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# Fraud Bases of Bulk Transferee Liability

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## FRAUD BASES OF BULK TRANSFEREE LIABILITY†

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### INTRODUCTION

Consider the so-called "black hole," a seeming void, a mass of apparently

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nothing. At least on one level, the black hole is the product of theory, an idea that defies appreciation in our experiential dimensions of time and space. For purposes of this extended metaphor, however, it is helpful to recognize that the black hole may be deceptive: what appears to be a void may in fact be the situs of the most densely packed matter. There could be more in that black hole than would be apparent to the casual observer, because even light cannot escape the attraction of the "void." More significantly, if theories positing black holes are viable, the black hole is a point of intense gravitational attraction, perhaps the greatest conceivable attraction.<sup>1</sup>

Efforts to reformulate the bulk sales law may preclude use of bulk sales avoidance theories promulgated in Article 6 of the Uniform Commercial Code ("UCC" or "Code"), leaving a void. But poet-physicists know better: what remains after the dust settles may instead be a black hole. That black hole could attract more commercial fraud detritus than ever imagined possible under the current Article 6 regime.<sup>2</sup>

This essay surveys the heavens in the wake of the recent American Law Institute ("ALI")<sup>3</sup> and National Conference of Commissioners on Uniform State Laws ("NCCUSL")<sup>4</sup> Repeal/Revision alternatives (the "Alternatives") to the current Article 6 bulk transfer law,<sup>5</sup> and suggests that consequences of the Alternatives not fully anticipated by the sponsoring organizations may clutter the commercial law in ways that will frustrate rather than serve the interests of transactors. Granted, there may be the stuff of "Chicken Little" here.<sup>6</sup>

The inquiry proceeds by describing the bulk sale in terms that emphasize its similarity to fraud principles generally. Then the relationship between the constructive and actual fraud bases of bulk sales liability is considered. Next the foundations of actual intent to defraud liability in the commercial law are ana-

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1. See generally, S. HAWKING, A BRIEF HISTORY OF TIME, FROM THE BIG BANG TO BLACK HOLES (1988).

2. UNIFORM COMMERCIAL CODE, Article 6, Bulk Transfers (1987). All citations to the Uniform Commercial Code (U.C.C.), unless otherwise indicated, are to the 1987 text. See *infra* Appendix for the complete text of Article 6.

3. The American Law Institute (ALI), developed in 1921 to prepare restatements of the law, was one of the bodies contributing to the drafting and promulgation of a revised Article 6. For a discussion of the ALI and its mission, see generally Goodrich, *The Story of the American Law Institute*, 1951 WASH. U.L.Q. 283; Lewis, *History of the American Law Institute and the First Restatement of the Law*, in AMERICAN LAW INSTITUTE RESTATEMENT IN THE COURTS 1 (perm. ed. 1945).

4. The National Conference of Commissioners on Uniform State Laws (NCCUSL), begun in 1892, is composed of unpaid commissioners who are appointed by state governors and who prepare acts for consideration by state legislatures. See generally Durhan, *A History of the National Conference of Commissioners on Uniform State Laws*, 30 LAW & CONTEMP. PROBS. 233 (1965). The NCCUSL was the second body participating in the drafting and promulgation of the revisions to Article 6.

5. UNIFORM COMMERCIAL CODE, Repealer of Article 6 Bulk Transfers and [Revised] Article 6 Bulk Sales (1989) (Revised U.C.C. Art. 6 (1989)). Approved by the NCCUSL in August, 1988, and by the ALI in May, 1989, the current text allows states to select one of two alternatives. Alternative A repeals Article 6; Alternative B revises Article 6. The repealer is the alternative recommended by the sponsoring organizations. Revised U.C.C. Art. 6, Prefatory Note at 620-21.

6. See J. JACOBS, ENGLISH FAIRY TALES 113 (3d ed. 1967) ("The skys-a-falling").



lyzed to support conclusions regarding the relationship between constructive and actual fraud principles. From that perspective, treatment of transferee liability issues as they are resolved under current Article 6 guides the analysis of the transferee liability issues posited by the Alternatives.

# I. RELATIONSHIP OF BULK TRANSFER LIABILITY TO THE ACTUAL INTENT TO DEFRAUD

Under Article 6, a bulk sale occurs when a business engaged in the sale of merchandise from stock<sup>7</sup> sells more than fifty-percent<sup>8</sup> of its inventory out of the ordinary course of business.<sup>9</sup> Currently, Article 6 provides limited protection for creditors of a bulk transferor by requiring that those creditors receive notice prior to a bulk transfer of assets.<sup>10</sup> Appraisal of the impact of the proposed Alternatives on this creditor protection requires an understanding of the fraud elements that arguably attend the bulk sale.

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7. U.C.C. § 6-102(3). *See also* Nolte v. Winstanley, 16 Ariz. 327, 145 P. 246 (1914) (fixtures, wagons, teams, and implements of manufacture are personalty, not stock in trade under terms of bulk sales statute); W.B. Parham & Co. v. Potts-Thompson Liquor Co., 127 Ga. 303, 56 S.E. 460 (1907) (bar fixtures are part of stock of goods within meaning of bulk sales statute); J. WHITE & R. SUMMERS, UNIFORM COMMERCIAL CODE § 20-2, at 891-900 (3d ed. 1988) (UCC bulk transfer law applies to transfers not in ordinary course of business, that constitute major part of inventory composed of materials, supplies, merchandise); Miller, *Bulk Sales Laws: Businesses Included*, 1954 WASH. U.L.Q. 1 (case law application of bulk sales law uniformly covers retail merchants and most restaurants, bars, and mercantile businesses; repair shops and farmers generally exempt; unclear whether manufacturers covered). *But see* Yeager v. Powell, 219 Ark. 713, 244 S.W.2d 141 (1951) (mortgage of repair shop's entire parts stock within bulk mortgage statute); North Am. Provision Co. v. Fischer Lime & Cement Co. 168 Ark. 106, 269 S.W. 993 (1925) (sales by wholesale merchants subject to bulk sales law); Michigan Packing Co. v. Messaris, 257 Mich. 422, 241 N.W. 236 (1932) (restaurants' supplies should be protected by bulk sales statute).

8. *See* Ganz v. Kovatch Corp. (*In re* Wicaco Mach. Co.), 55 Bankr. 588, 591 (Bankr. E.D. Pa. 1985) (court considers inventory's fair market value and debtor's tax return to compute 50% figure that determines "major part" of inventory), *appeal denied* 60 Bankr. 415 (E.D. Pa. 1986); Martin Marietta Corp. v. New Jersey Nat'l Bank, 505 F. Supp. 946, 950 (D.N.J.) (extracted sand basis of measuring inventory, not sand remaining in ground), *aff'd in part, remanded in part*, 653 F.2d 799 (3d Cir. 1981); *In re* Albany Brick Co., 12 U.C.C. Rep. Serv. (Callaghan) 165 (Bankr. M.D. Ga. 1972) (one third of inventory not major part of inventory). *See also* W. HAWKLAND, UNIFORM COMMERCIAL CODE SERIES 6-28 to 6-29 (1984) (urges addition of new subsection to 6-102 defining "major part" as "more than fifty percent in fair market value of the transferor's total inventory"); Miller, *Bulk Sales Law: Meaning to be Attached to the Quantitative and Qualitative Requirements Phases of the Statutes*, 1954 WASH. U.L.Q. 283, 320 (major part means more than one half).

Revised U.C.C. § 6-102(1)(c)(ii) defines a bulk sale as "a sale . . . of more than half the seller's inventory, as measured by value."

9. *See, e.g.*, First Nat'l Bank v. Crone, 157 Ind. App. 665, 671, 301 N.E.2d 378, 382 (1973) ("sale must be . . . a rare and irregular event, occurring but few times in life of a merchant"); National Bank v. Frydlewicz, 67 Mich. App. 417, 241 N.W.2d 471 (1976) (extraordinary transaction, outside day-to-day operation, is not in ordinary course). *But see* Murdock v. Plymouth Enters., Inc. (*In re* Curtina Int'l, Inc.), 23 Bankr. 969, 977 (Bankr. S.D.N.Y. 1982) (inventory liquidation sale in ordinary course where typical to transferor's industry, routine for transferor, and did not result in discontinuance of any line of transferor's business); Martin Marietta Corp. v. New Jersey Nat'l Bank, 505 F. Supp. 946 (D.N.J.) (large sale of sand in ordinary course because not atypical based on nature of business), *aff'd in part, remanded in part*, 653 F.2d 779 (3d Cir. 1981).

10. U.C.C. § 6-105.



The bulk sale may be construed in misrepresentation terms<sup>11</sup> from the perspective of a consensual (contract) creditor of the bulk transferor ("transferor"). The creditor supplies the transferor with goods or services and is willing to extend the transferor unsecured trade credit, relying on the apparent corpus of tangible assets. The creditor assumes that the transferor is stationary; the debtor-transferor's visible assets will provide a source of payment should the transferor become unwilling or unable to pay. To realize the value of those assets the creditor must simply attach the inventory either provisionally or by executing on a judgment against the transferor.<sup>12</sup> It is not clear, however, that the creditor's understanding of commercial law, including issues of provisional or postjudgment attachment, comports with reality. The transferor's visible assets might have been encumbered by a prior collateral interest in favor of an all assets lender.<sup>13</sup> Indeed, the very goods delivered to the transferor by the creditor may be subject to the prior claim of a secured party by operation of an after-acquired property clause in the security agreement between the transferor and its secured creditor.<sup>14</sup> Similarly, the bulk sale eliminates those assets upon which the creditors initially relied when contracting with the transferor. From the creditors' perspective, the bulk sale retroactively effects a misrepresentation concerning the financial condition of the transferor.

This essay will not argue that the creditor protection afforded under bulk sales law makes sense. Certainly, there are responsible arguments supporting the ALI's and NCCUSL's recommendation that Article 6 be repealed.<sup>15</sup> Were all who sell goods and services on open account sufficiently sophisticated, they would research their customers' creditworthiness more thoroughly and even obtain purchase money collateral interests where feasible.<sup>16</sup> Alternatively, it could be argued that, in most cases, providing goods on open account is economically

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11. See P. ALCES, *THE LAW OF FRAUDULENT TRANSACTIONS* ¶ 4.03[2], at 4-10 (1989) (citing *Elliot Grocer Co. v. Field's Pure Food Mkt., Inc.*, 286 Mich. 112, 114, 281 N.W. 557, 558 (1938) (sale of fixtures without accompanying sale of merchandise violated bulk sales statute because depleted visible assets on which creditor would rely)).

Dean Robert Clark discerned four consistent concerns that determine the duties of a debtor to its creditors: truth, respect, evenhandedness, and nonhinderance. Clark, *The Duties of the Corporate Debtor to its Creditors*, 90 HARV. L. REV. 505, 509-12 (1977). Application of these principles to bulk transactions illustrates the affinity between the bulk sales and fraudulent disposition law. Alces, *The Confluence of Bulk Transfer and Fraudulent Disposition Law*, 41 ALA. L. REV. 821, 840-42 nn.71-79 (1990).

12. See generally T. CRANDALL, R. HAGEDORN & F. SMITH, *DEBTOR-CREDITOR LAW MANUAL* (1985 & Supp. 1989) (thorough survey of provisional and postjudgment remedies available to the creditor of bulk transferor).

13. An "all assets lender" would have a perfected collateral interest in all of the debtor's personal property by operation of U.C.C. Art. 9 (1987).

14. U.C.C. § 9-204.

15. See Revised U.C.C. Art. 6, Prefatory Note; Rapson, *U.C.C. Article 6: Should It Be Revised or 'Deep-Sixed'?*, 38 BUS. LAW. 1753 (1983) (usefulness of Article 6 unclear for present day transactions; draft revisions are improvement but fall short of what is needed).

16. U.C.C. § 9-312(3), (4). These subsections assure priority of purchase money security interests (PMSIs) over earlier nonpurchase money interests that might be asserted under after-acquired property clauses. U.C.C. § 9-312 comment 3. Otherwise, the prior collateral interest in after-acquired property would generally prevail. U.C.C. §§ 9-204, 9-312(5).



rational. That is, in most commercial events, nothing goes wrong with a deal, from contracting to delivery to payment. Consequently, it would not be sensible for a supplier to paper all deals with the legal safeguards necessary in only a small fraction of cases.

But the commercial fraud law generally<sup>17</sup> and the bulk sales law particularly, vouchsafe after-the-fact adjustment of equities in ways that do not take into account a before-the-fact appraisal of the relative economic postures of the parties. For example, suppose that a creditor is left with a virtually worthless claim in bankruptcy while another party is in possession of goods manufactured through the use of materials made available to the debtor-transferor by that creditor. Courts may entertain theories that would ensure the compensation of the aggrieved creditor, even at the expense of a putative buyer in the ordinary course who later is identified as a bulk transferee. The balance of equities will almost certainly be affected by the state of affairs that exists at the time the bulk sale is challenged.<sup>18</sup>

Accepting the misrepresentation basis of the bulk sales law and appreciating the courts' willingness to reorder the claims of parties in bankruptcy, it may not be difficult to formulate the bulk sales cause of action in terms that parallel actual fraud principles. The bulk transferee, though perhaps not aware that there was an existing trade creditor relying on the transferor's inventory, may be chargeable with the knowledge that a sale of a majority of the transferor's stock could prejudice the interests of those who do business on open account with the transferor.<sup>19</sup> Of course, if the proceeds of the bulk sale are injected back into the business or used more directly to discharge outstanding claims, trade creditors have no standing to complain. In the aftermath of a bulk sale, however, the proceeds are often not injected back into the business or used to discharge creditors' claims. It is in such instances, where the transferor does not act as a responsible fiduciary of his creditors' interests,<sup>20</sup> that the case may move into a

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17. See generally Statute of 13 Elizabeth, ch. 5 (1571); Uniform Fraudulent Conveyance Act, 7A U.L.A. 161 (1978) [hereinafter UFCA]; Uniform Fraudulent Transfer Act, 7A U.L.A. 639 (1985) [hereinafter UFTA]; 11 U.S.C. §§ 547, 548 (1988).

18. Just as a bulk sale divests the transferor of its assets, the transaction may signal the failure of the business. A bulk sale is, necessarily, an unusual event. See *National Bank v. Frydlewicz*, 67 Mich. App. 417, 423, 241 N.W.2d 471, 471 (1976) (sale of retail stock after store closing is extraordinary transaction). See also *First Nat'l Bank v. Crone*, 157 Ind. App. 665, 671, 301 N.E.2d 378, 381-82 (1973) (bulk sales act applies when sale extraordinary, "a rare and irregular event, occurring but few times in life of a merchant") (citing *Sternberg v. Rubenstein*, 305 N.Y. 235, 112 N.E.2d 210 (1953)).

19. Cf. *Adrian Tabin Corp. v. Climax Boutique, Inc.*, 34 N.Y.2d 210, 220, 313 N.E.2d 66, 72, 356 N.Y.S.2d 606, 614 (1974) (Gabrielli, J., dissenting) (Article 6 contemplates, or should be construed to contemplate, imposition of burden on transferee to inquire into existence and extent of creditors' claims against transferor).

