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Remedies Under The Tennessee Commercial Code

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I. INTRODUCTION

Bankers are fond of telling the story about the hapless guarantor of a promissory note who, upon default of the maker, was called upon to pick up the note. "Oh, I didn't sign the note to pay it," he replied, "I just signed it so my friend could get the money." Security interests in personal property are given, and taken, for much the same reason—not to be invoked but to facilitate the sale or loan. Indeed, with the exception of the pawnbroker, lenders and condi-

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tional sellers extend credit on the expectation of repayment.[1] Even in times of economic recession and tight money most debtors pay their creditors more or less on time and without significant prodding.

Still, prudent sellers and lenders frequently take or retain security interests to protect themselves against the occasional default that the law of averages dictates will occur. A security interest is useful to the creditor even if he does not actually seek recourse against the collateral. It protects the creditor by insulating the debtor's assets from the claims of other creditors or his trustee in bankruptcy. The threat of enforcement of the security agreement serves as a psychological weapon to force the debtor to pay as agreed, and covenants in the security agreement may be used to exercise control over the debtor's operations. Nevertheless, the creditor occasionally must attempt to realize on his collateral in order to avoid certain loss. The rights and duties of a creditor who reaches this unhappy conclusion form the subject matter of this Article.

The scope of this Article is limited to a discussion of the enforcement of consensual[2] liens under the Uniform Commercial Code as enacted in title 47 of the Tennessee Code.[3] It does not include the panoply of other, nonconsensual remedies such as prejudgment attachment and postjudgment levy. In particular, this Article examines the applicability of the doctrine of election of remedies, the mechanics of repossession, and the rules applicable to the disposition of collateral, primarily as these concepts have been interpreted and applied by the courts of Tennessee.

II. Preservation of In Personam Rights Against the Debtor

A. *Election of Remedies*

In the typical secured transaction, the debtor obligates himself personally to the creditor and also grants to him a security interest in certain collateral. The question arises from time to time whether the creditor may proceed against both the collateral and the debtor personally, or whether the creditor must choose one of the two remedies. In Tennessee the creditor clearly need not make an election of

1. "Assuring repayment of the indebtedness, and not realization upon the collateral, is the main object of any sensible lender." 1 P. Coogan, W. Hogan & D. Vagts, Secured Transactions under the Uniform Commercial Code 863 (1977) [hereinafter cited as Coogan].

2. Some attention is given to the arguably nonconsensual lien or right to reclaim under Tenn. Code Ann. § 47-2-702 (1964). *See* text accompanying notes 58-72 *infra*.

3, Tenn. Code Ann. tit. 47 (1964).

mutually exclusive remedies. He can foreclose on the collateral and sue the debtor, although obviously he is entitled only to one satisfaction of his claim.

At common law respectable authority supported the proposition that a conditional vendor of a chattel forfeits his right to sue on the debt if he repossesses the collateral; retaking of possession was an election among inconsistent remedies.[4] Some courts avoided the election issue by reluctantly allowing sellers to enforce explicit contract provisions that permitted both repossession and deficiency suits.[5] The narrow common law rule, however, is not part of Tennessee jurisprudence.[6] The doctrine of election of remedies in secured transactions is rejected definitively by section 47-9-504(2) of the Tennessee Code, which permits both foreclosure and a deficiency judgment, even if the security agreement does not explicitly provide for deficiency judgments:

> If the security interest secures an indebtedness, the secured party must account to the debtor for any surplus, and, unless otherwise agreed, the debtor is liable for any deficiency. But if the underlying transaction was a sale of accounts, contract rights, or chattel paper, the debtor is entitled to any surplus or is liable for any deficiency only if the security agreement so provides.[7]

Under a recent Tennessee statute, however, the creditor's initial choice of remedies does have some impact on the subsequent availability of additional relief. Tennessee law now provides that the cred-

4. *See, e.g.*, Russell v. Martin, 232 Mass. 379, 122 N.E. 447 (1919); *cf.* Washington Cooperative Chick Ass'n v. Jacobs, 42 Wash. 2d 460, 256 P.2d 294 (1953) (vendor may either sue on the debt or repossess, but not both). For a textual discussion of election of remedies, see 2 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 43.6 (1965). *See also* Glenn, *The Conditional Sale at Common Law and as a Statutory Security*, 25 VA. L. REV. 559, 569-74 (1939). The theory was that repossession resulted in rescission of the sale, whereas suit on the indebtedness confirmed title in the buyer.

5. *See, e.g.*, White Motor Co. v. Briles, 137 Fla. 268, 188 So. 222 (1939).

6. Turner v. Brock, 53 Tenn. (1 Heisk.) 50 (1871). A number of states, but not Tennessee, recently have restricted by statute the right of a creditor with a security interest in consumer goods to repossess and resell, and then collect a deficiency judgment. *See, e.g.*, N.M. STAT. ANN. § 50A-9-504(2) (Supp. 1971).

7. This conclusion is reinforced by TENN. CODE ANN. § 47-9-501(1) (1964), which specifically makes rights and remedies cumulative. *Accord*, Williams v. Westinghouse Credit Corp., 250 Ark. 1065, 468 S.W.2d 761 (1971). If the plaintiff elects to proceed against the collateral by action, he is virtually encouraged by the statute to sue for possession and damages:

> In an action to recover personal property, in addition to the recovery of the property, the plaintiff may proceed to recover the balance due on the debt or the plaintiff may, in addition to recovering the personal property, obtain a judgment against the defendant for any debt or other claim arising out of the same transaction or set of circumstances, or the plaintiff may proceed solely for recovery of the personal property with the right to seek a judgment for additional relief in a subsequent action.

TENN. CODE ANN. § 23-2348 (Cum. Supp. 1976).

itor who avails himself of an "action to recover personal property"[8] (the statutory successor to the unconstitutional replevin statute)[9] may sue both for possession and on the instrument or contract, but "no deficiency judgment shall be obtained by the plaintiff(s) until plaintiff(s) shall have complied with all requirements of the Uniform Commercial Code applicable thereto."[10] Apparently these requirements are the disposition-of-collateral provisions of part 5 of Article 9.[11] This statute requires the plaintiff who forecloses by process to liquidate the collateral before he takes any action toward a personal judgment against the debtor. Presumably the "deficiency" or in personam portion of the action lies dormant in the bosom of the court between the filing of the suit and liquidation of the collateral. No such stricture against personal judgments applies when the collateral is taken by self-help.

B. Discharge by Impairment of Collateral

An important defense available to debtors and their sureties in actions brought against them personally by creditors is commonly referred to as "discharge by impairment of collateral." This term is used to refer to two different courses of action that cause discharge of the debtor's personal liability: (1) impairment of the collateral itself by the creditor without the consent of the debtor or surety, and (2) impairment of recourse against the collateral. An example of the first defense occurs when the creditor allows the collateral to deteriorate in value. In the second case, the creditor might allow the debtor to use the collateral in a manner rendering recourse against it meaningless. Such conduct discharges a surety who presumably relied on the value of the collateral when he guaranteed the debt, since the collateral would cushion any loss he might suffer by paying the debt.

This second type of impairment also occurs when the creditor fails to perfect his security interest in the collateral, thereby exposing it to a competing claim of a security interest by another creditor. When the third-party claim against the collateral prevails over the secured party's claim, the guarantor's exposure obviously is in-

8. TENN. CODE ANN. §§ 23-2341 to -2351 (Cum. Supp. 1976).

9. *See* text accompanying notes 32-34 *infra*.

10. TENN. CODE ANN. § 23-2348. The statute originally was drafted by a committee of the Tennessee Bankers Association in response to the decision in Mitchell v. Tennessee, 351 F. Supp. 846 (W.D. Tenn. 1972). The provision quoted in the text was not a part of the draft bill, but was added on the floor of the General Assembly.

11. *See* text accompanying notes 35-42 *infra* for a discussion of the mechanics of the statute.

creased, and accordingly the guarantor is discharged to the extent of the value of the security.[12]

The prudent creditor can avoid these discharges by obtaining the consent of the debtor or surety who otherwise would be discharged. This consent may be obtained before, at the time of, or after the conduct in question.[13] The consent commonly is found buried in the boiler-plate of a written security agreement.[14] Furthermore, a number of cases hold that failure to perfect a security interest does not ipso facto constitute an impairment of collateral giving rise to a discharge.[15] Nor does impairment of collateral discharge any one other than an accommodation party.

