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IN RE GOOD DEAL SUPERMARKETS, INC.:
A HASTY INVALIDATION OF UCC § 2-702(2) AS A
STATUTORY LIEN UNDER § 67(c)(1)(A) OF THE
BANKRUPTCY ACT

A seller who sells goods on credit to an insolvent buyer may reclaim the goods under § 2-702(2) of the Uniform Commercial Code¹ if he demands their return within ten days of the buyer's receipt. The ten day requirement is inapplicable, however, if the buyer makes a written misrepresentation of his solvency to the seller within three months before he receives the goods.² This right of reclamation is based on the common law right of rescission whereby a seller could rescind a sales contract and recover the goods upon a showing that the buyer obtained them fraudulently.³ The UCC provision relaxes the burden of proving fraud placed on earlier sellers by treating any insolvent buyer's receipt of goods on credit as a tacit business misrepresentation of solvency, and therefore fraudulent as against the particular seller.⁴ The right is limited, however, by § 2-702(3) of the Code.⁵

Subsection (3) of § 2-702 subordinates the seller's claim to the rights of buyers in the ordinary course of business and good faith purchasers who take the goods from the insolvent buyer prior to the seller's demand for their return. The limitation is based on apparent ownership and other estoppel theories⁶ adhered to in § 2-403 of the

¹ UNIFORM COMMERCIAL CODE [hereinafter UCC] § 2-702(2) provides:

Where the seller discovers that the buyer has received goods on credit while insolvent he may reclaim the goods upon demand made within ten days after the receipt, but if misrepresentation of solvency has been made to the particular seller in writing within three months before delivery the ten day limitation does not apply. Except as provided in this subsection the seller may not base a right to reclaim goods on the buyer's fraudulent or innocent misrepresentation of solvency or of intent to pay.

Id.

² *Id.*

³ 4A W. COLLIER, BANKRUPTCY ¶ 70.41 at 483 (14th ed. 1971) [hereinafter cited as COLLIER].

⁴ UCC § 2-702, Comment 2.

⁵ UCC § 2-702(3) provides:

The seller's right to reclaim under subsection (2) is subject to the rights of a buyer in ordinary course or other good faith purchaser under this Article (Section 2-403). Successful reclamation of goods excludes all other remedies with respect to them.

⁶ UCC § 2-403, Comment 1. The rationale behind the limitation is to protect subsequent purchasers, without notice, who take the goods from the buyer relying on his possession as an indication of his ownership.

UCC,⁷ which outlines the rights of such buyers and purchasers. As no other limitation is placed on the seller's right to reclaim, in the absence of such buyer or purchaser a seller who meets the requirements of § 2-702(2) should have little difficulty recovering his goods. The probable intervention of bankruptcy in most cases, however, raises a serious problem with regard to the seller's right to the goods when opposed by a trustee in bankruptcy.

Section 67(c)(1)(A) of the Bankruptcy Act⁸ invalidates as against the trustee "every statutory lien which first becomes effective upon the insolvency of the debtor."⁹ Thus a trustee, pointing out that the seller's right to reclaim is premised on the presence of an insolvent buyer, arguably need only show that § 2-702(2) is a statutory lien in order to defeat the seller's claim. In the recent case, *In re Good Deal Supermarkets, Inc.*,¹⁰ the court was of the opinion that the trustee made such a showing, and therefore held the seller's reclamation invalid in bankruptcy under § 67(c)(1)(A).

In the *Good Deal* case, the seller-petitioner delivered a quantity of potatoes to Good Deal Supermarkets, Inc., on credit on June 13, 1973. The following day Good Deal filed a petition for arrangement under Chapter XI of the Bankruptcy Act. On June 19, 1973, within the ten day reclamation period set out by the New Jersey version of § 2-702(2) of the UCC,¹¹ the seller demanded the return of the potatoes. Upon Good Deal's failure to comply with this demand, the seller sought relief before the bankruptcy court. In defense, the trustee raised the issue whether the New Jersey Code provision was a statutory lien invalidated in bankruptcy by § 67(c)(1)(A) of the Bankruptcy Act. The bankruptcy court ruled in favor of the trustee, and the seller appealed to the United States District Court for the District of New Jersey.

In affirming the bankruptcy court's ruling, the district court examined the "purpose and effect"¹² of both the New Jersey Code provision and § 67(c)(1)(A) of the Bankruptcy Act. The court first stated that § 2-702(2) of the Code had the effect of benefiting a particular class of creditors and promoting a state created priority. Analogizing these characteristics of § 2-702(2) to the characteristics of other state statutory liens, the court then deemed them to be "the very evils"

⁷ UCC § 2-403.

⁸ Bankruptcy Act § 67(c)(1)(A), 11 U.S.C. § 107(c)(1)(A) (1970).

⁹ *Id.*

¹⁰ 15 UCC REP. SERV. 624 (D.N.J. 1974).

¹¹ N.J.S.A. 12A:2-702(2) (Supp. 1974).

¹² 15 UCC REP. SERV. at 625.

which § 67(c)(1)(A) of the Bankruptcy Act was designed to eliminate.¹³ The court supported this conclusion by pointing out that the 1966 amendment to § 67(c)(1)(A) of the Act¹⁴ was directed at state created statutory liens which promoted priorities contrary to those established under the Act.¹⁵ Because § 2-702(2) of the New Jersey Code "disrupt[ed] the federally created order of priorities just as surely as those state created priorities specifically designated as 'liens,'" ¹⁶ the court concluded that it could have no application in a bankruptcy proceeding.

