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FIRST GALESBURG NATIONAL BANK & TRUST CO. v. JOANNIDES: A DEBTOR'S RIGHT IN REPOSSESSED COLLATERAL STRIPPED WITHOUT NOTICE*

Section 9-504(3) of the Uniform Commercial Code requires secured parties to notify debtors of post-default sales of collateral.[1] Despite the seemingly clear language of this section, Illinois courts have disagreed on its proper application.[2] The conflict centers on

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* 103 Ill. 2d 294, 469 N.E.2d 180 (1984).

1. All references to the Uniform Commercial Code pertain to the Code as adopted by Illinois. Section 9-504(3), the notice provision, is incorporated into chapter 26 of the Illinois Revised Statutes. Section 9-504(3) provides:

> Dispositions of 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 . . . must be commercially reasonable. Unless collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market, reasonable notification of the time and place of any public sale or reasonable notification of the time after which any private sale or other intended disposition is to be made shall be sent by the secured party to the debtor, if he has not signed after default a statement renouncing or modifying his right to notification of the sale.

ILL. REV. STAT. ch. 26, §9-504(3) (1983).

The Code defines a "secured party" as a "lender, seller or other person in whose favor there is a security interest, including a person to whom accounts or chattel paper have been sold." ILL. REV. STAT. ch. 26, §9-105(1)(m) (1983).

"Security interest" means "an interest in personal property or fixtures which secures payment or performance of an obligation. . . ." ILL. REV. STAT. ch. 26, §1-201(33) (1983).

Under the Code, "debtor" is defined as:

> [T]he person who owes payment or other performance of the obligation secured, whether or not he owns or has rights in the collateral, and includes the seller of accounts or chattel paper. Where the debtor and the owner of the collateral are not the same person, the term 'debtor' means the owner of the collateral in any provision of the code dealing with the collateral, the obligor in any provision dealing with the obligation, and may include both where the context so requires.

ILL. REV. STAT. ch. 26, §9-105(1)(d) (1983).

2. Courts have applied two diametrically opposed interpretations of section 9-504(3). One line of decisions espouses the absolute bar theory. *See, e.g.*, Staley Employee Credit Union v. Christie, 111 Ill. App. 3d 165, 443 N.E.2d 731 (1982) (absolute bar theory applied where the creditor notified the debtor of pending public sale but subsequently sold the collateral at a private sale without giving the debtor additional notice); State Nat'l Bank of Evanston v. Northwest Dodge, 108 Ill. App. 3d 376, 438 N.E.2d 1345 (1982) (absolute bar theory applied where the bank repossessed collateral from the automobile dealer and sold the collateral without notice); Spillers v. First Nat'l Bank of Arenzville, 81 Ill. App. 3d 199, 400 N.E.2d 1057 (1980) (absolute bar theory applied where creditor received a bid for the repossessed collateral and notified the debtor of the impending sale, but did not allow the debtor to respond to the bid price). The appellate court of the *Joannides* litigation also applied the abso-

whether the failure of a secured party to give notice to the debtor before disposing of collateral bars the secured party from recovering a deficiency judgment against the debtor.[3] This conflict was resolved in *First Galesburg National Bank & Trust Co. v. Joannides*.[4] In *Joannides*, the Illinois Supreme Court held that when collateral is sold without prior notice to the debtor, the value of the collateral sold is presumed to equal the amount of the indebtedness.[5] If a secured party successfully rebuts this presumption, he is entitled to recover a deficiency judgment.[6]

The circumstances which gave rise to the *Joannides* litigation are typical of many circumstances involving secured transactions.[7]

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lute bar theory. For a discussion of the appellate court's treatment of the absolute bar theory, see *infra* note 15.

The other interpretation of Section 9-504(3) is the rebuttable presumption theory, adopted by the *Joannides* court. *See, e.g.*, National Boulevard Bank v. Jackson, 92 Ill. App. 3d 928, 416 N.E.2d 358 (1981) (rebuttable presumption theory applied where the secured party notified the debtor of a public sale of collateral but subsequently sold the collateral at a private sale because no bidders appeared); A.A. Store Fixture Co. v. Kouzoukas, 87 Ill. App. 3d 631, 410 N.E.2d 131 (1980) (rebuttable presumption theory applied where the secured party claimed that he notified the debtor but failed to introduce any evidence substantiating the claim).

The absolute bar theory attempts to balance the relative control of the parties in a typical secured transaction. Wilmington Trust v. Conner, 415 A.2d 773 (Del. Supr. 1980). The secured creditor, who already enjoys a high degree of control, must give notice in order to collect a deficiency judgment. *Id.* at 780. The rebuttable presumption theory, on the other hand, attempts to avoid the arbitrary punishment of secured creditor. *Joannides*, 103 Ill. 2d at 298, 469 N.E.2d at 181. The court theorizes that the secured creditor should obtain the deficiency if a fair value was obtained for the collateral. *Id.* at 300-01, 469 N.E.2d at 183.

There is a geographical correlation between the theory adopted and the location of the court. With the exception of *Northwest Dodge*, 108 Ill. App. 3d at 376, 438 N.E.2d at 1345, all of the absolute bar cases were decided in either the third or fourth district. The rebuttable presumption decisions, on the other hand, are the product of the first district. Because Chicago's large financial institutions are located in the first district and the third and fourth districts contain less urban areas, it is possible that the rebuttable presumption decisions are the product of court's sympathy to creditors. Conversely, the absolute bar decisions may be the product of courts being sympathetic to debtors.

3. First Galesburg Nat'l Bank & Trust Co. v. Joannides, 103 Ill. 2d 294, 469 N.E.2d 180 (1984).

4. 103 Ill. 2d 294, 469 N.E.2d 180 (1984).