The Tennessee courts generally have followed a middle course in applying the rule of discharge by impairment of collateral. In the leading case of *Commerce Union Bank v. May*[16] a surety argued that his obligation on a promissory note was discharged by the creditor bank's failure to renew an insurance policy on a parcel of land that served as collateral for a loan. Although the case involved liability on a promissory note, the supreme court noted that the Code did not apply because the collateral was real property. Instead the court adopted section 132 of the *Restatement of Security* as the law of Tennessee governing real estate collateral:

> Where the creditor has security from the principal and knows of the surety's obligation, the surety's obligation is reduced pro tanto if the creditor
>
> (a) surrenders or releases the security, or
> (b) wilfully or negligently harms it, or

12. *See, e.g.*, Magnolia Homes Mfg. Corp. v. Montgomery, 451 F.2d 934 (8th Cir. 1971) (release of collateral for an inadequate price discharges accommodation parties); Shaffer v. Davidson, 445 P.2d 13 (Wyo. 1968) (failure to note a lien on the title certificate of a car discharges accommodation parties).

13. TENN. CODE ANN. § 47-3-606 (1964) provides in relevant part:

> The holder discharges any party to the instrument to the extent that without such party's consent the holder (a) without express reservation of rights releases or agrees not to sue any person against whom the party has to the knowledge of the holder a right of recourse or agrees to suspend the right to enforce against such person the instrument or collateral or otherwise discharges such person . . . or (b) unjustifiably impairs any collateral for the instrument given by or on behalf of the party or any person against whom he has a right of recourse.

14. Etelson v. Suburban Trust Co., 263 Md. 376, 283 A.2d 408 (1971) (note recited indorsers' "consent to . . . the release or exchange of any collateral without notice . . . .").

15. *See, e.g.*, Nation Wide, Inc. v. Scullin, 256 F. Supp. 929 (D.N.J. 1966); Rushton v. U.M.&M. Credit Corp., 245 Ark. 703, 434 S.W.2d 81 (1968); Lafayette Bank & Trust Co. v. Silver, 58 Misc. 2d 891, 296 N.Y.S.2d 926 (App. Term 1969); *cf.* Wohlhuter v. St. Charles Lumber & Fuel Co., 25 Ill. App. 3d 812, 323 N.E.2d 134, *aff'd*, 62 Ill. 2d 16, 338 N.E.2d 179 (1975) (knowing acceptance of personal liability nullifies defense of unjustifiable impairment).

16. 503 S.W.2d 112 (Tenn. 1973).

> (c) fails to take reasonable action to preserve its value at a time when the surety does not have an opportunity to take such action.[17]

The court concluded that the bank had not impaired the collateral because both parties were equally able to take the steps necessary to protect it.[18]

The *May* case has been followed in two subsequent Code cases. In *Tampa Bay Bank v. Loveday*[19] the president of a corporate debtor personally indorsed the corporation's note to the bank. The business subsequently folded, and the inventory, which the corporation had put up as security for the loan, disappeared. The court of appeals affirmed the trial court's judgment against the corporation's president,[20] noting that as president she could have taken steps to protect the collateral and that she was in a better position than the bank to protect the collateral. Similarly, *American National Bank v. Henderson,*[21] an unreported case decided in 1975 by the Court of Appeals for the Western Section, held that a bank's failure to see that an automobile was insured did not discharge the accommodation indorsers when the car was wrecked.

The Tennessee rule is stricter, however, with respect to perfection of security interests. In *Southern Credit Union v. Rucker*[22] the debtor Patten borrowed money from his credit union to buy a Corvette. The credit union obtained a security interest in the car and the personal guarantee of three of Patten's co-workers. The credit union then instructed Patten to re-title the car with a notation of the credit union's lien. Instead Patten obtained a clear title and used the title certificate to borrow from another lender, which properly noted its lien on the title. On Patten's default, the credit union sued the indorsers. The court of appeals, citing section 47-3-606 of the Tennessee Code, observed that the credit union "sen[t] a goat

17. RESTATEMENT OF SECURITY § 132 (1941).

18. Comment *c* to § 132 adds the following: "The nature of the security may impose upon the creditor duties to preserve its value so long as the creditor is the only person who can conveniently take the appropriate action."

19. 526 S.W.2d 480 (Tenn. App. 1974).

20. The trial court had found Loveday to be a maker of the note, rendering the discharge issue moot since impairment does not discharge a maker but only an accommodation party. Because the court of appeals found her to be an indorser and, therefore, a surety or accommodation indorser, it had to face the discharge issue.

21. Unreported cases were for a time in a limbo created by rule 31 of the rules of the supreme court. Revised and entered on April 30, 1976, the rule provided, *inter alia,* that "all unpublished opinions of any appellate court released prior to [April 30, 1976] shall not be cited as precedent in any brief or other materials presented to any court." On March 2, 1977, the supreme court, in response to arguments that this portion of the rule was impractical and jurisprudentially unsound, deleted the quoted language.

22. (Tenn. Ct. App., Sullivan County Eq. Div., Oct. 25, 1974).

to tend the cabbage patch" when it gave Patten the title papers. The credit union's action amounted to an unjustifiable impairment of the collateral and therefore released the co-signers from liability on the note. Thus the Tennessee rule apparently discharges a surety if the creditor fails to perfect its lien, but does not discharge the surety if the surety could have performed the omitted act just as easily as the creditor.[23]

III. REPOSSESSION

When a debtor defaults, his secured creditor must decide whether to attempt to take possession of the collateral. Sometimes the nature of the collateral is such that repossession would be counterproductive. For example, if the collateral is highly specialized equipment, the creditor may be better off allowing the debtor to retain the equipment and to use it to generate the cash necessary to pay off the debt. Usually, however, the secured party decides to repossess, either for the purpose of coercing the debtor into suddenly finding the money for the next installment or for the purpose of selling the collateral and applying the proceeds against the debt. The following portion of this Article sets out some of the methods for and implications of repossession.

A. Self-Help

The Code allows a secured party to take possession of his collateral from a defaulting debtor if he can do so without violence:

> **47-9-503. Secured party's right to take possession aftor default.**—Unless otherwise agreed a secured party has on default the right to take possession of the collateral. In taking possession a secured party may proceed without judicial process if this can be done without breach of the peace or may proceed by action. If the security agreement so provides the secured party may require the debtor to assemble the collateral and make it available to the secured party at a place to be designated by the secured party which is reasonably convenient to both parties. Without removal a secured party may render equipment unusable, and may dispose of collateral on the debtor's premises under §47-9-504.[24]

Under prior Tennessee law, the conditional vendor could not retake possession of his merchandise without judicial process absent

23. *See also* Tennessee Farmers Mut. Ins. Co. v. Scott, 8 UCC Rep. 399 (Tenn. App. 1970) (bank had not taken reasonable steps to preserve collateral).

24. TENN. CODE ANN. § 47-9-503 (1964). The right to repossess arises only upon "default." Article 9 of the Code does not define "default." That question is left to the terms of the security agreement. Whisenhunt v. Allen Parker Co., 119 Ga. App. 813, 168 S.E.2d 827 (1969). An acceleration clause is usually coupled with a default clause. For an excellent discussion of the efficacy of such clauses, see 1 COOGAN, *supra* note 1, § 8.02[1].

a specific provision in the conditional sales contract granting him that prerogative.[25] Section 47-9-503 overrules prior law by giving the secured party the right to repossess by self-help unless the security agreement specifically negates it.

Doubt as to the constitutionality of the Code's approval of self-help arose in 1969 when the United States Supreme Court held prejudgment garnishments of wages violative of due process because the deprivation of wages occurred without prior notice or an opportunity to be heard.[26] Three years later the Court found the Pennsylvania and Florida replevin statutes violative of the fourteenth amendment on similar grounds.[27] Armed with these cases, lawyers have argued that section 9-503, by legislatively authorizing direct action on the part of secured creditors without notice or an opportunity to be heard, is the functional equivalent of a state replevin statute and thus is prohibited by the fourteenth amendment. Some federal district judges have agreed with this analysis,[28] but the "state action" argument has been rejected by at least six different circuit courts, including the Sixth Circuit. The United States Supreme Court has refused to grant certiorari in all of these cases.[29] With the constitutionality of self-help repossession under section 9-503 settled beyond reasonable doubt,[30] the only qualification on the

25. *See, e.g.*, Rice v. Lusky Furniture Co., 167 Tenn. 202, 68 S.W.2d 107 (1934); Mitchell v. Automobile Sales Co., 161 Tenn. 1, 28 S.W.2d 51 (1930); Morrison v. Galyon Motor Co., 16 Tenn. App. 394, 64 S.W.2d 851 (1932). *But see* Third Nat'l Bank v. Olive, 198 Tenn. 687, 281 S.W.2d 675 (1955) (the *Mitchell* rule will not be extended to chattel mortgages).