The court's holding that § 2-702(2) of the UCC is a statutory lien within the purview of the Bankruptcy Act serves notice that a reclaiming seller may never recover fraudulently obtained goods when opposed by the buyer's trustee in bankruptcy. The absolute effect of this rationale should have encouraged the court to make a more thorough examination of the purpose and effect of the Code and bankruptcy provisions in question. Such an examination would have revealed that the issue was more complicated than the court's opinion indicates. Indeed, had the court given the necessary attention to the history of § 2-702(2) of the Code and § 67(c)(1)(A) of the Bankruptcy Act, it might easily have reached the opposite result.

Prior to the enactment of the UCC, most states permitted a seller of goods to rescind a sales contract and recover the property from the buyer only upon a showing that he was induced to enter the contract by the buyer's fraudulent misrepresentation.¹⁷ Although the fraud in such cases might relate to any material aspect of the sale,¹⁸ it most often concerned the buyer's misrepresentation of his financial condition. As a result, bankruptcy frequently intervened between the bargain and the seller's attempt to rescind. The intervention had little effect on the seller's right,¹⁹ however, as the trustee in bankruptcy

¹³ *Id.* at 626.

¹⁴ The 1966 amendment to § 67(c)(1)(A) of the Bankruptcy Act is discussed in the text accompanying notes 53-60 *infra*.

¹⁵ The priority order for bankruptcy is described in Bankruptcy Act § 64, 11 U.S.C. § 104 (1970).

¹⁶ 15 UCC REP. SERV. at 626.

¹⁷ 4A COLLIER ¶ 70.41 at 483.

¹⁸ An example of fraudulent conduct not involving a misrepresentation of solvency would be a buyer's falsification of identity. *See* National Silver Co. v. Nicholas, 205 F.2d 52 (5th Cir. 1953) (seller failed to prove fraud alleged).

¹⁹ The only difficulty the seller might have encountered arose from § 70(c) of the Bankruptcy Act. Bankruptcy Act § 70(c), 11 U.S.C. § 110(c) (1970). That section gives the trustee, on the date of the filing of the petition, the rights of a lien creditor by legal or equitable proceedings. *Id.* Most states, however, held the rights of the reclaiming seller superior to those of a lien creditor. 4A COLLIER ¶ 70.41 at 485. One exception arose

took title to the bankrupt's property subject to revestment in the seller upon rescission.²⁰ The real difficulty for the seller lay in proving fraud.

The states generally required the seller to demonstrate conclusively that he was induced to enter the contract by an insolvent buyer who concealed his insolvency and who had no intention to pay for the goods.²¹ However, presumably because a demonstrable intent not to pay was too difficult to establish in the majority of cases, other courts concluded that such intent was present where the buyer was aware that he was hopelessly insolvent.²² Their decisions were based on the valid presumption that when an insolvent person orders goods, he has done so with an intent not to pay for them. The most persuasive language supporting the utilization of this rationale was employed by Judge Learned Hand in *California Conserving Co. v. D'Avanzo*:²³

[A] man's affairs may reach such a pass that ordinarily honest persons would no longer buy, if they had no greater chance to pay; and the seller is entitled to rely upon that implication. He may assume that the buyer would not promise if the odds were so heavy against him. . . . In that event, if the buyer knows that he has no such hope, he deceives the seller, as much as though he intended not to pay at all.²⁴

Despite the existence of this trend toward lessening the seller's burden,²⁵ most courts nevertheless required the seller to establish fraudulent conduct by proving a demonstrable intent not to pay in order to recover the goods.²⁶ Thus, in cases where an insolvent buyer

in cases where the bankrupt was a trader and the state had a traders act. *Id.* See *Waltham Piano Co. v. Smith*, 37 F.2d 534 (4th Cir. 1930).

²⁰ *Donaldson v. Farwell*, 93 U.S. 631 (1876); 4A COLLIER ¶ 70.41 at 483.

²¹ The requirement that the seller prove that at the time of the sale the buyer had no intention to pay for the goods was established in *Donaldson v. Farwell*, 93 U.S. 631, 633-34 (1876). Most of the later cases, until enactment of the UCC in the particular state, maintained this precedent. See *Countryman, Buyers and Sellers of Goods in Bankruptcy*, 1 N. MEX. L. REV. 435, 454 (1971).

²² See, e.g., *Sternberg v. American Snuff Co.*, 69 F.2d 307 (8th Cir. 1934); *California Conserving Co. v. D'Avanzo*, 62 F.2d 528 (2d Cir. 1933); *Elbro Knitting Mills v. Schwartz*, 30 F.2d 10 (6th Cir. 1929); *Manly v. Ohio Shoe Co.*, 25 F.2d 384 (4th Cir. 1928).

²³ 62 F.2d 528 (2d Cir. 1933).

²⁴ *Id.* at 530.

²⁵ The trend is generally represented by the cases cited in note 22 *supra*. However, there is slight authority supporting rescission and recovery on an even less exacting standard: the buyer's innocent misrepresentation of solvency. See 4A COLLIER ¶ 70.41 at 487.

²⁶ See, e.g., *United Construction Co. v. Milam*, 124 F.2d 670 (6th Cir.), *cert.*

purchased goods in reliance on a long line of credit which suddenly dried up,²⁷ or where officers of the buyer company were negligently unaware of their company's insolvency,²⁸ or where the buyer merely had an illusory²⁹ intention to pay, pre-Code courts held that there was no fraud and the seller had no right to rescind. Because of the various results in the courts as well as the unrealistic burden imposed on the seller in those jurisdictions requiring a demonstrable intent not to pay, the drafters of the UCC attempted to ease the burden of the defrauded seller.³⁰ Therefore, Code § 2-702(2) relieves the seller of the requirement of proving fraud, an insolvent buyer's receipt of the goods being conclusive on the matter.³¹ However, contrary to Professor Llewellyn's belief that the broadened power of reclamation given the seller by § 2-702(2) "should find acceptance and approval in the bankruptcy courts,"³² it has faced stiff challenge by trustees since its inception.