20. Cf. *Krivo Indus. Supply Co. v. National Distillers & Chem. Co.*, 483 F.2d 1098, 1102-03, (1973), modified, 490 F.2d 916 (5th Cir. 1974) (indicates creditor control and dominance over debtor's affairs may establish liability); *A.G. Jensen Farms Co. v. Cargill, Inc.*, 309 N.W.2d 285, 290-94 (Minn. 1981) (primary creditor's exercise of substantial control over debtor's affairs gives rise to liability).

bankruptcy court. It may then be determined that the transferee was in the best position to avoid the consequences of the apparent "fraud."

### *A. Fraud and the Bulk Transfer Law*

In several important ways, bulk sales liability is akin to constructive fraud liability. That is, a transfer may be rendered "ineffective" merely because the plaintiff did not receive proper notice of the bulk sale.<sup>21</sup> Liability does not arise because the parties to the bulk transfer schemed to deprive the creditor of its property or of its interest in the property of the transferor. To prevail in the bulk sales action, the plaintiff need not establish the animus of the bulk transferor or transferee. Prejudice to the interests of the creditor is presumed notwithstanding evidence that the transfer was not the efficient cause of the prejudice to the creditor's position.<sup>22</sup> There is also no requirement that the plaintiff creditor demonstrate prejudice in fact.<sup>23</sup> In that way, bulk sales liability accrues in much the same way as constructive fraudulent disposition liability accrues under the uniform state law on fraudulent transfers<sup>24</sup> and the Bankruptcy Code.<sup>25</sup> So long as the claimant in a fraudulent disposition action establishes the bases of avoidance (generally impaired financial condition of debtor and debtor's receipt of inadequate consideration from the transferee),<sup>26</sup> the law does not care

21. U.C.C. § 6-105.

22. This might explain why the bulk sales law lacks any express remedial provision. It is not clear exactly what rights are provided for the victim of either a complying or noncomplying bulk sale.

23. *But cf.* 11 U.S.C. § 547(b)(5) which provides:

[T]he trustee may avoid any transfer of an interest of the debtor in property . . .

(5) that enables such creditor to receive more than such creditor would receive if

(A) the case was a case under chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

This element of a preference requires some improvement in the transferee's position over what the transferee would have received in a hypothetical liquidation of the debtor's assets. This implies that other creditors have been prejudiced. Absent such prejudice to the other creditors of the debtor, the transfer is not avoidable.

24. *See* UFTA §§ 4(a)(2), 5(a) (debtor must receive reasonably equivalent value); UFCA §§ 4-6 (debtor must receive fair consideration).

25. *See* 11 U.S.C. § 548(a)(2) (debtor may not receive less than reasonably equivalent value).

26. *See* 11 U.S.C. § 548(a). Section 548(a) provides:

The trustee may avoid any transfer . . . if the debtor . . . received less than a reasonably equivalent value . . . [and] was insolvent . . . or became insolvent as a result . . . [or] was engaged in business . . . for which any property remaining with the debtor was an unreasonably small capital . . . [or] believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured.

*See also* UFCA § 4 (conveyance made by person thereby rendered insolvent is fraudulent if without fair consideration); UFCA § 5 (conveyance made without fair consideration when person making it engaged in business or transaction for which remaining property is unreasonably small capital is fraudulent); UFCA § 6 (conveyance made without fair consideration when person making conveyance intends or believes he will incur debts beyond ability to pay is fraudulent); UFTA § 4(a) (transfer made is fraudulent if debtor made transfer without receiving reasonably equivalent value and was engaged in transaction for which remaining assets were unreasonably small or debtor rea-



whether the plaintiff-creditor was in fact harmed; prejudice is presumed, as it is in the bulk sales law.

Given the misrepresentation basis of bulk sales liability, the breadth of the class of potential plaintiffs under the current bulk sales law confirms that constructive fraud principles support the imposition of liability. Section 6-109 of Article 6 provides that all creditors "holding claims based on transactions or events occurring before the bulk transfer" are entitled to prior notice of the bulk sale and have standing to attack the sale if they do not receive the required notice. Thus, in addition to the contract creditors of the transferor, tort claimants (nonconsensual creditors) may set aside the bulk sale. That is so even though the nonconsensual creditors never relied on the corpus of the transferor's assets, and notwithstanding the fact that their claims may not be liquidated.<sup>27</sup>

The next step in the analysis is to describe the elements of actual fraud in the fraudulent disposition setting, focusing on their evolution in terms that will be relevant when applying the general fraudulent disposition law to bulk sales. That survey, combined with the foregoing conclusions regarding the nature of bulk sales fraud liability, foreshadows the effort to draw parallels between the constructive fraud and actual fraud law. An appreciation of those parallels is a prerequisite to determining transferee liability issues under the proposed bulk sales regime.

### *B. Actual Intent to Defraud in Fraudulent Disposition Law*

Fraudulent disposition law developed early in commercial jurisprudence, claiming roots in the Roman statutes,<sup>28</sup> and assuming the form we would perhaps first recognize in the Statute of 13 Elizabeth, a penal statute.<sup>29</sup> Accordingly, liability under the specific language of the statute was actual fraud liability. The statute proscribed all conveyances effected with the "actual intent to hinder, delay, or defraud" creditors of the transferor.<sup>30</sup> Recognition of constructive fraud liability began in earnest with *Twyne's Case*.<sup>31</sup> In that case, the court enumerated the so-called "badges of fraud" as an adjunct of actual fraud liability.<sup>32</sup> The badges of fraud focused on *indicia* of prejudice to the creditors of the grantor rather than on any specific showing that prejudice had in fact resulted. Development of the badges, and, therefore, the bases of constructive

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sonably should have believe he [she] would incur debts beyond ability to pay); UFTA § 5(a) (transfer is fraudulent if debtor made transfer without receiving reasonably equivalent value and debtor was insolvent or became insolvent as result).

27. See U.C.C. § 6-109 comment 1 (creditors, including those with unliquidated claims, who may have rights under various provisions of Article 6, identified by § 6-109(1)).

28. See 1 G. GLENN, *FRAUDULENT CONVEYANCES & PREFERENCES* § 60, at 82 (Rev. ed. 1940) (origins of fraudulent conveyances); Radin, *Fraudulent Conveyances at Roman Law*, 18 VA. L. REV. 109 (1931) (Roman law compelled distinction between actual and constructive fraud).

29. 1 G. GLENN, *supra* note 27, § 61c, at 93.

30. See *id.* § 61c, at 93. See also, e.g., PA. STAT. ANN. ch. 2 (UFCA) app. at 309 (Purdon 1954) (text of Statute of 13 Elizabeth, ch. 5, Rob. Dig. 295).

31. 3 Coke Rep. 80b, 76 Eng. Rep. 809 (Star Chamber 1601).

32. *Id.* The court listed the badges of fraud as follows:

fraud liability, resulted from an evidentiary predicament: how to prove an actual intent to hinder, delay, or defraud.<sup>33</sup> So conceived, actual and constructive fraud liability are symbiotically related avoidance theories.<sup>34</sup> That relationship underlies the formulation of actual and constructive fraud liability from the Statute of 13 Elizabeth, through the Uniform Fraudulent Conveyance Act ("UFCA"), to the most recent enactments, Bankruptcy Code Section 548 and the Uniform Fraudulent Transfer Act ("UFTA").

### 1. Statute of 13 Elizabeth and *Twyne's Case*

The Statute of 13 Elizabeth codified fraudulent disposition law in terms of actual intent to defraud, and the case law that elaborated on the statute's prescription, most notably *Twyne's Case*, focused on those indicia from which an intent to defraud might be inferred.<sup>35</sup> Insofar as the object of an intent to defraud the creditors of the transferor would be manifest in actions that compromised the interests of those creditors, and in light of the fact that the creditors' concern is entirely with the transferor's ability to satisfy its indebtedness, the objective indicia of fraudulent intent address those actions that affect the financial condition of the transferor.

The *Twyne's Case* badges of fraud may all be understood in terms of their relation to the financial condition of the transferor and to the implicit or actual misrepresentation of that financial condition. The four badges of fraud having the most contemporary significance are: (1) general gift (disposition of all or substantially all of the transferor's assets); (2) ostensible ownership (transferor

1st. That this gift had the signs and marks of fraud, because the gift is general, without exception of his apparel, or any thing of necessity; for it is commonly said, *quod dolus versatur in generalibus*.

2nd. The donor continued in possession, and used them as his own; and by reason thereof he traded and trafficked with others, and defrauded and deceived them.

3rd. It was made in secret, *et dona clandestina sunt semper suspiciosa*.

4th. It was made pending the writ.

5th. Here was a trust between the parties, for the donor possessed all, and used them as his proper goods, and fraud is always apparelled and clad with a trust, and a trust is a cover of fraud.

6th. The deed contains, that the gift was made honestly, truly and *bona fide: et clausae inconsuet' semper inducunt suspicionem*.

*Id.* at 80b-81a, 76 Eng. Rep. at 812-14 (footnotes omitted).

33. For cases construing the badges of fraud in evidentiary terms, see, e.g., *Bank of Josephine v. Hopson*, 516 S.W.2d 339 (Ky. 1974) (transfer by debtor anticipating suit is badge of fraud); *Interstate Acceptance Corp. v. Lovins*, 380 S.W.2d 805 (Ky. 1964) (mere sale of house quickly and at low price not fraud); *Watson v. Harris*, 435 S.W.2d 667 (Mo. 1968) (intent to place property beyond creditor reach evidence of fraud); *Allison v. Mildred*, 307 S.W.2d 447 (Mo. 1957) (use of strawman in transaction evidence of fraud); *Everett v. Gainer*, 269 N.C. 528, 153 S.E.2d 90 (1967) (intrafamilial conveyance raises suspicion of fraud).

34. See Jackson, *Avoiding Powers in Bankruptcy*, 36 STAN. L. REV. 725, 778 (1984) (intent difficult to prove; thus, fraudulent conveyance law also has objective standard to supplement).

35. See 3 Coke Rep. at 80b, 76 Eng. Rep. at 811 (debtor made preferential transfer prior to issuance of writ of execution on debtor's property). The court found sufficient evidence to infer an actual intent to defraud because of the coincidence of the six badges of fraud. *Id.* at 80b-81a, 76 Eng. Rep. at 812-14.



retained possession of the assets notwithstanding surrender of title in them to a third party); (3) clandestine disposition; and (4) disposition in anticipation of litigation (self-imposed insolvency).<sup>36</sup> Those financial condition indicia have retained their significance as fraudulent disposition law has evolved.

## 2. Uniform Fraudulent Conveyance Act

In the United States, the UFCA retained the Statute of 13 Elizabeth language proscribing conveyances effected with the "actual intent to hinder, delay, or defraud."<sup>37</sup> One goal of the UFCA, and perhaps the primary one, was to refine the objectification of fraudulent disposition law by concentrating on the financial condition indicia of actual fraud. The drafters of the UFCA endeavored to address "the confusions and uncertainties of the [then] existing law," particularly the courts' "attempt to make the Statute of Elizabeth cover all conveyances which wrong creditors, even though the actual intent to defraud does not exist."<sup>38</sup> The drafters confirmed that the law under the Statute of 13 Elizabeth had operated to avoid transfers that resulted in prejudice to creditors, even "where an intent to defraud on the part of the debtor does not exist."<sup>39</sup> To clarify the law, the UFCA drafters distilled from the cases the reasoning supporting the decisions to assure that the statute would provide courts with the guidance necessary to reach just decisions. The result was development of the constructive bases of fraudulent disposition liability, emphasizing the financial condition of the transferor at the time of and as a result of the conveyance. Substantively, the UFCA clarified the indicia of debtor insolvency<sup>40</sup> and defined the "fair consideration" requirement relating to the adequacy of the consideration a transferor received in exchange for the assets conveyed.

The concepts underlying the Act's two-pronged definition of "fair consideration" provide the analytical roadmap from which to track the development and occasional convergence of actual and constructive fraud. Under the UFCA, a transferee gives fair consideration if the transferee gives a "fair equivalent" in "good faith."<sup>41</sup> What the transferee gives the transferor in return for the property conveyance that is the subject of the UFCA action must be the fair

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36. The two badges not considered here but listed in *Twyne's Case*, creation of trust and protestations of bona fides, are not pertinent to the typical bulk sale. Cf. UFTA § 4 comment 5 (use of trust and recitations of good faith no longer significant evidence of fraud).

37. See UFCA § 7.

38. UFCA, Prefatory Note.

39. *Id.*

40. See *id.* (earlier uncertainty in law stemmed from absence of definite conception of insolvency).

41. UFCA § 3(a). The UFCA definition of fair consideration is further bifurcated, distinguishing between the fair consideration measure in outright transfers and collateral transfers. For a discussion of the anomaly of that distinction, see Sabella, *When Enough Is Too Much: Overcollateralization as a Fraudulent Conveyance*, 9 CARDOZO L. REV. 773, 776 n.17 (1987) (absolute conveyances covered by UFCA § 3(a) and fair consideration means "fair equivalent" for property conveyed; section 3(b) covers loan security transfers; need greater parity of value for transaction to pass § 3(a) standards).



equivalent of the property received by the transferee and the transferee must give that fair equivalent in "good faith," a term undefined in the Act.

The purpose of the fair equivalent requirement is to assure that a creditor of the transferor could set aside a conveyance that either substantially depletes the corpus of the transferor's assets or occurs when the financial condition of the transferor is already compromised. While the law will not police all transactions that might not ultimately prove beneficial to a party who has creditors, it will intercede to protect the interests of those creditors when the financial condition of the transferor is impaired. It is precisely in those circumstances that a creditor's interests would be prejudiced in the same way as if the transferor had an actual intent to hinder, delay, or defraud the creditor. Thus, from the creditor's perspective, the state of mind of an insolvent transferor is irrelevant; the result is the same whether the challenged conveyance was the product of animus (actual fraud) or merely the lack of business acumen (constructive fraud). The appropriateness of the commercial fraud law's intercession to protect the creditors' position in the constructive rather than actual fraud setting is debatable.<sup>42</sup> Nonetheless, it is clear that the UFCA (and its statutory successors) vindicates such treatment.

If this were the extent of the UFCA constructive fraud provisions, it might still be unclear to some that the constructive and actual fraud theories share a fundamental affinity after the promulgation of the UFCA. But, in addition to the requirement that the value given by the transferee be adequate, the definition of fair consideration requires a showing that the transferee gave the consideration in good faith. As Professor Kennedy has explained, the good faith requirement operates to police conveyances to insiders,<sup>43</sup> those peculiarly well positioned to take advantage of the transferor.<sup>44</sup> Good faith considerations focus on the subjective state of mind of the transferee.<sup>45</sup> The courts have noted

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42. Compare Baird & Jackson, *Fraudulent Conveyance Law and Its Proper Domain*, 38 VAND. L. REV. 829, 831-40 (1985) (argues that creditor monitoring, rather than fraudulent conveyance law, should control debtor misbehavior where consensual creditor would wish to restrict or prohibit certain debtor activities) with Smyser, *Going Private and Going Under: Leveraged Buyouts and the Fraudulent Conveyance Problem*, 63 IND. L.J. 781, 784 (1988) (argues broad application of fraudulent conveyance statutes necessary to protect creditor interests even where specific contractual provisions restricting certain debtor activities might not be desired).