26. Sniadach v. Family Fin. Corp., 395 U.S. 337 (1969).

27. Fuentes v. Shevin, 407 U.S. 67 (1972).

28. *See, e.g.*, Gibbs v. Titelman, 369 F. Supp. 38 (E.D. Pa. 1973), *rev'd*, 502 F.2d 1107 (3d Cir.), *cert. denied*, 419 U.S. 1039 (1974); Boland v. Essex County Bank & Trust Co., 361 F. Supp. 917 (D. Mass. 1973). For more details on the background of these cases, see Note, *Mitchell v. W.T. Grant Co.—The Repossession of Fuentes*, 5 MEM. ST. U.L. REV. 74 (1974).

29. Brantley v. Union Bank & Trust Co., 498 F.2d 365 (5th Cir.), *cert. denied*, 419 U.S. 1034 (1974); Nowlin v. Professional Auto Sales, Inc., 496 F.2d 16 (8th Cir.), *cert. denied*, 419 U.S. 1006 (1974); Shirley v. State Nat'l Bank, 493 F.2d 739 (2d Cir.) (similar statute), *cert. denied*, 419 U.S. 1009 (1974); Adams v. Southern California First Nat'l Bank, 492 F.2d 324 (9th Cir. 1973), *rev'g sub nom.* Adams v. Egley, 338 F. Supp. 614 (S.D. Cal. 1972), *cert. denied*, 419 U.S. 1006 (1974); Gibbs v. Titelman, 369 F. Supp. 38 (E.D. Pa. 1973), *rev'd*, 502 F.2d 1107 (3d Cir.), *cert. denied*, 419 U.S. 1039 (1974); Turner v. Impala Motors, Civ. No. C-73-50 (W.D. Tenn. 1973), *aff'd*, 503 F.2d 607 (6th Cir. 1974), *cited with approval in* Jackson v. Metropolitan Edison Co., 419 U.S. 345, 349 n.6 (1974).

30. As Professor Gilmore points out, however, the constitutionality of self-help does not make it safe:

> In the financing of business debtors repossession causes little trouble or dispute. In the underworld of consumer finance, however, repossession is a knockdown, drag-out battle waged on both sides with cunning guile and a complete disregard for the rules of fair play. A certain amount of trickery seems to be accepted: it is all right for the finance company to invite the defaulting buyer to drive over to its office for a friendly conference on refinancing the loan and to repossess the car as soon as he arrives. It is fairly safe for

secured party's right is the requirement that self-help be conducted without a breach of the peace.[31]

B. *Actions to Recover Personal Property*

Although *Fuentes*[32] was not applied to self-help repossession, it has been applied with a vengeance to the Tennessee replevin law.[33] In 1972 a special three-judge federal court entered a decree, consented to by the Attorney General of Tennessee, declaring the Tennessee statutes authorizing replevin unconstitutional. The post-hearing remedy of detinue, however, was left intact.[34] In 1973 the Tennessee General Assembly responded to the decree with a new statute[35] drafted to comply with the requirements of *Fuentes*. The statute created a new "action to recover personal property."[36] This action is brought by filing a sworn complaint in a circuit or chancery court, or a sworn civil warrant in general sessions court. The complaint or warrant must be accompanied by a copy of the security agreement, must explain why the plaintiff is entitled to possession,

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the finance company to pick up the car on the street wherever it may be parked, although there is always a danger that the buyer will later claim that he had been keeping a valuable stock of diamonds in the glove compartment. But the finance company will do well to think twice before allowing its man to break into an empty house, even though a well-drafted clause in the security agreement gives it the right to do exactly that. And if the housewife, who is invariably pregnant and subject to miscarriages, sits on the sofa, stove, washing machine or television set and refuses to move, the finance company will make a serious mistake if he dumps the lady or carries her screaming into the front yard. Juries love to award punitive damages for that sort of thing and the verdict will often be allowed to stand.

2 GILMORE, *supra* note 4, at 1212-13.

31. Harris Truck & Trailer Sales v. Foote, 58 Tenn. App. 710, 436 S.W.2d 460 (1968); Morrison v. Galyon Motor Co., 16 Tenn. App. 394, 64 S.W.2d 851 (1932). Professors White and Summers have concluded that entry into the debtor's residence or garage without permission is ipso facto a breach of the peace. J. WHITE & R. SUMMERS, UNIFORM COMMERCIAL CODE 967-69 (1972). The secured party who repossesses too vigorously or in breach of the peace opens himself to potential tort liability for trespass, assault and battery, conversion, or invasion of privacy, and possibly to criminal penalties. Thrasher v. First Nat'l Bank, 288 So. 2d 288 (Fla. App. 1974); Stone Machinery Co. v. Keesler, 1 Wash. App. 750, 463 P.2d 651 (1970) (sheriff accompanied secured party but without judicial process); WHITE & SUMMERS, *supra*, § 26-13; Annot., 35 A.L.R.3d 1016 (1971) (punitive damages); Annot., 99 A.L.R.2d 358 (1965).

32. Fuentes v. Shevin, 407 U.S. 67 (1972).

33. TENN. CODE ANN. §§ 23-2301 to -2328 (1955).

34. Mitchell v. Tennessee, 351 F. Supp. 846 (W.D. Tenn. 1972).

35. 1973 Tenn. Pub. Acts ch. 365, §§ 1-9, 11, 13 (codified at TENN. CODE ANN. §§ 23-2341 to -2351 (Cum. Supp. 1976)). Chapter 365 also repealed those portions of the replevin statute, TENN. CODE ANN. §§ 23-2301 to -2328 (1955), declared unconstitutional in Mitchell v. Tennessee, 351 F. Supp. 846 (W.D. Tenn. 1972), but left unchanged those portions pertaining to detinue.

36. TENN. CODE ANN. § 23-2341 (Cum. Supp. 1976).

and must describe and set forth the value of the collateral.[37] Upon filing of the complaint or warrant, the clerk is to issue process stating that a possessory hearing will be held before a judge or chancellor on a specified date. This hearing is not final nor on the merits, but merely affords the plaintiff an opportunity to obtain a writ of possession entitling him to gain physical possession of the property pending trial on the merits. By posting a bond in an amount of the value of the property, the plaintiff also may obtain from the judge or chancellor (but not from the clerk) an order restraining the defendant from damaging, concealing, or removing the property from the court's jurisdiction.[38] The defendant may waive his right to the possessory hearing by giving the property to the sheriff or other officer when process is served.[39]

As an alternative to giving notice by service of process, the plaintiff may begin his action by certified mail or by delivering to the defendant notice of the time and place for the filing of the application for a writ of possession. Such notice must be accompanied by a copy of the complaint and necessary attachments[40] and must be mailed or delivered at least five days before the hearing on plaintiff's application for a writ. At the hearing the court must order the issuance of an immediate writ of possession if it finds (1) that the plaintiff is entitled to possession of the property and (2) that the plaintiff gave the defendant notice at least five days prior to the hearing. The writ of possession, if issued, also serves as a summons for the full hearing on the merits to be held at a later date.

Upon application by the plaintiff, the court may order an immediate writ of possession without notice to the defendant if it finds that the property was obtained by fraud, misrepresentation, or theft, or if it finds that the defendant is concealing the property, is likely to remove the property from the jurisdiction of the court, is likely to dispose of it, is endangering it by unusually hazardous use, or is impairing the plaintiff's security interest by actions such as failure to maintain hazard insurance. A writ of possession issued pursuant to this section is conditioned upon the plaintiff's posting of a bond in an amount fixed by the court. The amount of the bond

37. *Id.* § 23-2343.

38. *Id.* § 23-2345. In Knox County, the restraining order, by court rule, must be coupled with an order directing the defendant to show cause why the restraining order should not be continued and why the requested relief should not be granted. This rule has no statutory basis but the procedure coincides with the general rules regarding ex parte and extraordinary relief. *See* TENN. R. CIV. P. 65.

39. TENN. CODE ANN. § 23-2344 (1973).

40. *Id.* § 23-2346A(1).

may be no less than the value of the property.[41] Unlike the statutes rejected by the Supreme Court in *Fuentes*,[42] the Tennessee statute requires (1) extraordinary circumstances and (2) a hearing before a judge prior to the issuance of the writ. In upholding the constitutionality of this portion of the statute, a three-judge federal court[43] pointed out that pre-hearing repossession is permissible only when a lien holder who is in danger of losing his security posts a bond[44] and obtains an order from a judge, rather than from a mere clerk as was permitted by the statutes struck down in *Fuentes*.

In addition to seeking recovery of the property, the plaintiff may include a prayer for recovery of the balance due on the underlying debt. Unfortunately, the General Assembly limited the availability of this dual remedy by providing that no deficiency judgment may be obtained until the plaintiff has complied with "all requirements of the Uniform Commercial Code applicable thereto."[45] Presumably, a judgment on the debt must await disposal of the collateral. The Act also increased the original jurisdiction of the general sessions court by raising the maximum permissible dollar amount for actions to recover personal property from 3,000 to 7,500.[46] The 7,500 figure refers to the value of either the collateral or the debt, and its effect is to bring mobile home transactions within the jurisdiction of the general sessions court.

