AUCTION INDUSTRY LEGAL MATTERS

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The auction industry is fast-paced, widely arching and varies in business operation size. It involves multiple interested parties and utilizes many platforms. At any given moment in the process of selling items in a bidding environment there are any number of legal circumstances that can arise. In addition, auction professionals are required to be flexible and adaptable to changing processes and technologies, making legal concerns even more prevalent.

While the National Auctioneers Association continually offers guidance to its members and expects them to uphold a strict code of ethics, there is no substitute for the advice from a legal professional.

This paper includes such topics as:
- Warranties
- Cybersecurity
- Liability
- Authenticity
- Contracts

These important considerations, and others, are just a sampling of the legal advice Kurt Bachman offers NAA members. Become an NAA member today to gain access to future legal columns, and so much more information to help grow your business efficiently and effectively!

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ABOUT THE AUTHOR

The legal topics discussed in this paper were written by Kurt Bachman and have appeared in past issues of *Auctioneer*, the official magazine of the National Auctioneers Association.

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Disclaimer: *Kurt R. Bachman and Beers Mallers Backs & Salin, LLP appreciate the opportunity to review and answer legal questions that will be of interest to auctioneers. The answers to these questions are designed to provide information of general interest to the public and are not intended to offer legal advice about specific situations or problems. Kurt R. Bachman and Beers Mallers Backs & Salin, LLP do not intend to create an attorney-client relationship by offering this information, and anyone's review of the information shall not be deemed to create such a relationship. You should consult a lawyer if you have a legal matter requiring attention.*

EXPRESS VS. IMPLIED WARRANTY

Question: What is the difference between an express and an implied warranty?

A warranty is generally an assurance by one party to an agreement of the existence of a fact upon which the other party may rely. A warranty is provided by one party with the intent to relieve the other party of any duty to investigate whether the fact is true.

It is also a promise to compensate the party for any loss if the fact warranted proves to be untrue. In other words, a warranty is a guaranty that some particular aspect is true. At an auction, the seller may make a warranty to the buyer. When a buyer purchases a lot that does not comply with the seller's warranty, the buyer may seek to recover damages for any loss. A warranty can be given for any lot and commonly relates to the character, quality, quantity, description, or performance of the lot. There are generally two broad categories of warranties—express warranties and implied warranties.

An express warranty is created by a statement of the auctioneer, a statement of the seller, specific terms in an advertisement, or the terms in a written sales agreement. The Uniform Commercial Code ("UCC") recognizes that an express warranty can be created for the sale of goods in several different ways.

First, any affirmation of a fact made by the seller to the buyer that becomes part of the basis for the agreement creates an express warranty that the lot will conform to the statement. UCC § 2-313(2)(a). A statement at a car auction, for example, that a vehicle "gets 25 miles per gallon and has a new transmission" would be an affirmation of facts that would likely create an express warranty.

Second, any description of the lot which becomes part of the basis of the agreement creates an express warranty that the goods will conform to the description. UCC § 2-313(2)(b). At a car auction, a description of a lot as a "2015 Ford Fusion Sedan" would likely create a warranty that the lot will conform to that description. Third, any sample or model which is made part of the basis of the agreement creates an express warranty that all of the goods will conform to the sample or model. UCC § 2-313(2)(c).

When an auctioneer is selling a large quantity of a particular item and only shows a few items as a sample, the sample would create an express warranty that the other items are the same as the sample.

An implied warranty is a warranty created by operation of law. These assurances are imposed to protect a buyer – regardless of whether the seller has agreed to provide these warranties.

The UCC implies certain warranties whenever goods are sold. The two warranties generally implied are the warranties of "merchantability" and "fitness for a particular purpose." UCC §§ 2-314 and 2-315. The warranty of merchantability applies when someone

When a buyer purchases a lot that does not comply with the seller's warranty, the buyer may seek to recover damages for a loss.

or a business deemed a "merchant" sells something.

