violation of the notice requirement gave rise to a presumption that

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6. 302 N.W.2d at 766. Notice requirements are found in section 41-09-50(3) of the North Dakota Century Code, which provides:

> Disposition of the collateral may be by public or private proceedings and may be made by way of one or more contracts. Sale or other disposition may be as a unit or in parcels and at any time and place and on any terms, but every aspect of the disposition, including the method, manner, time, place, and terms must be commercially reasonable. 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 any public sale or reasonable notification of the time after which any private sale or other intended disposition is to be made shall be sent by the secured party to the debtor, if he has not signed after default a statement renouncing or modifying his right to notification of sale. In the case of consumer goods no other notification need be sent. In other cases notification shall be sent to any other secured party from whom the secured party has received (before sending his notification to the debtor or before the debtor's renunciation of his rights) written notice of a claim of an interest in the collateral. The secured party may buy at any public sale and if the collateral is of a type customarily sold in a recognized market or is of a type which is the subject of widely distributed standard price quotations, he may buy at private sale.

N.D. CENT. CODE § 41-09-50(3) (Supp. 1981) (U.C.C. § 9-504(3)).

7. 302 N.W.2d at 760-64. In addition, Hansen also raised the following issues: First, the Bank was liable in tort for conversion of personal property; second, the Bank failed to dispose of the collateral in a commercially reasonable manner; and third, after proceeding against personal property, the Bank should not be allowed to foreclose on the real property. The Bank conceded that notice was not furnished Hansen prior to any sale. *Id.*

8. *Id.* at 766. *See* Bank of Gering v. Glover, 192 Neb. 575, 223 N.W.2d 56 (1974). In *Bank of Gering* defendant-appellee was an accommodation maker on a note covered by a security agreement in certain inventory, furniture, fixtures, and accounts receivable. Plaintiff-appellant had taken possession of the collateral, solicited bids, and sold it. *Id.* at 577, 223 N.W.2d at 57. The Supreme Court of Nebraska affirmed the trial court's ruling that the appellant, a secured creditor, was not entitled to a deficiency judgment against appellee who had received no notice of sale. The court found that notification was a condition precedent to a secured creditor's right to a deficiency judgment and compliance with an act framed in the creditor's interest was not an onerous burden. *Id.* at 579-80, 223 N.W.2d at 57-59. *See also* Maryland Nat'l Bank v. Wathen, 288 Md. 119, 414 A.2d 1261 (1980) (notice deemed condition precedent to receiving a deficiency judgment).

9. 302 N.W.2d at 765-66. The applicable portion of section 41-09-50(3) of the North Dakota Century Code is as follows:

> 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 time and place of any . . . sale or other intended disposition . . . to be made shall be sent by the secured party to the debtor, if he has not signed after default a statement renouncing or modifying his right to notification of sale.

N.D. CENT. CODE § 41-09-50(3) (Supp. 1981) (U.C.C. § 9-504(3)).

10. 302 N.W.2d at 766. Having determined from the record that the livestock and farm machinery were neither perishable nor customarily sold on a recognized market, the *Hansen* court found as a matter of law that secured creditors must notify debtors prior to the sale of collateral. *Id.* The court then granted Hansen a new trial on the merits with jury instructions to be provided in accordance with the court's findings. *Id.* (construing N.D. CENT. CODE § 41-09-50(3) (Supp. 1981) (U.C.C. § 9-504(3))).

the value of the collateral was equal to the indebtedness and that the burden of rebuttal was on the secured creditor.[11] *State Bank of Towner v. Hansen*, 302 N.W.2d 760 (N.D. 1981).

The general purpose of notice of sale of repossessed collateral is to provide the debtor with an opportunity to take appropriate steps to protect his interest in the collateral and to prevent undue prejudice in the disposition of the collateral by a secured creditor.[12] The importance of notice is that the amount of a deficiency judment will be inversely proportional to the sales price.[13] Notice thus protects the debtor from low and unreasonable sales prices.[14]

Many of the Uniform Commercial Code provisions governing default have their historical antecedents in the Uniform Conditional Sales Act (U.C.S.A.).[15] Courts construing default provisions under the U.C.S.A. generally have held a proper resale, including notice, to be a condition precedent to a seller's right to recover a deficiency.[16]

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11. *Id.* at 767. (citing State Bank of Burleigh County Trust Co. v. All-American Sub, Inc., 289 N.W.2d 772 (N.D. 1980)). The court in *Hansen* found the presumption and shifting of burden of proof the least harsh and most conducive to the U.C.C.'s intent of commercial reasonableness. *Id.* at 766-67. (construing N.D. CENT. CODE § 41-01-06 (1968) (U.C.C. § 1-106)).

12. Wilmington Trust Co. v. Conner, 415 A.2d 773 (Del. 1980). The Delaware Supreme Court found that the purpose of the notice requirement was threefold: "it gives debtor the opportunity to exercise his redemption rights under § 9-506 . . . it affords the debtor an opportunity to seek out buyers . . . and . . . it allows the debtor to oversee every aspect of the disposition, thus maximizing the probability that a fair sales price will be obtained." *Id.* at 776. *See* State Bank of Towner v. Hansen, 302 N.W.2d 760, 765; U.C.C. § 9-504 comments 1, 5 (1973).