5. *Id.* at 300-01, 469 N.E.2d at 183.

6. *Id.* The secured party may rebut the presumption by proving that the value of the collateral sold was less than the value of the indebtedness and that the sale was commercially reasonable. *Id.*

7. The typical scenario which gives rise to this type of litigation consists of a very simple fact pattern. The secured party makes either a sale or a loan to the debtor and retains a security interest in some property of the debtor. The debtor defaults on payments, and the secured party repossesses the collateral. The secured party sells the collateral without first notifying the debtor and then brings an action for a deficiency judgment. The debtor denies liability relying on the absolute bar theory, while the secured party relies on the rebuttable presumption theory and demands a deficiency judgment. Other jurisdictions have split on which theory they should apply. *Compare* Atlas Thrift Co. v. Horan, 27 Cal. App. 3d 999, 104 Cal. Rptr. 315 (1972) (applying the absolute bar theory) *with* Norton v. National Bank of Com-

The defendants' son entered into a floor plan financing agreement with the plaintiff-bank.[8] Collateral for the loan consisted of the automobile dealership inventory and a $50,000 guaranty by the defendants, the debtor's parents.[9] After the defendants' son defaulted on the loan payments,[10] the bank liquidated the inventory and subsequently notified the defendants that they would have to honor their guaranty because the sale of the collateral resulted in a deficiency.[11] The defendants refused to honor their guaranty contending that the bank had not complied with statutory notice requirements.[12] In an attempt to collect the $50,000, the bank brought an action on the guaranty.[13] Following adverse decisions in both the trial[14] and appel-

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merce, 240 Ark. 143, 398 S.W.2d 538 (1966) (applying the rebuttable presumption theory). For a definition of the absolute bar theory, see *infra* note 22 and accompanying text.

8. Under a floor plan financing agreement, an automobile dealer who has purchased automobiles executes a note to the lender for the amount of the purchase. The lender loans the amount and retains a security interest in the autos. After the dealer sells the autos, he repays the amount of the note to the lender, and the security interest is extinguished. *See, e.g.*, Harlan v. United States, 312 F.2d 402 (Ct. Cl. 1963); Volusia Discount Co. v. Alexander K-F Motors, 88 So. 2d 302 (Fla. 1956); G.F.C. Corp. v. Nesser, 273 S.W.2d 264 (Mo. 1954).

9. The dealership, Town and Country Dodge, was in poor financial condition in the late 1970's and the plaintiff bank requested that Joannides seek financing elsewhere. In order to calm the plaintiff bank's reservations, the debtor's parents agreed to guarantee the financing agreement for $50,000. The plaintiff bank acquiesced and continued its relationship with the dealership. *Joannides*, 103 Ill. 2d at 296, 469 N.E.2d at 180-81.

10. *Id.* The plaintiff bank learned that 32 cars had been sold without repayment to the bank. The plaintiff bank promptly took control of Town and Country and closed it. Tim Joannides, the debtor, was subsequently convicted in criminal court for converting the plaintiff bank's collateral. Appellant's Reply Brief at 8, First Galesburg Nat'l Bank v. Joannides, 103 Ill. 2d 294, 469 N.E.2d 180 (1984).

11. The plaintiff bank sent the following letter to the guarantors after the collateral had been sold:

> On Friday, May 8, 1981, the doors of Town and Country Dodge were closed to the public and subsequent to that the business has been placed in bankruptcy.
>
> The intent of this letter is to notify you that it now appears a loss will be realized and the bank will be forced to ask you to honor your guarantee of $50,000 dated February 19, 1980.
>
> We are available at your convenience to discuss this situation if you have questions.

Joannides, 103 Ill. 2d at 296-97, 469 N.E.2d at 181.

12. *Id.* The defendants relied on the absolute bar theory, which was formerly applied in the district where the dispute arose. *Id.* For a discussion of the geographical correlation between the judicial district and the application of the notice provision, see *supra* note 2.

13. *Joannides*, 103 Ill. 2d at 297, 469 N.E.2d at 181. The Joannides, as guarantors, were considered parties to whom notice must have been given pursuant to section 9-504(3), the notice provision. It is uniformly held that guarantors fall within the class of persons to whom section 9-504(3) notice must be given. Commercial Discount Corp. v. Bayer, 57 Ill. App. 3d 295, 372 N.E.2d 926 (1978); *see also* Zions First Nat'l Bank v. Hurst, 570 P.2d 1031 (Utah 1977) (section 1-105, which defines persons to whom notice must be given, includes guarantors).

14. At trial, the Joannides contended not only that the plaintiff-bank failed to

late courts,[15] the bank appealed to the Illinois Supreme Court.[16]

On appeal, the Illinois Supreme Court confronted the issue of whether the bank's failure to give notice[17] to the defendants before disposing of the inventory barred the bank from recovering a deficiency judgment.[18] The court adopted the rebuttable presumption theory and held that because the bank had sold the collateral without first notifying the defendants, the value of the collateral sold was presumed to equal the value of the defendants' son's indebtedness.[19] The court remanded the case to allow the bank an opportunity to rebut the presumption[20] and stated that the bank may rebut

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notify them but also that the plaintiff-bank did not dispose of the inventory in a commercially reasonable manner. The trial judge ruled that commercial reasonableness is a question of fact and is therefore properly delegated to the jury. The jury found that the sale was not commercially reasonable, and the court entered judgment on that finding alone. *Joannides*, 103 Ill. 2d at 297, 469 N.E.2d at 181.

