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An Agricultural Law Research Article

## **Horse-Tradin': The Legal Implications of Livestock Auction Bidding Practices**

### **Part 2 of 2**

by

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\$4,700. Hence, if Ann Purchaser had been declared the high bidder at \$4,900, Ann Purchaser could have rescinded the sale and avoided paying for the mare.<sup>107</sup>

On the other hand, if Ann Purchaser chooses to take the mare at the "last good faith bid prior to the completion of the sale," the result is not as clear. In applying the alternate remedy to Hypothetical 5, the last bid of \$5,200 by Ruth Deal is a secret repurchase bid. Because secret repurchase bids are legally invalid, Ann Purchaser is entitled to the confirmation of a contract between herself and Nick Consignor, and the price she must pay under that contract is the last good faith bid prior to any bid entered on behalf of seller.<sup>108</sup> Ruth Deal's bid of \$4,000 is a good faith bid, despite the rebate agreement, because Consignor intended to hold Deal accountable for the \$4,000 bid. Purchaser's bid of \$4,300 is a legitimate bid entered by Purchaser to top the good faith bid of Deal. But all bids after Purchaser's \$4,300 bid are fictitious bids because they are either seller's bids or bids induced by seller's puffing. Ann Purchaser must therefore pay \$4,300 for the mare, Back Track.<sup>109</sup>

If the bidding pattern of Hypothetical 5 is changed, the application of the alternate remedy reveals new difficulties. Assume that the bidding pattern and facts of Hypothetical 5 remain the same except that after Purchaser has bid \$3,500, Ruth Deal bids \$4,100 rather than \$4,000. Deal's bid of \$4,100 is a puffed bid because Consignor does not intend to hold her accountable for the \$4,100 bid. Hence, Purchaser's bid of \$3,500 is the last good faith bid prior to any bid being entered on behalf of seller. Purchaser, on this changed set of facts for Hypothetical 5, should therefore pay only \$3,500 for the mare.

Yet, even conceding that the \$4,100 bid and all later

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107. The remedy of rescission on the facts of Hypothetical 5 would be the same for Ann Purchaser whether the auction was a with or without reserve auction.

108. Full discussion as to why secret repurchase bids are illegal is provided in the commentary accompanying Hypothetical 1 (without reserve auctions) and Hypothetical 3 (with reserve auctions).

109. Ann Purchaser would also have to pay \$4,300 for the mare, Back Track, if Ruth Deal had stopped bidding at \$4,700. Forty-three Hundred Dollars is the last good faith bid on the facts of Hypothetical 5.

bids are invalid bids, it might be argued that Deal and Consignor had an agreement that Deal would in fact pay \$4,000 for the mare. Due to this agreement, it could be contended either that Deal is entitled to the mare at the \$4,000 price, or that, at least, Purchaser must pay \$4,000 for the mare. The better solution, however, would be that Deal is not entitled to the mare and that the courts should not make Purchaser pay more than her \$3,500 bid for the mare.

The language of § 2-328(4) refers to the "price of the last good faith bid." Courts should interpret that language as referring to the bidding pattern of the factual situation. Courts should not look toward evidence of extraneous agreements to determine the price which satisfies the Code. When the bidding pattern alone is considered, the \$3,500 bid is the last good faith. Moreover, the language of subsection 4 also states that the buyer can "take the goods."<sup>110</sup> Courts should interpret that language to mean that Purchaser is entitled to the mare as a way of protecting the expectations of good faith bidders when those expectations conflict with the expectations of a bidder who agreed to make fraudulent bids at the auction.<sup>111</sup> Finally, if courts were to allow Consignor to receive at least \$4,000 or Deal to have the mare at \$4,000, the \$4,000 would become a guarantee against loss caused by their own fraudulent conduct. This should not be allowed. Courts should interpret § 2-328(4) so as to remove all benefits and advantages from engaging in seller self-bidding. Confirmation of Purchaser's \$3,500 bid as the "last good

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110. The position taken here is that courts should resolve the application of the alternate remedy of § 2-328(4) by reference solely to the bidding pattern of the auction itself, rather than through the taking of evidence extraneous to the bidding pattern. This position is consistent with the position adopted earlier in the article concerning the way in which courts should resolve the application of the alternate remedy to the situation where the puffer enters the first bid made at the auction. See *supra* text accompanying note 99.

111. The use of the word "take" in § 2-328(4) indicates that the good faith bidder who has been defrauded through seller puffing is entitled to a statutory remedy analogous to specific performance. The defrauded good faith bidder is not limited to damages which is the usual contract remedy. Moreover, the word "take" is used in a context which indicates that the defrauded good faith bidder gets the goods period. In contrast to specific performance, the good faith bidder under § 2-328(4) is not required to show the inadequacy of damages as a remedy or the uniqueness of the goods as prerequisites to using the statutory remedy to "take" the goods.

faith bid" does just that.<sup>112</sup>

#### HYPOTHETICAL 6: SELLER SELF-BIDDING IN RELATED SALES

Quick McCall, an auctioneer, has agreed to sell six horses for Gus Wantsmore. Wantsmore is concerned, however, that the six horses sell for "top dollar." To stimulate "top dollar" prices, McCall and Wantsmore agree that for the first horse to pass through the auction ring, and only the first horse, a puffer will be employed to bid secretly.

Go First, a three year old stallion, is sold first. Tex Tibbets, an employee of McCall, jumps in at appropriate times to make bids. With the help of Tibbets' bids, Go First sells for a premium price. Wantsmore is very pleased at the sale of Go First.

Immediately following the sale of Go First, four more horses being sold by Wantsmore pass through the auction ring. No puffing occurs in the sales of these four horses. Wantsmore is pleased with the prices his horses are bringing, however.

The next horse to enter the auction ring is the sixth horse being sold by Gus Wantsmore. The horse is a seven year old mare named First Queen. Three bidders, including Becky Last, bid on the mare and the bidding is spirited. All three bidders are good faith bidders. Becky Last bids \$7,100 and when the other two bidders decline to bid further, Quick McCall gavels the horse sold. Wantsmore is delighted with the price for which First Queen sold.

Two weeks later, Becky Last learns that Tex Tibbets, who had bid on Go First for Wantsmore, was an employee of the auctioneer. Last feels that she has been "set up" and demands legal redress against Wantsmore.

From the facts of Hypothetical 6, it is clear that Gus

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112. In the author's opinion, the correct interpretive attitude courts should adopt in construing § 2-328(4) is the attitude expressed by the North Dakota Supreme Court in *Berg v. Hogan*, 311 N.W.2d 200 (N.D. 1981). The North Dakota Supreme Court expressed the attitude that § 2-328(4) was specifically designed to protect the defrauded good faith bidder and, therefore, should be construed liberally to protect the defrauded good faith bidder. *Id.* at 202-203.

Wantsmore used the bidding practice of having Tibbets bid on his first horse for the purpose of setting a standard or a pricing pattern which would thereafter influence the sales of his other horses so that they too would bring high prices. Gus Wantsmore may also be thinking beyond that day's auction sale to the market in general with the hope that setting "top dollar" prices for his horses at auction will allow him to ask "top dollar" prices for his horses in privately negotiated sales. At the same time, the facts also make clear that Gus Wantsmore did not puff the price of any individual horse aside from the first horse, Go First. The legal issue relevant to Becky Last is whether the fact of puffing in one sale will be held to be an improper influence on the bidding in a subsequent sale in which no direct puffing occurred.<sup>113</sup>

Case law is clear that such practices may give rise to legal remedies on behalf of the buyer at the subsequent sale. In cases where improper influence is found between puffing at one sale and bids at a subsequent sale, the courts consider the injury to the buyer at the second sale to be the same as the injury to a buyer in the directly puffed sale. In both sales, the puffing has the effect of inducing the buyer to bid higher than he would have otherwise done. It is irrelevant what the item being sold at auction is "worth." So long as the seller has used secret bids which have misled good faith bidders as to the competition that truthfully exists for the item being sold, then illegal puffing has occurred. Again, courts operate to protect the fair, open, competitive determination of prices at auction.<sup>114</sup>

There are, however, distinctions between auction sales

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113. Auctioneers and sellers use a wide assortment of tactics for the purpose of gaining the highest price possible for the items being sold. Many of these tactics are perfectly legal even though the tactics create an "auction fever" which induces people to pay more than they would have paid under less frenetic circumstances. DuBoff, *supra* note 7, at 504-506. Whether puffing in one sale for the purpose of influencing the prices in other sales is legal or illegal is the question raised by Hypothetical 6.

114. *Osborn v. Apperson Lodge*, 213 Ky. 533, 281 S.W. 500 (1926); *Curtis v. Aspinwall*, 114 Mass. 187 (1873); *Springer v. Kleinsorge*, 83 Mo. 152 (1884); *Morehead v. Hunt*, 16 N.C. 28 (Eq. 1826); *Edmunds v. Gwynn*, 157 Va. 538, 161 S.E. 892 (1932).

Four legitimate tactics exist which would allow Wantsmore to protect his interest in the horses. For full discussion of these four methods, see *supra* text accompanying notes 66-82.

actually involving puffing and auction sales merely influenced by puffing. With respect to the auction sale in which puffing has actually occurred, the courts are clear that there exists a conclusive presumption of fraud. With respect to a sale allegedly influenced by puffing that occurred in a separate sale, courts hold that the buyer is entitled only to a rebuttable presumption of fraud. In accordance with the rebuttable presumption, once the buyer proves that puffing has occurred in a *related* sale, the buyer is entitled to judgment unless the seller can provide evidence which clearly and conclusively establishes that the puffing in the separate sale did not influence or affect the bids made in the sale about which the buyer complains. The seller has the burden of coming forward with the evidence and the burden of proof that the puffing in the one sale had no impact in the subsequent sale. These burdens are placed on the seller because it is the seller who engaged in the fraudulent practice of puffing.<sup>115</sup>

Whether the buyer has proven that puffing occurred in a *related* auction sale is a question of fact. Important factors include whether the various sales occurred on the same day,<sup>116</sup> whether the sales occurred in the same continuous auction,<sup>117</sup> and whether the items sold were the same type of property.<sup>118</sup> If all three of these factors are found in the factual situation being litigated, courts have in the past ruled that the buyer has met the buyer's burden. The rebuttable presumption that fraud occurred in the auction sale about which buyer complains then arises.<sup>119</sup>

Whether the seller has established that no impact exists between the sale in which the puffing occurred and the sub-

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115. *Osborn v. Apperson Lodge*, 213 Ky. 533, 281 S.W. 500 (1926); *Curtis v. Aspinwall*, 114 Mass. 187 (1873); *Springer v. Kleinsorge*, 83 Mo. 152 (1884); *Morehead v. Hunt*, 16 N.C. 28 (Eq. 1826); *Edmunds v. Gwynn*, 157 Va. 538, 161 S.E. 892 (1932). Cf. *Bowman v. McClenahan*, 20 A.D. 346, 46 N.Y.S. 945 (N.Y. App. Div. 1897); 5 WILLISTON & THOMPSON, *supra* note 18, § 1664, at 4696.

116. *E.g.*, *Curtis v. Aspinwall*, 114 Mass. 187, 192 (1873).

117. *E.g.*, *Springer v. Kleinsorge*, 83 Mo. 152, 162 (1884).

118. *E.g.*, *Morehead v. Hunt*, 16 N.C. 28, 33 (Eq. 1826).

119. *E.g.*, *Edmunds v. Gwynn*, 157 Va. 538, 161 S.E. 892 (1932); *Peck v. List*, 23 W. Va. 338 (1883).

sequent sale is also a question of fact. Important factors include the motive of the seller in using puffing in the other sale,<sup>120</sup> the reasons aside from puffing which motivate the buyer to attack the validity and enforceability of the auction sale contract,<sup>121</sup> and the differences between the items sold which indicate that bids in the first sale did not influence bidder judgments in the subsequent sale.<sup>122</sup>

If a buyer bids at an auction to purchase an aggregate of items which have previously been sold individually in sales where puffing occurred, case law is clear that the buyer is entitled to a remedy because the aggregate can only be purchased by a bid greater than the sum of the high bids for the individual sales. Hence, the buyer's bid for the aggregate was clearly influenced by the puffed individual sales' prices.<sup>123</sup> Just as clearly, case law holds that if the puffing occurred after the sale about which buyer now complains, the buyer is not entitled to any remedy. Bids made prior to the time any puffing occurred obviously could not have been influenced by the puffing.<sup>124</sup>

The four subsections of § 2-328 generally cover the

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120. *Cf.* *Springer v. Kleinsorge*, 83 Mo. 152 (1884). Opinion indicated that the motive of the seller in puffing might be relevant, although the court did so with respect to a distinction between motives which has been rejected. If a seller puffed one sale without any motive to affect other sales at the same auction, the courts might be swayed to hold that the sale puffed was a fraudulent sale, but that other sales would not also be declared fraudulent. In effect, due to the seller's motive in puffing, the courts would treat the later sales as completely independent from the puffed sale.

121. *E.g.*, *Osborn v. Apperson Lodge*, 213 Ky. 533, 535, 281 S.W. 500, 502 (1926). Court made pointed reference to the evidence which indicated that the purchaser seeking rescission on the grounds of puffing may have actually wanted out of the contract because she did not like the family which bought the lot adjoining hers.

122. *E.g.*, *Morehead v. Hunt*, 16 N.C. 28, (Eq. 1826). Judge Henderson wrote: "The rule laid down by the complainant's counsel is certainly a wise one, that at the sale of a horse or an ox, puffing the sale of the horse is not puffing the sale of the ox, because the bidding for the one does not, in the estimation of the bidders, enhance the value of the other . . ." *Id.* at 35.

123. *Edmunds v. Gwynn*, 157 Va. 538, 161 S.E. 892 (1932). Purchaser seeking rescission of auction contract testified that he determined what his bid would be for the entire land parcel by adding up what the individual lots sold for and then bidding \$250 higher than that total. Purchaser sought rescission because the sales of the individual lots had been puffed.

124. *Osborn v. Apperson Lodge*, 213 Ky. 533, 281 S.W. 500 (1926). *Cf.* *Newman v. Woolley*, 201 Ky. 139, 255 S.W. 1050 (1923). Purchaser proved that auctioneer agreed to puff the sale for the seller. But the proof also established that the auctioneer

gamut of legal questions relating to auctions. Subsection 1 of the section specifically adopts the common law rule that each individual sale within an auction is a "separate sale."<sup>125</sup> Subsection 4 then specifically prohibits seller self-bidding unless proper notice is given without distinguishing between its application to the separate sales within an auction and its application to the auction as a whole. When these two subsections are taken together, it appears that the prohibition against puffing found in subsection 4 is meant to apply to the auction as a whole. Section 2-328 should therefore be interpreted to embody the principles discussed above and to prohibit seller self-bidding in related sales.<sup>126</sup>

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did not in fact puff because the bidding was so intense that no need to puff arose. *Id.* at 141, 255 S.W. at 1052.