13. *See* J. WHITE & R. SUMMERS, UNIFORM COMMERCIAL CODE § 26.9, at 1109 (2d ed. 1980). If the price obtained for collateral is high, the amount of the judgment will be low. The importance of the terms contained in the notice lies almost exclusively in the extent they protect against an unfair low price. *Id. See* Federal Deposit Ins. Corp. v. Farrar, 231 N.W.2d 602, 605 (Iowa 1975) (discussion of purposes for requiring notice).

14. Federal Deposit Ins. Corp. v. Farrar, 231 N.W.2d at 605. The court in *Farrar* stated the purpose of notice, under the Iowa counterpart of section 9-504 of the Uniform Commercial Code, was to permit the debtor to bid at the sale or to protect himself from an inadequate sale price. *Id.*

15. 2 UNIFORM LAWS ANN. 27-38 (1922). Approved in 1918, the U.C.S.A. was withdrawn in 1943, at which date 11 jurisdictions had adopted it. North Dakota was not one of them. *See* HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS AND PROCEEDINGS OF THE FIFTY-THIRD ANNUAL CONFERENCE 67 (1943).

16. *See* Commercial Credit Corp. v. Swiderski, 57 Del. 76, 195 A.2d 546 (Del. Super. Ct.), *reh'g denied*, 57 Del. 76, 196 A.2d 214 (Del. Super. Ct. 1963) (failure to give statutory notice of resale of car discharges buyer from contract); Frantz Equip. Co. v. Anderson, 37 N.J. 420, 181 A.2d 499 (1962) (noncompliance with statutory provisions governing resale deprives seller of right to deficiency judgment). *See also* 29 CATH. U.L. REV. 1013 (1980). A seller's right to repossessed goods depends on statutory guidelines. The seller's rights are as follows:

> Under the [U.C.S.A.], the seller could either notify the buyer of his intention to retake the goods upon default or retake without notice and then retain the goods for a ten-day period during which the buyer might redeem. . . . If the buyer did not redeem the goods and had paid at least fifty percent of their purchase price, the seller was required to sell the goods at public auction, with notice to both the buyer and the public. If less than fifty percent of the purchase price had been paid, the buyer could demand the sale of the goods. Absent such demand, the seller could voluntarily resell the goods or retain them as his own, thus discharging the buyer of liability for the balance due. . . . The proceeds of any resale were applied to costs of resale . . . and the satisfaction of the debt. The buyer was entitled to any surplus and was liable for any deficiency.

Id. at 1016-17 (footnotes omitted).

The 1972 official text of the Uniform Commercial Code (U.C.C.), adopted by North Dakota,[17] subjects "reasonable notice" of disposition of collateral under section 9-504(3) of the U.C.C. to two exceptions.[18] The exceptions control notice if collateral can be found to be "perishable or threatens to decline speedily in value,"[19] or if the collateral is "customarily sold on a recognized market."[20]

The notice exception for collateral "customarily sold in a recognized market" on its face, implies a regular sales market for a specific or similiar line of products.[21] However, the term "recognized market" has been interpreted quite restrictively to mean only stock markets or commodity markets.[22]

The major purpose for giving and requiring notice is for the debtor's protection against a low resale price.[23] The "perishable"

17. WHITE & SUMMERS, *supra* note 13, at 5. By 1968, 49 states had adopted the U.C.C. In 1974 Louisiana adopted portions of the 1972 official text to complete the adoption by all 50 states of all or portions of the U.C.C. *Id.* North Dakota enacted the U.C.C. on March 19, 1965, effective July 1, 1966. 1965 N.D. Sess. Laws ch. 296. In 1973 North Dakota became one of several states to adopt the 1972 official text of the U.C.C. 1973 N.D. Sess. Laws ch. 343.

18. N.D. CENT. CODE § 41-09-50(3) (Supp. 1981) (U.C.C. § 9-504(3)). The exceptions provided in the North Dakota Century Code are that no notice is required "when the collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market." *Id.*

19. *Id. See* 302 N.W.2d at 765-66. The *Hansen* court found from the record of the trial court that no evidence was offered to establish the condition of the cattle as being subject to rot or loss of significant value in a short time frame. The court took notice of the significant delay between repossession and resale and determined that in any event ample time existed to furnish Hansen with notice of the sale. *Id. See* United States v. Mid-States Sales Co., 366 F. Supp. 1099, 1103 (D. Neb. 1971). The court in *Mid-States Sales Co.* found that cattle were not perishable or subject to a speedy decline in value as viewed from the record at trial. Lacking such evidence, the court found that a two-week gap between a request to take back the cattle and time of sale was ample time to furnish notice. *Id.*

20. N.D. CENT. CODE § 41-09-50(3) (Supp. 1981) (U.C.C. § 9-504(3)). *See* 302 N.W.2d at 765. The *Hansen* court found that "[o]nly those items of collateral which are commonly sold on a market such as the stock market or the commodity market wherein the price at any given moment is fixed and is free from an individualized competitive bidding process fall within the category of 'recognized market' collateral which is exempt under Section 41-09-50, N.D.C.C., [9-504, U.C.C.]." *Id. See also* Norton v. National Bank of Commerce of Pine Bluff, 240 Ark. 143, ____, 398 S.W.2d 538, 540 (1966) (stock and commodity markets deemed "recognized markets").