C. *Bankruptcy Restraints on Repossession*

The most potent restraint on the secured party's right to repossess his collateral arises when the debtor files a petition in bankruptcy. By virtue of the Rules of Bankruptcy Procedure, which became effective October 1, 1973, in both straight bankruptcy and wage earner cases,[47] the filing of a petition in bankruptcy, either by

41. *Id.* § 23-2346A(2).

42. Fuentes v. Shevin, 407 U.S. 67 (1972).

43. Woods v. Tennessee, 378 F. Supp. 1364 (W.D. Tenn. 1974). The court relied on Mitchell v. W. T. Grant Co., 416 U.S. 600 (1974), in which the Supreme Court distinguished its *Fuentes* holding that the replevin statutes of Florida and Pennsylvania were invalid because they permitted sale of repossessed goods without notice or a hearing and without judicial order or supervision. In *Mitchell* the constitutional guarantee of procedural due process was satisfied because the Louisiana law required, as a precondition to sequestration of property from a defaulting debtor, that the creditor (1) furnish adequate security and (2) make a specific factual showing to obtain judicial authorization. *Id.* at 605-06.

44. The court also referred to the provision allowing the award of punitive damages to the defendant, including attorneys' fees, if the plaintiff wrongfully brings a possessory action or fails to prosecute. TENN. CODE ANN. § 23-2350 (Cum. Supp. 1976).

45. *Id.* § 23-2348.

46. *Id.* § 19-301. *See* text accompanying notes 8-11 *supra*.

47. The rules of chapters I-VII and XIII were promulgated by the United States Su-

a debtor or by one of his creditors, automatically places a moratorium on repossession of the debtor's property. Rule 601(a), applicable to straight bankruptcy cases provides:

> **Petition as Automatic Stay Against Lien Enforcement. (a) Stay Against Lien Enforcement.** The filing of a petition shall operate as a stay of any act or the commencement or continuation of any court proceeding to enforce (1) a lien against property in the custody of the bankruptcy court, or (2) a lien against the property of the bankrupt obtained within 4 months before bankruptcy by attachment, judgment, levy, or other legal or equitable process or proceedings.[48]

In straight bankruptcy cases, the stay is applicable only with respect to (1) property in the bankruptcy court's actual or constructive possession[49] and (2) judicial liens subject to invalidation under section 67a of the Bankruptcy Act.[50] The wage-earner stay is broader and is effective even when the court is not in possession of the property.[51] Similar stays are incidental to the filing of petitions in reorganizations,[52] arrangements,[53] and real property arrangements.[54] Unless lifted by the bankruptcy court, the stay remains in effect until the case is closed or dismissed, or until the property subject to the security interest is abandoned, transferred, or exempted. Relief from the automatic stay may be obtained, however, by filing a complaint in the bankruptcy court and thereby instituting an ad-

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preme Court by order of April 24, 1973, 411 U.S. 989, pursuant to the authority vested in it by 28 U.S.C. § 2075 (1970).

48. FED. RULE BANKR. P. 13-401(a), applicable to wage-earner cases, provides:

> A petition filed under Rule 13-103 or Rule 13-104 shall operate as a stay of the commencement or continuation of any action against the debtor, or the enforcement of any judgment against him, or of any act or the commencement or continuation of any court proceeding to enforce any lien against his property, or of any court proceeding for the purpose of rehabilitation of the debtor or the liquidation of his estate.

49. If the secured party has repossessed before filing a petition in straight bankruptcy, so that he and not the debtor has possession of the collateral, he may safely ignore the stay of rule 601 and proceed to foreclose. *In re* Magnum Opus Elec., Ltd., 2 Bankr. Ct. Dec. 545 (S.D.N.Y. 1976). The notice to the debtor/bankrupt mandated by TENN. CODE ANN. § 47-9-504(3) must be given, however, to the trustee. *In re* Hughes, 12 UCC Rep. 982 (E.D. Tenn. 1973).

Under Tennessee law, if the foreclosure of a deed of trust is commenced prior to the filing of the petition, the stay bars the sale because the property remains in the possession of the bankrupt until it is sold by the trustee under the deed of trust. *See* FED. RULE BANKR. P. 601, Advisory Committee's Note.

50. 11 U.S.C. § 107(a) (1970). The statute provides in substance that any nonconsensual lien on the bankrupt's property obtained by legal or equitable process within four months of the filing of the petition may be set aside by the trustee.

51. *Cf. In re* Williams, 2 Bankr. Ct. Dec. 1304, 1305 (N.D. Ga. 1976) ("a Chapter XIII court's power is founded on ownership by the debtor").

52. FED. RULE BANKR. P. 10-601 (effective August 1, 1975).

53. FED. RULE BANKR. P. 11-44 (effective July 1, 1974).

54. FED. RULE BANKR. P. 12-43 (effective August 1, 1975).

versary proceeding.[55]

The "automatic" aspect of the stays deserves special attention because a repossessing creditor might become ensnared inadvertently in the thicket of contempt. If the creditor attempts to repossess his collateral at any time after the petition in bankruptcy is filed, he risks a contempt citation by the bankruptcy judge even though he has no actual knowledge of the filing and acts in good faith. Although the UCC abhors the secret lien, the bankruptcy rules embrace the secret stay. The creditor's dilemma is best illustrated by the bankruptcy court's decision in *In re Tallyn.*[56] In *Tallyn* the bankrupt filed a petition on the morning of October 2. On October 3, the bank, acting without actual knowledge of the filing, repossessed the bankrupt's automobile. The bank subsequently sold the car after contacting the trustee but without taking any action in the bankruptcy court. In finding the bank in contempt of court and assessing a fine of one hundred dollars, the bankruptcy judge made these observations:

> Few things are any clearer in bankruptcy: even a lien creditor may do nothing on its own to enforce its lien. There is no automatic injunction [stay]. Frequently creditors will argue that they received no notice of bankruptcy, as here, or that they repossessed the property before receipt of the notice from the court. They feel they may do anything they wish until they receive a notice from the Bankruptcy Court. This is not so!
>
> Creditors must understand that the very "filing of a petition" activates the injunction and notice has nothing whatsoever to do with it. Therefore, the instant injunction fully obtained on October 2, 1974, at 9:20 a.m., without notice.
>
> Bankruptcy Rule 601 is an injunction [stay] which automatically goes into effect at the moment of the filing of the petition. *No notice for this purpose is required.* It is a lien creditor's duty and responsibility to ascertain whether a bankruptcy petition has been filed and upon inquiry, even by telephone, the Court will furnish that information relative to the name or names given by the inquirer.
>
> Here the lien creditor violated Bankruptcy Rule 601 in two respects:
>
> 1. Repossession of the vehicle after the filing of the petition and
> 2. Sale of the vehicle after the filing of the petition.
>
> Let it clearly be noted that a lien creditor is not without remedy. He may file a complaint for the recovery of his property and if entitled to the same, upon entry of an order, may recover the property from both the trustee and the bankrupt.[57]

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55. FED. RULE BANKR. P. 601(c). *See* FED. RULES BANKR. P., Part VI, which apply the Federal Rules of Civil Procedure to adversary proceedings in the bankruptcy court. In emergency situations, ex parte relief may be sought under FED. RULE BANKR. P. 601(d). Similar provisions are contained in the rules for rehabilitation chapter cases.

56. 1 Bankr. Ct. Dec. 487 (E.D. Va. 1975).

57. *Id.* at 487, 488. Several recent cases have denied secured creditors the right to repossess in chapter X cases when the debtor needs the collateral to operate or to make reorganization possible. *In re* Yale Express System, Inc., 384 F.2d 990 (2d Cir. 1967); *In re*

D. Reclamation of Goods under Article 2

Conventional legal wisdom holds (a) that a seller on open account holds no enforcible lien in his merchandise once he parts company with it and (b) that Article 9 of the Code exclusively governs the rights of UCC lienors. Like so many other bits of conventional wisdom, these propositions have exceptions, the most important of which is the right of a defrauded seller to reclaim his goods under section 2-702.[58] Subsections (2) and (3) provide:

> (2) Where the seller discovers that the buyer has received goods on credit while insolvent he may reclaim the goods upon demand made within ten (10) days after the receipt, but if misrepresentation of solvency has been made to the particular seller in writing within three (3) months before delivery the ten (10) day limitation does not apply. Except as provided in this subsection the seller may not base a right to reclaim goods on the buyer's fraudulent or innocent misrepresentation of solvency or of intent to pay.
> (3) The seller's right to reclaim under subsection (2) is subject to the rights of a buyer in ordinary course or other good faith purchaser or lien creditor under this chapter (§47-2-403). Successful reclamation of goods excludes all other remedies with respect to them.[59]

The statute represents only a slight departure from the common law. Prior law in Tennessee and in numerous other jurisdictions provided that the seller of goods delivered on credit had the power to rescind and recover the goods if the buyer fraudulently had misrepresented his solvency.[60] The Code continues this protection in modified form. If a buyer receives goods while insolvent, the seller may reclaim them by making a demand within ten days of the buyer's receipt. No proof of misrepresentation or of intent not to pay is required, but the power to rescind expires within ten days. The ten-day limit does not apply, however, if the misrepresentation is made in writing within the three-month period preceding delivery.[61] Thus speed on the part of the seller and his lawyer is essential,

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Bermec Corp., No. 71-B-291 (S.D.N.Y. 1971), *aff'd*, 445 F.2d 367 (2d Cir. 1971). In *Yale Express* the court of appeals did not require the debtor to make payments equal to the depreciation in value of the collateral. The case has been criticized as exceeding constitutional limits on the extent to which a secured creditor can be enjoined from repossessing property, when he is not being compensated for its use. Murphy, *Restraint and Reimbursement: The Secured Creditor in Reorganization and Arrangement Proceedings*, 30 BUS. LAW. 15 (1974).