Section 9-504(3), the notice provision, also requires that all sales be commercially reasonable. For the complete text of section 9-504(3) see *supra* note 1. The sale of repossessed collateral has been considered commercially reasonable in numerous cases. *See, e.g.*, Conti-Causeway Ford v. Jarossy, 114 N.J. Super. 382, 276 A.2d 402 (1971), *aff'd*, 118 N.J. Super. 521, 288 A.2d 872 (1972) (sale was commercially reasonable where the fair market value was obtained, even though the secured party was the only one at the sale); Weaver v. O'Meara Motor Co., 452 P.2d 87 (Alaska 1969) (the collateral was appraised and sold at appraisal price). The sale of collateral has not been considered commercially reasonable in several cases. Leasing Associates v. Slaughter & Son, Inc., 450 F.2d 174 (8th Cir. 1971) (no evidence concerning sale was introduced); Farmer's Equip. Co. v. Miller, 252 Ark. 1092, 482 S.W.2d 805 (1972) (a prolonged length of time between repossession and sale coupled with the failure to pursue parties genuinely interested in the collateral). In most cases involving lack of notice, the issue of commercial reasonableness is also raised. *See generally* Annot., 59 A.L.R. 3d (1974) (deals with a comprehensive examination of the commercial reasonableness issue).

15. *Joannides*, 103 Ill. 2d at 297, 469 N.E.2d at 181. The appellate court did not affirm the trial court decision on the basis of commercial reasonableness. Instead, the appellate court applied the absolute bar theory and ruled that the plaintiff bank was barred from a deficiency judgment because the plaintiff bank had failed to notify the debtors of the sale of collateral. *Id.*

16. *Joannides*, 103 Ill. 2d at 297, 469 N.E.2d at 181.

17. "Notice" is defined in section 1-201(26), which provides that a "person 'notifies' or 'gives' notice or notification to another by taking such steps as may be reasonably required to inform the other in ordinary course whether or not such other actually comes to know of it." ILL. REV. STAT. ch. 26, §1-201(26) (1983).

18. First Galesburg Nat'l Bank & Trust Co. v. Joannides, 103 Ill. 2d 294, 469 N.E.2d 180 (1984).

19. *Id.*

20. *Id.* There exists some controversy concerning the secured party's ability to rebut the presumption. At least one writer has commented that the rebuttable presumption theory may result in the denial of deficiency judgments in the majority of cases. White, *Representing the Low-Income Consumer in Repossessions, Resales and Deficiency Judgment Cases*, 3 U.C.C. L.J. 199, 224 (1970-71). The writer cites Barker v. Horn, 245 Ark. 315, 432 S.W.2d 21 (1968) to support the proposition that the presumption may be impossible to rebut. In *Barker*, the Arkansas court adopted the rebuttable presumption theory but dismissed the case without allowing the secured party an opportunity to rebut the presumption. *Id.* The *Barker* court discounted the plaintiff's ability to prove that the price obtained was an adequate amount. The writer's theory can be criticized, however, as many cases exist where the presumption

the presumption by proving both that the value of the collateral sold was less than the value of the indebtedness and that the sale was commercially reasonable.[21]

In reaching its conclusion, the court rejected the absolute bar theory. This theory states that a secured party is absolutely barred from a deficiency judgment if he disposes of collateral without first notifying the debtor.[22] The court initially examined the notice provision of the Uniform Commercial Code and indicated that it does not explicitly state that lack of notice bars a deficiency judgment.[23] Next, the court examined the debtor's rights and remedies provision of article nine and reasoned that a debtor has a right to recover any loss resulting from the secured party's failure to comply with the notice provision.[24] The court held that this protection is sufficient and, therefore, that an absolute bar is unnecessary.[25] The court concluded that the combination of the absence of absolute bar language from the notice provision and the presence of a debtor's cause of

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was successfully rebutted. *See, e.g.*, Conti-Causeway Ford v. Jarossy, 114 N.J. Super. 382, 276 A.2d 402 (1971), *aff'd*, 118 N.J. Super. 521, 288 A.2d 872 (1972) (the fair value of the goods was established through the bluebook value of the car); United States v. Whitehouse Plastics, Inc., 501 F.2d 692, 696 (5th Cir. 1974) (an appraisal made by an expert of 12 years experience was considered representative of the fair value of the collateral), *cert. denied sub nom* Baker v. United States, 421 U.S. 912 (1975); Weaver v. O'Meara Motor Co., 452 P.2d 87 (Alaska 1969) (an expert's appraisal of the value of collateral held sufficient to rebut the presumption). For a discussion of the secured party's ability to rebut the presumption, see Note, *Secured Transactions - New Jersey Upholds the Right of a Secured Party to Collect a Deficiency Judgment Under U.C.C. 9-504(2) Although Notice Provisions Were Not Observed*, 76 DICK. L. REV. 394, 398 (1971).

21. *Id.*

22. *Joannides*, 103 Ill. 2d at 299-300, 469 N.E.2d at 182.

23. *Joannides*, 103 Ill. 2d at 300-01, 469 N.E.2d at 182. Although the court reasoned that the absolute bar theory is not mandated by the language of the Code, it did not rest its decision solely on the absence of such language. Instead, the court examined the absence of absolute bar language in conjunction with section 9-507(1), the debtor's rights and remedies provision. *Id.* at 299-300, 469 N.E.2d at 182. For a discussion of section 9-507(1), see *infra* note 24 and accompanying text.