43. See Kennedy, *The Uniform Fraudulent Transfer Act*, 18 U.C.C. L.J. 195, 205 (1986) (elimination of good faith requirement would make avoidance of preferential transfers to insiders impossible). But see Note, *Good Faith and Fraudulent Conveyances*, 97 HARV. L. REV. 495, 503 (1983) (invalidation of preferences would merely "replace one recipient of the debtor's property with another").

44. See Alces & Dorr, *A Critical Analysis of the New Uniform Fraudulent Transfer Act*, 1985 U. ILL. L. REV. 527, 551-57 (discusses inclusive nature of insider status under Bankruptcy Code and UFTA; questions why drafters juxtaposed intentionally nonexclusive modifier "includes" with such extensive specification of relationships giving rise to insider status). Cf. 11 U.S.C. § 101(30) (1988) (insider defined in terms of specific relationships); UFTA § 1(7) (same).

45. See U.C.C. § 1-201(19) (subjective definition of good faith: "honesty in fact"). But see U.C.C. § 2-103(1)(b) (objective test of good faith regarding merchants: "observance of reasonable commercial standards of fair dealing").



a direct relationship between the lack of good faith and the existence of indicia of an actual intent to defraud under the UFCA. Three cases are illustrative.

In *Gifford-Hill & Co. v. Stoller*,<sup>46</sup> a state court considered an intrafamilial transfer, which is always suspect.<sup>47</sup> The husband had conveyed property to his wife within one week after a creditor initiated an action against him. The court considered the relationship between an actual intent to defraud and the good faith element of fair consideration under the UFCA.

'[G]ood faith,' among other characteristics, encompasses an absence or freedom from intent to defraud. Consequently, good faith and fraud are mutually exclusive terms; the presence of one excludes the existence of the other in the same subject. A lack of good faith is demonstrated by a transferee's participation in a plan to hinder creditors, even though the transfer may be supported by adequate consideration.<sup>48</sup>

Under the UFCA, the good faith element of fair consideration is relevant only in constructively fraudulent conveyances. The *Stoller* court, however, found a symbiotic relationship between good faith and fraud by inferring actual fraudulent intent from a lack of good faith. If the court's reasoning is correct, the distinction between actual and constructive fraud begins to blur.

In *Sparkman & McLean Co. v. Derber*,<sup>49</sup> a Washington appellate court reviewed the actions of an attorney-transferee of property. The court concluded that the attorney had not taken in good faith because the attorney was aware of the transferor's "chaotic financial situation" at the time of the conveyance. The court was troubled by the uneasy relationship between the lack of good faith, as an element of constructive fraud, and the actual intent to hinder, delay, or defraud. To resolve the perceived tension, the court relied on an earlier Washington decision — *Tacoma Association of Credit Men v. Lester*.<sup>50</sup> In *Lester* the

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46. 221 Neb. 757, 380 N.W.2d 625 (1986).

47. UFTA § 3 comment 2 (explains that value requirement will not be satisfied by consideration having no utility from creditor's viewpoint, such as love and affection). See, e.g., *United States v. West*, 299 F. Supp. 661, 664 (D. Del. 1969) (intrafamilial transaction alleged to be fraudulent more closely scrutinized than if between strangers, because fraud easily practiced and effectively concealed; *Springfield Ins. Co. v. Fry*, 267 F. Supp. 693, 695 (N.D. Okla. 1967) (property transfers between husband and wife neither invalid nor fraudulent by inference, but such transactions more closely scrutinized than those between unrelated parties); *Toledo Trust Co. v. Poole (In re Poole)*, 15 Bankr. 422, 432 (Bankr. N.D. Ohio 1981) (transfers between husband and wife or between family members suspect and subject to strictest scrutiny, particularly when consideration supporting transfer inadequate); *Kirkland v. Risso*, 98 Cal. App. 3d 971, 978-79, 159 Cal. Rptr. 798, 802 (1979) (transactions between close relatives not presumed fraudulent, but, when confidential relationship exists, parties held to fuller and stricter proof of fairness); *Richards v. Jones*, 16 Del. Ch. 227, 232, 142 A. 832, 835 (1928); *Sandler v. Parlapiano*, 236 A.D. 70, 71, 258 N.Y.S. 88, 90 (1932) (transfer made to near relatives without real consideration may be considered as likely to be in fraud of creditors); P. ALCES, *supra* note 11, ¶ 5.01[1][b], at 5-5 to 5-6 (citing *Orbach v. Pappa*, 482 F. Supp. 117, 119 (S.D.N.Y. 1979) (in intrafamily transaction, heavier burden exists to establish fair consideration for transfer)).

48. 221 Neb. at 764-65, 380 N.W.2d at 630 (citing *Filley v. Mancuso*, 146 Neb. 493, 20 N.W.2d 318 (1945)).

49. 4 Wash. App. 341, 481 P.2d 585 (1971).

50. 72 Wash. 2d 453, 433 P.2d 901 (1967).

court delineated three factors pertinent to the transferee good faith calculus: (1) honest belief in the propriety of the challenged conveyance; (2) *no intent* to take unconscionable advantage of others; (3) *no intent to hinder, delay, or defraud others*.<sup>51</sup> The *Derber* court adopted that approach and attempted to identify a distinction between the constructive and actual fraudulent conveyance law. The court found a difference in the evidentiary burden. The court held that the plaintiff must satisfy the "clear and satisfactory proof" standard to prove actual fraud.<sup>52</sup> To establish the lack of good faith basis of constructive fraud, however, the plaintiff must merely provide "substantial evidence" that any one of the three enumerated *Lester* bases was not satisfied.<sup>53</sup> Whether or not there is a real difference between those two evidentiary standards is arguable. It is clear, however, that the distinction drawn by the *Derber* court does not come ready-made in the UFCA. Rather, the *Derber* decision posits the fundamental affinity between the actual and constructive fraudulent disposition law.

### 3. Bankruptcy Code Section 548

The Bankruptcy Reform Act of 1978 modernized the debtor-creditor law. In so doing, it clarified fraudulent disposition law in the context of a bankruptcy proceeding. Section 548 of the Code, "Fraudulent Transfers," addresses the perceived incongruities of the predecessor enactments, including the UFCA.<sup>54</sup> Section 548 empowers a bankruptcy trustee to avoid those prebankruptcy transfers later deemed to be fraudulent. For present purposes, two aspects of section 548 are particularly noteworthy: the provision's continuation of the actual fraud language of the Statute of 13 Elizabeth and replacement of the "fair consideration" definition with the concept of "reasonably equivalent value."

Notwithstanding the passage of a few hundred years, the drafters of the late twentieth century bankruptcy law were not able to improve on the proscription against transfers effected with the "actual intent to hinder, delay, or defraud" creditors of the transferor.<sup>55</sup> So the actual fraud jurisprudence that developed around that formulation is pertinent under the actual fraud provision of section 548.

Recognizing the problematic nature of including a good faith element in the fair consideration calculus, however, the drafters of the Bankruptcy Code dropped the good faith concept from the avoidance provision of the constructive fraudulent transfer law and retained it only in the savings clause:

(c) Except to the extent that a transfer or obligation voidable under this section is voidable under section 544, 545, or 547 of this title, a transferee or obligee of such transfer or obligation *that takes for value and in good faith* has a lien on or may retain any interest transferred, or may enforce any obligation incurred, as the case may be, to the

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51. *Id.* at 458, 433 P.2d at 904 (emphasis added).

52. 4 Wash. App. at 349, 481 P.2d at 591.

53. *Id.*

54. 11 U.S.C. § 548(a). See *supra* note 26 for the pertinent text of § 548(a).

55. See 11 U.S.C. § 548(a)(1) (trustee may avoid transfer made "with actual intent to hinder, delay, or defraud" creditor).



extent that such transferee or obligee gave value to the debtor in exchange for such transfer or obligation.<sup>56</sup>

The absence of a good faith element in the reasonably equivalent value concept seems to distinguish constructive fraud from actual fraud more clearly than the earlier statutory approaches. Nonetheless, the financial condition bases of constructive fraud in section 548 are essentially similar to the *Twyne's Case* badges of fraud. So the confluence of actual and constructive fraud law that began in *Twyne's Case* and continued through the UFCA is preserved in Bankruptcy Code section 548. Indeed, it comes full circle in the latest incarnation of fraudulent disposition law promulgated by the NCCUSL — the UFTA.

#### 4. Uniform Fraudulent Transfer Act

Like its predecessors, the UFTA proscribes transfers effected with the "actual intent to hinder, delay, or defraud" creditors of the transferor.<sup>57</sup> The Act also provides for the avoidance of constructively fraudulent transfers - that is, those in which the transferee exchanges for less than a reasonably equivalent value at a time when the transferor's financial condition is or may be compromised.<sup>58</sup> So the tension between the actual and constructive fraud law remains much the same as it is under section 548 of the Bankruptcy Code.

The UFTA, however, surpasses the earlier enactments by providing a catalogue of indicia of fraudulent intent to complement the actual fraud provision.<sup>59</sup> The catalogue tracks substantially the *Twyne's Case* badges of fraud.<sup>60</sup> Three of the indicia, however, collapse actual and constructive fraud law:

- (8) the value of the consideration received by the debtor was [not] reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred;

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56. 11 U.S.C. § 548(c) (emphasis added). Under the UFCA, good faith is also a part of the savings provision by operation of the fair consideration concept in that section. UFCA § 9 provides that:

(1) Where a conveyance or obligation is fraudulent as to a creditor, such creditor, when his claim has matured, may, as against any person except a purchaser for fair consideration without knowledge of the fraud at the time of the purchase, or one who has derived title immediately or mediately from such a purchaser,

(a) Have the conveyance set aside or obligation annulled to the extent necessary to satisfy his claim, or

(b) Disregard the conveyance and attach or levy execution upon the property conveyed.

(2) A purchaser who without actual fraudulent intent has given less than a fair consideration for the conveyance or obligation, may retain the property or obligation as security for repayment.

57. UFTA § 4(a)(1).

58. *Id.* §§ 4(a)(2), 5(a).

59. *Id.* § 4(b).

60. *Twyne's Case*, 3 Coke Rep. 80b, 80b-81a, 76 Eng. Rep. 809, 812-14 (Star Chamber 1601). The court recognized six badges of fraud: 1) gifts of substantially all of the debtor's assets; 2) gifts with donor's continuing in possession; 3) gifts made in secret; 4) gifts pending litigation; 5) gifts in trust; and 6) gifts reciting that they are made in good faith. *Id.* See also *supra* notes 31-34 and accompanying text for a discussion of *Twyne's Case*.

- (9) the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred;
- (10) the transfer occurred shortly before or shortly after a substantial debt was incurred[.]<sup>61</sup>

Those indicia of actual fraud are also indicia of constructive fraud. The crucial and curious difference is that to establish constructive fraud the plaintiff creditor must establish *both* the impaired financial condition of the transferor *and* the inadequacy of the value given in exchange by the transferee.<sup>62</sup> But the mere fact of inadequacy of value *or* insolvency of the transferor constitutes an indicator of actual fraud sanctioned by the UFTA.<sup>63</sup> So, if establishing a *single* factor is ever construed as sufficient proof of actual fraud, it may be a less onerous burden for the plaintiff to establish actual fraud than to establish constructive fraud. The paradox lies in the amorphous nature of fraud itself.<sup>64</sup>

The next section of this article considers other contexts, including Article 6 bulk transfers law, in which the actual/constructive fraud law paradox has been played out.

### C. *The Convergence of Constructive and Actual Fraud*

The foregoing survey of the fraudulent disposition statutes has posited the tension between the constructive and actual fraud bases for transfer avoidance. The survey described the circular development of the relationship between actual and constructive fraud. Much as Gilmore described the merger of contract into tort,<sup>65</sup> the constructive fraud bases of avoidance are being merged into the actual fraud jurisprudence. Before considering the ramifications of the conclusions offered here for the new bulk transfer regime,<sup>66</sup> it is necessary to bring the actual/constructive fraud tension into sharper focus. The next part of this essay examines the courts' analysis of a transfer that occurs frequently in bankruptcy. This analytical tension also emerges in the bulk sales setting.

#### 1. Conversion of Non-Exempt Property

Under both federal bankruptcy law<sup>67</sup> and state debtor-creditor law<sup>68</sup> cer-

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61. UFTA § 4(8) - (10) comments 5, 6.

62. See UFTA § 4(a)(2), (5)(a).

63. See generally UFTA § 4(b) (factors used in determining actual intent).

64. See *Sleicher v. Sleicher*, 251 N.Y. 366, 371, 167 N.E. 501, 503 (1929) (Cardozo, C.J.) (phases of fraud are manifold). See also 1 J. STORY, COMMENTARIES ON EQUITY JURISPRUDENCE, AS ADMINISTERED IN ENGLAND AND AMERICA § 186, at 212 n.5 (1846) (fraud is infinite; were there strict rules defining fraud, relief would be perpetually eluded by new schemes) (quoting letter from Lord Hardwicke to Lord Kaimes (June 30, 1759)).

65. See G. GILMORE, THE DEATH OF CONTRACT 87-90 (1974) (growth of quasi-contract, unjust enrichment, and promissory estoppel indicates dissolution of classic contract consideration theory and merger with tort theories of liability).

66. See *infra* notes 113-254 and accompanying text for a discussion of the likely results of changing the bulk sales law.

67. 11 U.S.C. § 522 (1988).

68. See, e.g., CAL. CIV. PROC. CODE § 703.140(b) (West Supp. 1984); GA. CODE ANN. § 44-



tain property is exempt from the claims of creditors.<sup>69</sup> The object is to assure that the law does not produce so much debtor hardship for the sake of creditors' rights that the debtor is denied any real opportunity to rehabilitate itself.

Bankruptcy courts have had some difficulty determining whether a debtor's conversion of nonexempt property into exempt property on the eve of bankruptcy constitutes an actual intent to defraud creditors of the debtor or is merely unassailable strategic planning.<sup>70</sup> The tests developed by the courts reflect actual fraud indicia, focusing on the state of mind of the debtor to determine whether the debtor's actions were intended to hinder, delay, or defraud the debtor's creditors. The test posited by the United States Court of Appeals for the Second Circuit in *Bank of Pennsylvania v. Adlman (In re Adlman)*<sup>71</sup> focused on whether there is "convincing evidence of extrinsic fraud." The court reasoned that absent such a finding, the conversion would not constitute a fraudulent transfer.<sup>72</sup> The *Adlman* case concerned use of the proceeds from the sale of nonexempt real property to purchase exempt life insurance.<sup>73</sup> That is the type of exempt property that has been in issue in several of the leading conversion cases.

