IN THE COURT OF APPEALS OF IOWA

No. 8-918 / 08-0074
Filed March 26, 2009

C & J LEASING CORP., ASSIGNOR TO FRONTIER LEASING CORP., ASSIGNEE,
Plaintiff-Appellant,

vs.

BEASLEY INVESTMENTS, INC., d/b/a BRONZE BUNZ TANNING and SCOTT BEASLEY and HEATHER BEASLEY k/n/a HEATHER WILBUR, Individually,
Defendants-Appellees.

Appeal from the Iowa District Court for Polk County, Arthur E. Gamble, Judge.

Lessor appeals from a district court ruling awarding it damages in a breach of lease action against lessees. **AFFIRMED IN PART, REVERSED IN PART, AND REMANDED.**

Edward N. McConnell of Ginkens & McConnell, P.L.C., Clive, for appellant.

Mark A. Critelli of Critelli & Hubbard, P.C., Clive, for appellee Scott Beasley.

Heather Wilbur, California, pro se.

Heard by Mahan, P.J., and Miller and Doyle, JJ.

MILLER, J.

Frontier Leasing Corp. appeals from a district court ruling awarding it damages in a breach of lease action against Beasley Investments, d/b/a Bronze Bunz Tanning, Heather Beasley (now known as Heather Wilbur), and Scott Beasley. We affirm in part, reverse in part, and remand for further proceedings.

I. BACKGROUND FACTS AND PROCEEDINGS.

In August 2004, Beasley Investments entered into a lease agreement with C & J Leasing Corp. for tanning equipment to be placed in its tanning salon operation, Bronze Bunz Tanning. Scott Beasley and Heather Wilbur, who were married at the time, each personally guaranteed performance of the lease. C & J Leasing purchased the tanning equipment it provided to Beasley Investments for $140,000. The lease provided that "[o]wnership of the equipment shall at all times remain in Lessor," but gave Beasley Investments the option to purchase the equipment for $17,053 at the end of the lease.

Under the lease agreement, Beasley Investments was required to pay rent of $3432 each month for a period of fifty-nine months. The lease set forth late fees and interest to be paid on delinquent rent payments. It further provided that, in the event of lessee's default, C & J Leasing could require the lessee to pay "an amount equal to all unpaid rental payments" in addition to any other remedy available to it at law or equity. C & J Leasing later assigned the lease to Frontier Leasing, although it continued to act as Frontier Leasing's servicing agent for collection of the lease payments.

Beasley Investments defaulted on the lease agreement by failing to make required monthly payments in May and August 2005. Around that same time, Beasley and Wilbur separated and eventually divorced. Their dissolution decree assigned the tanning business, its equipment, and accompanying leases to Wilbur.

After the default, C & J Leasing took possession of the tanning equipment and sold it to a business operated by Wilbur's father, ML & HM Enterprises, Inc., for $125,000. It also entered into an agreement with ML & HM Enterprises for lease of the tanning equipment in November 2005. That lease required ML & HM Enterprises to make sixty monthly payments in the amount of $2814 each month with the option to purchase the equipment at the end of the lease for one dollar. C & J Leasing did not notify any of the defendants of its intended disposition of the tanning equipment until after it had already disposed of the equipment. It also did not give the proceeds from the sale of the equipment to Frontier Leasing as the assignee of the original lease.

C & J Leasing filed suit against the defendants in April 2006, seeking damages for their alleged breach of the lease agreement. Frontier Leasing was subsequently substituted as the plaintiff in the action after it assumed "direct management and servicing of" the Beasley Investments lease. Beasley filed an answer, generally denying the allegations contained in the petition and asserting failure to mitigate as an affirmative defense. Beasley Investments did not file an answer, and Wilbur filed a pro se answer.

The matter proceeded to a bench trial. Neither Beasley Investments nor Wilbur appeared at the trial. Beasley did appear and contested whether the disposition of the tanning equipment was commercially reasonable. Frontier Leasing stipulated that Beasley did not receive notice of the sale of the equipment before it occurred. It asserted that the disposition was nevertheless commercially reasonable. Frontier Leasing sought $87,132.84 in damages from the defendants. Those damages included past due rental payments, late fees, and interest, in addition to the present value of the rent for the remaining term of the lease agreement and an amount representing Frontier Leasing's residual value in the equipment, less the $125,000 C & J Leasing received from the sale of the equipment.

