

A Potential Pitfall for the Unsuspecting Purchaser of Repossessed Collateral: The Overlooked Interaction Between Sections 9- 504(4) and 2-312(2) of the Uniform Commercial Code

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TABLE OF CONTENTS

Introduction	168
I. The Problem	169
II. Rights of Purchaser of Repossessed Collateral in the Absence of Default	172
A. Purchaser's Rights Under Article Nine	173
B. Other Law Governing the Purchaser's Rights	181
III. Debtor's Remedies Against Purchaser	190
IV. Purchaser's Rights Against Selling Secured Party	195
A. The Warranty of Title Under Article 2	195
B. The Right of Restitution	201
V. The Inadequacy of the Purchaser's Common Law Remedy	204
VI. Proposed Amendment to Section 9-504(4)	209
A. Method for Allocating Risks Between Debtor and Purchaser	210
B. Statutory Solution	216

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INTRODUCTION

Under the provisions of the Uniform Commercial Code (the Code), a secured party may repossess collateral from a defaulting debtor.¹ Following the repossession, the secured party may sell the collateral at a foreclosure sale.² The purchaser of the collateral generally obtains all rights of the debtor through the foreclosure sale.³ The secured party's right to sell the collateral, however, is conditioned on the debtor actually being in default.⁴ Under the Code, the purchaser's rights against the debtor and third parties are also contingent on the debtor being in default.⁵ The Code does not,

1. U.C.C. §§ 9-501, -503. In this Article, all references to the Uniform Commercial Code are to the 1987 Official Text.

2. *Id.* § 9-504.

3. Section 9-504(4) of the Uniform Commercial Code provides:

When collateral is disposed of by a secured party after default, the disposition transfers to a purchaser for value all of the debtor's rights therein, discharges the security interest under which it is made and any security interest or lien subordinate thereto. The purchaser takes free of all such rights and interest even though the secured party fails to comply with the requirements of this Part or any judicial proceedings

(a) in the case of a public sale, if the purchaser has no knowledge of any defects in the sale and if he does not buy in collusion with the secured party, other bidders or the person conducting the sale; or

(b) in any other case, if the purchaser acts in good faith.

Id. § 9-504(4).

4. *Id.* §§ 9-501, -504(1); see 2 GRANT GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 43.3, at 1190-91 (1965) (stating that secured party cannot take action on debt or move against security until event of default has occurred); see also *Martens v. Hadley Memorial Hosp.*, 729 F. Supp. 1391, 1396 (D.D.C. 1990) (stating that default is prerequisite to secured party's right to repossess and sell collateral); *Wynn v. Adams County Bank*, 761 P.2d 234, 236 (Colo. Ct. App. 1988) (stating that creditor entitled to repossess inventory on debtor's default); *Borochoff Properties v. Howard Lumber Co.*, 155 S.E.2d 651, 655 (Ga. Ct. App. 1967) (explaining that secured party could sell collateral after debtor's bankruptcy, which constituted default under contract between parties); *Mitchell v. Ford Motor Credit Co.*, 688 P.2d 42, 47 (Okla. 1984) (holding creditor liable for conversion after repossessing where debtor was not in default); *Trimble v. Sonitrol of Memphis*, 723 S.W.2d 633, 643 (Tenn. Ct. App. 1986) (holding that pledgee, under pledge, only acquires special property right to sell collateral after default); *Wachovia Bank & Trust Co. v. McCoy*, 270 S.E.2d 164, 166 (W. Va. 1980) (holding that secured party may repossess and sell, lease, or otherwise dispose of collateral on default); WILLIAM D. HAWKLAND, HAWKLAND UCC SERIES § 9-501:05, at 708-11 (1982) (explaining that secured party has right to enforce security interest by any judicial procedure); Cynthia Starnes, *U.C.C. Section 9-504 Sales by Junior Secured Parties: Is a Senior Party Entitled to Notice and Proceeds?*, 52 U. PITT. L. REV. 563, 581 (1991) (suggesting that default of debtor is necessary prerequisite to secured party's exercising right to foreclose and sell collateral). But see *Watson v. Branch County Bank*, 380 F. Supp. 945, 976 (W.D. Mich. 1974) (holding that alleged default, in discretion of secured party, is sufficient to trigger right to repossess under article 9), *rev'd without opinion*, 516 F.2d 902 (6th Cir. 1975).

5. U.C.C. § 9-504(4). Section 9-504(4) applies only to a disposition of the collateral after default. It provides, "When the collateral is disposed of by a secured party after default, the disposition transfers to a purchaser for value all of the debtor's rights therein . . ." *Id.* (emphasis added); see also *Lichty v. Federal Land Bank of Omaha*, 467 N.W.2d 657, 661 (Neb. 1991) (stating that good faith purchaser of collateral property takes collateral property free of claims of defaulting debtor); 2 GILMORE, *supra* note 4, § 42.14, at 1175-80 (explaining that secured party's sale of collateral is wrongful when done without default).

however, clearly address the rights of the debtor and purchaser in the event that the secured party wrongfully declares the debtor in default and subsequently repossesses and sells the collateral. This Article addresses those rights under both the Code and the common law. It suggests that the drafters of the Code created an unintended paradox whereby the purchaser loses the battle over the collateral with the non-defaulting debtor, but is not given a right under the Code to recover damages from the selling secured creditor.⁶ For protection, the purchaser must resort to whatever rights may be available at common law or in equity.⁷ These rights, however, may be inadequate or unattractive.⁸ This Article therefore suggests amendments to article 9 of the Code to correct this inequity and uncertainty, and to clarify the rights of the parties.

I. THE PROBLEM

The problem is best illustrated by the following hypothetical situation:

Debtor, a collector of vintage automobiles, purchases an authentic 1948 Tucker to add to her collection. Debtor finances the sale through Bank, which attaches an enforceable security interest in the Tucker to secure repayment of the loan. The security agreement requires that Debtor maintain adequate insurance on the Tucker, with a minimum policy value equal to the amount of the debt owing to Bank. Debtor complies, and the insurance broker promptly mails proof of insurance to Bank. Bank receives the document, but misfiles it, due to a clerical error.

On a routine review of the file, a bank officer determines that Debtor has not complied with the agreement's insurance requirement and declares Debtor to be in default. Unable to reach Debtor for clarification,⁹ Bank repossesses the automobile and sells it at an

6. See U.C.C. § 2-312(2); *id.* § 2-312 cmt. 5. If the collateral is a good, the warranty of title under article 2 generally will not attach if it is purchased at a foreclosure sale. *Id.*; see also discussion *infra* Part IV.A (explaining general rule that no warranty of title attaches in foreclosure sale).

7. See *infra* Part II.

8. See Menachem Mautner, *The Eternal Triangles of the Law: Toward a Theory of Priorities in Conflicts Involving Remote Parties*, 90 MICH. L. REV. 95, 96 (1991) (arguing that legal remedies currently available to party in tort or contract are inadequate to redress aggrieved party). Where the collateral is unique or the wrongdoer is the original secured creditor and is judgment proof, a cause of action against the secured party will be inadequate. *Id.* Furthermore, the common law right of restitution, the potential remedy, is generally limited to the return of the purchase price, thereby depriving the purchaser of the benefit of his bargain. See *infra* note 144 and accompanying text.

9. The Author recognizes that this is an oversimplification of how the transaction would typically transpire in a commercial setting. Generally the creditor will make attempts to contact the debtor to determine whether insurance has been obtained. The creditor may also obtain

otherwise commercially reasonable sale to Purchaser.¹⁰ Debtor's attorney advises her that she may recover monetary damages from Bank for the wrongful repossession.¹¹ Due to the uniqueness of the automobile, Debtor instead seeks to reclaim the vehicle from Purchaser, but Purchaser refuses to relinquish it.

To determine the respective rights and the potential liabilities of the involved parties, two issues must be addressed: (1) whether Debtor can successfully reclaim the automobile from Purchaser and, if so; (2) whether Purchaser can, in turn, successfully recover damages from Bank for losses caused by Bank's failure to convey good title to him. Because Debtor was not in default under the agreement, having purchased the insurance,¹² Bank had no right under the Code to

insurance directly on the collateral and add the premium cost to the debt, an action generally permitted under a standard security agreement. See U.C.C. § 9-207(2)(a) (permitting secured party in possession of collateral to obtain insurance and add premium cost to debt). This heuristic example, however, raises the issues necessary for purposes of this discussion.

10. Other scenarios may arise where the secured party declares a default, though none exists under the hypothetical parties' agreement. Acceleration of the debt and subsequent declaration of default, under an insecurity clause, in bad faith and in violation of U.C.C. § 1-208 is one such situation. See *Brown v. Avemco Inv. Co.*, 603 F.2d 1367, 1380 (9th Cir. 1979) (holding that acceleration of debt by secured creditor acting in bad faith vitiates debtor's default); *Farmer & Merchants Bank of Centre v. Hancock*, 506 So. 2d 305, 316 (Ala. 1987) (holding that acceleration of note without reasonable basis for insecurity was unjustified and repossession without debtor's default was thus wrongful); cf. *In re Martin Specialty Vehicles*, 87 B.R. 752, 768 (Bankr. Mass. 1988) (ordering that lender be estopped from claiming default where lender approved substitution of collateral of lesser value for original collateral); *Friendly Credit Union v. Campbell*, 579 So. 2d 1288, 1291 (Ala. 1991) (deciding that debtor was not in default); *Whisenhunt v. Allen Parker Co.*, 168 S.E.2d 827, 832 (Ga. Ct. App. 1969) (holding that death of debtor was not default); *Cobb v. Midwest Recovery Bureau*, 295 N.W.2d 232, 238 (Minn. 1980) (holding that creditor's repeated acceptance of late payments prevented declaration of default and repossession); *Lincoln v. Grinstead*, 379 S.E.2d 671, 674 (N.C. Ct. App. 1989) (deciding that debtor's failure to make payments to seller due to breach of warranty was not default); *Mitchell v. Ford Motor Credit Co.*, 688 P.2d 42, 47 (Okla. 1984) (holding that debtor's sale of collateral was not default where account was not in default and creditor approved of sale).

11. See U.C.C. § 9-507(1) (providing debtor with right to recover damages for "any loss caused by [a secured party's] failure to comply with the provisions of" part 5 of U.C.C. article 9); see also *infra* note 14 (explaining that U.C.C. § 9-507(1) gives debtor right to recover damages from secured party who does not comply with default provisions).

12. Generally, the terms of default are found in the security agreement between the parties. See *Starnes*, *supra* note 4, at 564 (arguing that, because article 9 does not define default, default is essentially whatever parties say it is). Article 9 does not define default. See *First Nat'l Bank v. Beug*, 400 N.W.2d 893, 898 (S.D. 1987) (recognizing that default was sufficiently defined by parties' agreement); 2 GILMORE, *supra* note 4, § 43.3, at 1193 (stating that, beyond general requirement of timely payment, default is, within reason, matter of contract, and can best be defined as whatever security agreement says it is); JAMES J. WHITE & ROBERT S. SUMMERS, *UNIFORM COMMERCIAL CODE* § 25-2, at 1189 (3d ed. 1988) (stating that apart from modest limitations imposed by doctrine of unconscionability and requirement of good faith, default is whatever security agreement says it is); William E. Hogan, *Pitfalls in Default Procedure*, 2 UCC L.J. 244, 244 (1970) (recognizing that definition of default is not provided in Code, but is matter defined by particular agreement). Default commonly occurs when the debtor fails to perform or comply with a provision of the security agreement between the parties. *Manufacturers Hanover Leasing Corp. v. Ace Drilling Co.*, 726 F. Supp. 966, 969 (S.D.N.Y. 1989) (holding that because U.C.C. does not define default, parties' definition governs); *United States v. Pirnie*, 339

repossess or sell the vehicle.¹³ The Code clearly gives Debtor a cause of action against Bank for damages she sustained as a direct result of the wrongful repossession.¹⁴ With unique collateral,¹⁵ however,

F. Supp. 702, 712 (D. Neb. 1972) (holding that debtor's failure to properly care for collateral, in violation of agreement, constitutes default); *Whisenhunt*, 168 S.E.2d at 832 (holding that, while death may be included as basis for default, it is not automatically included, and that, absent specific inclusion in agreement, default occurs only when debtor fails to meet his obligation to make payments on debt); *Borochoff Properties v. Howard Lumber Co.*, 155 S.E.2d 651, 655 (Ga. Ct. App. 1967) (upholding security agreement that made bankruptcy event of default).

13. There are two specific sections of the U.C.C. that condition the right to repossess collateral upon the debtor's default. U.C.C. § 9-501 ("When a debtor is in default under a security agreement, a secured party has the rights and remedies provided in this Part [Five] . . ."); *id.* § 9-503 ("Unless otherwise agreed a secured party has on default the right to take possession of the collateral."). Further, § 9-504(1) conditions the right to *resell* the collateral upon the debtor's default. *Id.* § 9-504(1); *see also supra* note 4 (providing instances in which necessity of actual default has been upheld). The secured creditor's sale of the collateral before the debtor is in default would also violate U.C.C. § 9-207, which delineates the responsibilities of a creditor in possession of the collateral. U.C.C. § 9-207. The creditor may not impair the debtor's right to redeem the collateral. *Id.* § 9-207(2)(e). While a repledge of the collateral is permitted so long as the debtor's right to redeem is not impaired, a sale of the collateral would impair this right, and thus violate the creditor's duties under § 9-207.

14. U.C.C. § 9-507(1). Section 9-507(1) gives the debtor a right to recover damages from a secured party who does not comply with part 5 (Default provisions) of article 9. *Id.* Because Debtor was not in default, the bank wrongfully availed itself of the remedies for default provided in part 5. Therefore, Debtor is entitled to monetary damages under U.C.C. § 9-507(1) and the common law. *See Martin Specialty Vehicles*, 87 B.R. at 768 (holding that secured creditor was liable for damages for wrongful foreclosure where debtor was not in default under security agreement); *see also Georgia Cent. Credit Union v. Coleman*, 271 S.E.2d 681, 684 (Ga. Ct. App. 1980) (ruling that debtor had right to recover from creditor any losses suffered due to creditor's failure to comply with commercial code); *Kouba v. East Joliet Bank*, 481 N.E.2d 325, 331 (Ill. App. Ct. 1985) (indicating that debtor who specifically pleads statutory remedy could be entitled to statutory damages for wrongful repossession); *Universal C.I.T. Credit Corp. v. Shepler*, 329 N.E.2d 620, 630 (Ind. Ct. App. 1975) (stating that debtor is entitled to damages for conversion if debtor proves that secured creditor accelerated debt in bad faith); *Joyce v. Cloverbrook Homes*, 344 S.E.2d 58, 60-61 (N.C. Ct. App. 1986) (holding that party under repurchase agreement had duties of secured creditor and was liable to debtor for money damages under § 9-507(1) for failure to give debtors notice of sale as required by U.C.C.); *Peoples Acceptance Corp. v. Van Epps*, 395 N.E.2d 912, 917 (Ohio Ct. App. 1978) (ruling that debtor is entitled to damages where creditor failed to sell collateral in commercially reasonable manner, in violation of U.C.C.); *First City Bank v. Guex*, 677 S.W.2d 25, 30 (Tex. 1984) (holding that debtor was entitled to money damages for creditor's failure to comply with article 9); *Stone Machinery Co. v. Kessler*, 463 P.2d 651, 656 (Wash. Ct. App. 1970) (finding that debtor was entitled to compensatory damages for secured creditor's wrongful repossession); *WALTER RAUSHENBUSH, BROWN ON PERSONAL PROPERTY* § 15.11, at 507 (1975) (stating that secured party who converts collateral to his possession is liable for money damages under § 9-507(1), and for tort of conversion). The debtor may also have a defense to the creditor's action for a deficiency judgment. *See Hoch v. Ellis*, 627 P.2d 1060, 1065-66 (Alaska 1981) (stating that, where sale of repossessed collateral violated provision of U.C.C., secured creditor had burden of proving, by clear and convincing evidence, that sale was at fair market value); *Topeka Datsun Motor Co. v. Stratton*, 736 P.2d 82, 92 (Kan. Ct. App. 1987) (ordering consumer debtor relieved of liability for deficiency judgment where creditor violated U.C.C. in disposition of collateral); *Maryland Nat'l Bank v. Wathen*, 414 A.2d 1261, 1265 (Md. 1980) (holding that secured party who fails to give notice of sale to one of multiple debtors is barred from recovering deficiency judgment); *Bank of Burwell v. Kelley*, 445 N.W.2d 871, 879 (Neb. 1989) (stating that compliance with notice provisions of U.C.C. is condition precedent to secured creditor's recovery of deficiency judgment); *Whirlybirds Leasing Co. v. Aerospatiale Helicopter Corp.*, 749 S.W.2d 915, 919 (Tex. Ct. App. 1988) (explaining that creditor who violated U.C.C. was barred from deficiency

money damages may be insufficient.¹⁶ Debtor may therefore wish to reclaim the property that she rightfully owns and that was wrongfully taken from her. A careful reading of the Code and the relevant case law is required to determine the rights, under current law, of Debtor and Purchaser in the disputed collateral.

II. RIGHTS OF PURCHASER OF REPOSSESSED COLLATERAL IN THE ABSENCE OF DEFAULT

To determine whether Debtor may reclaim her good from Purchaser, the rights that Purchaser acquired through the sale must be ascertained. If, through the foreclosure sale, the purchaser received good title, defensible against the debtor, the purchaser would

judgment). *But see In re Excello Press*, 890 F.2d 896, 907 (7th Cir. 1989) (deciding that secured creditor's failure to comply with default provisions of article 9 merely raises rebuttable presumption that fair market value of collateral at proper sale would have occurred at amount equal to debt); *Barbour v. United States*, 562 F.2d 19, 22 (10th Cir. 1977) (stating that debtor's damages under U.C.C. § 9-507(1) are merely set-off against secured creditor's deficiency judgment); *Tennant Co. v. Martin's Landscaping*, 515 A.2d 665, 669 (Conn. Super. Ct. 1986) (holding that, where creditor sells repossessed collateral without giving required statutory notice, rebuttable presumption arises that proper sale would have been at amount equal to outstanding debt); *Westgate State Bank v. Clark*, 642 P.2d 961, 972 (Kan. 1982) (holding that, in non-consumer commercial transaction, secured party's failure to comply with provisions of U.C.C. is not absolute bar to deficiency judgment); *Commercial Credit Corp. v. Wollgast*, 521 P.2d 1191, 1197 (Wash. Ct. App. 1974) (holding that only penalty for secured creditor's failure to comply with statutory requirements is debtor's right to recover damages under U.C.C. § 9-507(1)). For an overview of the various approaches to this remedy, see CHRISTINE A. FERRIS & BENNETT H. GOLDSTEIN, *DISPOSITION OF REPOSSESSED COLLATERAL UNDER THE UNIFORM COMMERCIAL CODE* §§ 9.1 to 9.5 (1990) (explaining absolute bar rule, rebuttable presumption rule, and set-off rule as competing judicial approaches to noncompliance with code requirements) and Kathryn P. Seebart, *A Secured Party's Right to a Deficiency Judgment After Noncompliance with the Resale Provisions of Article 9*, 60 N.D. L. REV. 531, 534-36 (1984) (explaining that courts have advanced three methods to solve problem of second party's noncompliance with § 9-504: absolute bar approach, set-off approach, and shift approach).

15. This may also be true where the collateral is equipment that is essential to the debtor's business and difficult to replace. *See Martin Specialty Vehicles*, 87 B.R. at 768 (discussing lost profit damages for secured creditor's bad faith foreclosure on debtor's property that caused loss of corporate debtor's entire business).

16. A judgment for money damages entered against the selling secured creditor would be unsatisfactory where the secured creditor is insolvent or judgment proof, a situation that is not uncommon in today's business environment. For a sampling of the many authorities dealing with the various aspects of the savings and loan debacle, see Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183 (codified as amended in scattered sections of 2, 5, 12, 15, 26, 28, 31, 40, 42, and 44 U.S.C.); Lincoln Sav. & Loan Ass'n v. Wall, 743 F. Supp. 901, 921 (D.D.C. 1990) (upholding imposition of receivership on Lincoln Savings & Loan); Carol R. Goforth, *Criticizing the Financial Institution Insurance Agencies' "Super-Powers"*, 22 ARIZ. ST. L.J. 195, 198 (1990) (discussing benefits and advantages of special rights and privileges granted to FDIC in dealing with insolvency of financial institution); *Bonfire of the S&Ls*, NEWSWEEK, May 21, 1990, at 20 (arguing that burden of \$250 billion savings and loan debacle will ultimately be borne by taxpayers in form of higher taxes and program cutting); *The Unending Deposit Insurance Mess*, SCIENCE, Oct. 27, 1989, at 451 (arguing that politicians and regulators must surrender discretion that permits them to evade issue of need to budget for governmental financial commitments).

be entitled to retain the collateral.¹⁷ If the purchaser did not acquire good title to the property through the transfer by the creditor, the debtor may be able to defeat the purchaser's interest and reclaim the good.¹⁸

A. Purchaser's Rights Under Article 9

Article 9 of the Code permits the transfer of the debtor's rights in the collateral to the purchaser at a foreclosure sale only when the debtor is in default.¹⁹ The right of the secured creditor to enforce his security interest by availing himself of the remedies provided under the Code, including repossession and resale, is limited to instances "[w]hen a debtor is in default under a security agreement."²⁰ Article 9 also recognizes that the secured party "after default may sell, lease or otherwise dispose of the collateral."²¹ A secured party who has repossessed and sold collateral when the debtor is not in default, however, has converted the debtor's property²² because the creditor's actions are unauthorized by the Code.²³

17. *Brandywine Lanes v. Pittsburgh Nat'l Bank*, 264 A.2d 377, 382 (Pa. 1970) (holding that, where secured creditor has obtained valid judgment for repossession of collateral, assignee of judgment may enforce judgment and interest in collateral against debtor).