A similar scenario was examined more recently by a bankruptcy court in *Staats v. Beckman (In re Beckman)*.<sup>74</sup> In that case the challenged conversion was deemed fraudulent. As a basis for its conclusion, the *Beckman* court moved beyond the vague test of *Adlman* and developed a list of seven indicia of an actual intent to defraud when nonexempt assets are converted into exempt insurance just prior to bankruptcy. The list bears reproduction both to demonstrate its similarity to the badges of fraud and, therefore, to constructive fraud law, as well as to support the conclusion that in perhaps no area of the law is it more

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13-100 (Supp. 1988); ILL. REV. STAT. ch. 110, para. 12-1001 (1989); N.Y. DEBT. & CRED. LAW §§ 282, 283 (McKinney Supp. 1989); TEX. PROP. CODE §§ 41.001, 42.001 (Vernon 1986).

69. Exemptions are limited not only to the certain categories of property, but often to certain value amounts within those categories. See, e.g., 11 U.S.C. § 522(d)(2) (various exemptions allowed including motor vehicle value up to \$1200); CAL CIV. PROC. CODE § 703.140(b)(4) (exemptions may include debtor jewelry valued up to \$500); ILL. REV. STAT. ch. 110, para. 12-1001(d) (exemptions include up to \$750 in debtor's equity interest in implements, professional books, or tools of trade of debtor).

70. See *Federal Sav. & Loan Ins. Corp. v. Holt (In re Holt)*, 97 Bankr. 997 (Bankr. W.D. Ark. 1988) (knowing conversion of nonexempt assets into exempt assets is not fraudulent transfer), *aff'd*, 894 F.2d 1005 (8th Cir. 1990); *In re Armstrong*, 93 Bankr. 197 (Bankr. D. Neb. 1988) (use of proceeds from transfer of nonexempt assets to purchase exempt annuities is not fraudulent conveyance); *Ernst v. O'Brien (In re O'Brien)*, 67 Bankr. 317 (Bankr. N.D. Iowa 1986) (purchase of exempt life insurance assets with proceeds from sale of nonexempt real estate is not fraudulent transfer). But see *Staats v. Beckman (In re Beckman)*, 104 Bankr. 866 (Bankr. S.D. Ohio 1989) (conversion of nonexempt assets into unreasonable amount of exempt life insurance just prior to bankruptcy is fraudulent transfer); *Peoples State Bank & Trust Co. v. Saylor (In re Saylor)*, 100 Bankr. 57 (Bankr. D. Kan. 1988) (debtor insolvent at time of transfer and left with no remaining nonexempt assets after conversion had actual intent to defraud), *aff'd*, 98 Bankr. 542 (D. Kan. 1989).

71. 541 F.2d 999 (2d Cir. 1976).

72. *Id.* at 1005.

73. *Id.* at 1001.

74. 104 Bankr. 866 (Bankr. S.D. Ohio 1989).



clear that "those who can analyze do, and those who cannot, number."<sup>75</sup> The *Beckman* court enunciated the following factors:

- (1) whether there was *fair consideration* paid for the life insurance policy;
- (2) whether the debtor was *solvent or insolvent as a result of the transfer* or whether he was *insolvent at the time* of the transfer;
- (3) the amount of the policy;
- (4) whether the debtor intended, in good faith, to provide by moderate premiums some protection to those whom he had a duty to support;
- (5) the length of time between the purchasing of a life insurance policy and the filing of the bankruptcy;
- (6) the amount of non-exempt property which the debtor had after purchasing the life insurance policy;
- (7) the debtor's failure to produce available evidence and to testify with significant preciseness as to the pertinent details of his activities shortly before filing the bankruptcy petition.<sup>76</sup>

The first two elements parallel the familiar bases of constructive fraudulent disposition avoidance.

Although the *Beckman* court blurred the distinction between actual and constructive fraud, it did not rely solely on the enumerated indices in reaching its determination of actual fraud.<sup>77</sup> Rather, the court was particularly impressed by the fact that the debtor had not only failed to reveal the conversion but had actually obscured the insurance purchase in its bankruptcy filing.<sup>78</sup> That preoccupation with concealment and the relationship between concealment and the intent to defraud has also encroached upon the bulk sales law.

## 2. Degrees of Noncompliance with Article 6

Under Article 6, notice of an impending bulk transfer must be given to the creditors of the transferor.<sup>79</sup> The transfer is deemed "ineffective" as to any creditor who does not receive the requisite notice.<sup>80</sup> Is there, however, a difference between cases in which there is apparently an inadvertent failure to notify a single creditor or two and those in which there is a conscious choice not to comply with Article 6 and instead wait out the limitations period? Would it matter what efforts the parties made to conceal the bulk transfer when there has been a failure to comply through lack of notice? Is there a difference between active concealment and mere failure to disclose? These are some of the questions the courts have confronted in determining liability issues under current Article 6.

The fraudulent disposition statutes formulate different remedies for actual

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75. J. WHITE & R. SUMMERS, *supra* note 7, § 1-3, at 30.

76. 104 Bankr. at 870 (emphasis added) (citing *Mueller v. Redmond (In re Mueller)*, 867 F.2d 568, 570 (10th Cir. 1989)).

77. *Id.* at 870-71.

78. *Id.* at 871.

79. U.C.C. § 6-105 (1989).

80. *Id.*

and constructive fraud.<sup>81</sup> The remedies consider the proper parties plaintiff<sup>82</sup> and the extent of potential recovery for each type of fraud.<sup>83</sup> Moreover, in identifying plaintiffs, the statutes distinguish between present and future creditors and between those present creditors who knew of the fraudulent disposition and those who did not. The constructive fraudulent disposition law presumes fraud once the financial condition and insufficient value requisites are established;

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81. See *supra* notes 37-53, 57-64 and accompanying text for a discussion of the uniform fraudulent transfer acts.

82. Both the UFCA and the UFTA distinguish actual intent to defraud from constructive fraud in determining what types of creditors may attack the conveyance. UFCA § 7 and its counterpart in the UFTA, § 4(a)(1), both clearly provide that transfers made "with actual intent . . . to hinder, delay, or defraud" are fraudulent as to present and future creditors. Conversely, UFCA § 4 and UFTA § 5(a), which deal with constructively fraudulent conveyances, render such dispositions fraudulent as to existing creditors, but not to future creditors. The scope of those sections' proscription is limited to transactions in which the debtor was insolvent or was rendered insolvent by the transaction and did not receive "fair consideration" or "reasonably equivalent value."

On the continuum between actual intent to defraud and purely constructive fraud are cases involving equitable insolvency. These transactions, like those made with actual intent to defraud, are fraudulent as to both present and future creditors. The provisions are concerned with the lack of "a fair consideration" or "a reasonably equivalent value." Instead of actual insolvency, however, a surrogate for intent to defraud is inferred from the debtor's financial situation. UFTA § 4(a)(2)(i), which is based on UFCA § 5, provides that a transfer is fraudulent if the debtor "was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction." Likewise, UFTA § 4(a)(2)(ii), derived from UFCA § 6, characterizes as fraudulent transfers in which the debtor "intended to incur, or believed or reasonably should have believed that he [or she] would incur, debts beyond his [or her] ability to pay as they became due." These situations, though constructive bases of fraud, are more similar to actual intent cases because they concern events in which a debtor would know or would have reason to know of the consequences of its actions in light of its financial situation. Appropriately, as the fraud in issue moves on the continuum toward actual intent, future creditors are afforded the same rights they would receive were the transfer made with an actual intent to defraud.

83. See UFTA § 8(a); UFCA § 9. The UFTA contains a separate savings provision for cases involving actual intent to hinder, delay, or defraud. The savings clause provides that transfers are not voidable under UFTA § 4(a)(1), the actual intent provision, against persons taking in good faith and for a reasonably equivalent value or against their transferees or obligees. UFTA § 8(a). Conversely, cases involving constructive fraud are covered by UFTA § 8(b), which permits recovery from: (i) the initial transferee, regardless of his bona fides, (ii) the person for whose benefit the transfer was made, and (iii) subsequent transferees who did not take in good faith or failed to give value. *Id.* § 8(b). Again, the shelter principle protects any subsequent transferee or obligee of a bona fide transferee. UFTA § 8(b)(2). The comments to § 8 do not explain this dichotomy, but state that subsection 8(a) is drawn from UFCA § 9, and subsection 8(b) is drawn from Bankruptcy Code § 550(a). UFTA § 8 comments. The savings provisions of both UFCA § 9 and Bankruptcy Code § 550(a), however, fail to differentiate between actual and constructive fraud. See UFCA § 9 (provision applies to any fraudulent conveyance); 11 U.S.C. § 550(a) (1988) (same).

Arguably, the dichotomy employed promotes equity by requiring creditors to seek recovery from the malfasant debtor under UFTA § 8(a) while allowing recovery from a malfasant debtor or transferee under § 8(b). This is justified by the constructive fraud basis of recovery in § 8(b), under which the immediate transferee will have to have given less than reasonably equivalent value for the constructive fraud provision to operate against him. UFTA § 8(b). The UFCA, on the other hand, does not distinguish between actual and constructive fraud in its savings clause. See UFCA § 9. It merely provides that a creditor whose claim has matured may pursue his remedy "against any person except a purchaser for fair consideration without knowledge of the fraud at the time of the purchase, or one who has derived title immediately or mediately from such a purchaser. . . ." *Id.*



there is no requirement that a present creditor demonstrate any actual prejudice resulting from the fraud.

In bulk sales law, such distinctions are not immediately apparent in the language of the statute. While Article 6 provides that when there has been a failure to comply with notice requirements, the transfer is rendered ineffective, the statute does not expressly provide that the transfer is ineffective only as to those creditors who did not receive the requisite notice. Professors White and Summers, however, have suggested a reason to distinguish cases of "total non-compliance" from cases of "substantial but not full compliance."<sup>84</sup> The White and Summers construction, arguably supported by an official comment to section 6-104,<sup>85</sup> provides the basis for distinguishing an actual intent to defraud (total noncompliance) from mere constructive fraud liability (substantial compliance).<sup>86</sup> So construed, the conclusion seems to do some violence to the statute by making a problematic distinction between the bases of actual and constructive fraud to limit the class of proper parties plaintiff.<sup>87</sup>

A decision of a Connecticut court may shed some light on the characterization of the bulk transfer article as constructive fraud law. In *Goodyear Tire & Rubber Co. v. Tabs, Inc.*,<sup>88</sup> the court considered a nonuniform version of section 6-105, which required that the transferor file public notice of a bulk sale in the Office of the Secretary of State and send notice to its creditors by registered or certified mail.<sup>89</sup> The complaining creditor had received the notice sent by certified mail, but the notice had not actually been filed with the Secretary of State.<sup>90</sup> The defendant argued that the purpose of the notice had in fact been realized because the creditor had actually received the notice sent by certified mail.<sup>91</sup> The court rejected the argument and, relying on a strict construction of the statutory language, concluded that the notice deficiency rendered the transfer ineffective.<sup>92</sup>

It is not certain that the *Tabs* result is correct; indeed, the court's overall

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84. J. WHITE & R. SUMMERS, *supra* note 7, § 20-24, at 908-10.

85. *Id.* at 910 (author's interpretation strongly supported by U.C.C. § 6-104 comment 2 which asserts that satisfying unpaid creditors always cures defect). The authors, however, acknowledge that this comment can also be read to require the transferee to pay off all creditors. They dismiss this reading because it would "deprive the word 'cure' in the comment of its usual meaning." *Id.*

86. See P. ALCES, *supra* note 11, ¶ 4.04[4][b], at 4-54.

87. See J. WHITE & R. SUMMERS, *supra* note 7, at 909. The authors argue that:

For remedial purposes we believe that it is necessary to distinguish between cases of total noncompliance with Article Six and cases of substantial but not full compliance. . . . We would make the punishment fit the crime and treat the transfer ineffective [sic] only as against an aggrieved creditor and not against all creditors [in cases of partial noncompliance].

*Id.*

88. 26 U.C.C. Rep. Serv. (Callaghan) 1290 (Conn. Super. Ct. 1979).

89. *Id.* at 1295 (citing CONN. GEN. STAT. § 42a-6-106(3)).

90. *Id.*

91. *Id.*

92. See *id.* (citing CONN. GEN. STAT. § 42a-6-106(3)). Specifically the court found that "[t]he legislature used the word 'shall,' mandatory and not permissive language, and where the language is plain, courts will not speculate as to any supposed intention of the legislature . . . . Both the filing

formalistic analysis seems troublesome.<sup>93</sup> More significant than the court's holding, however, is the court's attitude toward bulk sales law. Considering that the transferor in *Tabs* sent notice to the creditor, it would be difficult to find any intent to defraud. Evidently intent was not dispositive, since the court deemed the transfer ineffective despite the transferor's bona fides.<sup>94</sup> If the *Tabs* analysis accurately reflects the courts' attitude toward bulk sales law, it may be that the distinction drawn by White and Summers between total noncompliance and substantial but not complete compliance may be assailable.

Further, the courts' reluctance to distinguish actual from constructive fraud in bulk sales suggests that there may be no such distinction. Consequently, under the current law, a transfer could be upset regardless of the absence of any intent to defraud. Instead, the mere failure to comply scrupulously with bulk sales notice requirements would establish the basis for avoidance. This reasoning implies that there is something inherently fraudulent about such a failure in light of the potential prejudice to the creditors of the transferor.

The issue of whether degrees of compliance with Article 6 matter has been the focus of several of the cases construing section 6-111, "Limitations of Actions and Levies." That section establishes a general six-month limitations period after a transfer for bringing an action. It further provides that "[i]f the transfer has been concealed, actions may be brought or levies made within six months after its discovery."<sup>95</sup> The provision is facially incongruous given the fact that a bulk sale effected in compliance with Article 6 would never have been concealed from those with an interest in it. That is, for a bulk sale to comply with Article 6, creditors of the transferor must receive notice of the sale.<sup>96</sup> The fact that the creditor did not receive the notice could certainly be evidence that the transferor and transferee were "concealing" the sale. The query, then, is whether Article 6, in section 6-111, contemplates a distinction between intentional and inadvertent concealment. That issue arises when a complaining creditor brings suit more than six months after the bulk sale and alleges that the transactors' failure to give the creditor notice constitutes 6-111 concealment, tolling the statute of limitations. The more willing the courts are to toll the limitations period as a result of *mere* noncompliance (rather than to require a showing of *active concealment*), the more it seems that the bulk sales law is concerned primarily with creditor protection. Nice distinctions between actual and constructive fraud appear to be of less consequence. Further, courts' willingness to avoid transfers on account of mere noncompliance supports the conclusion that a failure to give notice constitutes the type of creditor prejudice regulated by general fraudulent disposition principles. The cases demonstrate the scope of the debate surrounding the specific section 6-111 concealment issue

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with the secretary of state and the personal delivery or sending by registered mail *are required*." *Id.* (emphasis in original).