24. *Joannides*, 103 Ill. 2d at 300, 469 N.E.2d at 182. The debtor's rights and remedies provision, section 9-507(1), provides:

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

ILL. REV. STAT. ch. 26, §9-507(1) (1983).

25. *Joannides*, 103 Ill. 2d at 300, 469 N.E.2d at 182. Many of the cases which support the rebuttable presumption theory state that section 9-507(1) is sufficient to protect the debtor from losses caused by lack of notice. *See, e.g.*, Barker v. Horn, 245 Ark. 315, 432 S.W.2d 21 (1968) (section 9-507(1) precludes an absolute bar because damages recoverable can be asserted by way of a set-off or counterclaim); Norton v. National Bank of Commerce, 240 Ark. 143, 398 S.W.2d 538 (1966) (section 9-507(1) gives rise to a presumption that collateral is worth the amount of the debt).

action in the rights and remedies provision militates against adopting the absolute bar theory.[26]

In adopting the rebuttable presumption theory, the court also noted that article nine is intended to avoid penal results.[27] The court reasoned that an absolute bar of a deficiency judgment shields the debtor from a deficiency judgment even when lack of notice has not damaged the debtor.[28] This grants the debtor a windfall and arbitrarily penalizes the secured party.[29] The court decided that the rebuttable presumption theory comports with the intent of the Code to avoid arbitrary penalization of the secured party.[30] Requiring the secured party to prove both that the value of the collateral sold was less than the value of the indebtedness and that the sale was commercially reasonable removes the possibility that the secured party will be arbitrarily penalized.[31]

Analysis of the court's reasoning must include an examination of pre-Code law.[32] Section 1-103 of the Code allows principles of

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26. *Joannides*, 103 Ill. 2d at 299-300, 469 N.E.2d at 182.

27. *Id.* at 300-01, 469 N.E.2d at 182-83. The court refers to section 1-106(1), the specific intent provision, which provides in pertinent part:

> The remedies provided by this act shall be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed but neither consequential or special nor penal damages may be had except as specifically provided in this Act or by other rule of law.

ILL. REV. STAT. ch. 26, §1-106(1) (1983).

28. *Joannides* 103 Ill. 2d at 300-01, 469 N.E.2d at 182-83. The court noted, for example, that the Joannides did not intend to attend the sale or to redeem the collateral. The absolute bar theory, reasoned the court, deprives the secured party of an opportunity to obtain a deficiency judgment even if the goods were sold at a fair price. *Id.*

29. *Id.* The court stated that the secured party should be in as good a position as if the debtor had not defaulted. *Id.* If the debtor had fully performed, the secured party would receive the full contract amount. But when the debtor defaults and sale of collateral results in a deficiency, preventing a deficiency judgment deprives the secured party of an amount to which he was entitled. *Id.*

30. *Joannides*, 103 Ill. 2d at 300-01, 469 N.E.2d at 182-83.

31. *Id.* The court also pointed out that the rebuttable presumption theory leaves the debtor's rights and remedies intact. *Id.* For instance, even if a secured party rebuts the presumption and recovers a deficiency judgment, the debtor may still set-off any damages resulting from lack of notice. *Id.* at 301, 469 N.E.2d at 183. The existence of the debtor's set-off is an adequate deterrent to the improper disposition of collateral, according to the court. *Id.* Finally, the court intimated that its decision is consistent with the decisions in most other jurisdictions and supplied a list of rebuttable presumption decisions. For a list of rebuttable presumption decisions, see *Joannides*, 103 Ill. 2d at 301, 469 N.E.2d at 183.

32. Before the court's analysis is addressed, a preliminary examination of the justifications for the rebuttal presumption theory and a discussion of several other hybrid solutions to the notice issue are in order. The underlying justification for the rebuttable presumption theory is that the secured party should be allowed to collect a deficiency judgment when he can establish the fair value of the collateral. Kobuk Engineering & Contracting Services, Inc. v. Superior Tank Co., 568 P.2d 1007 (Alaska 1977). The courts also frequently cite the debtor's rights and remedies provision, section 9-507(1), and hold that the debtor already enjoys a remedy sufficient to protect

pre-Code law and equity to supplement the Code unless displaced by a provision's express language.[33] Pre-Code law strictly enforced the secured party's duty to inform the debtor of post-default[34] sales and denied deficiency judgments to secured parties that had not complied with the notice requirements.[35] The *Joannides* court

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the debtor against losses resulting from lack of notice. Barbour v. United States, 562 F.2d 19 (10th Cir. 1977). For a discussion of the *Joannides* court's application of this justification, see *supra* notes 24-26 and accompanying text. For a discussion of the fatal weakness of the reliance on section 9-507(1), see *infra* notes 32-38 and accompanying text.

Variations of the rebuttable presumption theory and the absolute bar theory exist. For example, one line of cases holds that lack of notice does not bar a deficiency judgment but at the same time does not create a presumption that the value of the collateral is equal to the amount of indebtedness. Instead, the debtor is required to rely solely on section 9-507(1) damages for any loss resulting from lack of notice. Leasco Computer, Inc. v. Sheridan Indus., 82 Misc. 2d 897, 371 N.Y.S.2d 531 (1975). In *Leasco*, the secured party leased a computer to the debtor for several years. When the debtor defaulted, the secured party repossessed and sold the computer without first notifying the debtor. Although the sale price was grossly unfair, the trial court did not bar the deficiency judgment. Instead, the court placed the burden on the debtor to prove that he had sustained damages resulting from lack of notice. *Id.* The debtor was forced to rely solely on section 9-507(1). *Id.* at 901, 371 N.Y.S.2d at 535. *See also* Grant County Tractor Co. v. Nuss, 6 Wash. App. 866, 496 P.2d 966 (1972) (debtor who does not receive notice of sale of repossessed collateral is restricted to section 9-507 set-off damages).