18. *Centennial State Bank v. S.C.K. Constr. Co.*, 518 S.W.2d 143, 151 (Mo. Ct. App. 1974) (holding that assignee has no greater rights than assignor); see also *infra* note 20 and accompanying text (stating that § 9-503 gives secured party right to repossess collateral on default).

19. U.C.C. § 9-504(4).

20. *Id.* § 9-501(1); see also *id.* § 9-503 (giving secured party right to repossess collateral "on default" unless parties agree); *id.* (stating that right "accrues on default"); see also *American Furniture Co. v. Extebank*, 676 F. Supp. 455, 457 (E.D.N.Y. 1987) (stating that secured party is entitled to sell collateral so long as default exists); *Central & S. Bank v. Williford*, 386 S.E.2d 688, 690 (Ga. Ct. App. 1989) (holding that secured creditor acquired right to repossess upon default); *Production Credit Ass'n v. Equity Coop Livestock Sales Ass'n*, 261 N.W.2d 127, 132-33 (Wis. 1978) (explaining that secured creditor has no right to repossess in absence of default); National Conference of Commissioners on Uniform State Laws and American Institute, *Uniform Commercial Code: Proceedings in Committee of the Whole* (Sept. 2-3, 1949), reprinted in *THE KARL LLEWELLYN PAPERS* 64 [hereinafter *Proceedings 1949*] (comments of Professor Allison Dunham, a principal drafter of U.C.C.) (stating that no right to repossess or sell exists in absence of default).

21. U.C.C. § 9-504(1); see also *DeVita Fruit Co. v. FCA Leasing Corp.*, 473 F.2d 585, 589 (6th Cir. 1973) (holding that secured party has right under U.C.C. to resell goods on debtor's default).

22. *RESTATEMENT (SECOND) OF TORTS* § 222A(1) (1965) ("Conversion is an intentional exercise of dominion or control over a chattel, which so seriously interferes with the right of another to control it that the actor may justly be required to pay the other the full value of the chattel.").

23. See *Brown v. Avemco Inv. Co.*, 603 F.2d 1367, 1380 (9th Cir. 1979) (stating that debtor is entitled to recover for conversion where creditor repossesses after accelerating debt in bad faith); *Universal C.I.T. Credit Corp. v. Shepler*, 329 N.E.2d 620, 630 (Ind. Ct. App. 1975) (holding that, where creditor accelerated debt in bad faith, repossession was act of conversion); *Farmers State Bank v. Haflich*, 699 P.2d 553, 559 (Kan. Ct. App. 1985) (stating that, where debtor is entitled to notice of right to cure, failure to send such notice vitiates debtor's default, and repossession thereafter amounts to conversion); *Lincoln v. Grinstead*, 379 S.E.2d 671, 674

Because the sale of the collateral by the secured party is not permitted under the Code when the debtor is not in default, the rights of the purchaser are unclear. Section 9-504(4) gives the purchaser for value all of the debtor's rights in the collateral "when the collateral is disposed of by a secured party after default."²⁴ Virtually every case that has addressed the purchaser's rights in the collateral under section 9-504 indicates that the rights arise through a sale conducted after default.²⁵ No court, however, has specifically applied section 9-504 to address the issue presented by the hypothetical: whether a good faith purchaser for value obtains rights in the collateral superior to the debtor when the debtor was not in default at the time of repossession and sale.

One court has addressed a similar issue in the context of a sale conducted after entry of judgment and issuance of a writ of attachment. In *Inmi-Etti v. Aluisi*,²⁶ Inmi-Etti, the owner of a motor vehicle, sued a car dealership, Pohanka, for conversion.²⁷ The car dealer had purchased the vehicle from Butler, who had obtained a default judgment against Inmi-Etti.²⁸ The judgment under which Butler had

(N.C. Ct. App. 1989) (holding that wrongful repossession constitutes conversion); *Mitchell v. Ford Motor Credit Co.*, 688 P.2d 42, 47 (Okla. 1984) (holding that creditor is liable for conversion for repossession where debtor is not in default); *WHITE & SUMMERS*, *supra* note 12, § 25-17, at 1240; *infra* notes 99-112 and accompanying text (discussing effect of wrongful repossession on secured creditor); *see also Pleasant v. Warrick*, 590 So. 2d 214, 217 (Ala. 1991) (holding that repossession is lawful where debtor is in default); *First Nat'l Bank v. Lachenmyer*, 476 N.E.2d 755, 765 (Ill. App. Ct. 1985) (deciding that debtor in default under security agreement is not entitled to recover for conversion).

24. U.C.C. § 9-504(4).

25. *See Personal Jet v. Callihan*, 624 F.2d 562, 569 (5th Cir. 1980) (holding that commercially reasonable sale of collateral by secured party after default of debtor transfers good title to purchaser); *West Chicago State Bank v. Rogers*, 515 N.E.2d 1261, 1271 (Ill. App. Ct. 1987) (holding that sale after default transfers all of debtor's rights to purchaser); *Lichty v. Federal Land Bank*, 467 N.W.2d 657, 661 (Neb. 1991) (stating that good faith purchaser of collateral at private sale acquires rights of defaulting debtor); *see also Davis v. Huntsville Prod. Credit Ass'n*, 481 So. 2d 1103, 1107 (Ala. 1985) (stating that creditor has no right to credit proceeds from foreclosure sale to second debt where debtor is not in default on that debt); *Production Credit*, 261 N.W.2d at 132-33 (holding that secured creditor has no right to possession of collateral in absence of default by debtor). *But see Watson v. Branch County Bank*, 380 F. Supp. 945, 954 (W.D. Mich. 1974) (stating, in dicta, that purchaser at foreclosure sale may take collateral free of debtor's security interest and all subordinate liens or security interests upon "alleged" default), *rev'd without opinion*, 516 F.2d 902 (6th Cir. 1975). The commentators also assume that the purchaser's rights against the debtor exist as a result of a sale after default. *See generally HAWKLAND*, *supra* note 4, § 9-504:11 (explaining that purchaser receives collateral free from rights of debtor and holders of subordinate security interests and liens); *Starnes*, *supra* note 4, at 564-67, 575-76 (suggesting that foreclosure rights of secured party under article 9, including right to resell, are conditioned on debtor's default); *WHITE & SUMMERS*, *supra* note 12, § 25-2, at 1189-91 (stating that default is whatever parties say it is and condition precedent to rights of parties under Part IV of article 9).

26. 492 A.2d 917 (Md. Ct. Spec. App. 1985).

27. *Inmi-Etti v. Aluisi*, 492 A.2d 917, 920 (Md. Ct. Spec. App. 1985).

28. *Id.*

attached and sold the vehicle was ultimately set aside.²⁹ The sale to Pohanka, however, had already been consummated.³⁰ The court held that Butler had no right to possess or sell the vehicle because the default judgment under which it was sold was invalid.³¹ Because Butler had no rights in the vehicle, he could transfer no rights to Pohanka.³² Accordingly, even though Pohanka had no knowledge of defects in either the underlying judgment or the certificate of title that it received from Butler, Pohanka was guilty of conversion and liable to the true owner for damages.³³

In another analogous case, *Fitzpatrick v. Bank of New York*,³⁴ a good faith purchaser for value obtained title to an automobile sold pursuant to a court judgment.³⁵ The original owner, however, had granted a security interest in the automobile to the defendant, Bank of New York,³⁶ and the security interest was properly noted on the original certificate of title.³⁷

The original owner had accumulated a significant number of parking tickets that resulted in a judgment in favor of the City of New York and the impoundment of the vehicle by the City Marshal.³⁸ Pursuant to the judgment, the car was then sold at public auction.³⁹ After the sale, a new certificate of title was issued to the purchaser by the Department of Motor Vehicles, which negligently dropped Bank of New York's lien from the title.⁴⁰ The plaintiff, Fitzpatrick, in turn purchased the vehicle from the auction purchaser without knowledge or notice of the bank's security interest.⁴¹ The court held that Fitzpatrick, who was concededly a good faith purchaser for value without knowledge or notice of the bank's interest,⁴² took title to the automobile subject to the security interest.⁴³ Although Fitzpatrick's seller had purchased the vehicle at a public auction conducted

29. *Id.* at 919.

30. *Id.*

31. *Id.* at 923. The suit through which Butler obtained a default judgment against Inmi-Etti was completely without merit. *Id.* at 918.

32. *Id.* at 923.

33. *Id.* at 924.

34. 480 N.Y.S.2d 864 (Civ. Ct. 1984).

35. *Fitzpatrick v. Bank of N.Y.*, 480 N.Y.S.2d 864, 864 (Civ. Ct. 1984).

36. *Id.*

37. *Id.* at 865 (explaining that original lien was "recorded and perfected by defendant . . . when car was bought new and financed by . . . original purchaser").

38. *Id.*

39. *Id.*

40. *Id.*

41. *Id.* (explaining that plaintiff received unencumbered certificate of title from Department of Motor Vehicles).

42. *Id.* at 868.

43. *Id.*

pursuant to a valid judgment and had received a "clean" certificate of title through the sale, the court reasoned that the seller took subject to the bank's interest, which was superior to that of the repossessing judgment creditor, the City of New York.⁴⁴ The court therefore concluded that Fitzpatrick could take no greater interest than his transferor had.⁴⁵ Because the original purchaser took subject to the security interest, so then did Fitzpatrick.⁴⁶

Although *Inmi-Etti* and *Fitzpatrick* were not decided under section 9-504(4), their principles are instructive. In *Inmi-Etti*, a good faith purchaser obtained no title to the good, even though the vehicle was sold under a facially valid judgment and attachment.⁴⁷ In *Fitzpatrick*, a good faith purchaser without notice of a superior interest did not obtain good and clear title to a good sold at public auction pursuant to a valid judgment.⁴⁸ These holdings are consistent with other cases that have considered the rights of purchasers at judicial or foreclosure sales.⁴⁹ Generally, sales approved by a court or conducted pursuant to a court decree are given greater deference than foreclosure sales conducted by private parties without court intervention.⁵⁰ If a good

44. *Id.* The court relied on (1) U.C.C. § 9-306(2), which provides that a security interest continues in collateral notwithstanding a sale unless the creditor authorizes the sale or the Code otherwise provides, and (2) U.C.C. § 9-307, which governs when a buyer of a good can take free of a perfected security interest. *Id.* at 865-66, 868.

45. *Id.* at 868 (relying on U.C.C. § 9-306(2)); see also U.C.C. § 2-403(1) ("A purchaser of goods acquires all title which his transferor had or had power to transfer.").

46. See *Fitzpatrick*, 480 N.Y.S.2d at 868; see also *supra* notes 43-45 and accompanying text (explaining that security interest continues in collateral notwithstanding sale unless sale was authorized by secured party).

47. *Inmi-Etti*, 492 A.2d at 919 (noting that no judicial sale was conducted, and suggesting that outcome may have been different had there been proper judicial sale).

48. *Fitzpatrick*, 480 N.Y.S.2d at 869. Although *Fitzpatrick* was legally the owner of the vehicle, the court recognized that he had no actual interest in the car because the amount owed under bank's security interest exceeded the vehicle's value. *Id.* Furthermore, the warranty of title under article 2 of the U.C.C. is breached when a good is transferred subject to a security interest about which the buyer does not know. U.C.C. § 2-312(1)(b).

49. See, e.g., *Walker Bank & Trust Co. v. Continental Kitchens*, 501 P.2d 639, 642 (Nev. 1972) (applying U.C.C. principles to third-party bank's security interest); *GMAC v. Stotsky*, 303 N.Y.S.2d 463, 467 (Sup. Ct. 1969) (holding that purchaser at sheriff's sale receives only rights and title to good that sheriff is able to convey); *Paccar Fin. Corp. v. Harnett Transfer*, 275 S.E.2d 243, 248 (N.C. Ct. App. 1981) (holding that purchaser for value at foreclosure sale conducted to satisfy mechanic's lien took subject to superior interest of secured creditor).

50. See U.C.C. § 9-507(2) (permitting challenges to procedures and commercial reasonableness of sales conducted without judicial approval, while providing that dispositions that have been approved by judicial proceeding are "conclusively deemed to be commercially reasonable"); see also *Hayes v. Sullivan*, Civ. A. 92-12020-K, 1992 WL 486914, at *3 (D. Mass. Dec. 3, 1992) ("[T]he sale is approved by the court and entitled to the deference accorded a judicially confirmed sale."); *Steichen v. First Bank Grand*, 372 N.W.2d 768, 773 (Minn. Ct. App. 1985) (stating that strict adherence to law of self-help repossession is necessary to prevent abuse and to discourage illegal conduct due to harshness of remedy); *Davis v. Wood*, 268 P.2d 371, 377 (Or. 1954) (commenting that, under pre-Code law, forfeitures of debtor's property were generally regarded with judicial hostility).

faith purchaser for value from a judgment creditor does not obtain rights in the purchased good superior to the original owner, where the underlying judgment is invalid, then a purchaser from a secured creditor who has wrongfully resorted to the self-help remedies of repossession and resale should obtain no greater rights under the Code. Similarly, if a good faith purchaser for value at a judicial sale takes subject to a superior security interest, such a purchaser at a foreclosure sale should be subordinate to the interest of the good's owner. *Inmi-Etti* and *Fitzpatrick* suggest, at the least, that a non-defaulting debtor may have a cause of action against a purchaser of repossessed collateral where the debtor was entitled to possession of the good.⁵¹

Part 5 of article 9⁵² and the Official Comments thereto⁵³ support this result. Their language demonstrates that the Code's drafters intended that default be the trigger of the secured party's rights and powers that are recognized in part 5.⁵⁴ The Code's history and the purposes of the language of section 9-504 also support this conclusion.

Subsection four of section 9-504 was drafted to insulate purchasers at foreclosure sales from the complaints of defaulted debtors over irregularities in the conduct of the sale.⁵⁵ Without some provision

51. When a debtor is not in default, the debtor is entitled to possession of the collateral unless the parties have otherwise agreed. See *Mevorah v. Goodman*, 65 N.W.2d 278, 285 (N.D. 1954) (deciding rights of conditional vendee under pre-Code law); see also U.C.C. § 9-503 ("Unless otherwise agreed a secured party has on default the right to take possession of the collateral.") (emphasis added).

52. See U.C.C. §§ 9-501 to -507 (setting forth rights and remedies of debtor and secured party after default).

53. See *id.* §§ 9-501 to -507 cmts.

54. See generally *id.* § 9-501(1), (6) cmts. (distinguishing scenario under which secured creditor is protected independent of default, implying that drafters intended that, generally, default is prerequisite to secured creditor's remedies). This conclusion is further supported by the commentators and case law. See generally *Jefferds v. Ellis*, 486 N.Y.S.2d 649, 651 (Sup. Ct. 1985) (quoting U.C.C. § 9-503 that "unless otherwise agreed, a secured party has on default the right to take possession of the collateral"); 2 GILMORE, *supra* note 4, § 44.7, at 1248 (explaining that purchaser of collateral has greater degree of protection in wrongful post-default transfers); WHITE & SUMMERS, *supra* note 12, §§ 25-1 to -5, at 1187-99 (discussing default as condition precedent to secured party's right to repossess and resell collateral); Starnes, *supra* note 4, at 564 (defining term "default" as contemplated by U.C.C.); *supra* notes 14, 23 (citing numerous cases in which creditors were held liable for conversion when property was transferred prior to debtors' default).

55. 2 GILMORE, *supra* note 4, § 44.7, at 1248; see also *Proceedings 1949*, *supra* note 20, at 71, wherein Professor Dunham discussed the purposes of the preliminary draft of U.C.C. § 9-504(4) (then § 8-604(3)), stating:

Subsection 3 [currently (4)] protects the validity of the sale as far as the purchaser at the sale is concerned, no matter how much the secured lender disregards the section. In other words, if the secured lender fails to sell as this section requires, the borrower's remedy is to look to the secured lender and not to the bona fide purchaser for value at the sale. So, in a sense, subsection (3) rejects the line of decisions that say that a

to protect them, prospective purchasers might avoid buying at foreclosure sales. Without some guarantee that defensible title will be conveyed at least when the sale is conducted in good faith in an arm's length transaction, purchasers would be purchasing an unknown quantity, at best, and a potential lawsuit, at worst. This would discourage potential buyers from participating in foreclosure sales. Additionally, even if they did buy, the price paid would reflect the uncertainties of the title they acquired.⁵⁶ By eliminating potential challenges by the debtor to the purchaser's title, the Code's drafters sought to protect defaulting debtors by maximizing the price paid at foreclosure sales and, thereby, maximizing the amount of the surplus to which the debtor is entitled, or, at least, minimizing the extent of any deficiency for which the debtor is liable.⁵⁷ The drafters also sought to embody the commercial expectations of the parties involved in foreclosure sales by limiting disputes over the conduct of sales to legal actions between the debtor and creditor.⁵⁸

Despite these goals, the Code does not grant absolute protection against all claimants. Specifically, purchasers are not protected from creditors who have interests superior to the selling secured party, even if they purchased in good faith.⁵⁹ Additionally, purchasers are

defect in the sale procedure goes to the jurisdiction and validity of the whole sale and therefore it is void and therefore there can be no purchaser for value.

Id.

56. HAWKLAND, *supra* note 4, § 9-504:11, at 839.

57. The debtor is liable for any deficiency between the amount received through disposition and the amount of the debt plus costs of repossession and resale, and is entitled to any surplus received in excess of these amounts. U.C.C. § 9-504(2). The Code's drafters sought to maximize the amount realized at sale by providing for informal sales mechanisms and permitting disposition at private sale. *Id.* § 9-504 cmt. 1 (commenting that private sales of repossessed collateral should be encouraged over public sales, because private sales often result in higher prices "to the benefit of all parties"); *Wilkerson Motor Co. v. Johnson*, 580 P.2d 505, 508-09 (Okla. 1978) (finding that clear intent of code was to permit seller flexibility in determining method of sale; recognizing that private sale will often result in higher realization of value of collateral); see Grant Gilmore, *The Secured Transactions Article of the Commercial Code*, 16 *VAL & CONTEMP. PROBS.* 27, 43 (1951) (stating that aim of default provisions of article 9 "should be to promote disposition of the collateral at the highest possible price"); see also *Hall v. Owen County State Bank*, 370 N.E.2d 918, 925 (Ind. Ct. App. 1977) (finding that "drafters recognized typical dismal results of sheriff's public sale" and opted to permit private sales through normal commercial channels).

58. See U.C.C. § 9-507 (permitting recovery by debtor for damages sustained due to secured party's failure to comply with article 9); OSCAR SPIVACK, *SECURED TRANSACTIONS (UNDER THE UNIFORM COMMERCIAL CODE)* 133 (ALI-ABA 1963) (explaining that "[U.C.C.] Article Nine's approach to foreclosure is designed to permit almost the same flexibility in the foreclosure sale and liquidation of collateral as would be the case where a businessman . . . sought to sell . . . goods in the ordinary course of business"); see also *Proceedings 1949*, *supra* note 20, at 71 (comments of Allison Dunham) (stating that "secured lender may sell in any manner with requirement that he give notice").

59. U.C.C. § 9-504(4). Section 9-504(4) provides only that the purchaser, under appropriate circumstances, takes free of the interests of the debtor, selling secured party, and of creditors with interests subordinate to the sellers. See generally Starnes, *supra* note 4, at 564-66

subject to the claims of the debtor or junior creditors when they know about the defects in the conduct of the sale, or act in collusion with the secured party, other buyers, or the party conducting the sale or generally do not act in good faith.⁶⁰ These limitations on purchasers' rights at foreclosure sales demonstrate that the Code rejects absolute protection for all purchasers and, in some cases, protection even for those who act in good faith.

One of the uniform laws regulating secured lending prior to the introduction and adoption of the Uniform Commercial Code, the Uniform Trust Receipts Act (UTRA),⁶¹ had a much simpler and broader approach to the protection of purchasers from secured lenders. The UTRA included a provision designed to accomplish essentially the same purposes as section 9-504(4). Section 6(3)(c) of the UTRA provided that a good faith purchaser for value from an entruster in possession under the Act, the creditor, took free of the trustee's, debtor/owner's, interest, even if the sale would constitute conversion of the property.⁶² Under this provision, the good faith purchaser from a secured creditor was protected against claims of the debtor even when the sale was completely unauthorized by the debtor or the law.

