

COMMENT

Refreshing the Page on Online Collateral Auctions

INTRODUCTION

Advances in technology have allowed for tremendous growth in the use of online auctions over the past decade. In 1998, online auction sales accounted for roughly \$2.1 billion of the total \$13 billion generated in sales by e-commerce.¹ In 2004, reports estimated that online auction sales would total \$100 billion within three years.² By 2007, eBay (the world's most popular online auction site) reported that \$35.6 billion in online auction sales were closed on its trading platform alone.³ Despite this growth in the use of online auctions, however, Article 9 of the Revised Uniform Commercial Code (U.C.C.) has failed to specify whether secured creditors can use these types of auctions to sell a debtor's collateral in the case of default.⁴ Article 9's silence leaves both secured creditors and debtors unsure about whether online auctions might be considered "commercially reasonable"—the standard that a secured creditor must meet in order to sell a defaulting debtor's collateral.⁵

While the popularity of online auctions has ballooned, this lack of certainty has stifled the growth of online collateral auctions (repossessed collateral

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1. Ken Bensinger, *Collecting: The Perils of Online Auctions*, WALL ST. J., Mar. 5, 1999, at W1.
 2. See DAVID C. WYLD, GOVERNMENT GARAGE SALES: ONLINE AUCTIONS AS TOOLS FOR ASSET MANAGEMENT 33 (2004), <http://businessofgovernment.org/sites/default/files/GovernmentGarageSale.pdf>. The increase in the use of online auctions is generally explained by their ability to achieve a higher price and their greater convenience. See *id.*
 3. 2007 EBAY ANNUAL REPORT 48, <http://files.shareholder.com/downloads/eBay/757479150x0x192977/08EAA22C-C31C-41AD-B4D3-0A954354566F/ar2007.pdf> (stating that total sales amounted to \$59.4 billion and that online sales accounted for 60% of total sales).
 4. U.C.C. § 9 (2009). The revised version of Article 9 became effective in all fifty states and the District of Columbia on July 1, 2001.
 5. U.C.C. § 9-610(b).

auctions conducted under Article 9).⁶ This uncertainty gives secured creditors an ever-present fear of litigation from unhappy debtors should they attempt to sell collateral at an online collateral auction. The potential for costly litigation, however, has not stopped all secured creditors from including online collateral auction provisions in their security agreements and selling collateral at online auction sites.⁷ While no comprehensive empirical evidence exists detailing the percentage of online collateral auctions, some experts in the field estimate that this percentage is as low as five to fifteen percent.⁸ Based on anecdotal accounts, however a large opportunity for growth in online collateral auctions exists, especially when studies show that over a quarter of internet users take part in online auctions.⁹ The noticeable lack of case law in this area also suggests that the vast majority of debtors do not pursue litigation following online collateral auctions, possibly because the debtors themselves are capitalizing on the efficiencies and benefits associated with these auctions.

The efficiencies and benefits associated with online collateral auctions include their expedience, inexpensive nature, and potential to sell to a “tremendously large, worldwide audience.”¹⁰ Additionally, studies consistently find that online collateral auctions produce higher prices relative to traditional auctions.¹¹ When compared to traditional auctions, whose ability to sell these types of items is geographically limited to a local community, online collateral auctions can reach a broader population of potential bidders. This extended capacity appears to benefit the seller with little or no downside.¹²