A variation of the absolute bar theory exists as well. Under one line of cases, the secured party is not only absolutely barred from a deficiency judgment but the debtor may also recover section 9-507(1) damages. *See, e.g.*, Skeels v. Universal C.I.T. Credit Corp., 335 F.2d 846 (3d Cir. 1964). In *Skeels*, the secured party repossessed collateral and sold it without notifying the debtor. *Id.* When the secured party sought a deficiency judgment, the court not only denied the deficiency judgment but also granted the debtor compensatory damages for business losses resulting from the lack of notice. *Id. See also* White, *Representing the Low-Income Consumer in Repossessions, Resales and Deficiency Judgments*, 3 U.C.C. L.J. 199, 225 (1970-71) (examples of cases in which the deficiency action was barred and debtor also received damages).

33. Section 1-103 of the Code provides:

> 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 other validating or invalidating cause shall supplement its provisions.

ILL. REV. STAT. ch. 26, §1-103 (1983).

34. What constitutes "default" is not defined in the Code but is left to the parties themselves. Borochoff Properties, Inc. v. Howard Lumber Co., 115 Ga. App. 691, 696, 155 S.E.2d 651, 654 (1967). *See also* Lakin, *Default Proceedings Under Article 9: Problems, Solutions, and Lessons to be Learned*, 8 AKRON L. REV. 1, 2 (1975) (includes discussion and examples of when default occurs as per the parties' agreement).

35. This was true in cases ranging from early common law to pre-Code statutory law. At early common law, the secured party (then called a *pledgee*) retained the collateral until the debtor's (the *pledgor's*) obligation was extinguished. This was the common law mechanism for preventing the debtor from obtaining multiple financing on the same chattel. If the debtor defaulted, the secured party had the right to sell the collateral and maintain a deficiency action if necessary. The secured party was absolutely required to notify the debtor of the sale in order to obtain a deficiency judgment. The courts reasoned that title did not pass from the debtor to the secured party and that the secured party could not dispose of the collateral without the debtor's knowledge. The rule was established at common law to allow the debtor an

stated, however, that the absolute bar theory should not be applied because it is not explicitly provided for in the notice provision.[36] The court also rejected the absolute bar theory because the debtor's rights and remedies provision already provides the debtor with sufficient remedies, which do not include an absolute bar.[37] The court erred in relying on these factors. The court should have focused on the fact that neither the notice provision nor the debtor's rights and remedies provision expressly displaces the absolute bar theory.[38] An examination of pre-Code law, which should complement the Code, reveals that the court erred in rejecting the absolute bar theory.

The court not only neglected pre-Code law but also failed to examine the Code as a whole. The court overlooked the general intent provision (section 1-102), which states that the purpose of the Code is to simplify and clarify commercial law and to permit the continued expansion of commercial practices through agreement of the parties.[39] Instead, the court relied on the specific intent provision (section 1-106), which states that penal results should be avoided.[40] The court afforded too much weight to the specific intent

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opportunity to redeem the collateral. National Bank of Illinois v. Baker, 128 Ill. 533, 21 N.E. 510 (1889); *see also* Rozet v. McClellan, 48 Ill. 345 (1868) (sale without debtor's knowledge held invalid). *See generally* 2 J. KENT, COMMENTARIES ON THE LAW 759, 583 (8th ed. 1873) (describes the common law roots of secured transactions law).

Under pre-Code statutory law, such as the Uniform Conditional Sales Act, the notice requirement was also strictly enforced. United Securities Corp. v. Tomlin, 57 Del. 219, 198 A.2d 179 (1964); Commercial Credit Corp. v. Swiderski, 57 Del. 76, 195 A.2d 546, *reh'g denied*, 196 A.2d 214 (1963); Frantz Equip. Co. v. Anderson, 37 N.J. Super. 420, 181 A.2d 499 (1962). *See* Henszey, *A Secured Creditor's Right to Collect a Deficiency Judgment under UCC Section 9-504: A Need to Remedy the Impasse*, 31 BUS. LAW. 2025, 2028 (1976) (discussion of the pre-U.C.C. statutory law and judicial treatment of notice provisions).

In Illinois, the law concerning chattel mortgages was codified prior to the adoption of the Uniform Commercial Code. ILL. REV. STAT. ch. 95, §27 (1957) (repealed laws 1981 p. 1012 eff. July 31, 1961). Under that statutory scheme, notice was a mandatory prerequisite to a deficiency judgment. W.H. Collins Ice Cream Co. v. Talmage, 210 Ill. App. 374 (1918).

36. *Joannides*, 103 Ill. 2d at 299, 469 N.E.2d at 182. The court fails to recognize as well, however, that the Code also lacks language expressly calling for a rebuttable presumption. The absence of absolute bar language is no reason to adopt the rebuttable presumption theory, which is also absent from the Code.

37. *Id.* at 299-300, 469 N.E.2d at 182.

38. Instead of relying on the absence of absolute bar language, the court should have relied on the absence of express language displacing the absolute bar theory. If the court had correctly read pre-Code law into the Code, it would not have rejected the absolute bar theory. For a discussion of how pre-Code law fits into the Code, see *supra* note 35 and accompanying text.

39. Section 1-102, the "general intent" provision, states that the underlying purposes and policies of the Code are "(a) to simplify, clarify and modernize the law governing commercial transactions; [and] (b) to permit the continued expansion of commercial practices through custom, usage and agreement of the parties. . . ." ILL. REV. STAT. ch. 26, §1-102(2)(a), (b) (1983).