Although the drafters of the Code presumably had knowledge of this provision, they chose the more limited language of section 9-504(4).⁶³ Because of the limitations included in section 9-504(4),⁶⁴

(explaining and distinguishing parties' relative rights).

60. U.C.C. § 9-504(4)(a)-(b); see also *Pippin Way, Inc. v. Four Star Music Co.*, 2 B.R. 454, 464 (Bankr. M.D. Tenn. 1979) (explaining that, where terms of foreclosure sale were so highly unusual and beneficial to merchant buyer as to put buyer on notice that sale was not commercially reasonable, buyer was not good faith purchaser for value and thus did not take free of debtor's interest in collateral).

61. 3A U.L.A. 577 (1981). The UTRA was originally proposed in 1933. Article 9 of the U.C.C. "supersedes prior legislation dealing with such security devices as chattel mortgages, conditional sales, trust receipts, factor's liens and assignments of accounts receivables," including the UTRA. U.C.C. § 9-101 cmt.; see also *id.* § 9-102(2); Robert M. Lloyd, *The Absolute Bar Rule in U.C.C. Foreclosure Sales: A Prescription for Waste*, 40 U.C.L.A. L. REV. 695, 722 n.148 (1993) (explaining that U.C.C. § 9-504(4) was derived from UTRA).

62. UTRA § 6(3)(c) provided:

A purchaser in good faith and for value from an entruster in possession takes free of the trustee's interest, even in a case which the entruster is liable to the trustee in conversion.

3A U.L.A. at 582.

63. See 2 GILMORE, *supra* note 4, § 44.7, at 1247-48 (commenting that U.C.C. article 9 drafters "followed [UTRA's] sensible provision but were, unfortunately, persuaded to spoil its admirable simplicity by introducing unnecessary complications"). Interestingly, Professor Karl Llewellyn, the Chief Reporter of the Code, was also involved in the drafting of the UTRA. See *Proceedings 1949*, *supra* note 20, at 65 (comments of Prof. Llewellyn) (discussing cross references adopted from UTRA and applied to secured transactions portion of U.C.C.).

64. See 2 GILMORE, *supra* note 4, § 44.7, at 1248 (explaining that article 9 "does not go as far as the UTRA [because] UTRA validated any sale by an entruster in possession [while] U.C.C.

the Code does not go as far to protect purchasers at foreclosure sales as the UTRA had gone.⁶⁵ Professor Gilmore, in his seminal treatise on article 9,⁶⁶ concluded that the Code drafters by using the more limited language of section 9-504(4), excluded from the section's protection pre-default purchasers of collateral from secured creditors.⁶⁷ It is not clear, however, whether this distinction was intended, although it is the implication of the chosen language.⁶⁸

Although the purchaser does not appear to be protected by the general shelter rule of section 9-504(4) in this context,⁶⁹ some protection may still be provided by the final sentence of the subsection.⁷⁰ In addition to sheltering the purchaser at the foreclosure sale from the debtor's claims where the debtor is in default, section 9-504(4) further provides that generally the good faith purchaser takes free of the rights of the debtor and the selling and subordinate secured parties, even if the seller has failed to comply with the requirements of article 9, part 5.⁷¹ Arguably, this provision applies where a secured party repossesses and disposes of collateral without the debtor being in default, because the secured party would clearly

section 9-504(4) covers only disposition by a secured party after default").

65. 2 GILMORE, *supra* note 4, § 44.7, at 1248. Professor Gilmore lamented that the Code drafters (himself included) did not choose the broad and simple route of the UTRA, and introduced unnecessary complications into U.C.C. § 9-504(4). *Id.* at 1247-48.

66. 2 GILMORE, *supra* note 4, § 43.1.

67. See 2 GILMORE, *supra* note 4, § 44.7, at 1248 (stating necessity, "under Article 9, [of] distinguish[ing] between wrongful pre-default and wrongful post default transfers").

68. See generally *Proceedings 1949*, *supra* note 20, at 64-71 (discussing language and scope of shelter provision ultimately adopted as UCC § 9-504(4)). During the early deliberations over what was enacted as U.C.C. § 9-504(4), nothing was said about what effect, if any, a wrongful declaration of default would have on the rights of the purchaser. *Id.* An early draft of the Official Comment to U.C.C. § 9-504, however, seems to indicate that the drafters intended to achieve, through U.C.C. § 9-504(4), the same result in protecting purchasers as that reached under the UTRA. UNIFORM COMMERCIAL CODE (Draft of Article IX Comments 1950), § 9-504 cmt. 2. The draft of the comment provided:

2. Subsection (3) provides that a purchaser from a lender in possession takes free of any rights of the debtor even though the lender has not complied with the statutory requirements of sale. This Subsection follows a similar provision in the Uniform Trust Receipts Act and in the section on resale by a seller (Section 2-706).

Id. The reference in this draft to the seller's breach of the requirements of sale, as well as the comment ultimately adopted, still indicate that the drafters intended the protection of the purchaser to extend only to instances where there were defects in the sale. See U.C.C. § 9-504 cmt. What protection, if any, a purchaser would receive when the debtor was not in default was left unanswered.

69. U.C.C. § 9-504(4) (stating that purchaser "takes free of all . . . rights even though secured party fails to comply with requirements of this part").

70. *Id.* § 9-504(4)(b) (stating that "in any other case if the purchaser acts in good faith," he takes free of rights of debtor and junior secured creditors).

71. *Id.* § 9-504(4) (stating specifically that "[t]he purchaser takes free of all [the debtor's] rights and interests even though the secured party fails to comply with the requirements of this Part or of any judicial proceedings" if they act in good faith in private sale or do not know of secured party's failure to comply and did not collude in public sale).

have failed to comply with the Code. The Official Comments make clear, however, that the purchaser's rights arise only when the secured party sells after default.⁷² Additionally, this provision appears to permit a good faith purchaser to avail himself of the sheltering provision of section 9-504(4), even though the secured party violated the standards for repossession⁷³ or resale.⁷⁴ Because the initial rights granted in the shelter provision are predicated upon the debtor's default, its protection apparently does not extend to cover sales in the absence of a default.⁷⁵ Accordingly, because the debtor in the hypothetical was not in default, our purchaser is not protected under section 9-504(4).

B. *Other Law Governing the Purchaser's Rights*

As just established, the right of the secured party to sell to a purchaser for value, and the accompanying power to transfer the debtor's rights, require the debtor's default. In the absence of default, the secured party should have no such right or power.⁷⁶ There is no clear indication, however, that the drafters considered what effect the absence of default would have on a dispute between the subsequent purchaser and the original debtor. Professor Gilmore recognized that section 9-504(4) protected purchasers of repossessed collateral only where the sale was conducted after default.⁷⁷ He further acknowledged that article 9 was silent on what protection, if any, good faith purchasers at foreclosure sales would receive if the selling secured party wrongfully declared a default under the security agreement.⁷⁸ Thus, a purchaser must look to other applicable laws for protection.⁷⁹

72. Official Comment 4 to § 9-504 states:

Subsection (4) provides that a purchaser for value from a secured party *after default* takes free of any rights of the debtor and of the holders of junior security interests and liens, even though the secured party has not complied with the requirements of this Part or of any judicial proceedings.

Id. § 9-504 cmt. 4 (emphasis added).

73. *See id.* § 9-503 (describing conditions under which "self-help" is acceptable, and when secured creditor must instead resort to judicial proceeding). If, for example, a self-help repossession cannot be accomplished without a breach of the peace, the secured creditor must resort to judicial proceedings. *Id.*

74. *See id.* § 9-504(3) (requiring that debtor receive notice of disposition of collateral, and that all aspects of disposition be conducted in commercially reasonable manner).

75. *See* 2 GILMORE, *supra* note 4, § 44.7, at 1248 (distinguishing pre-default transfers from post-default transfers, and differing rights of purchasers attaching thereto).

76. *See* 2 GILMORE, *supra* note 4, §§ 42.14, 44.7, at 1176, 1246 (explaining that secured party has wrongfully transferred to third party if transfer takes place before debtor's default).

77. 2 GILMORE, *supra* note 4, § 44.7, at 1248.

78. 2 GILMORE, *supra* note 4, § 42.14, at 1180.

79. 2 GILMORE, *supra* note 4, § 42.14, at 1180.

Having failed to qualify as a protected purchaser under section 9-504(4), our buyer may look to article 2 of the Code to determine what rights he received through the sale.⁸⁰ Section 2-403(1) provides generally that a purchaser acquires through a sale whatever rights or title the seller had.⁸¹ If the selling secured party had good title, the purchaser, in turn, received good title. Conversely, if the secured party has less than good title, the purchaser generally receives that lesser interest. Where, however, the selling secured party wrongfully repossessed and sold the collateral, as in our hypothetical, the secured party would not have acquired good title to the collateral, and could not transfer good title to the good faith purchaser under this provision.⁸²

Section 2-403 further provides, however, that a good faith purchaser for value obtains good title in a transfer from a seller with "voidable title" acquired through a "transaction of purchase."⁸³ If the selling creditor obtained at least "voidable title" through a purchase transaction, our purchaser, having acted in good faith and given value, would receive good title through the foreclosure sale and, thus, could successfully defend an action brought by the debtor to reclaim the good.

Under section 2-403, to have the power to transfer good title to a good faith purchaser for value, the transferor must (1) obtain voidable title (2) through a "transaction of purchase."⁸⁴ A possessor

80. U.C.C. § 9-504(1) provides that the sales aspect of the secured creditor's disposition of the collateral, if it is a good, is governed by article 2. U.C.C. § 9-504(1).

81. Section 2-403(1) provides:

A purchaser of goods acquires all title which his transferor had or had power to transfer except that a purchaser of a limited interest acquires rights only to the extent of the interest purchased. A person with voidable title has power to transfer good title to a good faith purchaser for value. When goods have been delivered under a transaction of purchase the purchaser has such power even though

- (a) the transferor was deceived as to the identity of the purchaser, or
- (b) the delivery was in exchange for a check which was later dishonored, or
- (c) it was agreed that the transaction was to be a "cash sale," or
- (d) the delivery was procured through fraud punishable as larcenous under the criminal law.

Id. § 2-403(1); *see also id.* § 2-403 cmt. 1 (stating that basic policy of law allowing transfer of such title as transferor has is generally continued and expanded in subsection (1)); *United Road Mach. Co. v. Jasper*, 568 S.W.2d 242, 245 (Ky. Ct. App. 1978) (holding that because subsequent purchaser purchased in good faith from original purchaser, seller was estopped from asserting that subsequent purchaser had no title to goods); PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE COMMENTARY NO. 6, *reprinted in* 3B U.L.A. 623-25 (1992) (discussing "shelter principle" and its use to protect right to transfer).

82. *See infra* notes 99-102 and accompanying text (discussing relationship between title of transferor and transferee of good).

83. U.C.C. § 2-403(1).

84. *See American Standard Credit v. National Cement Co.*, 643 F.2d 248, 268 (5th Cir. 1981) (explaining that under good faith purchaser for value rule of U.C.C., "sale to good-faith

who has only void title to a good has absolutely no power to transfer any rights in the good, even to a good faith purchaser.⁸⁵ One who has obtained voidable title to a good has the power under limited circumstances, although not the right, to transfer better title to a good faith purchaser for value.⁸⁶ For this reason, the distinction between void title and voidable title obtained through a transaction of purchase becomes critical.

The term "void" has been defined as applying to an event that is absolutely "ineffective, inoperative, and incapable of ratification and which thus has no force or effect so that nothing can cure it"⁸⁷: a person who obtains possession of the property without the consent of the rightful owner has void title;⁸⁸ a thief obtains void title;⁸⁹ one who converts property acquires merely void title;⁹⁰ generally, one

purchaser for value cures the defects in seller's 'voidable' title; it cannot, however, cure 'void' title"); *Iola State Bank v. Bolan*, 679 P.2d 720, 726 (Kan. 1984) (holding that financing bank was not good faith "purchaser" when obtaining voidable title through its debtor's sale of goods to third party because "no reasonable man could find that the bank could deny that it had knowledge of the nature of . . . the title"); *Foley v. Product Credit Ass'n*, 753 S.W.2d 876, 879 (Ky. Ct. App. 1988) (holding that "principle of voidable title" protects creditor against charge of conversion").

85. See *Brown & Root, Inc. v. Ring Power Corp.*, 450 So. 2d 1245, 1249 (Fla. Dist. Ct. App. 1984) (applying Florida law, which does not allow thief to transfer title to good faith purchaser); *Inmi-Etti v. Aluisi*, 492 A.2d 917, 920 (Md. Ct. App. 1984) ("He who hath not cannot give . . ."); see also Grant Gilmore, *The Commercial Doctrine of Good Faith Purchase*, 63 YALE L.J. 1057, 1060 (1954) (discussing "cash sale theory," under which seller's power to transfer title ends in presence of fraud); Daphne D. Sipes, *Effects of Conversion and Trade Custom on Article 2 Titles*, 11 AM. J. TRIAL ADVOC. 277, 278-81 (1987) (explaining that shelter theory does not apply to void title).

86. U.C.C. § 2-403(1); see also *First Nat'l Bank v. Carbajal*, 645 P.2d 778, 781 (Ariz. 1982) (holding that defaulting buyer in cash sale has voidable title and has limited power to transfer title to good faith purchaser); *Flemming v. Thompson*, 343 A.2d 599, 600 (Del. 1975) (quoting Delaware Code: "A purchaser of goods acquires all title which his transferor had or had power to transfer [and a] person with voidable title has power to transfer a value."); Mautner, *supra* note 8, at 98 (commenting that converter who has obtained voidable title may pass good title to third party acting in good faith); William L. Tabac, *The Unbearable Lightness of Title Under the UCC*, 50 MD. L. REV. 408, 422 (1991) (explaining that person with voidable title may have power to transfer good title to good faith purchaser for value because courts must "look beyond the rights conferred by the contract of sale to perceptions of third party purchasers").

87. BLACK'S LAW DICTIONARY 1086 (6th ed. 1990).

88. See *In re Hennessy*, 494 A.2d 853, 856 (Pa. Super. Ct. 1985) (stating that voidable title requires assent of original owner; otherwise, title is void).

89. See *Brown & Root*, 450 So. 2d at 1249 (holding that one in possession of stolen property has no possessory or ownership right); *Carlsen v. Rivera*, 382 So. 2d 825, 826 (Fla. Ct. Dist. App. 1980) (stating that possessor of stolen items cannot convey good title or voidable title); *Touch of Class Leasing v. Mercedes-Benz Credit of Can.*, 591 A.2d 661, 667 (N.J. Super. Ct. App. Div. 1991) (stating that thieves acquire no title to stolen goods) (citing *O'Keeffe v. Snyder*, 416 A.2d 862, 867 (N.J. Sup. Ct. 1980)); *Marvin v. Connelly*, 252 S.E.2d 562, 563 (S.C. 1979) (explaining that absent assent of rightful owner, seller of stolen property conveys no title). A thief may, however, transfer good title to money and negotiable instruments. RESTATEMENT (SECOND) OF TORTS, *supra* note 22, § 229 cmt. d; accord U.C.C. §§ 3-302, -305.

90. See *Mattson v. Commercial Credit Business Loans*, 723 P.2d 996, 999 (Or. 1986) (stating that converters have no rights in collateral of security interests).

who has possession, but no claim to title or authority to transfer the good, has void title.⁹¹

"Voidable" describes an act that "may be avoided rather than an invalid act which may be ratified."⁹² Voidable title is acquired when the property is voluntarily delivered to another by the rightful owner, typically with the understanding that some condition will be met.⁹³ A transfer of voidable title requires the initial intent of the true owner to part with the goods, although the owner may be misled or fraudulently induced to do so:⁹⁴ one who buys a good with a check that is later dishonored acquires voidable title;⁹⁵ one who receives a good with the understanding that he will pay for it promptly in cash, but fails to do so, obtains voidable title;⁹⁶ one who receives a good under false pretenses acquires voidable title.⁹⁷ Simply put, voidable title can be cured; void title cannot.⁹⁸

91. See *Touch of Class Leasing*, 591 A.2d at 667 (reiterating that parties merely converting goods to own use after attaining possession through some manner other than transaction of purchase do not possess even voidable title); *O'Keefe*, 416 A.2d at 867 (explaining that generally thieves acquire no title); see also *Courtright Cattle Co. v. Dolsen Co.*, 604 P.2d 522, 526 (Wash. Ct. App. 1979) (holding that mere possession gives no authority to transfer title).

92. BLACK'S LAW DICTIONARY, *supra* note 87, at 1087.

93. See HAWKLAND, *supra* note 4, § 2-403:05, at 871-72; RAUSHENBUSH, *supra* note 14, § 9.6, at 199; see also *American Standard Credit v. National Cement Co.*, 643 F.2d 248, 268 (5th Cir. 1981) (explaining that in order for purchaser to obtain voidable title, owner must deliver goods with intent that purchaser become owner); *Atlas Auto Rental Corp. v. Weisberg*, 281 N.Y.S.2d 400, 403 (Civ. Ct. 1967) (stating that possession is not enough to create voidable title, as transfer must be authorized by owner); *Marvin*, 252 S.E.2d at 563 (stating that concept of voidable title depends on original owner's assent to transfer); Richard L. Barnes, *Toward a Normative Framework for the Uniform Commercial Code*, 62 TEMP. L. REV. 117, 132 (1989) (stating that one principle of voidable title is that true owner could not lose title through theft).

94. HAWKLAND, *supra* note 4, § 2-403:05, at 874 (noting that no title passed to purchaser unless seller "voluntarily hand[s] over the goods"); *Sipes*, *supra* note 85, at 277-81 (explaining that transferee receives voidable title if original owner initially intended to part with her interest in good).

95. U.C.C. § 2-403(1)(b); see also *In re Samuels & Co.*, 526 F.2d 1238, 1243 (5th Cir.) (describing how buyers with subsequently dishonored checks attain voidable title transferable to good faith purchasers), *cert. denied*, 429 U.S. 834 (1976).

96. U.C.C. § 2-403(1)(c); see *Collingwood Grain v. Coast Trading Co.*, 744 F.2d 686, 690 (9th Cir. 1984) (explaining that initial buyer with voidable title has power to transfer good title to good faith purchaser for value even though initial buyer fails to make required cash payments); *Shacket v. Roger Smith Aircraft Sales*, 497 F. Supp. 1262, 1267 (N.D. Ill. 1980) (reiterating that under U.C.C., purchaser acquires voidable title and power to transfer good title even though purchaser has failed to pay for goods under "cash sale"); *First Nat'l Bank v. Carbajal*, 645 P.2d 778, 781 (Ariz. 1982) (stating that purchaser who fails to pay seller obtains voidable title even though transaction is "cash sale"); see also *House of Stainless v. Marshall & Ilsley Bank*, 249 N.W.2d 561, 564 (Wis. 1977) (finding that buyer who obtains goods on credit with understanding that seller will be promptly paid obtains voidable title).

97. A purchaser obtains voidable title where his "transferor was deceived as to the identity of the purchaser . . . or delivery of the good was procured through fraud," even if the fraud constitutes a crime. U.C.C. § 2-403(1)(a), (d).

98. See HAWKLAND, *supra* note 4, § 2-403:01, at 865 (explaining that "one having a 'voidable title,' as distinguished from a 'void title,' had the power to pass a perfect title to a bona fide purchaser").

Under section 2-403, the rights of the purchaser of wrongfully repossessed collateral depend on the selling creditor's rights.⁹⁹ For the purchaser to prevail under section 2-403, the secured creditor must have obtained at least voidable title through the repossession.

As has been previously discussed, the Code does not give the secured party the right to repossess when the debtor is not in default. This is so because a secured creditor does not, merely by virtue of having a security interest, obtain title to the good.¹⁰⁰ By virtue of the security interest, the creditor obtains only a conditional property interest¹⁰¹ and obtains no higher right to the good than the Code grants.¹⁰² Under the U.C.C., the creditor has no right to possess and sell the collateral when the debtor is not in default.¹⁰³ On the other hand, the Code does not define the status of a secured creditor who has wrongfully repossessed and sold the collateral.¹⁰⁴ In an effort to resolve uncertain situations caused by the Code's silence, section 1-103 provides that common law principles supplement the Code where the Code has not displaced the common law.¹⁰⁵ Because the Code is silent on this issue, the common law must be considered to determine the effect of the wrongful repossession, and the nature of the secured creditor's resulting interest.¹⁰⁶

99. Currently, under the U.C.C., a transferee's rights are governed by the rights of his transferor. *Id.* §§ 2-403, 9-504(4). For a thought-provoking challenge and proposed alternative to this derivational approach, see generally Mautner, *supra* note 8 (proposing that conduct and relative equities govern disputes over property between two innocent parties rather than rights each has given to or derived from wrongdoer).

100. Tabac, *supra* note 86, at 441; see *Cheyenne Mountain Bank v. Whetstone Corp.*, 787 P.2d 210, 212 (Colo. Ct. App. 1990) (stating that at attachment of security interest, secured creditor holds only lien on collateral, and, upon debtor's default, creditor holds inchoate possessory interest).