21. *See* Federal Deposit Insurance Corp. v. Farrar, 231 N.W.2d 602, 605 (Iowa 1975); State Bank of Towner v. Hansen, 302 N.W.2d 760, 765 (N.D. 1981); O'Neil v. Mack Trucks, Inc., 533 S.W.2d 832, 836 (Tex. Civ. App. 1975), *rev'd on other grounds,* 542 S.W.2d 112, 116 (Tex. 1976). *See also* WHITE & SUMMERS, *supra* note 13, at 1111. The secured creditors in *O'Neil* and *Farrar* tried to claim the exception of "recognized markets" for trucks and autos. In both cases the creditors sought to show by implication a distinct and commonly accepted sales market via dealership, wholesale markets. The courts, however, did not agree. 231 N.W.2d at 605; 533 S.W.2d at 836.

22. Norton v. National Bank of Commerce of Pine Bluff, 240 Ark. 143, 398 S.W.2d 538 (1966). In *Norton* the Arkansas Supreme Court defined "recognized market" as follows:

> Obviously the Code dispenses with notice in this situation only because the debtor would not be prejudiced by the want of notice. Thus a "recognized market" might well be a stock market or a commodity market, where sales involve many items so similar that individual differences are nonexistent or immaterial, where haggling and competitive bidding are not primary factors in each sale, and where the prices paid in actual sales of comparable property are currently available by quotation.

Id. at ____, 398 S.W.2d at 540.

23. *See* Wilmington Trust Co. v. Conner, 415 A.2d 775, 776 (Del. 1980). *See supra* note 12 and accompanying text for a discussion of the purpose of the notice requirement.

and "recognized market" notice exceptions, however, can be important to the creditor without being prejudicial to the debtor.[24] Therefore, benefit to both debtor and creditor is derived by application of these exceptions.[25]

Courts reviewing actions for deficiency judgments have available three separate and distinct applications of law.[26] The three theories have been classified as the "absolute bar," "shift," and "set-off" theories.[27]

The "absolute bar" theory represents the case law of those jurisdictions that totally bar a creditor from a deficiency judgment when he has failed to comply with U.C.C. provisions.[28] Modern proponents of the "absolute bar" theory generally justify its application by applying U.C.C. sections 1-103[29] and 9-507[30] as

24. *See* WHITE & SUMMERS, *supra* note 13, at 1111. Both the debtor and the creditor stand to gain by obtaining high sale prices on repossessed collateral. The time consumed giving notice might have a disastrous effect if such collateral is perishable or threatening to decline speedily in value or about to rot for lack of refrigeration or proper storage. *Id.* The value of this exception to both creditor and debtor is obvious under these and similar conditions. The facts, however, must clearly substantiate that the collateral is perishable or threatens to decline speedily in value. *See, e.g.*, United States v. Mid-States Sales, Co., 336 F. Supp. at 1103.

When collateral is "customarily sold in a recognized market" the debtor does not need the protection afforded by notice because supply and demand in places such as the New York Stock Exchange, determine the price and value of the goods. *See* WHITE & SUMMERS, *supra* note 13, at 1111. Additionally, such markets are relatively free from human conspiracy and manipulation. *Id. See* United States v. Mid-States Sales Co., 336 F. Supp. at 1103 (cattle were not sold in a recognized market); State Bank of Towner v. Hansen, 302 N.W.2d at 765 (cattle and farm machinery were not sold in a recognized market).

25. U.C.C. § 9-504(1)(b), (2) (1973) (codified at N.D. CENT. CODE § 41-09-50 (1)(b), (2) (Supp. 1981)). These sections of the U.C.C. provide the creditor with the power to apply the sale proceeds, after payment of the sale expenses, to the indebtedness secured by the collateral sold. *Id.* Furthermore, a secured creditor must account to the debtor for any surplus and unless otherwise agreed, the debtor is liable for any remaining and unpaid indebtedness. This power of offset and deficiency liability likely will result in the best price possible. The creditor will receive a maximum offset against the debt, and the debtor receives the best possible price without worry of spoilage or manipulation. *See id.*

26. Wilmington Trust Co. v. Conner, 415 A.2d at 777-78. The three applications identified by the *Wilmington Trust* court were the "absolute bar," the "set-off," and the "shift" theories. *Id.* The Delaware Supreme Court in *Wilmington Trust* adopted the "absolute bar" theory, which was well settled law in Delaware under the Uniform Conditional Sales Act. *Id.* at 779.

27. *Id.* at 777-78. The applications are named after the result and style of determination in deficiency cases. Under the "absolute bar" theory the right to a deficiency is totally barred when there has been some form of creditor misbehavior. *Id.* Courts using this theory generally find strict compliance with the Code a condition precedent to the award of a deficiency. *See id.*

The "set-off" application provides a creditor with an absolute right to receive a deficiency judgment, but a debtor is allowed to setoff his or her damages arising under section 9-507(1) of the U.C.C. against the deficiency awarded. *Id.* at 778. The "shift" application allows a deficiency, but in cases of creditor misconduct, the value of the collateral is presumed equal to the debt and the burden of proving a deficiency is shifted to the creditor. Only upon successfully rebutting the presumption is a deficiency judgment entered. *Id. See* Bank of Gering v. Glover, 192 Neb. 575, 579, 223 N.W.2d 56, 58-59 (1974) (discussion on holding strict compliance with Code a condition precedent). *See also* WHITE & SUMMERS, *supra* note 13, at 1127-34; 45 MO. L. REV. 162, 165-66 (1980) (discussion of the different deficiency remedies).