The district court entered a ruling in favor of Beasley, finding the sale of the tanning equipment was "not done in a commercially reasonable manner under the standards set forth in Iowa Code section 554.9627." The court further found while Frontier Leasing's "failure to give Scott Beasley notice of the sale of the collateral is not an absolute bar to a deficiency judgment under Iowa Code section 554.9626, [Beasley] has established [Frontier Leasing] failed to mitigate damages." It reasoned that had Frontier Leasing given proper notice to Beasley, "he would have cured the default and there would be no deficiency." The court accordingly determined Frontier Leasing was not entitled to any deficiency judgment against Beasley. It did, however, find Frontier Leasing was entitled to a deficiency judgment against Beasley Investments and Wilbur in the amount of $6416.65. The court calculated that judgment in part by subtracting the

remaining amount due under the original lease from the total amount due under the lease C & J Leasing entered into with ML & HM Enterprises.

Frontier Leasing appeals. It claims the district court erred in determining the disposition of the tanning equipment was not commercially reasonable and in failing to enter a deficiency judgment against Beasley. It further claims the court erred in calculating the deficiency judgments against Beasley Investments and Wilbur.

II. SCOPE AND STANDARDS OF REVIEW.

Our scope of review in this action is for the correction of errors at law. Iowa R. App. P. 6.4. The findings of fact in a law action are binding upon us if they are supported by substantial evidence. Iowa R. App. P. 6.14(6)(*a*). Evidence is substantial if a reasonable mind would accept it as adequate to reach the same findings. *Frontier Props. Corp. v. Swanberg*, 488 N.W.2d 146, 147 (Iowa 1992).

III. MERITS.

Before reaching the merits of the issues Frontier Leasing raises on appeal, we believe some background discussion of the applicable provisions of Iowa's Uniform Commercial Code (UCC) will aid our analysis. Iowa Code sections 554.9609(1)(a) and 554.9610(1) (2005) allow a secured creditor, such as Frontier Leasing, to repossess and dispose of collateral upon a debtor's default. Section 554.9615(1) requires the creditor to apply the proceeds of the disposition first to the expenses of the disposition and then to the satisfaction of

the indebtedness secured by the collateral. The debtor or secondary obligor is liable for any deficiency under section 554.9615(4).

Section 554.9610(2) provides that "[e]very aspect of a disposition of collateral, including the method, manner, time, place, and other terms, must be commercially reasonable." A creditor is additionally required to provide the debtor and secondary obligor with a "reasonable authenticated notification of disposition" within a reasonable time before the intended disposition. *See* Iowa Code §§ 554.9611(2); .9612(2). These sections "clearly make[ ] commercial reasonableness *and* notification mandatory for the secured creditor." *Hartford-Carlisle Sav. Bank v. Shivers*, 566 N.W.2d 877, 880 (Iowa 1997) (emphasis added).

However, in an action arising from a business transaction in which the amount of a deficiency is in issue, the secured party "need not prove compliance with the provisions of this part relating to . . . disposition . . . unless the debtor or a secondary obligor places the secured party's compliance in issue." Iowa Code § 554.9626(1)(a). Here, Beasley was the only party to raise Frontier Leasing's compliance with the provisions of part 6 in Article 9 of the UCC as an issue at trial.[1] Because Beasley placed Frontier Leasing's compliance in issue, Frontier Leasing bore the "burden of establishing that the . . . disposition . . . was conducted in accordance with this part." *Id.* § 554.9626(1)(b). With this

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[1] We therefore need not and do not decide whether Frontier Leasing's disposition of the collateral was commercially reasonable as to Beasley Investments and Wilbur. Default judgments were entered against them due to Beasley Investments' failure to file an answer and Wilbur's failure to appear at trial. Thus, the only issue before us as to Beasley Investments and Wilbur is whether the amount of damages the court assessed against them was correct.

framework in mind, we turn to the first issue raised by Frontier Leasing on appeal: whether the district court erred in determining the disposition of the tanning equipment was not commercially reasonable.