58. TENN. CODE ANN. § 47-2-702 (1964). For a thorough and thougbtful analysis of the conflict between § 2-702 and the Bankruptcy Act, see Sebert, *The Seller's Right to Reclaim; Another Conflict Between the Uniform Commercial Code and the Bankruptcy Act?*, 52 NOTRE DAME LAW. 219 (1976).

59. TENN. CODE ANN. § 47-2-702 (1964).

60. Richardson v. Vick, 125 Tenn. 532, 145 S.W. 174 (1912); *see* 3 S. WILLISTON, SALES §§ 636, 637 (1948). *See also* 1A COOGAN, *supra* note 1, at 1880.

61. TENN. CODE ANN. § 47-2-702(2) (1964).

although the process of actual repossession may be commenced at a more leisurely pace if the demand is timely.[62]

Although the statute clearly acknowledges the right of the "defrauded"[63] seller to reclaim vis-à-vis the buyer, it also provides that the seller's right to recover goods "is subject to the rights of a buyer in the ordinary course"[64] or "other good faith purchaser *or lien creditor* under this chapter (§ 47-2-403)."[65] The Fifth Circuit in a case with a tortured history held that the rights of a perfected secured party take priority over the rights of a reclaiming seller in the same goods.[66] On the other hand, the Sixth Circuit applied Kentucky law in *In re Mel Golde Shoes, Inc.* and found that the seller's right to reclaim takes priority over an attachment lien.[67]

A more common conflict has arisen between the reclaiming seller and the buyer's trustee in bankruptcy. Bankruptcy Judge Clive Bare of the Eastern District of Tennessee, relying on Tennessee law, held in *In re Royalty Homes, Inc.*[68] that bankruptcy does not cut off a seller's reclamation rights. The Third Circuit in *In re Kravitz*[69] held for the trustee in bankruptcy against the sellers. Professor Hawkland has concluded that *Kravitz* was based upon the peculiar local law of Pennsylvania and opined that, under the law of most other states, the seller would prevail over a lien creditor and perforce over the trustee in bankruptcy.[70] *Federal's Inc. v. Matsushita Electric Corp.*,[71] decided on April 19, 1977, provides addi-

62. *In re* Mel Golde Shoes, Inc., 403 F.2d 658 (6th Cir. 1968); *In re* Childress, 6 UCC Rep. 505 (E.D. Tenn. 1969). *Childress* emphasizes that an intervening bankruptcy petition in straight bankruptcy does not toll the ten-day period or excuse demand. The demand can be made on the hankrupt or upon the receiver in possession of the goods. The rule applicable to a petition under chapter XI is similar, although demand would be made on the debtor-in-possession or on the receiver.

63. The base line of subsection (2) is the proposition that any receipt of goods on credit by an insolvent buyer amounts to a tacit business misrepresentation of solvency and, therefore, is fraudulent as against the particular seller. TENN. CODE ANN. § 47-2-702, comment 2 (1964).

64. *Cf.* TENN. CODE ANN. § 47-9-307(1) (1964).

65. TENN. CODE ANN. § 47-2-702(3) (1964) (emphasis supplied); *see* English v. Ralph Williams Ford, 17 Cal. App. 3d 1038, 95 Cal. Rptr. 501 (1971).

66. *In re* Samuels & Co., 526 F.2d 1238 (1976) (en banc), *rev'g* 510 F.2d 139 (1975); *accord, In re* Daley, Inc., 17 UCC Rep. 433 (D. Mass. 1975).

67. 403 F.2d 658, 661 (6th Cir. 1968).

68. 8 UCC Rap. 61 (E.D. Tenn. 1970); *accord, In re* Mel Golde Shoes, Inc., 403 F.2d 658 (6th Cir. 1968).

69. 278 F.2d 820 (3d Cir. 1960).

70. Hawkland, *The Relative Rights of Lien Creditors and Defrauded Sellers—Amending the Uniform Commercial Code to Conform to the Kravitz Case*, 67 COM. L.J. 86 (1962).

71. [Current] BANKR. L. REP. (CCH) ¶ 66,399 (6th Cir. 1977), *rev'g In re* Federal's Inc., 402 F. Supp. 1357 (1975). Although the district court also had held that § 2-702 conflicts with

tional support for that view. The Sixth Circuit, applying Michigan law, held that a receiver in bankruptcy did not prevail over a seller's reclamation petition even if he was viewed as an "intervening lien creditor." The court looked to pre-Code Michigan law, as it did in *Mel Golde,* and concluded that since a trustee as hypothetical judgment lien creditor acquires only such title to property as the debtor had, a trustee's claim is subordinate to that of a reclaiming seller. Therefore, the law seems clear, especially in the Sixth Circuit, that the reclaiming seller prevails over the trustee.[72]

E. Rights of Junior Lien Holders to Compel Marshaling

A secured party's right to repossess his collateral may be frustrated by the holder of a junior security interest who invokes the equitable principle of "marshaling of liens." In the usual case, the secured party with the prior lien is entitled to possession as against a secured party with a subordinate lien.[73] The Code, however, also provides that "[u]nless displaced by the particular provisions [of the Code], the principles of law and equity . . . shall supplement its provisions."[74] One such principle is marshaling—

> a rule which courts of equity sometimes invoke to compel a creditor who has the right to make his debt out of either of two funds to resort to that one of them which will not interfere with or defeat the rights of another creditor who has recourse to only one of these funds.[75]

The principle arose primarily in cases of land transactions and has been explained by the Tennessee Supreme Court as follows: If A has a mortgage on lots 1 and 2, and B levies on lot 2, chancery, applying the marshaling doctrine, will require A to foreclose first on lot 1 and satisfy his claim, insofar as possible, out of the proceeds

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the Bankruptcy Act, the Sixth Circuit found no such conflict. *See also In re* Telemart Enterprises, Inc., 524 F.2d 761 (9th Cir. 1975) (seller prevailed over trustee, and no conflict between § 2-702 and Bankruptcy Act was found).

72. Apparently the Code's Permanent Editorial Board agrees. In 1966 it amended § 2-702 by deleting the language "or lien creditors" following "good faith purchaser" in the first sentence of § 2-702(3). Tennessee has not yet adopted the proposed amendment, altbough the 1972 amendments to the Code should be introduced into the General Assembly in late 1977 or early 1978.

73. Priorities are determined initially by reference to TENN. CODE ANN. § 47-9-312. The Federal Tax Lien Act of 1966, Pub. L. No. 89-719, § 101, 80 Stat. 1125 (1966) (amending I.R.C. §§ 6323 & 6325), may have considerable impact on the question of priorities hetween the secured party and the tax collector. For a comprehensive discussion of the Act, see 1 COOGAN, *supra* note 1, at 1269-1322.

74. TENN. CODE ANN. § 47-1-103 (1964).

75. Farmer's Loan & Trust Co. v. Kip, 192 N.Y. 266, 283, 85 N.E. 59, 64 (1908).

of lot 1 so as to give both A and B the maximum protection.[76] The principle should be equally applicable to conflicting secured parties.[77] It would behoove a junior lien holder to investigate a repossessing party's other collateral in order to protect his own security interest.

IV. Disposition of Collateral

Obtaining possession of the collateral is only half the battle. One also must dispose of the collateral in a way that maximizes the return to the secured party while avoiding the many pitfalls in the Code.[78] The remainder of this Article focuses upon the various restraints placed on the secured party's right to sell the collateral and upon the consequences of his failure to comply with the standards of the Code.

