



6-1-1971

Bulk Transfers-Stepchild of the Uniform Commercial Code

Louis W. Levit

Follow this and additional works at: <http://scholarship.law.nd.edu/ndlr>



Part of the [Law Commons](#)

Recommended Citation

Louis W. Levit, *Bulk Transfers-Stepchild of the Uniform Commercial Code*, 46 Notre Dame L. Rev. 694 (1971).

Available at: <http://scholarship.law.nd.edu/ndlr/vol46/iss4/4>

This Article is brought to you for free and open access by NDLScholarship. It has been accepted for inclusion in Notre Dame Law Review by an authorized administrator of NDLScholarship. For more information, please contact lawdr@nd.edu.

BULK TRANSFERS—STEPCHILD OF THE UNIFORM COMMERCIAL CODE?

*Louis W. Levit**

I. Introduction

The purpose of this Article is to review the more important considerations and pitfalls inherent in any transaction which falls within the definition of a "bulk transfer"¹ under article 6 of the Uniform Commercial Code. It is concerned only with problems which arise directly from the "bulk" nature of the transaction. Other problems which arise in these transactions, such as questions of adequacy of consideration, possible vulnerability under the Bankruptcy Act, and compliance with corporate formalities are beyond the scope of this Article. The careful practitioner must, of course, always take these factors into consideration when a bulk sale is being effected.

Today, the subject of bulk transfers is governed in virtually every state by article 6 of the Uniform Commercial Code. This article is the successor to the Bulk Sales Acts which were designed to prevent the following two common types of commercial fraud:

- (a) The merchant, owing debts, who sells out his stock in trade to a friend for less than it is worth, pays his creditors less than he owes them, and hopes to come back into the business through the back door some time in the future.
- (b) The merchant, owing debts, who sells out his stock in trade to any one for any price, pockets the proceeds, and disappears leaving his creditors unpaid.²

The second type of sale will often be voidable under most state fraudulent conveyance laws or under section 67d³ of the Bankruptcy Act. The first type, however, would, in the absence of bulk sales legislation, usually be free from attack. Accordingly, under both pre-Code law and the present article 6, stringent conditions have been imposed upon those sales in bulk which were deemed most likely to give rise to this type of fraud.

II. Definition of "Bulk Transfer"

The practical and legal problems inherent in any "bulk transfer" can be

* Member, Illinois Bar; B.S., University of Chicago, 1943; J.D., University of Chicago, 1946; Associate Editor of the *Commercial Law Journal*. This Article is based in part on an article prepared for a handbook on creditors' rights, published by the Illinois Institute for Continuing Legal Education.

1 The Code uses the terms "bulk transfer," "transferor," and "transferee" rather than "bulk sale," "seller," and "buyer," on the theory that the new terms are somewhat broader in scope. It is doubtful whether article 6 affects any transactions which would not come within the general category of bulk sales. In this Article, the older terms will frequently be employed for purposes of clarity.

2 UNIFORM COMMERCIAL CODE § 6-101, Comment 2.

3 11 U.S.C. § 107(d) (1964).

understood only through a detailed analysis of the statutory provisions. First consideration, of course, must be given to the scope and extent of the types of transfers subject to article 6.

Section 6-102⁴ defines a "bulk transfer" as follows:

- (1) A "bulk transfer" is any transfer in bulk and not in the ordinary course of the transferor's business of a major⁵ part of the materials, supplies, merchandise or other inventory (Section 9-109) of an enterprise subject to this Article.
- (2) A transfer of a substantial part of the equipment (Section 9-109) of such an enterprise is a bulk transfer if it is made in connection with a bulk transfer of inventory, but not otherwise.

Subsection 6-102(3) further restricts the application of the article by limiting it to enterprises "[W]hose principal business is the sale of merchandise from stock, including those who manufacture what they sell." Thus, sales of service businesses are excluded even though they may include a substantial inventory of goods and supplies which are ultimately intended for sale or consumption.⁶

In these respects the Code is considerably more restricted in operation than pre-Code laws which covered sales of the "major portion of tangible personal property,"⁷ regardless of whether inventory or equipment was involved, and regardless of the nature of the business.

The reasoning advanced in support of the Code restrictions is unconvincing. Comment 2, section 6-101, implies that the great danger of fraud lies in sales by "merchants" of "stock in trade," presumably because inventory is more readily removable than equipment. The need for bulk sales legislation, however, arises from the fact that for the seller, at least, the sale converts both inventory and equipment into cash which can be, and frequently is, quickly removed and withheld from creditors. The danger of such fraud is every bit as great when equipment alone is sold as when inventory is included.

⁴ All section references are to the Uniform Commercial Code, 1962 Official Text, unless specifically otherwise stated.

⁵ The word "major," without qualification, poses two problems. First, does it mean "more than half" or merely a substantial portion? Second, does it refer to quantity, or value, or perhaps a combination of both? One lower court decision suggests that \$10,000 (in value) may constitute the major part of a \$35,000 inventory. In re Shirts "N" Slax, Inc., 4 U.C.G. REP. SERV. 873 (Ref. E.D. Pa. 1967). For a discussion of the "value-quantity" question, see R. DUESENBERG & D. KING, SALES & BULK TRANSFERS UNDER THE UNIFORM COMMERCIAL CODE § 15, pp. 15-5, 15-6 (1968) [hereinafter cited as DUESENBERG].