The initial challenge arose from a limitation placed upon the seller's right to reclaim by § 2-702(3) of the Code. This section, prior to a 1966 amendment, subjected the seller's right to the rights of a lien creditor, or one who obtained a lien on the property in the buyer's possession before the seller reclaimed his goods. Since § 70(c) of the Bankruptcy Act³³ specifically grants the trustee in bankruptcy the powers of a lien creditor under applicable state law, the intervention of bankruptcy gave rise to the question whether the trustee's power was superior to the right of a subsequent reclaiming seller. Because § 2-702(3) of the UCC merely stated that the seller's claim was "subject" to the rights of a lien creditor, and those rights were not clearly defined elsewhere in the Code,³⁴ the issue of who should prevail be-

denied, 317 U.S. 642 (1942); *Rochford v. New York Fruit Auction Corp.*, 116 F.2d 584 (2d Cir. 1940); *In re Tate-Jones & Co., Inc.*, 85 F. Supp. 971 (W.D. Pa. 1949); *John Heidsik Co. v. Rechter*, 291 Mich. 708, 289 N.W. 304 (1939).

²⁷ *Schroth v. Monarch Fence Co.*, 229 F. 549 (6th Cir. 1916).

²⁸ *In re General Lumber Products Co.*, 21 F.2d 979 (D. Md. 1927).

²⁹ *In re Paper City Mill Supply Co.*, 28 F.2d 115 (D. Mass. 1928).

³⁰ Llewellyn, *Memorandum in N.Y. Law Rev. Comm'n, Report and Record of Hearings on the Uniform Commercial Code*, Legis. Doc. No. 65, 126 (1954).

³¹ See note 4 and accompanying text *supra*.

³² Llewellyn, *Memorandum in N.Y. Law Rev. Comm'n, Report and Record of Hearings on the Uniform Commercial Code*, Legis. Doc. No. 65, 126 (1954).

³³ Bankruptcy Act § 70(c), 11 U.S.C. § 110(c) (1970). The trustee in bankruptcy is also granted the status of lien creditor in Article 9 of the UCC. UCC § 9-301(3).

³⁴ UCC § 9-301(1)(b) does contain a statement of the rights of a lien creditor. However, those rights are only defined as they pertain to the holder of a security interest. This merely raises the issue whether § 2-702(2) grants a security interest. Although it has been suggested that the seller does have a security interest, perfectable

came a subject of great controversy.³⁵

Due to this controversy, the Code's Permanent Editorial Board recommended the deletion of the lien creditor limitation in 1966.³⁶ The purpose of the proposed deletion was to eliminate the Code's confusing cross-reference regarding the rights of lien creditors as well as to establish uniformity among the states.³⁷ Since § 70(c) of the Bankruptcy Act gives the trustee only the power of a lien creditor under applicable state law, the amendment should finally resolve the priority controversy in favor of the defrauded seller. The applicable state law is the UCC, and § 2-702(3) specifically designates those who may prevail over a reclaiming seller. The purposeful deletion of lien creditors from § 2-702(3) should thus result in the interpretation that a lienor may not prevent a reclaiming seller from recovering his goods.³⁸ Because of the uncertain result under former § 2-702, and the

on demand for the goods, apparently no court has adopted this rationale. See 4A COLLIER ¶ 70.62A at 720-21.

³⁵ The controversy arose primarily among the commentators, whose various solutions are briefly but accurately summarized in Note, *In re Federal's Inc.: A New Way For the Trustee in Bankruptcy to Defeat a Reclaiming Seller*, 35 U. PRRT. L. REV. 922 (1974). In contrast to the popularity of the lien creditor problem among the writers, only two courts have been confronted with the issue. In these cases, *In re Mel Golde Shoes, Inc.*, 403 F.2d 658 (6th Cir. 1968), and *In re Kravitz*, 278 F.2d 820 (3d Cir. 1960), both the Sixth and Third Circuits adopted similar interpretations of § 2-702(3) but reached different results. Both courts realized that the seller's claim was subject to the rights of an intervening lien creditor, and concluded that the rights of the latter, vis-a-vis the reclaiming seller, were undefined in the Code. Thus, they found resort to the appropriate pre-Code state law necessary for determining who should prevail. The Sixth Circuit, applying Kentucky law, concluded that the rights of the reclaiming seller were superior; the Third Circuit reached the opposite result under Pennsylvania law. Assuming the courts' resort to pre-Code state law correct, the results in other states would also differ according to the particular rights granted lien creditors and reclaiming sellers in the identical situation.

³⁶ U.C.C. PERMANENT EDITORIAL BOARD, 1966 OFFICIAL RECOMMENDATIONS FOR AMENDMENT OF THE U.C.C. 3 (1967).

³⁷ *Id.* The cross-reference referred to in the Board's recommendations is found in UCC § 2-702(3). That section directs the reader to § 2-403 of the Code for the rights of a lien creditor. Section 2-403 does not define these rights, however, but further cross-references the reader to Articles 6, 7 and 9. The ensuing search reveals that only § 9-301(3) provides any definition of a lienor's rights, and as suggested in note 35 *supra*, the applicability of that section is questionable. The initial cross-reference then offers no clarification of the rights of lien creditors, and the Board's conclusion that it is confusing appears sound.