40. *Joannides*, 103 Ill. 2d at 300, 469 N.E.2d at 182-83. For the complete text of section 1-106, see *supra* note 27.

provision and consequently failed to see that the rebuttable presumption theory contradicts the general intent provision.[41] The rebuttable presumption theory neither simplifies and clarifies commercial law nor permits the continued expansion of commercial practices through agreement of the parties.[42] On the contrary, it both complicates commercial law and frustrates expansion of commercial practices.[43] If a secured party does not give notice to the debtor before disposing of collateral, the debtor is deprived of the opportunity to negotiate a possible settlement.[44] The debtor is also deprived of his right and opportunity to redeem the collateral.[45] A

41. While it is true that the provision of the Code should be construed in a manner that avoids penal results, McGrady v. Chrysler Motors Corp., 46 Ill. App. 3d 136, 360 N.E.2d 818 (1977), this goal must submit to the underlying purposes and goals of the Code. Servbest Foods, Inc. v. Emessee Industries, Inc., 82 Ill. App. 3d 662, 403 N.E.2d 1 (1980). In *Servbest*, the court stated that the general purpose of the Code is to establish a practical working tool for parties involved in commercial practices. *Id.* at 671, 403 N.E.2d at 8. Even if the rebuttable presumption theory removes the possibility that the secured party may be denied a deficiency when the debtor has suffered no damage, the *Joannides* court failed to see that the rebuttable presumption theory contradicts the general purpose of the Code. For an analysis of the rebuttable presumption theory and examples of how that theory contradicts the general intent of the Code, see *infra* notes 45-47 and accompanying text.

42. *See infra* notes 45-57 and accompanying text (guarantors are less likely to aid debtors if collateral may be sold without notice, thus frustrating agreement of the parties).

43. *See infra* notes 45-47 and accompanying text (rebuttable presumption theory discourages guarantors from participating in secured transactions).

44. The ability of a debtor to negotiate with the secured party is important when the purpose of the Code is examined. The Code calls for the "continued expansion of commercial practices through. . .agreement of the parties." ILL. REV. STAT. ch. 26, §1-102(2)(b) (1983). If a secured party sells the collateral without notifying the debtor, the debtor never has an opportunity to negotiate or even discuss the situation with the secured party. Allowing a secured party to dispose of collateral without notifying the debtor directly contradicts the policy which mandates that the parties should work together.

45. The debtor's right to redeem is also closely related to the intent of the Code. Redemption not only serves to promote maximum participation between the parties but also simplifies and clarifies secured transactions. When a debtor successfully obtains sufficient capital to redeem, the need for a sale and possibly litigation are eliminated. Disallowing the right to redemption effectively opens the door to complicated default sales and possible litigation. In addition, it is important to note that the notice requirement was instituted at common law to allow the debtor an opportunity to redeem collateral. National Bank of Illinois v. Baker, 128 Ill. 533, 21 N.E. 510 (1889); Tucker v. Wilson, 24 Eng. Rep. 379, 1 P. Wms. 261 (1714). For a discussion of the common law roots of secured transactions law, see *supra* note 35 and accompanying text. Section 9-506, which sets forth the debtor's right to redeem, provides:

> At any time before the secured party has disposed of collateral or entered into a contract for its disposition under Section 9-504. . .the debtor or any other secured party may. . .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.

ILL. REV. STAT. ch. 26, §9-506 (1983).

guarantor must now constantly check the status of collateral to insure that it is not sold without his knowledge,[46] and persons in a position to become guarantors in secured transactions are less likely to do so when the collateral may be sold without prior notice.[47] Consequently, the rebuttable presumption theory complicates the mechanics of a secured transaction and discourages agreement of the parties.[48]

In relying on the specific intent provision, the *Joannides* court also violated an accepted rule of statutory interpretation. It is a generally accepted principle that the general provisions of a statute must not be interpreted in a manner that negates the specific provisions.[49] The court nevertheless relied on an intent provision to the extent that it negated the notice and redemption provisions.[50] Under the rebuttable presumption theory, a secured party is not required to notify the debtor of post-default sales of collateral in order to

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46. Guarantors must be given notice when a secured party disposes of collateral. *See supra* note 13 (discusses parties to whom notice must be given). A guarantor is also a party most likely to redeem collateral, and notification of the sale will promote maximum participation by the guarantor. Notification of the sale will simplify and clarify the secured transaction. *See supra* note 45 (discusses the debtor's right to redeem collateral). In short, notice to a guarantor may solve the entire problem, as a guarantor is likely to have capital sufficient to redeem the collateral.

47. A prospective guarantor may decline to enter into the secured transaction for two reasons. First, the guarantor may be hesitant because he knows that the collateral may be disposed of without notice. Second, the guarantor may be held liable for the guaranteed amount even if the debtor is absolved of liability. *See, e.g.*, Investors Acceptance Co. of Livingston v. James Talcott, Inc., 61 Tenn. App. 307, 454 S.W.2d 130 (1969). In *Investors*, the court stated that a guarantor may be held liable even when the secured party wrongfully terminates the contract. *Id.* at ____, 454 S.W.2d at 136. This was true because, in that case, the secured party had an "unlimited" contractual right to demand the guaranty amount. *Id.* It follows that a prospective guarantor will be careful of entering into a secured transaction.

48. While it is true that the debtor in the *Joannides* decision probably did not deserve the protection of the absolute bar theory (*see supra* note 10), the average debtor is not a criminal. For instance, some debtors voluntarily return collateral upon default and attempt to cooperate with the secured party. *See, e.g.*, Hemken v. First Nat'l Bank of Litchfield, 76 Ill. App. 3d 23, 394 N.E.2d 868 (1979). In *Hemken*, the debtor voluntarily returned the collateral and subsequently requested an opportunity to redeem the collateral. *Id.* at 25, 394 N.E.2d at 870. The secured party sold the collateral without notifying the debtor and rebuffed the debtor's effort to redeem the collateral. *Id.* The rebuttable presumption theory is not fair to good faith debtors because it allows secured parties to manipulate collateral in any manner.