⁶ Examples of businesses held excluded under this section include: photo-processing (Film Marketing Serv., Inc. v. Homer Photo Labs, Inc., 18 Montg. Co. L. R. 190 (Pa. C. P. 1966)); towing vehicles (All Nite Garage, Inc. v. A.A.A. Towing, Inc., 85 Nev. 211, 452 P.2d 902 (1969)); and printing (Markert v. College Offset Press, Inc., 6 Pa. D. & C. 2d 519 (Phil. County Ct. 1955)). Early Pennsylvania lower court decisions holding restaurants and cocktail lounges to be subject to article 6 [Zinni v. One Township Line Corp., 36 Pa. D. & C. 2d 297 (Del. County Ct. 1965) and Uhr v. 3361, Inc., 21 Pa. D. & C. 2d 348 (Phil. County Ct. 1960)] have not been followed in recent decisions. Kane-Miller Corp. v. Tip Tree Corp., 60 Misc.2d 776, 303 N.Y.S.2d 273 (Sup. Ct. 1969); Nichols v. Acers Co., 415 S.W.2d 683 (Civ. App. Tex. 1967).

⁷ E.g., UNIFORM FRAUDULENT CONVEYANCE ACT § 1.

Equally naive is the reasoning relied on in support of the exclusion of so-called service businesses. Comment 2, section 6-102, states:

The businesses covered are defined in subsection (3). Notice that they do not include farming nor contracting nor professional services, nor such things as cleaning shops, barber shops, pool halls, hotels, restaurants, and the like whose principal business is the sale not of merchandise but of services. While some bulk sales risk exists in the excluded businesses, they have in common the fact that unsecured credit is not commonly extended on the faith of a stock of merchandise.

This is absolute nonsense. The fact is that purveyors of meats and produce to restaurants are entitled to just as much protection as are sellers of clothing, hardware, or raw materials to merchants and manufacturers. All of these creditors rely on the overall financial ability, integrity, and stability of their customer. The danger of fraud in bulk sales of service businesses is no less, and the burden of compliance no greater, than in bulk sales of mercantile or manufacturing businesses; no valid reason exists why similar regulations should not apply in all cases.

It has been suggested that creditors of service businesses are not normally trade creditors.⁸ This is simply not true. Restaurants, hotels, cleaners, and virtually all other types of service enterprise necessarily do incur unsecured credit in substantial quantities for supplies, merchandise, and services which are used, consumed, and in many instances, resold in the course of the service operation. The suppliers of these services are no more readily able to obtain security for their debts than are trade creditors of ordinary businesses; they are entitled to the same protection against sales in bulk.

III. Specific Exclusions

The scope of article 6 is restricted even more by section 6-103 which specifically excludes from its operation the following transfers:

- (1) Those made to give security for the performance of an obligation;⁹
- (2) General assignments for the benefit of all the creditors of the transferor; and subsequent transfers by the assignee thereunder;
- (3) Transfers in settlement or realization of a lien or other security interest;
- (4) Sales by executors, administrators, receivers, trustees in bankruptcy, or any public officer under judicial process;
- (5) Sales made in the course of judicial or administrative proceedings for the dissolution or reorganization of a corporation and of which notice is sent to the creditors of the corporation pursuant to order of the court or administrative agency;

⁸ DUESENBERG at § 15.02[2].

⁹ Cf. UNIFORM COMMERCIAL CODE § 9-111 which states that "The creation of a security interest is not a bulk transfer under Article 6"

- (6) Transfers to a person maintaining a known place of business in this State who becomes bound to pay the debts of the transferor in full and gives public notice of that fact, and who is solvent after becoming so bound;
- (7) A transfer to a new business enterprise organized to take over and continue the business, if public notice of the transaction is given and the new enterprise assumes the debts of the transferor and he receives nothing from the transaction except an interest in the new enterprise junior to the claims of creditors;
- (8) Transfers of property which is exempt from execution.

Basically, these excluded transactions fall into the following four categories:

- 1) *Security transactions* [Subsections (1) and (3)]. These are excluded on two grounds: first, because they are regulated under article 9, which generally requires either public filing or a transfer of possession to perfect against unsecured creditors;¹⁰ and second, because security transactions were not considered likely to lead to the type of fraud which article 6 is designed to prevent. This reasoning, while generally sound, is not immune from criticism. Although a security transfer for new consideration is ordinarily not prejudicial to the interests of general unsecured creditors, their rights can be, and often are, seriously jeopardized by bulk transfer to secure antecedent indebtedness.¹¹ Similarly, a bulk transfer in settlement of a security interest, whether voluntary or by foreclosure and sale, can under article 9 extinguish, without notice, the rights of unsecured creditors.¹² Prior to the Code, many states included bulk mortgages in their bulk sales laws, and strong arguments have been made for their inclusion in article 6.¹³
- 2) *Judicial sales: sales by executors, assignees, trustees in bankruptcy, and other fiduciaries, and sales made in the course of judicial administration* [Subsections (2), (4), and (5)]. These sales are excluded because they are generally conducted under judicial and/or statutory controls which entail ample notice to creditors and either competitive bidding or other adequate safeguards.¹⁴

10 UNIFORM COMMERCIAL CODE §§ 9-302, 9-305.

11 It is no answer to say that such transfers may be set aside as preferences under section 60 of the Bankruptcy Act. This remedy is expensive, cumbersome, and dependent on the ability to prove both insolvency (in the bankruptcy sense) and reasonable cause on the part of the transferee to believe the transferor was insolvent.

12 See P. COOGAN, W. HOGAN & D. VAGTS, *SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE* § 22.08[3] (1969) [hereinafter cited as COOGAN].

13 Bulk transfers for antecedent debts were included under the original draft of the Code. See UNIFORM COMMERCIAL CODE §§ 6-103(1), 6-105(1) (1952 version).

14 Note that sales by executors, administrators, receivers, and trustees are exempt even when made without notice. Other types of sales are exempt only when notice is given to creditors. Sales under the Bankruptcy Act, including sales by debtors in possession under chapters X, XI, and XII of the Bankruptcy Act, are also exempt. Debtors in possession have all the powers of a receiver or trustee in bankruptcy — powers which are not affected by state legislation because they are derived from federal law.