³⁸ It should be noted that an alternative interpretation, that it is necessary to look to pre-Code state law because § 2-702 contains no provision as regards the rights of a lien creditor against a reclaiming seller, may be offered. The result, however, would be altered in only the few jurisdictions which previously held the rights of a lien creditor superior. Moreover, the interpretation offered in the text seems more reasona-

probable success of the reclaiming seller after the amendment, trustees were forced to turn to § 67(c)(1)(A) of the Bankruptcy Act as a means of defeating the defrauded seller's rights in bankruptcy.

Section 67(c)(1)(A), which invalidates all statutory liens that become effective on a debtor's insolvency, is the last in a long line of bankruptcy legislation aimed at preventing state legislatures from creating priorities in favor of certain classes of creditors.³⁹ The history of this legislation reveals that all liens, whether consensual or nonconsensual, were originally held to be valid in bankruptcy unless invalidated by some specific provision of the Bankruptcy Act.⁴⁰ The Chandler Act of 1938⁴¹ codified this case law in § 67(b),⁴² which validated all statutory liens including those "arising or perfected while the debtor is insolvent and within four months prior to the filing of the petition" in bankruptcy.⁴³ At the same time, Congress invalidated virtually all state created priorities because they disturbed the order of priority established in § 64 of the Act.⁴⁴ In addition, the Chandler Act subordinated payment of valid statutory liens to the federal administration and wage priorities because so many statutory liens had been created that they often exhausted the bankrupt's estate, leaving these priorities unpaid.⁴⁵ As a result of these developments, many state legislatures converted what would have been invalid priorities into statutory liens under the pressure of various creditor groups.⁴⁶ This proliferation of priorities as liens because of the advantageous position of statutory liens on the priority ladder presented grave difficulties for the uniform priority scheme which Congress had sought to establish.

To "check the growing trend in State statutes of labelling as 'liens' what essentially are 'priorities,'" and to further the objective of the Chandler Act "to build up, as far as feasible and equitable, the resi-

ble since the drafters of § 2-702(3) designated those whose rights should be considered, and the omission of lien creditors indicates that their rights should never prevail over those of a reclaiming seller.

³⁹ See S. REP. NO. 1159, 89th Cong., 2d Sess. (1966) [hereinafter cited as S. REP. 1159], reprinted in 2 U.S. CODE CONG. & AD. NEWS (1966) 2459.

⁴⁰ 4 COLLIER ¶ 67.20 at 211.

⁴¹ Act of June 22, 1938, ch. 575, §§ 1-703, 52 Stat. 840.

⁴² Act of June 22, 1938, ch. 575, § 67(b), 52 Stat. 876.

⁴³ *Id.* at 876-77.

⁴⁴ Bankruptcy Act § 64, 11 U.S.C. § 104 (1970). See S. REP. NO. 1159, 2 U.S. CODE CONG. & AD. NEWS (1966) 2456-57.

⁴⁵ Act of June 22, 1938, ch. 575, § 67(c), 52 Stat. 877. See S. REP. 1159, 2 U.S. CODE CONG. & AD. NEWS (1966) 2457.

⁴⁶ S. REP. 1159, 2 U.S. CODE CONG. & AD. NEWS (1966) 2457.

dual fund for distribution among the general unsecured creditors,⁴⁷ Congress again amended the statutory lien provisions of the Bankruptcy Act in 1952.⁴⁸ The most important change effected by these amendments took place in § 67(c)(2),⁴⁹ which invalidated as against the trustee all state created statutory liens attached to personal property and not accompanied by possession, levy, sequestration, or distraint. Like the Chandler Act before them, however, the 1952 amendments created additional problems: § 67(c)(2) invalidated some legitimate devices while leaving other clearly disguised priorities untouched;⁵⁰ it was unclear whether the possession standard was one of actual or constructive possession;⁵¹ and a priority conflict arose with regard to the proper method of satisfying tax liens.⁵² These difficulties necessitated another revision of the § 67 lien provisions in 1966.⁵³

Under the 1966 amendment Congress successfully eliminated the tax lien priority problem presented by the 1952 amendments.⁵⁴ In addition, the possession criteria and the distinction between real and personal property were dropped as grounds for invalidation of statutory liens. Instead, Congress adopted new standards for invalidation in § 67(c)(1) of the Act. These criteria provide that all statutory liens which arise upon the insolvency of the debtor,⁵⁵ or which are not perfected or enforceable against a bona fide purchaser from the debtor on the date of bankruptcy,⁵⁶ or which are for rent⁵⁷ are invalid against the trustee. To preclude the possibility that some legitimate security devices might be considered statutory liens because their effectiveness depended on state recordation statutes,⁵⁸ Congress also

⁴⁷ Weinstein, *Amendments to the Bankruptcy Act as Proposed and Pending Before the Congress*, 24 REF. J. 28, 32 (1950).

⁴⁸ Act of July 7, 1952, ch. 579, §§ 1-54, 66 Stat. 420.

⁴⁹ Act of July 7, 1952, ch. 579, § 21, 66 Stat. 428.

⁵⁰ S. REP. 1159, 2 U.S. CODE CONG. & AD. NEWS (1966) 2461.

⁵¹ Compare *City of New York v. Hall*, 139 F.2d 935 (2d Cir. 1944) (requiring actual possession) with *Davis v. City of New York*, 119 F.2d 559 (2d Cir. 1941) (allowing levy followed by seizure). See 4 COLLIER ¶ 67.281 at 415 n.8.

⁵² S. REP. 1159, 2 U.S. CODE CONG. & AD. NEWS (1966) 2458-59. For a thorough discussion of the shortcomings of the 1952 amendment regarding statutory liens, see Kennedy, *Statutory Liens in Bankruptcy*, 39 MINN. L. REV. 697 (1955).

