South Carolina Law Review

Volume 40
Issue 1 *ANNUAL SURVEY OF SOUTH CAROLINA LAW*

Article 14

Fall 1988

Secured Transactions

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SECURED TRANSACTIONS

I. COURT ADOPTS "REBUTTABLE PRESUMPTION" RULE IN THE EVENT OF FAILURE TO NOTIFY IN A DEFAULT SALE

The South Carolina Court of Appeals has determined that a creditor's failure to give notice of the sale of a debtor's collateral is not an absolute bar to obtaining a deficiency judgment. Failure to give notice merely creates a rebuttable presumption that the collateral is worth at least the amount of the debt. The burden of proving otherwise rests on the secured party.

In *Mathias v. Hicks*[1] a creditor failed to follow the notice requirement of section 36-9-504(3) of the South Carolina Code of Laws.[2] Mathias sold his restaurant to Hicks, taking a note for approximately $18,000 secured by fixtures, furniture, and equipment in the restaurant. About a year and a half after she purchased the restaurant, Hicks closed its doors and defaulted on the note, still owing almost $16,500. Following default, Mathias removed the equipment and, without notifying Hicks, requested bids from three local restaurant equipment dealers. He sold the equipment to the highest bidder for $1,500 and sought a deficiency judgment from Hicks for the balance due. Hicks claimed

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1. 294 S.C. 305, 363 S.E.2d 914 (Ct. App. 1987).

2. The section reads as follows:

> Disposition of the collateral may be by public or private proceedings and may be made by way of one or more contracts. Sale or other disposition may be as a unit or in parcels and at any time and place and on any terms but every aspect of the disposition including the method, manner, time, place and terms must be commercially reasonable. *Unless collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market, reasonable notification of the time and place of any public sale or reasonable notification of the time after which any private sale or other intended disposition is to be made shall be sent by the secured party to the debtor,* and except in the case of consumer goods to any other person who has a security interest in the collateral and who has duly filed a financing statement indexed in the name of the debtor in this State or who is known by the secured party to have a security interest in the collateral. The secured party may buy at any public sale and if the collateral is of a type customarily sold in a recognized market or is of a type which is the subject of widely distributed standard price quotations he may buy at private sale.

S.C. CODE ANN. § 36-9-504(3) (Law. Co-op. 1976) (emphasis added).

that Mathias' failure to notify her of the sale had violated the statutory requirement of notice and, therefore, barred him from obtaining a deficiency judgment. On the other hand, Mathias argued that failure to give notice was not an absolute bar to recovering the deficiency. He asserted that this failure created a rebuttable presumption that the collateral was worth the amount of the debt and that the creditor then had the burden of proving otherwise. The trial court and the court of appeals agreed with Ms. Hicks, and the courts granted Mathias the deficiency judgment.

The statute allows for a deficiency judgment[3] but also provides that "every aspect of the disposition . . . must be commercially reasonable." A second requirement of the statute is that "reasonable notification of the time and place of any public sale . . . or other intended disposition . . . made shall be sent by the secured party to the debtor."[4] A literal reading shows that these requirements are distinct and separate. First, the statute requires commercial reasonableness. Second, it requires notice. The statute mandates that reasonable notice "shall be sent."[5] There can be no misunderstanding of that requirement; it means that notice *must* be sent.[6]

Both parties agreed that the requisite notice was not given, but they disagreed on the appropriate sanction for such failure. The court in *Mathias* focused on "the failure of the UCC to specify a bar to deficiency for lack of notice."[7] The statute deal-

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3. *Id.* § 36-9-504(2).

4. *Id.* § 36-9-504(3).

5. *Id.*

6. It might be appropriate here to note certain policies and requirements within the Uniform Commercial Code. S.C. CODE ANN. § 36-1-106(1) (Law. Co-op. 1976) states that remedies are to be liberally administered "to the end that the aggrieved party may be put in as good a position as if the other party had fully performed but neither consequential or special nor penal damages may be had except as specifically provided in this act or by other rule of law." In this case the aggrieved party, the creditor Mathias, had been injured by the loss of his right to receive future payments in the total amount of $15,000. Therefore, section 36-1-106 suggests that he should be able to recover it all. S.C. CODE ANN. § 36-9-507(1) (Law. Co-op. 1976), however, seems to indicate otherwise: that because of Mathias's failure to supply notice, he may have forfeited his right to a deficiency. According to S.C. CODE ANN. § 36-1-103 (Law. Co-op. 1976), conflicts under the Code should be resolved by referring to prior common law. The common law in South Carolina clearly indicates that failure to notify results in forfeiture of a right to a deficiency judgment. *See* Johnson Cotton Co. v. Cannon, 242 S.C. 42, 129 S.E.2d 750 (1963).