101. See *Cheyenne Mountain Bank*, 787 P.2d at 212 (stating that after debtor defaults, secured creditor holds inchoate possessory interest in disposition of property); see also U.C.C. § 1-201(37) (stating that security interest "secures payment or performance of an obligation"); *Trimble v. Sonitrol of Memphis*, 723 S.W.2d 633, 638 (Tenn. Ct. App. 1986) (explaining that secured creditor acquired only special property interest in debtor's collateral, giving creditor right to sell collateral upon default in payment of debt). See generally 1 GILMORE, *supra* note 4, §§ 11.1 to 11.2, at 333-40 (defining nature of security interests).

102. *Spickler v. Lombardo*, 25 U.C.C. Rep. Serv. (Callaghan) 1500, 1508 (Pa. Ct. Com. Pl. 1978) (stating that parties to secured transaction only have rights given to them by Code).

103. See U.C.C. §§ 9-501, -503, -504(1); *Production Credit Ass'n v. Equity Coop Livestock Sales Ass'n*, 261 N.W.2d 127, 131 (Wis. 1978).

104. See U.C.C. § 9-501 & cmts.

105. *Id.* § 1-103 (providing that, unless displaced, "the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake and bankruptcy, or other validating or invalidating cause shall supplement its provisions"); see also *Maryland Nat'l Bank v. Wathen*, 414 A.2d 1261, 1264-65 (Md. 1980) (relying on U.C.C. § 1-103 to hold that debtor's remedy under U.C.C. § 9-507(1) does not exclude common law remedy).

106. See *WHITE & SUMMERS*, *supra* note 12, §§ 25-16 to -17, at 1238, 1240-42 (discussing use of common law tort liability to remedy wrongful repossession by awarding conversion damages based on fair market value of collateral at time of conversion); see also *Mercedes-Benz Credit*

The general rule is that a secured party who repossesses collateral when the debtor is not in default is liable for conversion.¹⁰⁷ A cause of action for conversion arises where a party intentionally exercises dominion or control over the good of another so as to seriously interfere with the owner's rights.¹⁰⁸ Conversion can be committed by dispossessing the true owner of the good¹⁰⁹ or by disposing of the good without the authority or consent of the owner.¹¹⁰ A secured party converts collateral through interference with a debtor's immediate and unconditional right to the good.¹¹¹ When the secured party is not entitled to possession, as where the debtor is not

Corp. v. Morgan, 850 S.W.2d 297, 298 (Ark. 1993) (explaining that secured creditor is liable for conversion if debtor was not in default when chattel repossessed); *Mitchell v. Ford Motor Credit Co.*, 688 P.2d 42, 45 (Okla. 1984) (holding that creditor who repossessed when debtor was not in default was liable for conversion).

107. See *Chemical Sales Co. v. Diamond Chem. Co.*, 766 F.2d 364, 368 (8th Cir. 1985) (holding that improper sale of collateral after repossession may constitute conversion where creditor's actions seriously interfere with debtor's ownership rights); *In re Buttram*, 2 B.R. 92, 96 (Bankr. N.D. Okla. 1979) (finding that secured creditor who repossessed collateral after filing of bankruptcy petition in violation of automatic stay was guilty of conversion); *Pleasant v. Warrick*, 590 So. 2d 214, 217 (Ala. 1991) (finding no conversion because plaintiff was in default); *Friendly Credit Union v. Campbell*, 579 So. 2d 1288, 1290-91 (Ala. 1991) (holding that repossession of collateral by secured creditor is conversion where debtor is not in default); *Day v. Schenectady Discount Corp.*, 611 P.2d 568, 572 (Ariz. Ct. App. 1980) (recognizing that improper sale of repossessed collateral by secured creditor may constitute conversion); *Lincoln v. Grinstead*, 379 S.E.2d 671, 673 (N.C. Ct. App. 1989) (holding that wrongful disposition of repossessed collateral by party with security interest constitutes conversion); *Mitchell*, 688 P.2d at 44 (finding conversion where goods were repossessed when plaintiff was not in default); *Johns v. Park*, 773 P.2d 1328, 1331-32 (Or. Ct. App. 1989) (stating that creditor committed conversion where security interest did not attach to debtor's property due to inadequate description in security agreement); *ITT Commercial Finance Co. v. Riehn*, 796 S.W.2d 248, 251 (Tex. Ct. App. 1990) (holding that secured creditor converts collateral when it deals with collateral in unlawful manner). This is consistent with the Code's treatment of purchases from debtors when the sale is in violation of a creditor's security interest. See, e.g., *American Furniture Co. v. Extebank*, 676 F. Supp. 455, 458 (E.D.N.Y. 1987) (holding that buyer with whom debtor does not regularly conduct business is liable for conversion, if sale to buyer interferes with security interest); *Ranier v. Gifford*, 688 S.W.2d 753, 755-56 (Ky. Ct. App. 1985) (holding transferee of original debtor liable to secured creditor for conversion); *First Pa. Banking & Trust Co. v. Liberati*, 422 A.2d 1074, 1077-78 (Pa. Super. Ct. 1980) (finding that purchaser who buys collateral subject to perfected security interest is liable to secured creditor for conversion); see also Steve H. Nickles, *Enforcing Article 9 Security Interests Against Subordinate Buyers of Collateral*, 50 GEO. WASH. L. REV. 511, 520-36 (1982) (examining and explaining basis of buyers' liability to secured party for conversion of collateral).

108. RESTATEMENT (SECOND) OF TORTS, *supra* note 22, § 222A; see *Farmers State Bank v. Haflich*, 699 P.2d 553, 558 (Kan. Ct. App. 1985) (stating that conversion is unauthorized exercise of right over goods of another); *Frost v. Eggeman*, 638 P.2d 141, 144 (Wyo. 1981) (explaining that conversion occurs when people treat property belonging to others as their own, thus denying true owner enjoyment of ownership rights).

109. RESTATEMENT (SECOND) OF TORTS, *supra* note 22, § 223(a).

110. *Id.* § 223(e).

111. See *Andrews v. Mid-America Bank & Trust Co.*, 503 N.E.2d 1120, 1122 (Ill. App. Ct. 1987) (holding that creditor did not convert good because buyer did not have unconditional and absolute right to immediate possession of good).

in default,¹¹² and unjustifiably repossesses the collateral, the secured party is liable for conversion.¹¹³

A person who converts a good receives no rights to it, including the power to transfer it; that is, the converter obtains void title.¹¹⁴ In *Mattson v. Commercial Credit Business Loans*,¹¹⁵ the Oregon Supreme Court addressed the rights of a purchaser from a converter,¹¹⁶ and the application of section 2-403's shelter provision in that context.¹¹⁷ In *Mattson*, the plaintiff had contracted for West Coast Lumber (not a party to the action) to cut lumber from the plaintiff's land and resell it with the plaintiff's approval.¹¹⁸ During the course of the contract, West Coast entered the plaintiff's land and cut 285,000 board feet of lumber without the plaintiff's knowledge or permission,¹¹⁹ thereby converting the lumber.¹²⁰ Plaintiff initially sued West Coast, seeking money damages for the conversion.¹²¹ During the course of that litigation, Commercial Credit Business Loans extended West Coast a line of credit secured by West Coast's inventory, including the converted lumber.¹²² Under the Code, Commercial Credit was therefore a purchaser of the lumber.¹²³ When West Coast filed for bankruptcy after losing the initial litigation, Mattson sued Commercial Credit to reclaim any proceeds from the sale of the lumber.¹²⁴

112. See *supra* note 13 and accompanying text (stating that U.C.C. §§ 9-501 and 9-503 condition right to repossess collateral upon debtor's default).

113. See *Farmers State Bank*, 699 P.2d at 558-59 (holding that unjustifiable taking of collateral constituted conversion); *Production Credit Ass'n v. Equity Coop Livestock Sales Ass'n*, 261 N.W.2d 127, 132 (Wis. 1978) (explaining that conversion occurs on creditor's wrongful repossession when buyer has possession of good or is entitled to immediate possession).

114. See *supra* text accompanying note 91.

115. 723 P.2d 996 (Or. 1986).

116. *Mattson v. Commercial Credit Business Loans*, 723 P.2d 996, 998-1002 (Or. 1986).

117. *Id.* at 999.

118. *Id.* at 997.

119. *Id.*

120. *Id.*

121. *Id.*

122. *Id.*

123. See U.C.C. § 1-201(32) (defining "purchase" as including "taking by sale, discount, negotiation, mortgage, pledge, lien, issue or re-issue, gift or any other transaction creating an interest in property"). Section 1-201(32) defines "purchase" broadly to include taking property by "mortgage, pledge, lien, . . . or any other voluntary transaction creating an interest in property." *Id.* A "purchaser" is defined by U.C.C. § 1-201(33). Granting a security interest constitutes a purchase for purposes of the Code, and the secured creditor is therefore considered a purchaser. See *In re Samuels & Co.*, 526 F.2d 1238, 1243 (5th Cir.) (holding that secured creditors are included in Code definition of purchasers), *cert. denied*, 429 U.S. 834 (1976).

124. *Mattson*, 723 P.2d at 998.

The Oregon Supreme Court held that West Coast acquired no title or interest in the lumber by virtue of the conversion.¹²⁵ As a purchaser from one with void title, Commercial Credit therefore received only void title through the transaction and was not protected by section 2-403(1).¹²⁶ Additionally, the court found that West Coast acquired no rights to which Commercial Credit's security interest in the lumber could attach.¹²⁷ Because Commercial Credit received no valid interest in the lumber, Mattson could trace both the lumber and the identifiable proceeds from its sale in Commercial Credit's possession.¹²⁸

Other courts are generally in accord with the *Mattson* holding that a transferee from a converter does not obtain good title.¹²⁹ Both at common law and under section 2-403, one who has converted a good does not have the power to transfer good title, even to a good faith purchaser for value. The purchaser from the converter receives void title, and thus loses to the property's rightful owner in a title contest.¹³⁰

Furthermore, voidable title for section 2-403 purposes must be acquired under a "transaction of purchase."¹³¹ The Code defines the term "purchase" broadly to encompass "any voluntary transaction creating an interest in property."¹³² Conversely, transfers of interests that are not voluntary, and are consummated without the owner's consent, are not purchases.¹³³ The broad definition of purchase

125. *Id.* at 999.

126. *Id.*

127. *Id.* U.C.C. § 9-203(1)(c) requires that the debtor have rights in the collateral before a security interest may attach to it. U.C.C. § 9-203(1)(c).

128. *Mattson*, 723 P.2d at 1000.

129. See, e.g., *Swift & Co. v. Jamestown Nat'l Bank*, 426 F.2d 1099, 1104 (8th Cir. 1970) (holding that converter had no title to convey to good faith purchaser for value); *Inmi-Etti v. Aluisi*, 492 A.2d 917, 923 (Md. Ct. Spec. App. 1985) (finding that buyer of converted property did not obtain good title); *Bay Spring Forest Prods. v. Wade*, 435 So. 2d 690, 694 (Miss. 1983) (holding converter of chattel transfers no title to purchaser); *O'Keeffe v. Snyder*, 416 A.2d 862, 867 (N.J. 1980) (stating that thieves acquire no title and could not transfer title to others).

130. *Swift & Co.*, 426 F.2d at 1104 (stating that rightful owner of goods retains title to goods after sale by converter and may follow goods into hands of good faith purchaser for value); see also *Peper v. American Exch. Nat'l Bank*, 205 S.W.2d 215, 217 (Mo. Ct. App. 1947) (reiterating that owner can reclaim property from innocent purchaser where owner was divested of property without consent); *Hertz Corp. v. Hardy*, 178 A.2d 833, 839 (Pa. Super. Ct. 1962) (holding that true owner of good can replevy it from good faith purchaser for value who received void title through thief).

131. U.C.C. § 2-403(1); see also *American Standard Credit v. National Cement Co.*, 643 F.2d 248, 268 (5th Cir. 1981); HAWKLAND, *supra* note 4, § 2-403:05, at 874 (explaining that only voluntary transaction, which constitutes purchase under U.C.C., can create voidable title).

132. U.C.C. § 1-201(32).

133. An example of an involuntarily created interest is a lien creditor's interest acquired through judicial process, which is not a purchase. *Id.* § 9-301(3) (defining lien creditor); see also *Citizens Bank v. Taggart*, 191 Cal. Rptr. 729, 734 (Ct. App. 1983) (finding no policy reason to

includes the initial granting of a security interest,¹³⁴ which is, by definition, a voluntary transfer of an interest in the debtor's property.¹³⁵ Repossession and disposition of the collateral in the absence of the debtor's default, however, is not made with the debtor's consent, and thus is involuntary.¹³⁶ The creditor's interest created through the wrongful repossession, bare possession, is thus not created voluntarily and should not qualify as a purchase transaction.¹³⁷

The secured party who repossesses in the absence of a default has converted the collateral. Therefore, the creditor, through the repossession, does not acquire "voidable title" through a "transaction of purchase," but merely acquires void title. The purchaser of the repossessed collateral, thus, cannot avail itself of the shelter provision of section 2-403(1). Through the sale, the purchaser only receives the

grant lien-creditor good faith purchaser status); *National Shawmut Bank v. Vera*, 223 N.E.2d 515, 517 (Mass. 1967) (finding that lien creditor was not purchaser because status was not voluntary); Steven L. Harris, *The Interaction of Articles 6 and 9 of the Uniform Commercial Code: A Study in Conveyancing, Priorities, and Code Interpretation*, 39 VAND. L. REV. 179, 238-39 (1986) (stating that lien creditor is not purchaser because lien was not acquired through voluntary transaction); Charles W. Mooney, Jr., *The Mystery and Myth of "Ostensible Ownership" and Article 9 Filing: A Critique of Proposals to Extend Filing Requirements to Leases*, 39 ALA. L. REV. 683, 721 (1988) (noting that lien creditors are treated differently under Code than purchasers). But see Dan S. Schechter, *Judicial Lien Creditors Versus Prior Unrecorded Transferees of Real Property: Rethinking the Goals of the Recording System and Their Consequences*, 62 S. CAL. L. REV. 105, 160-61 (1988) (arguing that differences between judicial lien creditors and purchasers are not important enough to justify differential treatment). Other "non-purchasers" include a trustee in bankruptcy and an assignee for the benefit of creditors. U.C.C. § 9-301(3); see also *Bassett Furniture Indus. v. Wear*, 583 F.2d 992 (8th Cir. 1978) (holding that, like lien creditor, trustee is not purchaser); *C Tek Software v. New York State Business Venture Partnership*, 117 B.R. 762, 768 (Bankr. D.N.H. 1990) (stating that, under Code, bankruptcy trustee only has rights of lien creditor and therefore is not purchaser).

134. U.C.C. §§ 9-103 cmt. 7, 1-201(32) (stating that purchase includes voluntary "taking by mortgage, pledge, lien"); see also *In re Samuels & Co.*, 526 F.2d 1238, 1242 (5th Cir.) (stating that Code definition of purchaser includes persons taking interest by voluntary mortgage, pledge, or lien), *cert. denied*, 429 U.S. 834 (1976).

135. See U.C.C. §§ 9-102(1)(a) (limiting application of article 9 to transactions *intended* to create security interests), 9-203(1)(a) (requiring agreement between parties for creation of enforceable security interest).

136. See *Cheyenne Mountain Bank v. Whitestone Corp.*, 787 P.2d 210, 212 (Colo. Ct. App. 1990) (stating that secured party's inchoate possessory interest in collateral arises upon debtor's default).

137. In a standard security agreement, while the debtor generally agrees to permit the secured creditor to repossess the collateral when the debtor is in default, this consent does not extend to situations where the debtor has fully complied with the agreement's terms and therefore is not in default. See U.C.C. § 9-503 (permitting secured creditor and debtor to agree to debtor's cooperation in assisting creditor's repossession); see also 4 THOMAS D. CRANDALL ET. AL., *UNIFORM COMMERCIAL CODE* § 27.4 (1993) (proposing that security agreements include standard provisions in which debtor agrees to repossession on default); AM. JUR. LEGAL FORMS §§ 253:4661-63, 253:4687 (1993) (stating rights of secured creditors to repossess collateral in event of debtor's default).

same title as his transferor had, void title.¹³⁸ The rightful owner of the property can accordingly trace it into the hands of the purchaser.¹³⁹ Neither the common law nor the Code as currently drafted protects the purchaser at a foreclosure sale from claims of the debtor if the debtor was not in default at the time of the sale.¹⁴⁰

III. DEBTOR'S REMEDIES AGAINST PURCHASER

At common law, the owner of converted goods can sue in trover for money damages¹⁴¹ or in replevin for possession of the goods.¹⁴² These actions are available not only against the wrongdoer, but also against subsequent innocent purchasers.¹⁴³ Because our hypothetical purchaser obtained no title to the property from the sale, the

138. U.C.C. § 2-403(1) (allowing purchaser to receive all rights and title possessed by transferor).

139. See Dale A. Oesterle, *Deficiencies of the Restitutionary Right to Trace Misappropriated Property in Equity and in UCC § 9-306*, 68 CORNELL L. REV. 172, 216 (1983) (characterizing innocent purchaser as constructive trustee from whom owner can retrieve property).

140. See *supra* text accompanying note 103.

141. See RAUSHENBUSH, *supra* note 14, § 5.4, at 43 (defining trover as action from which titleholder may recover from converter value of property at time of conversion); see also Janiszewski v. Behrmann, 75 N.W.2d 77, 80 (Mich. 1956) (recognizing that aggrieved party may sue for money damages or, if wrongdoer disposed of property, may proceed in assumpsit to recover amount wrongdoer received).

142. See RAUSHENBUSH, *supra* note 14, § 5.4, at 44 (describing replevin as action to recover converted chattel); see also Bryant v. Sears Consumer Fin. Corp., 617 So. 2d 1191, 1194 (La. Ct. App. 1993) (stating that traditional remedy for conversion is return of property and if property cannot be returned, money damages equal to value of property at time of conversion).

143. See, e.g., Swift & Co. v. Jamestown Nat'l Bank, 426 F.2d 1099, 1104 (8th Cir. 1970) (holding that owner may follow goods to bona fide third purchaser, even though purchaser acted in good faith and lacked knowledge of wrongful conversion); Inmi-Etti v. Aluisi, 492 A.2d 917, 924 (Md. Ct. Spec. App. 1985) (recognizing that innocent party is liable to owner even though innocent party took possession of chattel without knowledge, or even reason to know, that transferor had no power to transfer proprietary interest); Mattson v. Commercial Credit Business Loans, 723 P.2d 996, 1000-01 (Or. 1986) (considering commercial practicality of tracing proceeds of converted goods into hands of subsequent parties until chattel reaches bond fide purchaser); Frost v. Eggeman, 638 P.2d 141, 145 (Wyo. 1981) (requiring purchaser to pay owner rent as restitution, even though purchaser entered premises believing he acted under color of law); Oesterle, *supra* note 139, at 216 (explaining that owner can sue innocent purchaser even if wrongdoer is solvent and available to be sued). The only intention required on the part of a converter is the intention to exercise control over the good; the party need not intend to deprive the rightful owner of the good, nor even know that another person claims to be the rightful owner. See Shaw's D.B. & L. v. Fletcher, 580 S.W.2d 91, 95 (Tex. Ct. App. 1979) (stating that defendant should ascertain ownership rights of transferor, and that defendant's mere possession of owner's property constitutes conversion); see also Andrews v. Mid-America Bank & Trust Co., 503 N.E.2d 1120, 1122 (Ill. App. Ct. 1987) ("The essence of conversion is not acquisition by the wrongdoer but a wrongful deprivation of the owner thereof."). See generally RESTATEMENT OF RESTITUTION § 203 (1937) (limiting liability of innocent converter to value of property converted because there is no conscious wrongdoing that can be deterred); RESTATEMENT (SECOND) OF TORTS, *supra* note 22, §§ 222A-223 (defining conversion as "intentional exercise of dominion or control over a chattel which so seriously interferes with the right of another to control it that the actor may justly be required to pay the other the value of the chattel").

debtor, as the rightful owner, may replevy it from the purchaser's possession. The debtor could also elect to seek damages from the purchaser equal to the fair market value of the converted property.¹⁴⁴

The right of replevin may be conditioned, however, on the debtor's paying the debt to the purchaser.¹⁴⁵ In pre-Code cases, where a pledgee¹⁴⁶ sold the collateral, thereby converting it, the purchaser acquired no title, but was entitled to be subrogated in equity to the pledgee/seller's rights on the debt against the pledgor (debtor).¹⁴⁷ This subrogation right was limited to the return of the purchase price.¹⁴⁸ This is analogous to the hypothetical situation, in that the sale is by a secured creditor who has possession. In the case of a pledge, however, the pledgee's initial possession was rightful, whereas in our hypothetical situation the secured creditor's possession of the collateral was wrongful.

The Code seems to support this common law right. Section 9-506 provides the debtor with the right to redeem the collateral after repossession and before sale or disposition under section 9-504.¹⁴⁹

144. See, e.g., *Inmi-Etti*, 492 A.2d at 924 (awarding damages equal to fair market value of property at time of conversion); *Janiszewski*, 75 N.W.2d at 80 (stating general rule that measure of damages is value at time of conversion); *Mattson*, 723 P.2d at 998 (limiting plaintiff's options to recovery of converted lumber from third parties or recovery of sales proceeds from converter); *Frost*, 638 P.2d at 144 (determining damages by value of property converted and placing burden of proof on plaintiff if value is disputed). The owner may also be entitled to damages for the reasonable value of the use of the property while it was in possession of the converter. *Id.* at 145.