- 3) *Transfers to solvent enterprises which assume the debts of a transferor* [Subsections (6) and (7)]. These exceptions are largely meaningless in most states because they apply only where the buyer voluntarily accepts the very consequences which would follow from noncompliance with the act—namely, liability for payment of the seller's debts. Only in those states which may impose an additional penal sanction for non-compliance do these exclusions have any substantial effect.
- 4) *Transfers of exempt property* [Subsection (8)]. Obviously, if property is exempt under the law, creditors are not affected by its transfer. It is difficult, however, to conceive of a situation where a sale which would otherwise qualify as a bulk transfer under the act would be composed entirely of exempt property.

IV. Duties of Parties

Article 6 imposes upon both buyer and seller strict requirements designed to insure adequate notice to creditors.¹⁵ These requirements consist generally of preparation and preservation of a list of creditors and a schedule of property and of transmitting adequate notice to creditors.

Section 6-104 provides that in order for the transfer to be effective against creditors:

- 1) The buyer must require the transferor to furnish a list of existing creditors;
- 2) The parties together must prepare a schedule of the property transferred, sufficient to identify it; and
- 3) The buyer must preserve the list and schedule for six months next following the transfer and permit inspection of either or both and copying therefrom at all reasonable hours, or must file the list and schedule with the public officer designated by the state legislature.

The formal requirements of the list of creditors are spelled out by subsection 6-104(2). The list must be signed and sworn to or affirmed by the seller or his agent. It must contain the names and business addresses of all creditors, including those whose claims are disputed. If there is an outstanding bond or debenture issue with an indenture trustee, the list need include as to such indebtedness only the name and address of the indenture trustee and the total principal indebtedness.

Subsection 6-104(3) provides that responsibility for the completeness and

¹⁵ The California version differs radically from article 6. California has met many of the criticisms leveled above by including many transactions and enterprises excluded under the Uniform Code. It has then turned around and rendered the entire article virtually meaningless by substituting publication and public filing for actual notice to creditors. See CAL. COMM. CODE §§ 6102(1)-(3), 6102(5), 6105, 6107 (West 1964).

accuracy of the list of creditors rests with the seller. The transfer is not rendered ineffective by errors and omissions unless the buyer is shown to have had knowledge thereof.¹⁶

Note that, notwithstanding subsection 6-104(3), virtually the entire responsibility for compliance rests on the buyer. It is he who must first demand the list, he who must assist in the preparation of the schedule of property, and he who is responsible for the preservation and/or filing of both documents. Finally, and most important, it is the buyer who will suffer the major consequences of noncompliance. If the sale is defective, he will be subjected to the claims of the seller's creditors.¹⁷

Also note that while subsection 6-104(3) relieves the buyer of responsibility for completeness and accuracy of the list of creditors, no similar provision exists with regard to the schedule of property. Errors or omissions in the designation or description of the property transferred will subject the buyer to creditors' claims; the buyer must, therefore, satisfy himself that the schedule of property is complete and accurate in every respect.

The creditors to be included in the list are not completely clear. The Code speaks of existing creditors, but does not specify the cutoff date as of which the list is to be prepared. Obviously, the only creditors who can be listed are those existing at the time of preparation of the list. In most instances, however, practical considerations will require the list to be prepared at least several days in advance of the sending of notices pursuant to section 6-105. This raises the question whether creditors whose claims come into existence during the intervening period should be listed and notified. The answer would seem to be that they should. Caution, therefore, requires that an amended list be prepared adding such interim creditors.¹⁸ Other than the limitation to existing creditors, there is no restriction as to the types of creditors required to be listed. All who may have claims must be included: trade creditors, lenders, tort creditors (and subrogees thereof), taxing bodies, utilities with accrued but unbilled claims, and secured as well as unsecured creditors. Probably a substantial number, and perhaps even a majority, of the lists of creditors which are prepared under article 6 are defective in this respect. Many bulk transfers which have gone unchallenged might well have been upset had any creditor or creditors chosen to challenge the list. In this area, as in most others under this article, the attorney for the buyer just cannot be too careful!¹⁹

With regard to the schedule of property, the Code states only that it must be "sufficient to identify it."²⁰ There is no requirement that the cost price or

16 UNIFORM COMMERCIAL CODE § 1-201(25) provides that "A person 'knows' or has 'knowledge' of a fact when he has actual knowledge of it." Whether this definition overrules pre-Code cases holding that buyers are presumed to know of the existence of certain creditors in all cases is open to question. *E.g.*, *United States v. Goldblatt Bros.*, 128 F.2d 576 (7th Cir. 1942).

17 UNIFORM COMMERCIAL CODE § 6-105.

18 The agreement of sale should carefully prescribe the extent to which the seller can incur new debts during the interim period. It should contain strict requirements to insure their being properly listed.

19 See DUESENBERG at § 15.04; Rapson, *Article 6 of the Uniform Commercial Code: Problems and Pitfalls in Conducting Bulk Sales*, 68 COM. L.J. 226, 226-27 (1963) [hereinafter cited as Rapson].

20 UNIFORM COMMERCIAL CODE § 6-104(1)(b).

other valuation of the property be shown. It is, however, certainly necessary that the schedule be detailed. In most instances a schedule which would be sufficient to meet the requirements of the ordinary buyer or seller and their respective attorneys should be sufficient for the purpose of article 6.

The article gives two options with respect to preservation of the list and schedule. The buyer may keep and preserve the list and schedule for a period of six months and permit copying and inspection during reasonable hours, or he may file them with the public officer designated by the statutes of the particular state—usually the Secretary of State or Recorder of Deeds.²¹ Which course to pursue may depend on the particular facts and circumstances as well as the personal preferences of the buyer and his counsel.

As a general rule, it is recommended that the buyer preserve the list rather than file it even though a certain amount of inconvenience may result. The documents are then examined only by those having a legitimate interest therein rather than being available to the general public and may be withdrawn from public view after expiration of the six-month period.

The next, and perhaps the key, requirements imposed by the article are those of Sections 6-105 and 6-107 which state the form, manner, and extent of notice which must be given to creditors.²² Two types of notice are provided. A short form may be used where creditors of the seller are to be paid in full; the so-called long form is required where creditors are not to receive full payment or where the buyer is in doubt in this respect.