⁵³ Act of July 5, 1966, Pub. L. No. 89-495, § 4, 80 Stat. 268-69. 11 U.S.C. § 107(c) (1970).

⁵⁴ Bankruptcy Act § 67(c)(3), 11 U.S.C. § 107(c)(3) (1970).

⁵⁵ Bankruptcy Act § 67(c)(1)(A), 11 U.S.C. § 107(c)(1)(A) (1970).

⁵⁶ Bankruptcy Act § 67(c)(1)(B), 11 U.S.C. § 107(c)(1)(B) (1970).

⁵⁷ Bankruptcy Act § 67(c)(1)(C), 11 U.S.C. § 107(c)(1)(C) (1970).

⁵⁸ S. REP. 1159, 2 U.S. CODE CONG. & AD. NEWS (1966) 2460.

added § 1(29a) to the Bankruptcy Act.⁵⁹ This section defines "statutory lien" as:

a lien arising solely by force of statute upon specified circumstances or conditions, but shall not include any lien provided by or dependent upon an agreement to give security, whether or not such lien is also dependent upon statute and whether or not the agreement is made fully effective by statute.⁶⁰

While this definition adequately serves the purpose for which it was designed, it does not actually define the term "lien." The lack of such definition raises the issue whether certain statutes, not specifically designated as liens, are in fact "statutory liens" subject to the invalidation provisions of § 67(c)(1). In the *Good Deal* case, the New Jersey district court was confronted with this problem in its examination of § 2-702(2) of the UCC. Despite the lack of specific guidance, the court nevertheless found that § 2-702(2) was a statutory lien invalid in bankruptcy under § 67(c)(1)(A). In light of the history of the relevant Code and Bankruptcy provisions, particularly with regard to the relative validity of the defrauded seller's right of rescission in bankruptcy and the attempted continuation of this right in § 2-702(2) of the Code, it appears that the district court drew too hasty a conclusion.

The district court in *Good Deal* focused on the "purpose and effect" of UCC § 2-702(2) in deciding first that it was a statutory lien and then concluding that it was invalidated by § 67(c)(1)(A) of the Bankruptcy Act. In deciding the first issue the court apparently found it unnecessary to discuss whether the seller's right was indeed statutory. Although it may be argued that § 2-702(2) of the Code is merely a codification of common law and therefore not comprehended within the meaning of the term "statutory,"⁶¹ it appears the district court was correct in overlooking this position. One court has previously declared a banker's lien to be a statutory lien even though the

⁵⁹ Act of July 5, 1966, Pub. L. No. 89-495, § 1, 80 Stat. 268, 11 U.S.C. § 1(29a) (1970). The amendment arose from the Third Circuit's decision in *In re Quaker City Uniform Co.*, BANKR. L. REP. ¶ 58,728 (2d Cir. 1955), which labelled a chattel mortgage dependent upon a state recordation statute for effectiveness against subsequent purchasers, a statutory lien. Although the decision was later withdrawn in *In re Quaker City Uniform Co.*, 238 F.2d 155 (3d Cir. 1956), and expressly rejected in *In re New Haven Watch & Clock Co.*, 253 F.2d 577, 582 (2d Cir. 1958), Congress apparently felt the need to finally resolve the issue.

⁶⁰ Bankruptcy Act § 1(29a), 11 U.S.C. § 1(29a) (1970).

⁶¹ It should be noted that the invalidation provisions of § 67(c) of the Bankruptcy Act only apply to "statutory liens." Thus, even if the common law right of rescission and reclamation is adjudged a lien, any conclusion that it is not a "statutory" right within the meaning of § 67(c) would remove it from possible invalidation.

statute defining the lien only codified common law.⁶² Moreover, a decision that statutes codifying the common law are not included within the term "statutory" would create severe practical problems. Courts would be forced into the unenviable task of comparing statutes to their common law equivalents, measuring the changes made in codification, and deciding in each case whether the statute corresponded sufficiently to the common law to avoid inclusion within the term. For these reasons, it seems the New Jersey district court was at least on firm ground in giving no attention to the "statutory" argument. The court's decision that § 2-702(2) is a "lien," however, is questionable at best.

The district court analogized § 2-702(2) to other state statutory liens because it benefits "a particular class of creditors and tends to promote a state created priority."⁶³ Regardless of whether these are indeed characteristics of § 2-702(2), the court failed to complete the analogy, overlooking the fact that the seller does not possess ordinary lien rights. Normally, a lienor may force a sale of "the subject property to satisfy the indebtedness and recover or claim any deficiency resulting thereon from the debtor as an unsecured creditor."⁶⁴ Under § 2-702, however, the reclaiming seller has no further remedy beyond successful reclamation of the goods.⁶⁵ The absence of the power to realize the § 2-702(2) right by forcing a sale of the property, combined with the exclusion of the right to claim for the difference between resale and contract price, provides strong evidence that § 2-702(2) is not a lien.⁶⁶ The district court was remiss in not carrying the analogy

⁶² *Goggin v. Bank of America Nat. Trust & Sav. Ass'n.*, 183 F.2d 322 (9th Cir.), cert. denied, 340 U.S. 877 (1950).

⁶³ 15 UCC REP. SERV. at 626.

⁶⁴ 4A COLLIER ¶ 70.41 at 493. The editors of COLLIER have previously raised the argument presented in the text, that § 2-702(2) does not confer ordinary lien rights. Nevertheless, the district court in *Good Deal* completely overlooked it.