93. See *id.* (analysis limited to statutory construction).

94. *Id.*

95. U.C.C. § 6-111.

96. *Id.* § 6-105.



and the more general commercial fraud issues implicated.<sup>97</sup>

In two decisions, the United States Court of Appeals for the Ninth Circuit found that mere noncompliance does not constitute concealment. In *In re Del Norte Depot, Inc.*<sup>98</sup> and *In re Borba*,<sup>99</sup> the panels asserted that a common sense construction of Article 6 compels the conclusion that some affirmative act of concealment is necessary to toll the limitations period.<sup>100</sup> The *Borba* court reasoned that

[i]f failure to give notice is concealment, then the language [in Section 6-111] referring to the date the transferee took possession as the commencement of the running of the statute has no effect whatsoever, and neither does reference [in Section 6-111] to the date of discovery of the transfer if there has been concealment.<sup>101</sup>

Several state courts have reached the same conclusion. In *SVM Investment v. Mexican Exporters, Inc.*,<sup>102</sup> a Texas appellate court decided that the complaining creditor either knew or should have known about the transfer on the basis of the facts presented.<sup>103</sup> Similarly, in *Pipeline Materials, Inc. v. Turf Irrigation Corp.*,<sup>104</sup> a Colorado appellate court found that because the transferee's possession of the goods sold in bulk was open and notorious, there was no concealment notwithstanding the transactors' failure to comply with the statutory notice requirements.<sup>105</sup>

Other courts have demonstrated, by degrees, a different attitude toward the concealment issue. A New York appellate court, in *E.J. Trum, Inc. v. Blanchard Parfums, Inc.*,<sup>106</sup> found that total noncompliance constituted section

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97. See *Lang v. Graham (In re Borba)*, 736 F.2d 1317 (9th Cir. 1984) (failure to give notice of impending bulk sale not concealment for purpose of tolling statute of limitation); *Chartered Bank of London v. Diamant (In re Del Norte Depot, Inc.)*, 716 F.2d 557 (9th Cir. 1983) (mere defects in bulk transfer notice not concealment, given mechanisms other than bulk transfer notice adequate to notify creditors of creation of security interest); *Pipeline Materials, Inc. v. Turf Irrigation Corp.*, 754 P.2d 775 (Colo. Ct. App. 1988) (mere failure to notify of bulk transfer does not toll statute of limitations absent statutory language to contrary); *SVM Investments v. Mexican Exporters, Inc.*, 685 S.W.2d 424 (Tex. Civ. App. 1985) (technical noncompliance with notice requirement not concealment where through informal notice actual knowledge of transfer communicated). See also *E.J. Trum, Inc. v. Blanchard Parfums, Inc.*, 33 A.D.2d 689, 306 N.Y.S.2d 316 (N.Y. App. Div. 1969) (noncompliance with notice requirements tantamount to concealment); *Columbian Rope Co. v. Rinek Cordage Co.*, 314 Pa. Super. 585, 461 A.2d 312 (1983) (complete failure to comply with notice provisions of bulk transfer law constituted concealment).

98. *Chartered Bank of London v. Diamant (In re Del Norte Depot, Inc.)*, 716 F.2d 557 (9th Cir. 1983).

99. *Lang v. Graham (In re Borba)*, 736 F.2d 1317 (9th Cir. 1984).

100. *In re Del Norte*, 716 F.2d at 561; *In re Borba*, 736 F.2d at 1320.

101. *In re Borba*, 736 F.2d at 1320. See also *In re Del Norte*, 716 F.2d at 561 n.7 (mere defect in bulk transfer notice that has been filed, absent actual fraud, not concealment of transaction).

102. 685 S.W.2d 424 (Tex. Civ. App. 1985).

103. *Id.* at 428-29 (creditor who conducted business with entity created after bulk transfer made held to have had knowledge of transfer).

104. 754 P.2d 775 (Colo. Ct. App. 1988).

105. *Id.* at 776.

106. 33 A.D.2d 689, 306 N.Y.S.2d 316 (N.Y. App. Div. 1969).

6-111 concealment.<sup>107</sup> Perhaps most noteworthy, however, is the decision of the Pennsylvania Superior Court in *Columbian Rope Co. v. Rinek Cordage Co.*<sup>108</sup> That court considered the role of Article 6 in the general scheme of commercial law and held that total noncompliance must be treated as concealment. The court reasoned that any other outcome would encourage those transactors unwilling to afford creditors the Article 6 protections to assume the risk, for a brief six month period, that the sale would be discovered.<sup>109</sup> The *Rinek* court characterized bulk transfer law in commercial fraud terms. The court found that "the transferee's intent or scienter is not relevant to the harm the bulk transfer statute seeks to prevent."<sup>110</sup> More crucially, the court doubted that "a transferee might ordinarily purchase all of the transferor's stock in trade, thus rendering the transferor a hollow shell, without considering or making provision for the transferor's creditors."<sup>111</sup> That is, the court recognized that a bulk transfer which substantially impairs a creditor's rights establishes the type of fraud policed by the commercial fraud law. Further, the court was willing to charge the transferees with knowledge of that prejudicial impact. Whether the transferor and transferee intended harm is irrelevant: the fraud is accomplished by the transfer.<sup>112</sup>

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107. *Id.* at 689, 306 N.Y.S.2d at 317. *But see* *Aerolineas Argentinas v. Hansen & Yorke Co.*, 12 U.C.C. Rep. Serv. (Callaghan) 329 (N.Y. Civ. Ct. 1973) (*Trum* holding limited to particular department of New York Supreme Court in which decided; complaining creditor must show more than mere noncompliance) (citing *Trum*, 33 A.D.2d 689, 306 N.Y.S.2d 316 (N.Y. App. Div. 1969)).

108. 314 Pa. Super. 585, 461 A.2d 312 (1983).

109. *Id.* at 591, 461 A.2d at 315.

110. *Id.* at 592, 461 A.2d at 315 (citing J. WHITE & R. SUMMERS, UNIFORM COMMERCIAL CODE § 19-1, at 757 (2d ed. 1980) (transferees sometimes advised by attorneys not to comply with Article 6 notice)).

111. *Id.*

112. A comparison may be drawn with the scienter requirement attending misrepresentation liability. While the tort of fraud or deception does carry an element of intent, courts are often willing to settle for something less, imposing liability on the basis of recklessness, negligence, or even strict liability principles. This relaxation of the scienter requirement allows courts to circumvent the often elusive proof of the defendant's actual state of mind.

Liability for reckless misrepresentation represents something short of intent but more than negligence. Evidence that a statement was made irresponsibly, with knowledge and appreciation of the risk involved, is sufficient to sustain the action for fraud. For a general discussion of these issues and a survey of the pertinent cases, see P. ALCES, *supra* note 11, ¶ 2.02[3][a], at 2-17 to 2-18 (citing *Louisiana Power & Light Co. v. United Gas Pipe Line Co.*, 642 F. Supp. 781 (E.D. La. 1986) (fraud found based on defendant's reckless indifference for truth); *Buechin v. Ogden Chrysler-Plymouth, Inc.*, 159 Ill. App. 3d 237, 511 N.E.2d 1330 (1987) (car dealer's failure to inform buyer car had been driven 650 miles is fraudulent); *Schatz v. Vidlak*, 229 Neb. 4, 424 N.W.2d 613 (1988) (reckless misrepresentation that gross profit was net profit is fraudulent)). For purposes of the comparison here, the courts' preoccupation with the relative equitable posture of the parties is particularly noteworthy. Because a defendant is in a better position to appreciate the veracity of the representation, a court may impose liability when a plaintiff has relied detrimentally on the representation. See, e.g., *Duhl v. Nash Realty, Inc.*, 102 Ill. App. 3d 483, 429 N.E.2d 1267 (1981).

Liability for negligent misrepresentation represents a further expansion of fraud premised on less than intentional misrepresentation. Whether by case law, or by statute, misrepresentations of material facts, even if accomplished "by mistake," are actionable. See, e.g., *Grenell v. City of Harmosa Beach*, 103 Cal. App. 3d 864, 163 Cal. Rptr. 315 (1980); ALA. CODE § 6-5-101 (1975). The



Under this formulation of the bulk sales law, the focus is on the harm (and potential harm) caused rather than the evil in transactors' hearts. With such a focus, bulk sales law plays an important role in the commercial fraud law. Impairment of the operation of the current Article 6 would therefore leave a gap.

Before discussing the ALI and NCCUSL proposed alternatives to the current bulk sales regime, a summary of the premises formulated in this section is useful:

- (1) Bulk transfer law is premised on general commercial fraud principles;
- (2) Bulk transfer law is generally construed as constructive fraud law, focusing on creditor prejudice rather than transferor and transferee intent to defraud;
- (3) Fraudulent dispositions may be avoided on either a constructive or actual fraud basis;
- (4) Constructive fraud law has developed as an adjunct of the actual fraud law;
- (5) Developments in the fraudulent disposition law have, increasingly, confirmed the affinity between the bases of actual and constructive fraud liability;
- (6) In the context of conversions of nonexempt property to exempt property just prior to bankruptcy, the courts infer intent to defraud

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scienter requirements are relaxed to avoid the undesirable result of leaving a victim uncompensated for the loss inflicted by a negligent party.

In making negligent misrepresentations actionable, courts will engage in standard negligence analysis: 1) Was a duty owed by defendant to plaintiff? 2) Was that duty breached? 3) Was plaintiff injured? 4) Was the breach of duty the proximate cause of the plaintiff's injury? *See Ultramares Corp. v. Touche*, 255 N.Y. 170, 191, 174 N.E. 441, 449 (1931) (Cardozo, J.) (negligent misrepresentations sustain inference of fraud). In *Ultramares*, a creditor of a corporation relied to its detriment on a negligently prepared audit which provided a more hopeful picture of the corporation's finances than was warranted. *Id.* at 173-75, 174 N.E. at 442. Imposition of liability for this negligence proceeded from the duty owed the creditor by the defendant. *Id.* at 179, 174 N.E. at 444. The duty analysis allows courts to recognize negligent misrepresentations by finding a duty was owed; at the same time, a court may prevent overbroad imposition of liability by finding no duty in appropriate cases. Indeed, scholars have argued that the finding of a duty is more a means to a legal conclusion than a useful analytical device. W. PROSSER, J. WADE & V. SCHWARTZ, *CASES AND MATERIALS ON TORTS* 415-16 (7th ed. 1982).

As a final expansion of liability for misrepresentation, some states impose strict liability with no scienter requirement. Liability may be imposed for the incidents of an entirely innocent misrepresentation. There is both statutory authority, e.g., ALA. CODE § 6-5-101 (misrepresentations of material fact made "by mistake and innocently . . . constitute legal fraud") and case authority, e.g., *Community Hosp. of Roanoke Valley, Inc. v. Musser* (*In re Musser*), 24 Bankr. 913 (W.D. Va. 1982) (assignment ineffective although misrepresentation about purpose of assignment innocent); *Susser Petroleum Co. v. Latina Oil Corp.*, 574 S.W.2d 830 (Tex. Ct. App. 1978) (liability imposed regardless of whether misrepresentation is innocent); *Reda v. Sincaban*, 145 Wis. 2d 266, 426 N.W.2d 100 (Wis. Ct. App. 1988) (strict liability imposed for misrepresentation), recognizing liability for innocent misrepresentations. Venerable authority has suggested, however, that the imposition of such liability is clearly a minority position. 37 C.J.S. *Fraud* § 25 (1943). The conclusion of the Virginia Supreme Court concisely formulates the point: "Whether the representation is made innocently or knowingly, if acted on, the effect is the same." *B-W Acceptance Corp. v. Benjamin T. Crump Co.*, 199 Va. 312, 315, 99 S.E.2d 606, 609 (1957).

(actual fraud) from circumstances suggesting prejudice to the interests of the debtor's creditors (constructive fraud); and

(7) Bulk sales cases concerning the effect of noncompliance on the concealment provision of the section 6-111 statute of limitations obscure the relationship between intent (actual fraud) and prejudice to creditors (constructive fraud) in Article 6.

These conclusions provide a basis for evaluating transferee liability issues under current Article 6 and under the proposed revision Alternatives.

## II. THE REVISIONS AND THE BLACK HOLE

The Alternatives promulgated by the ALI and NCCUSL respond to contemporary criticisms of Article 6 by reducing the theories of recovery available to the creditor-victims of a bulk transfer. Alternative A, which would repeal Article 6 in its entirety, would deny creditors all of the protections currently afforded them by the bulk sales law. Alternative B, in comparison, would respond to particular issues that have generated debate under the current law. The drafters of Alternative B have developed a statute that, while arguably providing some creditor protection, would compromise substantially the theories available to complaining creditors under the present law. By limiting liability of bulk transferees, the drafters of the Alternatives have created what some may consider a gap, and what others may perceive is more akin to a black hole.

If aggrieved creditors are unable to recover against transferees to the same extent as they may now recover under the bulk sales law — that is, if there is in fact a remedial black hole — it is fair to assume that creditors will seek alternate ways to respond to the deficiencies. Given the fundamental affinity between fraudulent disposition and bulk sales law posited in Part I of the essay, it may be that the UFCA, UFTA, and Bankruptcy Code section 548 could be interposed to fill the void.

### A. *The Status Quo and Transferee Liability*

One of the more glaring deficiencies in current Article 6 is the statute's failure to provide specific and substantial protections for creditors of the bulk transferor. First, a creditor who is duly notified under the statute may be able only to witness the sale of the assets and may have no legal means to prevent the sale or assert a claim against the assets transferred in bulk.<sup>113</sup> Second, if the transactors do not comply with the notice requirements, the form and extent of the transferee's liability for the ineffective transfer is uncertain. This latter point is particularly relevant to the present inquiry.

#### 1. Transferee Liability in Optional Section 6-106 States

There are, in fact, two "uniform" versions of current Article 6. The version enacted in most states contains no provision for the application of bulk sales proceeds to the claims of the transferor's creditors. A version adopted in a

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113. See *supra* note 12 and accompanying text for a discussion of remedies available to a creditor of a bulk transferor.



few states,<sup>114</sup> however, expressly creates a duty to apply proceeds to the transferor's outstanding obligations. Optional section 6-106 imposes this duty on the transferee.<sup>115</sup>

Optional section 6-106 imposes a duty upon the transferee to apply the consideration payable to the transferor to the claims of creditors appearing on the section 6-104 list as well as section 6-107 creditor claimants. Where the optional provision is in force, courts have had to determine the consequences of the transferee's failure to comply with the direction of the optional provision. The section does not expressly authorize the imposition of personal liability on the transferee. Nevertheless, to provide some sanction for the transferee's noncompliance with the application of proceeds requirement, several courts have imposed personal liability.<sup>116</sup>

In *Darby v. Ewing's Home Furnishings*,<sup>117</sup> the United States District Court for the Western District of Oklahoma held that a transferee who fails to comply with optional section 6-106 may be personally liable to the creditors of the transferor for either the value of the property transferred in bulk or for the amount the transferee paid for the property.<sup>118</sup> A Kentucky court, in *Cornelius v. J & R Motor Supply Corp.*<sup>119</sup> reached a similar conclusion regarding personal liability. In that case, the transferee commingled the property transferred in bulk with other property.<sup>120</sup> That commingling had precluded the transferor's creditors from reaching the transferred property.<sup>121</sup> The court held that the creditors were entitled to impose personal liability on the transferee in an amount equal to their pro rata share of all creditors' claims existing at the time of the bulk sale.<sup>122</sup>

Several bankruptcy courts have also imposed personal liability. The courts generally have relied on the scope of the trustee's avoiding powers to support their conclusion.<sup>123</sup> The decision of the Bankruptcy Court for the Southern Dis-

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114. U.C.C. § 6-106, with some variation, has been adopted by Alaska, California, Florida, Idaho, Kansas, Kentucky, Maryland, Minnesota, Mississippi, Montana, New Jersey, North Dakota, Oklahoma, Pennsylvania, South Dakota, Tennessee, Texas, Utah, Virgin Islands, Washington, and West Virginia.