A merchant is generally someone who buys and sells goods of the same kind or has special knowledge or skills particular to the goods. Regarding the implied warranty of merchantability, the UCC provides:

(1) Goods to be merchantable must be at least such as:
  (a) pass without objection in the trade under the contract description;
  (b) in the case of fungible goods, are of fair average quality within the description;
  (c) are fit for the ordinary purposes for which such goods are used;
  (d) run, within the variations permitted by the agreement, of even kind, quality and quantity within each unit and among all units involved;
  (e) are adequately contained, packaged, and labeled as the agreement may require; and,
  (f) conform to the promise or affirmations of fact made on the container or label if any

UCC § 2-314. This warranty of merchantability applies to all goods sold, unless disclaimed, by a merchant.

The other commonly known implied warranty is the warranty of fitness for a particular purpose. Section 2-315 of the UCC provides: "Where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods, there is unless excluded or modified under the next section an implied warranty that the goods shall be fit for such purpose."

This warranty is implied by law, if a seller knows or has reason to know of a particular purpose for which some item is being purchased, the seller is guaranteeing that the item is fit for that particular purpose. The warranty of fitness is different from the warranty of merchantability in two ways.

First, the warranty of fitness applies to all sellers – it is not limited to just merchants. Second, the warranty of fitness requires the seller to know or have reason to know of a specific purpose to which the good sold is going to be used.

Auctioneers should generally limit or disclaim the existence of any warranties at an auction. An auctioneer may seek to disclaim any warranties by making an announcement before the auction and including a disclaimer in the bidder's registration agreement.

A disclaimer generally is any words or conduct which tend to negate or limit any warranty. The use of the phrases "as is," "where is," and "with all faults" are examples of disclaimers. Use of the expression "as is" implies that the buyer will take the entire risk as to the quality of the property and make his or her own inspection of the lot. The use of the phrases "as is," "where is," and "with all faults" by themselves in the registration agreement (as long as it is clear and made conspicuously) is usually sufficient to disclaim express warranties and implied warranties. UCC § 2-316.

It is a good practice for auctioneers to take the extra step, however, and specifically disclaim all implied warranties. In some jurisdictions, these implied warranties must be specifically disclaimed. In other jurisdictions, these implied warranties cannot be disclaimed

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An express warranty is a warranty created by a clear statement or specific conduct of the seller. An implied warranty generally is a warranty created by operation of law. Auctioneers should exercise caution and limit the warranties made or disclaim all warranties.

DO AUCTIONEERS NEED TO WORRY ABOUT CYBERSECURITY?

Question: Is it necessary for auctioneers to be concerned about cybersecurity?

Yes, auctioneers should generally be aware of cybersecurity risks and take steps to reduce the risks of data breaches. Cybersecurity is protecting information that a business has stored in a digital or electronic format. Auctioneers, and other business owners, often state that they do not have much information to protect, but in reality all business owners do have valuable information stored in a digital or electronic format.

What information do auctioneers need to protect?

The most common types of information business owners, including auctioneers, have to protect are:

1. Sellers' information – this could include names, address, email addresses, date of birth, credit card numbers (or other financial information), or social security numbers;
2. Bidders' information – this could include names, address, email addresses, date of birth, credit card numbers (or other financial information), or social security numbers;
3. Employee's information – this could include names, address, email addresses, date of birth, financial information, or social security numbers;
4. Information about your business – business identity theft has been on the rise;
5. Vendor information – information about who your business does business with and account numbers;
6. Marketing or other strategic plans;
7. Trade secrets; and,
8. Financial data and history such as information that may commonly be stored in Quickbooks.

Information on the company and its sellers, bidders, employees and vendors as well as marketing and strategic plans, trade secrets and financial data are just some of the things auctioneers must consider in its cybersecurity protection planning.

Auctioneers should take the risk of security breach seriously—too many people think it cannot happen to them.

What is a cybersecurity breach?

A cybersecurity breach is generally the unauthorized acquisition of computerized data that compromises the security, confidentiality, or integrity of business or personal information maintained by the business or person.

What steps should a business take when there is a cybersecurity breach?