⁶⁵ UCC § 2-702(3).

⁶⁶ Professor Countryman in his article *Buyers and Sellers of Goods in Bankruptcy*, 1 N. MEX. L. REV. 435, 455 (1971), suggests that a seller invoking UCC § 2-702(2) will have difficulty distinguishing it from the vendor's privilege held a statutory lien in *In re Trahan*, 283 F. Supp. 620 (W.D. La.), *aff'd, per curiam* 402 F.2d 796 (5th Cir. 1968), cert. denied, 394 U.S. 930 (1969). He fails to note, however, that the Louisiana statute gives the seller "a preference on the price of his property, over the other creditors of the purchaser," rather than a right to possession of the property. 283 F. Supp. at 623 n.2. The distinction can thus easily be made on the basis that a right to recover the price is characteristic of a lien while recovery of the property is not. Indeed, a lien has been defined as a "charge upon property . . . for the payment or discharge of a particular debt or duty in priority to the general debts or duties of the owner." 51 AM. JUR. 2d, Liens, § 1 (1970). The definition is synonymous with the Louisiana vendor's privilege, but not with the seller's right of reclamation under § 2-702(2) of the UCC.

to this point.

Besides the argument that the reclaiming seller does not possess ordinary lien rights, there exist several other factors which support the proposition that § 2-702(2) is not a lien. Of considerable importance is the fact that during consideration of the 1966 amendments to the Bankruptcy Act, no mention of their intended effect on any provision of the UCC was made.⁶⁷ It has been suggested that this lack of clarification was the result of a congressional assumption "that the rights granted in Article 2 of the UCC cannot be deemed liens."⁶⁸ Of course, it can be argued to the contrary that Congress felt no need to define the effect of the amendments on the Code, the new provisions being explicit within themselves. In light of the historical recognition of the reclaiming seller's right in bankruptcy courts, however, it seems improbable that Congress would subject Code § 2-702(2) to the invalidation provisions of § 67(c) of the Bankruptcy Act without some mention of its intent to do so.

The bankruptcy courts' recognition of the seller's right to rescind a sales contract and recover the goods also provides the basis for another argument which the district court only superficially considered. Prior to the Code, the reclaiming seller had to satisfy the burden of proving fraudulent misrepresentation on the part of the buyer.⁶⁹ The drafters of § 2-702(2) sought to relax this burden by making an insolvent buyer's receipt of goods conclusive evidence of fraud.⁷⁰ It may be argued, therefore, that § 2-702(2) merely changes the rules of evidence, leaving the seller with his common law right of rescission but affording him the benefit of an irrebuttable presumption. If this be the case, § 2-702(2) would not seem to be subject to the invalidation provisions of § 67(c) of the Bankruptcy Act, which apply only to statutory liens.

The district court in *Good Deal* apparently recognized this position in its statement that the comments to § 2-702 suggest that only an evidentiary change was intended,⁷¹ but chose instead to rely on the practical effect of the Code provision as the basis for its decision.⁷² In so doing, the court ignored substantial authority which supports the conclusion that § 2-702(2) merely changes the evidentiary aspects of the state law of fraud rather than supplanting the former right of

⁶⁷ 4 COLLIER ¶ 67.281 at 420-21.

⁶⁸ *Id.* at 421.

⁶⁹ See notes 20-29 and accompanying text *supra*.

⁷⁰ UCC § 2-702, Comment 2. See Llewellyn, *supra* note 31.

⁷¹ 15 UCC REP. SERV. at 625.

⁷² *Id.* at 625-26.

rescission.⁷³ As the conclusive presumption of fraud is the only material change in the seller's right under § 2-702(2), the district court should have considered in more detail the position that the reclaiming seller is not a lienor, but upon demand or rescission, the actual owner of the property. This conclusion follows logically from earlier cases holding that where the buyer has defrauded the seller, rescission of the contract automatically reverts title in the latter.⁷⁴ Under this analysis the defrauded seller holds neither a statutory right nor a lien and, therefore, should not be subject to the invalidation provisions of § 67(c).

In relying instead on the practical effect of § 2-702(2) as the standard for determining whether or not the seller's right is a lien, the district court made one final error. Although Congress failed to note the intended effects of the 1966 bankruptcy amendments on the Code, the rationale for the enactment of the new invalidating standards was offered. Senate Report Number 1159⁷⁵ reveals that the 1966 amendments, like those of 1952, were aimed at state created priorities validated in bankruptcy under the rubric of liens.⁷⁶ The invalidation of such priority devices, which often exhaust bankrupt estates at the expense of federally designated priority claimants⁷⁷ and unsecured creditors, is an unimpeachable objective of bankruptcy legislation. The New Jersey district court properly recognized the congressional attempt to fulfill this purpose in quoting from the Senate Report.⁷⁸ In holding the application of § 2-702(2) contrary to the policy behind amended § 67(c)(1)(A) of the Bankruptcy Act, however, the court

⁷³ Comment 2 of § 2-702 specifically notes that the basis of reclamation is the buyer's fraud. Thus the premise of the seller's right to rescind and recover is arguably unchanged by § 2-702(2), and the former right of rescission is only altered by the adoption of a new evidence requirement, a showing that the buyer was insolvent when he received the goods, as conclusive of fraud. Such an analysis is apparently consistent with the drafter's intentions, as indicated by Professor Llewellyn's explanation that § 2-702(2) "slightly enlarge[s] the existing law of reclamation." Llewellyn, *Memorandum in N.Y. Law Rev. Comm'n, Report and Record of Hearings on the Uniform Commercial Code*, Legis. Doc. No. 65, 126 (1954) (emphasis added). Since § 2-702(2) represents a reasonable state judgment that fraud is present in the situation described, and because the existence of fraud remains the essential element of reclamation, the district court in *Good Deal* should have considered more thoroughly whether § 2-702(2) merely offered a redefinition of the fraud required for exercise of the common law right of rescission.