115. See *infra* Appendix for the text of optional § 6-106. The UCC provides for the omission of §§ 6-107(2)(e), 6-108(3)(c), and 6-109(2) whenever optional § 6-106 is not enacted.

116. See *Darby v. Ewing's Home Furnishings*, 278 F. Supp. 917 (W.D. Okla. 1967) (failure to comply with U.C.C. § 6-104 renders transferee liable for value of goods or purchase price); *Cornelius v. J. & R. Motor Supply Corp.*, 468 S.W.2d 781 (Ky. Ct. App. 1971) (buyer who commingled goods acquired in violation of bulk sales law personally liable); *Mid-America Indus., Inc. v. Retchie*, 767 P.2d 416 (Okla. 1989) (failure to comply with notice provisions of bulk sales law gives rise to personal liability).

117. 278 F. Supp. 917 (W.D. Okla. 1967).

118. *Id.* at 919.

119. 468 S.W.2d 781 (Ky. Ct. App. 1971).

120. *Id.* at 782.

121. *Id.* at 783. The court noted that a transferee could be held personally liable if he or she undermined the creditor's right to reach the goods by disposing of or converting the property for his or her own use. *Id.*

122. *Id.* at 784.

123. See, e.g., *Bakst v. Vono (In re Gold Rush East, Inc.)*, 55 Bankr. 126 (Bankr. S.D. Fla.

trict of Florida in *Babkst v. Nono* (In re *Gold Rush East, Inc.*)<sup>124</sup> is particularly interesting. The court did not rely on optional section 6-106 notwithstanding the fact that it was the governing law in that jurisdiction. Instead, the court found that the transfer violated section 6-104. The court then held that the trustee could rely upon that violation to avoid the transfer pursuant to Bankruptcy Code section 544(b).<sup>125</sup> *Sbar's, Inc. v. New Jersey Art & Craft Distributors, Inc.*,<sup>126</sup> a similarly provocative decision, also involved a jurisdiction that has adopted optional section 6-106.<sup>127</sup> In *Sbar's*, the New Jersey Superior Court found a section 6-104 violation and relied on that section, rather than on section 6-106, to impose personal liability on the bulk transferee.<sup>128</sup>

In states adopting optional section 6-106, courts will recognize a transferee duty to apply the bulk sale proceeds to the claims of a transferor's creditors as one basis for imposing personal liability on the transferee. From the *Gold Rush* and *Sbar's* decisions, however, it would seem that even where optional section 6-106 is in force courts may be willing to impose personal liability on the basis of a violation of the section 6-104 notice requirements. Accepting section 6-104 as an independent source of liability may be sufficient to support the imposition of personal liability even in states that have not adopted optional section 6-106. Although other cases affirm that conclusion, a sense of uncertainty about personal liability generally persists under the current law.

## 2. Transferee Liability in States That Have Not Adopted Optional Section 6-106

Insofar as optional section 6-106 recognizes a transferee's duty to protect the interests of the transferor's creditors, it arguably provides a basis from which to formulate the consequences of the transferee's breach of that duty, including the imposition of personal liability. The states that have not enacted optional section 6-106, however, differ on the issue of transferees' personal liability. Even among courts within the same jurisdiction there is disagreement. Decisions in those states can be placed in three categories: no personal liability of transferee; possible personal liability of transferee; and personal liability of transferee.

### a. No Transferee Liability

In *American Express Co. v. Bomar Shoe Co.*<sup>129</sup> and *Get It Kwik of America, Inc. v. First Alabama Bank*,<sup>130</sup> the courts held that an in personam action

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1985) (trustee may avoid transfer and recover from transferee where transfer voidable under state law); *Stolba v. Mastandrea* (In re *Pritchard*), 8 Bankr. 688 (Bankr. C.D. Cal. 1981) (trustee may avoid transfer and recover from transferee where transferee fails to comply with state bulk sales law).

124. 55 Bankr. 126 (Bankr. S.D. Fla. 1985).

125. *Id.* at 127.

126. 205 N.J. Super. 516, 501 A.2d 560 (1985).

127. N.J. STAT. ANN. § 12A:6-106 (West 1962 & Supp. 1990).

128. 205 N.J. Super. at 518, 501 A.2d at 561 (purchaser may be ordered to satisfy debt owed by debtor to plaintiff only to extent of fair value of goods transferred).

129. 125 Ga. App. 408, 187 S.E.2d 922 (1972).

130. 361 So. 2d 568 (Ala. Civ. App. 1978).



against the transferee was not available to a creditor who had not received the statutorily mandated notice.<sup>131</sup> The courts relied on the fact that the states providing the governing law (Georgia and Alabama, respectively) had not enacted optional section 6-106; these legislative decisions were deemed probative of the transferee liability issue.<sup>132</sup>

#### b. Possible Transferee Liability

The *Bomar Shoe* and *Get It Kwik* decisions were rendered by intermediate appellate courts.<sup>133</sup> More recent decisions by the supreme courts of those same states have left unresolved the question of the transferee's personal liability. In *McKesson Robbins v. Bruno's, Inc.*,<sup>134</sup> the Alabama Supreme Court recognized that a transferee could be personally liable to the transferor's creditors.<sup>135</sup> Similarly, the Georgia Supreme Court, in *Johnson v. Vincent Brass & Aluminum Co.*<sup>136</sup> and *Boss v. Bassett Furniture Industries*,<sup>137</sup> intimated that Article 6 presented no impediment to the imposition of personal liability.<sup>138</sup> The *Boss* court reasoned that supplementary principles of law and equity incorporated into the Code by operation of section 1-103 would provide the source of transferee personal liability.<sup>139</sup>

In New York, there is also inconsistent treatment of the transferee personal liability issue. The New York courts seem to weigh the level of culpability of the transferee in resolving the issue. In *Satenspiels Markets, Inc. v. Hing Lung Chinese Restaurant, Inc.*,<sup>140</sup> the court found that a transferee would not be personally liable to a creditor where the transferee had no knowledge of the claim of the creditor who had not received notice.<sup>141</sup> A similar focus on the transferee's culpability was also evident in *HLC Imports Corp. v. M & L Siegel, Inc.*,<sup>142</sup> an earlier New York case. The *HLC* court suggested that, though the complaining creditor had no basis under Article 6 to impose personal liability on the transferee, the creditor might be able to bring a tort action against the transferee.<sup>143</sup>

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131. *Bomar Shoe*, 125 Ga. App. at 410, 187 S.E.2d at 924; *Get it Kwik*, 361 So. 2d at 571-72. Cf. *New Haven Tobacco v. O'Brien*, 37 Conn. Supp. 815, 818, 438 A.2d 440, 442 (1981) (notes exception to rule in cases in which transferee misappropriated or commingled assets) (citing *Cornelius v. J. & R. Motor Supply Corp.*, 468 S.W.2d 781, 783 (Ky. Ct. App. 1971)).

132. 125 Ga. App. at 410, 187 S.E.2d at 924; 361 So. 2d at 571.

133. 125 Ga. App. at 408, 187 S.E.2d at 922; 361 So. 2d at 568.

134. 368 So. 2d 1 (Ala. 1979).

135. *Id.* at 2.

136. 244 Ga. 412, 260 S.E.2d 325 (1979).

137. 249 Ga. 166, 288 S.E.2d 559 (1982).

138. *Johnson*, 244 Ga. at 414, 260 S.E.2d at 326; *Boss*, 249 Ga. at 169, 288 S.E.2d at 562.

139. 249 Ga. at 169, 288 S.E.2d at 562. (nothing in UCC indicates [creditor] may not proceed on any common law or equitable grounds against transferee, notwithstanding bulk transfer law).

140. 2 U.C.C. Rep. Serv. 2d (Callaghan) 1370 (N.Y. Civ. Ct. 1987).

141. *Id.* at 1372.

142. 98 Misc. 2d 179, 413 N.Y.S.2d 605 (N.Y. Civ. Ct. 1979).

143. *Id.* at 180, 413 N.Y.S.2d at 606 (citing *Jacobs v. Tannenbaum*, 249 A.D. 847, 292 N.Y.S. 735 (1937); *Gabbe v. Kleban Drug Corp.*, 6 Misc. 2d 457, 161 N.Y.S.2d 245 (1957) (insurance broker granted judgment against buyer of business on alleged agreement by buyer to assume liability for insurance premiums)). The *HLC* court stated that the New York City civil court's jurisdiction

c. *Definite Transferee Liability*

Clearly most troubling to the drafters of the proposed Alternatives is the substantial body of cases that have categorically imposed personal liability on the transferee in states not adopting optional section 6-106.<sup>144</sup> Courts in at least five states have construed the bulk sales law to support the imposition of personal liability on a bulk transferee. In these cases, the courts have not deemed transferee scienter dispositive.

The bankruptcy court sitting in the Southern District of New York construed the New York bulk sales law in *In re Curtina International, Inc.*<sup>145</sup> In that case, the court found that the transferee would be personally liable under Article 6 to the creditors of the transferor "for the value of the merchandise transferred."<sup>146</sup> The *Curtina* opinion supports a formulation of the state's law that sanctions in personam recovery against the transferee, not just for an amount equal to the value paid by the transferee, but for the fair market value of the assets transferred in bulk.<sup>147</sup>

In *John Boyle & Co. v. Colorado Patio & Awning Co.*,<sup>148</sup> the Colorado Court of Appeals referred to pre-U.C.C. bulk sales law in the state to support the imposition of personal liability on the bulk transferee.<sup>149</sup> The *Boyle* court imposed on the transferee the additional burden of establishing that the value of the property transferred in bulk was less than the value of the complaining creditor's claim.<sup>150</sup> Most provocative is the court's suggestion that the transferee breached a fiduciary duty to the creditors of the transferor.<sup>151</sup> In *Boyle*, the transferee was the president and sole stockholder of the transferor corporation. He was aware of both the transferor's financial condition and the complaining creditor's claim

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was limited to the exceptional case involving tortious conduct or breach of contract. *Id.* General equity jurisdiction of actions for rescission or reformation due to Article 6 violations was granted to the city civil courts by statute in 1980. N.Y. City Civ. Ct. Act § 213 (1989).

144. See, e.g., *Ross v. Randolph (In re Villa Roel, Inc.)*, 57 Bankr. 835, 839 (Bankr. D.D.C. 1985) (bulk transferee liability measured by value of assets on date of transfer); *Murdock v. Plymouth Enters., Inc. (In re Curtina Int'l, Inc.)*, 23 Bankr. 969, 979 (Bankr. S.D.N.Y. 1982) (noncompliance with bulk sales law rendered transferee accountable to creditors of transferor); *John Boyle & Co. v. Colorado Patio & Awning Co.*, 654 P.2d 335, 336 (Colo. Ct. App. 1982) (corporate director liable to creditor for improper notice of transfer of assets); *Vincent Brass & Aluminium Co. v. Johnson*, 149 Ga. App. 537, 538, 254 S.E.2d 752, 754 (garnishment action against transferee in rem proceeding), *rev'd on other grounds*, 244 Ga. 412, 260 S.E.2d 325 (1979); *Starman v. John E. Wolfe, Inc.*, 490 S.W.2d 377, 383 (Mo. Ct. App. 1973) (transferee in bulk sale liable to creditor of transferor upon failure to give proper notice).

145. *Murdock v. Plymouth Enters., Inc. (In re Curtina Int'l, Inc.)*, 23 Bankr. 969 (Bankr. S.D.N.Y. 1982).

146. *Id.* at 979.

147. *Id.* at 980.

148. 654 P.2d 335 (Colo. Ct. App. 1982).

149. *Id.* at 336. The court emphasized not only the transactors' failure to comply with Article 6, but also that the transferee had breached a fiduciary duty to the plaintiff-creditor. *Id.*

150. *Id.* (defendant-transferee would be liable because did not demonstrate value of property transferred was less than debt owing plaintiff).

151. *Id.*



against the transferor.<sup>152</sup> Admittedly, the relationship between the transferor and transferee in *Boyle* was somewhat atypical. Nonetheless, it is conceivable that in other bulk sales contexts there might be a sufficiently close relationship between a transferor and transferee to support the imposition of transferee liability based on a breach of fiduciary duty.<sup>153</sup> The scope of that type of theory is not certain. The possibility, however, further demonstrates the impact of relaxed scienter requirements in the constructive fraud law.<sup>154</sup>

The personal liability law in Georgia is also not a paradigm of clarity. While the state courts and bankruptcy courts formulating the state law have stopped short of sanctioning personal liability of a bulk transferee, they have recognized the availability of a garnishment action to reach the proceeds realized by the transferee upon a subsequent disposition of the property transferred in bulk.<sup>155</sup> The Georgia Court of Appeals, in *Vincent Brass & Aluminum Co. v. Johnson*,<sup>156</sup> characterized the garnishment action against the transferee as an in rem rather than in personam proceeding.<sup>157</sup> Certainly, from the perspective of the transferee, the distinction is one of form rather than substance.

The Missouri Court of Appeals, in *Starman v. John E. Wolfe, Inc.*,<sup>158</sup> also recognized the viability of a garnishment action against the bulk transferee. The court determined that the transferee would be liable for either the amount paid

152. *Id.*

153. For cases finding constructive fraud for innocent misrepresentations based on the relationship of the parties, see, e.g., *Crawford Painting & Drywall Co. v. J.W. Bateson Co.*, 857 F.2d 981 (5th Cir. 1988) (contractor/subcontractor), *cert. denied*, 109 S. Ct. 850 (1989); *Zimpel v. Trawick*, 679 F. Supp. 1502 (W.D. Ark. 1988) (vendor/vendee); *Chandler v. Chandler*, 514 So. 2d 1307 (Ala. 1987) (parent/child); *Barrett v. Bank of Am.*, 183 Cal. App. 3d 1362, 229 Cal. Rptr. 16 (1986) (bank/depositor). See generally P. ALCES, *supra* note 11, ¶ 2.02[4], at 2-24 to 2-26 (citing *Zeilenga v. Stelle Indus., Inc.*, 52 Ill. App. 3d 753, 757, 367 N.E.2d 1347, 1349-50 (1977) (factors to be considered in determining existence of confidential relationship include kinship, difference in age, plaintiff's health, plaintiff's mental condition, plaintiff's previous reliance on defendant), *id.*, ¶ 7.02[1][d], at 7-13 to 7-17 (discusses cases where fiduciary liability found between lenders and borrowers).