125. An analogous provision in the Uniform Sales Act reads: "Where goods are put up for sale by auction in lots, each lot is the subject of a separate contract of sale." UNIFORM SALES ACT § 21(1) (1922).

An implicit holding of the cases which rule that if puffing has occurred in one sale at an auction, then a rebuttable presumption exists that the puffing affected other sales at the auction, is that each of the sales is a separate sale. By contrast, when puffing has occurred in the same sale as the one being challenged, the courts hold that a conclusive presumption of fraud exists.

126. The interpretation presented in the text of the interrelationship between the subsections of § 2-328 accentuates the fraud analysis of auctions at the expense of the contract analysis of auctions found in subsection 3 of § 2-328. The text interpretation basically treats subsection 3 of § 2-328 as irrelevant to the resolution of the issue presented by Hypothetical 6.

The text interpretation that § 2-328 should be construed to prohibit puffing in the auction as a whole, as opposed to merely prohibiting puffing in discrete separate sales of the auction, applies regardless of whether the auction is a with or without reserve auction. In neither type auction does the actual puffing occur in the same sale about which the good faith bidder is complaining. Hence, a distinction between with and without reserve auctions, which is relevant with respect to how and when a contract is formed at an auction, is not relevant when fraud alone is involved.

If the interpretation of § 2-328 presented in the text is rejected, the good faith bidder still may be able to gain legal relief under § 1-103 of the Uniform Commercial Code. Section 1-103 reads as follows: "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." U.C.C. § 1-103 (1977). Hence, even if § 2-328 is not interpreted to prohibit seller self-bidding in related sales, § 1-103 preserves the case law which clearly establishes that seller self-bidding in related sales can constitute fraud at an auction. *Cf.* 2 W. HAWKLAND, UNIFORM COMMERCIAL CODE: SERIES § 2-328:05 (1982); Cudahy, *The Sales Contract—Formation*, 49 MARQ. L. REV. 108, 120 (1965). Both Hawkland and Cudahy, in reference to a different issue about auctions,

In Hypothetical 6, Becky Last can establish that the directly puffed sale and the sale allegedly affected by that puffing occurred on the same day, as part of one auction in which Gus Wantsmore's horses sold one after another. This should give rise to a rebuttable presumption of fraud on her behalf. Moreover, Wantsmore adopted the puffing in the first sale for the explicit *purpose* of affecting the prices to be reached in the other sales of his horses. Finally, Becky Last bases her legal claim solely on a feeling that she had been "set up." Last is not just looking for an excuse to get out of the sales contracts. Wantsmore's only defense is to claim that the sixth horse sold was a mature mare, First Queen, and that puffed bids were on a young stallion, Go First.<sup>127</sup> The trier of fact should be left to decide whether the difference between stallions and mares is sufficient to conclude that Wantsmore has proven that the judgment of the bidders in the sixth sale was not influenced by the puffed bids of the first sale. If the trier of fact concludes that the difference is insufficient, the decision should be upheld.<sup>128</sup>

If this conclusion is reached, Becky Last is entitled to the remedies which are set forth in § 2-328(4). Rescission, once again, is an easy remedy to apply because it would simply mean that Betty Last voids the sale and has no obligation

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make the point that § 1-103 was adopted to indicate clearly that the Code did not abolish common law remedies for other forms of fraud not specifically covered by the Code.

127. The bland statement that the difference between a young stallion and a mature mare is so great that the bidding on the young stallion could not have had any impact on the bidding for the mature mare may well mask a significant bloodline relationship between the two horses. For example, First Queen may be the dam of Go First. If the offspring sells for a premium price, bidders may well receive the impression that owning the dam could result in producing another offspring which will also bring a premium price. Thus, closer scrutiny of the facts may reveal relationships, bloodline and otherwise, between the items sold at the two separate sales in the auction which belie the denial of any influence from one sale to the other.

128. As indicated in the text, whether or not puffing in one sale has influenced the bidding in another sale is a question of fact. Appellate courts are always reluctant to reverse a trial court judgement about questions of fact. See *Osborn v. Apperson Lodge*, 213 Ky. 533, 281 S.W. 500 (1926). Court of Appeals in affirming judgement of trial court showed great deference to chancellor who "being on the ground and familiar with the parties, after an analysis of the evidence reached the conclusion that there was no by-bidding, and that the sale was fairly conducted in so far as it affected either of the appellants." *Id.* at 536, 281 S.W. at 503.

to pay for the mare. But if Betty Last desires to keep the mare, the alternate remedy of taking the mare "at the price of the last good faith bid prior to the completion of the sale" is more difficult to apply.

The interpretation of this alternate remedy which has been previously used (the last good faith bid prior to any bid on behalf of seller),<sup>129</sup> does not appear to be applicable to the fact situation as in Hypothetical 6. In a sense, all the bids presented in the sale of First Queen by all three competing bidders are good faith bids because none of the bids was meant to be fictitious. Moreover, no bid in the auction of First Queen was entered on behalf of the seller. Hence, no particular bid in the bidding pattern of Hypothetical 6 is readily identifiable as the last good faith bid. Furthermore, examination of the bidding pattern of the sixth sale does not reveal what the bids would have been or where the bids would have begun and ended if no seller self-bidding influence had existed.<sup>130</sup> If the courts were to try to fix a "last good faith" bid, the courts would apparently have to take evidence as to what the "true" value of Gus Wantsmore's horses were. The courts would be involved in a very speculative undertaking, for the auction price is solely dependent upon the supply-demand factors generated at the auction itself. The auction price is not inherently related to any concept of "intrinsic" value.<sup>131</sup>

It has previously been argued that courts should not de-

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129. See *supra* text accompanying notes 44-47 & 96-97 (discussion of the alternate remedy as the last good faith bid prior to any bid on behalf of the seller).

130. In all other bidding patterns discussed thus far in the article, examination of the bidding pattern reveals (except for one instance) the last good faith bid prior to any bid on behalf of the seller. The one exception is the bidding pattern where the puffer enters the first bid at the auction. But even in this latter instance, the good faith bidder can be given the option of adopting the puffer's first bid as the last good faith bid. See *supra* text accompanying notes 98-99. But in a factual situation like Hypothetical 6, where the puffing occurred in a separate sale and all the bids in the sale complained about were entered by good faith bidders, even the option to adopt the puffer's bid as the last good faith bid does not exist.

131. *Peck v. List*, 23 W. Va. 338 (1883). The opinion of Judge Green in *Peck* contains an excellent discussion asserting that auctions are meant to be price-determining mechanisms which respond solely to the supply and demand of bidders without any regard or concern for any intrinsic value alleged to exist independent of the "wishes and wants of bidders." *Id.* at 383-86, 392-95.

termine the last good faith bid by becoming involved in evidence extrinsic to the bidding pattern itself.<sup>132</sup> The same argument is applicable here. Courts should determine the last good faith bid based solely upon the bidding pattern itself. In this instance, because the bidding pattern does not reveal a last good faith bid, Becky Last should be limited to the remedy of rescission. While Becky Last's expectation of owning the mare, First Queen, is defeated if she is limited to rescission, the danger of doing injustice to the seller through a speculative determination of the "last good faith" bid is avoided. At the same time, Gus Wantsmore, as seller, has been denied the benefits of his puffing as it affected the sale of First Queen because he has denied the sale.

Hypotheticals 1 through 6 have illustrated the legal relationships between buyers and sellers at with and without reserve auctions. Each hypothetical assumed that the auction was a voluntary auction on the part of the seller. But what if the auction were not a voluntary auction? What if the auction were a forced sale utilizing the auction method? For an understanding of the forced sale situation, let us turn our attention to Hypothetical 7.

#### HYPOTHETICAL 7: FORCED SALE AUCTION

Mythical Square National Bank repossessed Dreams Abound, a five year old champion mare, from Tex Whitter who had originally purchased the mare with money lent to him by the bank. The repossession was accomplished in accordance with the applicable provisions of the Uniform Commercial Code.

Also in accordance with the Uniform Commercial Code, Mythical Square National Bank holds a public auction for the sale of the repossessed mare, Dreams Abound. Tweed Manhattan attends the auction and begins the sale with a bid of \$27,000. Margaret Teller tops that with a bid of \$30,000 which she has entered at the behest of her employer, Mythical Square National Bank. Manhattan then bids \$33,000; Teller bids \$38,000; Manhattan bids \$40,000; Teller bids \$43,000; Manhattan bids

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132. See *supra* text accompanying notes 99 & 110.

\$45,000. No further bids are made and the auctioneer gavels the mare, Dreams Abound, as sold to Tweed Manhattan for \$45,000.

Mythical Square National Bank is quite pleased with the sale because the purchase price of \$45,000 is just what the bank needed to cover the costs for conducting the public auction.

Two weeks later, Manhattan learns, for the first time, that Margaret Teller was an employee of the repossessioning bank. Manhattan realizes that he paid more at the auction than he would have had to pay for Dreams Abound if Margaret Teller had not been bidding. Manhattan wants to get out of paying \$45,000 for the mare, Dreams Abound.

If this auction had been a voluntary auction, such as those discussed in Hypotheticals 1 through 6, Tweed Manhattan would undoubtedly be entitled to legal remedies against Mythical Square National Bank because the Bank has used an unannounced puffer at the sale. However, § 2-328(4) specifically says: "This subsection shall not apply to any bid at a forced sale."

To understand the meaning of § 2-328(4) in the context of a forced sale, it is important to recall that the owner of the property is not necessarily the seller at auction.<sup>133</sup> Both Tex Whitter, the debtor, and Mythical Square National Bank, the creditor, have ownership interests in the mare, Dreams Abound. But in order to be considered the seller, a party must have the power to immunize the person alleged to be the puffer from responsibility for any bids that person enters.

In Hypothetical 7, it is clear that Whitter does not control the public auction at which Dreams Abound is being sold.<sup>134</sup> If Whitter were to bid himself, or to induce anyone else to bid, those bids would be bona fide because the Bank

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133. For a fuller discussion of the distinction between an owner and seller at an auction, and for a fuller discussion of the definition of who is a puffer, see *supra* text accompanying notes 6-15.

134. *Dudley v. Little*, 2 Ohio 504 (1826). Case involves a judicial sale at auction for taxes which had not been paid. During the opinion, the Court commented upon the relationship between the owner whose land was being sold and the agent for the state who is in charge of the auction sale. The Court opined: "Over a sale of this description, the owner has no control—he can not refuse a bid, or adjourn the sale, or

can hold Whitter or his agent accountable for the bids.<sup>135</sup> Hence, Tex Whitter is not a seller under § 2-328(4). Whitter is therefore entitled to bid just like any other member of the public. Whitter is not required to announce his intention to bid to other bidders. Moreover, Whitter can bid for the sole purpose of pushing the bids higher so that he will owe a smaller or no deficiency at the end of the auction.<sup>136</sup>

Whether the Bank is a seller under § 2-328(4) is a more complex issue. It could be argued that the Bank is not a seller because any bid the Bank enters will reduce the amount owed by the debtor on the outstanding debt being foreclosed. Thus, the Bank is in fact being held accountable

fix a sum below which the property shall not be struck down. The sale is managed by the agent of the state. The owner is not consulted." *Id.* at 505.

135. When a secured party disposes of the collateral after default by the debtor, the secured party is required to give "reasonable notification of the time and place of any public sale . . . to the debtor." U.C.C. § 9-504(3) (1972). The comments to this subsection state that the reason for the notification requirement is to allow the debtor to protect their interest in the property "by taking part in the sale . . . if they so desire." U.C.C. § 9-504 comment 5 (1972). *Accord* Liberty National Bank of Fremont v. Greiner, 62 Ohio App. 2d 125, 405 N.E.2d 317 (1978).

136. A goodly amount of confusion has existed as to who is the seller immunized from the penalties for self-bidding by the last sentence of § 2-328(4). The New York Law Revision Commission and Professor Hawkland in his 1964 treatise both argued that the debtor (i.e. Whitter in Hypothetical 7) is the seller at a forced sale. 1 W. HAWKLAND, A TRANSACTIONAL GUIDE TO THE UNIFORM COMMERCIAL CODE § 1.13040503 (1964); 1 NEW YORK LAW REVISION COMM'N STUDY OF THE U.C.C. § 2-328, at 444 (1955). In the author's opinion, the Commission and Professor Hawkland became confused because they assumed that the owner of the property is identical to the seller at the auction. As has been indicated in the text, the owner of the property is not necessarily the seller at the auction.

By 1982, Professor Hawkland realized that he had made a mistake on this point. In his most recent treatise, Professor Hawkland acknowledges that the debtor in forced sales situations is not the seller and that the debtor can therefore bid, not because the debtor has been immunized by the last sentence of § 2-328(4), but because the debtor is just like any other person (aside from the seller) who comes to the auction to bid. 2 W. HAWKLAND, UNIFORM COMMERCIAL CODE SERIES § 2-328:04, at 566 (1982). Professor Hawkland and the author are therefore in agreement that the debtor is not the seller at a forced auction sale.

Hypothetical 7 uses as the example of a forced sale a repossession sale carried out by the secured party under § 9-504 of the Uniform Commercial Code. As the discussion of Hypothetical 7 proceeds, other examples of forced sales should also be kept in mind: judicially ordered partition, bankruptcy, receivership, conservatorship, administratorship, executorship. In the author's opinion, the relevant legal rules about seller self-bidding under § 2-328(4) are the same no matter which specific type of forced sale has given rise to the auction.

for its bids. The reduction in amount owed by the debtor, however, is a reduction in an amount collectible in collateral proceedings. With respect to the auction sale itself, the Bank does have control and is not held accountable for its bids.<sup>137</sup> Margaret Teller, the agent, is not going to have to pay on any bid she has entered in the auction of *Dreams Abound*. In fact, Margaret Teller was instructed by her employer to bid for the purpose of puffing the sale. The Bank adopted this bidding practice for the the purpose of protecting itself against having to seek a deficiency judgment.<sup>138</sup> Section § 2-328(4) should, therefore, be interpreted so that Mythical Square National Bank, the creditor, is a seller.<sup>139</sup>

The last sentence of § 2-328(4) states that the "subsec-

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137. It should be emphasized once again that a person is a seller at an auction only if that person controls the auction in such a way that the person or the person's agent will not be held accountable for bids entered at the auction. Under discussion in the text is the issue of whether and under what circumstances, a debtor or a creditor in a forced sale auction should be considered a seller. Under one set of circumstances, a bankruptcy sale, the author contends that neither the debtor nor the creditor is a seller. In a bankruptcy sale, the bankruptcy trustee is the person in charge of the auction and therefore the seller under § 2-328(4). Hence, at a bankruptcy auction, both the debtor and the creditor can bid, without giving notice or needing the immunity afforded seller self-bidding via the last sentence of § 2-328(4), just like any other person who comes to the auction. At a bankruptcy sale, neither the debtor nor the creditor is the seller.