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6. See Michael Korybut, *Article 9's Incorporation Strategy and Novel, New Markets for Collateral: A Theory of Non-Adoption*, 55 BUFF. L. REV. 137, 156-57 (2007).
 7. Richard H. Nowka, *eBay Auctions of Repossessed Motor Vehicles—A Template for Commercial Reasonableness Under Revised Article 9*, 31 S. ILL. U. L.J. 281, 308-17 (2007).
 8. Korybut, *supra* note 6, at 159-60 (outlining interviews of secured transactions attorneys in an attempt to determine the slow level of online auction growth in the Article 9 context); *see id.* at 160 (“What was also apparent from talking to these Interviewees was the dearth of any reliable empirical data about whether or not Article 9 secured creditors [use] online auctions. That absence of data is important because . . . empirical uncertainty begets legal and business uncertainty.”).
 9. JOHN B. HERRIGAN, PEW INTERNET & AM. LIFE PROJECT, ONLINE SHOPPING: INTERNET USERS LIKE THE CONVENIENCE BUT WORRY ABOUT THE SECURITY OF THEIR FINANCIAL INFORMATION iv (2008), http://www.pewinternet.org/~media/Files/Reports/2008/PIP_Online%20Shopping.pdf.
 10. Michael Korybut, *Online Auctions of Repossessed Collateral Under Article 9*, 31 RUTGERS L.J. 29, 30 (1999).
 11. *See, e.g.*, WYLD, *supra* note 2.
 12. For years, scholars worried about the limitations of online auctions and whether purchasers would feel comfortable buying items online. *See, e.g.*, Korybut, *supra* note 10, at 58-59. However, these fears have been greatly assuaged by advances in technology and online

The inefficiencies associated with slow online collateral auction growth will likely be exacerbated in the wake of the recent financial crisis. These effects have been observed in the first quarter of 2010, with one commentator noting that “personal bankruptcy filings in a dozen states increased by double-digit percentages over 2009’s monthly averages.”¹³ Corporate bankruptcy filings are increasing as well.¹⁴ This rise in the number of bankruptcies will result in more auctions for repossessed collateral such as cars, business capital, and other assets in order to satisfy debts owed to secured creditors.

To date, only a few pieces of scholarship have addressed the issue of whether online collateral auctions would satisfy the “commercially reasonable” requirement under Article 9.¹⁵ While these articles provide a framework to understand how online auctions might be judged under Article 9, they fail to analyze relevant case law.¹⁶ This omission is critical, as all cases that review the use of online collateral auctions suggest that they can be used in a commercially reasonable manner.¹⁷

Accordingly, this Comment attempts to move the discussion forward and fill this gap in current scholarship by using relevant case law to advocate for the commercial reasonableness of online collateral auctions. The Comment proceeds in two parts. Part I provides a brief review of Article 9’s commercial reasonableness requirement. Part II reviews the relevant case law that prior scholarship fails to analyze. This Part also draws conclusions as to why the case law suggests that courts support the use of online collateral auctions. The Comment concludes by synthesizing these positive signals with regard to online collateral auctions, and it asserts that Article 9 should be amended to reflect how courts analyze online dispositions of collateral.

security. See, e.g., Bob Tedeschi, *E-Commerce Report; No Longer a Niche Marketing Outlet, the Internet Is Now Attracting Shoppers from Almost All Walks of Life*, N.Y. TIMES, Mar. 29, 2004, at C4, available at <http://www.nytimes.com/2004/03/29/business/e-commerce-report-no-longer-niche-marketing-outlet-internet-now-attracting.html> (citing a Pew Research poll that found that roughly 83 million Americans shopped online in 2004); 2007 EBAY ANNUAL REPORT, *supra* note 3, at 2 (noting that by 2007 eBay alone included 83 million active users).

13. Kevin O’Leary, *Personal Bankruptcies Hit a High and May Keep Rising*, TIME, Apr. 5, 2010, <http://www.time.com/time/business/article/0,8599,1977728,00.html>.
14. Chelsea Emery, *U.S. Business Bankruptcies Rose 7 Pct in January*, REUTERS, Feb. 3, 2010, <http://www.reuters.com/article/idUSN0315693620100203> (noting that in January of 2010, 342 companies sought bankruptcy protection per day in the United States).
15. Korybut, *supra* note 6, at 156-157; Korybut, *supra* note 10, at 30; Michael Korybut, *Searching for Commercial Reasonableness Under the Revised Article 9*, 87 IOWA L. REV. 1383 (2002); Nowka, *supra* note 7.
16. See sources cited *supra* note 15.
17. See *infra* Part II.