49. *See, e.g.*, Harrell v. Board of Trustees of S. Ill. Univ., 48 Ill. App. 3d 319, 321, 362 N.E.2d 441, 444 (1977); Johnson v. Town of Evanston, 39 Ill. App. 3d 419, 426, 350 N.E.2d 70, 76 (1976); Dianis v. Waenke, 29 Ill. App. 3d 133, 142, 330 N.E.2d 302, 310 (1975). *See also* Hemken v. First Nat'l Bank of Litchfield, 76 Ill. App. 3d 23, 394 N.E.2d 868 (1979). In *Hemken*, the secured party sold collateral without notifying the debtor, even though the debtor made several efforts to redeem the collateral. *Id.* at 25, 394 N.E.2d at 870. If the debtor had known of the time and place of the sale, he could have redeemed the collateral then and there. Without notice, however, the debtor was unable to redeem the collateral. *Id.*

50. *See infra* note 51-54 and accompanying text (discusses the rebuttable presumption theory's frustration of the debtor's right to redeem collateral).

obtain a deficiency judgment.[51] A secured party may evaluate the repossessed collateral and determine whether notice is desired.[52] If a debtor is not notified of an impending sale and is unaware of the status of the collateral, it becomes extremely difficult for the debtor to exercise his right of redemption.[53] The rebuttable presumption theory, therefore, essentially nullifies the notice and redemption provisions.[54]

The court's treatment of the notice provision not only disregards pre-Code law and erroneously relies on the specific intent provision but also neglects to examine the judicial treatment of other Code requirements. For example, a secured party must file a financing statement in order to perfect a security interest in collateral.[55] Filing of a financing statement is a condition precedent to a secured party's right to priority over non-secured creditors.[56] The purpose of the financing statement is to notify the debtor's prospective creditors of the existence of an encumbrance on the collateral.[57]

The notice requirement for a post-default sale of collateral serves a similar purpose. The notice requirement enables the debtor to attend the sale and allows the debtor to directly view the propriety of the sale.[58] In addition, the notice requirement allows the

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51. As stated in *Joannides*, the secured party does not need to give notice in order to obtain a deficiency judgment. *Joannides*, 103 Ill. 2d at 300-01, 469 N.E.2d at 182-83. Instead, the secured party need only show that the sale was both commercially reasonable and that the value of the collateral was less than the value of the indebtedness. *Id.*

52. If repossessed collateral appears to be worth more than the value of the indebtedness, the secured party may end up with a surplus. If the debtor is unaware of the sale he may never be credited with the surplus. Therefore, in addition to removing the longstanding notice requirement, the rebuttable presumption theory opens the door to abuses which are not present with the absolute bar theory.

53. *See supra* note 49 (discusses the debtor's traditional right to redeem collateral).

54. *See supra* notes 50-53 and accompanying text (discussing the court's implicit negation of the debtor's redemption provision).

55. The perfection of a security interest is the process by which the secured party notifies "the world" that some property of the debtor is encumbered. This is accomplished through the filing of a financing statement. Interstate Steel Co. v. Ramm Mfg. Co., 108 Ill. App. 3d 404, 438 N.E.2d 1381 (1982).

56. Section 9-302(1) of the Code states that "a financing statement must be filed to perfect all security interests. . . ." ILL. REV. STAT. ch. 26, §9-302(1) (1981). Illinois case law mandates that a financing statement be filed in order to perfect a security interest. First Bank & Trust Co. v. Post, 10 Ill. App. 3d 127, 293 N.E.2d 907 (1973); Bank of Broadway v. Goldblatt, 103 Ill. App. 2d 243, 243 N.E.2d 501 (1968).

57. This prevents the debtor from obtaining multiple loans using the same chattel as collateral. Prospective creditors need only check financing statement records to determine whether the property is encumbered. Bramble Transp. v. Sam Senter Sales, Inc., 294 A.2d 97, 103 (Del. Super. 1971), *aff'd*, 294 A.2d 104 (1972). *See supra* note 55.

58. *See supra* note 35. The debtor's presence at the sale may be extremely important. For instance, if the sale is by public auction the debtor may participate in the bidding and cause the sale price to be higher. Spillers v. First Nat'l Bank, 81 Ill. App. 3d 199, 202, 400 N.E.2d 1057, 1060 (1980); Stensel v. Stensel, 63 Ill. App. 3d 639,

debtor to exercise his right of redemption.[59] The purpose of requiring that a financing statement be filed as a condition precedent to priority over other creditors is similar to that of the notice and redemption provisions, and therefore the *Joannides* court should have strictly enforced the notice requirement.

The court adopted the rebuttable presumption theory, yet the theory is not consonate with the realities of the secured transaction setting. The rebuttable presumption theory is not fair to good faith debtors because it allows secured parties to manipulate collateral in any manner.[60] If repossessed collateral appears to be worth more than the value of the indebtedness, the secured party may decide not to notify the debtor of the sale and wrongfully retain any surplus.[61] The debtor, unaware of the sale, has no means by which to ascertain whether a surplus was obtained at the sale.[62] Thus, the rebuttable presumption theory may result in abuse of debtors' rights in possible surpluses from repossession sales.