7. 294 S.C. at 309, 363 S.E.2d at 916.

ing with liability for noncompliance states:

> If it is established that the secured party is not proceeding in accordance with the provisions of this part disposition may be ordered or restrained on appropriate terms and conditions. If the disposition has occurred the debtor or any person entitled to notification . . . has a right to recover from the secured party any loss caused by a failure to comply with the provisions of this part.[8]

Confusion arises from interpretation of the permissive language in this section ("may be ordered") and the mandatory construction of the notice requirement itself.

Other jurisdictions have analyzed the problem of a creditor's deviation from U.C.C. requirements in repossessing or reselling collateral, resulting in three different remedies.[9]

At one extreme, failure to follow Article 9 triggers an absolute bar to recovery of a deficiency judgment.[10] *Skeels v. Univer-*

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8. S.C. CODE ANN. § 36-9-507(1) (Law. Co-op. 1976).

9. *See* J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE, § 26-15 (2d ed. 1980).

10. Jurisdictions that have adopted the absolute bar rule are ARKANSAS: First State Bank of Morrilton v. Hallett, 291 Ark. 37, 722 S.W.2d 555 (1987); CALIFORNIA: Backes v. Village Corner, Inc., 197 Cal. App. 3d 209, 242 Cal. Rptr. 716 (1987); DELAWARE: Wilmington Trust v. Conner, 415 A.2d 773 (Del. 1980); DISTRICT OF COLUMBIA: Brown v. General Motors Acceptance Corp., 490 A.2d 1125 (D.C. 1985); IOWA: Barnhouse v. Hawkeye State Bank, 406 N.W.2d 181 (Iowa 1987); KANSAS: Topeka Datsun Motor Co. v. Stratton, 12 Kan. App. 2d 95, 736 P.2d 82 (1987) (absolute bar if consumer transaction; rebuttable presumption if commercial transaction); KENTUCKY: Bank Josephine v. Conn, 599 S.W.2d 773 (Ky. Ct. App. 1980); MAINE: Union Trust Co. of Ellsworth v. Hardy, 400 A.2d 384 (Me. 1979); MICHIGAN: State Bank of Standish v. Keysor, 166 Mich. App. 93, 419 N.W.2d 752 (1988); MONTANA: Westmont Tractor Co. v. Continental I, Inc., 731 P.2d 327 (Mont. 1986); NEBRASKA: Allis-Chalmers Corp. v. Haumont, 220 Neb. 509, 371 N.W.2d 97 (1985); NEW JERSEY: Midlantic Nat'l Bank v. Coyne, 222 N.J.Super. 649, 537 A.2d 798 (1987) (bar if no notice given; rebuttable presumption only if notice was given but unfair price received); NEW YORK: First City Div. of Chase Lincoln First Bank v. Vitale, 123 A.D.2d 510, N.Y.S.2d 766 (N.Y. App. Div. 1987); OHIO: Huntington Nat'l Bank v. Stockwell, 10 Ohio App. 3d 30, 460 N.E.2d, 303 (1983); SOUTH DAKOTA: First Nat'l Bank of Minneapolis v. Kehn Ranch, Inc., 394 N.W.2d 709 (S.D. 1986); TENNESSEE: Farmers & Merchants Bank v. Dyersburg Prod. Credit Ass'n, 728 S.W.2d 10 (Tenn. Ct. App. 1986) (court never reached issue but implied the absolute bar rule); UTAH: Haggis Management v. Turtle Management, 745 P.2d 442, (Utah 1985); VERMONT: United States v. Lang, 610 F. Supp. 292 (D. Vt. 1985), VIRGINIA: *In re* Bishop, 482 F.2d 381 (4th Cir. 1973) (applying Virginia law); WISCONSIN: Vic Hansen & Sons, Inc. v. Crowley, 57 Wis. 2d 106, 203, N.W.2d 728 (1973); Southern Wis. Cattle Credit Co. v. Lemkau, 140 Wis. 2d 830, 412 N.W.2d 159 (Ct. App. 1987); WYOMING: Stephens v. Sheridan Pub. Employees Fed. Credit Union, 594 P.2d 473 (Wyo. 1979).