138. Remember that protecting oneself against a sacrifice sale is not sufficient justification under case law, the Uniform Sales Act, or the Uniform Commercial Code for unannounced seller self-bidding. See the discussion under Hypothetical 3 for the arguments and authorities supporting this statement. In the example of forced sales through repossession, creditor bidding is in fact solely to protect against a sacrifice sale because if the creditor's bids drives the price above what the creditor is owed, the excess price goes to the debtor. Hence, a creditor who bids is legally blocked from bidding in a manner which enhances the price to the direct benefit of the creditor. U.C.C. § 9-502(2) and § 9-504(2) (1972).

139. Confusion has also existed as to whether a creditor should be considered the seller under § 2-328(4). The New York Law Revision Commission and Professor Hawkland in his 1964 treatise both concluded that the creditor in a repossession auction is not the seller. Both the Commission and Professor Hawkland reached this conclusion because they did not want the creditor to gain the immunity afforded sellers from penalties for bidding without notice which the last sentence of § 2-328(4) provides. 1 W HAWKLAND, *A TRANSACTIONAL GUIDE TO THE UNIFORM COMMERCIAL CODE* § 1.13040503 (1964); 1 NEW YORK LAW REVISION COMMISSION, *STUDY OF THE U.C.C. § 2-328*, at 444 (1955). But of course, the conclusion that the creditor is not the seller means that the creditor is just like any other person who comes to the auction to bid—i.e., all persons (except sellers) can bid without any requirement for giving notice to anyone. Hence, the conclusion that the New York Law Revision

tion shall not apply to any bid at a forced sale." This means that unannounced bidding by the seller is not considered to be fraudulent at a "forced" sale such as a repossession sale.<sup>140</sup> The conduct of Mythical Square National Bank was therefore not improper, and Tweed Manhattan has no claim for legal redress for fraud against the Bank.

This gives rise to the question of why puffing is allowed at forced auction sales but prohibited at voluntary auction sales. The contrast in treatment is even more pronounced when a comparison is made between § 21(4) of the Uniform-Sales Act and § 2-328(4) of the Uniform Commercial Code. Both subsections prohibit puffing by sellers at auctions. However, the last sentence of § 21(4) reads: "Any sale contravening this rule may be treated as fraudulent by the buyer."<sup>141</sup> Case law has interpreted this sentence to mean that puffing is prohibited at forced auction sales just as it is at voluntary auction sales.<sup>142</sup>

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Commission and Professor Hawkland reached completely undercut the reason they gave for reaching that conclusion.

By 1982, Professor Hawkland realized that he had made a mistake about the classification of the creditor. Professor Hawkland now has concluded that the creditor in a repossession auction is indeed the seller under § 2-328(4). 2 W. HAWKLAND, UNIFORM COMMERCIAL CODE SERIES § 2-328:04, at 566-67 (1982). Professor Hawkland and the author are therefore in agreement that the creditor is the seller at a repossession auction sale.

140. *Sly v. First National Bank of Scottsboro*, 387 So. 2d 198 (Ala. 1980); 2 W. HAWKLAND, UNIFORM COMMERCIAL CODE SERIES § 2-328:04 (1982).

Various provisions of the Uniform Commercial Code make it clear that a secured party may purchase the collateral at a sale conducted because the debtor is in default. U.C.C. § 9-501(1), (5) (judicial sale pursuant to an execution on a judgment), § 9-504(3) (foreclosure) (1972).

141. The full text of § 21(4) of the Uniform Sales Act reads: "Where notice has not been given that a sale by auction is subject to a right to bid on behalf of the seller, it shall not be lawful for the seller to bid himself or to employ or induce any person to bid at such sale on his behalf, or for the auctioneer to employ or induce any person to bid at such sale on behalf of the seller or knowingly to take any bid from the seller or any person employed by him. Any sale contravening this rule may be treated as fraudulent by the buyer."

142. *Cranston v. Western Idaho Lumber & Bldg. Co.*, 41 Idaho 141, 238 P. 528 (1925). *Cf.* *Toy v. Griffith Oldsmobile Co.*, 342 Mich. 533, 70 N.W.2d 726 (1955); *Drew v. John Deere Co. of Syracuse, Inc.*, 19 A.D.2d 308, 241 N.Y.S.2d 267 (1963). Both cases involve possible conflict between § 21(4) of the Uniform Sales Act which prohibits seller self-bidding without notice and the provisions of other laws which allow the creditor to bid at repossession sales.

Professor Hawkland and the New York Law Revision Commission both com-

In a repossession sale, the prime example of a forced sale under § 2-328(4),<sup>143</sup> the bona fide bidder is protected somewhat from puffing by the creditor-owner. Up to the amount owed by the debtor, the creditor-owner can manipulate the repossession auction sale through puffed bids. These creditor bids do mislead bona fide bidders into thinking that greater competition exists than is in fact true. Moreover, the puffed bids do cause the bona fide bidders to bid higher than would otherwise have been necessary. However, a collateral consequence of each bid entered by the creditor is that the underlying debt is reduced. Every puffed bid, therefore, has an aspect favorable to the debtor. The fraud against the bona fide bidder, in other words, is not unadulterated fraud; it is not clearly undesirable conduct which benefits only the perpetrator of the fraud.

If the creditor-owner bids above the amount owed by the debtor, these bids are *not* puffed, because the creditor-owner is accountable for the bid because any surplus belongs to the debtor-owner.<sup>144</sup> For bids above the amount owed by the debtor, the creditor-owner is a bona fide bidder who is making a judgment that the item being auctioned is worth more than the amount owed by the debtor on the item.

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ment that the Uniform Commercial Code by allowing seller self-bidding without notice at forced sales is changing the prior law as reflected in common law case decision and § 21(4) of the Uniform Sales Act. 2 W. HAWKLAND, UNIFORM COMMERCIAL CODE SERIES § 2-328:04, at 566 (1982), NEW YORK LAW REVISION COMMISSION, STUDY OF THE U.C.C. § 2-328, at 444 (1955). The drafters of the Uniform Commercial Code had adopted this change already in the first official text issued. U.C.C. § 2-328(4) (1952). The comments to § 2-328(4) in the 1952 version and later versions do not provide a single sentence, however, which explains why the drafters adopted this change.

In all the Williston treatises on Contracts and Sales, from the first editions to the most recent editions, the authors never mention that a different rule about seller self-bidding and notice might exist for voluntary auction sales than for forced auction sales. Only one author mentions that a different rule on seller self-bidding and notice might be wise for forced auctions sales in comparison to voluntary auctions sales – a student author. Comment, *Agreements for Fictitious Bids at Auctions*, 31 YALE L.J. 431, 432 (1921)

143. *Supra* note 138 lists other types of forced sales that are covered by the last sentence of § 2-328(4), but repossession auction sales under § 9-504 are likely to be the most common forced sales and therefore most likely the type of forced sale about which the drafters were thinking when they adopted the last sentence of § 2-328(4).

144. U.C.C. §§ 9-502(2), 9-504(2) (1972)

Thus, the creditor-owner's conduct is not fraudulent in the later bids above the amount owed by the debtor.

While the rule of law is that puffed bidding is *per se* fraudulent at voluntary auctions,<sup>145</sup> the courts initially showed sympathy for puffed bidding when motivated by the desire to protect against a sacrifice sale.<sup>146</sup> In a forced sale context, the concern that a sacrifice sale will occur is even higher because of the likelihood that no or few bidders will appear. In that instance, the property will probably sell for less than it should and the debtor will be faced with a larger deficiency claim. If the creditor is allowed to bid, at least one bidder will be present,<sup>147</sup> and unannounced creditor bidding will not dampen enthusiasm of bona fide bidders. Protection against a sacrifice sale price is thereby promoted. A major reason courts decided against allowing seller self-bidding at voluntary auctions was because the motive could not easily be discerned.<sup>148</sup> In the context of the forced sale, however, the distinction between bids protecting the property from a sacrifice sale price and from bids enhancing the price of the property is more obvious. The amount owed by the debtor is an objective amount which marks the level of protective bids. Beyond that amount, creditor bids are simply good faith bids.

Thus, one justification for the Uniform Commercial Code position allowing unannounced seller self-bidding in forced sales is the desire to protect against sacrifice sales which result in excessive deficiency amounts being owed by debtors. As a policy matter, protection for the debtor at forced sales has been chosen over protection for the bona

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145. See the authorities cited *supra* in note 92.

146. *E.g.*, Reynolds v. Dechaums, 24 Tex. 174 (1859). See Peck v. List, 23 W. Va. 338, 383-392 (1883). Discussion of the English equity cases which were sympathetic to puffed bids when motivated by the desire of the seller to protect against a sacrifice sale. See generally WILLISTON SALES, *supra* note 20, § 298.

The American rule that puffing is *per se* fraudulent applies regardless of the motivation for the puffing. Springer v. Kleinsorge, 83 Mo. 152 (1884); Towle v. Leavitt, 23 W. Va. 360 (1851); Peck v. List, 23 W. Va. 338 (1883).

147. Read *supra* note 140 for citation to Uniform Commercial Code provisions allowing the secured party to bid on collateral at foreclosure sales.

148. *E.g.*, Peck v. List, 23 W. Va. 338, 387-389 (1883).

fide bidders.<sup>149</sup>

Another justification is the desire for conformity with other laws. Special repossession statutes, for example automobile repossession statutes,<sup>150</sup> often state that the creditor-owner is entitled to bid at the repossession sale. If § 2-328(4) uniformly applied the prohibition against seller self-bidding to all auction sales, serious problems would exist for courts in deciding whether § 2-328(4) and these other statutes are consistent and, if not, which law should be controlling. By exempting forced sales from the prohibition on unannounced seller self-bidding, the Uniform Commercial Code has avoided potential dissonance with other laws.<sup>151</sup>

If the facts of Hypothetical 7 were changed so that the

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149. Professor Hawkland seems to argue that the justification for allowing creditors to bid without giving notice when they are selling their debtor's collateral is that the practice occurs all the time anyway, no matter what the law says, and therefore, other bidders just ought to have to expect that the practice is occurring. 2 W. HAWKLAND, UNIFORM COMMERCIAL CODE SERIES § 2-328:04, at 567 (1982). By contrast, the argument presented in the text stresses that the justification for the last sentence of § 2-328(4) is to be found in the protection thereby provided debtors against possibly burdensome and unfair deficiency judgements, not in the widespread existence of the creditor conduct.

150. *Toy v. Griffith Oldsmobile Co.*, 342 Mich. 533, 70 N.W.2d 726 (1955); *Drew v. John Deere Co. of Syracuse, Inc.*, 19 A.D.2d 308, 241 N.Y.S.2d 267 (1963). Both cases have citations to Michigan and New York statutes, respectively, which allowed creditors to bid at vehicle repossession sales. Cf. *Blair v. Hewitt*, 185 Wash. 430, 55 P.2d 607 (1936). Judicial sale to collect on a judgement rendered against debtor. In ordering the judicial sale, the court had "accorded the right to bid at the sale individually or collectively" to the creditors.

151. Section 21(4) of the Uniform Sales Act which prohibited seller self-bidding without proper notice even in forced sales did create dissonance with other statutes. *Toy v. Griffith Oldsmobile Co.*, 342 Mich. 533, 70 N.W.2d 726 (1955); *Drew v. John Deere Co. of Syracuse, Inc.*, 19 A.D.2d 308, 241 N.Y.S.2d 267 (1963).

Earlier in the discussion under Hypothetical 3, *Drew v. John Deere* was discussed as providing case authority for the proposition that repurchase bids are legally permissible. Also in that earlier discussion, secret repurchase bids were determined to be impermissible and *Drew v. John Deere* was distinguished as controlling authority. Now in light of the discussion in the text here, another reason for distinguishing *Drew v. John Deere* has been clarified.

*Drew v. John Deere* factually involves a forced sale situation. Hence, the fact that the creditor, as seller, bid on the property without having given the proper notice should be understood as simply an exercise of the immunity for seller self-bidding without notice at forced sales authorized by the last sentence of § 2-328(4). *Drew v. John Deere* need not, and should not, be interpreted as standing for the broader proposition that secret repurchase bids are legally permissible in voluntary auction sales.

auction was expressly declared to be without reserve, contract analysis under § 2-328(3) would provide legal redress to Manhattan. In a without reserve auction, a contract is formed when a good faith bid is made, subject only to a higher good faith bid being entered. Tweed Manhattan therefore formed a contract with the Bank when he entered the first bid of \$27,000. That contract should stand unless the higher bid of \$30,000 by Margaret Teller is a good faith bid. While the Teller bid of \$30,000 was not fraudulent under § 2-328(4), that fact does not automatically mean that the bid was a good faith bid. Teller's bid should not be considered a good faith bid because it is a bid for which Teller will not be held responsible. The bid is fictitious under § 2-328(3) even if the bid is not considered fraudulent under § 2-328(4). Hence, Tweed Manhattan should be able to pursue contract remedies of damages or specific performance if the Bank refuses to honor the contract at \$27,000. The Bank cannot argue with this result because the Bank selected the without reserve auction as the type of auction to be used in the repossession sale.<sup>152</sup>

The seller's conduct and the practice of puffing have been the focus of attention to this point. Buyers also can engage in conduct that may undermine the fairness, openness, and competitive determination of prices at auctions. Conduct stifling competition is the converse of seller self-bidding. The next two hypotheticals present factual situations which focus on the buyer's conduct and conduct stifling competition.

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152. As for why the Bank might opt to use a without reserve repossession auction, rather than a with reserve auction, read the comments made *supra* in note 89.

If a repossessing creditor uses a without reserve auction, and the tactic backfires because the only bids made (which complete the contract and bind the seller) are very low so that the purchaser gets a very good bargain, the creditor can probably expect that the debtor will defend against the deficiency judgement on the basis that the choice of using a without reserve auction was not a "commercially reasonable" method of sale. U.C.C. § 9-504(3) (1972) (sets forth the requirement that the foreclosure in all its aspects be commercially reasonable). Indeed, the debtor is authorized to sue the creditor for "any loss caused by a failure to comply with" the commercially reasonable requirements of the Code. U.C.C. § 9-507 (1972).