If creditors are to be paid in full, the notice need only state: that a bulk transfer is about to be made; the names and business addresses of the transferor and transferee and all other business names and addresses used by the transferor within three years so far as is known to the transferee; and that the debts of the transferor are to be paid in full as they fall due as a result of the transaction, and the address to which creditors can send their bills.²³

If the debts of the seller are not to be paid in full or if the buyer is in doubt, the notice must also state: the location and general description of the property to be transferred and the estimated total of the transferor's debt; the address where the schedule of property and list of creditors may be inspected; whether the transferor is to pay existing debts, and, if so, the amount of such debts and to whom owing; and whether the transfer is for new consideration, and, if so, the amount of such consideration and the time and place of payment.²⁴ In states where optional section 6-106 is adopted and the transfer is for new consideration, the amount of such consideration and the time and place where creditors are to file their claims must also be set forth in the long form notice.²⁵

21 The Florida legislature committed a classic *faux pas* when it adopted verbatim the literal words of the Code — "a public office to be here identified." FLA. STAT. ANN. tit. 38, § 676.6-104(1)(c) (1966).

22 The notice requirements for auction sales are contained in section 6-108. Applicable state and federal tax statutes should also be consulted. These frequently contain requirements for bulk transfers which go far beyond the requirements of the Code. See, e.g., ILL. STAT. ANN. ch. 48, § 750 (Smith-Hurd 1967).

23 UNIFORM COMMERCIAL CODE § 6-107(1)(a)-(c).

24 UNIFORM COMMERCIAL CODE § 6-107(2)(a)-(d).

25 UNIFORM COMMERCIAL CODE § 6-107(c).

The notice must be in writing and must be given at least ten days²⁶ before the buyer takes possession of the goods or pays for them, whichever happens first. It must be transmitted either by personal delivery or registered or certified mail to all persons shown on the list of creditors furnished by the seller and to all other persons who are known to the buyer to hold or assert claims against the seller.²⁷

These two sections are replete with pitfalls for the buyer. Note that here again the entire responsibility falls on his shoulders. The buyer must prepare and serve the notice and decide which of the two types of notice to use.

The first decision to be made is with respect to the time of the notice. Section 6-105 requires notice to be given at least ten days before the buyer takes possession of the goods or pays for them, whichever happens first. Determination of the critical time is not as simple as it seems. In the first place, what is meant by taking possession? A purchaser of a going business will usually want some degree of control over its operations from the moment he commits himself to the purchase. This may take the form of having one or more of his agents personally on the premises supervising or observing operations. Could it be argued that this constitutes taking possession and that the notice must be sent out at least ten days prior thereto? Such an argument seems hardly tenable, but the purchaser should carefully refrain from taking any steps before the expiration of the ten day period which might conceivably be construed as taking possession.

The time of payment test produces even greater difficulties. In almost every transaction of this type the seller will require some form of earnest money to be paid or deposited at the time the original contract is entered into. This will ordinarily precede any notice to creditors. If the statutory provision is given an extremely literal interpretation, compliance will of course be impossible in such cases. The courts will probably hold that time of payment means the time of payment of the balance of purchase price. It certainly appears, however, that the language of the statute could be improved.²⁸

Another pitfall lies in the seemingly innocuous provision for a short form notice.²⁹ On its face this provision provides a simplified procedure to be used where the debts of the seller are going to be paid in full. The reasoning is that if creditors are going to be paid they have no interest in the additional information prescribed by the long form notice. The problem, as far as the buyer is concerned, is that he can never know with certainty whether or not the debts will in fact be paid. This is particularly true because section 6-107 refers to all debts of the seller, not just those debts required to be included on the list of creditors, and not just those debts which are actually so included. Thus, a buyer can never

26 UNIFORM COMMERCIAL CODE § 6-105.

27 UNIFORM COMMERCIAL CODE § 6-107(3).

28 All states would be well-advised to follow the example of Wisconsin which incorporated language specifically defining payment as "the major part of the purchase price." WIS. STAT. ANN. tit. 40, § 406.105 (1964). Wisconsin also avoided the ambiguity of the "major part" text of § 6-102 with reference to inventory by specifying major part *in value*. WIS. STAT. ANN. tit. 40, § 406.102(1) (1964). Surprisingly, the Permanent Editorial Board dismissed both of these highly desirable clarifications as "redundant" and "unnecessary." REPORT NO. 2 OF THE PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE 105, 112 (1965).

29 UNIFORM COMMERCIAL CODE § 6-107(1)(a)-(c).

know with absolute certainty that all the debts are going to be paid, and the careful practitioner will insist that the long form notice be used in every case. As a matter of fact, probably the least burdensome requirement of article 6 is that of including the additional information required in the long form notice. The really burdensome details are the same, regardless of which form is used. When one has taken pains to comply with all of these steps in order to make the transaction effective against creditors, it is pure folly to jeopardize the entire program by using the short form notice.³⁰

Subsection 6-107(3) provides that the notice shall be delivered personally or sent by registered or certified mail to all the persons shown on the list of creditors and to all other persons known to the transferee to hold or assert claims against the transferor. This paragraph codifies the rule announced in *United States v. Goldblatt Brothers*.³¹ In that case the court held that creditors known to the buyer must be notified even though not listed by the seller. Furthermore, the court held that a buyer is presumed to know that any business enterprise must be indebted to certain types of creditors such as the taxing bodies and utilities. Notwithstanding the seemingly protective provisions of subsection 1-201(25),³² this rule may be applied in cases under article 6. Extreme care must, therefore, be taken to be sure that notice is given to every creditor or potential creditor who could conceivably fall within this classification.