154. See Alces, *Generic Fraud and the Uniform Fraudulent Transfer Act*, 9 CARDOZO L. REV. 743 (1987) (discusses potential impact of relaxed scienter requirements on fraud calculus in certain leveraged business acquisition cases). Cf. *Crowley v. Green*, 148 Colo. 142, 148, 365 P.2d 230, 233 (1961) (quoting *Fishel v. Goddard*, 30 Colo. 147, 154, 69 P. 607, 609 (1902)). In *Crowley*, the court noted that

[T]he relationship of a director of a corporation to the legal entity which he represents is fiduciary, and the law treats him as a trustee in this respect. . . . A purchase by him of corporate assets may not be void ab initio as to creditors, but he will not be permitted to reap a benefit to their detriment by dealing in them as a third party, because the law inhibits a trustee from speculating in the subject matter of his trust. Hence, it follows, that if he does purchase corporate assets he must account to those who have the right to demand it for the full value of the property so purchased.

155. *American Express Co. v. Bomar Shoe Co.*, 125 Ga. App. 408, 410, 187 S.E.2d 922, 924 (1972) (creditor of defendant has remedy of garnishment) (citing *Jaques & Tinsley Co. v. Carstarphen Whse. Co.*, 131 Ga. 1, 2, 62 S.E. 82, 82 (1908)).

156. 149 Ga. App. 537, 254 S.E.2d 752, *rev'd on other grounds*, 244 Ga. 412, 260 S.E.2d 325 (1979).

157. *Id.* at 538, 254 S.E.2d at 754.

158. 490 S.W.2d 377 (Mo. Ct. App. 1973).

to the transferor for the assets or the value of the assets.<sup>159</sup> The United States Court of Appeals for the District of Columbia Circuit, in *In re Villa Roel, Inc.*,<sup>160</sup> upheld the personal liability of a bulk transferee to the complaining creditor for the value of the assets transferred in bulk. As to the measure of that personal liability, the court reasoned that the value paid by the transferee for the assets would be used to determine the value of the assets transferred.<sup>161</sup>

Consequently, while not all states have addressed the issue, a substantial number of the courts that have considered transferee liability have identified some theory to support the imposition of personal liability. As an alternative to finding liability under section 6-106, the courts most often rely on the section 6-104 obligation imposed on the parties to a bulk transfer to notify the creditors of the transferor.<sup>162</sup> Some decisions suggest that a court may consider or even assume the transferee's scienter or close relationship with the transferor.<sup>163</sup> Additionally, bankruptcy courts, reviewing the trustee's right to proceed against the bulk transferee, have found a bankruptcy interest supporting the imposition of personal liability. It is in bankruptcy, however, that the consequences of personal liability may prove most problematic from the perspective of transferees.

### 3. Personal Liability of the Bulk Transferee upon Bankruptcy: Impact of *Moore v. Bay*

The rule of the case of *Moore v. Bay*<sup>164</sup> operates with section 544(b) of the Bankruptcy Code to afford the trustee greater recovery in bankruptcy than would be available to creditors of the transferor under state law.<sup>165</sup> Under *Moore*, a trustee can avoid a debtor's disposition of property so long as the trustee can identify an actual creditor who has standing to avoid the transfer. *That avoidance is not limited to the amount of that particular creditor's claim*; rather, it extends to the value of the entire transfer. For example, suppose a creditor with standing to attack a bulk transfer had a claim against the debtor-transferor in the amount of \$1000 and the debtor had transferred \$1,000,000 in assets to the transferee. The debtor's trustee in bankruptcy could invalidate the entire bulk sale, recovering the entire \$1,000,000 in assets from the transferee, leaving the transferee with an unsecured claim against the property of the bank-

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159. *Id.* at 385.

160. *Ross v. Randolph (In re Villa Roel, Inc.)*, 57 Bankr. 835 (Bankr. D.D.C. 1985).

161. *Id.* at 839 (damages determined by value of items transferred on date of transfer and not reduced by posttransfer expenditures transferee may have made).

162. *See Bakst v. Vono (In re Gold Rush East, Inc.)*, 55 Bankr. 126 (Bankr. S.D. Fla. 1985) (transfer voidable under state law; trustee may avoid transfer and recover from transferee); *Sbar's, Inc. v. New Jersey Art & Craft Distribs., Inc.*, 205 N.J. Super. 516, 501 A.2d 560 (1985) (creditor may seek personal liability against purchaser for value of goods where sale ineffective under state law).

163. *See, e.g., Jacobs v. Tannenbaum*, 249 A.D. 847, 848, 292 N.Y.S. 735, 737 (1937) (transferee personal liability based on nature of business and time lapse between transfer and entry of judgment).

164. 284 U.S. 4 (1931).

165. *Id.* at 5.



ruptcy estate.<sup>166</sup>

Section 544(b) operates to subrogate the trustee to the claim of an existing creditor of the debtor with standing to attack the debtor's disposition of property. Under general subrogation law, the trustee's claim should be determined by and be limited to the claim of the creditor to which the trustee is subrogated.<sup>167</sup> By permitting the trustee to avoid the entire transfer, without limitation to the claim of the existing creditor, the rule of *Moore v. Bay* departs from subrogation law in a manner not necessarily supported by the policy interests underlying the bankruptcy law. The rule of *Moore v. Bay*, therefore, has been extensively criticized as inconsistent with basic subrogation principles and fundamental bankruptcy policies.<sup>168</sup>

Dean Jackson has asserted that the *Moore v. Bay* gloss on section 544(b) frustrates the temperamental fit between state law and the federal bankruptcy law:

[S]ection 544(b) creates incentives for individual creditors to resort to bankruptcy not for collective reasons but to achieve individual advantage. The costs imposed by such incentives do not even proceed from a careful consideration of the inequities of the nonbankruptcy rule; to the contrary, the commentary gives no indication that any given nonbankruptcy property law is particularly unwise.<sup>169</sup>

In a later article, Dean Jackson and Professor Scott recognized that the *Moore v. Bay* rule "reinforces the deterrent effects of the trustee's avoidance powers."<sup>170</sup>

166. See Dunham, *Post-Petition Transfers in Bankruptcy*, 39 U. MIAMI L. REV. 1, 113 n.490 (1984) (courts construing *Moore* have held trustee's avoidance power is not limited by claim of creditor in position to avoid transfer; where creditor can avoid transaction, entire transfer is set aside; Congress intended to implement doctrine of *Moore*) (discussing *Murdock v. Plymouth Enters., Inc. (In re Curtina Int'l, Inc.)*, 23 Bankr. 969, 981 (Bankr. S.D.N.Y. 1982) (entire bulk sales transfer set aside)). See also Jackson, *supra* note 34, at 742 (under *Moore*, trustee may avoid entire interests that subrogated creditor could have avoided only to amount of claim) (citing *In re Plonta*, 311 F.2d 44 (6th Cir. 1962); *Mercantile Trust Co. v. Kahn*, 203 F.2d 449 (8th Cir. 1953); *City of New York v. Rassner*, 127 F.2d 703 (2d Cir. 1942)).

167. See, e.g., *United States v. Munsey Trust Co.*, 332 U.S. 234, 242, (1947) (subrogee replaces one whose claim has been paid); *Phoenix Ins. Co. v. Erie & W. Transp. Co.*, 117 U.S. 312, 321 (1886) (insurer's rights of subrogation limited to rights of insured). See generally 73 AM. JUR. 2d *Subrogation* § 106 (1974 & Supp. 1990); 83 C.J.S. *Subrogation* § 14 (1953 & Supp. 1990).

168. See J. MACLACHLAN, *HANDBOOK OF THE LAW ON BANKRUPTCY* 331 (1956) (*Moore* court did not grasp point of case and did not understand effect of its decision); Jackson & Scott, *On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors' Bargain*, 75 VA. L. REV. 155, 183 (1989) (effect of *Moore* is to redistribute assets beyond requirement of collectivization, thus exacerbating perverse incentive problems); Jackson, *supra* note 34, at 744-48 (*Moore* involved two issues: 1) extent to which trustee may avoid transfer; and 2) beneficiaries of avoidance; court resolved both issues wrongly); Kennedy, *The Trustee in Bankruptcy as a Secured Creditor Under the Uniform Commercial Code*, 65 MICH. L. REV. 1419, 1422 (1967) (*Moore* has survived despite attacks on its logic and equity). But see 2 G. GLENN, *supra* note 28, § 505, at 867 (*Moore* correct, else present Bankruptcy Act would have legislated ruling out of existence). See also Schwartz, *Moore v. Bay—Should Its Rule Be Abolished?*, 29 REF. J. 67 (1955); Comment, *The Trustee in Bankruptcy and the Secured Creditor*, 17 ARK. L. REV. 46, 56 (1962) (*Moore* commonly attacked improperly by combining consideration of extent of recovery and identification of beneficiary).

169. Jackson, *supra* note 34, at 750.

170. Jackson & Scott, *supra* note 168, at 181.

Even acknowledging the validity of the creditor misbehavior deterrent argument, however, the authors are concerned about its only being applied in the bankruptcy setting.<sup>171</sup> They argue that the danger of forum shopping exists so long as creditor remedies differ in state and federal fora.<sup>172</sup>

At the state level, Article 6 provides that a bulk transfer not in compliance with the specified notice requirements is "ineffective."<sup>173</sup> Bankruptcy Code section 544(b), as federal law, provides that the trustee may set aside any transfer by the debtor that is "voidable" under state law.<sup>174</sup> The terminology of the state and federal law is not parallel. Nevertheless, the courts that have confronted the interrelation of Article 6 and section 544 have determined that the trustee may use the *Moore v. Bay* interpretation of section 544(b) to recover assets from a transferee who acquired them in a noncomplying bulk sale.<sup>175</sup> For example, in *In re Wicaco Machine Co., Inc.*,<sup>176</sup> the court found that once the trustee has established the elements of an Article 6 action, the trustee may recover either property transferred in bulk or the value of the property under section 544.<sup>177</sup>

Bankruptcy courts have been willing to identify bases of liability aside from section 544. In *In re Radcliffe's Warehouse Sales, Inc.*,<sup>178</sup> the Bankruptcy Court for the Western District of Washington considered an action by the trustee to avoid a debtor's transfer of assets as both a noncomplying bulk sale and a constructively fraudulent transfer under section 548 of the Code.<sup>179</sup> The court noted that the trustee's section 544(b) bulk sales action was derivative, dependent on there being a creditor of the debtor-transferor with standing to avoid the bulk sale.<sup>180</sup> Insofar as the action was not commenced within six months of the bulk sale, the court concluded that there remained an open factual question: whether the bulk sale had been concealed so as to toll the running of the limitations period under section 6-111 of Article 6.<sup>181</sup> The court also noted that a coincident fraudulent transfer action would lie if the trustee could establish that the debtor-transferor had received less than a reasonably equivalent value for the

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171. *Id.* at 184.

172. *Id.*

173. U.C.C. § 6-105. See also *supra* notes 79-87 and accompanying text for a discussion of the meaning of "ineffective."

174. 11 U.S.C. § 544 (1988).

175. See, e.g., *Danning v. Daylin, Inc.*, 488 F.2d 185 (9th Cir. 1973) (section 70(e), predecessor of § 544(b), applied); *Ganz v. Kovatch (In re Wicaco Mach. Co.)*, 55 Bankr. 588 (Bankr. E.D. Pa. 1985) (Article 6 and § 544(b) applied), *appeal denied*, 60 Bankr. 415 (E.D. Pa. 1986); *Stolba v. Mastrandrea (In re Pritchard)*, 8 Bankr. 688 (Bankr. C.D. Cal. 1981) (section 70(e) applied).

176. 55 Bankr. 588 (Bankr. E.D. Pa. 1985).

177. *Id.* at 592.

178. *McCoy v. Grinnell (In re Radcliffe's Whse. Sales, Inc.)*, 31 Bankr. 827 (Bankr. W.D. Wash. 1983).

179. *Id.* at 828.

180. *Id.* at 832. This point was critical to whether the trustee would be restricted to the state statute of limitations or would be able to utilize the more generous federal statute of limitations in Bankruptcy Code § 108. *Id.* at 830-32.

181. *Id.* at 832. If there is concealment, the state statute of limitations (U.C.C. § 6-111) would be tolled until discovery of the transfer. *Id.* at 831.



assets.<sup>182</sup> Because that determination contemplates a factual review, the court deemed summary judgment on the fraudulent transfer issue inappropriate.<sup>183</sup> Still, the case illustrates the potential for a trustee's prosecution of both a section 544(b) bulk sales action and a section 548 fraudulent transfer action on the same facts.<sup>184</sup>

The bankruptcy court in *In re Sergio, Inc.*<sup>185</sup> also links Article 6 and fraud bases of recovery. In that case, there was a series of property transfers among the owners of a closely held enterprise and its principals as well as between the enterprise and its creditors. The court found a sufficient basis to support both a bulk transfer action under Article 6 and an action premised on the debtor's actual intent to hinder, delay, or defraud its creditors.<sup>186</sup> The court found that each of the badges of fraud as defined by Hawaii case law was in evidence.<sup>187</sup> Further, the court determined that since the bulk transferees knew of the financial condition and design of the transferor, the violation of Article 6 also established an actual intent to defraud action.<sup>188</sup>

While every bulk sale may not evidence an actual intent to defraud, there is sufficient coincidence between the two theories to present the possibility in bulk sales litigation that a constructive fraud action would lie as well.<sup>189</sup> That affinity should be considered when evaluating the impact of the Alternatives on the relationship between the bulk sales and fraudulent disposition law, particularly in

182. *Id.* at 829.

183. *Id.*

184. *Id.* at 832. For other cases in which the same potential for that affinity existed, see, e.g., *Best Mfg., Inc. v. White Plains Coat & Apron Co. (In re Danielle Laundries, Inc.)*, 40 Bankr. 404, 408-10 (Bankr. S.D.N.Y. 1984) (trustee brought action based on fraudulent conveyance and state bulk sales law); *Limperis v. Kolacny (In re Chicago Music Corp.)*, 36 Bankr. 626, 632 (Bankr. N.D. Ill. 1984) (trustee allowed to collect property fraudulently transferred in bulk).

185. *Nakagawa v. Sergio, Inc. (In re Sergio, Inc.)*, 16 Bankr. 898 (Bankr. D. Haw. 1981).

186. *Id.* at 910.

187. *Id.* at 908. The court listed the badges of fraud:

- a. The transferor is indebted or insolvent;
- b. The conveyance is general, i.e., that the debtor's entire estate is diminished, thereby leaving him insolvent;
- c. Consideration for the conveyance is absent;
- d. The conveyance is secret and concealed;
- e. The conveyance is made to a family member or to one of close relationship;
- f. The conveyance is made while a suit against the debtor is pending or is threatening;
- g. The transferee takes the property in trust for the debtor;
- h. The debtor remains in possession, reserves the use and benefit, and deals with the property as his own.

*Id.*

188. *Id.* at 909. See also *McCoy v. Grinnell (In re Radcliffe's Whse. Sales, Inc.)*, 31 Bankr. 827, 832 (Bankr. W.D. Wash. 1983) (court willing to impose greater liability if transferee acted to conceal transaction). For examples of cases holding the transferee personally liable to the transferor's creditor, see *supra* notes 144-63 and accompanying text.