## HYPOTHETICAL 8: AGREEMENTS NOT TO BID

Cinderella White places her colt, Prince Charming, in the spring yearling sale. The colt has excellent bloodlines and White expects the colt to bring a very good price.

At the pre-sale showing of the horses, conversation among the experienced, knowledgeable horsemen centers on Prince Charming and how much the colt will sell for. General agreement exists that Prince Charming will likely bring the highest price of the sale.

Grumpy Small hears these conversations and becomes worried that he might not be able to afford the colt which he sorely wants to own. Small hears similar comments from several other bidders—Sharif Nottingham, Lance LaRue, Emil Scrooge, and Henry Tudor. These five bidders then talk among themselves and reach agreement on a common bidding scheme as follows: Each bidder will bid independently but each agrees to top the previous bid by only a small increment. If one of the five is declared the successful bidder, a post-auction sale will be held among the five. At the post-auction sale, they will bid against each other for the colt with the initial bid being the price paid at the public auction. Whoever bids the highest at the post-auction sale has to pay the auction price for the colt. The amount bid in excess of the auction price will then be divided equally among the other four bidders in payment for their conduct at the public auction.

At the public auction, Small begins the bidding at \$1,000; Tudor tops him with a bid of \$1,050; Nottingham then bids \$1,100; Faith Goode bids \$1,200; Small bids \$1,250; Scrooge bids \$1,300; Faith Goode bids \$1,400; LaRue bids \$1,450; Small bids \$1,500. By this point, Faith Goode has become discouraged at bidding further because she is new to the business and sees that her competing bidders are experienced, knowledgeable horsemen. Goode does not bid further and to everybody's surprise, the hammer falls on Small's bid of \$1,500. Faith Goode is a good faith bidder who knew nothing of the agreement between the other five bidders.

In accordance with the pre-auction agreement among the five, Small and his cohorts hold a post-auc-

tion sale. At the post-auction sale, Small bids \$9,500 for the colt. He pays \$1,500 to the auctioneer and divides the surplus between Nottingham, LaRue, Scrooge, and Tudor. White feels cheated and wants to get her colt, Prince Charming, back, if possible.

If there had been no agreement, the five bidders would have pursued their own independent interests at the public auction. It is not possible to determine the exact price that would have resulted if each member of the agreement had been bidding independently, but it is obvious that the agreement between the five bidders prevented competitive bidding at the auction. Cinderella White's complaint is that the agreement interfered with the fair, open, competitive determination of price.

Courts disfavor agreements which dampen competition at auction.<sup>153</sup> The agreement set forth in Hypothetical 8 is a classic auction ring, a well-known bidder device used to purchase items at auction for prices well below the price that would be set through fair, open, competitive bidding.<sup>154</sup> The agreement would be condemned even if Grumpy Small could present evidence that the number of bidders was not lessened by the agreement about the post-auction sale.<sup>155</sup> Moreover, case law would support Cinderella White even if Grumpy Small could convince a court that White suffered no harm from the agreement.<sup>156</sup> The existence of the agreement itself constitutes a fraud. To remedy the fraud, Cinderella White is entitled to rescind the sale.<sup>157</sup>

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153. See generally 6A CORBIN, *supra* note 10, § 1468; 14 WILLISTON 3d, *supra* note 17, § 1648A; 2 WILLISTON SALES (rev.), *supra* note 19, § 299.

154. See generally: DuBoff, *supra* note 7, at 507-508; Smith, *Auction Rings*, 1981 CRIM. L. REV. 86.

155. *E.g.*, Master Builders' Ass'n of Kansas v. Carson, 132 Kan. 609, 296 P. 693 (1931). Accord 14 WILLISTON 3d, *supra* note 17, § 1648A, at 306. It is not the impact of the agreement upon the number of bidders which is relevant to the legality of the agreement, but the impact of the agreement upon the competitiveness between the bidders that matters.

156. *E.g.*, Swan v. Chorpenning, 20 Cal. 182 (1862); Gibbs v. Smith, 115 Mass. 592, 593 (1874).

157. *E.g.*, Barnes v. Mays, 88 Ga. 696, 16 S.E. 67 (1892). See generally 6A CORBIN, *supra* note 10, § 1468, at 571; 2 WILLISTON SALES (rev.), *supra* note 19, § 299. Both Professors Corbin and Williston describe a contract which has been obtained by a bidder through an agreement not to bid with other bidders as a contract "voidable"

While early case law seemed to hold that any agreement about bidding between potentially independent bidders was fraudulent,<sup>158</sup> courts soon began to allow agreements in certain instances.<sup>159</sup> Permissible agreements were distinguished from impermissible agreements on the basis of the motive behind the agreement. If bidders entered the agreement for the purpose of dampening competition with the expectation of buying the item for less than it would otherwise bring, the agreement was fraudulent. On the other hand, if the potential bidders entered the agreement for the sole purpose of pursuing or protecting the separate and distinct interests of the individual parties, the agreement was not fraudulent.<sup>160</sup> These latter agreements were permissible even if the number of bidders was decreased or the amount received by the seller was reduced.<sup>161</sup>

Certain agreements are clearly impermissible. One bidder cannot pay another potential bidder to refrain from bidding.<sup>162</sup> Also, bidders cannot enter into auction rings such as described in Hypothetical 8.<sup>163</sup> On the other hand, certain

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at the option of the seller who has thereby been defrauded. A seller is entitled to rescind the contract obtained through an illegal agreement not to bid whether the contract was formed at a with or a without reserve auction. 2 W. HAWKLAND, *UNIFORM COMMERCIAL CODE SERIES* § 2-328:05 (1982).

158. *See, e.g.*, *Kearney v. Taylor*, 56 U.S. (15 How.) 494, 520-22 (1853); *Jenkins v. Frink*, 30 Cal. 586, 591 (1866). Both opinions discuss the argument that all agreements not to bid are *per se* fraudulent. *See also* Note, *Agreements Not to Bid at Judicial Sales*, 47 U.S. L. REV. 433 (1933).

159. *E.g.*, *Kearney v. Taylor*, 56 U.S. (15 How.) 494 (1853); *Jenkins v. Frink*, 30 Cal. 586 (1866). *See generally* Note, *Agreements Not to Bid at Judicial Sales*, 47 U.S. L. REV. 433 (1933). *Cf.* *Gibbs v. Smith*, 115 Mass. 592 (1874).

160. The classic statement of the distinction between legal and illegal agreements not to bid, based on the motivation of the bidders for entering into the agreement, is found in the opinion of Judge Devens in *Gibbs v. Smith*, 115 Mass. 592 (1874). *Accord* *Gulick v. Webb*, 41 Neb. 706, 60 N.W. 13 (1894); *James v. Fulcrod*, 5 Tex. 512 (1851). *See generally* 2 *WILLISTON SALES* (rev.), *supra* note 19, § 299.

161. *E.g.*, *Nat'l Bank of the Metropolis v. Sprague*, 20 N.J. Eq. 159, 168-69 (1869); *Spokane Savings & Loan Soc. v. Park Vista Improvement Co.*, 160 Wash. 12, 20, 294 P. 1028, 1036 (1930). *Cf.* *Dorison v. Schultz*, 109 N.J.L. 242, 243, 160 A. 497, 498 (1932).

162. *Barnes v. Mays*, 88 Ga. 696, 16 S.E. 67 (1892); *Gibbs v. Smith*, 115 Mass. 592 (1874); *Goble v. O'Connor*, 43 Neb. 49, 61 N.W. 131 (1894); *Taylor v. Lafavers*, 221 S.W. 957 (Tex. Comm. App. 1920). *But see* *Cahn v. Baccich & De Montluzin*, 144 La. 1023, 81 So. 696 (1918).

163. *Frank v. Blumberg*, 78 F. Supp. 671 (E.D. pa. 1948). *See generally*, *Smith*,

agreements are clearly permissible. Creditors can appoint one creditor to bid on the property for the protection of all.<sup>164</sup> Creditors and debtors can agree to allow the creditor to purchase without competition from debtor bids in return for a promise by the creditor not to seek a deficiency judgment.<sup>165</sup>

Other agreements between potentially independent bidders are evaluated on a case-by-case basis.<sup>166</sup> Most of these agreements involve the formation of partnerships or joint ventures for the purchase of the property at auction. One factor in the determination is the time at which the joint venture or the partnership was formed. If the joint venture or partnership was formed at the auction itself, the courts are unlikely to permit the agreement.<sup>167</sup> If the joint venture or partnership was formed weeks before the auction as a legitimate business venture between the parties, however, courts

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*Auction Rings*, 1981 CRIM. L. REV. 86. *But cf.* *Berg v. Plitt*, 178 Md. 155, 12 A.2d 609 (1940).

164. *Grandberry v. Mortgage Bond & Trust Co.*, 159 Miss. 460, 132 So. 334 (1931); *Murphy v. DeFrance*, 105 Mo. 53, 15 S.W. 949 (1891); *Nat'l Bank of the Metropolis v. Sprague*, 20 N.J. Eq. 159 (1869); *Gulick v. Webb*, 41 Neb. 706, 60 N.W. 13 (1894); *Blair v. Hewitt*, 185 Wash. 430, 55 P.2d 607 (1936); *Spokane Savings & Loan Soc. v. Park Vista Improvement Co.*, 160 Wash. 12, 294 P. 1028 (1930).

165. *Sturgis v. Wylie*, 196 Ark. 970, 120 S.W.2d 571 (1938); *Parlor City Lumber Co. Inc. v. Sandel*, 186 La. 982, 173 So. 737 (1937); *Dorison v. Shultz*, 109 N.J.L. 242, 160 A. 497 (1932).

166. Possibly the best statement of this case-by-case approach is found in *Gulick v. Webb*, 41 Neb. 706, 60 N.W. 13 (1894) where Judge Harrison stated: "... we consider a better and more practical (doctrine),— that where an examination of all the facts and circumstances shows the object of the association was to enable the parties to compete where, without combining, they could not do so, formed for an honest purpose, and with such an intent, and not with any view to preventing competition or deterring bidders, or 'chilling bids,' the sale will be upheld and completed." *Id.* at 15.

*See, e.g.*, *Handal v. Knepper*, 269 A.D. 967, 58 N.Y.S.2d 132 (1945); *Bell v. Harrington*, 81 Okla. 1, 196 P. 137 (1921). *See generally* 6A CORBIN, *supra* note 10, § 1468, at 572-574.

167. *Wooton v. Hinkle*, 20 Mo. 290 (1855); *Taylor v. Lafevers*, 221 S.W. 957 (Tex. Civ. App. 1920). Both cases involve situations where two bidders had been bidding against each other at an auction. During the auction, the two bidders reach an agreement to become "partners" in the property upon which they are bidding and as "partners" they now designate only one of them to continue bidding. *Cf.* *Cahn v. Baccich & DeMontluzin*, 144 La. 1023, 81 So. 696 (1918). Dissenting judge construes the facts to be a sham partnership agreement created after the bidders had been bidding against each other at the auction sale. *Id.* at 701-702.

are much more willing to allow the agreement to stand.<sup>168</sup> A second factor is whether the price was expected to be too high for the members to bear individually. In that case, allowing the agreement to stand would not dampen competition. In fact, competition would be increased because there would be an additional bidder—the group with the funds to spend and the willingness to risk those funds.<sup>169</sup> A third factor is whether the item being sold is of a greater quantity than the members to the agreement individually need, but which can be divided so as to accommodate their individual needs. If so, allowing the agreement to stand would again increase the competition at the auction. The group becomes an additional bidder.<sup>170</sup> Finally, courts consider whether the agreement was reached and held in secret. If so, suspicion is easily aroused that the parties to the agreement have something to hide. If the parties are open about the agreement, the suspicion that the parties are using secrecy to gain an unfair advantage is dissipated.<sup>171</sup>

The Uniform Commercial Code does not have a specific provision relating to agreements not to bid at auctions.<sup>172</sup> Section 1-103 of the Code, however, states: "Unless displaced by the particular provisions of this Act, the princi-

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168. *Kearney v. Taylor*, 56 U.S. (15 How.) 494 (1853); *Raper v. Thorn*, 202 Okla. 235, 211 P.2d 1007 (1949); *James v. Fulcrod*, 5 Tex. 512 (1851).

169. *Kearney v. Taylor*, 56 U.S. (15 How.) 494, 518-520 (1853); *Berg v. Plitt*, 178 Md. 155, 160, 12 A.2d 609, 614 (1940); *Raper v. Thorn*, 202 Okla. 235, 239, 211 P.2d 1007, 1011 (1949).

170. *Jenkins v. Frink*, 30 Cal. 586, 591-92 (1866); *Raper v. Thorn*, 202 Okla. 235, 239, 211 P.2d 1007, 1011 (1949); *James v. Fulcrod*, 5 Tex. 512, 521 (1851).

171. *Cf. Switzer v. Skiles*, 8 Ill. (3 Gilman) 529 (1846). Bidding through an agent is permissible and an agency agreement cannot be construed as an agreement to stifle competition.

Professor Corbin asserts that secrecy is a fact which "bears against" the lawfulness of agreements to bid collectively, although not "necessarily decisive" of the issue. 6A CORBIN, *supra* note 10, § 1468, at 574. Concern about secrecy has also bothered Professor Smith. Professor Smith therefore advocates that unannounced agreements to bid collectively, no matter the motive for entering the agreement, should be treated as fraudulent. However, if the agreement to bid collectively is put in writing and noticed to the auctioneer, then Professor Smith argues that the agreement should be considered a lawful bidding practice on the part of prospective bidders. Smith, *Auction Rings*, 1981 CRIM. L. REV. 86, 89-91.

172. The Uniform Sales Act did not have a provision addressing agreements not to bid either.

ples of law and equity, including . . . fraud, misrepresentation, . . . shall supplement its provisions." Therefore, the principles previously discussed remain good law under the Code.<sup>173</sup> Moreover, the most authoritative provisions relating to agreements not to bid, Restatement of Contracts § 517 and Restatement of Contracts, Second §§ 187-188, reflect the law as it has been presented here.<sup>174</sup>

Another issue in relation to agreements not to bid arises if the facts of Hypothetical 8 are changed so that Faith Goode, instead of deciding to bid no more, decides to bid further. Faith Goode enters a bid for \$2,000. For whatever reason, Small and his cohorts do not enter a higher bid and the colt, Prince Charming, is sold to Goode for \$2,000. Of course, because the colt was sold to Faith Goode, the post-auction sale which Small and cohorts had agreed to hold does not occur. Is Cinderella White entitled to void the sale to Faith Goode?