A. Deficiency Judgment against Beasley.

At the trial, Frontier Leasing stipulated that Beasley was not provided with notification of the disposition of the tanning equipment prior to its disposition. Thus, irrespective of the commercial reasonableness of the disposition, it is clear Frontier Leasing did not comply with the mandatory notice provisions in sections 554.9611 through 554.9613. It therefore failed to prove the disposition was conducted in accordance with the provisions of part 6 in Article 9 of the UCC, which require *both* commercial reasonableness and notification. *See Hartford-Carlisle Sav. Bank*, 566 N.W.2d at 880. Furthermore, our supreme court has stated that "lack of notice itself suggests [a creditor] did not act in a commercially reasonable manner." *Beneficial Fin. Co. v. Reed*, 212 N.W.2d 454, 458 (Iowa 1973). We therefore agree with the district court that the disposition of the tanning equipment was not commercially reasonable. We must next determine what effect Frontier Leasing's noncompliance has upon its claim to a deficiency judgment against Beasley.

The answer to this question again requires some additional background discussion regarding significant amendments that were made to Article 9 of our UCC during the 2000 legislative session. Prior to that time, Article 9 simply provided that a "debtor can sue for damages occasioned by a secured creditor's noncompliance with the commercial reasonableness and notice requirements."

See Hartford-Carlisle Sav. Bank, 566 N.W.2d at 880 (citing former section 554.9507(1), now section 554.9625). Whether that provision was the debtor's exclusive remedy for a creditor's noncompliance was an issue before many courts that was not decided uniformly. *Id.* In *Reed*, 212 N.W.2d at 459-60, our supreme court set out the two competing interpretations of the damages provision in former section 554.9507(1).

"Under the first interpretation—the absolute bar rule—a secured creditor's failure to give proper notice or sell in a commercially reasonable manner is an absolute bar to any *right* to recover a deficiency." *Hartford-Carlisle Sav. Bank*, 566 N.W.2d at 880-81. This theory imposes "an irrebuttable presumption that the value of the collateral equals the value of the debt or judgment obtained." *Id.* at 881. Courts adopting this theory emphasized the important purposes served by the notice provisions of Article 9: "to insure the debtor a fair price and opportunity to redeem." *Id.* at 882.

> Under the second interpretation—the rebuttable presumption rule—a secured creditor's failure to give notice or sell in a commercially reasonable manner creates a rebuttable presumption that the value of the collateral is at least equal to the unpaid balance of the debt.

Id. at 881. This rule shifts to the secured creditor the burden of proving "what the sale would have brought if done in compliance with" the commercial reasonableness and notification requirements of Article 9. *Id.* (quoting *Reed*, 212 N.W.2d at 460). "Thus, the amount between what the sale brought when performed improperly, and what it should have brought if done correctly, would be damages allowable to the debtor." *Id.* "If such amount did not equal the total

deficiency, the creditor may recover, in the proper manner, the amount remaining unpaid." *Id.*

The court in *Reed* did not decide which interpretation it would follow because the creditor failed to establish its entitlement to recovery under either rule. *See Hartford-Carlisle Sav. Bank*, 566 N.W.2d at 881. However, in cases following *Reed*, our supreme court "left no doubt that it was adopting the position that lack of notice defeated a claim to a deficiency judgment." *Id.* That is until the court's decision in *Barnhouse v. Hawkeye State Bank*, 406 N.W.2d 181 (Iowa 1987). In *Barnhouse*, the court declined to apply the absolute bar rule in the case before it primarily because the underlying purposes of the notice provisions in Article 9 had not been frustrated. 406 N.W.2d at 186-87. The court in *Hartford-Carlisle Savings Bank*, 566 N.W.2d at 879, was consequently asked to decide whether the absolute bar rule was abrogated by *Barnhouse*, and if so, whether the rebuttable presumption rule would apply instead.