sal C.I.T. Credit Corp.[11] is often quoted for the theory behind this rule:

> [T]o permit recovery by the security holder of a loss in disposing of collateral when no notice has been given, permits a continuation of the evil which the Commercial Code sought to correct. The owner should have an opportunity to bid at the sale. It was the secret disposition of collateral by chattel mortgage owners . . . which the Code sought to correct. . . . A security holder who disposes of collateral without notice denies to the debtor his right of redemption which is provided him in Section 9-506. In my view, it must be held that a security holder who sells without notice may not look to the debtor for any loss.[12]

At the other extreme, a second possible consequence of a creditor's misconduct automatically would allow recovery of a deficiency judgment although subject to set-off by the amount of any damages suffered by the debtor.[13] These damages usually are calculated as the difference between the fair market value of the collateral and the actual resale price.[14] In this line of cases, the burden of proof regarding fair market value falls on the debtor. The *Mathias* court did not address this alternative, perhaps because of its limited acceptance in few jurisdictions.

The emerging majority of courts follow a middle ground in the event of a creditor's violation. They follow the theory of a "rebuttable presumption,"[15] the option followed in *Mathias*.

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11. 222 F. Supp. 696 (W.D. Pa. 1963) (action by automobile dealer against finance company which had removed all of dealer's cars from lot), *vacated*, 335 F.2d 846 (3d Cir. 1964).

12. *Id.* at 702.

13. Jurisdictions that have adopted the set-off rule are ALABAMA: Jones v. First Nat'l Bank, 505 So. 2d 352 (Ala. 1987); ARIZONA: Gulf Homes, Inc. v. Goubeaux, 136 Ariz. 33, 664 P.2d 183 (1983); OKLAHOMA: Beneficial Fin. Co. v. Young, 612 P.2d 1357 (Okla. 1980).

14. J. WHITE & R. SUMMERS, *supra* note 9, § 26-15.

15. Jurisdictions that have adopted the rebuttable presumption rule are ALASKA: Dischner v. United Bank Alaska, 725 P.2d 488 (Alaska 1986); COLORADO: First Charter Lease Co. v. McAl, Inc., 679 P.2d 114 (Colo. Ct. App. 1984); CONNECTICUT: Connecticut Bank & Trust Co. v. Incendy, 207 Conn. 15, 540 A.2d 32 (1988); FLORIDA: Landmark First Nat'l Bank v. Gepetto's Tale O' the Whale, Inc., 498 So. 2d 920 (Fla. 1986); GEORGIA: Emmons v. Burkett, 256 Ga. 855, 353 S.E.2d 908 (1987); HAWAII: Liberty Bank v. Honolulu Providoring, Inc., 65 Haw. 273, 650 P.2d 576 (1982); Bank of Hawaii v. Davis Radio Sales & Serv., 727 P.2d 419 (Haw. Ct. App. 1986); IDAHO: Butte County Bank v. Hobley, 109 Idaho 40, 707 P.2d 513 (Ct. App. 1985); ILLINOIS: Papas v.

This rule presumes that the collateral is worth at least the amount of the debt. In order to recover a deficiency, the secured party bears the burden of proving that the value of the collateral did not equal the debt at the time of the sale. The most difficult problem faced here is the amount and character of proof needed to sufficiently rebut the presumption. In *Weaver v. O'Meara Motor Co.*,[16] sufficient proof consisted of first soliciting offers from a four-state area, followed by providing depositions of two appraisers regarding the property's value.