The Code provides, as did most of its predecessors, that the notice may be given either personally or else sent by registered or certified mail.³³ Obviously, personal service will not be feasible except in a very rare case. The choice is between registered and certified mail. Where creditors are located within the continental United States, certified is clearly preferable because of the substantial saving in expense. Notices should always be delivered to the post office for mailing rather than dropped into a letter box. In case of dispute, it is far better to have an official receipt from the United States Post Office than to be forced to rely on the receipts of the creditors or the affidavit of the buyer or his agent.

V. Duty of Purchaser to Apply Proceeds (Optional Section 6-106)

Prior to the Code certain states, notably Pennsylvania, adopted a form of bulk sales statute requiring the purchaser to apply the proceeds of sale to the claims of the seller's creditors.³⁴ The vast majority of states, however, adopted the so-called New York rule which eliminated any reference to distribution of proceeds.³⁵ Opinion was divided as to whether the additional safeguards provided by the Pennsylvania type statute justified the substantial burden imposed on the potential purchaser.

The same division of opinion was encountered in the drafting of article 6. Consequently, the commissioners adopted an optional section (6-106) and suggested that with regard to its inclusion state statutes might differ without serious

30 DUESENBERG at § 22.11; Rapson at 228. Cf. COOGAN at § 22.11[5][k].

31 128 F.2d 576 (7th Cir. 1942).

32 See note 16 *supra*.

33 UNIFORM COMMERCIAL CODE § 6-107(3).

34 COOGAN at § 22.04[3][b].

35 *Id.* § 22.04 n.20.

damage to the principle of uniformity.³⁶ At this date only eighteen states and the Virgin Islands have adopted section 6-106.³⁷ These are to a large extent the same states which formerly followed the Pennsylvania rule.

Section 6-106 applies only to a bulk transfer in which new consideration is paid. It imposes on the purchaser a duty to assure that such consideration is applied so far as necessary to pay all debts of the seller which are either:

- 1) Shown on the list furnished by the transferor; or
- 2) Filed in writing in the place stated in the notice to creditors within thirty days after the mailing of such notice.³⁸

If any debts are in dispute, the amount in dispute may be withheld from distribution until the dispute is settled or adjudicated.³⁹ If the new consideration payable is not enough to pay all of the said debts in full, distribution shall be made pro rata.⁴⁰

For those states which do not have a general statute providing for payment of money into court, the adoption of subsection 6-106(4) is recommended. This subsection authorizes the buyer to pay the consideration into court within ten days after taking possession. He can then discharge his duty under section 6-106 by giving appropriate notice by registered or certified mail to all of the creditors to whom that runs. On motion of any interested party, the court may order the distribution of the consideration to the persons entitled to it.

Where section 6-106 is adopted, the Permanent Editorial Board recommends that the following subsection also be adopted:

Subsection 6-107(2)-(3) providing for inclusion in the long form notice of the time and place where creditors are to file their claims;

Subsection 6-108(3)(c) providing that in case of auction sales the auctioneer must assure that the net proceeds of the auction are applied as provided by section 6-106; and

Subsection 6-109[2] providing that against the aggregate obligation imposed by the article concerning application of proceeds the transferee or auctioneer is entitled to credit for sums paid to particular creditors of the transferor, not exceeding the sums believed in good faith to be properly payable to such creditors.

Section 6-106 has been lauded as providing the only effective means of really protecting creditors of a bulk seller.⁴¹ What then are reasons for its rejection by the overwhelming majority of jurisdictions which have adopted the Code?

36 It would have been more honest merely to have acknowledged an irreconcilable difference of opinion and let it go at that.

37 2 U.L.A., *UNIFORM COMMERCIAL CODE* 473 (1968).

38 *UNIFORM COMMERCIAL CODE* § 6-106(1).

39 *UNIFORM COMMERCIAL CODE* § 6-106(2).

40 *UNIFORM COMMERCIAL CODE* § 6-106(3).

41 See, e.g., Hawkland, *Remedies of Bulk Transfer Creditors Where There Has Been Compliance With Article 6*, 74 *COM. L.J.* 257, 261-62 (1969).

First, of course, there is the substantial additional burden placed on the buyer. Unless he can exercise the option of subsection 6-106(4), he is compelled in effect to serve at his own expense, without compensation, and without indemnity, as a trustee for the benefit of the seller's creditors. This burden must be discharged under a statutory grant of authority which is almost naive in its simplistic approach. He operates under a duty which runs to all creditors falling within the two classes described above and which may be enforced by any one of these creditors for the benefit of all.⁴²

A second, and much more perplexing problem arises from subsections (2) and (3) which provide:

- (2) If any of said debts are in dispute the necessary sum may be withheld from distribution until the dispute is settled or adjudicated.
- (3) If the consideration payable is not enough to pay all of the said debts in full distribution shall be made pro rata.

The combined effect of these two subsections may well be an indefinite delay in distribution of the proceeds. Suppose disputed, contingent, or unliquidated claims are asserted in amounts which, if allowed in full or in part, may create a deficiency. It may be months or years before these are ultimately settled or litigated. During this period, the buyer can make only partial distribution, and in some instances no distribution at all, if he wishes to avoid the risk of double liability. The seller, of course, can receive nothing unless and until all of these debts are fully discharged. Meanwhile, who is to bear the burden and expense of litigating and/or negotiating the liquidation and determination of the amounts in question?⁴³ the buyer, who is only a stakeholder? the seller, who may ultimately realize little or nothing? The body of creditors will generally be the real parties in interest, but they are hardly in a position to act effectively unless represented by a trustee or other fiduciary for whom the Code makes no provision.

Subsection (3) requires pro rata distribution. Questions of priority and lien rights under state and federal law are completely disregarded. Certainly, it was not the intention of the draftsmen of the Code to abrogate all statutory and common law priorities in bulk transfer situations. The fact is that questions of priority are often complex and the answers uncertain. The buyer who makes distribution without a complete and thorough analysis of all priority rights will be placing himself in great peril. The only safe course open to the buyer is to pay the proceeds into court under section 6-106(4) or a state interpleader statute.