I. A BRIEF OVERVIEW OF ARTICLE 9 AND THE COMMERCIALLY REASONABLE STANDARD

Many sections of Article 9, including those dealing with the disposition of collateral, are written to provide a certain amount of flexibility while protecting the interests of both the secured party and the debtor. Professor Grant Gilmore, one of the architects and original drafters of Article 9, stated at the time of its drafting that the “policy of Article 9 is to allow [the] disposition of the collateral without hampering restrictions, in the hope that . . . there will develop a pattern of using commercial outlets to sell goods for the going price at the least possible cost.”¹⁸ Article 9’s standard of commercial reasonableness was designed to achieve this goal.

Specifically, the text of Article 9 states that a disposition of collateral will meet the commercially reasonable standard only if each of its factors is commercially reasonable.¹⁹ These factors consist of “the method, manner, time, place, and other terms” of the sale.²⁰ The aspects that courts analyze when determining whether an auction satisfies commercial reasonableness include: the price received,²¹ the type of disposition (public or private),²² the amount and timing of notification to interested parties,²³ the timing of the sale,²⁴ the place of the sale,²⁵ and the publicity used to promote the auction.²⁶ All of these

18. Grant Gilmore, *Article 9 of the Uniform Commercial Code—Part V: Default*, 7 PERS. FIN. L.Q. REP. 4, 7 (1952).

19. U.C.C. § 9-610(b) (2009).

20. *Id.*

21. U.C.C. § 9-627(a).

22. U.C.C. § 9-610(b) (“If commercially reasonable, a secured party may dispose of collateral by public or private proceedings, by one or more contracts, as a unit or in parcels, and at any time and place and on any terms.”). Comment 3 to section 9-610 states that the “Article does not specify a period within which a secured party must dispose of collateral. This is consistent with this Article’s policy to encourage private dispositions through regular commercial channels.” U.C.C. § 9-610 cmt.3.

23. U.C.C. § 9-612(b) (stating that secured parties must send the debtor(s) notification of the auction at least ten days before it is to be held); U.C.C. § 9-613 (noting that the notification must include the names and contact information of the secured party; a description of the collateral to be auctioned; and the date, time, and place of the auction).

24. See U.C.C. § 1-203 (outlining the general obligation of good faith, which would prevent a secured party from holding collateral without sale for an unreasonably long period of time).

25. U.C.C. § 9-610(b) (“If commercially reasonable, a secured party may dispose of collateral . . . at any time and place . . .” (emphasis added)).

factors are measured in considering whether an auction is commercially reasonable.

Unfortunately, what rises to the level of being commercially reasonable is not clarified in other parts of Article 9, with the exception of section 9-627. Section 9-627 provides three “safe harbor” provisions. This section of Article 9 states that “[a] disposition of collateral is made in a commercially reasonable manner if the disposition is made: (1) in the usual manner on any recognized market; (2) at the price current in any recognized market . . . ; or (3) otherwise in conformity with reasonable commercial practices among dealers.”²⁷

While this section reduces some confusion about the definition of commercial reasonableness, one must look to the case law to define the contours of commercial reasonableness as applied to each factor. As online collateral auctions have yet to be extensively considered by courts, the uncertainty related to these standards is even more troublesome for secured creditors who face potential litigation should a debtor dispute the use of an online collateral auction. These fears have led to slow growth in online collateral auctions, despite their greater efficiencies and their ability to achieve higher prices.²⁸ As the physical location of the auction is the only factor dramatically changed (or, rather, destroyed) by selling collateral online, a revision to the U.C.C. that expressly allows for the reasonable use of online collateral auctions would permit courts to look to previous case law on the reasonableness of physical auctions when reviewing the aspects of an online sale. This modification would provide additional clarity to secured creditors and promote the use of these more efficient auctions.

II. WHAT CASE LAW SUGGESTS ABOUT ONLINE COLLATERAL AUCTIONS

The small amount of case law regarding online collateral auctions can reduce a secured creditor’s anxiety only to a limited extent. To date, the only case analyzed by scholars is *In re A.W. Logging*, an unreported bankruptcy case

26. See U.C.C. § 9-614 (specifying the information that must be put in the notice of auction (advertisements), which includes details that closely mimic those required for proper notification under Section 9-612).