In *First National Bank of Dothan v. Rikki Tikki Tavi, Inc.*,[17] another question of a rebuttable presumption arose. The creditor bank repossessed restaurant equipment and notified the debtor of its intent to sell. The bank then contacted three local appraisers and received bids from two. The bank actively sought the participation of the restaurant/debtor in its attempts to ascertain the value of the collateral. The court considered this adequate evidence of the value of the restaurant equipment. In *Dothan*, there was no question regarding notice. Additionally,

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Speizman, 158 Ill. App. 3d 557, 511 N.E.2d 768 (1987); INDIANA: Bloomington Nat'l Bank v. Goodman Distrib., Inc., 482 N.E.2d 727 (Ind. Ct. App. 1985); KANSAS: Garden Nat'l Bank v. Cada, 241 Kan. 494, 738 P.2d 429 (1987) (*But see* Topeka Datsun Motor Co. v. Stratton, 12 Kan. App. 2d 95, 736 P.2d 82 (1987)) (absolute bar if consumer, rather than commercial, transaction)); MARYLAND: DiDomenico v. First Nat'l Bank, 57 Md. App. 62, 468 A.2d 1046 (1984), *aff'd*, 302 Md. 290, 487 A.2d 646 (1985); MASSACHUSETTS: Poti Holding Co. v. Piggott, 15 Mass. App. Ct. 275, 444 N.E.2d 1311 (1983); *In re* Travis, 67 Bankr. 406 (Bankr. D. Mass. 1986); MINNESOTA: Chemlease Worldwide, Inc. v. Brace, Inc., 338 N.W.2d 428 (Minn. 1983) (burden on debtor to show no notice; then burden on secured party to prove fair price); MISSISSIPPI: McKee v. Mississippi Bank & Trust Co., 366 So. 2d 234 (Miss. 1979); MISSOURI: Wirth v. Heavey, 508 S.W.2d 263 (Mo. Ct. App. 1974); NEVADA: U C Leasing v. Laughlin, 96 Nev. 157, 606 P.2d 167 (1980); NEW JERSEY: Midlantic Nat'l Bank v. Coyne, 222 N.J. Super. 649, 537 A.2d 798 (1987) (rebuttable presumption *only* if notice given but unfair price received; bar if no notice given); NEW MEXICO: First Nat'l Bank v. Jiron, 106 N.M. 261, 741 P.2d 1382 (1987); NEW YORK: Telmark, Inc. v. Lavigne, 124 A.D.2d 1055, 508 N.Y.S.2d 737 (1986); NORTH CAROLINA: Church v. Mickler, 55 N.C. App. 724, 287 S.E.2d 131 (1982); NORTH DAKOTA: Farmers State Bank v. Thompson, 372 N.W.2d 862 (N.D. 1985); OREGON: Meyers v. Arnold, 57 Or. App. 503, 645 P.2d 577 (1982); PENNSYLVANIA: Savoy v. Beneficial Consumer Discount Co., 503 Pa. 74, 468 A.2d 465 (1983); RHODE ISLAND: Associates Capital Serv. Corp. v. Riccardi, 122 R.I. 434, 408 A.2d 930 (1979); TEXAS: General Motors Acceptance Corp. v. Byrd, 707 S.W.2d 292 (Tex. Civ. App. 1986); WASHINGTON: Rotta v. Early Indus. Corp., 47 Wash. App. 21, 733 P.2d 576 (1987).

16. 452 P.2d 87 (Alaska 1969) (buyer defaulted on installment contracts with which he had bought trucks; seller repossessed, resold, and sought deficiency judgment).

17. 445 So. 2d 889 (Ala. 1984).

the debtor was fully involved in the process of obtaining bids —a far cry from the one-sided process encompassed in *Mathias*.

Mathias substantially reduced this necessary threshold of evidence by accepting three hand-written bids from the only three local dealers contacted about the sale of the equipment.[18] No appraisal was made; no offering of sale outside the immediate area was attempted; no alternative means of disposal were explored. Following the court's analysis, this prima facie showing of value was sufficient to sustain the burden of proof.

Previously, the South Carolina Court of Appeals had recognized the importance of the policy underlying the notice requirement. The court considered this issue in *General Motors Acceptance Corp. v. Carter*[19] and said that

> [t]he purpose of Section 36-9-504(3) is to enable a debtor to protect his interest in the collateral by paying the debt, finding a buyer or being present at the sale to bid on the collateral or have others to do so, to the end that the secured property may not be sacrificed by sale at less than true value.[20]

Unfortunately for the defendant in *Mathias*, the *Carter* case was vacated barely one month before her case was heard.[21]

The *Mathias* court found that the statute gives no guidance in the proper method to sanction an offending party.[22] The court, therefore, may have looked to the pre-U.C.C. judicial standard.[23]

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18. 294 S.C. at 307, 363 S.E.2d at 915. *See also* Record at 18-23 and 85-87.