From a legal prospective, these are the most important steps to take after a cybersecurity breach:

1. Secure the business data—The business must take immediate action to stop the breach and secure the data, computers, and network. It is essential to stop the breach and prevent additional data loss. This will generally require an investigation to determine how the breach occurred, determine the size of the breach, and evaluate what data was lost or exposed.
2. Fix Vulnerabilities – The business must take appropriate action to strengthen cybersecurity, this could include changing access codes, changing passwords, cutting off access where the breach occurred.
3. Mitigation – The business must take any steps to the extent possible to recover the data, limit further exposure, and reduce risks to customers, employees, and vendors.
4. Notify Appropriate Parties – Most states have enacted legislation requiring notification of security breaches involving personal information. The business should notify law enforcement, notify individuals who were affected by the security breach, notify individuals who may have been affected by the security breach, and anyone else required by law.

What is the true cost of a cybersecurity breach?

There are too many changing variables involved to come up with a good calculation of how much a data breach is likely to cost a business. The factors included to determine the true cost of a security breach include: investigate costs and stopping the breach, lost productivity, lost data, mitigation cost, lost business due to information about the breach (including damage to the reputation), what data was lost or exposed (how egregious the breach is), legal costs, any state or federal fines, and any lawsuits or judgments as a result of the breach.

When a breach occurs, there are several significant problems such as the complete loss of your valuable data, information about your business could be stolen in an effort to steal the identity of your business, and information about your employees or customers in an effort to steal their identities. If you information is completely lost, how will you be able to operate your business? Your business

What should businesses do to reduce the risk of cybersecurity breaches?

There are several things that businesses can do to reduce the risk of a data breach. First, auctioneers should take the risk of security breach seriously – too many people think it cannot happen to them. Second, auctioneers should get frequent evaluations and assessments of the data, computer system, and network from an expert. Third, auctioneers should update computers, servers, and networks as necessary. Fourth, talk with an attorney licensed in your state about the risk of security breaches and your obligation in the event of a breach. Fifth, appropriately train employees who use the computers and have access to the network. Finally, auctioneers should consider putting together an incident response plan—this is a plan about what to do in the event of a security breach and shows that the business has taken steps to prepare for an incident.

In conclusion, auctioneers must be aware of the risks related to a cybersecurity breaches and take reasonable steps to reduce the risk.

Under the fiduciary duties of an auction professional, they are required to make full disclosure to their seller of all important information.

WHEN IS THE AUCTIONEER LIABLE?

Question: What is my duty to the seller? When can I be held liable when things go wrong?

An auctioneer is generally the agent of the seller and owes the seller a fiduciary duty. A fiduciary duty is the highest legal standard imposed by the law. It is used for individuals who reasonably place faith, confidence, and trust in their agent. Rose v. Nat'l Auction Grp., Inc., 646 N.W.2d 455, 464 (2002). The existence and extent of the auctioneer's duties to the seller are determined, in part, by the terms of the auction contract. The duties are determined by the scope of the authority conferred and the obligations imposed by the seller. An auctioneer is under a duty to the seller to act only as authorized, and an auctioneer who exceeds such authority or who risks the seller's property without authority becomes responsible to the seller for all loss or damage caused by the unauthorized acts. 3 Am. Jur. 2d, Agency § 204.

An auctioneer must exercise the utmost good faith, loyalty, and honesty toward his or her seller. An auctioneer must consider the interest of his or her seller above his or her own interests. An auctioneer may not make a secret profit in a transaction or secretly acquire, directly or indirectly, any interest in the subject matter of the agency. An auctioneer must avoid situations that could create any type of conflict of interest between himself or herself and a seller.

An auctioneer cannot misrepresent any matter in connection with the agency. If it appears that an auctioneer has concealed or has taken any unfair advantage of the confidential relationship, the transaction will not be allowed to stand. An auctioneer must consider the interest of the seller, even when it means suppressing the auctioneer's self-interest. The duty of loyalty also includes the duty to not compete with the seller regarding the subject matter of the contract. 3 Am. Jur. 2d, Agency § 225.

In addition, an auctioneer who is given custody of property may be held liable for the failure, or the failure of his or her agents, to exercise reasonable care, skill, and diligence in the protection and preservation of the property. An auctioneer is also under a duty to record and account for all money received for the seller during the agency relationship. An auctioneer must also account for, pay, or deliver to his or her seller money or property which comes into the hands of the auctioneer while conducting the business of the agency.