Cinderella White can truthfully argue that because of the agreement between Small and cohorts, she has been deprived of a fair, open, and competitive determination of price at the auction. Without the Small agreement, the auction would have been conducted in a different manner because six independent bidders would have been bidding

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173. 2 W. HAWKLAND, *UNIFORM COMMERCIAL CODE SERIES* § 2-328:05 (1982); Cudahy, *The Sales Contract—Formation*, 49 *MARQ. L. REV.* 108, 120 (1965).

174. *RESTATEMENT OF CONTRACTS* § 517 (1932) reads as follows: "A bargain not to bid at an auction, or any public competition for a sale or contract, having as its primary object to stifle competition, is illegal."

*RESTATEMENT (SECOND) OF CONTRACTS* § 187 (1981) states: "A promise to refrain from competition that imposes a restraint that is not ancillary to an otherwise valid transaction or relationship is unreasonably in restraint of trade."

*RESTATEMENT (SECOND) OF CONTRACTS* § 188(2) (1981) provides: "Promises imposing restraints that are ancillary to a valid transaction or relationship include the following: (c) a promise by a partner not to compete with the partnership."

As is clear from the quotations from the restatements, the Restatement Second does not have a section which specifically addresses agreements not to bid. Rather, the Restatement Second has subsumed agreements not to bid under the more general heading of agreements in restraint of trade. The comments to §§ 187-188, however, make very clear that the substantive law which § 517 of the original Restatement codified has been preserved in the Restatement Second through §§ 187-188. *RESTATEMENT (SECOND) OF CONTRACTS* § 187 comment c, illustrations 3 & 4, and Reporter's Note comment c (1981); *RESTATEMENT (SECOND) OF CONTRACTS* § 188 comment h, illustration 15 and Reporter's Note comment h (1981).

rather than one good faith bidder and an auction ring. But Faith Goode is a good faith bidder who had no knowledge of and took no part in the agreement existing between Small and friends. The issue facing the courts on the facts of Hypothetical 8 as changed is whether the law should protect the integrity of the auction sale on behalf of Cinderella White or the justifiable expectation of Faith Goode that her contract should be honored.

While authority relating to this issue is sparse, case law<sup>175</sup> and commentary<sup>176</sup> holds that Faith Goode should be protected in her contract expectations. Three reasons seem to exist for this preference. First, if the law were to favor Cinderella White, no auction contract could be considered "secure" or "final." Such contracts could be repudiated because of conduct involving neither the seller nor the buyer.<sup>177</sup> Second, rescission is a remedy which is imposed by the courts to prevent the person who perpetrated a fraud from profiting from wrongdoing.<sup>178</sup> Unless a direct public

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175. *Cash v. Dean*, 16 Mich. 12 (1867). *Cf.* *United States v. Von Cseh*, 354 F. Supp. 315 (S.D. Tex. 1972). The United States government sought to foreclose against property sold at auction to a good faith bidder. The government claimed that the auction had been conducted in such a way as to deprive the government of its tax lien against the property. Court held for the good faith purchaser at auction. *Brochers v. Nickel*, 35 Okla. 473, 130 P. 138 (1913). Court granted replevin to the good faith purchaser of the property at auction against the seller of the property. The seller had repossessed the property because of a dispute with the auctioneer over payment for the property that had been auctioned.

*But cf.* *Short v. Sun Newspapers, Inc.*, 300 N.W.2d 781 (Minn. 1980). Court reversed summary judgement and reinstated case to allow plaintiff to seek specific performance against an auction seller even though a good faith bidder bought the property at the auction. Auction involved conduct by plaintiff which improperly stifled the bidding but the seller may have acquiesced in the plaintiff's improper conduct.; *Ives v. Culton*, 229 S.W. 321 (Tex. Civ. App. 1921). Debtor and auction buyer entered an agreement which improperly stifling the bidding at a foreclosure auction sale of land. Auction buyer then sued the occupier of the land, who had bought the land from Debtor prior to the foreclosure auction, for trespass to try title. Court granted judgement to the auction buyer as against the good faith occupier of the land.

176. 14 WILLISTON 3d, *supra* note 17, § 1648A, at 307; 2 WILLISTON SALES (rev.), *supra* note 19, § 299, at 212.

177. *Case v. Dean*, 16 Mich. 12, 28 (1867).

178. An action in fraud involves five elements: 1) a false representation; 2) knowledge of the falsity on the part of the person making the representation; 3) intent to mislead others into relying upon the misrepresentation; 4) reliance by the party claiming injury for the fraud; and 5) injury resulting from having relied on the false

interest exists,<sup>179</sup> courts do not desire to punish a person for the impermissible conduct of others. For this reason, courts have held that sales at which agreements not to bid have been in effect are voidable rather than void.<sup>180</sup> Third, even though the contract expectations of Faith Goode are protected by upholding the sale, Cinderella White is not thereby deprived of seeking legal redress for the injury she has in fact suffered. Cinderella White is entitled to pursue damages, both compensatory and punitive, through common law fraud actions or through statutory remedies relating to restraints of trade.<sup>181</sup>

A final comment needs to be made about agreements not to bid. It is obvious that the seller will be entitled to a fraud remedy for buyer agreements not to bid only if the seller learns of the existence of these agreements and can prove their existence by satisfactory evidence. Learning and proving are easier said (in hypotheticals) than done (in the real world of auctions and courts.) Sellers might reasonably conclude that precautionary measures which prevent agreements not to bid from devastating the price are worth more than a theoretical right to rescind.

Earlier, four methods were discussed whereby sellers

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representation. *Schwartz v. Capital Savings & Loan Co.*, 56 Ohio App. 2d 83, 84, 381 N.E.2d 957, 958 (1978).

179. 2 WILLISTON SALES (rev.), *supra* note 19, § 299, at 212.

The public might have a direct interest when the auction was conducted under the auspices of a court, such as a bankruptcy auction, where the court has to confirm the sale. The public might also have a direct interest when the auction involved a sale of public property so that the public would desire that the auction be conducted anew to gain even higher bids than the bid entered by the good faith bidder at the auction which is being challenged.

Hypothetical 8 is a purely private, voluntary auction sale. The public has no direct interest in the auction. The public's interest in the auction of Hypothetical 8 is only the general interest of promoting fair, open, and competitive auctions. *Cf. Short v. Sun Newspapers, Inc.*, 300 N.W.2d 781, 788-89 (Minn. 1980).

180. *Barnes v. Mays*, 88 Ga. 696, 16 S.E. 67 (1892); *Berg v. Platt*, 178 Md. 155, 161, 12 A.2d 609, 615 (1940); *Breslin v. Brown*, 24 Ohio St. 565, 569 (1874). All three cases state that it is the seller who has the option to uphold or to void the sale when the bidders have entered improper agreements not to bid. Read *supra* note 157 for treatise citations on this same point.

181. RESTATEMENT (SECOND) OF CONTRACTS (1981) addresses agreements not to bid in the sections of the Restatement relating to restraints of trade. Read *supra* note 174 for fuller discussion.

can prevent sacrifice sales.<sup>182</sup> These four methods can be used to prevent sacrifice sales in auctions being manipulated by buyers through agreements not to bid. First, in with and without reserve auctions, the seller can set an announced minimum price. Second, in with reserve auctions, sellers can publicly withdraw the item from the auction. Third, if a "no-sale" condition has been included in the auction announcements, sellers can exercise a "no-sale" provision to prevent the completion of the sale. In this manner, sellers can protect themselves anytime they are suspicious that the auction was not fair, open, and competitive. The drawback to public withdrawals and "no-sale" provisions is that the seller does not complete the sale. Finally, in with reserve auctions, sellers can give proper notice of the right to engage in self-bidding. While this might dampen the enthusiasm of bona fide bidders, it would also allow the seller to provide competition to the auction ring so that maximum bids can be obtained. These precautionary measures should be kept in mind as sellers plan how best to utilize auctions.<sup>183</sup>

#### HYPOTHETICAL 9: OTHER CONDUCT STIFLING COMPETITION

Ichabod Caldoon owns the stallion, Black One. Due to the hard economic times, Caldoon has to sell his horses. He puts them in an auction for disposal.

Caldoon's neighbor, an 18 year old, Cisca Kidd, has groomed Black One since a colt and has become very attached to the stallion. Although she knows the stallion is owned by Ichabod Caldoon, Cisca Kidd feels that the stallion belongs to her. She has talked to Pancho Part-

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182. Read *supra* text accompanying notes 66-90.

183. Professor DuBoff writes that sellers justify secret reserve prices as necessary to protect against illegal agreements not to bid among buyers. DuBoff, *supra* note 7, at 508, 511. Cf. Smith, *Auction Rings*, 1981 CRIM. L. REV. 86. "A seller may protect himself by taking expert advice and by fixing a sufficiently high reserve price." *Id.* at 90.

One court even approved seller puffing on the ground, *inter alia*, that the seller needed to engage in puffing to prevent being defrauded by bidders who had entered into agreements not to bid among themselves. *Reynolds v. Dechaums*, 24 Tex. 174, 178 (1859).

ner, another neighbor, to ask Partner's assistance in buying the stallion.

The auction sale is a very emotional event for Caldoon, Kidd, and Partner. Caldoon decides to leave the sale because he cannot bear to see his horses being auctioned. Kidd and Partner stay. When Black One enters the auction ring, Cisca Kidd rises with emotion and loudly announces that the stallion is "her" horse and that she cannot stand for the stallion to be bought by anyone but herself. Moved by Kidd's words, partner rises and announces that anyone who buys the stallion takes the stallion subject to any competing claims of ownership that heirs to the original owner, who sold the horse to Caldoon, may have. While this is true, no heirs of the original owner have ever made or threatened to make any claim to the stallion.

The auctioneer begins the sale. Cisca Kidd bids \$1,000. Despite repeated efforts by the auctioneer, other persons attending the sale cannot be coaxed into bidding on the stallion. The auctioneer gavels the stallion sold to Cisca Kidd.

After the sale, Ichabod Caldoon hears of the comments made by Kidd and Partner. As much as Caldoon would like for Kidd to have the stallion, Caldoon is incensed that the stallion sold for \$1,000. Caldoon intends to void the sale, if possible.

The conduct of Cisca Kidd and Pancho Partner in Hypothetical 9 does not involve any promise not to bid or to bid only in a sham fashion. Their conduct leaves the other persons attending the auction free to bid and to simply ignore Kidd and Partner's comments. Kidd and Partner can therefore argue that the lack of bids is attributable to the independent judgments of these other persons. Ichabod Caldoon can respond that the comments of Kidd and Partner appealed to the sympathies and fears of the other persons attending the auction and that, as a result, other persons were "chilled" from entering bids. Cisca Kidd's argument is strengthened, and the position of Ichabod Caldoon is correspondingly weakened, by the fact that Kidd's comment was completely true. On the other hand, the position of Ichabod Caldoon appears to be strengthened, and Kidd's claim

weakened, by the fact that the comment of Partner misrepresents the soundness of Caldoon's title to the stallion.

While agreements not to bid have been given the most attention,<sup>184</sup> courts have also been willing to provide relief to sellers deprived of a fair, open, and competitive auction through other types of bidder conduct which stifles or chills bidding.<sup>185</sup> A court would therefore not accept Kidd and Partner's argument that the failure of others to bid was due solely to their independent judgments. A court would agree with Caldoon that Kidd and Partner's comments are relevant in determining whether the auction was fair. Ichabod Caldoon will, however, have the burden of presenting evidence to convince the jury that the comments of Kidd and Partner were calculated to stifle, dampen, or chill the bidding.<sup>186</sup> If Caldoon can carry that burden, fraud will have been established and Caldoon will be entitled to legal relief.<sup>187</sup>

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184. Professors Corbin, Hawkland, and Williston have concentrated in their treatises almost exclusively on agreements not to bid when they have discussed buyer bidding practices at auctions. These commentators have only given passing mention to other conduct stifling competition. 6A CORBIN, *supra* note 10, § 1468; 1 W. HAWKLAND, A TRANSACTIONAL GUIDE TO THE UNIFORM COMMERCIAL CODE § 1.13040502 (1964); 2 W. HAWKLAND, UNIFORM COMMERCIAL CODE SERIES § 2-328:05 (1982); 14 WILLISTON 3d, *supra* note 17, § 16648A; 2 WILLISTON SALES (rev.), *supra* note 19, § 299.

By its own language referring to a "bargain not to bid," § 517 of the RESTATEMENT OF CONTRACTS exhibits the same emphasis on agreements not to bid to the neglect of other conduct stifling competition at auctions.

185. One treatise writer has clearly distinguished agreements not to bid from other bidder conduct stifling competition. Indeed, this treatise writer places greater emphasis on other conduct stifling competition than on agreements not to bid. J. BATEMAN, LAW OF AUCTIONS 165-66 (1st ed. Am. 1883).

Both American Jurisprudence and Corpus Juris make the distinction between agreements not to bid and other conduct stifling competition. 7 AM. JUR. 2d *Auctions & Auctioneers* §§ 24-25 (1980); 6 C.J. *Auctions & Auctioneers* §§ 31-32 (1916). Compare 7A C.J.S. *Auctions & Auctioneers* § 14 (1980).

186. *Hahn v. Duveen*, 133 Misc. Rep. 871, 234 N.Y.S. 185 (1929); *Tinch v. Farmers' Exchange Bank of Lindsay*, 136 Okla. 162, 276 P. 735 (1929). See also 7A C.J.S. *Auctions & Auctioneers* § 14, at n.43 (1980).

187. The legal relief to which Caldoon will be entitled is the remedy of rescission. *Nash v. Elizabeth City Hospital Co.*, 180 N.C. 59, 104 S.E. 33 (1920); *Herndon v. Gibson*, 38 S.C. 357, 17 S.E. 145 (1893).