Our supreme court determined that *Barnhouse* was "an exception to the rule and therefore must be limited to its facts." *Hartford-Carlisle Sav. Bank*, 566 N.W.2d at 883. It thus reaffirmed Iowa's continued acceptance of the absolute bar rule, but in doing so noted the "vast majority of courts have now determined that the justifications for the absolute bar rule have worn too thin and the legal analysis giving birth to the rule was wrong in the first place." *Id.* at 884 (citing Barkley Clark, *The Law of Secured Transactions Under the Uniform Commercial Code* ¶ 4.12[5][a], at 4-217 to 4-220 (rev. ed. 1993)). The court consequently concluded that "[p]erhaps the time has come for us to revisit the issue." *Id.*

Our legislature heeded the court's advice in *Hartford-Carlisle Savings Bank* and adopted, for the most part, the new version of Article 9 of the UCC effective July 1, 2001. *See First State Bank v. Clark*, 635 N.W.2d 29, 32 n.1 (Iowa 2001). This version resolves the ambiguities in former section 554.9507(1) regarding the effect of a secured creditor's noncompliance with the statute upon the creditor's claim to a deficiency judgment by explicitly adopting the rebuttable presumption rule. *See* Iowa Code § 554.9626(1)(d); *see also* James J. White & Robert S. Summers, *Uniform Commercial Code* § 25-13, at 915 (5th ed. 2000) (stating the revised version of Article 9 "adopts the rebuttable presumption rule . . . and so, for the first time, recognizes that a reduction or a denial of a deficiency judgment is an appropriate remedy"). We therefore reject Beasley's assertion that the absolute bar rule "is still arguably good law" in Iowa. This brings us to Frontier Leasing's arguments regarding the district court's supposed incorrect application of section 554.9626 in determining Frontier Leasing was not entitled to a deficiency judgment against Beasley.

Section 554.9626(1)(c) provides that

> if a secured party fails to prove that the . . . disposition . . . was conducted in accordance with the provisions of this part relating to . . . disposition . . . the liability of a debtor or a secondary obligor for a deficiency is limited to an amount by which the sum of the secured obligation, expenses, and attorney's fees exceeds the greater of:
> (1) the proceeds of the . . . disposition . . . ; or
> (2) the amount of proceeds that would have been realized had the noncomplying secured party proceeded in accordance with the provisions of this part relating to . . . disposition. . . .

Paragraph (d) additionally provides that

> for purposes of paragraph "*c*", subparagraph (2), the amount of proceeds that would have been realized is equal to the sum of the

> secured obligation, expenses, and attorney's fees unless the secured party proves that the amount is less than that sum.

Iowa Code § 554.9626(1)(d). Thus, unless the secured party proves that compliance with the relevant provisions would have yielded a smaller amount, under paragraph (d) the amount that a complying disposition would have yielded is deemed to be equal to the amount of the secured obligation, together with expenses and attorney's fees. *Id.* § 554.9626 cmt. 3. The secured party consequently may not recover any deficiency unless it meets this burden. *Id.*

We agree with the district court that Frontier Leasing did not meet its burden to show that had it complied with the notice provisions, the amount of proceeds from such a disposition would have been less than the amount of its secured obligation. Beasley, whom the court found credible, testified that had he been given proper notice, "he would have cured the default and there would be no deficiency." Frontier Leasing presented no evidence contradicting Beasley's testimony or showing what a complying disposition would have yielded. Neither of its witnesses was able to testify as to the tanning equipment's fair market value, instead simply opining that the price received for the equipment was commercially reasonable. Nor did Frontier Leasing submit any appraisal as to the fair market value of the tanning equipment. We reject its assertion that Beasley was "required to show the price obtained for the equipment fell significantly below the range of prices a complying disposition would have brought." The provision Frontier Leasing relies on in support of this argument, section 554.9626(1)(e), does not apply to the facts of this case.[2]

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[2] Section 554.9626(1)(e) states that

In light of the foregoing, we affirm the district court's determination that Frontier Leasing was not entitled to a deficiency judgment against Beasley. We must next consider whether the court erred in its calculation of Frontier Leasing's deficiency judgment against Beasley Investments and Wilbur.

B. Deficiency Judgments against Beasley Investments and Wilbur.

Our consideration of this issue leads us to Article 13 of our UCC, which deals with leases and governs damages in the event of a lessee's default. Frontier Leasing claims the applicable formula for calculating the damages owed to it in this case due to the lessee's default is found in Iowa Code section 554.13529. We do not agree.