28. *See* WHITE & SUMMERS, *supra* note 13, at 1128 n.170. The states that appear to impose an absolute bar on recovery of a deficiency judgment by noncomplying secured creditors are California, District of Columbia, Florida, Georgia, Illinois (split), Iowa, Maine, Massachusetts (split), New York (split), Ohio, Oklahoma, Pennsylvania, Utah, Wisconsin, and Wyoming. *Id.* at 1134 n.191. *Accord* 45 MO. L. REV. 162, 165 n.17.

29. N.D. CENT. CODE § 41-01-03 (1968) (U.C.C. § 1-103). This section of the U.C.C. incorporates the general rules of common law and equity unless specifically exempted by the Code. *Id.*

30. *Id.* § 41-09-53 (1968) (U.C.C. § 9-507). Section 41-09-53 provides the debtor with remedies

statutory authority.[31] Generally case law adhering to the "absolute bar" theory denied deficiency judgments because of strict statutory notice requirements.[32] As a result, strict compliance with U.C.C. provisions became a prerequisite to obtaining a deficiency judgment.[33] Furthermore, proponents citing the case law interpreting notice requirements under the U.C.S.A., claim the U.C.C. drafters purposely chose not to alter an accepted debtor remedy.[34]

The opponents to the "absolute bar" theory claim the results obtained by its application are harsh and punitive to the creditor.[35]

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for a creditor's failure to comply with the statute under the U.C.C. This section does not provide for punititve damages. *Id. But see* John Deere Co. v. Nygard Equip., Inc., 225 N.W.2d 80 (N.D. 1974). In *Nygard* a farm implement manufacturer terminated a dealer's franchise and seized and sold its property valued in excess of amounts owing pursuant to the security agreement entered into between the parties. The court granted punitive damages because the facts indicated the existence of malice, oppression and fraud. *Id.* at 95. The court, however, did not decide whether faulty compliance under the U.C.C. would have supported the same award. *Id.*

31. C.I.T. Corp. v. Haynes, 161 Me. 353, 358, 212 A.2d 436, 439 (1965). The court in *Haynes* denied a deficiency judgment using the rationale that, under pre-Code commercial law, most courts had denied such judgments and no reasonable justification existed to change applicable case law. *Id. See* Skeels v. Universal C.I.T. Credit Corp., 222 F. Supp. 696, 702 (W.D. Pa. 1963), *rev'd on other grounds,* 335 F.2d 846 (3d Cir. 1964) (in lack of notice cases the debtor loses his opportunity to protect his interest by repurchasing the collateral or by being present at the sale); Wilmington Trust Co. v. Conner, 415 A.2d 773, 780 (Del. 1980) (section 9-507 is not adequate to protect debtor and is not debtor's exclusive remedy); Camden Nat'l Bank v. St. Clair, 309 A.2d 329, 332 (Me. 1973) (nothing in the language of section 9-507 of the U.C.C suggested that the section was the debtor's exclusive remedy).

32. *See, e.g.,* Maryland Nat'l Bank v. Wathen, 288 Md. 119, 414 A.2d 1261 (1980). In *Wathen* the court found that permitting a deficiency judgment would nullify debtor's notice and participation rights and permit a continuation of bad faith by creditors, which the U.C.C. sought to correct. *Id.* at ____, 414 A.2d at 1264. This belief was strengthened further by the ease with which a creditor may provide notice under section 9-504 of the U.C.C. *Id.* The U.C.C. provides for only reasonable notice and lacks the specificity of the U.C.S.A. *See* 2 UNIFORM LAWS ANN. 27-38 (1922); U.C.C. § 9-504(3) (1972) (codified at N.D. CENT. CODE § 41-09-50(3) (Supp. 1981)). *See also* Skeels v. Universal C.I.T. Credit Corp., 222 F. Supp. 696, 702 (W.D. Pa. 1963) (disposition without notice denies debtor his right of redemption).

33. Bank of Gering v. Glover, 192 Neb. 575, 223 N.W.2d 56 (1974). The *Gering* court used the following as its reason for finding notice a prerequisite to obtaining a deficiency judgment:

> The creditor is given several options in disposing of collateral and very minimal formal requirements. The burden on the secured creditor is to comply with the law. The act [U.C.C.] is framed in his interest. It is not onerous to require him to give notice of the time and place of sale. . . . On the other hand, to permit him to proceed otherwise does place an onerous burden on the debtor. It prevents the debtor from taking steps to protect his interests at the sale.

Id. at 579, 233 N.W.2d at 59.

34. *See* Leasco Data Processing Equip. Corp. v. Atlas Shirt Co., 66 Misc. 2d 1089, 1091, 323 N.Y.S. 2d 13, 15 (Civ. Ct. 1971). In *Leasco* the court reasoned:

> If the authors of the U.C.C. proposed to overthrow the firmly established and generally accepted construction of the older statute [Uniform Conditional Sales Act] denying recovery for a deficiency where there was not precise compliance with the notice requirement, they surely would have manifested that intent in clear and unambiguous language. In fact, there is not the slightest intimation of any such purpose to be found in the U.C.C.

Id. (citation omitted).

35. *See, e.g.,* State Bank of Burleigh County Trust Co. v. All-American Sub, Inc., 289 N.W.2d 772 (N.D. 1980). In *All-American Sub* the North Dakota Supreme Court found that the "shift" deficiency theory was "more in the spirit of commercial reasonableness." *Id.* at 780.