A. Obligations While in Possession of the Collateral

Section 9-207[79] imposes certain duties on the secured party during the period between repossession and sale or at any time before sale if the secured party has perfected his security interest by possession. Not surprisingly, he is required to "use reasonable care in the custody and preservation of collateral in his possession"[80]—the duty of a pledgee at common law.[81] This duty cannot be disclaimed or waived,[82] but the security agreement may spell out different standards of care that are not "manifestly unreasonable."[83] The collateral may be used or operated to preserve its value (for example, a plant may be run in order to maintain its value as a going concern[84]), or it may be used in a manner authorized by the security agreement or by a court of competent jurisdiction. A specific exception is made under this section of the Code for consumer goods.[85] During the time

76. Parr, Nolen & Co. v. Fumbanks, 79 Tenn. 391, 394-95 (1883); *accord,* Gilliam v. McCormack, 85 Tenn. 597, 4 S.W. 521 (1887). *See generally* G. Bogert & G. Bogert, Trusts and Trustees 377-79 (2d ed. 1962).

77. *Cf.* Hope v. Wilkinson, 82 Tenn. 21, 25 (1884).

78. Tenn. Code Ann. §§ 47-9-504, 9-505, 9-507 (1964).

79. *Id.* § 47-9-207.

80. *Id.* § 47-9-207(1).

81. *Id.* § 47-9-207, comment 1.

82. *Id.* § 47-9-207, comment 4; § 47-9-501(3).

83. *Id.* § 47-9-501(3).

84. In Southern States Dev. Co. v. Robinson, 494 S.W.2d 777 (Tenn. App. 1972), the secured party took possession of and ran a manufacturing plant pursuant to a security agreement. He was held liable, however, to trade creditors for inventory sold and used while running the operation.

85. Tenn. Code Ann. § 47-9-207(4) (1964). Nevertheless, the collateral cannot be used for an inordinate period. Moran v. Holman, 514 P.2d 817 (Alas. 1973).

the secured party is in possession, the risk of loss remains with the debtor to the extent of any deficiency in insurance coverage, but the secured party has an obligation to insure.[86] Any nonmonetary increase in the collateral may be held as additional security.[87] Finally, the collateral may not be commingled unless it is fungible.[88]

B. *Retention in Satisfication*

Although a foreclosure sale of the collateral usually follows repossession, the draftsmen of the Code observed that "[e]xperience has shown that the parties are frequently better off without a resale of the collateral . . . ."[89] Section 9-505[90] embodies this alternative by permitting the secured party, after default, to propose in writing retention of the collateral as full satisfaction of the debtor's obligation. Again, however, an exception arises in the case of consumer goods: if the debtor has paid sixty percent of the obligation secured by the collateral, the secured party must dispose of it under section 9-504 within ninety days of taking possession unless the debtor has waived his rights in writing *after* default.[91]

Written notice of the secured party's proposal must be sent to the debtor and, except in the case of consumer goods, also must be sent to any other secured party who has properly filed a financing statement or to any unperfected security interest holder of whose interest the retaining party has actual notice. If no one objects within thirty days, the secured party may retain the collateral in satisfication of the debtor's obligation, without selling it[92] and without regard to its actual value.[93] If any secured party raises a timely objection, of course, the creditor must dispose of the collateral in accordance with the rules set forth below. Thus it is incumbent on the secured party to search the records before giving such notice.

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86. TENN. CODE ANN. §§ 47-9-504(1), 2-509, 2-510 (1964); *see* Harvard Trust Co. v. Racheotes, 337 Mass. 73, 147 N.E.2d 817 (1958).

87. TENN. CODE ANN. § 47-9-207(2)(c) (1964).

88. *Id.* § 47-9-207(2)(d). For a comprehensive discussion of the creditor's rights and duties regarding collateral in the secured party's possession, see 2 GILMORE, *supra* note 4, at 1127-80.

89. TENN. CODE ANN. § 47-9-505, comment 1 (1964).

90. *Id.* § 47-9-505.

91. *Id.* § 47-9-505(1).

92. *Id.* § 47-9-505(2). Notice to junior lien holders is not required in consumer goods transactions. *Id.*

93. Cerasoli v. Schneider, 311 A.2d 880 (Del. Super. Ct. 1973). The safeguard in such a case is the right of the dehtor to ohject and thereby to require sale of the collateral. *Id.*

C. *Sale of Collateral*

The heart of part 5 of Article 9 is section 9-504,[94] which provides a relatively flexible and simple guide to the disposition of collateral, with the goal of producing the maximum possible amount from the disposition. The draftsmen rejected the Uniform Conditional Sales Act approach of detailed statutory regulation and opted for "a loosely organized, informal, anything-goes type of foreclosure pattern, subject to ultimate judicial supervision and control . . . ."[95]

(1) "Commercially Reasonable"

Although the Code confers considerable discretion on the secured party when he sells the collateral, the Code imposes one overriding requirement. "[E]very aspect of the disposition including the method, manner, time, place and terms must be commercially reasonable."[96] The phrase "commercially reasonable" is not defined in the Code, but its goal is to assure the highest possible realization prices,[97] for the benefit of both the secured party and the debtor. The Code thus remits to the courts the task of determining appropriate standards.

> These requirements place upon the creditor the good faith duty to the debtor to use reasonable means to see that a reasonable price is received for the collateral.
>
> . . . Obviously, each case will turn on its particular facts . . . . Generally, evidence as to every aspect of the sale including the amount of advertising done, normal commercial practice in disposing of particular collateral, the length of time elapsing between repossession and resale, whether deterioration of the collateral has occurred, the number of persons contacted concerning the sale, and even the price obtained, is pertinent.[98]

The Tennessee Court of Appeals has furnished certain additional guidelines. "The disposition shall be made in keeping with prevailing trade practices among reputable and responsible business and commercial enterprises engaged in the same or a similar business."[99] In response to clients who inquire how they should sell

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94. TENN. CODE ANN. § 47-9-504 (1964).

95. 2 GILMORE, *supra* note 4, at 1183.

96. TENN. CODE ANN. § 47-9-504(3) (1964).

97. TENN. CODE ANN. § 47-9-504, comment 1 (1964); Dunham, *Article 9 of the Revised Uniform Commercial Code, Secured Transactions,* 1950 N.J. STATE BAR ASS'N YEARBOOK 91, 95; *see* 2 GILMORE, *supra* note 4, § 43.1.

98. Clark Leasing Corp. v. White Sands Forest Prod., Inc., 87 N.M. 451, 454-55, 535 P.2d 1077, 1080-81 (1975).

99. Mallicoat v. Volunteer Fin. & Loan Corp., 57 Tenn. App. 106, 111, 415 S.W.2d 347, 350 (1966). Professor Gilmore states that "[t]he obligation on the secured party is to use his best efforts to see that the highest possible price is received for the collateral." 2 GILMORE, *supra* note 4, at 1234.

their collateral, the author translates these rules by posing this question: "Assuming you owned the collateral and wanted to sell it for as much as you could get out of it, how would *you* sell it? Then that's how to sell it." So far not a single client has responded that he would take three bids from three automobile dealers or would limit his advertising to a notice at the front door of the courthouse.[100]

A sale is not ipso facto not "commercially reasonable" because the sales price is too low, although according to the *Clark Leasing*[101] case, price is one factor to be considered. Indeed, section 9-507[102] states that the availability of a better price is not "of itself sufficient to establish that the sale was not made in a commercially reasonable manner." Professor Epstein cautions, however, that, although "low resale price alone is not enough, the primary issue in most cases seems to be the sufficiency of the price . . . . [L]ittle more than an unusually low resale price is needed to establish that the sale was not commercially reasonable."[103]

In Tennessee a low resale price may even void the sale if the courts extend the real property rule to chattels. In *Jordan v. Mosely*[104] two houses and a lot worth sixteen thousand dollars were bought at the foreclosure sale for two thousand dollars by the beneficiary of the trust deed. The court of appeals affirmed the chancellor's decision to set the sale aside and endorsed his conclusion that the purchase at one-eighth of the property's value "would shock the conscience of any right-thinking person . . . ." Although the Code provides that such a purchaser takes free and clear of the debtor's rights in the collateral, it requires the purchaser to act "in good faith."[105] A purchaser for an amount absurdly small in relation to the value of the collateral may have great difficulty in establishing his bona fides.[106]

100. Old habits die hard, however. Although the Code has been the law of Tennessee for 13 years, many creditors still seem content merely to comply with the pre-Code notice-of-sale procedure, first enacted in 1889, that required advertising by printed poster at as many as three public places in the county. 1889 Tenn. Pub. Acts ch. 81, § 1, at 117. That procedure cannot be reconciled with the standards laid down in *Mallicoat,* and creditors relying on the old forms are foreclosing on borrowed time.