We begin with section 554.13523(1)(e), which provides in relevant part that if a lessee fails to make a payment when due, the lessee is in default under the lease contract and the lessor may "dispose of the goods and recover damages (section 554.13527), or retain the goods and recover damages (section 554.13528), or in a proper case recover rent (section 554.13529)." *See also* Iowa Code § 554.13527(1) (stating that after a default by a lessee under the lease contract, "the lessor may dispose of the goods concerned or the undelivered balance thereof by lease, sale, or otherwise"). The question

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> if a deficiency . . . is calculated under section 554.9615, subsection 6, the debtor or obligor has the burden of establishing that the amount of proceeds of the disposition is significantly below the range of prices that a complying disposition to a person other than the secured party, a person related to the secured party, or a secondary obligor would have brought.

Section 554.9615(6)(a) provides that a deficiency following a disposition is calculated in the above manner only if "the transferee in the disposition is the secured party, a person related to the secured party, or a secondary obligor." The disposition here was to a person related to a secondary obligor. Thus, this section does not apply to shift the burden to Beasley as Frontier Leasing urges.

presented to us is whether this is a proper case for the recovery of rent under section 554.13529. We think not.

Section 554.13529(1)(a) states that after default by the lessee under the lease contract, the lessor may recover from the lessee accrued and unpaid rent as of the date of entry of judgment in favor of the lessor in addition to the present value for the then remaining lease term of the lease agreement plus any incidental damages "for goods accepted by the lessee and *not repossessed by or tendered to the lessor*." (Emphasis added.) The official comments to section 554.13529 explain that

> an action for the full unpaid rent (discounted to present value as of the time of entry of judgment as to rent due after that time) is available as to goods not lost or damaged *only if the lessee retains possession of the goods or the lessor is or apparently will be unable to dispose of them at a reasonable price after reasonable effort*.

Iowa Code § 554.13529 cmt. 1 (emphasis added).

There is no dispute that Frontier Leasing's agent, C & J Leasing, took possession of the tanning equipment after Beasley Investments' default and thereafter disposed of it for what Frontier Leasing claims was a reasonable price. It is thus clear that section 554.13529 does not govern the calculation of Frontier Leasing's damages in this case. The question remains, however, as to whether the district court's determination of the deficiency judgment due to Frontier Leasing from Beasley Investments and Wilbur was correct.

The district court did not specify which damages provision in Article 13 it utilized in arriving at its determination that Frontier Leasing was entitled to a

deficiency judgment of $6416.65 against Beasley Investments and Wilbur. It instead found as follows:

> The original lease was 59 payments of $3432 or $202,488. Defendants paid lease payments of $24,024. Late fees accrued in the amount of $2766.65. This leaves an amount due under the lease of $181,230.65. The lease to [Wilbur's] father provides for 60 payments of $2814 or $168,840. This leaves a deficiency of $12,390.65. The security deposit is credited against the deficiency in the mount of $5974. This leaves a net deficiency amount of $6416.65.

Neither section 554.13527(2) nor 554.13528(1) authorizes calculation of damages in that manner. The parties' lease agreement also does not allow such a calculation of damages. We therefore agree with Frontier Leasing that the district court erred in its determination of damages. *See* Iowa Code § 554.13523 (setting forth lessor's available remedies upon lessee's default). We accordingly remand this case to the district court for a recalculation of the damages due to Frontier Leasing from Beasley Investments and Wilbur.

On remand, the court should determine whether section 554.13527 or 554.13528 governs the damages that may be awarded to Frontier Leasing. The damages set forth in section 554.13527(2) apply if Frontier Leasing's agent, C & J Leasing, disposed of the tanning equipment "by lease agreement substantially similar to the original lease agreement and the new lease agreement is made in good faith and in a commercially reasonable manner." On the other hand, if "the disposition is by lease agreement that for any reason does not qualify for treatment under section 554.13527, subsection 2, or is by sale or otherwise," the lessor may recover damages pursuant to section 554.13528(1). It is not clear

based on the record before us whether Frontier Leasing's agent, C & J Leasing, disposed of the tanning equipment by lease or sale.[3]

In any event, regardless of whether section 554.13527 or 554.13528 applies, the court must discount rents to present values as directed by each of those sections. *See* Iowa Code §§ 554.13527(2), .13528(1). We therefore agree with Frontier Leasing that the court erred in failing to do so in its initial damages calculation. We also agree with Frontier Leasing that it is entitled to any incidental damages it incurred "in connection with return or disposition of the goods, or otherwise resulting from the default" pursuant to section 554.13530.[4] *See id.* §§554.13527(2), .13528(1) (allowing an award of damages under section 554.13530).