27. U.C.C. § 9-627(b). Article 9’s reference to “recognized market” in the second safe harbor factor is not defined in any part of the Code. Rather, “recognized market” is defined in comment 4 to section 9-627. “[T]he concept of a ‘recognized market’ . . . is quite limited; it applies only to markets in which there are standardized price quotations for property that is essentially fungible, such as stock exchanges.” U.C.C. § 9-627 cmt.4.

28. See *supra* notes 10-12 and accompanying text.

that endorsed the use of online collateral auctions.²⁹ The case dealt with a Chapter 11 bankruptcy in which a creditor was authorized to sell equipment, but the court did not specify a method.³⁰ The creditor chose to auction the collateral online.³¹ In reviewing the commercial reasonableness of the online auction, the court noted: “The evidence showed that Iron Planet is a well-respected auction website [T]he Court is not persuaded that, by listing the equipment for sale on the Iron Planet site, the [debtor] was not exposed [to a] broad market.”³²

While this case certainly helps advocates of online collateral auctions, a single (unreported) decision does not come close to illustrating a broad acceptance of online auctions. Other courts, however, have moved beyond *In re A.W. Logging*, and at least a half dozen other cases provide support for online collateral auctions.³³

A. *Online Collateral Auctions Before In re A.W. Logging*

While there are subsequent decisions that support the use of online collateral auctions, court decisions that were handed down before *In re A.W. Logging* undercut scholars’ claims that the case was entirely groundbreaking. As early as 1993, courts showed a willingness to push the boundaries of commercial reasonableness in novel types of auctions. In *Union National Bank of Wichita v. Schmitz*, a Kansas appellate court reversed a lower court finding that dealer-only wholesale auctions were per se commercially unreasonable.³⁴ The trial court had rejected a bank’s sale of a repossessed vehicle because the vehicle “was not reasonably exposed on the *retail* market.”³⁵ This unusual disposition of collateral was not dispositive for the appellate court, however, as it analyzed this type of auction against the traditional nine factors used to determine commercial reasonableness under the U.C.C.³⁶

29. *In re A.W. Logging, Inc.*, No. 05-500, 2006 WL 2860808 (Bankr. D. Idaho Oct. 4, 2006).

30. *Id.* at *1-2.

31. *Id.* at *2.

32. *Id.* at *8.

33. While the case law is still relatively sparse, it should be noted that a thorough search of Westlaw did not reveal a single case disputing the use of online auctions.

34. *Union Nat’l Bank v. Schmitz*, 853 P.2d 1180, 1186-88 (Kan. Ct. App. 1993).

35. *Id.* at 1183 (emphasis added).

36. See *Westgate State Bank v. Clark*, 642 P.2d 961 (Kan. 1982). The factors to determine commercial reasonableness identified by the Kansas Supreme Court in the *Westgate* decision include:

Perhaps most relevant to online collateral auctions is the way in which the *Schmitz* court analyzed the method of sale. The court took a reasoned, rather than a reactive, approach. Instead of dismissing the method of sale, the court analyzed the same factors that it used to determine every other question of commercial reasonableness under Article 9. “We conclude that a dealer-only wholesale auction may be commercially reasonable We reach this conclusion . . . because the trial court focused on the wrong factors in reaching its decision.”³⁷

As courts appear willing to analyze nontraditional types of auctions through the traditional modes of analysis, it is relevant to understand how courts interpret factors when they include an online element. Before *In re A.W. Logging*, two courts acknowledged the potential benefits of advertising on the Internet and found that online advertisements were commercially reasonable aspects of a disposition of collateral. A federal district court in Kansas approved the use of online advertising in the disposition of over \$200,000 of construction equipment after the company defaulted on a \$400,000 promissory note.³⁸ While the court did not analyze the commercial reasonableness of the “remaining factors” in any sort of depth, it specifically noted that the “plaintiff advertised the sale in multiple national trade publications and on several [I]nternet sites commonly used by the construction industry.”³⁹ A district court in Georgia issued a strikingly similar comment in holding that the disposition of tractors after default on a promissory note was commercially reasonable.⁴⁰ The court noted that the advertising used included notice in the *Atlanta Journal-Constitution* as well as advertising “on the *TruckPaper.com* [I]nternet site on June 6, 2003.”⁴¹

These courts’ specific statements suggest that the use of online advertising benefits the overall argument for commercial reasonableness. If these courts did not think that online advertising added any benefit to the sale, or if it did

(1) The duty to clean up, fix up, and paint up the collateral; (2) public or private disposition; (3) wholesale or retail disposition; (4) disposition by unit or in parcels; (5) the duty to publicize the sale; (6) length of time collateral held prior to sale; (7) the duty to give notice of the sale to the debtor and competing secured parties; (8) the actual price received at the sale; and (9) other factors.