⁷⁴ 4A COLLIER ¶ 70.41 at 483.

⁷⁵ S. REP. 1159, 2 U.S. CODE CONG. & AD. NEWS (1966) 2456.

⁷⁶ *Id.* at 2457.

⁷⁷ *Id.*

⁷⁸ 15 UCC REP. SERV. at 626.

extended the congressional purpose beyond its reasonable scope. Surely § 2-702(2) of the UCC benefits reclaiming sellers in bankruptcy, and in this light it might be argued that the Code section disrupts the federally created order of priorities.⁷⁹ The benefit afforded the defrauded seller, however, does not appear to be a priority disruptive of the enunciated purpose of § 67(c)(1)(A).⁸⁰

The fundamental purpose of the Bankruptcy Act is equitable distribution of a bankrupt's assets. Ideally, accomplishment of this objective would involve a pro rata distribution of the estate among all creditors. Social, economic, and political pressures, however, have resulted in deviation from a strict rule of equality.⁸¹ One such deviation has been the recognition that a seller may recover his property from a bankrupt buyer on proof of fraud. The basic principle which justifies this result seems to be that other creditors of the bankrupt should not profit from a wrong perpetrated by the debtor. Inattention to the aspect of fraud, which underlies § 2-702(2), allows results contrary to this principle of unjust enrichment. To assert, as the district court did, that § 2-702(2) is "inimical to the very purposes of the Bankruptcy Act"⁸² because it disrupts the federally created order of priorities, ignores the real purpose behind the 1966 amendments. The invalidation provisions were aimed at liens that are essentially disguised priorities, created by states to avoid the invalidation of such priorities under § 60 of the Bankruptcy Act. Section 2-702(2), historically recognized in bankruptcy as the seller's right to rescind and recover, has never been the subject of an attempted disguise. Nor has the principle behind the rights afforded the reclaiming seller been questioned in the courts. Indeed, if anything, § 2-702(2) of the Code aids the trustee by limiting the time in which the defrauded seller may make his demand. To hold that enactment of the 1966 amendments reveals Congress' intent to terminate recovery for defrauded sellers is itself inimical the historical recognition of the defrauded seller's right and the general maxim that a bankrupt's creditors

⁷⁹ *Id.* This argument forms the basis for the district court's conclusion that the effect of UCC § 2-702(2) violates the general aim of the 1966 amendments to the Bankruptcy Act. The court, however, failed to consider the element of fraud inherent in the seller's right to reclaim, and historically recognized as a ground for recovery before satisfaction of priority claims. In addition, in concentrating on the general aim of the amendments, the court overlooked the specific purpose of § 67(c)(1)(A), with which Code § 2-702(2) does not seem to be in conflict. These factors are discussed in the text accompanying notes 83-85 *infra*.

⁸⁰ S. REP. 1159, 2 U.S. CODE CONG. & AD. NEWS (1966) 2461.

⁸¹ *Id.* at 2457.

⁸² 15 UCC REP. SERV. at 626.

should not benefit from the bankrupt's wrongs.

However, if the courts do embrace the holding that § 2-702(2) of the UCC is a statutory lien, it may be that a closer look at the invalidation provisions of § 67(c) is necessary. Both courts that have found § 2-702(2) to be a statutory lien have merely stated that it takes effect upon the insolvency of the debtor-buyer, and is therefore invalid under § 67(c)(1)(A) of the Bankruptcy Act.⁸³ It may be argued, however, that § 2-702(2) is not necessarily invalidated in bankruptcy by § 67(c)(1)(A) merely because insolvency of the debtor is one of the factors required for application of the UCC provision. A contract for sale on credit, the seller's discovery of the buyer's insolvency, and the seller's demand within ten days of the buyer's receipt of the goods are also required for maturation of the seller's right. Thus, for example, a reclaiming seller might argue that his right to recover the goods takes effect only when he demands their return within ten days of the buyer's receipt rather than when the buyer becomes insolvent.

Even more persuasive is the argument that § 67(c)(1)(A) invalidates only those statutory liens which become effective when distribution of the buyer's assets is appropriate. This contention arises from language contained in Senate Report Number 1159, which states that § 67(c)(1)(A) "strikes at liens which merely determine the *order of distribution* upon insolvency or liquidation."⁸⁴ If indeed § 67(c)(1)(A) only invalidates those liens which arise upon an affirmative adjudication of a bankruptcy petition, § 2-702(2) would appear to be without its scope. The Code provision requires only an insolvent debtor, not

⁸³ For the text of Bankruptcy Act § 67(c)(1)(A), 11 U.S.C. § 107(c)(1)(A) (1970), see note 9 *supra*. The two cases that have held § 2-702(2) to be a statutory lien include the case discussed in this comment, *In re Good Deal Supermarkets, Inc.*, 15 UCC REP. SERV. 624 (D.N.J. 1974), and a case from the Eastern District of Michigan, *In re Federal's, Inc.*, 12 UCC REP. SERV. 1142 (E.D. Mich. 1973). In the *Federal's* case the district court took the same approach as the court in *Good Deal*, examining the effect of Code § 2-702(2) and concluding that it constituted a priority in conflict with the federally designed priority order. In so concluding, the court found it to be in essence a statutory lien of the type Congress sought to eliminate by enacting § 67(c)(1)(A). The court, however, did not stop at this point, but held that because a conflict in statutes existed and § 2-702(2) was thus inapplicable in bankruptcy, resort to pre-Code state law was necessary for a determination of the seller's rights. Since the seller had failed to show an intent not to pay on the part of the buyer, a pre-Code prerequisite to recovery in Michigan, the trustee prevailed. The latter part of the *Federal's* decision has been criticized for this resort to pre-Code law. R. Duesenberg and L. King, 3A BENDER'S UNIFORM COMMERCIAL CODE SERVICE § 13.03[4] at 13-18 n.23.1 (Supp. 1974). Regardless of the possible incorrectness of the district court's return to the common law, the *Federal's* decision is otherwise identical to *Good Deal*, and therefore subject to the same criticisms raised in this comment.