101. Clark Leasing Corp. v. White Sands Forest Prod., Inc., 87 N.M. 451, 454-55, 535 P.2d 1077, 1080-81 (1975).

102. TENN. CODE ANN. § 47-9-507(2) (1964).

103. D. EPSTEIN, CONSUMER PROTECTION 312 (1976); *see, e.g.,* Atlas Constr. Co. v. Dravo-Doyle Co., 3 UCC Rep. 124 (Pa. Ct. C.P. 1965). *See also* Mercantile Fin. Corp. v. Miller, 292 F. Supp. 797, 801 (E.D. Pa. 1968); Goodin v. Farmers Tractor & Equip. Co., 249 Ark. 30, 458 S.W.2d 419 (1970); Franklin State Bank v. Parker, 136 N.J. Super. 476, 346 A.2d 632 (1975).

104. (Tenn. Ct. App., Knox County Eq. Div., April 14, 1973).

105. TENN. CODE ANN. § 47-9-504(4)(b) (1964).

106. For a discussion of the evidentiary considerations in establishing the relationship

A question frequently posed by clients is whether the solicitation of sealed bids, or private sale, is an acceptable alternative to sale by public auction. The question must be analyzed by asking which of the two alternatives is more "commercially reasonable" and by determining which type of sale would yield a higher return. Professors White and Summers consider it "unwise to require a public sale by auction if the same or a higher price can be obtained by the submission of sealed bids."[107] The two commentators go on, however, to caution that, whereas Article 9 does not require a specific number of bidders, "every single-bid sale invites scrutiny." White and Summers conclude that "[i]t may well be that multiple invitations to bid are a prerequisite of a commercially reasonable sale."[108] Whichever route is chosen, a bona fide effort must be made to advertise the sale properly and to solicit bidders,[109] and a lawyer inexperienced in auction sales should not conduct the sale.[110] Perhaps the best approach is to sell the collateral in a manner recommended by persons experienced in selling similar items.[111]

One consideration in favor of a public, or auction, sale[112] is based upon the observation that many foreclosure sales actually involve two sales. At the first sale, the secured party attempts to comply with the technical requirements of the Code, such as giving proper notice to the debtor, and then buys the property himself. If the purchase price is less than the amount of the debt, the creditor, having now "disposed" of the collateral, is entitled to a deficiency claim against the debtor. For the second sale, the creditor fixes up the collateral and uses the selling techniques best calculated to maximize his return. Although one could argue that the effort that went into the second sale should have gone into the first sale, secured parties will continue to seek the increased financial benefits of the two-sale procedure as long as it is permitted. Therefore, the first sale should be a public sale, because the secured party can buy

between price and value, see WHITE & SUMMERS, *supra* note 31, at 989-92. Professor Gilmore opines that, despite proper notification and publicity, if only the secured party appears at the sale, he can bid the property in for 10% of its value and that, absent fraud, the transaction should be unassailable. 2 GILMORE, *supra* note 4, at 1245. In light of *Mosely*, however, a higher bid is recommended.

107. WHITE & SUMMERS, *supra* note 31, at 993.

108. *Id.* at 993-94.

109. *See, e.g.*, California Airmotive Corp. v. Jones, 415 F.2d 554 (6th Cir. 1969); *In re* Webb, 17 UCC Rep. 627 (S.D. Ohio 1975).

110. Liberty Nat'l Bank & Trust Co. v. Acme Tool Div. of Rucker Co., 540 F.2d 1375 (10th Cir. 1976).

111. *See id.*

112. *See* TENN. CODE ANN. § 47-9-504, comment 1; § 47-2-706, comment 4 (1964).

the collateral for himself only at a public sale unless the collateral is of a type customarily sold in a recognized market, such as listed stock, or is the subject of "widely distributed standard price quotations."[113]

When the stakes are large enough, the secured party may desire assurance that an intended sale will be commercially reasonable. Section 9-507(2) provides the creditor a source of such assurance: "A disposition which has been approved in any judicial proceeding or by any bona fide creditors' committee shall conclusively be deemed to be commercially reasonable."[114] Note that the statute is applicable only to approval obtained *prior* to the sale.[115]

(2) "Notice to the Debtor"

Although the Code vests the secured party with considerable discretion in arranging for the sale of the collateral, it does require notice to the debtor of the time and place of the sale.[116] The purpose of these requirements is to enable the debtor to protect his interest in the property by paying the debt, finding a buyer, or attending the sale to bid on the property so that the property will not be sacrificed at less than its true value.[117] The Code does not specify the form of the notice, although written rather than oral notice is probably called for since the statute requires that notice be "sent."[118] Certified or registered mail is the most desirable medium because it provides: (1) a written record of the type of notice sent, (2) proof of mailing, and (3) written proof of receipt if the debtor signs the return receipt. All of these items are extremely valuable evidence if the question of notice subsequently is litigated. In order to avoid the plea that the registered letter never was picked up and that the debtor thus did not receive actual notice of the sale, a copy of the

113. *Id.* § 47-9-504(3).

114. *Id.* § 47-9-507(2). Bryant v. American Nat'l Bank & Trust Co., 407 F. Supp. 360 (N.D. Ill. 1976); *In re* Zsa Zsa Ltd., 352 F. Supp. 665 (S.D.N.Y. 1972); Old Colony Trust Co. v. Penrose Indus. Corp., 280 F. Supp. 698 (E.D. Pa. 1968) (declaratory judgment held a "judicial proceeding"), *aff'd*, 398 F.2d 310 (3d Cir. 1968).

115. TENN. CODE ANN. § 47-9-507, comment 2 (1964). *But see* Grant County Tractor Co. v. Nuss, 6 Wash. App. 830, 496 P.2d 966 (1972) (determination may be made in a deficiency suit).

116. TENN. CODE ANN. § 47-9-504(3) (1964).

117. Commercial Credit Corp. v. Holt, 17 UCC Rep. 316 (Tenn. App. 1975). White and Summers quite realistically refer to this goal as a "forlorn hope" the debtor will find money or friends to bid. WHITE & SUMMERS, *supra* note 31, at 982.

118. TENN. CODE ANN. § 47-9-504(3) (1964). *But see* Bondurant v. Beard Equip. Co., 21 UCC Rep. 340 (Fla. Dist. Ct. App. 1977); A.J. Armstrong Co. v. Janburt Embroidery Corp., 97 N.J. Super. 246, 234 A.2d 737 (1967) (oral notice sufficient).

notice should be sent to the debtor by ordinary first class mail. This technique allows the creditor to take advantage of the evidentiary presumption of delivery.[119]

The Code also requires that notice of the proposed sale be sent to the "debtor."[120] The term includes not only the principal debtor but also co-signers, co-makers, sureties, and guarantors—anyone "who owes payment or other performance of the obligation secured."[121] Except when consumer goods form the collateral, notice also must be sent to other secured parties who have interests in the collateral evidenced by filed financing statements or whom the secured party knows to have such interests.[122]

Prior to default, the debtor cannot waive the notice requirement even in a business or commercial context.[123] The Code itself, however, waives notice in three special situations: (1) when the collateral is perishable; (2) when the collateral is of a kind threatening to decline in value rapidly, such as Christmas trees repossessed on December 20; and (3) when the collateral is of a type customarily sold on a recognized market, such as listed stock.[124] Nevertheless, the prudent secured party will attempt to give notice even in these circumstances if at all possible in order to avoid a later argument over whether the collateral fits into one of the excepted categories.

The Code requires "reasonable" notification, but does not indicate when notice must be given in order to be "reasonable."[125] The parties may stipulate, as they often do in the security agreement, what will constitute a reasonable period. Professor Henson argues that five-days' notice generally is recognized as reasonable, apparently because that phrase so often appears in security agreements.

119. In light of the current performance of the United States Post Office, the presumption of delivery perhaps is no longer realistic.

120. TENN. CODE ANN. §47-9-504(3) (1964).

121. *Id.* § 47-9-105(1)(d). Norton v. National Bank of Commerce, 240 Ark. 143, 398 S.W.2d 538 (1966); Hepworth v. Orlando Bank & Trust Co., 323 So. 2d 41 (Fla. Dist. Ct. App. 1975); Third Nat'l Bank & Trust Co. v. Stagnaro, 25 Mass. App. Dec. 58 (1962).

122. TENN. CODE ANN. § 47-9-504(3) (1964).

123. Ennis v. Atlas Fin. Co., 120 Ga. App. 849, 172 S.E.2d 482 (1969); C.I.T. Corp. v. Haynes, 161 Me. 353, 212 A.2d 436 (1965); Commercial Credit Corp. v. Holt, 17 UCC Rep. 316 (Tenn. App. 1975). A debtor who voluntarily surrenders collateral under circumstances suggesting that he does not care what happens to it, however, may be deemed to have waived post-default notice. Commercial Credit Corp. v. Wollgast, 11 Wash. App. 117, 521 P.2d 1191 (1974); Grant County Tractor Co. v. Nuss, 6 Wash. App. 866, 496 P.2d 966 (1972). The prudent secured party still should give notice to avoid litigation of the waiver issue.