Union Nat’l Bank, 853 P.2d at 1186.

37. *Id.* at 1184.

38. *Gen. Elec. Capital Corp. v. Stelmach Constr. Co.*, No. CIV.A. 00-2026-CM, 2001 WL 969052, at *1-2 (D. Kan. Aug. 15, 2001) (applying Kansas law).

39. *Id.* at *9.

40. *Fin. Fed. Credit Inc. v. Boss Transp., Inc.*, 456 F. Supp. 2d 1367, 1367-69 (M.D. Ga. 2006).

41. *Id.* at 1374.

not favor a finding of commercial reasonableness, then no justification would exist for mentioning these efforts.

B. Moving Beyond In re A.W. Logging

While the three cases above illustrate courts' willingness to embrace novel auction types, courts after *In re A.W. Logging* have proceeded still further. Indeed, two courts found that online collateral auctions are commercially reasonable, and one case even illustrates a debtor's desire to use an online collateral auction. While these cases do not alleviate all fears about the potential invalidation of online collateral auctions, they show movement toward making online collateral auctions more common—a shift that would allow both debtors and secured creditors to capitalize on this more efficient disposition of collateral.

The first case, from Ohio, dealt with the commercial reasonableness of selling a freightliner truck online.⁴² On first blush, it appeared that the court might avoid the issue of whether the online auction was commercially reasonable because it invalidated the sale based on another specific provision in the Ohio Revised Code.⁴³ The court, however, did not stop at the invalidation. Instead, it noted that, despite the Ohio Code's public sale requirement, the court "would agree that the method Daimler Chrysler used to dispose of the secured collateral was a 'commercially reasonable' private sale."⁴⁴ Thus, the court clearly states that but for the specific public sale requirement in the Ohio Code, it would find a generalized disposition of collateral through an online collateral auction commercially reasonable. While this appears to be the first non-bankruptcy case to state that an online collateral auction can be commercially reasonable, it is not the only one.

*CNH Capital America, LLC v. Wilmot Farming Ventures, LLC*⁴⁵ is the most recent case to hold an online collateral auction to be commercially reasonable. CNH Capital disposed of repossessed agricultural equipment online.⁴⁶ The

42. *Daimler/Chrysler Truck Fin. v. Kimball*, No. 2007-CA-07, 2007 WL 4358476, at *1 (Ohio Ct. App. Dec. 14, 2007).

43. *Id.* at *4 ("R.C. 1317.16(A) and (B) [of the Ohio Revised Code] mandate that a secured party's disposition of collateral secured in an agreement within the coverage of the RISA must be through a public sale.").

44. *Id.* at *5.

45. *CNH Capital Am., LLC v. Wilmot Farming Ventures, LLC*, No. 07-0611, 2008 WL 2386166 (W.D. La. June 11, 2008).

46. *Id.* at *9. CNH Capital also noted that it had used eqpower.com to dispose of collateral for the prior eight years and argued that eqpower.com was the "most effective method." *Id.*

court discussed the online collateral auction and noted that of the eight pieces sold, two items were sold at above wholesale value, three items were sold at 100% of wholesale value, and three items were sold at 93% of wholesale value.⁴⁷ Approving of these prices, the court found that “there is no genuine issue of material fact for a jury to conclude [that] CNH Capital’s methods [of selling collateral online] were anything but commercially reasonable.”⁴⁸ The fact that the court finds commercial reasonableness in such an emphatic way indicates that this type of finding is more likely than Article 9’s silence suggests.⁴⁹