Under the fiduciary duty, auctioneers are required to make full disclosure to their seller of all important information. The general rule for an agent is that:

The duty of an agent to make full disclosure to his principal of all material facts to the agency is fundamental to the fiduciary relation of principal and agent. It is a primary incident of the obligation of an agent that he make prompt, full, and frank disclosure and account of all matters concerning the agency, and he must give the principal any information that the latter would desire to have and which can be communicated to him without violating a superior duty to a third person.

Cruikshank v. Horn, 386 N.W. 134 (Iowa Ct. App. 1986). The rule requiring full disclosure applies even where the auctioneer acquired the information outside the scope of the agency relationship or prior to the inception of the agency. In addition, the

auctioneer should advise the seller of any risk and disclose concerns.

An auctioneer also has a duty to follow the reasonable instructions of the principal. If the seller requests a specific reserve to be placed on a lot, the auctioneer should do so. If an auctioneer fails to follow the seller=s reasonable instructions, the auctioneer becomes liable to the seller for all loss or damage which naturally results from the auctioneer's acts.

If an auctioneer engages in any conduct that may violate his or her fiduciary duty, the seller can file a lawsuit and seek damages from the auctioneer. The elements of a claim for breach of fiduciary duty are: (1) the existence of a fiduciary duty, (2) breach of the duty, (3) causation, and (4) damages. First United Pentecostal Church of Beaumont v. Parker, 514 S.W.3d 214, 220 (Tex. 2017). When a breach of fiduciary duty is established, courts generally disallow any fee, because of the auctioneer's disloyalty and as a deterrent. In addition, the courts can award monetary damages to compensate sellers for the injury caused by the breach.

An auctioneer should be aware of his or her fiduciary duties and keep his or her responsibilities in mind while working with a seller. The high duty of care is a recognition of the trust a seller places in an auctioneer.

CRUIKSHANK V. HORN, 386 N.W.134 (IOWA CT. APP. 1986).

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TERMS AND AUTHENTICITY OF GOODS

Question: What terms should auctioneers consider including in their auction contract regarding the authenticity of goods?

It depends on what is being sold and your business. The sale of unauthorized replica and counterfeit goods is illegal. Counterfeiting is a form of trademark infringement. It's the act of making or selling lookalike goods or services bearing fake trademarks. The sale of counterfeit goods could have an impact on the auctioneer, auctioneer's reputation, and the auctioneer's business. Therefore, specific issues relating to authenticity should be evaluated to determine whether they should be addressed in the auction contract.