This procedure will get the buyer off the hook but will usually be totally unacceptable to the seller who will be faced with a long, complex court administration before he receives any portion of the purchase proceeds. The statute is completely silent on the mechanics of administration. No indication is given in regard to the method of filing claims, machinery for settlement of disputes, ordering of priorities, or for the appointment and/or compensation of the officers who

⁴² UNIFORM COMMERCIAL CODE § 6-106(1).

⁴³ Subsection 6-106(2) speaks only of disputed claims. It must be presumed that claims which are undisputed, but are contingent and/or unliquidated, will be treated in the same fashion.

are to administer the fund. The court is asked to perform the duties of administering an estate, which may well be insolvent, without any of the usual guidelines found in statutes providing for administration of estates.⁴⁴

Finally, it should be noted that the funds held out by the buyer are not required to be earmarked and are not impressed with any trust in favor of the seller's creditors. If the buyer should misappropriate the proceeds or if they are attached by the buyer's creditors, the seller's creditors may have nothing more than a general claim against the seller.⁴⁵

Section 6-106 will, in general, be practicable primarily in those cases where the debts are readily determinable and the proceeds are clearly sufficient to pay these debts in full. Unfortunately, this is the type of situation where the added protection is least needed. Where there is uncertainty and a possible deficiency of proceeds to meet obligations, section 6-106 will more than likely present insuperable obstacles to compliance with the Code. The result will often be a liquidation in bankruptcy or receivership to the detriment of buyer, seller, and creditors alike.

VI. Auction Sales

Section 6-108 prescribes special rules applicable to sales at public auction. Under pre-Code law in most states, auction sales were generally excluded from the operation of the bulk sales acts on the theory that since auction sales are usually publicly advertised well in advance, creditors would have ample opportunity to learn of the proposed sales and to take appropriate action to protect their rights. The draftsmen of the Code obviously felt otherwise:

[I]t is equally clear that if auctions were excluded entirely from the transfers covered by the Article the way would be open to a debtor to carry out a bulk transfer of his property without notice to his creditors and without any duty upon anyone to see to the application of the proceeds.⁴⁶

How a debtor could expect an auction sale to be successful without some form of public advertising or notification is difficult to understand. It would seem that the possibility of creditors being defrauded through auction sales would be far less than the possibility in the case of private sales of equipment or of service enterprises which are specifically exempt!

In the case of auction sales it is not feasible, of course, to apply the requirements applicable to other sales because neither the purchase price nor the identity of the purchasers is known until the time of sale. The Code, therefore, provides that it is the auctioneer who must receive and retain the schedules of property⁴⁷ and must give the requisite notice.⁴⁸ The notice need indicate

44 Compare the usual elaborate provisions of statutes treating insolvent or probate estates or corporate liquidations with the approach of section 6-106. All of the problems that arise in these types of administration can be present when distributing the proceeds of a bulk sale.

45 This question does not appear to have been considered by any court. The result may depend on whether the seller has in fact earmarked the proceeds and set them aside under conditions giving rise to an express or implied trust under general equity principles.

46 UNIFORM COMMERCIAL CODE § 6-108, Comment 1.

47 UNIFORM COMMERCIAL CODE § 6-108(3)(a).

48 UNIFORM COMMERCIAL CODE § 6-108(3)(b).

only the time and place of the auction sale.⁴⁹ As in the case of ordinary sales, the notice must be given by registered or certified mail to all persons shown on the list and to all persons known to hold or assert claims against seller.⁵⁰

Where section 6-106 is in force, the adoption of subsection 6-108(3)(c) is recommended by the Permanent Editorial Board. This subsection requires the auctioneer to assure that the net proceeds of the auction are applied in accordance with section 6-106.⁵¹

The final subsection of section 6-107 provides that noncompliance will not affect the validity of the sale or the title of the purchaser, but that if the auctioneer knows that the auction constitutes a bulk transfer he becomes liable to the creditors of seller as a class for the amount owing to them up to, but not exceeding, the net proceeds of the sale.⁵²

VII. Effect of Noncompliance on Creditors' Rights

As we have noted, the effect of noncompliance, except in case of auction sales, is to render the sale ineffective against any creditor.⁵³ Section 6-109 provides:

- (1) The creditors of the transferor mentioned in this Article are those holding claims based on transactions or events occurring before the bulk transfer, but creditors who become such after notice to creditors is given (Sections 6-105 and 6-107) are not entitled to notice.

- [(2) Against the aggregate obligation imposed by the provisions of this Article concerning the application of the proceeds (Section 6-106 and subsection (3)(c) of 6-108) the transferee or auctioneer is entitled to credit for sums paid to particular creditors of the transferor, not exceeding the sums believed in good faith at the time of the payment to be properly payable to such creditors.]⁵⁴

Subsection (1) raises questions of great practical importance in situations where compliance is had as to all but one or more creditors who are inadvertently omitted. Of course, if these creditors are not listed and/or known to the buyer, he is absolved under the provision of subsection 6-104(3). But suppose the omitted creditors were listed and overlooked, or that although not listed, they

49 Section 6-108(b)(3) requires the auctioneer to give "notice of the auction by registered or certified mail at least ten days before it occurs." This language is meaningless unless construed to require specification of time and place of the proposed sale.

50 UNIFORM COMMERCIAL CODE § 6-108(3)(b).

51 Thus, the auctioneer is asked to comply with section 6-106, a section which by its specific terms excludes auction sales. One is reminded of the old logical paradox presented by the card with legends on both sides, one stating "the statement on the other side of this card is true," and the other stating "the statement on the other side of this card is false."

52 As in the case of section 6-106, however, the proceeds are not required to be earmarked, or impressed with any statutory trust in favor of the seller's creditors. In the absence of voluntary earmarking or segregation the seller's creditors may merely become general creditors of the auctioneer.