If the seller were to discover the conduct stifling competition before the auctioneer declared the property sold, the seller would be entitled to withdraw the property

Misrepresentation is usually an element of fraud.<sup>188</sup> Yet, Kidd's comments about the stallion do not contain any misrepresentation. However, courts are so protective of fair, open, competitive auctions that, in this context, truthful comments may be fraudulent if they are calculated to stifle competition. Appeals to sympathy, however truthful, may constitute impermissible conduct stifling competition.<sup>189</sup> Comments at the beginning of a bankruptcy auction by a creditor that he intends to bid to a certain level if necessary to protect his interest, if made for the purpose of discouraging potential bidders, impermissibly chills the bidding.<sup>190</sup> Comments which challenge the authenticity of the item being sold may not be used by a participant to unnerve other bidders so that he may then purchase the item himself.<sup>191</sup> In these instances, the seller who was harmed because of the comments can rescind. By contrast, truthful statements con-

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from the auction sale regardless of whether the auction was a with or without reserve auction. See J. BATEMAN, LAW OF AUCTIONS 165-66 (1st ed. Am. 1883)

188. Read *supra* note 178 for a listing of the elements of a cause of action in fraud.

189. *Herndon v. Gibson*, 38 S.C. 357, 17 S.E. 145 (1893). Auction was a foreclosure sale at which Mrs. Gibson stood up and informed the assembled potential bidders that she was a widow who was dependent upon the land being foreclosed for support, that she intended to bid on the land, and that she desired nobody else to bid against her. Trial court held for Mrs. Gibson on the basis that no conduct stifling competition could be founded upon true statements that did not mislead other potential bidders. The South Carolina Supreme Court reversed saying: "Under the laws of this state, fraud in the concealment or misrepresentation of facts is not the only fact which will vitiate a public sale. Anything by a party in interest that chills the sale—prevents free competition amongst the bidders—will, on complaint, cause such sale to be set aside." *Id.* at 358, 17 S.E. at 146.

190. *Cf. Murphy v. DeFrance*, 105 Mo. 53, 15 S.W. 949 (1891). Administrator of an estate was selling real estate of the deceased through auction. Creditors of the deceased announced as the auction began that their claims against the estate far exceeded the value of the land. As result, other bidders did not bid and the creditors, collectively, purchased the land for \$100. Administrator sought to have the sale set aside on the basis that the agreement to bid collectively and the announcement by the creditors chilled the bidding. Trial court found for the Administrator but the Supreme Court of Missouri reversed on the basis that neither the creditor agreement to bid collectively nor the creditor announcement was for the purpose of suppressing competition.

191. *Cf. Hahn v. Duveen*, 133 Misc. 871, 234 N.Y.S. 185 (1929). Case did not involve an auction. Case involved a suit by an owner of a painting against an art critic on the basis of slander of title because the art critic had questioned the authenticity of the painting. At end of trial, jury unable to reach a unanimous verdict. Trial

cerning information which the audience needs to evaluate the bidding are permissible. Thus, a bidder's comments at a tax sale that the purchaser of the tax title will have neither a warranty deed nor abstract of title,<sup>192</sup> or comments at an auction that a priority dispute between two creditors may ultimately affect the title,<sup>193</sup> are permissible even though they lessen bidders' enthusiasm. Sellers in these instances are not entitled to legal relief.

Courts are not tolerant of misrepresentation as a technique to stifle competition. Contracts have been rescinded when the buyer used a decoy bidder, such as relative or employee of the seller, to chill the competition by inducing the belief among other bidders that the seller is engaged in puffing.<sup>194</sup> Sales have been set aside when the buyer induced the belief in the assembled audience that the buyer is purchasing for a charitable organization when in fact that is not true.<sup>195</sup> Courts have held that buyers are engaged in im-

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judge then overruled the defendant art critic's motion to dismiss and set the case for retrial

In the horse industry, a seller might claim that a bidder had chilled the bidding if the bidder questioned the bloodlines of the horse being sold at auction.

192. *Cf.* *Tinch v. Farmers Exchange Bank of Lindsay*, 136 Okla. 162, 276 P. 735 (1929). Attorney for the Bank announced as the foreclosure auction was beginning that the land was being sold without any title from the Bank, without any abstract of title, and for cash on the barrelhead. Attorney stated that whoever made the high bid would get the title "just as it was." *Id.* at 163, 276 P. at 736. Court ruled that these comments of the attorney did not slander the title and that therefore the foreclosure sale was properly confirmed by the trial court.

193. *United States v. Von Cseh*, 354 F. Supp. 315 (S.D. Tex. 1972). Auction was conducted by a judgment creditor who announced as the auction began that the United States government also had claims against the property under a tax lien. When the United States tried to set aside the auction on the basis that these comments chilled the bidding thereby depriving the government of its tax lien, the Court ruled that the comments were permissible because fairness required that the potential bidders be informed about the tax lien claim of the government.

194. *Rogers v. Rogers*, 13 Grant Ch. (U.C.) 143, cited with approval in *Nash v. Elizabeth City Hosp. Co.*, 180 N.C. 59, 61, 104 S.E. 33, 35 (1920). Purchaser used the seller's son to bid as the purchaser's agent. Other bidders did not bid either because of sympathy for the son or fear that the son was puffing for his father, the seller. Court granted rescission to the seller (the father) on the basis that the purchaser's conduct chilled the bids.

195. *Nash v. Elizabeth City Hosp. Co.*, 180 N.C. 59, 104 S.E. 33 (1920). Buyer at auction convinced the assembled audience that he was buying the hospital being sold for a charitable, non-profit community organization. In fact, buyer was buying hospital as a private investment. Seller was willing to tolerate sale at a lower price if

permissible stifling conduct when they submit sharp bids to the auctioneer,<sup>196</sup> or when they reach an agreement with the auctioneer to report the sale for a predetermined set price rather than the final bid.<sup>197</sup> Courts assuredly would hold that Partner's comment slandering Caldoon's title was a misrepresentation stifling competition.

The Uniform Commercial Code does not contain a provision governing such conduct. Section 1-103, which retains common law fraud and misrepresentation to supplement the Code, is the only relevant provision. In light of the case law defining conduct stifling competition, Ichabod Caldoon should have little difficulty in using § 1-103 to rescind the sale of the stallion, Black One.

Hypotheticals 1 through 9 have allowed an exploration of the seller bidding practice of puffing and the buyer bidding practice of conduct stifling competition. These hypotheticals focused on the legal implications of these bidding practices upon the buyer-seller relationship at with and without reserve auctions. Two other relationships need to be explored briefly: the relationship between the auctioneer and the seller or buyer, and the relationship between perpetrators of the fraud, either the seller and puffer or the members of the agreement not to bid.

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bought by a charitable, non-profit community organization but was unwilling to accept a lower price if bought as a private investment. Recall that a sale at which conduct stifling competition occurs is voidable at the option of the seller.

196. *Short v. Sun Newspapers, Inc.*, 300 N.W.2d 781 (Minn. 1980). A sharp bid is a bid in the form of "X dollars more than the highest bid received from any other bidder." A sharp bid is a fraudulent bid in so far as the seller is concerned because the bidder who enters such bid has "a guaranteed high bid" which likely allows the bidder to get the property "for less than he would have offered in a sum-certain bid." Hence a sharp bid is an example of conduct stifling competition at an auction. *Id.* at 788-89.

197. *Robenson v. Yann*, 224 Ky. 56, 5 S.W.2d 271 (1928). *Cf.* *Clark v. Stanhope*, 109 Ky. 521, 59 S.W. 856 (1900).

If the buyer has an agreement with the seller that the buyer will only have to pay a certain amount for the property no matter what the buyer bids, then this is a rebate bidding agreement which is a form of puffing. Issues related to rebate bidding agreements were discussed in connection with Hypothetical 5 earlier. By contrast, if the buyer and the auctioneer agree, without the knowledge of the seller, that the buyer will only pay a certain amount no matter what the buyer bids, then the buyer has engaged in conduct stifling competition which allows the seller to rescind the sale. The two cases cited in this footnote have facts related to this latter pattern.

## HYPOTHETICAL 10: AUCTIONEER SHILL OR PHANTOM BIDDING

Clarian Voice, the auctioneer, is employed by Missus Cunningham to sell her yearling filly, Happy Days. Voice will receive the normal commission of ten percent of the final sale price.

Clarian Voice employs her niece, Soft Whisper, to jump into the bidding to push the price of the filly higher. Soft Whisper gauges the mood of the crowd correctly, jumps in at the appropriate times to bid with the end result that the filly, Happy Days, sells for a good price. Missus Cunningham is delighted with the sales price and Clarian Voice is delighted with her commission.

Two weeks later, Dennis Bought, the purchaser of Happy Days, learns of the shill bidding by Soft Whisper. Bought confronts Missus Cunningham with the information and demands that redress be made. Missus Cunningham truthfully denies any prior knowledge that Clarian Voice had used a shill bidder to puff the price of the filly. Missus Cunningham tells Bought that he will have to sue the auctioneer because she is not responsible for what happened at the sale. Dennis Bought says he will not do that because with the commissions made from horse sales, Voice and Whisper have just moved to Italy to become art auctioneers. Dennis Bought stands firm that he is entitled to legal remedies against Missus Cunningham.

Dennis Bought will argue that Missus Cunningham's lack of knowledge that Clarian Voice would use a shill bidder<sup>198</sup> is irrelevant. Even though Missus Cunningham is innocent of direct wrongdoing, Voice was her agent and

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198. The term "shill" is the term more commonly used to label a decoy bidder who is specifically employed by and for the auctioneer. The terms "puffer" or "by-bidder" are terms more commonly used when the decoy bidder is working for the seller, regardless of whether employed directly by the seller or through the auctioneer as seller's agent.

Auctioneer's also sometimes accept "phantom bids"—i.e., bids which were in fact never made, but which the auctioneer pretends were made by actual bidders somewhere in the audience. Fuller discussion of phantom bids can be found in DuBoff, *supra* note 7, at 505 n.47.

Cunningham should not profit from her agent's wrongdoing. By contrast, Missus Cunningham will not only stress her own innocence from wrongdoing, but she will also emphasize that Voice engaged in the shill bidding for Voice's own purposes—to boost her commission. In light of her innocence from wrongdoing and Voice's motivation for self-enrichment, Cunningham will insist that the contract is valid.

Case law clearly favors Dennis Bought. The reasons are, first, that the auctioneer is the agent of the seller and therefore the seller has greater ability to control the actions of the auctioneer.<sup>199</sup> The seller should therefore bear the risk of auctioneer wrongdoing because the seller selected the auctioneer.<sup>200</sup> Courts consider it irrelevant that the auctioneer engaged in shilling for the auctioneer's own purposes without regard for the seller's honesty and reputation.<sup>201</sup> Second,

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199. The relationship between an auctioneer and the seller who employs the auctioneer is a complex agency relationship. The auctioneer is an agent of the seller; as an agent, the auctioneer is subject to the control of the seller via lawful directions from the seller which the auctioneer must obey. RESTATEMENT (SECOND) OF AGENCY §§ 1 comment e, 14 comment b (1958). At the same time, the auctioneer is not a servant of the seller. Rather, the auctioneer is an independent contractor who is not subject to the control of the seller with regard to his physical conduct. *Id.* §§ comment e, 2 comment b, 14N.

200. See, e.g., RESTATEMENT (SECOND) OF AGENCY § 261 (1958). Section 261 reads as follows: "A principal who puts a servant or other agent in a position which enables the agent, while apparently acting within this authority, to commit a fraud upon third persons is subject to liability to such persons for the fraud."

The comments to § 261 explain this rule stating:

The principal is subject to liability under the rule stated in this Section (§ 261) although he is entirely innocent, has received no benefit from the transaction, and, as stated in Section 262, although the agent acted solely for his own purposes. Liability is based upon the fact that the agent's position facilitates the consummation of the fraud, in that from the point of view of the third person the transaction seems regular on its face and the agent appears to be acting in the ordinary course of the business confided to him.

*Id.* comment a, at 570.

201. See, e.g., RESTATEMENT (SECOND) OF AGENCY § 262 (1958). Section 262 states: "A person who otherwise would be liable to another for the misrepresentations of one apparently acting for him is not relieved from liability by the fact that the servant or other agent acts entirely for his own purposes, unless the other has notice of this." In the comments, the drafters of § 262 justify the section upon the following reasons:

Rationale. A person relying upon the appearance of agency knows that the apparent agent is not authorized to act except for the benefit of the principal. This is something, however, which he normally cannot ascertain and something, therefore, for which it is rational to require the principal, rather than

if the courts were to decide for the innocent seller, the innocent buyer would suffer the detriment of puffed bidding while the seller would gain the benefit of agent wrongdoing. In effect, a holding for the seller would allow the seller to retain the benefits without having to accept responsibility for how those benefits were obtained. For this reason, courts consider the protestations of innocence by sellers, who hold tightly to the proceeds of the sale gained through shilling, to be hollow.<sup>202</sup> Third, the courts have concluded that holding for the innocent purchaser better protects the integrity of auctions. The courts thereby promote confidence in auction sales among potential buyers because these buyers know that they can seek legal relief if they are misled through fake competition and fictitious bids.<sup>203</sup>

Section 2-328(4) of the Uniform Commercial Code does not contain language which directly condemns shill bidding

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the other party, to bear the risk. The underlying principle based upon business expediency—the desire that third persons should be given reasonable protection in dealing with agents finds expression in many rules . . .

*Id.* comment a, at 572.

202. See generally RESTATEMENT (SECOND) OF AGENCY §§ 82-83 (1958). Section 82 reads as follows: "Ratification is the affirmance by a person of a prior act which did not bind him but which was done or professedly done on his account, whereby the act, as to some or all persons is given effect as if originally authorized by him."

Section 83 provides: "Affirmance is either (a) a manifestation of an election by one on whose account an unauthorized act has been done to treat the act as authorized, or (b) conduct by him justifiable only if there were such an election."

Comment c to § 83 explains subpart (b) as follows:

Conduct which is justifiable only if there is ratification constitutes an affirmance, under the circumstances stated in Sections 97-99. Thus, there is a ratification if the purported principal with knowledge of the facts receives or retains property to which he is entitled only if the earlier transaction is validated, or brings or maintains an action or defense based upon its validity. Such conduct is evidence of his consent but even if he disclaims an intent to affirm, ratification results. This rule is based upon the belief that one should not be permitted to obtain or retain the benefits of an act purported to be done on his account unless he is made responsible for the means by which they have been obtained.

*Id.* comment c, at 213.

*Cf. id.* § 98 (Receipt of Benefits as Affirmance) and accompanying comment e; § 99 (Retention of Benefits as Affirmance) and accompanying comment a.

203. *Cerreta v. Costello*, 212 A.D. 687, 209 N.Y.S. 257 (1925). See *Veazie v. Williams*, 49 U.S. (8 How.) 134, 151-53 (1850); *Curtis v. Aspinwall*, 114 Mass. 187, 194 (1873). See generally 2 WILLISTON SALES (rev.), *supra* note 19, § 298.

by the auctioneer.<sup>204</sup> Instead, the language of § 2-328(4) provides remedies to buyers "if the auctioneer knowingly receives a bid on the seller's behalf."<sup>205</sup> Based on the reasoning of the preceding paragraph, shill bidding by an auctioneer should, for purposes of § 2-328(4), be considered to be bidding on the seller's behalf.<sup>206</sup> Section 2-328(4) would therefore be available to innocent purchasers, like Dennis Bought, who could utilize either the remedy of rescission or the alternate remedy of taking the "goods at the price of the last good faith bid."