Therefore, the "shift" and "set-off" theories resulted.[36] Courts, citing U.C.C. sections 1-106[37] and 9-507[38] and the Code's apparent lack of specific language, have held that the "absolute bar" theory totally conflicts with the spirit of commercial reasonableness entwined in the U.C.C.[39] Furthermore, the courts declared that under the "shift" theory, a non-complying creditor, before receiving a deficiency judgment, must rebut a presumption that the collateral is equal to the value of the secured indebtedness.[40]

Before the court in *State Bank of Towner v. Hansen*[41] reviewed the deficiency judgment, it examined the creditor's defenses for not providing notice.[42] In addressing one of the creditor's notice exceptions, the one of perishability,[43] the *Hansen* court relied on factual evidence and testimony to determine that there had been adequate time for the creditor to furnish reasonable notice to the debtor.[44] Under the facts of the case livestock and farm machinery,

36. *See* WHITE & SUMMERS, *supra* note 13, at 1132 n.187. The states that appear to apply the presumption or shift approach against secured creditors are Arkansas, Colorado, Connecticut, Illinois (split), Indiana, Texas, Alaska, Mississippi, Nevada, New Jersey, New Mexico, North Dakota, North Carolina and Rhode Island. *Id.* at 1134 n.193. *See also* Universal C.I.T. Credit Co. v. Rone, 248 Ark. 665, 453 S.W.2d 37 (1970); Levers v. Rio King Land and Inv. Co., 93 Nev. 95, 560 P.2d 917 (1977); Clark Leasing Corp v. White Sands Forest Prods., Inc., 87 N.M. 451, 535 P.2d 1077 (1975).

37. N.D. CENT. CODE § 41-01-06 (1968) (U.C.C. § 1-106). Section 41-01-06 provides as follows:

> The remedies provided by this title shall be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed but neither consequential or special nor penal damages may be had except as specifically provided in this title or by other rule of law.
>
> Any right or obligation declared by this title is enforceable by action unless the provision declaring it specifies a different and limited effect.

Id.

38. N.D. CENT. CODE § 41-09-53 (1968) (U.C.C. § 9-507).

39. Hall v. Owen County State Bank, ___ Ind. App. ___, 370 N.E.2d 918 (1977). In settling for the "shift" or presumption application, the *Hall* court determined that the U.C.C. was intended to do away with rigid rules of laws designed to govern all situations in favor of more fluid guidelines, which allow case by case analysis. It was hoped that this procedure would allow parties to reach the merits of the case instead of becoming entangled in procedural technicalities. *Id.* at ___, 370 N.E.2d at 927 (citing 2 GILMORE, SECURITY INTERESTS AND PERSONAL PROPERTY § 44.9.4, at 1264 (1965)).

40. *Id.* at ___, 370 N.E.2d at 928. The court in adopting the shifting of the burden of proof from the debtor to creditor and requiring the presumption to be rebutted, stated the following:

> We think that this is a sound policy, for in cases where the debtor was not notified of impending sale, the creditor should be in a much better position to prove the value of collateral at the time of disposition. Furthermore, it seems fundamentally unfair to put the burden of showing value of collateral after it has been repossessed and sold upon the debtor who has received insufficient notice of disposition.

Id. (citations omitted). *See* State Bank of Burleigh County Trust Co. v. All-American Sub, 289 N.W.2d 772 (N.D. 1980) (the shift or presumption application prevents harsh and punitive results against the creditor).

41. 302 N.W.2d 760.

42. 302 N.W.2d at 765-66. In *Hansen,* Appellee-Towner conceded that no notice was given to Hansen prior to the sale of any of the collateral. Appellee-Towner claimed no notice was necessary since the livestock and farm machinery were perishable or sold on recognized markets. Both factors are exceptions to the notice requirements under section 9-504 of the U.C.C. *Id.* (construing N.D. CENT. CODE § 41-09-50 (Supp. 1981) (U.C.C. § 9-504)).

43. *Id.* at 765.

44. *Id.* (citing United States v. Mid-States Sales Co., 336 F. Supp. 1099 (D. Neb. 1971)). The

as a matter of law, were not "perishable" and thus the exception would not circumvent the notice requirement.[45]

The creditor alternatively raised the issue of collateral "customarily sold in a recognized market" and, therefore, no notice was required.[46] In addressing the "recognized market" exception the *Hansen* court cited *Norton v. National Bank of Commerce of Pine Bluff*[47] and determined that a "recognized market" meant only markets which had fixed prices at any moment and in which the sales themselves were free from haggling and competitive bidding.[48] Thus, equipment auction sales and livestock sales, the success being determined by the competitive bidding of participants, did not fall within the statutory "recognized market" exception to notice.[49] The *Hansen* court agreed with the court in *O'Neil v. Mack Trucks, Inc.*,[50] that the term "recognized market" was most restrictive under the U.C.C.[51] Accordingly, the *Hansen* court held that livestock and farm machinery were collateral not customarily sold in a recognized market.[52] Therefore, as a matter of law, reasonable notice was required by statute.[53]

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court in *Hansen* relied on the testimony of the witnesses and inferred from the 18-20 day gap between the date of repossession and date of sale that the collateral was not perishable. As in *Mid-States*, 336 F. Supp. 1099, the court in *Hansen* determined that sufficient time was available to have furnished reasonable notice as provided by section 9-504(3) of the U.C.C. 302 N.W.2d at 765.