53 UNIFORM COMMERCIAL CODE § 6-105.

54 The bracketed subsections are optional.

were creditors of whom he did have or should have had knowledge, such as taxing bodies or utilities.⁵⁵

There would seem to be no doubt that in such an instance the transfer should be ineffective as to the omitted creditors. They will not receive notice and may therefore be prevented from taking steps to insure payment of their claims from the proceeds of sale. The transferee could not complain if he were subjected to liability for these particular claims.

But what about the claims of the creditors who were duly scheduled and did receive notice? And what about the interim creditors who were not entitled to notice?⁵⁶ The language of the Code states that failure of compliance in any respect renders the transfer "ineffective as to any creditor."⁵⁷ Literally applied, this would mean that even the creditors who were duly listed and received notice could still press their claims against the transferee. Such a result seems neither logical nor equitable, and it is unlikely that the courts will interpret the Code in such a harsh fashion. However, since there have been no decisions in point at this time, great care must be taken in every bulk sale to avoid even the most minor omission.⁵⁸

VIII. Creditors and Transferees of the Buyer

Assuming that a transfer is ineffective, what is the effect on subsequent transferees? With regard to purchasers, the answer is given by section 6-110, which provides:

When the title of a transferee to property is subject to a defect by reason of his non-compliance with the requirements of this Article, then:

- (1) a purchaser of any of such property from such transferee who pays no value or who takes with notice of such non-compliance takes subject to such defect, but
- (2) a purchaser for value in good faith and without such notice takes free of such defect.

Note that here in section 6-110 the Code speaks of "notice" rather than "knowledge." Unlike "knowledge," which is defined as "actual knowledge,"⁵⁹ a person has "notice" of a fact when "[F]rom all the facts and circumstances known to him at the time in question he has reason to know that it exists."⁶⁰

Thus, a good faith⁶¹ purchaser for value⁶² who neither knows nor has reason to know of his seller's noncompliance takes free of the claims of the creditors of

⁵⁵ See text accompanying notes 31-32 *supra*.

⁵⁶ See UNIFORM COMMERCIAL CODE § 6-109(1).

⁵⁷ UNIFORM COMMERCIAL CODE § 6-105.

⁵⁸ In the event of subsequent bankruptcy, however, there would seem to be no doubt that the transaction would be completely voidable if it was ineffective and therefore voidable as against any creditor having a claim provable in the bankruptcy proceedings. Bankruptcy Act § 70e, 11 U.S.C. § 110e (1964). See *Moore v. Bay*, 284 U.S. 4 (1931).

⁵⁹ UNIFORM COMMERCIAL CODE § 1-201(25)(a).

⁶⁰ UNIFORM COMMERCIAL CODE § 1-201(25).

⁶¹ "Good faith" means honesty in fact in the conduct or transaction concerned. UNIFORM COMMERCIAL CODE § 1-201(19).

⁶² Value is broadly defined by the Code to cover almost any type of consideration sufficient to support a simple contract. UNIFORM COMMERCIAL CODE § 1-201(44).

the original seller; all others take subject to all defects arising from noncompliance.

A related question concerns the relative rights of creditors of the buyer and seller where the requirements of article 6 have not been met. Pre-Code cases often turned on the question whether the transaction was void or merely voidable. If absolutely void, of course, the buyer never received any interest in the property supposedly transferred and there was nothing to which the rights of the buyer's creditors could attach. The courts generally held, however, that the sale was merely voidable at the instance of the seller's creditors, provided that the rights of creditors of the buyer had not already attached.⁶³ The rights of the buyer's creditors were paramount if they were perfected earlier in point of time.⁶⁴

Although the Code uses the term "ineffective" rather than voidable, the leading judicial decision to date follows the reasoning of the pre-Code cases. *In re Dee's, Inc.*⁶⁵ involved a contest between the respective trustees of an individual bankrupt and of a corporation to which he had made a bulk transfer without complying with article 6. Since the corporate bankruptcy was filed before the individual case, the court held that the corporate trustee should prevail. The court reasoned that "the purported transfer was voidable rather than void,"⁶⁶ and therefore the rights of the seller's creditors were cut off when the corporate bankruptcy commenced.⁶⁷

IX. Limitations

The possible harsh effect of some of the provisions previously discussed is abated to a certain extent by the short limitation period prescribed by the Code. Section 6-111 provides that:

No action under this Article shall be brought nor levy made more than six months after the date on which the transferee took possession of the goods unless the transfer has been concealed. If the transfer has been concealed, actions may be brought or levies made within six months after its discovery.

In any instance, therefore, in which there has been anything resembling an attempt at substantial compliance, the six-month period will run from the date of the transfer and will be an absolute bar to any action commenced after its expiration.⁶⁸

A question may arise as to just what constitutes commencement of the action. It would appear that in order to toll the statute creditors would have to take overt action against the transferee either by naming him as a party defendant in an action or by asserting action against the goods through a creditor's bill, receivership, or levy.

63 *E.g.*, *Schwartz v. A.J. Armstrong Co.*, 179 F.2d 766 (2d Cir. 1950).

64 *Id.*

65 311 F.2d 619 (3d Cir. 1962).

66 *Id.* at 622.

67 *Id.*

68 In *Aluminum Shapes, Inc. v. K-A-Liquidating Co.*, 290 F. Supp. 356 (W.D. Pa. 1968), the court held that concealment under section 6-111 encompasses only cases of affirmative concealment, as contrasted with mere non-disclosure or failure to give "public notice."

In the typical case, creditors will probably commence, or may have already commenced, an action against the seller or on his open account. When this has been reduced to judgment the creditor will then proceed to levy, under applicable procedures, against the property which is now in the buyer's possession. The critical date should be the date on which the actual levy was attempted and not the date on which the action was commenced against the seller.