While the case law and statutory provisions favor the innocent purchaser over the innocent seller, the innocent seller is not without recourse against the auctioneer.<sup>207</sup> As a fiduciary, the auctioneer has certain obligations of obedience and loyalty to the seller.<sup>208</sup> By engaging in shill bidding for his own purposes, to the embarrassing detriment of the seller, the auctioneer has violated these fiduciary obligations.

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204. Several states do have statutes which specifically prohibit shill bidding. *E.g.*, LA. REV. STAT. ANN. § 15 (West 1973); N.M. STAT. ANN. § 67-13-1 (1974). Florida also has a statute which prohibits shill bidding but it contains a final clause which says "the provisions of this section shall not apply to auctions of livestock and agricultural products." FLA. STAT. ANN. § 839.021 (West 1976).

205. The language of § 21(4) of the Uniform Sales Act, does more clearly address the shill bidding situation. Section 21(4) states: "Where notice has not been given that a sale by auction is subject to a right to bid on behalf of the seller, it shall not be lawful for the seller to bid himself or to employ or induce any person to bid at such sale on his behalf, or for the auctioneer to employ or induce any person to bid at such sale on behalf of the seller or knowingly to take any bid from the seller or any person employed by him." (emphasis added).

206. Professor DuBoff takes the same position in his article. DuBoff, *supra* note 7, at 506-507.

Even if § 2-328(4) were not interpreted to prohibit shill bidding by an auctioneer, shill bidding would still be a common law fraud and § 1-103 of the Code states that common law fraud shall supplement the Code provisions. *Id.* at 507.

For additional discussion of § 1-103 as preserving common law fraud as a source of causes of actions with regard to seller or buyer bidding practices, read *supra* note 126.

207. The fiduciary relationship between an auctioneer and the seller is clearly defined in two restatement provisions on agency. RESTATEMENT (SECOND) OF AGENCY § 13 (1958); RESTATEMENT (SECOND) OF AGENCY § 387 (1958).

Section 13 reads: "An agent is a fiduciary with respect to matters within the scope of his agency." Section 387 makes the same point in different language which reads: "Unless otherwise agreed, an agent is subject to a duty to his principal to act solely for the benefit of the principal in all matters connected with his agency."

208. The duty to obey is set forth in the following provisions of the Restatement:

Innocent sellers are therefore entitled to sue the auctioneer for both compensatory and, because shill bidding is intentional, punitive damages.<sup>209</sup>

### HYPOTHETICAL 11: AUCTIONEER AGREEMENTS WITH BIDDERS

Arthur Hoos has been employed by Gomer Pyle to sell his mare, *Sail On Now*, at auction. On the day of the auction, Hoos is standing outside *Sail On Now's* stall, when a good friend, Greta Gold, approaches the stall. Gold informs Hoos that she will be unable to attend the auction that afternoon, but she does want to bid on *Sail On Now*. Gold tells Hoos that she is willing to pay \$600 for the horse no matter what the other bids are and asks that her bid of \$600 be entered at the appropriate time. Hoos informs Gold that she will surely be the high bidder because Hoos cannot imagine the mare, *Sail On Now*, generating other bids close to the \$600 level.

That afternoon at the auction, Hoos puts the mare up for sale. The bidding is much more competitive than Hoos had thought it would be. Four bidders are still in the bidding when the bidding hits \$580. When another bid of \$590 is entered, Hoos bids \$600 for Greta Gold. Then, because he had assured Gold, his good friend, that she would get the horse, Hoos uses a quick hammer to gavel the horse sold for \$600. Several bidders object that they wanted to bid again, but Hoos says that the hammer has fallen and that the sale on *Sail On Now* is over.

Later that afternoon, Gomer Pyle learns of what happened at the auction. Pyle objects to the sale and says he will refuse to convey the horse to Greta Gold. Gold insists that she is the owner of the horse and demands that the auction sale be honored.

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RESTATEMENT (SECOND) OF AGENCY §§ 380 (Duty of Good Conduct), 383 (Duty to Act only as Authorized), 385 (Duty to Obey) (1958).

The duty of loyalty is spelled out in the following sections: § 387 (Duty of Loyalty—General principle), § 389 (Acting as Adverse Party without Principal's Consent), § 391 (Acting for Adverse Party without Principal's Consent), and § 394 (Acting for One with Conflicting Interests). *Cf.* §§ 388, 390, 392, 393, 395, 396.

209. *See Hatfield v. Rouse & Sons Northwest*, 100 Idaho 840, 606 P.2d 944 (1980).

As agent, the auctioneer owes a duty of loyalty to the seller which entails the commitment to obtain the best price which is attainable at the auction sale.<sup>210</sup> The auctioneer is not allowed to dilute that loyalty by serving someone with conflicting interests.<sup>211</sup> Hence, the auctioneer cannot serve both the buyer and the seller in the same auction.<sup>212</sup>

If these general rules are applied strictly, it could be argued that the auctioneer, Hoos, could not reach an agreement to enter a bid for Greta Gold under any circumstances. Hoos would simply have to tell Gold to locate another person to depute as her agent to enter the \$600 bid. Sometimes, however, it might be impossible or inconvenient for the person who desires to bid to locate another agent to enter the bid. In that situation, if the auctioneer ignores the request by the potential bidder to enter the suggested bid, the auctioneer may well deprive the seller of an additional bidder who could either keep the bidding momentum moving or who would enter the high bid. In either situation, the seller is deprived of a higher price. An argument can thus be made that allowing the auctioneer in certain circumstances to enter a bid for an absentee bidder is in the best interests of his principal (the seller).

Courts have not, in fact, applied the general rules so strictly. The auctioneer is not prevented under any and all circumstances from entering a bid on behalf of an absentee bidder. Courts allow the auctioneer to enter a single, discrete bid on behalf of an absentee bidder.<sup>213</sup> Courts do not allow the auctioneer to be deputed by an absentee bidder to bid generally because the obligation to enter the bidding generally puts the auctioneer squarely into the conflict of in-

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210. See RESTATEMENT (SECOND) OF AGENCY § 379 (Duty of Care and Skill) and comment c, illustration 3 (1958); § 424 (Agents to Buy or to Sell) and comments a & b. See also T. PARSONS, THE LAW OF CONTRACTS 535 (9th ed. 1904).

211. RESTATEMENT (SECOND) OF AGENCY §§ 391 (Acting for Adverse Party without Principal's Consent), 394 (Acting for One with Conflicting Interests) (1958).

212. Brock v. Rice, 68 Va. 812 (1876). See Richard v. Holmes, 59 U.S. (18 How.) 143 (1855); Becker v. Crabb, 223 Ky. 549, 4 S.W.2d 370 (1928). Cf. Scott v. Mann, 36 Tex. 157 (1871). See generally WILLISTON SALES 2d, *supra* note 20, § 298, at 689.

213. Richards v. Holmes, 59 U.S. (18 How.) 143 (1855). Accord WILLISTON SALES 2d, *supra* note 20, § 298, at 689.

terests situation between the buyer's desire to buy cheaply and the seller's desire to sell high.<sup>214</sup> On the facts of Hypothetical 11, Arthur Hoos could accept the request of Greta Gold to bid one time at \$600 for the mare, Sail On Now. No conflict of interests exists on these facts between Gold's stated willingness to pay \$600 and Pyle's unstated desire to have the additional bid push the price higher.

The conclusion that Greta Gold could depute Arthur Hoos, the auctioneer, to enter the exact bid of \$600 has several consequences which should be made clear. Because the bid was legitimate and in good faith, Greta Gold is an innocent, good faith bidder. Arthur Hoos, as the auctioneer, was authorized by Gomer Pyle to complete the sale through the fall of the hammer. Thus, when the hammer fell, a contract was formed between Gold and Pyle. Greta Gold should not be deprived of her contract because of the wrongdoing, if any, of a third party.<sup>215</sup>

At the same time, upholding the contract for Gold has

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214. Brock v. Rice, 68 Va. 812 (1876). See Richards v. Holmes, 59 U.S. (18 How.) 143 (1855). But see Scott v. Mann, 36 Tex. 157 (1871). The Texas Supreme Court appears to approve of the agent for the seller bidding multiple times as agent for the buyer "if sold at public outcry in market overt, or in the manner in which sales are usually made by ministerial officers." *Id.* at 164.

Although the case law and the restatement provisions cited in this and immediately preceding footnotes indicate that the majority position is that an auctioneer cannot be the agent for a bidder for purposes of entering multiple bids, the practice of the auctioneer bidding multiple times for bidders does exist. For example, an auction catalog recently had the following statement in it: "MAIL BIDS. Determine the maximum bid on the vehicle of your choice. Send cashier's check for that amount to Antiques, Inc. payable to Antiques, Inc. The auctioneer will bid for you in \$100 increments above the galley bid. If unsuccessful, your check will be returned. If successful, your check will be deposited. If able to purchase the vehicle at less than your maximum bid, a refund will be made." Catalog for the 11th Annual International Antique & Classic Car Auction held June 3-5, 1983, in Tulsa, Oklahoma, at p. 18.

This statement in the catalog vividly portrays, in the author's opinion, the conflict of interest created by an auctioneer attempting to sell for the greatest amount while also trying to bid multiple times for a bidder who wants to purchase as cheaply as possible. If the auctioneer actually serves the seller, who is by law the principal of the auctioneer, by selling for the greatest amount bid, the greatest amount bid is the maximum amount specified in the cashier's check. No refund should ever be available.

215. For a fully developed argument that an innocent buyer at auction should be favored over an innocent seller at auction, read *supra* the text and notes discussing Hypothetical 10.

adverse consequences for Pyle. Pyle lost the opportunity to have a possibly higher price determined at the auction. The wrongdoing is clear; Arthur Hoos violated his duty of loyalty to Pyle not when he agreed to enter the bid for Gold, but when he used the quick hammer to protect Gold from further competition. By using the quick hammer to prevent further bidding, Hoos has engaged in conduct stifling competition to the detriment of his principal.<sup>216</sup> For his quick hammer, Hoos can be held accountable for compensatory and punitive damages to Gomer Pyle.<sup>217</sup>

### HYPOTHETICAL 12: ENFORCEMENT OF SELLER-PUFFER AGREEMENTS

Silas Marner places his filly, Special Event, in the prestige spring horse auction. To insure that the filly brings a good price, Marner hires Cecilia LeGree to bid on the filly as a puffer. Marner and LeGree agree that she is to be compensated for her puffing services by receiving 10% of the amount above \$10,000 which is bid by bona fide bidders for the filly, Special Event.

On the day of the auction, Cecilia LeGree watches the auction sale of Special Event. As the bids approach

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216. See *Robenson v. Yann*, 224 Ky. 56, 5 S.W.2d 271 (1928); *Clark v. Stanhope*, 109 Ky. 521, 59 S.W. 856 (1900). Both cases involve situations where the highest price that could have been obtained for the property sold was not obtained because of the violation of fiduciary duties owed by the auctioneer to the seller or the guardian to the ward respectively. Cf. *Becker v. Crabb*, 223 Ky. 549, 4 S.W.2d 370 (1928). Auctioneer violated fiduciary duty to seller to sell for the best possible price when auctioneer held sale just to earn commissions even though the attendance was poor and the resulting bids were ruinously low for the seller.

217. See *Hatfield v. Rouse & Sons Northwest*, 100 Idaho 840, 606 P.2d 944 (1980).

While Hypothetical 10 involved auctioneer shill bidding, a species of puffing, the quick hammer of Hypothetical 11 is, as the text indicates, more closely akin to other conduct stifling competition. In either instance, however, the author is of the opinion that the innocent buyer should be protected in his contract expectations rather than the innocent seller whose agent the wrongdoing auctioneer is. See *supra* note 215.

If the facts of Hypothetical 11 were changed so that Hoos and Gold had actually agreed to use a quick hammer to guarantee that Gold would get the horse for \$6000, then this agreement would have been conduct stifling competition which is illegal. *Robenson v. Yann*, 224 Ky. 56, 5 S.W.2d 271 (Ky. Ct. App. 1928). Under these changed facts, Pyle would then be entitled to gain rescission of the auction sales contract

\$10,000, only two bona fide bidders are still bidding. At this point LeGree enters a bid of \$10,200. Bonnie Needer responds by bidding \$10,600; April Spring bids \$11,000; LeGree bids \$11,700; Needer bids \$12,200. At this point April Spring indicates to the auctioneer that the bidding has gone higher than she wants to go and that she is dropping out of the bidding. LeGree continues to bid against Needer until Needer bids \$14,600. LeGree does not make an additional bid and the auctioneer lets the hammer fall with a sale at \$14,600 to Bonnie Needer.

Silas Marner congratulates LeGree after the sale of her efforts and tells her that he will send her a check for \$460 the next day. After a week has passed with no check coming in the mail, LeGree calls Marner to inquire about being paid for her puffing services. Marner says that he is in a stingy mood and has decided not to pay her anything. Marner is discourteous to LeGree and tells her to sue him for the money. LeGree immediately goes to her attorney to discuss bringing a lawsuit for enforcement of the contract and to collect her \$460.

Courts are unlikely to be sympathetic to Cecilia LeGree's lawsuit because her agreement with Silas Marner is an agreement to defraud bona fide bidders.<sup>218</sup> Some sympathy might, however, be generated in the courts for LeGree's claim if the courts are seriously upset with the fact that denying relief to LeGree will result in "unjust" enrichment to Silas Marner who gets the benefit of her puffing without having to pay for the service.<sup>219</sup>

Courts have traditionally taken a "hands-off" attitude

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218. See generally 6A, CORBIN, *supra* note 10, §§ 1455 (Bargains for the Purpose of Defrauding Others), 1469 (Puffing and By-Bidding at Auctions); 14 WILLISTON 3d, *supra* note 17, § 1648B (Effect of "Puffing" of Bids at Auction Sales); 15 WILLISTON 3d, *supra* note 17, § 1738 (Bargains which Involve Wrongs to Third Persons).