Frontier Leasing is additionally entitled to the remedies provided in its lease agreement with Beasley Investments. *See id.* § 554.13523(1)(f) (providing that in addition to the statutory remedies, the lessor may, upon the lessee's default, "exercise any other rights or pursue any other remedies provided in the lease contract"); *see also id.* § 554.13523(3). Such remedies include the late rental charges and interest set forth in paragraph 3 of the agreement. The court should calculate the late rental charges as of the date set forth in the applicable

[3] An agreement entered into between C & J Leasing and ML & HM Enterprises, d/b/a Bronze Bunz Tanning, on November 13, 2005, for the lease of the tanning equipment was entered into evidence at trial. However, there was also evidence in the record suggesting that Frontier Leasing's agent, C & J Leasing, sold the equipment to ML & HM Enterprises for $125,000 as demonstrated by a check in that amount made out to C & J Leasing on December 13, 2005, by Bronze Bunz Tanning.

[4] At trial, Frontier Leasing claimed it incurred $37 in incidental damages.

damages provision.[5] *Compare id.* § 554.13527(2) (stating the lessor may recover accrued and unpaid rent from the lessee "as of the date of the commencement of the term of the new lease agreement") *with id.* § 554.13528(1) (stating the lessor may recover accrued and unpaid rent from the lessee "as of the date the lessor repossesses the goods or an earlier date on which the lessee makes a tender of the goods to the lessor").

Finally, we question whether Frontier Leasing is entitled to the residual value of the equipment in the damages award it requests against Beasley Investments and Wilbur. Although the lease itself does not define or even mention residual equipment value, Frontier Leasing correctly notes that under the lease it could avail itself of remedies under the UCC, which would include Iowa Code section 554.13532. That section permits a lessor to recover from the lessee, in addition to any other permitted recovery, "an amount that will fully compensate the lessor for any loss of or damage to the lessor's residual interest in the goods caused by the default of the lessee." *Id.* § 554.13532. Frontier Leasing bears the burden of proving it actually sustained loss or injury to its residual interest in the equipment as a result of the lessee's default. *See Poulsen v. Russell*, 300 N.W.2d 289, 295 (Iowa 1981).

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[5] We agree with Frontier Leasing that the court erred in awarding it only $2766.65 in late rental charges. It appears from our review of the record that the court adopted that amount from a damages calculation completed by an employee of C & J Leasing in April 2005, several months before the trial in this matter. We do not, however, agree with the $6692.40 in late rental charges claimed by Frontier Leasing at trial and on appeal. Frontier Leasing arrived at that amount by multiplying thirty-nine past due rental payments by the late rental charge set forth in the lease agreement. However, it is clear from our review of the record that there were only thirty-two payments that were past due as of the time of trial. We know of no authority or statute, nor does Frontier Leasing provide us with any, that would allow it to add "two payments . . . through to cover the judicial process" as it attempted to do elsewhere in its damages calculation.

We do not believe that, as Frontier Leasing suggests, the lessee's failure to exercise the purchase option provided for in the lease entitles Frontier Leasing to recover damages under section 554.13532. The parties' lease agreement did not require Beasley Investments to exercise the purchase option, much less convert the option into an obligation in the event of a default. Even if Beasley Investments had not breached the lease, it was free to simply return the equipment to Frontier Leasing at the end of the lease term—the same action provided for in the lease in the event of default. Thus, any assumption that but for the default, Beasley Investments would have exercised the option allowing it to purchase the tanning equipment for $17,053 rather than returning it is speculative at best.

IV. CONCLUSION.

We affirm the district court's determination that Frontier Leasing was not entitled to a deficiency judgment against Beasley. However, we reverse the court's award of damages against Beasley Investments and Wilbur in the amount of $6416.65 and remand for a recalculation of the damages due to Frontier Leasing from those parties consistent with the directions provided herein.

Costs on appeal are assessed against Frontier Leasing.

AFFIRMED IN PART, REVERSED IN PART, AND REMANDED.