It is probably safe to say that in many instances where bulk sales were in fact defective, the six-month limitation period has saved the day for the buyers. Perhaps this is just as well. If at the end of six months no creditor has been sufficiently hurt to have commenced action, the buyer should be entitled to rest secure in the knowledge that his title is free from attack for any technical defect.

X. Creditors' Rights

The preceding discussion has examined article 6 primarily from the point of view of the buyer who wishes to consummate a bulk sale without running the risk of liability to the seller's creditors. It is now appropriate to examine the problem from the other side—that of the creditors of the transferor who is about to effect a bulk transfer.

If article 6 has not been complied with, the creditor, of course, has the right to proceed against the goods in the hands of the transferee and to levy against them or take such other action as would have been available if the transfer had not taken place. He must act promptly within the period of limitations. If the transfer has not been concealed he must act within six months after transfer of possession; if the transfer is concealed, he must act within six months of its discovery.⁶⁹

But what are the remedies available to the creditor who receives a timely and appropriate notice of a bulk transfer? First of all, the fact that he received a notice may not necessarily mean that all the provisions of the article have been fully met. The schedule of property may not have been prepared and preserved as required, and there is always the possibility, particularly in a bankruptcy proceeding, that he may be able to take advantage of the fact that other creditors were either omitted from the list of creditors or not properly notified. If he commences an action or institutes bankruptcy or insolvency⁷⁰ proceedings within the limitation period and proves that the sale was defective in any respect, he may effect a recovery from the buyer.

Where section 6-106 is in force the creditors can look to the buyer who is under a statutory obligation to apply the proceeds. But in the absence of section 6-106, how can the creditor assure himself that he will receive his fair share of the proceeds? Similarly, how can he assure himself that the consideration being paid is actually fair and represents the highest and best return available? The answer to these questions depends largely on particular state laws. If local law permits attachment or garnishment before judgment, he may proceed effectively

⁶⁹ UNIFORM COMMERCIAL CODE § 6-111.

⁷⁰ As of this date, the notice of a bulk sale, even by an insolvent seller, does not constitute an act of bankruptcy, but many groups, notably the National Bankruptcy Conference, have long advocated an appropriate amendment to the Bankruptcy Act.

to tie up the fund in the buyer's hands. On the other hand, if state law requires either a pre-existing judgment or a showing of extraordinary circumstances, accompanied by a substantial bond, the creditor may be powerless to act before it is too late. If grounds exist, state court receivership proceedings or even outright bankruptcy proceedings may be utilized.

The trouble with the last two remedies is that the cure may often be worse than the disease. In most instances, receivership under state law or a federal bankruptcy proceeding results in liquidation at auction for far less than the proposed bulk sale with substantially higher expenses of administration. It will be a rare instance where bankruptcy or receivership is preferable to an honestly administered bulk sale.

Where the creditor has reason to believe that the sale may be fraudulent or for an excessively inadequate consideration, he may be able to obtain relief by injunction. However, this would ordinarily require the posting of substantial bond; and if it turned out that the proposed sale was perfectly proper, the creditor might find himself substantially liable in damages as a result of his interference with the sale. This is clearly a remedy to be exercised only in extreme cases.

It is fortunate that in most instances it is possible to obtain cooperation from the parties and their attorneys. This will satisfy creditors as to the adequacy of the price, and it will assure them of prompt and proper distribution of the proceeds. Often bulk sales are made in cooperation with a committee or other representative of creditors with adequate voluntary controls which will ensure that no dissipation can occur. In the absence of such voluntary safeguards, however, the creditors' remedy may be quite limited.

XI. Conclusion

Article 6 meets a definite need, and in spite of its deficiencies it works surprisingly well in actual practice. There are, however, extensive gaps in the protection provided, and there are many areas of uncertainty. Parties to a bulk transfer, particularly the buyer and the creditors of the seller, must be unusually diligent if their rights are not to be jeopardized.

Article 6 has been described, perhaps not too harshly, as the "step-child" of the Uniform Commercial Code.⁷¹ Certainly it would seem that it does not show the effects of the painstaking research and careful consideration given to the other articles. The sharp division of opinion on the adoption of section 6-106 graphically illustrates the inability of the draftsmen to reconcile the two basic objections of any bulk sales law—to provide an inexpensive, expedient method of transferring good title to the buyer and to protect the rights of the seller's creditors.

Certain changes are clearly desirable. The present restrictions of section 6-102 should be relaxed and the article broadened to include all bulk transfers of tangible personal property, regardless of the nature of the enterprise. A clear and concise test, similar to the Wisconsin statute, should be incorporated to determine just what the "major part" of the inventory and/or equipment is.

⁷¹ Rapson at 226.

Similarly, an attempt should be made to limit the creditors protected by the statute to those whose claims are either fixed or readily ascertainable.

The present provisions for a short form notice should be deleted. The only time a short form notice can be safely used is when the buyer can rely absolutely on the seller's paying his debts in full—and when that happens, the buyer need not comply at all!

Section 6-105 should be amended to provide that noncompliance renders the transfer ineffective or voidable only as to creditors who are not notified or who are otherwise denied the protection of the article.⁷² If possible, the statute should be framed in such a way as to avoid the application in a subsequent bankruptcy proceeding of the doctrine of *Moore v. Bay*.⁷³

Against this background, it should be possible to construct an alternative to present section 6-106 which can win general approval. Among other things, this section should provide for segregation, earmarking, and holding in trust the funds to be paid to creditors so that they are not mere general creditors of the buyer. The Permanent Editorial Board could well devote extensive efforts and research toward the development of appropriate machinery which will adequately protect creditors without placing an undue burden on buyer and seller, and without subjecting the buyer and seller to the ambiguities and uncertainties of the present statute.

72 For example, it would be ineffective where creditors are denied the opportunity to examine the schedule of property and list of creditors. In this latter case, the limitation period ought to run from the date of such denial.

73 284 U.S. 4 (1931). In all probability this will require an appropriate and long overdue amendment of section 70e of the Bankruptcy Act. See note 58 *supra*.