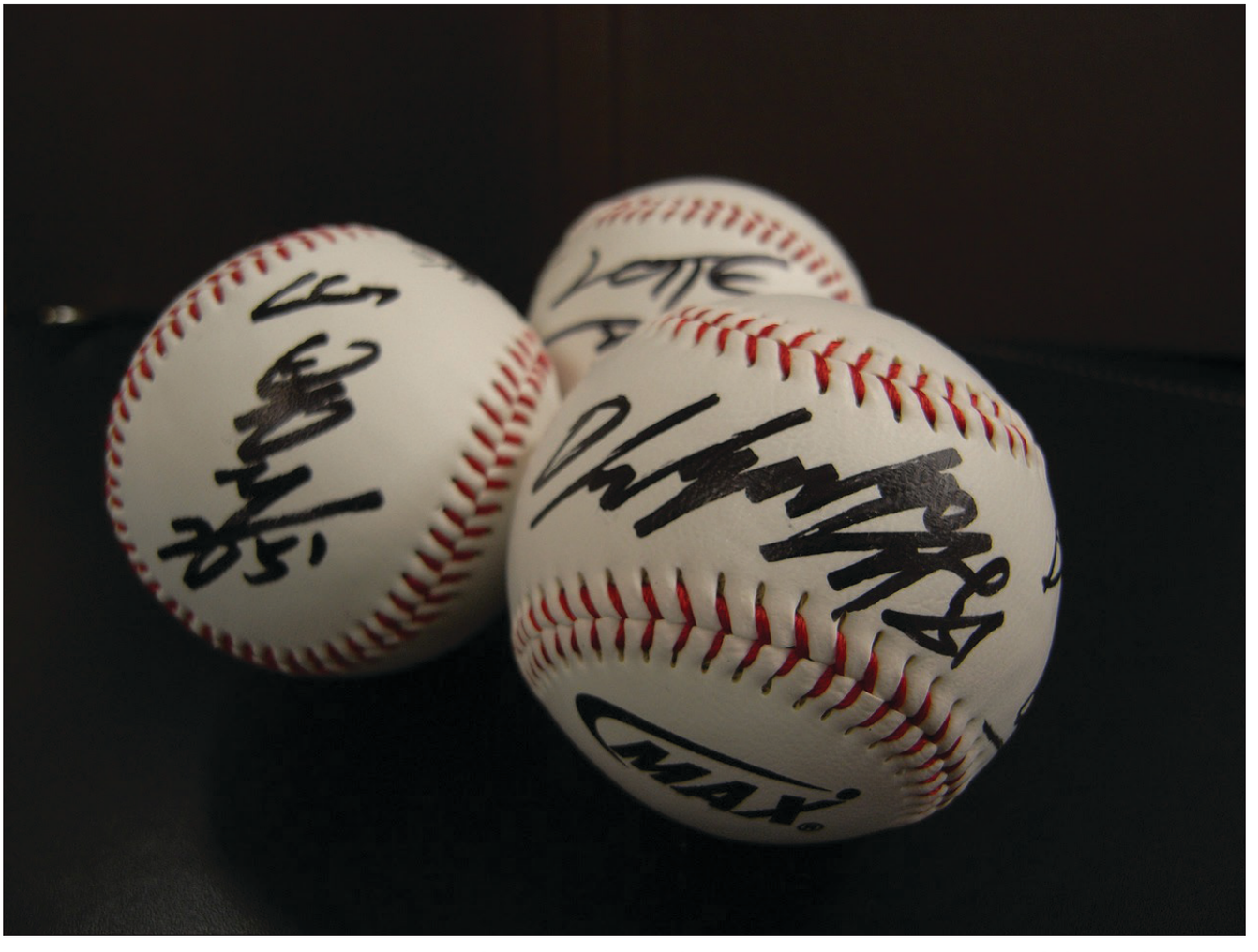
First, who are your sellers and bidders? There is a broad range of approaches to this issue. I have worked with auctioneers who require each seller to represent and warrant the authenticity of the goods that will be sold. I have also worked with auctioneers who do not require each seller to represent and warrant the authenticity of the goods that will be sold. Some auctioneers require certain goods to be reviewed by an expert to verify authenticity and/or grading. Other auctioneers do not require goods to be evaluated and/or graded by an expert. From my perspective, the best practice is to (at least) require the seller to represent and warrant that the goods are authentic. Auctioneers should exercise caution before agreeing to help a seller who is not sure of the authenticity of his or her goods and is unwilling to find out. This policy helps protect your bidders from purchasing illegal merchandise, protects your reputation, and helps intellectual property rights owners protect their rights.

Second, what should an auctioneer do when there is a dispute regarding the authenticity of an item? If the seller states that Lot 16 is authentic and the buyer says that it is not, the auctioneer may find himself or herself in the middle. Both parties could be demanding the money from the auctioneer. In addition, there may be statutory or administrative requirements that auctioneers pay the seller within a specific period of time. Is there

an exception when there is a dispute regarding the authenticity of specific goods? In some situations, it may be appropriate for an auctioneer to file an interpleader action. An interpleader action is a lawsuit to compel two or more parties to litigate a dispute. An auctioneer, for example, could file an interpleader action naming both the seller and the buyer to have them fight out the authenticity issue. This type of action is often used by a party who holds the property of another, but does not know who is entitled to it.

Third, if an auctioneer takes possession of goods to have them evaluated and graded by an expert, who chooses the expert? Who covers the costs of the expert's evaluation? Who bears the risk of loss if the goods are damaged or destroyed? What happens if it is not authentic? Who is responsible for the cost of shipping the items to the expert for evaluation? What happens if the item is destroyed while traveling to or from the expert to the auctioneer? Is there insurance on the goods? If so, is it the seller's insurance or the auctioneer's? What is the insured value of the goods? The auction contract should answer these key questions.