45. 302 N.W.2d at 765.

46. N.D. CENT. CODE § 41-09-50(3) (Supp. 1981) (U.C.C. § 9-504(3)) (notice exception for creditors with respect to perishable goods). *See* 302 N.W.2d at 765.

47. 302 N.W.2d at 756 (citing Norton v. National Bank of Commerce of Pine Bluff, 240 Ark. 143, 398 S.W.2d 538 (1966)). In determining that used cars are not sold in a recognized market, the Arkansas Supreme Court in *Norton* stated:

> Obviously the Code dispenses with notice in this situation only because the debtor would not be prejudiced by the want of notice. Thus a "recognized market" might well be a stock market or a commodity market, where sales involve many items so similar that individual differences are nonexistent or immaterial, where haggling and competitive bidding are not primary factors in each sale, and where the prices paid in actual sales of comparable property are currently available by quotation.

240 Ark. at ____, 398 S.W.2d at 540. *See* WHITE & SUMMERS, *supra* note 13, at 1111 (defines a recognized market as one similar to the New York Stock Exchange).

48. 302 N.W.2d at 765. *See* Norton v. National Bank of Commerce of Pine Bluff, 240 Ark. 143, 298 S.W.2d 538 (1966); Federal Deposit Ins. Corp. v. Farrar, 231 N.W.2d 602 (Iowa 1975); O'Neil v. Mack Trucks, Inc., 533 S.W.2d 832 (Tex. Civ. App. 1975), *rev'd on other grounds*, 542 S.W.2d 112 (Tex. 1976).

49. 302 N.W.2d at 765.

50. 533 S.W.2d 832, 836 (Tex. Civ. App. 1975), *rev'd on other grounds*, 542 S.W.2d 112 (Tex. 1976).

51. 302 N.W.2d at 765.

52. *Id.* The *Hansen* court determined that auction sales and livestock sales cannot satisfy the restrictive definition of "recognized market." The sole purpose of auction type sales is to get as high a price as possible. To do this, however, the participants are enticed into competitive bidding. Generally, the bidding is more competitive with larger groups of participants. Under no circumstances can an auction sale compare to the case law definition. *See id. See also* Norton v. National Bank of Commerce of Pine Bluff, 240 Ark. 143, ____, 398 S.W.2d 538, 540 (1966); WHITE & SUMMERS, *supra* note 13, at 1111.

53. 302 N.W.2d at 760. The trial court had presented the notice issue as a question of fact to the jury. The North Dakota Supreme Court, however, ruled this was in error because the jury was not required to return a special verdict on this point. The supreme court remanded the case for a new

The *Hansen* court next addressed the debtor's assertion that failure to furnish notice should result in an "absolute bar" of the creditor's deficiency judgment.[54] Relying on precedent established by *State Bank of Burleigh County Trust Co. v. All-American Sub, Inc.*,[55] the *Hansen* court ruled against the debtor and adopted the "shift" or "presumption" theory as the appropriate deficiency judgment application.[56] The court in *Hansen* determined that the presumption rightfully shifted to the creditor the burden of proving that the fair market value of the collateral sold was not equal to the amount of the debt.[57]

The court noted the particular harsh and disproportionate results that would be obtained by applying the absolute bar under debtor's request.[58] If such punitive results were desired, the *Hansen* court felt the drafters of the U.C.C. would have included express language mandating it.[59] The court supported its reasoning by reviewing applicable sections of the North Dakota Century Code, which advocate commercial reasonableness.[60]

By relying on its interpretation of applicable statutes and the *All American Sub* precedent, the *Hansen* court allowed a deficiency judgment only if the creditor could overcome a presumption that the fair market value of the collateral sold was equal to the indebtedness.[61] Once the presumption was rebutted the creditor's

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trial with the jury to receive instruction that as a matter of law the debtor is entitled to notice pursuant to section 41-09-50(3) of the North Dakota Century Code. *Id.* (citing N.D. CENT. CODE § 41-09-50(3) (Supp. 1981) (U.C.C. § 9-504(3))).

54. *Id.* at 766-67. Hansen attempted to establish precedent in North Dakota by citing a pre-U.C.C. case concerning warehousemen receipts and notice. *Id.* at 766 n.2 (citing Heaton v. Hoerr, 66 N.D. 430, 266 N.W. 261 (1936)). (a warehouseman's sale of grain to satisfy a lien for storage charges without compliance with the notice statute was void and, therefore, could not recover a deficiency).

55. 289 N.W.2d 772 (N.D. 1980). *All-American Sub, Inc.* was the first case in which the North Dakota Supreme Court used the presumption or shifting of burden theory.

56. 302 N.W.2d 766-68 (citing State Bank of Burleigh County v. All-American Sub, Inc., 289 N.W.2d 772 (N.D. 1980)). The *Hansen* court particularly disliked the harsh and disproportionate results promulgated by the "absolute bar" theory. The creditor stood to lose more than $200,000 if barred from a deficiency judgment. The court thought that the application of the "absolute bar" theory would be similar to an award of punitive damages, which the U.C.C. does not provide. Thus, in the spirit of commercial reasonableness, the *Hansen* court reasoned that the presumption method was the better compromise. *Id.*

57. *Id.* at 768 (citing Hall v. Owen State Bank, ____ Ind. App. at ____, 370 N.E.2d at 928). The court in *Hall* found it fundamentally unfair that the debtor, who received insufficient notice of sale, be required to prove the value of collateral sold by the creditor. At the time of disposition the misbehaving creditor should be in a much better position to prove the fair market value of the repossessed collateral. ____ Ind. App. at ____, 370 N.E. 2d at 928.