219. 6A CORBIN, *supra* note 10, § 1463 (Denial of All Remedy is Variable in Effect and Often Unjust). The cases that Professor Corbin uses to develop his argument that the courts should not blindly deny recovery to a party because that party is seeking to have a fraudulent contract enforced are primarily cases between debtors and the transferees to whom the debtors transferred property in fraud upon creditors. About this factual situation, Professor Corbin writes: "Property has been transferred in reliance on this return promise; and refusal of all remedy operates to cause a forfeiture often disproportionate to the degree of the transferor's (debtor's) wickedness and to the extent of harm done. It takes no account of the transferor's (debtor's) depen-

toward granting relief to any person who comes into the court asking the court for legal assistance with enforcement of a fraudulent agreement. The courts do not want to appear to be condoning fraudulent conduct. Courts therefore generally deny relief to the party petitioning for the court's assistance. In effect, the courts refuse to be drawn into the dispute between the parties.<sup>220</sup>

Although § 2-328(4) does not specifically discuss whether puffing agreements between the seller and the puffer are enforceable, courts have ruled that § 2-328(4) does make it clear that the seller-puffer agreement is fraudulent.<sup>221</sup> Courts have allowed the seller to use the declaration in § 2-328(4) that seller-puffer agreements are fraudulent to obtain dismissal of the puffer's petition.<sup>222</sup> Similarly, when sellers have petitioned the court for enforcement of a seller-puffer agreement that the puffer would return any property obtained at the auction, courts have allowed the puffer to show that the seller-puffer agreement is fraudulent and not enforceable.<sup>223</sup>

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dents and it supports the spectacle of the transferee's unjust enrichment by keeping property for which he paid nothing and in breach of his promise." *Id.* § 1463, at 550.

By contrast Professor Williston argues that courts should not become involved in the enforcement of fraudulent contracts. Professor Williston considers it "immaterial" that one party gains a benefit due to the refusal of the courts to become involved. 15 WILLISTON 3d, *supra* note 17, § 1787 (Rescission of and Quasi-Contractual Recovery Under Executed Illegal Bargains).

220. The statements in the text involve so many principles of law as applied to so many different factual situations that a single citation of authority to support those statements is not really possible. But the statements are supported by the full, extensive coverage given to fraudulent agreements in both the Corbin and Williston treatises on contracts. *See generally* 6A CORBIN, *supra* note 10, Ch. 86 (Bargains to Defraud or Otherwise Injure Third Persons); 15 WILLISTON 3d, *supra* note 17, Ch. 51 (Agreements Tending to Corruption or Immorality).

221. *Wade v. Ingram*, 528 F. Supp. 495 (E.D. Ark. 1981).

222. *Id.* *See also* *Dealey v. East San Mateo land Co.*, 21 Cal. App. 39, 130 P. 1066 (1913). Court construed a statute which is very similar to § 2-328(4) and concluded that the remedy of the statute was not just limited to innocent defrauded good faith bidders. Court held that the seller could use the statute to establish that the agreement with the auctioneer, that the auctioneer would use puffing and be compensated extra for the puffing, was a fraudulent agreement that the courts would not enforce.

223. *Troughton's Administrator v. Johnston*, 3 N.C. (2 Hayw.) 277 (Superior Ct. Halifax 1804).

Several courts<sup>224</sup> and Professor Corbin<sup>225</sup> have been concerned that the result of these decisions is to allow benefit to one of the parties to the fraudulent agreement. If the puffer is denied compensation under the puffing agreement, the seller gets the benefit of the puffer's service without having to pay for it. On the other hand, if the seller is denied return of his property under the puffing agreement, the puffer is rewarded for cheating the seller because the puffer gets to keep the property. It can be argued that even among "thieves" there should be some honor. Hence, several courts have suggested that if the party who has been truly defrauded, i.e., the good faith bidder against whom the puffing was effective, does not complain, then the agreement between the puffer and seller should be enforceable according to the terms of the puffing agreement itself.<sup>226</sup>

The concern about allowing one party to the fraudulent agreement to benefit by refusing to enforce the puffing agreement should be recognized only if § 2-328 is amended to add a subsection 5 which specifically addresses the enforcement of puffing agreements. This new subsection could read as follows:

Agreements between a seller and another person to bid

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224. See *Jennings v. Jennings*, 182 N.C. 26, 108 S.E. 340 (1921). Cf. *Berg v. Plitt*, 178 Md. 155, 12 A.2d 609 (1940); *Short v. Sun Newspapers, Inc.*, 300 N.W.2d 781 (Minn. 1980). These latter two cases are factual situations which are better classified as other conduct stifling competition rather than puffing. Puffing agreements are the immediate focus of the discussion in the text under Hypothetical 12.

225. 6A CORBIN, *supra* note 10, § 1463. A fuller discussion of § 1463 is set forth *supra* in note 219. Cf. 6A CORBIN, *supra* note 10, §§ 1460 (Does Enforcement Depend on Which Party Proves the Illegality?), 1462 (Effect of Conveyances and Other Performance Under the Fraudulent Bargain), 1464 (Enforcement of Transferee's Promise by Preventing Him from Asserting the Illegality as a Defense), 1465 (Enforcement of Restitution When Defendant was in Greater Fault or the Intended Fraud Not Actually Consummated).

226. The courts which are sympathetic to the enforcement of the puffing agreement talk about these agreements as being voidable at the option of the good faith bidder who has been defrauded, rather than the agreement being void *ab initio*. *Berg v. Plitt*, 178 Md. 155, 161, 12 A.2d 609, 615 (1940); *Jennings v. Jennings*, 182 N.C. 26, 27, 108 S.E. 340, 341 (1921). Other courts which are sympathetic to the enforcement of the puffing agreement use an estoppel theory to say that the party who desires to assert the fact that the agreement is fraudulent as a defense is not permitted to raise this defense. *Short v. Sun Newspapers, Inc.*, 300 N.W.2d 781, 789 (Minn. 1980).

on behalf of the seller are enforceable only under the following conditions:

- a) Within 20 days after a petition being filed seeking enforcement of a puffing agreement, the party seeking enforcement of the agreement provides proof to the court that the good faith bidder who was defrauded by the puffing agreement has been notified of the filing of the lawsuit;
- b) The notice to the good faith bidder shall inform him that he has 30 days within which to intervene in the lawsuit to seek relief from the fraud that had been perpetrated against him by the puffing agreement;
- c) If proof is not properly provided of compliance with conditions a) and b), the lawsuit shall be dismissed and relief will be denied to the party filing the petition;
- d) If proof is properly provided of compliance with conditions a) and b), and if the defrauded good faith bidder does not intervene within 30 days, then the lawsuit to enforce the puffing agreement will be allowed to continue on a conclusive presumption that failure to intervene by the good faith bidder means that he has no objections to the transaction on the grounds of fraud. The puffing agreement will then be treated as a nonfraudulent agreement.
- e) If a good faith bidder does intervene, the claims of the party seeking enforcement of the puffing agreement shall be dismissed and the lawsuit shall continue as a suit by the defrauded good faith bidder against the parties to the puffing agreement.

Courts have justified their refusal to provide legal relief to parties to a fraudulent agreement on the basis that such refusal serves as a deterrent to others who in the future may contemplate formation of a fraudulent agreement. By leaving the parties to a fraudulent agreement in the identical position in which the parties entered the court, these courts have sent a message to others contemplating such agree-

ments that they enter these agreements at their own peril. Courts should not provide any incentive to parties contemplating a fraudulent agreement to enter that agreement.<sup>227</sup> On the other hand, if the truly defrauded party is given proper notice and does not in fact object to the agreement on grounds of having been defrauded, then no reason to deter that particular agreement exists. Under these latter conditions, the refusal to enforce the agreement results only in unjust enrichment to one party to the puffing agreement.<sup>228</sup> Courts ought not allow a party to benefit from violating an agreement which is no longer deemed fraudulent.

### HYPOTHETICAL 13: ENFORCEMENT OF AGREEMENTS NOT TO BID BETWEEN MEMBERS OF THE AGREEMENT

Victoria Subvert attends the fall auction sale of two year old racing stock. Subvert intends to purchase a gelding, For Sure, which she feels will be an outstanding racehorse in the upcoming derbies.

At the sale, Subvert encounters George Shi who also intends to bid on the gelding, For Sure. Subvert wants to eliminate competition for the gelding so she offers Shi 10% of purses won by For Sure during the three year old season if Shi will refrain from bidding at the auction. Shi agrees to the deal and does not bid at the auction in accordance with his agreement with Subvert. Subvert purchases the gelding for \$1,500.

One year later, at the next fall sale, Shi asks Subvert when she will be sending him the \$3,000 owed him for not bidding the previous year on For Sure. Shi com-

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227. Professor Corbin thinks that deterrence "can not be shown" and that therefore the deterrence rationale does not support the refusal of the courts to enforce fraudulent agreements between the parties to the fraudulent agreement itself. 6A CORBIN, *supra* note 10, § 1463, at 550.

228. *Berg v. Plitt*, 178 Md. 155, 12 A.2d 609 (1940). Facts of this case were that the defrauded party had been given notice and had approved the transaction. Moreover, the defrauded party, who was not a party in the lawsuit, gave no indication that he desired to pursue a fraud claim against the parties to the fraudulent agreement. The defrauded party in this case was a seller and the fraudulent agreement was an agreement not to bid. Case involved a breach of contract action by one party to the agreement not to bid against the other party for having botched the agreement.

ments that he was pleased that For Sure had earned money in several races to the total of \$30,000. Subvert responds that For Sure is her racehorse and that she does not intend to share the gelding's race earnings with anyone.

Three days later, George Shi files a lawsuit against Victoria Subvert which seeks an accounting and payment of money owed him under the agreement between them.

Case law is very clear that George Shi will not be given an accounting or other legal relief. Just as courts refuse to assist a party seeking to enforce puffing agreements, so they similarly refuse to provide assistance to any party to an agreement not to bid.<sup>229</sup>

There is an important distinction, however, between puffing agreements and agreements not to bid. Puffing agreements are fraudulent to the bidding audience as a whole because it is not known initially which good faith bidders will be affected. In this sense, puffing agreements can be considered to be a fraud on the public in a general sense. By contrast, an agreement not to bid has a clear target, the seller. In this sense, agreements not to bid perpetrate a private fraud.<sup>230</sup> Courts might feel less inclined to enforce an agreement involving public fraud, as contrasted to private fraud, because public fraud seems to undermine the integrity of auctions to a greater extent. Based partially on this distinction, the Supreme Court of Minnesota has indicated that courts might enforce agreements not to bid.<sup>231</sup>

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229. *E.g.*, *Frank v. Blumberg*, 78 F. Supp. 671 (E.D. Pa. 1948); *Jennings v. Jennings*, 182 N.C. 26, 108 S.E. 340 (1921); *James v. Fulcrod*, 5 Tex. 256 (1851) (all these cases involved agreements not to bid at auctions). *See* *Swan v. Chorpenning*, 20 Cal. 182 (1862), *Conway v. Garden City Paving and Post Co.*, 190 Ill. 89, 60 N.E. 82 (1901); *Gibbs v. Smith*, 115 Mass. 592 (1874); *King v. Winants*, 71 N.C. 469 (1874), *Daily v. Hollis*, 27 Tex. Civ. App. 570, 66 S.W. 586 (1901) (all these cases involved agreements not to bid in the bidding process to gain a contract to perform public work projects).

The discussion in the text under Hypothetical 13 about the enforcement of agreements not to bid is also applicable to agreements to engage in other conduct stifling competition.

230. If the seller is the government so that the agreement not to bid is a fraud upon the taxpayers as a whole, then concerns about fraud upon the public again arise.

231. *Short v. Sun Newspapers, Inc.*, 300 N.W.2d 781 (Minn. 1980). Case involved

This distinction between public fraud and private fraud, however, seems unsound. The agreement not to bid is just as fraudulent regardless of the number of intended victims. The correct issue for the court is not whether the agreement should be approved or disapproved based on the magnitude of the fraud, but whether the fraud should be condoned or assisted in any manner by the court.<sup>232</sup> Moreover, agreements not to bid are a species of agreements in restraint of trade. Restraints of trade always raise public fraud concerns because of the anti-trust implications.<sup>233</sup>

Courts should condone agreements not to bid only when no deterrence will result from denying assistance to the party seeking enforcement of the agreement. This will be this case only in situations in which the truly defrauded party is given notice of the lawsuit seeking enforcement of the agreement not to bid and then declines to take action to gain relief from the fraud.<sup>234</sup> If a seller does not seek rescission when he is aware of the fraudulent agreement, a presumption can be made that no fraud has been perpetrated. Courts should then enforce the agreement according to its

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a sharp bid submitted by Short, who is the plaintiff in the lawsuit. A sharp bid defrauds the seller, but the court was concerned that the seller (the defendant) had participated in the sharp bid and was therefore estopped from asserting fraud as a defense. Read *supra* notes 196 & 226. Sharp bids also defraud the other good faith bidders who submit sum-certain bids because their bids are necessarily ineffective. *Id.* at 788. While the Supreme Court of Minnesota allowed the lawsuit between the sharp bidder and the estopped seller to go forward, the court seemed to hint that other good faith bidders should join the lawsuit and then object to the sharp bidding on the basis of fraud. *Id.* at 789.

232. Professor Corbin discusses the distinction between fraud on the public and fraud on a private individual and concludes that the distinction is without merit. Professor Corbin too argues that the real issue is the legality or illegality of the agreement and how courts will react to a request to enforce an illegal agreement, not the magnitude of the harm caused by the illegal agreement. 6A CORBIN, *supra* note 10, § 1468, at 570-71.

For a full discussion of whether courts should provide assistance in the enforcement of fraudulent agreements, read the text and notes under Hypothetical 12.

233. Read *supra* note 174.

234. It should be remembered that with respect to agreements not to bid or other conduct stifling competition, the courts treat the sale at which these agreements or the conduct has defrauded the seller as voidable at the option of the seller. The seller may, if the seller so desires, enforce the sale despite the fraudulent agreement or fraudulent conduct that existed during the sale. 6A CORBIN, *supra* note 10, § 1468, at 571, 14 WILLISTON 3d, *supra* note 17, § 1648A, at 307.

terms so as to avoid unjustly enriching one party. On the other hand, if the seller has not been made aware that an agreement not to bid was used, or if he seeks rescission, then the agreement not to bid should not be enforced. In these latter two situations, failure to enforce the agreement deters because others contemplating an agreement not to bid will know that, if the seller is unaware of the agreement or seeks rescission, the agreement will be unenforceable. The risk of being successfully double-crossed will assuredly deter some from entering into the fraudulent agreement in the first place.

While the Uniform Commercial Code has no provision dealing specifically with agreements not to bid at auctions, the preservation of principles of law and equity in § 1-103 should be sufficient legal authority to reach the results which have been urged in the preceding paragraph.