Authenticity issues are coming up more frequently. It is not just for art auctions anymore. Comic books, sports memorabilia, autographs and other goods can also be evaluated for authenticity and graded. The best practice is to include specific terms in the auction contract to address these issues. Including specific terms related to these issues in the auction contract reduces the likelihood of dispute and costly litigation.



Auctioneers should exercise caution before agreeing to help a seller who is not sure of the authenticity of his or her goods and is unwilling to find out.

ARE WRITTEN CONTRACTS NECESSARY?

Question: Is there any reason for a licensed auctioneer to not have a written auction contract with each and every seller?

No. The auction contract is essential to protecting the auctioneer.

An auctioneer should have a written contract with each and every seller in order to protect himself or herself, even when it is not required by state law. The contract should be as clear and concise as possible based on the circumstances. It should be written in plain English (without unnecessary legalese) by a licensed attorney and explain the terms of the auction and how the auctioneer will be paid.

An auctioneer is the agent of the seller. The agency relationship is created by each party's agreement and consent to the relationship. In general terms, the seller must agree to permit the auctioneer to act on his or her behalf and the auctioneer must agree to act on behalf of the seller. In the auction industry, this normally takes place when the auctioneer and seller execute the written auction contract.

The contract should establish the parties' agreement to the agency relationship and the terms of the agreement. In the event there is a legal dispute over whether an agency relationship exists, the person seeking to establish the agency relationship has the burden to prove it. The best evidence of an agency relationship is the auction contract between the parties establishing the consent of the parties to the relationship and its terms.

The authority of the auctioneer is essential to the agency relationship. The seller defines the scope of the undertaking and gives the agent the authority he or she needs to accomplish the assigned task. The auctioneer's authority is limited to the specific authority granted. The auctioneer's authority to act on behalf of the seller should be clearly established in the auction contract. The authority of an auctioneer may be in general terms and be as broad as the seller chooses to make it. The seller may grant power to the agent to exercise judgment and broad discretion.

If it does not state that the auctioneer has the authority to do a specific act, then the auctioneer should assume he or she does not have authority to do the specific act. If the auctioneer is authorized to sell a boat, for example, the auctioneer does not have authority to sell the seller's truck. If the auction

contract does not give the auctioneer authority to charge a buyer's premium, the auctioneer should not charge a buyer's premium.

Furthermore, if a seller breaches the auction contract, the auctioneer needs to be able to prove that an agreement existed and the seller authorized the sale of the property. In addition, the auctioneer needs to be able to prove the essential terms of the contract. Individuals can unintentionally forget the details of an oral contract. Plus, some individuals are untruthful. A written contract will definitively establish the terms of the auction and avoid a "he said/she said" dispute. As it has been said by many "a verbal contract isn't worth the paper it is written on."

Because of the importance of the auction contract, several states have laws or regulations which require an auctioneer to have a written contract with the seller. The State of Indiana licensing statute, for example, states that "no [auctioneer] shall sell goods or real estate at auction until the auctioneer or auction company involved has first entered into a written contract with the owner or consignor of such goods or real estate, which contract sets forth the terms and conditions upon which such auctioneer or auction company accepts the goods or real estate for sale." Indiana Code § 25-6.1-6-4.

Florida law also requires an auctioneer or auction business to have a written agreement with the owner of the property to be sold. Florida Statutes Annotated § 468.388. Florida requires the auction contract to state "(a) the name and address of the owner of the property; (b) the name and address of the person employing the auctioneer or auction business, if different from the owner; and (c) the terms and conditions upon which the auctioneer or auction business will receive the property for sale and remit the sales proceeds to the owner." F.S.A. § 468.388(1).

Several other states require written auction contracts. I am shocked to see auctioneers still being disciplined for the failure to enter into a written auction contract. An auctioneer was disciplined by the Illinois Department of Financial and Professional Regulation in November of 2016. A real estate auctioneer was fined $500.00 for failure to enter into a written auction contract prior to the date of the auction and for failure to provide documents. While the fine itself is not significant, being publicly disciplined and the related reporting requirements are significant.