⁸⁴ S. REP. 1159, 2 U.S. CODE CONG. & AD. NEWS (1966) 2461.

one who has been adjudged a bankrupt under the Bankruptcy Act. In addition, although insolvency under the UCC includes the bankruptcy definition,⁸⁵ an insolvent is also defined under the Code as one "who either has ceased to pay his debts in the ordinary course of business or cannot pay his debts as they become due. . . ."⁸⁶ Thus the right to reclaim arguably arises outside of bankruptcy, under a different standard than that utilized in § 67(c)(1)(A), and therefore § 2-702(2) would seem not to be invalidated by § 67(c)(1)(A).

If Code § 2-702(2) escapes invalidation under either of these arguments, however, it will also have to avoid § 67(c)(1)(B)⁸⁷ which invalidates as against the trustee all statutory liens ineffective against a bona fide purchaser of the goods on the date of bankruptcy. Initially, the seller's right would appear to fail under this test as it is subject to the rights of a bona fide purchaser under § 2-702(3).⁸⁸ However, the proviso to § 67(c)(1)(B) specifies that if § 2-702(2) is not invalid against the trustee under § 70(c) of the Bankruptcy Act, the seller's right to reclaim may be perfected after the date of bankruptcy against a bona fide purchaser.⁸⁹ With the deletion of the lien creditor limitation from § 2-702(3), and assuming the seller perfects by demand within ten days after the buyer's receipt of the goods, Code § 2-702(2) will pass muster under this invalidation provision.⁹⁰ Until this argument is fully considered, then, it must be concluded that Code § 2-702(2), even if designated a statutory lien, should not automatically be invalidated in bankruptcy.

⁸⁵ UCC § 1-201(23). A person is deemed insolvent under the Bankruptcy Act . . . whenever the aggregate of his property, exclusive of any property which he may have conveyed, transferred, concealed, removed, or permitted to be concealed or removed, with intent to defraud, hinder, or delay his creditors, shall not at a fair valuation be sufficient in amount to pay his debts.

Bankruptcy Act § 1(19), 11 U.S.C. § 1(19) (1970).

⁸⁶ UCC § 1-201(23).

⁸⁷ Bankruptcy Act § 67(c)(1)(B), 11 U.S.C. § 107(c)(1)(B) (1970).

⁸⁸ UCC § 2-702(3). For the text of § 2-702(3), see note 5 *supra*.

⁸⁹ Bankruptcy Act § 67(c)(1)(B), 11 U.S.C. § 107(c)(1)(B) (1970).

⁹⁰ The first proviso to § 67(c)(1)(B) would allow the seller to reclaim his goods within the ten day period, including the time after the petition for bankruptcy has been filed, if his lien is superior to that of a trustee under § 70(c) of the Bankruptcy Act. Section 70(c) grants the trustee the power of a hypothetical lien creditor, and until the dispute regarding the lien creditor limitation in Code § 2-702(3) is finally resolved, the seller's success under the proviso will remain uncertain. If the deletion of the lien creditor limitation from § 2-702(3) has the predicted effect of securing the seller's right to reclaim against such lienor in the ten day period, however, the seller should be able to defeat the trustee's power as a bona fide purchaser under the proviso to § 67(c)(1)(B). See note 39 and accompanying text *supra*.

The failure of the district court in *Good Deal* to consider the factors discussed above renders its conclusion that § 2-702(2) is a statutory lien invalid in bankruptcy under § 67(c)(1)(A) of the Bankruptcy Act highly questionable. The absence of full lien rights in the seller's reclamation privilege, and the lack of clear congressional intent to include UCC § 2-702(2) within the term "statutory lien," provide strong evidence that the seller's right to reclaim is not a lien within the purview of the Bankruptcy Act. In addition, since the conclusive presumption of fraud is the only substantial change in the seller's historical right to rescind and recover made by § 2-702(2), there is adequate reason to consider the UCC provision as only a rule of evidence. Finally, the district court's assertion that the seller's right to reclaim is inimical to the purposes of the Bankruptcy Act overlooks the true effect of § 2-702(2). Certainly there is a legitimate purpose in protecting the debtor's assets from depletion and preserving the federal priority order, but that purpose does not contemplate the perpetuation of the debtor's fraudulent gains. Section 2-702(2) is not a disguised priority, the explicit device at which § 67(c)(1)(A) was aimed. It merely continues and makes uniform a right long recognized in bankruptcy, and by limiting that right to ten days, aids the trustee in preserving the bankrupt's estate. In light of these considerations, and the possibility that even if § 2-702(2) is a statutory lien it is not invalid under § 67(c), the district court's opinion in *Good Deal* can only be viewed as a superficial preliminary to a developing controversy. Until a clear indication of the intended scope of the statutory lien invalidation provisions is provided by Congress, the court's analysis in *Good Deal* should not be considered decisive of the issue.

C. LYNCH CHRISTIAN, III