Indeed, at least one debtor has raised the argument that not selling collateral online is commercially unreasonable under Article 9.⁵⁰ In *Lister v. Lee-Swofford Investments*, the collateral was composed of the inventory of a used tractor parts dealership, which “included some new tractor parts and some rebuilt parts, but consisted largely of parts obtained by dismantling salvage tractors . . . bought for that purpose.”⁵¹ In disputing the commercial reasonableness of the sale, *Lister* used testimony from two individuals who purchased some collateral at the auction. Both buyers “expressed the opinion that an auction like that conducted here was not the proper way to sell such items.”⁵² Instead of selling the collateral at a physical auction, one of the buyers “opined that some items could have been marketed over the [I]nternet.”⁵³ While the court could not “agree that appellee’s inexperience in disposition of this type of collateral or the failure of many parts dealers to attend the auction despite wide advertising conclusively establishes the disposition of the inventory was commercially unreasonable,”⁵⁴ the fact that these arguments were raised suggests a desire—even on the part of debtors—to see their collateral auctioned online. All previous articles supporting online collateral auctions discuss only the benefits to secured creditors; this case illustrates that *debtors* might also favor this reform.

47. *Id.*

48. *Id.*

49. In almost all other cases examined, the court designates a specific section to analyze the commercially reasonable nature of dealing with any aspect of a disposition of collateral online. Because of the lack of such a section in this case, it appears that the court finds the possibility that online auctions can be commercially reasonable obvious.

50. *Lister v. Lee-Swofford Invs., L.L.P.*, 195 S.W.3d 746 (Tex. App. 2006).

51. *Id.* at 750.

52. *Id.* at 751.

53. *Id.* at 751 n.7.

54. *Id.* at 753.

As scholars have noted, online collateral auction jurisprudence is sparse; however, it does exist and could increase as more secured creditors come to appreciate the potential benefits of online collateral auctions. The small amount of case law does not detract from the fact that courts have continually approved of online collateral auctions or from the fact that no case exists in which a court has invalidated an online collateral auction.⁵⁵ Courts' consistency on this issue will, one hopes, persuade the authors of the U.C.C. to amend the Code in a way that reassures secured creditors about the use of online collateral auctions.

CONCLUSION

Despite the case law's consistently positive view of online collateral auctions, the uncertainty stemming from Article 9's silence continues to keep many secured creditors and debtors from reaping the benefits of online dispositions of collateral. While this Comment asserts that online auctions possess inherent advantages over traditional auctions, it does not advocate a regime where online auctions are per se commercially reasonable. Rather, using language from *Union National Bank of Wichita v. Schmitz*, a revision to Article 9 should be added to illustrate that online collateral auctions, just like physical auctions, "may be commercially reasonable."⁵⁶ Because online collateral auctions encompass many advantages, including efficiency and the ability to attract larger numbers of potential bidders, it is not necessary for Article 9 to give them preference over traditional auctions. A level playing field, however, seems necessary to address secured creditors' reticence.⁵⁷

Ultimately, the goal of Article 9 with regard to the disposition of collateral, as described in Part I, is to implement guidance and procedures to achieve the highest prices possible in collateral dispositions.⁵⁸ A change to Article 9 that puts online collateral auctions on equal footing with traditional auctions will allow Article 9 to achieve this goal better, as studies consistently find that online collateral auctions produce higher prices overall.⁵⁹ Courts appear willing

55. While the sale in *Daimler/Chrysler Truck* was invalidated, it was not invalidated because of the use of an online collateral auction. See *Daimler/Chrysler Truck Fin. v. Kimball*, No. 2007-CA-07, 2007 WL 4358476, at *1 (Ohio Ct. App. Dec. 14, 2007).

56. *Union Nat'l Bank v. Schmitz*, 853 P.2d 1180, 1186-88 (Kan. Ct. App. 1993).

57. See Korybut, *supra* note 6, at 162-69.

58. See Gilmore, *supra* note 18.

59. See, e.g., WYLD, *supra* note 2.

to embrace this type of revision to the U.C.C., which would benefit both debtors and secured creditors. It is time for Article 9 to reflect that change.

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