The absolute bar theory is more complimentary with the realities of a typical secured transaction. The absolute bar theory both simplifies and clarifies secured transactions and promotes maximum participation between the parties.[63] Under the absolute bar theory, secured parties know that notice is a condition precedent to a deficiency judgment, and they will therefore comply with the notice provision.[64] Receipt of notice enables debtors to exercise their post-default right of redemption.[65] Debtors may attend the sale and

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643, 380 N.E.2d 526, 529 (1978). It is also appropriate to note that the debtor has a right to view the sale. The secret disposition of collateral was one of the problems the common law and statutory law sought to prevent. *See* Skeels v. Universal C.I.T. Credit Corp., 222 F. Supp. 696, 702 (W.D. Pa. 1963) (discusses the common law reasoning for the notice provision).

59. *See supra* note 35 (discusses the debtor's common law right to attend the sale and redeem the collateral).

60. *See supra* note 48 (discusses the ability of the secured party to manipulate collateral and wrongfully retain any surplus).

61. *Id.*

62. *Id.*

63. *See supra* note 39 and accompanying text (the general intent of the code calls for maximum participation of all parties).

64. The burden on the creditor to notify the debtor is not cumbersome. In fact, the potential damage to the debtor from lack of notice far outweighs the burden on the secured party to notify the debtor. As the Supreme Court of Delaware stated:

> The burdens placed on the creditor under the Code are minimal, while the results of his noncompliance may be very onerous to the debtor. . . .We are unable to see any unfairness in protecting the debtor's rights to the exclusion of those of the creditor when the creditor has been placed in such a high degree of control of the relationship and carries such a small burden in order to gain the advantages of the Statute.

Wilmington Trust Co. v. Conner, 415 A.2d 773, 780 (Del. Supr. 1980).

65. *See supra* note 35 (discusses the debtor's common law right to redeem collateral prior to a repossession sale).

enhance the sale price by participating in the bidding,[66] or they may negotiate a settlement with the secured party.[67] In short, the absolute bar theory clarifies the secured transaction and simplifies the relationship between the parties because the debtor is constantly aware of the status of collateral.

The absolute bar theory also inhibits the secured party's ability to manipulate repossessed collateral. If a debtor is notified of a sale of repossessed collateral, the likelihood that he will be deprived of a surplus is lessened.[68] More importantly, however, the burdens placed on the secured party to notify the debtor of post-default sales are greatly outweighed by the onerous consequences which may flow if a debtor is not notified of the sale.[69] It is not unduly burdensome to require notice, especially when the secured party enjoys such a high degree of control over the relationship. Consequently, the rebuttable presumption theory grants the secured party an unfair advantage in a relationship in which it already enjoys a high degree of control.[70]

In summary, the court's reliance on the absence of absolute bar language in the Code and its reliance on the debtor's rights and remedies provision does not justify adoption of the rebuttable presumption theory.[71] Pre-Code law, which is subsumed into the code, mandates strict enforcement of the notice provision.[72] In addition, the court's analysis of the U.C.C. essentially negates the notice and redemption provisions.[73] The court's treatment of the notice provision falls far short of the strict judicial treatment of other code provisions, such as the financing statement provision.[74]

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66. *See supra* note 58 (debtor may bid in the auction and otherwise view the propriety of the sale).

67. In commercial transactions, the debtor sometimes uses loans and secured transactions to expand a going concern. Unfortunately, however, the debtor's attempts at expanding a business often ends with frustration and lack of capital. When that occurs, the secured party may either repossess the collateral or negotiate a settlement with the debtor. *See, e.g.*, Hoch v. Ellis, 627 P.2d 1060 (Alaska 1981) (the secured party allowed the debtor a chance to obtain sufficient capital to continue the business, but the business subsequently failed).

68. *See supra* notes 48, 60-62 (discusses the potential abuses open to the secured party to withhold notice and consequently retain any surplus).

69. *See supra* note 61 (there exists no apparent unfairness in placing the burden of notice on the secured party, especially since it already enjoys a high degree of control).

70. *Id.*

71. *See supra* notes 32-38 and accompanying text (the court relied on the absence of absolute bar language but failed to find support for the rebuttable presumption theory either).

72. *See supra* note 35 (the Code subsumes pre-Code law, and notice is a condition precedent to a deficiency judgment under pre-Code law).

73. *See supra* notes 38-48 and accompanying text (the court's reading of the statute essentially denies the debtor his right to redeem).

74. *See supra* notes 55-59 and accompanying text (the notice to debtors is just as important as creditor priority, and thus, the notice provision should be enforced).

On a practical level, the rebuttable presumption theory frustrates the debtor's right to redeem, deprives the debtor of an opportunity to negotiate a settlement with the secured party, discourages prospective guarantors from aiding debtors,[75] and restrains a debtor's ability to frustrate deceptive manipulation of collateral.[76] The absolute bar theory, on the other hand, upholds the debtor's right to notice, gives effect to all the Code's provisions, simplifies and clarifies secured transactions, and promotes maximum participation of the parties.[77]

Although the *Joannides* court resolved the Illinois conflict concerning the notice issue, analysis of the rebuttable presumption theory reveals that the debtor's position is significantly weakened. The rebuttable presumption theory unjustifiably strengthens the secured creditor's position, while at the same time it diminishes the debtor's traditional rights. The *Joannides* court's grant of power allowing the secured party to manipulate the collateral and its parallel deprivation of debtor rights constitutes an unreasonable construction of a clearly worded statute. An equitable application of section 9-504 requires incorporation of the absolute bar rule into Illinois law.

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75. *See supra* notes 38-48 and accompanying text (guarantors are less likely to aid debtors if collateral may be sold without notice).

76. *See supra* notes 60-62 (under the rebuttable presumption theory, the secured creditor may choose not to give notice and retain any surplus).

77. *See supra* notes 60-66 and accompanying text (the absolute bar theory forces secured creditors to give notice, and allows the debtor to fully participate by possibly redeeming the collateral).