145. 2 GILMORE, *supra* note 4, § 42.14, at 1179 ("The debtor should be entitled to redeem his property from the transferee on tendering the amount of the secured obligation and payment to the transferee would discharge the obligation.").

146. See *McLemore v. Louisiana State Bank*, 91 U.S. 27, 28 (1875) (holding that pledgee has duty to "take that care of the pledge which a careful man bestows on his own property"); *RAUSENBUSH*, *supra* note 14, § 15.6, at 484 ("A pledgee, as one to whom the goods of another are delivered for a special purpose, is a bailee of the property in his possession."). A pledgee under common law is equivalent to a secured creditor in possession of the collateral for purposes of perfection under the U.C.C. *Id.*

147. 2 GILMORE, *supra* note 4, § 42.14, at 1179 (explaining that purchaser is subrogated in equity to pledgee's rights against debtor to prevent unsatisfactory result of purchaser losing property to owner and converter being repaid debt by owner); see also *Talty v. Freedman's Sav. & Trust Co.*, 93 U.S. 321, 325 (1876) (allowing third party to recover from converter only after third party has paid off owner's claim).

148. See 2 GILMORE, *supra* note 4, § 42.14, at 1179 (stating that debtor may redeem property when he has tendered amount of secured obligation).

149. U.C.C. § 9-506 provides:

At any time before the secured party has disposed of collateral or entered into a contract for its disposition under Section 9-504 or before the obligation has been discharged under Section 9-505(2) the debtor or any other secured party may unless otherwise agreed in writing after default redeem the collateral by tendering fulfillment of all obligations secured by the collateral as well as the expenses reasonably incurred by the secured party in retaking, holding and preparing the collateral for disposition, in arranging for the sale, and to the extent provided in the agreement and not prohibited by law, his reasonable attorneys' fees and legal expenses.

The debtor may redeem the collateral by satisfying the obligations, including the entire debt if it has been appropriately accelerated.¹⁵⁰ Because no sale was properly made under section 9-504, which requires the debtor's default,¹⁵¹ the debtor's section 9-506 right of redemption should continue despite the foreclosure sale.¹⁵²

Furthermore, the debtor should not, as a result of the secured creditor's wrongful act, lose the benefit of her bargain, the use of the money lent. While a secured creditor may accelerate a debt and require immediate payment of the entire balance if the parties' agreement so provides, the creditor may only do so if the debtor is in default,¹⁵³ or if the creditor, in good faith, deems itself insecure.¹⁵⁴ While good faith is generally considered to be a subjective standard, requiring only honesty in fact,¹⁵⁵ any attempt by our hypothetical creditor to accelerate the debt caused by the creditor's own negligence should not meet even that minimal standard.¹⁵⁶ Thus, in the

U.C.C. § 9-506.

150. *Id.*; see also *id.* § 9-506 cmt. (requiring debtor to fulfill all obligations in one installment if agreement contains acceleration clause).

151. *Id.* § 9-504 (permitting secured party to "sell, lease or otherwise dispose of any or all of the collateral in its then condition or following any commercially reasonable preparation or processing" after default).

152. See HAWKLAND, *supra* note 4, § 9-506:04, at 878 ("An improper disposition under section 9-504 or an improper strict foreclosure under section 9-505 means that the period of redemption under section 9-506 has not ended, and thus the debtor and any other secured party still have the right to redeem the collateral.").

153. HAWKLAND, *supra* note 4, § 9-501:03, at 702 (explaining that acceleration is typically triggered by certain defined events); WHITE & SUMMERS, *supra* note 12, § 25-3, at 1191 ("Security agreements almost universally provide that under certain circumstances the secured party may accelerate the maturity of the debt and cause all payments to become immediately due and payable."); see also *Bowen v. Danna*, 637 S.W.2d 560, 564 (Ark. 1982) (finding that good faith of creditor is unnecessary where right to accelerate is conditioned on occurrence of event that is completely under control of debtor); *Sheet Metal Workers Local # 76 Credit Union v. Hufnagle*, 295 N.W.2d 259, 264 (Minn. 1980) (holding that right to accelerate debt on default is not implied in agreement where agreement contains no express acceleration clause); *General Elec. Credit Corp. v. Castiglione*, 360 A.2d 418, 422 (N.J. Super. Ct. Law Div. 1976) (holding that in absence of acceleration clause, installment payments could not be accelerated upon default); *J.R. Hale Contracting Co. v. United N.M. Bank*, 799 P.2d 581, 591 (N.M. 1990) (interpreting U.C.C. as requiring honest subjective belief on part of creditor that debtor's default was reasonable).

154. See U.C.C. § 1-208 (defining insecurity as good faith belief that prospect of payment or performance is impaired).

155. See *Watseka First Nat'l Bank v. Ruda*, 552 N.E.2d 775, 779 (Ill. 1990) (recognizing both that majority of courts find, and Code drafters intended, that good faith standard for acceleration of debt be subjective); see also U.C.C. § 1-201(19) (defining good faith as "honesty in fact in the conduct or transaction").

156. See *Watseka First Nat'l Bank*, 552 N.E.2d at 782 (holding that creditor met subjective standard of good faith where there was no evidence that creditor did not have in its possession information it claimed caused it to accelerate debt); *Lane v. John Deere Co.*, 767 S.W.2d 138, 142 (Tenn. 1989) (construing § 1-208 good faith standard as requiring creditor to act with honest belief that debtor's ability to perform is impaired, and prohibiting creditor from abusing acceleration clause); *State Bank of Lehi v. Woolsey*, 565 P.2d 413, 418 (Utah 1977) (interpreting § 1-208 to require some reasonable justification for accelerating debt).

absence of some evidence of a good faith belief in the insecurity of the debt or the debtor's default, the creditor cannot accelerate the debt, and the debtor retains the right to make payments, according to the party's agreement, over time. Redemption would, therefore, only require that the debtor remain current on the secured obligation.

By subrogating the purchaser to the amounts due for redemption of the collateral, the purchaser would receive some compensation for the loss of the asset, although potentially less than they paid and less than the benefit for which they bargained. A debtor, however, may attempt to defeat the subrogation claim of the purchaser as many jurisdictions deny to a wrongfully repossessing secured creditor all further claims on the debt or the collateral.¹⁵⁷ In those jurisdictions, because the creditor has no further claims against the debtor, arguably there is nothing to which the purchaser can be subrogated. This result, however, seems to leave the debtor unjustly enriched receiving both the return of the collateral and the discharge of the debt.¹⁵⁸

A debtor may further defend against a purchaser's restitution action by counterclaiming for damages arising from the debtor's lost use of the good from the time of repossession to the time the debtor reclaimed it. In an action for equitable restitution, the party who received the unjust enrichment cannot be made worse off than he was before receiving the value for which restitution is sought.¹⁵⁹ If the debtor has sustained damages due to lost use of the collateral, the debtor may be entitled to offset those losses against any amount recoverable by the purchaser.¹⁶⁰

157. See *supra* note 14 (citing numerous authorities for proposition that debtor has claim against creditor who repossessed property in bad faith).

158. 2 GILMORE, *supra* note 4, § 42.14, at 1179 (explaining that purchaser has subrogation right to prevent his losing property and someone else receiving payment of debt).

159. Steven B. Dow & Nan S. Ellis, *The Payor Bank's Right to Recover Mistaken Payments: Survival of Common Law Restitution Under Proposed Revisions to Uniform Commercial Code Articles 3 and 4*, 65 IND. L.J. 779, 786-87 (1990) (recognizing, as defense to restitution, argument that restitution would result in loss to defendant if defendant is not wrongdoer but merely party from whom plaintiff is seeking recovery); see also RESTATEMENT OF RESTITUTION, *supra* note 143, § 149 (stating that purpose of restitution is to make plaintiff whole, but amount defendant must repay is based on defendant's tortious conduct or negligence of both parties in creating situation giving rise to right of restitution).

160. See *Himebaugh v. Chalker*, 245 N.W. 576, 577 (Mich. 1932) (reducing damages assigned by value of purchaser's use of land in equitable action for rescission); *Bartlett v. Smith*, 109 N.W. 260, 261 (Mich. 1906) (allowing plaintiff to recover payments and reasonable value of improvement made in good faith less value of use of premises); *Frost v. Eggeman*, 638 P.2d 141, 145 (Wyo. 1981) (holding, in conversion action, that innocent purchaser of good at invalid judicial foreclosure sale is liable to owner for reasonable value of use of property while in purchaser's possession). A plaintiff that successfully replevies a good may also recover damages for losses due to the detention and depreciation of the good. See RESTATEMENT (SECOND) OF

The purchaser should be entitled to recover from the debtor only the amount by which the debt was reduced due to the sale because that is the extent to which the debtor has been unjustly enriched. That amount would equal the purchase price less (1) the incidental fees and costs of the foreclosure sale that were credited against the sale proceeds, and (2) any damages sustained by the debtor due to loss of use of the collateral.¹⁶¹

Under either the common law or the Code the purchaser would, at best, be entitled only to the periodic payments under the security agreement for which the debtor is obligated.¹⁶² Additionally, under the common law, the purchaser's subrogation in equity was limited to the lesser amount of the debt or the purchase price,¹⁶³ thus depriving the purchaser of the benefit of his bargain. The common law solution accordingly may be unattractive to a purchaser who did not bargain for the return of the purchase price paid over time.¹⁶⁴ Where the collateral is unique, as in the hypothetical, even full repayment of the purchase price may be an unsatisfactory solution from the purchaser's perspective.

Under both the Code and the common law, the hypothetical debtor may replevy the automobile from the purchaser because she has good title and the purchaser has void title. The purchaser may be subrogated to future payments due from the debtor until the price paid, less costs and other damages, is returned. The purchaser may

TORTS, *supra* note 22, § 922 cmt. b (allowing recovery of damages for detention and harm to chattel as well as expenses of recapture if property is recaptured without consent of tortfeasor); *see also, e.g.,* Garoogian v. Medlock, 592 F.2d 997, 1002 (8th Cir. 1979) (basing amount of damages on fair rental value of property and damages to property willfully inflicted by defendant); White Motor Credit Corp. v. Sapp Bros. Truck Plaza, 249 N.W.2d 489, 493-94 (Neb. 1977) (awarding damages for wrongful detention because defendant owed duty of reasonable care to prevent damages and pilferage).

161. *See* RESTATEMENT OF RESTITUTION, *supra* note 143, § 43 (entitling person who mistakenly discharges duty of another because he believed it to be his duty to restitution from that other person).

162. *See* *Ricklefs v. Clemens*, 531 P.2d 94, 100 (Kan. 1975) (granting plaintiff damages equal to difference between property represented to plaintiff by defendant and actual value of property when received); *Theobald v. Sprouse*, 257 So. 2d 516, 518 (Miss. 1972) (limiting plaintiff's recovery to purchase money paid plus interest).

163. *See* RESTATEMENT OF RESTITUTION, *supra* note 143, §§ 43, 162 (preventing unjust enrichment by limiting recovery of subrogating party).

164. *See* RESTATEMENT OF RESTITUTION, *supra* note 143, § 4(d) (creating constructive trust to prevent unjust enrichment of person who has equitable duty to convey title to another property). The purchaser may also seek to retain possession of the collateral to secure repayment of the subrogated debt, particularly in view of the fact that the purchaser did not bargain to be a financier. *See id.* (granting restitution by placing lien on disputed item). As the subrogee to the secured creditor's rights under the contract, however, the purchaser would receive, at best, a nonpossessory security interest in the collateral as provided in the original agreement between the debtor and secured creditor. *See id.* §§ 4(d), 43 (treating transaction as though rights were specifically assigned rather than mistakenly conveyed).

prefer, however, to seek immediate relief from the selling secured party, in lieu of taking the debtor's payments over time.

IV. PURCHASER'S RIGHTS AGAINST SELLING SECURED PARTY

A. *The Warranty of Title Under Article 2*

If the debtor replevies the collateral from the purchaser, the next issue to consider is whether the purchaser has a remedy against the secured creditor, who failed to convey good title. Equity seems to require that the creditor, at a minimum, be obligated to return the monies paid to it by purchaser. Fairness dictates that the actor who caused the conflict should bear the ultimate responsibility for making the other parties whole again.¹⁶⁵ This conclusion is not compelled, however, under the current language of the Code.¹⁶⁶

The Code implies in most contracts for the sale of goods "a warranty by the seller that . . . the title conveyed shall be good, and its transfer rightful."¹⁶⁷ In the hypothetical, this warranty, if given by the bank, would clearly have been breached because the bank had no right to sell the good to the purchaser, and did not convey good title as required. This would entitle the purchaser to damages under article 2.¹⁶⁸

The warranty, however, is not implied in sales where the circumstances "give the buyer reason to know that the person selling does not claim title in himself or that he is purporting to sell only such right or title as he . . . may have."¹⁶⁹ It would seem that no circum-

165. See HAWKLAND, *supra* note 4, § 2-312:08, at 406 (requiring wrongdoer to account for fair worth of property).

166. See U.C.C. § 2-312(1) (warranting title, but not stating explicitly who is responsible if property is encumbered).

167. *Id.* § 2-312(1)(a). A warranty is excluded only when the contract contains specific language to the contrary or when the circumstances are such that the buyer should reasonably know the seller does not claim title. *Id.* § 2-312(2).

168. See, e.g., *Ricklefs v. Clemens*, 531 P.2d 94, 100 (Kan. 1975) (holding defendant liable for damages to buyer for breach of warranty of title, although he was innocent seller of stolen vehicle); *Riggs Motor Co. v. Archer*, 240 S.W.2d 75, 76 (Ky. Ct. App. 1951) (entitling innocent buyer to recover damages for breach of title warranty from innocent seller of stolen property); *Theobald v. Sprouse*, 257 So. 2d 516, 518 (Miss. 1972) (permitting owner to recover purchase price plus interest from purchaser); see also U.C.C. § 2-714(2) ("The measure of damages for breach of warranty is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount."). Buyers are also typically entitled to recover incidental and consequential damages. *Id.* §§ 2-714(3), -715.

169. U.C.C. § 2-312(2); see also, e.g., *Bank of Nova Scotia v. Equitable Fin. Management*, 708 F. Supp. 678, 683 (W.D. Pa.) (finding that no warranty of title attached to sale where buyer was to originally purchase machinery through broker for price of \$123,000, but consummated sale 10 days later directly with seller for \$100,000 based on court's view that suspicious circumstances should have put buyer on notice of potential claims against machinery), *aff'd*, 882 F.2d 81 (3d

stances in the hypothetical sale gave the purchaser reason to know that the bank did not claim to at least have the right to transfer the automobile as against the debtor. According to Official Comment 5 to section 2-312, however, the warranty of title does not attach to a sale by a foreclosing secured party.¹⁷⁰ Courts that have considered the issue have generally agreed that the exceptional circumstances present at a foreclosure sale by a secured party or a judicial sale,

Cir. 1989); *Simmons Mach. Co. v. M & M Brokerage*, 409 So. 2d 743, 752-53 (Ala. 1982) (holding that warranty of title does not attach either to sale or trade-in of good where buyer knows of possible security interest in good); *Potter v. Owens*, 535 So. 2d 173, 174-75 (Ala. Civ. App. 1988) (deciding that documents and circumstances of transaction that purported to sell interest in portable building attached to leased trailer gave buyers reason to know that no warranty of title was made); *Sumner v. Fel-Air, Inc.*, 680 P.2d 1109, 1112-13 (Alaska 1984) (characterizing as question of fact whether circumstances of purchase of airplane from lessee excluded warranty of title); *Maroone Chevrolet v. Nordstrom*, 587 So. 2d 514, 517 (Fla. Dist. Ct. App. 1991) (reversing trial court's failure to submit to jury question whether circumstances of sale, which buyer arranged with third party and which was consummated through seller/dealer for purposes of financing, were sufficient to give buyer notice of potential problems with title); *Shelly Motors, Inc. v. Bortnick*, 631 P.2d 594, 596-97 (Haw. Ct. App. 1981) (finding that sales transaction, where seller tells buyer that he is only conveying whatever interest seller has and that title is "open," creates genuine issue of material fact precluding summary judgment on warranty of title claim); *Jones v. Linebaugh*, 191 N.W.2d 142, 144 (Mich. Ct. App. 1971) (ruling that whether buyer had reason to know that seller was not claiming to have title, where seller said he would try to obtain title from owner, was question for jury). For examples of unique sales transactions that would not give a buyer reason to know that the warranty of title was excluded, see *Spillane v. Liberty Mut. Ins. Co.*, 317 N.Y.S.2d 203, 206 (Civ. Ct. 1970) (attaching warranty of title to sale by insurer after insurer took assignment of ownership upon assured party's payment of claim), and *John St. Auto Wrecking v. Motors Ins. Corp.*, 288 N.Y.S.2d 281, 284 (Dist. Ct. 1968) (finding implied warranty of title where insurer sold repossessed automobiles and purchaser had no way of knowing title was limited to what defendant could convey).

170. U.C.C. § 2-312 cmt. 5. The comment provides that:

Subsection (2) recognizes that sales by sheriffs, executors, foreclosing lienors and persons similarly situated are so out of the ordinary commercial course that their peculiar character is immediately apparent to the buyer and therefore no personal obligation is imposed upon the seller who is purporting to sell only an unknown or limited right.

Id.; see *Vend-A-Matic v. Foothill Capital Corp.*, 37 B.R. 838, 841-42 (Bankr. E.D. Mich. 1984) (attaching no warranty of title to secured creditor's sale of bankrupt debtor's assets); Steve H. Nickles, *Rights and Remedies Between UCC Article 9 Secured Parties with Conflicting Security Interests in Goods*, 68 IOWA L. REV. 217, 254 (1983) (noting that buyers at forced sale were traditionally required to assume risk that superior encumbrances would survive disposition of property to them). *But see Bogestad v. Anderson*, 173 N.W. 674, 675 (Minn. 1919) (ruling that warranty of title will be implied in foreclosure sale of chattel mortgage under pre-U.C.C. common law); Susan Block-Lieb, *Fishing in Muddy Waters: Clarifying the Common Pool Analogy as Applied to the Standard Commencement of a Bankruptcy Case*, 42 AM. U. L. REV. 337, 392 n.219 (1993) (postulating that buyer of repossessed collateral may have warranty of title claim against selling junior secured creditor if senior creditor enforces claim against collateral); Hogan, *supra* note 12, at 256 (stating that "there is no caveat emptor in relation to title" in sale under U.C.C. § 9-504(4) that protects purchaser as long as he is not party to deficiencies of resale). Members of the National Conference of Commissioners on Uniform State Laws recognize that under U.C.C. § 2-312 and its Official Comments, as currently written, no warranty of title attaches to either a judicial or foreclosure sale. See U.C.C. § 9-504(4) reporters' explanatory note 3, at 11 (Discussion Draft, Sept. 2, 1993).

noted in the comments to section 2-312,¹⁷¹ give the buyer notice sufficient to preclude the attachment of the warranty of title.¹⁷²

Although the general rule is that no warranty of title attaches in a foreclosure sale, this rule developed primarily in cases in which the defect was in the original title of the debtor, and not caused by actions of the secured seller.¹⁷³ Under the common law, sellers who were not the owner and did not represent themselves as the owner did not warrant the title of the person who was believed to be the true owner.¹⁷⁴ The courts believed that the purchaser could himself determine whether the property was encumbered or subject to liens or claims, and that the seller was often in no better position to discover title defects than the purchaser.¹⁷⁵

171. U.C.C. § 2-312 cmt. 5.

172. See, e.g., *Vend-A-Matic*, 37 B.R. at 841-42 (finding that no warranty of title attached to sale by secured creditor of bankrupt debtor's assets); *Harris Intertype Corp. v. Robertson*, 16 Cal. Rptr. 159, 165 (Dist. Ct. App. 1961) (refusing to imply warranty of title in resale of collateral by secured party after debtor's default); *Stuart v. American Sec. Bank*, 494 A.2d 1333, 1338 (D.C. 1985) ("[T]he doctrine of *caveat emptor* applies to foreclosure sales because a trustee makes no warranty of title and is generally subject to no duty to investigate or describe outstanding licensor encumbrances."); *Marvin v. Connelly*, 252 S.E.2d 562, 563 (S.C. 1979) (denying purchaser warranty of title from purchase of property at judicial sale); *First State Bank v. Keilman*, 851 S.W.2d 914, 924 (Tex. Ct. App. 1993) (holding that "one who bids upon property at foreclosure sale does so at his own peril"); *Diversified, Inc. v. Walker*, 702 S.W.2d 717, 723 (Tex. Ct. App. 1985) (refusing to grant warranty of title to foreclosure purchaser when deed of trust was void); *Feldman v. Rucker*, 109 S.E.2d 379, 385 (Va. 1959) (applying doctrine of *caveat emptor* to foreclosure sale carried out under deed of trust). This rule originally developed at common law. See, e.g., *Harris v. Lynn*, 25 Kan. 281, 285-86 (1881) (disallowing warranty of title in judicial sale and placing burden on plaintiff to prove agreement otherwise); *Bogstad*, 173 N.W. at 675 (recognizing that if there was mortgage on property at time of sale, there was representation of warranty against prior encumbrances); *Cohn v. Ammidown*, 24 N.E. 944, 944 (N.Y. 1890) (denying warranty of title where circumstances made clear that defendant transferred only interest he held); see also 47 AM. JUR. 2d *Judicial Sales* §§ 262-263 (1969) (stating prevailing view that there is generally no warranty of title at judicial sale and that doctrine of *caveat emptor* applies); 1 SAMUEL WILLISTON, *THE LAW GOVERNING SALES OF GOODS AT COMMON LAW AND UNDER THE UNIFORM SALES ACT* § 220, at 566-67 (Rev. ed. 1948) (explaining that those who sell by virtue of authority in fact or law are not liable for lack of title unless they expressly warrant title). The common law rule was codified, first, in 1906 in § 13 of the Uniform Sales Act, 1A U.L.A. 88, official cmt. (1989), and then in its successor, article 2 of the Uniform Commercial Code, U.C.C. § 2-312(2).