19. 290 S.C. 216, 349 S.E.2d 342 (Ct. App. 1986), *appeal dismissed*, 293 S.C. 465, 361 S.E.2d 620 (1987), *cause vacated*, 293 S.C. 466, S.E.2d 620 (Ct. App. 1987) (action by secured party against consumer debtor for deficiency judgment following resale of repossessed automobile).

20. 290 S.C. at 219, 349 S.E.2d at 343.

21. The reason given for vacating the judgment was that the parties had settled "contingent upon the vacation of the Opinion of the Court of Appeals." 293 S.C. at 466, 361 S.E.2d at 620.

22. "Given the divergency of authority, we must determine the approach to be taken in South Carolina. This issue has not been decided under the Uniform Commercial Code in this state." 294 S.C. at 309, 363 S.E.2d at 916. S. C. CODE ANN § 36-9-507 (Law. Co-op. 1976) seems to indicate that sanctions are available. The court, however, did not focus on this aspect.

23. S.C. CODE ANN. § 36-1-103 (Law. Co-op. 1976) reads as follows:
Supplementary general principles of law applicable. Unless displaced by the particular provisions of this act, 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, bankruptcy, or

Prior to the adoption of the U.C.C., the South Carolina Supreme Court dealt with the notice requirement in *Johnson Cotton Co. v. Cannon*.[24] Although the court found that there had been adequate notice given, it said that

> [i]f the respondent had not given notice to the appellants of the time and place of sale, we would have no hesitation in holding that a deviation from the terms of the statute would invalidate the attempted sale pursuant thereto, because the deviation, however slight, would be a warrant for other and greater departures from the definite and exact requirements of the statute.[25]

The U.C.C. provides that, unless displaced by the Code, common law should supplement its provisions. Since the U.C.C. is silent as to denial of a deficiency judgment,[26] the court of appeals should have followed the pre-Code rule of *Johnson Cotton* and found that failure to give notice would bar a deficiency judgment.

A more recent South Carolina Supreme Court case, *Altman Tractor & Equipment Co. v. Weaver*,[27] discussed the sufficiency of notice under section 36-9-504(3).[28] In upholding a lower court decision, the court stated that "[a]ll that is required is that the secured party take reasonable steps to see that the debtor is notified. . . . The trial judge was correct in holding reasonable notification of the sale had been sent. Allowance of a deficiency judgment and denial of the counterclaim was therefore proper."[29] Although this issue was not reached, the court's statement implies that had no notice been attempted, a deficiency judgment would not have been allowed. Though briefly mentioned by the court in *Mathias*,[30] *Altman Tractor* failed to sway

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other validating or invalidating cause shall supplement its provisions.

Id.

24. 242 S.C. 42, 129 S.E.2d 750 (1963) (following default on installment payments and after resale of the collateral, a deficiency judgment was sought against commercial buyers of an irrigation system).

25. *Id.* at 55, 129 S.E.2d at 757.

26. S.C. CODE ANN § 36-1-103 (Law. Co-op. 1976).

27. 288 S.C. 449, 343 S.E.2d 444 (1986) (secured party sued for deficiency judgment following default, repossession, and resale of combine and grain header).

28. *See supra* note 2.

29. 288 S.C. at 451, 343 S.E.2d at 445.

30. "The question was not reached in *Altman Tractor* because the Supreme Court found reasonable notification." 294 S.C. at 309, 363 S.E.2d at 916.

its decision.

The effects of *Mathias* appear to be threefold: first, on the notice requirement itself; second, on creditor's rights; and third, on the rights of the debtor. As a result of this decision, the notice requirement has lost any real meaning. If a creditor decides not to notify the debtor of a default sale, all he needs to do is obtain a few bids on the collateral. Because of this, the creditor's rights in the collateral have expanded to the severe detriment of the debtor's rights. The debtor no longer can count on notice being given to allow him an opportunity to protect his interests. Had the court isolated its holding to include only commercial transactions, its policy arguments and sanctions might be more palatable despite the divergence from prior South Carolina law. By eliminating the notice requirement, *Mathias* appears to have substantially damaged every debtor's rights and opportunities regarding his collateral following a default sale, while opening the door for unscrupulous creditors.

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