58. 302 N.W.2d at 767.

59. *Id.*

60. *Id.* The *Hansen* court paid close attention to the liberal remedies and to the desire to place parties in as good a position as if the defaulting party had performed. The court also noted that the U.C.C. specifically provides no punitive damages to debtors. *Id.* (construing N.D. CENT. CODE §§ 41-01-06, -09-53 (1968) (U.C.C. §§ 1-106, 9-507)).

61. 302 N.W.2d at 766 (citing State Bank of Burleigh County v. All-American Sub Inc., 289 N.W.2d 772, 779-80 (N.D. 1980)). *See* Hall v. Owen County State Bank, ____ Ind. App. ____, ____, 370 N.E.2d 918, 928 (1977) (presumption theory followed); Levers v. Rio King Land & Inv. Co., 93 Nev. 95, ____, 560 P.2d 917, 920 (1977) (presumption theory followed).

deficiency could be computed using the greater of collateral value as proven or the amount received from collateral sold.[62] The court further directed that once noncompliance was determined the creditor could not rely on the price received at the sale, but must introduce other credible and objective evidence to rebut the presumption.[63]

The court was thus satisfied that the spirit of commercial reasonableness entwined in the U.C.C. was upheld.[64] The creditor was given an opportunity to prove and obtain a deficiency judgment, regardless of accidental or intentional error, and the debtor was reasonably protected from prejudicial treatment by repossessing creditors.[65]

The holding of the *Hansen* decision firmly established the notice requirement in creditor disposition of repossessed livestock and farm machinery.[66] Although the "perishable or threatening to decline speedily in value" exception is still a factual question, the court in *Hansen* reasoned that the "customarily sold in a recognized market" exception did not include livestock and equipment auction sales.[67]

One implication of *Hansen* is the arguably deterrent effect the shifting of the burden may have on noncomplying creditors. Although the presumption that the collateral is equal to the value of

62. 302 N.W.2d at 767. The North Dakota Supreme Court established a two-part test for the limitation of a deficiency judgment. The calculation is as follows:

> Upon overcoming such presumption the secured creditor will only be allowed to recover a deficiency for the lesser of: (a) the difference between the indebtedness and the fair market value of the collateral sold, or (b) the difference between the indebtedness and the actual amount received upon sale of the collateral.

Id.

63. *Id.* at 768. *See* Universal C.I.T. Credit Co. v. Rone, 248 Ark. 665, 669, 453 S.W.2d 37, 38-40 (1970). In *Rone* the creditor repossessed and sold a pickup truck and car without furnishing notice to Rone. The court imposed the presumption theory and the creditor sought to rebut with employee testimony. The court refused to allow this testimony because the issue was the fair market value and not what price was received. The court stated that because the sale did not conform with the statute, more than evidence of the sales price would be needed to rebut the presumption. *Id.* at 40.

64. 302 N.W.2d at 767 (construing N.D. CENT. CODE § 41-01-06 (1968) (U.C.C. § 1-106)). Section 41-01-06 of the North Dakota Century Code concerns the liberal treatment of remedies as to all parties and provides that damages are limited to compensatory damages. N.D. CENT. CODE § 41-01-06 (1968) (U.C.C. § 1-106). *See also id.* § 41-01-02 (U.C.C. § 1-102). Subsection one of section 41-01-02 provides that the title shall be liberally construed and applied. *Id.* § 41-01-02(1). Subsection two speaks of the purposes and policies of this act. *Id.* § 41-01-02(2). Subsection three provides that provisions of the act may be varied by agreement, except when otherwise provided and the obligations of good faith, diligence, reasonableness, and care may not be disclaimed. *Id.* § 41-01-02(3).

65. 302 N.W.2d at 768. The North Dakota Supreme Court reversed and remanded the case for a new trial in accordance with the views expressed in the opinion. *Id.* The case was settled prior to a new trial. Hansen was allowed possession and title to his real property by agreeing to apply oil royalties to a stipulated deficiency. Telephone interview with Sherry Mills Moore, Att'y for Appellant, State Bank of Towner v. Hansen, 302 N.W.2d 760 (1981) (Feb. 19, 1982).

66. *Id.* at 766.

67. *Id.* at 765 (citing Norton v. National Bank of Commerce of Pine Bluff, 240 Ark. 143, 398 S.W.2d 538 (1966)). *See* N.D. CENT. CODE § 41-09-50(3) (Supp. 1981) (U.C.C. § 9-504).

the secured indebtedness appears to penalize a creditor, it actually acts as a deterrent only when the creditor does not meet his notice requirement and when the value of the collateral is less than the outstanding debt.