173. See, e.g., *Vend-A-Matic*, 37 B.R. at 841 (finding that assets sold after abandonment did not include vending machines because vending machines were not included in sales contract); *Harris Intertype Corp.*, 16 Cal. Rptr. at 165 (concluding that purchaser was aware that title passed by seller was defective); see also *Michie v. National Bank*, 558 S.W.2d 270, 277 (Mo. Ct. App. 1977) (recognizing no warranty of title by lender in foreclosure sale of real estate under deed of trust where debtor's interest was life estate but purchaser expected to receive fee simple).

174. WILLISTON, *supra* note 172, § 220, at 566-67 (likening seller to agent because seller can give no more title than owner had); see also *Bassett v. Lockard*, 60 Ill. 164, 165 (1871) ("[T]he goodness of the title must be at the purchaser's own risk."); *Neal v. Gillaspay*, 56 Ind. 451, 453 (1877) (comparing purchaser at judicial sale with purchaser of real estate who conveys property without covenant).

175. *Stuart*, 494 A.2d at 1338 (advising purchaser to make his own investigation before turning over his deposit); *Barnard v. Duncan*, 38 Mo. 170, 186 (1866) (stating that "where facts, or means of information, concerning the condition and value of the thing sold are equally

Where the debtor is not in default, however, that logic does not hold. The purchaser cannot protect his interests through a search of the public records because the issue is the circumstance of default, not any title encumbrance; the breach is not due to the owner's defective title, but the inability of the selling secured party to transfer title because the debtor is not in default. Additionally, the seller's knowledge of the defect is clearly superior to that of the purchaser as only the debtor and secured seller are parties to the agreement upon which the foreclosure is based.

A few cases have held that a purchaser may recover from a foreclosing seller for the seller's failure to convey good title due to the seller's own conduct. An early example was *Bogestad v. Anderson*.¹⁷⁶ In *Bogestad*, mortgage collateral, a team of horses, was sold in an invalid foreclosure sale.¹⁷⁷ The horses' original owner alleged that because the mortgage under which they were sold had been satisfied, the ensuing sale was invalid.¹⁷⁸ The Minnesota Supreme Court ruled that while the purchaser at a foreclosure sale generally does not receive a warranty of title against prior encumbrances, he does receive a warranty, or at least a representation, that the sale is made under a valid and existing mortgage.¹⁷⁹ The court held that if, on remand, the trial court determined that the mortgage had in fact been discharged, the purchaser was entitled to a return of the purchase price paid.¹⁸⁰ The court thus drew a distinction between the seller warranting the title of the original owner and warranting that the right to sell exists, with the purchaser recovering only for a breach of the latter.¹⁸¹ The court made this finding, however, with minimal discussion of, or citation to, any authority.¹⁸²

A more recent case also recognized this distinction and permitted the successful bidder at a foreclosure sale to recover contract damages

accessible to both parties, and nothing is said or done which tends to impose on the other, or to mislead him, there is no fraud in which the law can notice").

176. 173 N.W. 674 (Minn. 1919).

177. *Bogestad v. Anderson*, 173 N.W. 674, 674-75 (Minn. 1919). In an earlier case between the debtor and lender, the Minnesota Supreme Court held that the mortgage debt had been discharged when the debtor made a partial payment of the debt and gave the lender a new note, which was not secured by the collateral. *Anderson v. Willson*, 157 N.W. 582, 583 (Minn. 1916).

178. *Bogestad*, 173 N.W. at 675. Despite its earlier decision in *Willson*, the court held that the judgment in the *Willson* case was not evidence of the discharge. *Id.* The court went on to note that the purchaser must still prove that the sale was improper due to the discharge of the mortgage. *Id.*

179. *Id.*

180. *Id.*

181. *Id.*

182. *Id.* The only authority given by the court was a reference to the English law of pledges. *Id.* (citing *Morley v. Attenborough*, 3 Ex. 500 (1849)).

from the seller who failed to convey title due to its erroneous foreclosure on a mortgage. In *Basiliko v. Pargo Corp.*,¹⁸³ the lender scheduled a trustee's sale of a parcel of real property, pursuant to a deed of trust, based on the borrower's default.¹⁸⁴ A few minutes before closing time on the day before the sale, the borrower cured the delinquency, vitiating the default.¹⁸⁵ Although immediately and properly credited, the payment did not come to the attention of the selling trustees until after the sale.¹⁸⁶ At the sale, the plaintiff, Basiliko, was the successful bidder and secured his bid with a deposit.¹⁸⁷ Shortly thereafter, Basiliko contracted to sell the property to Pargo Corporation, which then contracted to sell it to another party.¹⁸⁸ On the settlement date, the trustees refused to consummate the sale to Basiliko, advising him that they were not authorized to sell the property because of the debtor's payment.¹⁸⁹ The District of Columbia Court of Appeals held that Basiliko was entitled to recover damages from the trustees for loss of the benefit of his bargain due to the trustees' breach of the executory sales contract.¹⁹⁰

The court's opinion centered on the correct measure of damages for breach of an executory contract for the sale of real estate.¹⁹¹ As a threshold issue, however, the court considered the viability of the purchaser's cause of action against the lender and its agents.¹⁹² The court held that the general rule of *caveat emptor* in foreclosure sales did not apply where the seller failed to convey title because it lacked the initial authority to conduct the sale.¹⁹³ According to the court, "the rule of *caveat emptor* can provide no basis for exempting the foreclosure sale vendor from the usual obligation that 'a vendor is bound to know that he can deliver that which he professes to sell.'"¹⁹⁴ The court also noted that to deny the purchaser recovery would unfairly place the risk of the seller's mistake on the buyer.¹⁹⁵

183. 532 A.2d 1346 (D.C. 1987)

184. *Basiliko v. Pargo Corp.*, 532 A.2d 1346, 1347 (D.C. 1987).

185. *Id.*

186. *Id.*

187. *Id.*

188. *Id.*

189. *Id.*

190. *Id.* at 1348-50.

191. *Id.* at 1347-49 (considering whether purchaser was entitled to damages sustained due to lost benefit of bargain, or whether recovery was instead limited to return of deposit paid plus interest and expenses).

192. *Id.* at 1349.

193. *Id.*

194. *Id.* (quoting *Trans World Airlines v. Skyline Air Parts*, 193 A.2d 72, 75 (D.C. 1963)).

195. *Id.*

While the court clearly intended to reach an equitable solution between the parties, and probably accomplished it, this court, as had the court in *Bogestad*, did so with little support from prior authorities.¹⁹⁶

These decisions provide some grounding for a cause of action by our purchaser against the lender for its failure to convey good title.¹⁹⁷ Each case is substantially similar to the hypothetical in that the seller's own conduct caused the failure to convey good title to the foreclosure purchaser.¹⁹⁸ The distinction between warranting the owner's title and warranting the seller's authority to sell¹⁹⁹ seems both logical and equitable, as the selling secured party has no particular knowledge of the former, but has both knowledge and control of the latter. Yet, since being decided, neither case has been relied on as authority, even within its own jurisdiction.²⁰⁰

Moreover, other cases have rejected the distinction, finding that no warranty of title exists even where the sale was void due to the seller's actions.²⁰¹ The Texas Court of Appeals, for example, has gone so

196. See *id.* (relying on GEORGE E. OSBORNE, HANDBOOK ON THE LAW OF MORTGAGES (2d ed. 1970)); *Trans World Airlines*, 193 A.2d at 72. *Trans World Airlines*, however, did not arise in the context of a foreclosure sale. *Id.* at 73 (arising from breach of contract to deliver airline equipment). The case addressed only whether a seller can raise impossibility of performance as a defense to a breach of contract action where the seller's actions caused the impossibility. *Id.* at 74-75. The section of the Osborne treatise cited by the court in *Basiliko* merely discusses the general rule that there is no warranty of title in a foreclosure sale except to the extent that the seller makes misrepresentations. OSBORNE, *supra*, § 344, at 741. This section could arguably support recovery in a situation similar to *Basiliko*, if the court found that the seller impliedly made a misrepresentation by conducting the sale without authority. The D.C. Court of Appeals, however, did not find that the seller impliedly made a misrepresentation. *Basiliko*, 532 A.2d at 1349. The court simply stated, without support, that the rule of caveat emptor does not apply when the failure to convey title was caused by the seller's lack of authority to sell. *Id.*

197. This cause of action could be recognized either under U.C.C. § 2-312, for a breach of the warranty of title, or at common law or equity. See *Basiliko*, 532 A.2d at 1348 (granting damages to purchaser against seller who breaches contract for sale of property measured by difference between contract price and fair market value); *Bogestad v. Anderson*, 173 N.W. 674, 675 (Minn. 1919) (finding limited warranty that seller had authority to sell and transfer title in chattel mortgage, pre-Code security device); see also U.C.C. § 1-103 (recognizing common law cause of action in case otherwise governed by U.C.C.).

198. See *Basiliko*, 532 A.2d at 1349 (stating that erroneous foreclosure of loan was within exclusive knowledge and control of lender); *Bogestad*, 173 N.W. at 674 (stating that lender caused foreclosure and sale to plaintiff when mortgage may have been paid).

199. See *Basiliko*, 532 A.2d at 1349 (stating that selling mortgagee does not give any warranty of title, but is liable for mistake relating to underlying authority to conduct sale); *Bogestad*, 173 N.W. at 675 (finding no warranty of title on foreclosure sale, but implying warranty or representation by mortgagee of subsisting mortgage upon property sold).

200. *Bogestad* has not been cited by a federal or state court in the 75 years since it was decided. *Basiliko* has only been cited for its holding on the proper measure of damages for breach of contract for the sale of real property. See *Pagan v. Murray*, 628 A.2d 110, 111 n.1 (D.C. 1993) (holding that vendor breached sales contract by declaring it void at end of 45 day settlement period).

201. See, e.g., *Hutson v. Wood*, 105 N.E. 343, 348 (Ill. 1914) (stating that buyer at judicial sale bids at own risk and thus is not entitled to return of money where judgment under which sale

far as to place the burden on the purchaser to determine whether the lender has the power to sell.²⁰²

The language of section 2-312(2), as explained by comment 5, together with the general reluctance of most courts to extend the warranty of title to foreclosure actions, would probably preclude the purchaser from recovering under a warranty of title theory in the proposed hypothetical. Yet, comment 5 to section 2-312 leaves open the possibility that a purchaser who has had a unique good reclaimed by the rightful owner may have a claim for restitution against the seller, even though no warranty attached to the sale.²⁰³ Thus, we must determine whether the purchaser has a right of restitution under the common law against the secured creditor.

B. *The Right of Restitution*

A party who has given value to another, yet has received nothing in exchange, may seek return of the value paid.²⁰⁴ Restitution may be available as an equitable remedy where the aggrieved party has no available remedy at law and the recipient of the value would otherwise

was made is void); *England v. Clark*, 5 Ill. 486, 490-92 (1843) (holding that caveat emptor applies to execution sales, and that purchaser is not entitled to return from judgment creditor of price paid where property sold did not belong to debtor); *Dixon v. City Nat'l Bank*, 395 N.E.2d 620, 624 (Ill. App. Ct. 1979) (holding that purchaser at void execution sale is not entitled to recover purchase price from creditor), *aff'd*, 410 N.E.2d 843 (Ill. 1980); *Diversified, Inc. v. Walker*, 702 S.W.2d 717, 722-23 (Tex. Ct. App. 1985) (holding that purchaser at foreclosure sale is not entitled to damages where sale is conducted by lender and title conveyed thereunder was void). The Texas Court of Appeals stated in *Diversified* that "there is no precedent in the law that would support any theory of warranty on the part of the noteholder." *Id.* at 723. The Illinois Supreme Court expressed a similar view in *Hutson*:

The rule of caveat emptor applies to sales upon execution and judicial sales, and we know of no case where a purchaser at such a sale, in the absence of a statute, has been enabled to recover the money paid, either for a defective title or where for want of power to make the sale he has acquired no title.

Hutson, 105 N.E. at 348; *see also Niland v. Deason*, 825 F.2d 801, 811 (5th Cir. 1987) (explaining that because deed of trust given to creditor creates only lien, title never vests in creditor, and therefore, foreclosure sale transfers title directly from debtor to purchaser with no warranty of title being made by creditor); *Michie v. National Bank*, 558 S.W.2d 270, 275-77 (Mo. Ct. App. 1977) (holding that there is no warranty of title in foreclosure sale of real estate where, although defect was in debtor's title, purchaser alleged that seller knew of limited interest and still purported to sell unlimited interest); *Sandel v. Burney*, 714 S.W.2d 40, 41 (Tex. Ct. App. 1986) (indicating that because foreclosure sale transfers legal title from owner of mortgaged property to purchaser, title never vests in creditor and therefore creditor makes no warranty of title).

202. *Diversified*, 702 S.W.2d at 723-24.

203. *See* U.C.C. § 2-312(2) cmt. 5 ("This subsection does not touch upon and leaves open all questions of restitution arising in such cases, when a unique article so sold is reclaimed by a third party as the rightful owner.").

204. *See* RESTATEMENT OF RESTITUTION, *supra* note 143, § 15 cmt. g (stating that payor is entitled to recover money paid to payee when, because of lack of consideration or mistake of fact, payor does not get expected exchange).

be unjustly enriched by its retention.²⁰⁵

Specifically, a right of restitution exists in favor of a buyer who fails to receive, due to a mistake of fact, the bargained-for interest in property.²⁰⁶ This right may be limited by trade usage applicable to a transaction in which the parties generally understand that the buyer assumes the risk of failure²⁰⁷ or invalid title.²⁰⁸ In sales in which the buyer has assumed the risk of invalid title, the seller is not unjustly enriched by retention of the sale proceeds, the amount of which presumably reflects the value of the uncertain title that the buyer obtained.²⁰⁹ Such may be the case in a foreclosure sale.²¹⁰

The *Restatement of Restitution* recognizes the same limitation on the warranty of title as the comments to section 2-312 of the Code.²¹¹

205. See *Hutson*, 105 N.E. at 348-50 (holding that purchaser at void foreclosure sale is entitled to be repaid taxes and special assessments before owner regains possession of property); Oesterle, *supra* note 139, at 175-76 (observing that unjust enrichment of one who has received benefit is common thread that "unite[s] all restitutionary doctrines").

206. See *RESTATEMENT OF RESTITUTION*, *supra* note 143, § 24(1). The *Restatement* provides that:

Unless it is otherwise agreed, a right to restitution exists in favor of a person who, erroneously believing because of a mistake of fact that another has a right, title or power, other than an interest in land, and induced by such mistake has paid money to the other in exchange for the transfer of or promise to transfer the right or title or for the exercise of or the promise to exercise the power, if because of the non-existence of such right, title, or power, the payor fails to receive what it was agreed he should receive.

Id.; see also *Gremillion v. Roy*, 51 So. 576, 577 (La. 1910) (finding vendor who was unable to convey good title liable for restitution of purchase price even though parties did not agree to warranty); *Washington Sec. Co. v. State*, 114 P.2d 965, 967 (Wash. 1941) (holding State liable for return of price paid where it mistakenly sold land owned by private individual); *RESTATEMENT OF RESTITUTION*, *supra* note 143, § 24(1) cmt. a (stating that section concerns rules governing sales agreements where buyer does not get what he expected because of defect in interest of seller or power of one conducting transfer).

207. See *RESTATEMENT OF RESTITUTION*, *supra* note 143, § 24 cmt. b (explaining that what purchaser gets in event of invalid sale is dependent upon custom where risk can fall on either buyer or seller); see also *Woods v. Somerset County Tax Claim Bureau*, 32 Pa. D. & C.3d 62, 66-70 (Somerset County 1984) (finding that while normal inference in judicial sales is that purchaser takes risk that no title may pass, statutory exception exists in tax sale where transaction is void due to double assessment).

208. See *RESTATEMENT OF RESTITUTION*, *supra* note 143, § 24 cmt. d (explaining that in sales on execution, purchaser assumes risk that subject matter is not owned by debtor, and, therefore, purchaser is not entitled to recover in event of invalid title); see also *Gremillion*, 51 So. at 577 (finding that one who purchases interest of minor in land, without court approval, has no reason to believe sale is valid, and thus is not entitled to return of price paid).

209. See *In re Guaranteed Muffler Supply Co.*, 1 B.R. 324, 329 (Bankr. N.D. Ga. 1979) (finding that lack of warranty of title typically is reflected in reduced price of good at sale); *Woods*, 32 Pa. D. & C.3d at 66 (stating that buyer takes risk of defective title and is not entitled to restitution because buyer received what he bargained for and seller is not, therefore, unjustly enriched by retention of purchase price in judicial sale).

210. See *Stuart v. American Sec. Bank*, 494 A.2d 1333, 1338 (D.C. 1985) (holding that bid of purchaser at foreclosure sale makes allowance for potential outstanding encumbrances).

211. Comment d to § 24 of the *Restatement of Restitution* provides that:

Normally, the seller of a chattel warrants his title, and the purchaser has the alternative of maintaining an action for breach of contract or of getting the return of his

Specifically, the risk of defective title in a sale on execution, without court approval, is deemed to be on the purchaser.²¹² Even if no title is transferred by the sale, the seller is entitled to retain the monies paid and the purchaser has no restitutionary claim, unless the parties otherwise agree.²¹³ The purchaser may, however, be subrogated on the debt and lien against the debtor whose debt was satisfied by the sale.²¹⁴

A sale on execution of a debt, without court approval, is the common law predecessor to a foreclosure sale under article 9.²¹⁵ Thus, it seems that the common law and equity also fail to provide the innocent purchaser, who gave value in good faith, with a remedy against the seller, who is the culpable party. Presumably, the rationale for this approach is that the price paid at a foreclosure sale, which is usually significantly less than fair market value, reflects the risks

consideration. On the other hand, the transaction may be conducted on the basis that even though no title passes by the transaction the purchaser is to take the risk. This is the normal inference in sales on execution by a sheriff or other officer, not requiring confirmation by a court. In these sales, unless it is otherwise agreed, the purchaser assumes the risk that the subject matter is not owned by the execution debtor and hence if there is a failure of title, he is not entitled to recover the purchase price from the officer, or from the creditor or other beneficiary in the absence of fraud or misrepresentation.

RESTATEMENT OF RESTITUTION, *supra* note 143, § 24 cmt. d. Comment 5 to § 312 of the U.C.C., on the other hand, provides that:

Subsection (2) recognizes that sales by sheriffs, executors, foreclosing lienors and persons similarly situated are so out of the ordinary commercial course that their peculiar character is immediately apparent to the buyer and therefore no personal obligation is imposed upon the seller who is purporting to sell only an unknown or limited right.

U.C.C. § 2-312 cmt. 5.

212. RESTATEMENT OF RESTITUTION, *supra* note 143, § 24 cmt. d; *see also* Note, *Execution Sales — Rights of Bona Fide Purchasers*, 24 MINN. L. REV. 805, 825-26 (1940) (arguing that purchaser is not only liable if title fails but is also liable to sheriff for any amount left unpaid on his bid).

213. *See* RESTATEMENT OF RESTITUTION, *supra* note 143, § 24 cmt. d; *see also* *Hutson v. Wood*, 105 N.E. 343, 348 (Ill. 1914) (ruling that, absent statute, purchaser is unable to recover money paid in event of either defective title or no title acquired due to defective sale).

214. *Hutson*, 105 N.E. at 348-49 (holding that court, in equity, can find that purchaser of property at void execution sale is subrogated to debt that was discharged by sale); *In re Arnold's Estate*, 78 Pa. D. & C. 76, 78 (Orphans Ct. Phila. County 1951) (stating, in dicta, that one who has paid debt of another with expectation of standing in creditor's shoes, is subrogated on debt); *see* RESTATEMENT OF RESTITUTION, *supra* note 143, § 43 (stating that person who unintentionally through mistake of fact pays debt and discharges lien on property of another is entitled to restitution in amount of value of benefit conferred); *see also id.* § 24 cmt. d (explaining that purchaser may have right of restitution against execution debtor whose debt was paid off by way of subrogation); Note, *supra* note 212, at 826-27 (explaining that general rule of caveat emptor applies to execution sales). *But see* *Bassett v. Lockard*, 60 Ill. 164, 166 (1871) (finding that purchaser at judicial sale pays for whatever title is conveyed, not for subrogation of debt, and that sale discharges debt and creditor has no further rights in debt or collateral).