124. TENN. CODE ANN. § 47-9-504(3) (1964). The disposition still must he commercially reasonable. In addition, the "recognized market" exception does not apply to sellers of used cars. WHITE & SUMMERS, *supra* note 31, at 984.

125. TENN. CODE ANN. § 47-9-504(3) (1964).

The reasonableness of notice is really a jury question and depends upon the time a reasonably prudent debtor (perhaps a contradiction in terms) would need to act to protect his interests. Henson suggests that five days is reasonable only if the period is measured from the time of anticipated receipt.[126] The better practice is to give at least ten-days' notice, and prudence dictates two to three-weeks' notice if the amounts involved are large.[127]

The general rule requires only that the notice be properly posted and addressed, not that it be received.[128] The Tennessee Court of Appeals modified the general rule, however, in *Mallicoat v. Volunteer Finance and Loan Corp.*[129] In *Mallicoat* the creditor mailed written notification to the debtor. Although the letter was returned undelivered, the creditor sold the collateral. The court held that the creditor had not given proper notice because the creditor knew where the debtor worked, where his parents lived, and that the debtor had not received the notice. The court emphasized the creditor's affirmative duty to follow up on notice that comes back unopened. A secured party in Tennessee, therefore, is well advised to try to assure that his debtor actually receives notice of the sale.[130]

The contents of the notice depend upon whether the sale is to be public or private. If it is to be private, the notice must specify only the time after which a private sale or disposition will be made.[131] For a public sale, the notice must set forth the exact date, time, and place of the sale.[132]

If the debtor has been adjudicated a bankrupt at the time notice is sent, the creditor also must notify his trustee in bankruptcy. In *In re Hughes*[133] the secured party, a finance company, repossessed a car, in which it held a valid security interest, one day after Hughes had filed a voluntary petition in bankruptcy. Although it subsequently learned of the bankruptcy, the creditor proceeded to sell the car without leave of the bankruptcy court or notice to the trustee.

126. R. HENSON, HANDBOOK ON SECURED TRANSACTIONS §§ 10-11, at 248-49 (1973).

127. Two days certainly is inadequate. Cities Serv. Oil Co. v. Ferris, 9 UCC Rep. 899 (Mich. Dist. Ct. 1971); Conti Causeway Ford v. Jarossy, 114 N.J. Super. 382, 276 A.2d 402 (1971).

128. TENN. CODE ANN. § 47-1-201(38) (1964); Randolph v. Franklin Inv. Co., 21 UCC Rep. 348 (D.C. Ct. App. 1977); Steelman v. Associates Discount Corp., 121 Ga. App. 649, 175 S.E.2d 62 (1970); Hawkins v. General Motors Acceptance Corp., 250 Md. 146, 242 A.2d 120 (1968).

129. 57 Tenn. App. 106, 415 S.W.2d 347 (1966).

130. *Accord, In re* Bishop, 482 F.2d 381 (4th Cir. 1973).

131. TENN. CODE ANN. § 47-9-504(3) (1964).

132. *Id.;* J.T. Jenkins Co. v. Kennedy, 45 Cal. App. 3d 474, 119 Cal. Rptr. 578 (1975); Jones v. Garcia, 538 S.W.2d 492 (Tex. Civ. App. 1976).

133. 12 UCC Rep. 982 (E.D. Tenn. 1973).

The bankruptcy judge held that section 9-105(1)(d) of the Code[134] and section 70a of the Bankruptcy Act[135] required that notice of the time, place, and terms of the sale be given to the trustee. The finance company did not give notice to the trustee, and, accordingly, was held liable to the trustee for the interest on the note plus ten percent of the principal pursuant to section 9-507(1) of the Code.[136]

(3) "Application of Proceeds of Disposition"

Pursuant to section 9-504(1) of the Code, proceeds from the disposition of the collateral are distributed in the following order:

> (a) the reasonable expenses of retaking, holding, preparing for sale, selling and the like and, to the extent provided for in the agreement and not prohibited by law, the reasonable attorneys' fees and legal expenses incurred by the secured party;
> (b) the satisfaction of indebtedness secured by the security interest under which the disposition is made;
> (c) the satisfaction of indebtedness secured by any subordinate security interest in the collateral if written notification of demand therefor is received before distribution of the proceeds is completed. If requested by the secured party, the holder of a subordinate security interest must seasonably furnish reasonable proof of his interest, and unless he does so, the secured party need not comply with his demand.[137]

Subsection (a) includes commercially reasonable expenses incurred in preparing the collateral for sale.[138] Some authority supports the proposition that a secured party is obligated in certain instances to condition or maintain collateral in his possession,[139] but generally the courts permit the secured party to sell the collateral in the condition it was in at the time of repossession.[140] In Tennessee the parties may provide for attorneys' fees in the security agreement, but the amount thereof is within the reserved discretion of the trial court. Appellate courts will not interfere with the amount set by the trial court unless some injustice has been perpetrated.[141] Subsection (b), satisfaction of the debt secured, should pose no problem to the secured party and therefore deserves no discussion

134. TENN. CODE ANN. § 47-9-105(1)(d) (1964).
135. 11 U.S.C. § 110(a) (1970).
136. TENN. CODE ANN. § 47-9-507(1) (1964).
137. *Id.* § 47-9-504(1)(a)(c).
138. *Id.;* Davis v. Small Business Inv. Co., 535 S.W.2d 740 (Tex. Civ. App. 1976).
139. Harris v. Bower, 266 Md. 579, 295 A.2d 870 (1972).
140. Eaton, Yale & Towne v. Sherman Indus. Equip. Co., 316 F. Supp. 435 (E.D. Mo. 1970); Goodin v. Farmers Tractor & Equip. Co., 249 Ark. 30, 458 S.W.2d 419 (1970).
141. Dole v. Wade, 510 S.W.2d 909 (Tenn. 1974); Harpole v. Bank of Dyer (Tenn. Ct. App., Gibson County Eq. Div., Aug. 5, 1975).

here. The third category, satisfaction of subordinate security interests, is more vexing. A junior secured creditor, whose lien is discharged by the sale,[142] can participate in the distribution only if he delivers to the selling secured party a written notification of a demand for his share and if he furnishes, upon request, reasonable proof of his security interest.[143] An electrostatic copy should suffice. Finally, the secured party must account to the debtor for any surplus and, unless otherwise agreed, the debtor is liable for any deficiency.[144]

D. Consequences of Failure to Comply with Disposition Rules

If the secured party fails to comply with the Code standards for disposition of collateral, for example, by failing to give proper notice or by failing to sell in a commercially reasonable manner, a number of courts will punish him by denying the right to a deficiency judgment.[145] This arbitrary approach was rejected by the Tennessee Court of Appeals in *Commercial Credit Corp. v. Holt.*[146] In *Holt* Commercial Credit Corporation had failed to give notice of the sale of collateral to Holt, the debtor. Judge Drowota, in a lucid and well-reasoned opinion, set out a more flexible rule for violations of the Tennessee Commercial Code standards. He summarized the law as follows: In seeking a deficiency, (a) the creditor must prove, as part of his case-in-chief, that he complied with the notice and commercially-reasonable requirements of section 47-9-504(3); (b) if the plaintiff does not satisfy the trial court that he has complied, the defendant is entitled to a set-off or credit against the deficiency; (c) the set-off is the difference between what was received and what would have been received had the plaintiff complied with the Code; and (d) the difference will be presumed to be at least the amount of the deficiency unless the creditor proves otherwise.

The Code sets out a special rule for failure to comply with notice and commercial reasonableness in consumer goods transactions. Section 47-9-507(1) gives the debtor the right to recover, in any event, the finance charge plus ten percent of the principal or cash price. Note that the debtor might recover a sum substantially greater than his actual loss as calculated in *Holt,* since the penalty

142. TENN. CODE ANN. § 47-9-504(4) (1964).

143. *Id.* § 47-9-504(1)(c).

144. *Id.* § 47-9-504(2).

145. For a collection of these cases and a trenchant analysis of the reasoning (or lack of reasoning) of the various courts, see WHITE & SUMMERS, *supra* note 31, at 1000-07.

146. 17 UCC Rep. 316 (Tenn. App. 1975).

is calculated on the basis of the original principal and total finance charge.

V. Conclusion

The Code provides a host of judicial and nonjudicial remedies for the secured creditor. The remedies are flexible and calculated to protect the interests of both the debtor and the secured party. The penalties for noncompliance, however, can be substantial. Therefore, the secured creditor is well advised to familiarize himself with the intricacies of the statute and to follow them carefully. Compliance with the Code is an absolute defense.