Two factors seem to prevent the placing of the burden of proof on the creditor from serving as a sufficient deterrent. First, the *Hansen* court did require evidence other than the price derived from the sale and testimony from the creditor's employees.[68] Whether the additional evidence presented is sufficient to rebut the presumption, however, is an *ad hoc* determination to be made by the trier of fact. In *Hall v. Owen County State Bank*[69] the Bank overcame the presumption with minimal evidence of value, by showing good faith efforts and a commercially reasonable sale.[70] In contrast, in *Wirth v. Hearvey,*[71] evidence of the creditor's valuation combined with the original purchase agreement was sufficient to rebut the presumption.[72] The apparent ease with which creditors may overcome the presumption should serve warning to debtors that although it is the creditor that bears the burden, the debtor must be prepared to offer counterevidence or run the risk of a directed verdict.[73]

The second factor which prevents deterrance is that in a sale at less than value the court will allow a deficiency only to the extent of value as proven minus the indebtedness.[74] This can not have a

68. 302 N.W.2d at 768.

69. ___ Ind. App. ___, 370 N.E.2d 918 (1977).

70. Hall v. Owen County State Bank, ___ Ind. App. ___, ___, 370 N.E.2d 918, 929 (1977). The *Hall* court considered the question of overcoming the presumption to be one of fact, which was to be decided from all aspects of the sale. The court did not distinguish between the value of the collateral and the reasonableness of the sale. The court in *Hall* determined that a commercially reasonable sale properly established the value of the collateral. *Id.*

71. 508 S.W.2d 263 (Mo. 1974). In *Wirth* the value placed on the collateral by the creditor amounted to $650. The court found that this was a fair value after interpreting the sales contract. *Id.* at 269.

72. 508 S.W. 2d at 268.

73. *See* Clark Leasing Corp. v. White Sands Forest Prods., Inc., 87 N.M. 451, ___, 535 P.2d 1077, 1080 (1975). The *Clark* court found the creditor must prove that a commercially reasonable sale was made. However, once the creditor has established a prima facie case, the debtor must present evidence to avoid a directed verdict. *Id.*

74. *See* 302 N.W.2d at 767. Three examples of deficiency judgments calculated under the presumption application as defined by the North Dakota Supreme Court are shown below. The problems assume noncompliance and that the presumption has been overcome.

A.

Debt	=	$10,000			
Collateral fair market value	=	7,000			
Collateral sold for	=	3,000			
Results under *Hansen* presumption, lesser of:					
	1) Debt	$10,000		2) Debt	$10,000
	-FMV	7,000		-Sold for	3,000
Deficiency		$ 3,000			$ 7,000
Creditor receives deficiency of		$ 3,000			

deterrent effect because the creditor receives what he would have received regardless of the notice deficiency. In fact, an incentive may be hiding here should the debtor elect to default and not defend the action.

Currently under section 9-507 of the U.C.C., only compensatory damages are available to a debtor for noncompliance by a creditor.[75] This means that attorney fees and other costs of litigation are not recoverable, even though these costs are directly related to the creditor's noncompliance. The debtor must now weigh the costs of litigation against any increment to be gained by resisting a deficiency judgment.

Finally, the debtor under section 9-506 of the U.C.C. has the right at any time before the secured party disposes of the collateral to redeem the collateral.[76] Currently, it appears a debtor would

B.	Debt	=	$10,000		
	Collateral fair market value	=	3,000		
	Collateral sold for	=	3,000		
	Result under *Hansen* presumption, lesser of:				
	1) Debt	$10,000		2) Debt	$10,000
	-FMV	3,000		-Sold for	3,000
	Deficiency	$ 7,000			$ 7,000
	Creditor receives deficiency of	$ 7,000			
C.	Debt	=	$10,000		
	Collateral fair market value	=	2,500		
	Collateral sold for	=	3,000		
	Results under *Hansen* presumption, lesser of:				
	1) Debt	$10,000		2) Debt	$10,000
	-FMV	2,500		-Sold for	3,000
	Deficiency	$ 7,500			$ 7,000
	Creditor receives deficiency of	$ 7,000			

75. N.D. CENT. CODE § 41-09-53(1) (1968) (U.C.C. § 9-507(1)). Section 41-09-53(1) provides in part:

> If it is established that the secured party is not proceeding in accordance with the provisions of this part disposition may be ordered or restrained on appropriate terms and conditions. If the disposition has occurred the debtor or any person entitled to notification or whose security interest has been made known to the secured party prior to the disposition has a right to recover from the secured party any loss caused by a failure to comply with the provisions of this part. 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 percent of the principal amount of the debt or the time price differential plus ten percent of the cash price.

Id.

76. *Id.* § 41-09-52 (1968) (U.C.C. § 9-506). Section 41-09-52 of the North Dakota Century Code provides:

> At any time before the secured party has disposed of collateral or entered into a contract for its disposition under section 41-09-50 or before the obligation has been discharged under subsection 2 of section 41-09-51, the debtor or any other secured

have no redress for the loss of his right to redeem, which was caused by the noncompliance of the creditor in the sale of collateral without notice.

The significant split among states in this area suggests that neither method of deficiency is better.[77] Until section 9-504(3) is legislatively amended or the case law changes, the "presumption" theory on deficiency judgments is the law in North Dakota.[78]

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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 in the agreement and not prohibited by law, his reasonable attorneys' fees and legal expenses.

Id.

77. *See* 45 MO. L. REV. 162, 169 (1980) (amendment to article 9 of the U.C.C. recommended as the best way to settle the issue of whether to grant a deficiency judgment).

78. 302 N.W.2d at 768. The *Hansen* court extended the presumption theory to situations in which the debtor asserts that the secured creditor has failed "to dispose of the collateral in a commercially reasonable manner." *Id.*