215. *State Bank v. Hansen*, 302 N.W.2d 760, 764 (N.D. 1981) (stating that U.C.C. § 9-504 authorizes secured party to dispose of collateral upon default without court judgment).

assumed by the buyer, including the risk of defective title.²¹⁶

In the hypothetical, while the purchaser at the foreclosure sale can be held to have assumed the risk that a superior interest recognized in section 9-504(4) exists,²¹⁷ it is doubtful that the purchaser "knowingly" assumed the risk of the secured seller's conversion. Regardless of the purchaser's expectations or knowledge, the fact remains that the seller, who injured two innocent parties, is currently free from liability to the purchaser under the Code, common law, and equity, and the two innocent parties are left to battle over the good.

V. THE INADEQUACY OF THE PURCHASER'S COMMON LAW REMEDY

Unless a court, in equity, fashions a new remedy for the purchaser as against the seller, the purchaser's sole remedy is the restitutionary

216. See Fowler V. Harper & Mary Coate McNeely, *A Synthesis of the Law of Misrepresentation*, 22 MINN. L. REV. 939, 978 (1938) (arguing that vendee assumes risk of defective title with price being adjusted to reflect risk unless vendor represents otherwise); see also *Moister v. National Bank*, 1 B.R. 324, 329 (Bankr. N.D. Ga. 1979) (finding that, in sale, lack of warranty of title is typically reflected in reduced price of good); *Stuart v. American Sec. Bank*, 494 A.2d 1333, 1338 (D.C. 1985) (presuming that bid of purchaser at foreclosure sale makes allowance for potential outstanding encumbrances); *Woods v. Somerset County Tax Claim Bureau*, 32 Pa. D. & C.3d 62, 66 (Somerset County 1984) (positing that in judicial sale, as in quitclaim deed, buyer takes risk of defective title and is not entitled to restitution because buyer received what he bargained for and, therefore, seller is not unjustly enriched by retaining of purchase price); RESTATEMENT OF RESTITUTION, *supra* note 143, § 24 cmt. d (explaining that normal inference in execution sales is that purchaser assumes risk, including that of defective title). The price realized at a foreclosure sale is typically well below market value and often below liquidation value. See Craig H. Averch & Michael J. Collins, *Avoidance of Foreclosure Sales as Preferential Transfers: Another Serious Threat to Secured Creditors*, 24 TEX. TECH L. REV. 985, 989-90 (1993) (indicating that foreclosure sales, which are typically conducted swiftly and without sufficient opportunity for competitive bidding, and which contain little motivation on part of creditor to maximize price, often do not even generate amount equal to liquidation value of property); Alex M. Johnson, Jr., *Critiquing the Foreclosure Process: An Economic Approach Based on the Paradigmatic Norms of Bankruptcy*, 79 VA. L. REV. 959, 959-60 (1993) (observing that prices realized at foreclosure sales often are completely inadequate, thereby leaving debtor without property and still owing debt). A sale can be commercially reasonable while realizing a price far below market value. See U.C.C. § 9-507(2) ("The fact that a better price could have been obtained by a sale at a different time or in a different method from that selected by the secured party is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner."); William H. Henning, *An Analysis of Durrett and Its Impact on Real and Personal Property Foreclosures: Some Proposed Modifications*, 63 N.C. L. REV. 257, 278 (1985) (arguing that there are numerous examples of courts sustaining sales as commercially reasonable even though they bring in collateral for far less than fair market value); see also, e.g., *Sierra Fin. Corp. v. Brooks-Farrer Co.*, 93 Cal. Rptr. 422, 426 (Ct. App. 1971) (finding that sale was commercially reasonable even when goods worth over \$27,600 sold for \$500); *School Supply Co. v. First Nat'l Bank*, 685 S.W.2d 200, 203-04 (Ky. Ct. App. 1984) (finding commercially reasonable \$20,564 sale of collateral with value in excess of \$163,000).

217. See *supra* notes 59-61 and accompanying text (explaining that purchaser can be subject to claims of those with superior interest, or of debtor or junior creditors, when there is defect in sale, or purchaser did not act in good faith); see also Nickles, *supra* note 170, at 254 (explaining that purchasers at forced sales have usually been required to assume risk that superior interest in property will survive sale).

right of subrogation on the debt against the debtor.²¹⁸ This right is limited to the amount by which the debtor benefitted.²¹⁹ From the foreclosure sale, the debtor would receive a benefit to the extent of the debt reduction.²²⁰ Under the Code, the costs of repossession and sale are paid from the monies received at the sale before the debt is reduced.²²¹ Therefore, the debtor's benefit would be equal to the purchase price less (1) costs of repossession and sale, and (2) damages sustained due to lost use of the collateral.²²² If the entire debt is discharged due to the wrongful repossession and resale,²²³ even though the price was insufficient to pay the debt in full, the debtor arguably received a benefit equal to the amount of the entire debt, and the purchaser should be subrogated to that amount. The maximum amount of subrogation is generally limited, however, to the value paid by the subrogee.²²⁴ Therefore, in restitution, the purchaser will not receive more than the purchase price paid, and is likely to receive substantially less.

If our hypothetical purchaser is limited to the return of his purchase price, he will lose the benefit of his bargain²²⁵ with the

218. See *Dixon v. City Nat'l Bank*, 395 N.E.2d 620, 621 (Ill. App. Ct. 1979) (holding that purchasers could not recover purchase price from creditor, but, where proceeds of void sale go to satisfying debt owed to creditors, purchaser becomes subrogated to rights of creditor against debtor); see also *supra* notes 141-64 and accompanying text (discussing debtor's remedies against purchaser).

219. See RESTATEMENT OF RESTITUTION, *supra* note 143, § 43 & cmts. a, d (stating that person who unintentionally discharges duty, or releases debt of another by paying third party, is entitled to restitution of benefit conferred up to amount given); *Dow & Ellis*, *supra* note 159, at 786-87 (discussing defense where debtor is not required to give up benefit received if such restitution will result in actual loss due to change in position).

220. See RESTATEMENT OF RESTITUTION, *supra* note 143, § 155 & cmt. c (explaining that debtor is under no obligation to pay more than amount of debt to person who has discharged it).

221. U.C.C. § 9-504(1).

222. See *supra* notes 144-60 and accompanying text (discussing debtor's remedies against purchaser).

223. See *supra* note 14 (discussing debtor's causes of action against creditor in event of wrongful repossession and resale).

224. RESTATEMENT OF RESTITUTION, *supra* note 143, § 43; see also *Gremillion v. Roy*, 51 So. 576, 577 (La. 1910) (holding that seller of property with void title is generally liable for restitution of purchase price); RESTATEMENT OF RESTITUTION, *supra* note 143, § 162 (explaining that one whose property is used to discharge debt of another is entitled to be subrogated to position of lien-holder).

225. Under the U.C.C., a party is generally entitled to receive the benefit of his bargain. See, e.g., U.C.C. § 1-106 (indicating that aggrieved party will generally be put in as good position as if other party had performed); *Metalcraft v. Pratt*, 500 A.2d 329, 336 (Md. Ct. Spec. App. 1985) (emphasizing that party suffering from breach of contract is entitled to damages that would place him in as good position as if contract had not been breached). This is also generally the measure of damages for common law breach of contract actions in the United States. See, e.g., *Basiliko v. Pargo Corp.*, 532 A.2d 1346, 1348 (D.C. 1987) (holding that, in breach of contract action for sale of real estate, aggrieved party is entitled to standard contract damages, thus providing plaintiff with benefit of bargain); *Donovan v. Bachstadt*, 453 A.2d 160, 164 (N.J. 1982) (applying "American rule," providing for damages based on benefit of bargain, to breach of

bank, as he bargained for a unique automobile. He will lose the automobile and its value, receiving, at most, the return of his money over time.²²⁶ Under current law, the purchaser is not entitled to further damages from either the selling creditor or the debtor.²²⁷

The limited damages available to the purchaser in restitution are less than what would be recoverable under a Code cause of action. The sale is clearly within the scope of article 2 and therefore, a Code breach of contract would warrant the imposition of Code damages.²²⁸ In the event of a breach of contract, the Code seeks to place an aggrieved party in as good a position as it would have been had no breach occurred.²²⁹ The Code indicates that it and its remedies are to be liberally construed to effect this purpose.²³⁰ In assessing damages under the Code, the focus is on the loss suffered by the aggrieved party, not the benefit received by the other party.²³¹

Under the Code, where a seller fails to deliver conforming goods²³² due to a breach of warranty, including the warranty of title,²³³ the aggrieved buyer is entitled to more than simply the return of the purchase price paid.²³⁴ The buyer is entitled to be compensated for losses caused by the breach, including incidental and consequential damages.²³⁵ Generally, the measure of damages for a breach of the warranty of title is the difference between the value of the goods as warranted and as accepted, at the time and place of

contract action).

226. See *supra* notes 161-64 and accompanying text (discussing what purchasers are entitled to recover from debtors); see also *supra* notes 167-217 and accompanying text (discussing purchasers' rights and remedies against creditors under U.C.C., common law, and equity).

227. See *supra* notes 167-217 and accompanying text (indicating that remedies discussed are only ones available under law).

228. See U.C.C. §§ 2-102 (providing that article 2 of Code applies to "transactions in goods"), 9-504(1) (providing that sales aspect of article 9 foreclosure sale is subject to article 2).

229. *Id.* § 1-106.

230. *Id.* §§ 1-102 & cmt. 1, -106 cmt. 1.

231. *Id.* § 1-106 & cmt. 1 (setting forth purpose of Code damages as compensation of aggrieved party).

232. A seller's failure to deliver conforming goods is a breach of contract entitling the buyer to damages. See *id.* § 2-301 (stating that "obligation of seller is to transfer and deliver . . . in accordance with the contract"); *id.* § 2-711 (listing buyer's remedies for breach by seller).

233. See *Ricklefs v. Clemens*, 531 P.2d 94, 100 (Kan. 1975) (holding that measure of damages for breach of warranty is loss directly resulting from breach of warranty); *Metalcraft v. Pratt*, 500 A.2d 329, 336 (Md. Ct. Spec. App. 1985) (noting that courts generally agree that damages for breach of warranty under U.C.C. § 2-714 apply to breaches of warranty of title). See generally Jane M. Draper, Annotation, *Measure of Damages in Action for Breach of Warranty of Title to Personal Property Under UCC § 2-714*, 94 A.L.R.3d 583, 583-93 (1979) (discussing cases where courts have determined measure of damages for breach of warranty of title by applying U.C.C. § 2-714, which deals with breach of warranty).

234. See U.C.C. §§ 2-714 to -715 (listing buyer's damages for breach in regard to accepted goods, as well as incidental and consequential damages).

235. *Id.* § 2-714(2), (3).

acceptance.²³⁶

If special circumstances exist, however, for example when a unique good is involved,²³⁷ damages in a different amount may be proven and recovered.²³⁸ An appropriate measure of damages is then the value of the good on the date of dispossession.²³⁹ This measure is appropriate regardless of whether the good has appreciated or depreciated since acceptance.²⁴⁰ When damages are assessed as of the date of dispossession, the purchaser receives the value of the good lost, at the time it is lost, due to the breach of the warranty of title. The purchaser is placed in as good a position as he would have been had the seller conveyed good title as required.²⁴¹

In the event of a breach, the buyer also is entitled to recover incidental and consequential damages.²⁴² Incidental damages are generally expenses incurred in the course of the transaction due to actions a party must take in response to the other party's breach.²⁴³ Expenses recoverable as incidental damages include those "reasonably

236. *Id.* § 2-714(2).

237. See *Jeanneret v. Vichey*, 541 F. Supp. 80, 85 (S.D.N.Y.) (finding that New York courts have looked to special circumstances exception under U.C.C. when deciding damages for breach of warranty involving "unique goods"), *rev'd on other grounds*, 693 F.2d 259 (2d Cir. 1982); *Metalcraft*, 500 A.2d at 336 (noting that involvement of unique good or chattel is factor in determining existence of special circumstances).

238. U.C.C. § 2-714(2); see also *Metalcraft*, 500 A.2d at 336 (holding that when special circumstances exist, different damages may be either greater or lesser than value of goods at acceptance); *Security Nat'l Bank v. Hufford*, 754 P.2d 561, 566 n.6 (Okla. Ct. App. 1987) (noting that measure of damages for breach of warranty of title is equal to loss directly and naturally resulting from breach); Roy R. Anderson, *Buyer's Damages for Breach in Regard to Accepted Goods*, 57 Miss. L.J. 317, 365-68 (1987) (discussing appropriate measure of damages in action for breach of warranty of title).

239. See *Metalcraft*, 500 A.2d at 336; *Itoh v. Kimi Sales*, 345 N.Y.S.2d 416, 419-20 (Civ. Ct. 1973) (finding that value of damages should be value of property when it was taken away). But see *Jerry Parks Equip. Co. v. Southeast Equip. Co.*, 817 F.2d 340, 343 (5th Cir. 1987) (finding that measure of damages is value of goods at acceptance and, absent other evidence, is equal to purchase price).

240. *Ricklefs v. Clemens*, 531 P.2d 94, 100 (Kan. 1975) (finding dispossession date appropriate where good had depreciated since purchase); *Metalcraft*, 500 A.2d at 336 (holding that measure of damages is value of goods at date of dispossession regardless of whether value was more or less than it was on date of acceptance); *Schneidt v. Absey Motors*, 248 N.W.2d 792, 798 (N.D. 1976) (stating that damages are determined at date of dispossession where good had appreciated in value since purchase).

241. See *Metalcraft*, 500 A.2d at 336 (noting that general principle of contract law is that party receives benefit of his bargain by being put in as good position as he would have had contract not been breached); see also *National Micrographics Sys. Inc. v. OCE-Indus.*, 465 A.2d 862, 869 (Md. Ct. Spec. App. 1983) (stating that law tries to encourage reliable contracting by giving nonbreaching party benefit of bargain); *Jerry Parks*, 817 F.2d at 343 (stating that purpose of Code damages is to put complaining party in position that is as good as party would have been if contract had been performed).

242. U.C.C. § 2-714(3). See generally Roy R. Anderson, *Incidental and Consequential Damages*, 7 J.L. & COM. 327 (1987) (discussing incidental and consequential damages).

243. *Petroleo Brasileiro, S.A., Petrobás v. Ameropan Oil Co.*, 372 F. Supp. 503, 508 (E.D.N.Y. 1974) (stating that in absence of specified damages in contract, plaintiff may include incidental damages resulting from defendant's breach).

incurred in the inspection, receipt, transportation care and custody" of rejected goods, or in connection with effecting cover.²⁴⁴

Consequential damages generally do not arise within the buyer-seller relationship, resulting instead from the particular needs of the buyer that the seller could reasonably foresee.²⁴⁵ Consequential damages may include damages for loss of use of the good, interest and finance charges, repair costs, transfer charges, and sales and use tax.²⁴⁶ Specifically, in an action for breach of the warranty of title, recoverable consequential damages may include the costs incurred by the buyer in defending its right to the good, such as reasonable attorney's fees.²⁴⁷ Clearly, if the buyer is required to pay damages to the good's rightful owner due to the seller's breach of the warranty

244. U.C.C. § 2-715(1) provides that:

Incidental damages resulting from the seller's breach include expenses reasonably incurred in inspection, receipt, transportation and care and custody of goods rightfully rejected, any commercially reasonable charges, expenses or commissions in connection with effecting cover and any other reasonable expense incident to the delay or other breach.

U.C.C. § 2-715(1); *see also id.* (giving buyer right to "cover" after seller's breach by making reasonable purchase of goods to substitute for those due from seller).

245. *Petroleo Brasileiro*, 372 F. Supp. at 508 (stating that consequential damages "do not arise within the scope of the immediate buyer-seller transaction, but rather stem from losses incurred by the non-breaching party in its dealings, often with third parties, which were a proximate result of the breach"). U.C.C. § 2-715(2)(a) provides:

(2) Consequential damages resulting from the seller's breach include (a) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise.

U.C.C. § 2-715(2)(a).

246. *Anderson*, *supra* note 242, at 360-64 (listing examples of recurring categories of consequential damages); *see also* *Seekings v. Jimmy GMC*, 638 P.2d 210, 215 (Ariz. 1981) (stating that consequential damages are those damages that can reasonably be supposed to be with contemplation of parties at time of contracting); *Riggs Motor Co. v. Archer*, 240 S.W.2d 75, 76 (Ky. Ct. App. 1951) (holding that buyer was entitled to damages including amount expended for automobile repairs and accessories). *But see* *Theobald v. Sprouse*, 257 So. 2d 516, 518 (Miss. 1972) (holding that repair costs incurred are not recoverable in action for breach of warranty of title).

247. *See* *Universal C.I.T. Credit Corp. v. State Farm Mut. Auto. Ins. Co.*, 493 S.W.2d 385, 391 (Mo. Ct. App. 1973) (stating that in warranty of title action, buyer may collect as consequential damages his expenses, including attorney's fees, incurred in defending title to good after buyer has given seller notice of third-party claim); *see also* *Perkins State Bank v. Connolly*, 632 F.2d 1306, 1315 (5th Cir. 1980) (holding that attorney's fees are recoverable in indemnity action based on payment and defense of third-party breach of warranty action under article 4 of U.C.C.); *Chemco Indus. Applicators Co. v. E.I. du Pont de Nemours & Co.*, 366 F. Supp. 278, 286 (E.D. Mo. 1973) (holding du Pont liable for attorney's fees expended on third-party claim); *Alterman Foods v. G.C.C. Beverages*, 310 S.E.2d 755, 756 (Ga. Ct. App. 1983) (holding that attorney's fees incurred by buyer in defense of third-party breach of warranty action are recoverable as consequential damages); *Murray v. Holiday Rambler*, 265 N.W.2d 513, 527 (Wis. 1978) (holding that attorney's fees and expenses incurred in third-party litigation are recoverable as consequential damages, but attorney's fees incurred in litigation between buyer and seller are not). *See generally* David T. Schaefer, Note, *Attorneys' Fees for Consumers in Warranty Actions — An Expanding Role for the U.C.C.*, 61 IND. L.J. 495 (1986) (discussing recoverability of attorneys' fees in breach of warranty litigation).

of title, the buyer is entitled to indemnification from the seller for the amounts paid.²⁴⁸

Under either approach to the measure of general damages for breach of the warranty of title, the purchaser is entitled to recover the fair market value of the good, as determined at the time of either acceptance or dispossession because the value of the goods as accepted is zero.²⁴⁹ Either version of the fair market value should exceed the purchase price as the vast majority of foreclosure sales occur at substantially less than fair market value.²⁵⁰ Additionally, the buyer would be entitled to recover incidental and consequential damages it has incurred as a result of the seller's failure to convey good title.²⁵¹

If our hypothetical purchaser were able to recover damages under the Code for the seller's failure to convey good title, the purchaser would receive the fair market value²⁵² of the Tucker plus incidental and consequential damages, including costs incurred in defending his title against the debtor.²⁵³ Yet, as the law currently stands, at most the purchaser would recover only the purchase price, paid over time. This amount is likely to be substantially less than the fair market value of the good. The purchaser can only be made whole by permitting a Code cause of action against the seller, consistent with the general policies of the Code and article 2 in particular.²⁵⁴

VI. PROPOSED AMENDMENT TO SECTION 9-504(4)

The cases and commentary discussed above establish that both the

248. See Anderson, *supra* note 242, at 427 (arguing that buyer was entitled to "indemnification" from manufacturer for damages that were incidental). U.C.C. § 2-607(5) (a) binds a seller, who, after notice, has refused to defend a warranty action brought by a third party against the buyer, to the determination of facts made in that litigation. See *Perkins State Bank*, 632 F.2d at 1315 (awarding attorney's fees for third-party suits under article 4 warranties); *Chemco Indus.*, 366 F. Supp. at 283-84 (discussing third-party suit under implied warranties of merchantability and fitness); *Universal C.I.T. Credit Corp.*, 493 S.W.2d at 392 (discussing indemnification in warranty of title action); see also *Catlin Aviation Co. v. Equilease Corp.*, 626 P.2d 857, 859 (Okla. 1981) (holding that it is obligation of seller who warrants title to clear title).

249. The fair market value of goods transferred with void title is zero. See *Jerry Parks Equip. Co. v. Southeast Equip. Co.*, 817 F.2d 340, 343 (5th Cir. 1987) (discussing calculation of damages). The value of the goods as warranted, that is, with good title, is the fair market value. The difference between the two is, therefore, equal to the fair market value. *Id.*

250. See *supra* note 216 (citing examples of foreclosure sales at reduced prices).

251. U.C.C. § 2-715 & cmt.

252. *Id.* § 2-713(1) & cmt. The good as accepted, with void title, would have a market value of zero. As warranted, the purchaser would have received good title, and thus, the value would be market value. The damages the purchaser has actually sustained are thus equal to the automobile's fair market value. *Id.*

253. See *id.* § 2-715 (listing examples of recoverable incidental and consequential damages).

254. *Id.* §§ 1-106 & cmt. 1, 2-703 cmt. 4, 2-711 cmt. 3 (stating that remedies provided by U.C.C. should be liberally administered).