It is time to review the basics and make sure the essentials are in place. Auctioneers should make sure a written auction contract is prepared and signed prior to prior to the auctioneer doing any work.

LEGAL OPTIONS FOR AUCTIONS WITH RESERVES

Question: What happens when bids fail to meet the reserve at an auction with reserve? Can a seller waive the reserve and accept a bid below the reserve amount?

Before getting to the answer of these questions, it is important to remind auctioneers of the key differences between auctions with reserves and auctions without reserves. In an auction with reserve, the seller, in placing the property up for auction, is merely advising the public of its willingness to entertain bids. Each bid constitutes an offer, which the seller is not obligated to accept. Conversely, in an auction without reserve—also commonly known as an "absolute auction,"—the seller, through its agent (the auctioneer) is deemed to make an offer by virtue of putting the property up for auction. Each bid made on the property is an acceptance and therefore forms a contract, subject only to the contingencies of a higher bid/acceptance or the withdrawal of the bid made before the fall of the hammer, i.e., the conclusion of the auction.

So, what happens when the bids fail to meet the reserve at an auction with reserves? In an auction with reserve, the seller reserves the right not to sell the property and can withdraw the property from the auction before acceptance of the highest bid. See UCC 2-328(3) ("In an auction with reserve the auctioneer may withdraw the goods at any time until he announces completion of the sale."). At an auction with reserve, this generally means the seller may choose to withdraw the property at any time before the fall of the hammer. If the highest bid is too low the offer is not accepted and no contract is formed.

In 2008, the Supreme Court of New Hampshire had the opportunity to consider what happens after the auction if the bids are less than the reserve and the seller wants to complete the transaction. Foley v. Wheelock, 950 A.2d 178 (N.H. Sup. 2008). The essential facts of the case are interesting. There were two owners of real estate who decided they could not get along. One individual filed a lawsuit requesting the court to partition the real estate.

The reserve price limits the auctioneer's authority to accept a bid on behalf of the seller but does not limit the seller's authority to waive the reserve and accept a bid below the reserve.

Because they could not resolve their dispute, the court ordered the property to be sold at a public auction with a reserve of $179,000. The auction was advertised and five qualified bidders participated. At the end of the auction, the high bid was only $140,000. Despite the reserve of $179,000, the trial court decided to accept the bid and complete the sale. The other party objected and later appealed. The Supreme Court of New Hampshire affirmed the decision of the trial court. It stated that the law generally does not prevent "a seller, after having held an auction 'with reserve' at which the reserve price was not met, from subsequently accepting a sub-reserve offer for his property. In such circumstances, a sale may still be consummated by the seller's acceptance of an offer." It continued, "In other words, while a seller who reserve price has not been met at auction is under no further obligation to complete the transaction, this does not mean the seller cannot subsequently accept a sub-reserve price." The reserve is established by the seller to protect the seller, but the seller can waive the reserve.

The Supreme Court of New Hampshire explained: "A reserve price is not an immovable minimum price at which bidding must start; it acts only as a floor below which bids need not be automatically accepted by the seller." The reserve price limits the auctioneer's authority to accept a bid on behalf of the seller but does not limit the seller's authority to waive the reserve and accept a bid below the reserve.

There are some issues relating to documentation and authority auctioneers should consider. For example, the best practice would be for any acceptance of a bid below the reserve price to be in writing. Otherwise, if the seller later denies accepting a bid below the reserve price, it exposes an auctioneer to possible litigation. When the seller is a trust, estate, corporation, or LLC, there could be questions as to who has authority to make the decision and sign the document accepting a bid for less than the reserve price. For corporations and LLCs, is the resolution granting authority broad enough to include acceptance of a price below the reserve? Auctioneers should consider these issues and adopt policies and procedures to protect themselves.

Auctioneers must be aware of these issues. An auctioneer does not have authority to accept a bid that is less than the reserve price set by the seller, unless the seller specifically waives the reserve and decides to accept the highest bid.