Uniform Commercial Code and the common law inadequately address the respective rights of the debtor and purchaser where the collateral is sold in the absence of a default. As the law currently stands, in lieu of pursuing a claim against the secured creditor,²⁵⁵ an astute debtor may proceed against the purchaser, seeking either to reclaim the collateral or recover damages for conversion.²⁵⁶ This gap in the Code shifts the loss to one of the innocent parties in the transaction, while permitting the wrongdoer, the secured creditor, potentially to retain the benefit it received from the purchaser.²⁵⁷ Purchasers at foreclosure sales are entitled to greater certainty as to the rights they obtain through the sale.²⁵⁸ Debtors should be given guidance on their right to reclaim property that has been wrongfully foreclosed and sold. The resolution of the paradox created by the Code should balance the equities between the parties to the transaction. A paradigm for resolving this conflict is needed.

A. Method for Allocating Risks Between Debtor and Purchaser

Two of the primary goals of article 9 are to promote efficiency and certainty in secured financing transactions.²⁵⁹ These goals are

255. See *id.* § 9-507(1) (providing debtor with remedy against secured creditor for violations of part 5 of article 9).

256. In some instances, the secured creditor will purchase the good at the foreclosure sale, and then resell it as the "owner" to another. Averch & Collins, *supra* note 216, at 989 (discussing how secured creditor converts lien through foreclosure sale). Much of the foregoing analysis will apply to this type of transaction as well. Clearly, where the secured creditor is the purchaser, it will take subject to all of the debtor's rights because the debtor was not in default. See U.C.C. § 9-504(4) (providing protection generally for good faith third-party purchaser of collateral from secured party where debtor is in default); *supra* notes 19-23 and accompanying text (stating that secured party who sells property of nondefaulting debtor has converted property). The later sale to a third party will be subject to article 2 as a sale of a good. U.C.C. §§ 2-102, -106. The general rule on title would therefore still apply. See *id.* § 2-403 (stating that purchaser acquires all title that his transferor had). The only difference would be that the warranty of title would attach to the sale, in the absence of special circumstances or a disclaimer by the seller. *Id.* § 2-312. In this type of transaction, the purchaser would still lose the property to the debtor who is the rightful owner. See *supra* notes 19-139 and accompanying text (setting out rights of purchaser at forced sale, and observing that current version of article 9 does not protect purchase where debtor is not in default). If the warranty of title attaches to the sale, however, the purchaser will have a Code remedy for the seller's failure to convey good title. U.C.C. § 2-312(1).

257. The secured creditor will retain the benefits from the sale only if the debtor does not pursue the creditor under U.C.C. § 9-507(1) or the common law. Yet as to the purchaser, the secured creditor is free from liability. See *supra* notes 208-16 and accompanying text (discussing apportionment of liability at foreclosure sale).

258. See U.C.C. § 9-101 cmt. ("The aim of this Article is to provide a simple and unified structure within which the immense variety of present-day secured financing transactions can go forward with less cost and with greater certainty.").

259. *Id.*; see also Gilmore, *supra* note 57, at 36 (stating that purpose of article 9 "is to make the taking of security easy, cheap and certain"); REPORT OF PEB STUDY GROUP, UNIFORM COMMERCIAL CODE 2 (December 1, 1992) [hereinafter PEB REPORT] (stating that uncertainty adds to transactional costs and can result in reduced availability of credit). For this analysis, I

partially accomplished by the Code's existing provisions for resolving purchaser-debtor disputes that arise through a foreclosure sale after default.²⁶⁰ They could also be furthered by a Code framework for resolving conflicts that arise from a foreclosure sale in the absence of default. If incorporated into the Code, a solution to the problem would reduce the need to resort to costly litigation, increase certainty, and decrease transactional costs associated with foreclosure sales.²⁶¹ By closing the current gap in the rights acquired by purchasers, article 9 will move closer to "the comprehensive scheme for the regulation of security interests in personal property" that the drafters sought to achieve.²⁶²

Historically, the resolution of disputes between owners and purchasers of collateral has focused on the concept of "title."²⁶³ If the purchaser did not receive title to the disputed property from his transferor, then the owner, who held good title, could reclaim the property regardless of the purchaser's good faith or lack of knowledge.²⁶⁴ On the other hand, if the purchaser acquired good title, then the owner was divested of it by operation of law.²⁶⁵ Because only one party could hold good title, the determination of the title issue resolved the dispute.

This approach was further embodied in the common law doctrines of *nemo dat*²⁶⁶ and *qui prior est tempore potior est jure*.²⁶⁷ Generally,

accept that the goals of article 9 are worthwhile. For critiques of these goals, see Alan Schwartz, *The Continuing Puzzle of Secured Debt*, 37 VAND. L. REV. 1051 (1984) (questioning whether certainty creates efficiency for economy as whole) and Richard L. Barnes, *The Efficiency Justification for Secured Transactions: Foxes with Soxes and Other Fanciful Stuff*, 42 KAN. L. REV. 13 (1993) (stating that article 9 is weak justification for interference and foreclosure of choices). Even if the goals are assailable, both the courts and the committees currently working on the revision of article 9 continue to be guided by them. See, e.g., *Farns Assocs. v. South Side Bank*, 417 N.E.2d 818, 822-23 (Ill. App. Ct. 1981) (applying article 9 in order to promote underlying purposes and policies); *Borg-Warner Acceptance Corp. v. First Nat'l Bank*, 238 N.W.2d 612, 614-15 (Minn. 1976) (discussing purposes of article 9); *Matteson v. Harper*, 682 P.2d 766, 769 (Or. 1984) (discussing purposes of article 9). See generally PEB REPORT, *supra* (relying on espoused purposes of article 9 as basis for recommendations of change).

260. See *supra* notes 55-60 and accompanying text (discussing risky default at foreclosure sale).

261. See PEB REPORT, *supra* note 259, at 2 (stating that increasing certainty decreases transactional costs); Mautner, *supra* note 7, at 101 (arguing that rules should be drafted to increase certainty, and thereby decrease need to resolve disputes judicially and in turn, decrease costs of dispute resolution). Increasing certainty and thereby decreasing the costs incident to a commercial transaction was one of the primary purposes guiding the drafters of article 9. See U.C.C. § 9-101 cmt; see also *id.* § 1-102 & cmts.

262. U.C.C. § 9-101 cmt.

263. See Mautner, *supra* note 8, at 97-99 (discussing doctrinal-derivational approach to triangle conflicts).

264. See Mautner, *supra* note 8, at 129-30 (discussing entrustment of goods).

265. Mautner, *supra* note 8, at 129-30.

266. The rule of "Nemo dat quod non habet," meaning "he who has not cannot give," dates from Roman times. Boris Kozolchik, *Transfer of Personal Property by a Nonowner: Its Future in Light*

the first claim to the property was superior. The original holder of title, who had not been lawfully divested of it, prevailed over subsequent parties claiming title to the good because the original owner was "first in time."²⁶⁸ The purchaser prevailed only when the seller had some right or title that was transferable as against the owner of the property.

This historical approach is reflected in the current method by which the Code and courts resolve disputes between purchasers and "owners" of property. Section 2-403 conditions the rights of a purchaser on the transferor's title.²⁶⁹ If a purchaser does not acquire good title, the original owner is entitled to reclaim the property, again despite the purchaser's good faith or lack of knowledge.²⁷⁰ This is currently true even if the owner was in a position to prevent the loss of the good.²⁷¹

This preoccupation with title is antithetical to the general approach of the U.C.C. Article 9 specifically rejects title as the criterion that determines the rights and responsibilities of the parties to a secured transaction.²⁷² The drafters similarly rejected title as a determinative factor in article 2.²⁷³ The drafters declared that their rejection of title as definitive reflected a need to "avoid making practical issues

of its Past, 61 TUL. L. REV. 1453, 1462-63 (1987) (discussing "newness" of grantees rights).

267. "He who is first in time is first in right." Mautner, *supra* note 8, at 135 (discussing priority rules of common law for resolving conflicts); see also *Peper v. American Exch. Nat'l Bank*, 205 S.W.2d 215, 220-21 (Mo. Ct. App. 1947) (holding that, in equity, where one of two innocent persons must suffer because of wrongdoing of third party, one whose interest arose first prevails).

268. See *Fawcett v. Osborn*, 32 Ill. 411, 424 (1863) (holding that true owner may follow his property and reclaim it wherever found); RAUSHENBUSH, *supra* note 14, § 9.3, at 193 (discussing general rule that one who has no title to goods cannot pass title to even bona fide purchaser); Mautner, *supra* note 8, at 135 (discussing common law for resolving conflicting transactions in land).

269. U.C.C. § 2-403(1)(c) provides that "a purchaser acquires all title which his transferor had or had power to transfer." U.C.C. § 2-403(1)(c).

270. See *supra* notes 141-44 and accompanying text (discussing remedies for owner of converted goods).

271. See Mautner, *supra* note 8, at 98 (discussing doctrinal-derivational approach).

272. U.C.C. § 9-202, entitled "Title to Collateral Immaterial," states, "Each provision of this Article with regard to rights, obligations and remedies applies whether title to collateral is in the secured party or in the debtor." U.C.C. § 9-202. In his treatise, Professor Hawkland explains that U.C.C. § 9-311 "reinforces the notion that questions of who has 'legal title' to the collateral are irrelevant insofar as the rights, obligations and remedies of the secured party, the debtor and interested third parties are concerned." HAWKLAND, *supra* note 4, § 9-311:01, at 186.

273. See U.C.C. § 2-101 cmt. (stating that contract is to be basis for legal action); National Conference of Commissioners on Uniform State Laws and American Law Institute, *Uniform Commercial Code: Report of Committee on the Proposed Commercial Code, Developments Since September, 1949*, at 8 (Sept. 1950). In responding to Professor Williston's attack on the proposed U.C.C.'s minimization of the importance of title, the Committee stated, "[A]dmitting that this minimizing of title is a 'break with tradition,' your Committee feels that Article 2 sets forth a body of rules with respect to sales in a form more usable by practicing attorneys and businessmen" than previous commercial laws. *Id.*

between practical men turn upon the location of an intangible something, the passing of which no man can prove by evidence."²⁷⁴ Yet that is precisely what the current focus on title accomplishes. The comparative equities between the parties are not considered. The relative abilities of the parties to prevent or mitigate the damages caused by the secured creditor's wrongful actions are immaterial. The sole issue considered is whether title remained with the original owner or instead passed to the purchaser. Once that issue is settled, the respective rights of the parties mechanistically fall in line.

Some commentators have suggested that the time has come for the Code and the courts to move away from their fixation on title for the resolution of disputes between parties who did not transact with each other, both of whom are not responsible for the losses sustained.²⁷⁵ By shifting the focus from title and its appurtenant rights and obligations, the Code can be revised to resolve the claim to the collateral in an equitable fashion, and place the ultimate responsibility on the culpable party, the secured seller.²⁷⁶

Considerations of economic efficiency, relative culpability, loss avoidance, and loss minimalization permit the resolution of the debtor-purchaser dispute in a manner that is more equitable and consistent with the aims of the Code.²⁷⁷ Economic efficiency should encourage the maximization of the price paid at foreclosure sales.²⁷⁸ The more certain the title received in a sale, and the less likely that the debtor can successfully challenge the purchaser's title, the more

274. U.C.C. § 2-101 cmt.

275. See, e.g., Mautner, *supra* note 8, at 99 (arguing that solutions based on justice or efficiency are preferable to Code); Tabac, *supra* note 86, at 410 (stating that transactions should be based on ownership principles).

276. The secured creditor is the party "at fault" in a legal and moral sense, having acted in contravention of both the law and its agreement with the debtor. As demonstrated in the text, while the secured creditor currently is liable to the debtor for her damages, it is not liable to the purchaser. See *supra* notes 207-17 and accompanying text (discussing unjust apportionment of liability under Code); see also U.C.C. § 9-507(2) (providing debtor with cause of action against secured party who violates article 9).

277. See Mautner, *supra* note 8, at 99 (proposing alternatives to doctrinal-derivational approach for resolving triangle conflicts that do not focus on intermediate party); see also Starnes, *supra* note 4, at 577 (proposing economic efficiency as factor to consider in resolving article 9 disputes).

278. See Gilmore, *supra* note 57, at 43 (arguing that default provision of article 9 should promote disposition of collateral at highest possible price); Starnes, *supra* note 4, at 577 (stating that specific goal of article 9 is maximization of efficiency and certainty). Price maximization is one of the policies underlying U.C.C. § 9-504. See *supra* note 57 (observing that debtor is entitled to any surplus over his liabilities). Professor Gilmore noted that the drafters' goal in structuring the rules for disposition of collateral by a secured creditor was to "lay down rules which would promote the highest possible yield on disposition of the collateral." Grant Gilmore, *Article 9 of the Uniform Commercial Code - Part V*, 7 PERS. FIN. L.Q. 4, 7 (1952).

valuable the collateral and the greater the purchase price will be,²⁷⁹ thereby achieving economic efficiency.²⁸⁰ The current hodgepodge of law, which favors the debtor over the purchaser for no better reason than the debtor was "first in time," and which requires the parties to resort to the judicial process for a declaration of rights, is economically inefficient.²⁸¹

The equitable concerns of relative culpability and loss avoidance are interrelated. Relative culpability considers whether either party is "blameworthy" vis-a-vis the other party because its actions or failure to act either permitted or facilitated the creditor's wrongful conduct.²⁸² Loss avoidance weighs each party's ability to avoid the loss by preventing the secured party's unauthorized repossession and sale.²⁸³

Between the debtor and purchaser, while each may be legally and morally "innocent," having acted in accordance with the Code and common law, one party may be more blameworthy for the loss if she acted or failed to act when she had the opportunity to prevent the loss. Likewise, where one party is aware of the defect and has the ability to prevent the consummation of the sale, the law should require that party to do so, or risk losing the right to the good.²⁸⁴

The debtor is more likely to be in a position to influence the creditor's actions because she is the one with a contractual and ongoing relationship with the secured party. Often, a debtor will be in a position to prevent the loss where she knows that the secured creditor is operating under misinformation, but fails to correct the creditor's error. Similarly, where a creditor wrongfully declares a default, if the debtor is capable of providing the creditor with

279. See *Moister v. National Bank*, 1 B.R. 324, 328 (Bankr. N.D. Ga. 1979) (stating that, in sales consummated without attachment of warranty of title, uncertainty of title is reflected in purchase price); *Woods v. Somerset County Tax Claim Bureau*, 32 Pa. D. & C.3d 62, 66 (Ct. Com. Pls. 1984) (holding that in judicial sale, buyer takes risk of defective title and pays price accordingly).

280. In this context, economic efficiency means maximizing satisfaction, or gain, while minimizing the costs associated with achieving it. See Barnes, *supra* note 259, at 14-15, 26-27 (defining efficiency as measure of satisfaction taking into account relative costs); Richard Posner, *Utilitarianism, Economics, and Legal Theory*, 8 J. LEGAL STUD. 103 (1979) (defining wealth and its relationship to wealth maximization as amount people are willing to pay to get something or be paid to give it up).

281. See *In re Samuels & Co.*, 526 F.2d 1238, 1247 (5th Cir.) (stating that goal of article 9 is continuity of perfected security interests despite subsequent loss of control of collateral by debtor), *cert. denied*, 429 U.S. 834 (1976).

282. Mautner, *supra* note 8, at 128.

283. See Mautner, *supra* note 8, at 99-102, 128 (discussing priority rules to promote efficiency).

284. Mautner, *supra* note 8, at 104 (stating that in dispute between two innocent parties, where one can avoid loss, equity requires that other party receive priority).

information necessary to vitiate the declaration of default, she should be encouraged to do so. While the debtor, having no duty to act, may not be legally "blameworthy" if she fails to act, her failure would contribute to the loss of the good and therefore should be considered in resolving a dispute over the collateral.

Additionally, repossession and resale do not happen instantaneously.²⁸⁵ The debtor is given the right, under the Code, to enjoin a secured creditor's attempt to wrongfully repossess or resell.²⁸⁶ Given this power, the debtor is more likely to be in a position to prevent the loss than the purchaser, a stranger to the financing arrangement.²⁸⁷ The debtor, therefore, should be required to avail herself of the Code's protections or lose her rights in the collateral as against the purchaser.

In some situations, neither the debtor nor the purchaser will be able to mitigate or avoid the loss. Under those circumstances, the culpability and avoidance concerns are insufficient to achieve a solution. With all else being equal, distributive justice seeks to minimize the loss incurred in the transaction.²⁸⁸ To accomplish loss minimalization, the party who would suffer the greatest harm by losing the good should prevail.²⁸⁹ The loss sustained due to the deprivation of the use and value of the good would generally be the same for the debtor or purchaser in the hypothetical propounded. The debtor, however, who is apt to have purchased the good in the marketplace, is more likely to have paid at or near fair market value for the good than the purchaser who bought at a foreclosure sale.²⁹⁰ If neither party was in a position to prevent the loss, the debtor, who probably invested more in the acquisition of the collateral, should prevail to minimize the loss sustained in the transaction as a whole.

To reach the most equitable result, these considerations would have to be weighed in each case. This case by case approach, however, would defeat the economic efficiency gained by the predictability of

285. U.C.C. § 9-504(3) (requiring secured party, under most circumstances, to give debtor reasonable notice before sale is consummated).

286. *Id.* § 9-507(1) ("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.").

287. For the purchaser to be in a position to avoid the loss, he would presumably need to know that the disposition is unauthorized and unlawful. In such a situation, the purchaser would not be acting in good faith and would not be entitled to protection under § 9-504(4). See *id.* § 9-504(4) (setting out rights of purchasers who act in good faith).

288. Mautner, *supra* note 8, at 103-05 (discussing concept of justice as method of allocating risk of wrongdoer's action).

289. Mautner, *supra* note 8, at 103-05 (discussing distributive justice).

290. See *supra* note 216 (discussing risk factors that go into calculation of fair price).

outcome and the reduced transactional costs that result therefrom. Therefore, a Code solution that accounts for these factors as they would arise in most circumstances, as discussed above, is warranted. Such a balancing results in a different answer to the issues in debtor-purchaser conflict than the current "title" approach.

B. Statutory Solution

With the foregoing policies and purposes in mind, section 9-504 should be redrafted as follows:

(4)(a) When collateral is disposed of by a secured party after default, the disposition transfers to a purchaser for value all of the debtor's rights therein, discharges the security interest under which it is made and any security interest or lien subordinate thereto. The purchaser takes free of all such rights and interest even though the secured party fails to comply with the requirements of this Part or any judicial proceedings

(1) in the case of a public sale, if the purchaser has no knowledge of any defects in the sale and if he does not buy in collusion with the secured party, other bidders or the person conducting the sale; or

(2) in any other case, if the purchaser acts in good faith.

(b) An otherwise qualified purchaser under subsection (a) who purchases at a sale under this section acquires such rights notwithstanding a subsequent determination that the secured party's declaration of default was unjustified or otherwise invalid if the debtor has failed to preserve his rights in the collateral under section 9-507(1) in a timely and reasonable manner.

(c) A purchaser who voluntarily or otherwise relinquishes the collateral, pays or is liable for damages, or defends an action by a debtor who was not in default at the time of the sale, may recover from the secured party any loss sustained, including the purchase price paid, and incidental and consequential damages.

The proposed section (4)(a) and its subsections (1) and (2) are the current sections (4) and its subsections (a) and (b). Proposed section (b) attempts to balance the equities between the debtor and the purchaser. If the debtor has failed to avail herself of her rights to restrain the sale or otherwise protect her interest in the collateral before the sale, equity requires that the debtor bear the loss of the collateral resulting from the secured party's wrongful actions. On the other hand, if the debtor has had insufficient time to prevent the sale, or otherwise has acted reasonably to protect her rights, the debtor should not lose the right to the collateral.

In the event that the debtor prevails over the purchaser, the purchaser is expressly given the right to recoup his full losses from

the selling secured creditor under proposed section (c). This section is designed to countermand the language of Official Comment 5 to section 2-312, which currently bars recovery from the selling secured party under an action for breach of the warranty of title.²⁹¹

In either event, the purchaser and the debtor are protected, and the wrongdoer, the selling secured party, remains ultimately liable for the damages caused by its actions. If the debtor has delayed or acted unreasonably to prevent the sale, the purchaser obtains title to the good and the debtor retains her action for damages against the creditor under section 9-507(1). If the debtor is unable to protect herself in a reasonable and timely manner, the debtor may reclaim the collateral from the purchaser. The purchaser may then recover damages from the selling secured party. This proposed amendment closes a gap, however unintended, created by the current language of the Code and its Official Comments.

291. U.C.C. § 2-312 cmt. 5.