189. Given the problematic nature of valuation analyses in the fraudulent disposition law and the impact of valuations on the constructive fraud calculus, it may be that post hoc value determinations would result in the avoidance of certain bulk sales on a constructive fraud basis. See *Alces & Dorr, supra* note 44, at 557-63.

light of the impact of *Moore v. Bay*.<sup>190</sup>

### B. Repeal or Revision of Article 6

Prominent among the shortcomings of existing Article 6 identified by the drafters of the proposed alternatives is the current law's treatment of transferee liability issues. Specifically, the drafters of the revision have responded to the concern that bulk transfer liability may be imposed in a manner and to an extent wholly out of proportion to the evil accomplished by a noncomplying bulk sale. Not convinced that the evil addressed by the bulk sales law remains a contemporary commercial problem, the drafters seem convinced that the bulk sales law may have outlived its ratio decidendi.<sup>191</sup>

That conclusion was the basis of both the repeal and the revision alternatives. The NCCUSL concluded that there remains no good commercial reason for bulk sales liability; they recommend Alternative A, the repealer.<sup>192</sup> Since all states may not agree with the NCCUSL, the drafters also proposed an Alternative B ("Revision"). The Revision adjusts the calculus to impose bulk sales liability on transferees in fewer contexts than under current law. Further, it contemplates a more limited liability.<sup>193</sup>

Revised section 6-107 addresses the scope of transferee liability to both claimants and creditors. All claimants are creditors but not all creditors are claimants.<sup>194</sup> The Revision defines a transferee-buyer's duty to apply the pro-

190. 284 U.S. 4 (1931).

191. See Revised U.C.C. Article 6, Prefatory Note, *Background*.

In the legal context in which Article 6 (1987 Official Text) and its nonuniform predecessors were enacted, the benefits to creditors appeared to justify the costs of interfering with good faith transactions.

[T]here is no evidence that, in today's economy, fraudulent bulk sales are frequent enough, or engender credit losses significant enough, to require regulation of all bulk sales, including the vast majority that are conducted in good faith.

*Id.*

192. See Revised U.C.C. Article 6, Prefatory Note, *Recommendation*.

The National Conference of Commissioners on Uniform State Laws and the American Law Institute believe that changes in the business and legal contexts in which sales are conducted have made regulation of bulk sales unnecessary. The Conference and the Institute therefore withdraw their support for Article 6 of the Uniform Commercial Code and encourage those states that have enacted the Article to repeal it.

*Id.*

193. Revised U.C.C. § 6-107. See *infra* Appendix for a portion of the text of Revised U.C.C. § 6-107.

194. See Revised U.C.C. § 6-102(f) (1989) (creditor defined as claimant or other person holding claim). Claimant is defined as:

[A] person holding a claim incurred in the seller's business other than:

(i) an unsecured and unmatured claim for employment compensation and benefits, including commissions and vacation, severance and sick-leave pay;

(ii) a claim for injury to an individual or to property, or for breach of warranty, unless:

(A) a right of action for the claim has accrued

(B) the claim has been asserted against seller, and



ceeds of the bulk sale according to a "schedule of distribution."<sup>195</sup> If the buyer fails to make the proper distribution to a creditor, the buyer will be liable to the creditor for the amount of the creditor's claim, less any amount that the creditor would not have realized even if the buyer had complied with the schedule of distribution.<sup>196</sup> The buyer will also be liable to all claimants (but not necessarily all creditors) for the buyer's failure to comply with any of the other requirements of section 6-104, such as the notice requirements.<sup>197</sup> Again, the buyer's liability would be reduced by the amount that the claimant could not have recovered even had the buyer complied with the section 6-104 requirements.<sup>198</sup>

Those liability rules are subject to two substantial limitations. First, the buyer who has acted in good faith will not be liable for any violation of the section 6-104 requirements.<sup>199</sup> Second, even the buyer who has not acted in good faith will be liable *only on an in personam basis*. That is, the liability cannot exceed twice the net contract price paid by the buyer, *less the amount of any proceeds already paid to or for the benefit of the seller*.<sup>200</sup> Subsection 6-107(8) reflects the drafters' intent to clarify the in personam (rather than in rem) nature of any cause of action against the buyer who has in bad faith failed to comply with the requirements of section 6-104.

The revised section reads in pertinent part:

(8) A buyer's failure to comply with the requirements of Section 6-104(1) does not (i) impair the buyer's rights in or title to the assets, (ii) render the sale ineffective, void, or voidable, (iii) entitle a creditor to more than a single satisfaction of his [or her] claim, or (iv) create liability other than as provided in this Article.<sup>201</sup>

The Revision substantially compromises the rights of a complaining creditor or trustee in bankruptcy to upset a bulk sale. Even if the creditor or trustee prevailed in a Revised Article 6 action, it is likely that the extent of the recovery would be limited. As a result, a creditor might turn to other commercial fraud theories to accomplish the type of recovery available under current Article 6. If that strategy is successful, trustees may recover even more than under the current bulk sales law. Consequently, the object of those who sought the promulga-

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(C) the seller knows the identity of the person asserting the claim and the basis upon which the person has asserted it.

*Id.* § 6-102(e). *Cf. id.* § 6-102(d) (claim defined as "right to payment . . . whether or not . . . reduced to judgment, liquidated, fixed, matured, disputed, secured, legal, or equitable"). Given this broad definition, the language in the definition of creditor, "or other person holding a claim," may include those persons excluded from the definition of claimants under the "other than" provisions.

195. Revised U.C.C. § 6-106 (1989).

196. *Id.* § 6-107(1)(a).

197. *Id.* § 6-107(1)(b).

198. *See id.* § 6-107(2) (creditor has burden of establishing validity and amount of claim while buyer must establish amount creditor would not have realized if buyer had complied).

199. *Id.* § 6-107(3).

200. *Id.* § 6-107(4).

201. *Id.* § 6-107(8). *See also id.* § 6-107 comment 2 (asserts that change in available remedy for creditor, from avoidance of sale to recovery of damages, precludes bankruptcy trustee's avoidance of sale under Bankruptcy Code § 544(b)).

tion of Revised Article 6, avoidance (or invalidation) of *Moore v. Bay*,<sup>202</sup> may be frustrated. Moreover, if the trustee is better off using a commercial fraud theory other than that the trustee would be prosecuting under the current law, the drafters' efforts may in fact prove to have backfired.

### 1. The Worst of Times

In the course of the last decade or so, commercial transactors have witnessed the proliferation of commercial fraud theories. The scienter requirement has been relaxed as more and more courts seem willing to find actionable negligent and even innocent misrepresentations.<sup>203</sup> Plaintiff-debtors have utilized a breach of fiduciary duty theory to recover substantial damages from creditors deemed to have taken unfair advantage.<sup>204</sup> These more aggressive and successful fraud actions against lenders may stem from the same commercial forces that have accommodated the expanded application of the fraudulent disposition law to contexts not originally contemplated by the drafters of the Statute of 13 Elizabeth.<sup>205</sup>

As the scope of commercial fraud actions expands, the relations among various fraud theories have become manifest. It is now clear that expansion of one offensive fraud theory will affect the construction of complementary theories. It is also clear that, presented with plausible arguments, the courts, particularly bankruptcy courts, will not hesitate to test the limits of an existing theory to redress a perceived inequity. From the perspective of those defending against expansive fraud theories, these may indeed be the worst of times.<sup>206</sup>

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202. 284 U.S. 4 (1931).

203. For cases utilizing a negligent fraud theory, *see, e.g.*, *Cameron v. Outdoor Resorts of Am., Inc.*, 611 F.2d 105, 106 (5th Cir. 1980) (corporation liable for agent's negligent misrepresentations); *Gilbane Bldg. Co. v. Nemours Found.*, 606 F. Supp. 995, 1002 (D. Del. 1985) (subcontractor reliance on project owner's knowledge is basis for negligent misrepresentation); *Harbor Mechanical, Inc. v. Arizona Elec.*, 496 F. Supp. 681, 685 (D. Ariz. 1980) (contractor alleged negligent performance not actionable absent contractor duty). For cases utilizing an innocent misrepresentation theory, *see, e.g.*, *Community Hosp. of Roanoke Valley, Inc. v. Musser (In re Musser)*, 24 Bankr. 913, 922 (W.D. Va. 1982) (innocent misrepresentation of nature of documents rendered assignment invalid); *Susser Petroleum Co. v. Latina Oil Corp.*, 574 S.W.2d 830, 832 (Tex. Ct. App. 1978) (false business advice actionable even if made innocently).

204. *See, e.g.*, *Barnett Bank v. Hooper*, 498 So. 2d 923, 926 (Fla. 1986) (bank's fiduciary relationship gave rise to duty to disclose); *Jacques v. First Nat'l Bank*, 307 Md. 527, 540, 515 A.2d 756, 765 (1986) (bank owed duty of reasonable care because agreed to process loan application); *Deist v. Wachholz*, 208 Mont. 207, 210, 678 P.2d 188, 193 (1984) (special relationship between bank and loan customer gave rise to bank's fiduciary duty).

205. *See* P. ALCES, *supra* note 11, ¶ 5.02[4] (discusses application of fraudulent disposition law to leveraged buyouts, intercorporate guaranties, and foreclosure of collateral interests) (citing *United States v. Tabor Court Realty Corp.*, 803 F.2d 1288 (3d Cir. 1986), *cert. denied*, 483 U.S. 1005 (1987); *Rubin v. Manufacturers Hanover Trust Co.*, 661 F.2d 979 (2d Cir. 1981); *Durrett v. Washington Nat'l Ins. Co.*, 621 F.2d 201 (5th Cir. 1980)).

206. A. CAPPELLO & F. KOMOROSKE, *LENDER LIABILITY* (1988); J. NORTON & W. BAGGETT, *LENDER LIABILITY LAW AND LITIGATION* §§ 501-04, (1989); Chaitman, *Emerging Theories of Lender Liability* (ABA 1985-1987).



a. *United States v. Tabor Court Realty*<sup>207</sup>

Leveraged business acquisitions have recently been the subject of fraudulent disposition attack.<sup>208</sup> The cases generally focus on the constructive fraud incidents of such transactions. But one decision, *Tabor Court Realty*, is particularly noteworthy. In that case, the court, recognizing the parallels between actual intent to defraud and constructive fraud, found that certain leveraged business acquisitions would be avoidable on either basis.<sup>209</sup> That finding is significant for the bulk sales calculus.

In *Tabor Court Realty*, the target was a closely held corporation. The principals sought to cash out their interests when the firm began to experience financial difficulties. The buyer obtained acquisition financing from Institutional Investors Trust (IIT), which required that the assets of the target be used to secure repayment of the financing.<sup>210</sup> The court found that IIT was in a position to recognize the impact that the financial arrangement would have on the creditors of the target. Accordingly, the court held that the leveraged buy-out (LBO) was voidable as a constructively fraudulent conveyance under the Pennsylvania UFCA.<sup>211</sup> The court further concluded that the lender's awareness of the consequences of the transaction on the interests of the target's creditors was sufficient to establish an actual intent to hinder, delay, or defraud the creditors of the target.<sup>212</sup> It was the defendant's awareness of the prejudicial impact of the LBO on the target's creditors that supported the actual intent to defraud action. It seems that a bulk transferee would be in the same position to appreciate the

207. 803 F.2d 1288 (3d Cir. 1986), *cert. denied*, 483 U.S. 1005 (1987).

208. See *United States v. Gleneagles Inv. Co.*, 565 F. Supp. 556, 576 (M.D. Pa. 1983) (new management is not fair consideration for corporate stock transfer), *aff'd sub nom.*, *United States v. Tabor Court Realty Corp.*, 803 F.2d 1288 (3d Cir. 1986), *cert. denied*, 483 U.S. 1005 (1987); *Wienboldt Stores, Inc. v. Schottenstein*, 94 Bankr. 488, 500 (N.D. Ill. 1988) (LBOs are not exempt from fraudulent conveyance laws); *Ohio Corrugating Co. v. Security Pac. Business Credit, Inc. (In re Ohio Corrugating Co.)*, 70 Bankr. 920 (Bankr. N.D. Ohio 1988) (LBOs are not immune from fraudulent conveyance attack); *Roxbury State Bank v. The Clarendon*, 129 N.J. Super. 358, 324 A.2d 24 (fraudulent conveyance where no fair consideration exchanged for grantor's encumbrance of assets to facilitate buyout), *cert. denied*, 66 N.J. 316, 331 A.2d 16 (1974); *Sharrer v. Sandlas*, 103 A.D.2d 873, 477 N.Y.S.2d 897 (N.Y. App. Div. 1984) (fraudulent conveyance when target of LBO receives no consideration and left with unreasonably small assets), *appeal denied*, 63 N.Y.2d 610, 473 N.E.2d 1190, 484 N.Y.S.2d 1024 (1984). See also *Hansen v. Cramer*, 39 Cal. App. 2d 321, —, 245 P.2d 1059, 1060-61 (1952) (because benefit of conveyance inured to third party (discharge of debt) and not grantor, not for fair consideration; grantor rendered insolvent, therefore transfer void).

But see *Jones v. National City Bank (In re Greenbrook Carpet Co.)*, 722 F.2d 659 (11th Cir. 1984) (bank's collateral interest from LBO not avoidable as fraudulent transaction); *Credit Managers Ass'n v. Federal Co.*, 629 F. Supp. 175 (C.D. Cal. 1985) (questionable whether LBOs subject to fraudulent conveyance attack); *Cate v. Nicely (In re Knox Kreations, Inc.)*, 474 F. Supp. 567 (E.D. Tenn. 1979) (LBO not fraudulent conveyance because target not then insolvent, nor rendered insolvent thereby), *aff'd in part, rev'd in part*, 656 F.2d 230 (6th Cir. 1981).

209. 803 F.2d at 1304-05 & n.9.

210. *Id.* at 1292.

211. *Id.* at 1304-05. The Pennsylvania UFCA is codified at PA. STAT. ANN. tit. 39, §§ 351-63 (Purdon 1954 & Supp. 1990).

212. 803 F.2d at 1296, 1304-05.

consequences of the bulk sale on the transferor's creditors.<sup>213</sup>

The *Tabor* court's conclusion concerning the good faith element of "fair consideration" under the UFCA is particularly instructive in light of the Revised Article 6 absolute protection of good faith transferees. The very same facts that supported the actual intent to defraud action in *Tabor Court Realty* also supported the finding that the transferee had not given a fair equivalent *in good faith*. The United States Court of Appeals for the Third Circuit confirmed that the transferee had not given the consideration in good faith

because it knew, or should have known, that the money it lent the mortgagors was used, in part, to finance the purchase of stock from the mortgagors' shareholders, and that as a consequence of the loan, IIT and its assignees obtained a secured position in the mortgagors' property to the detriment of creditors.<sup>214</sup>

Good faith may have the same meaning in the UFCA as it does in the revision of Article 6.<sup>215</sup> If that is so, the *Tabor Court Realty* decision provides the predicate to support a finding that in many cases the buyer will be exposed to bulk sale liability under the Revision *or* actual intent to defraud liability under the uniform fraudulent disposition law or Bankruptcy Code section 548.<sup>216</sup>

b. *Kidder Skis International v. Williams*<sup>217</sup>

Preferential transfers are voidable in bankruptcy<sup>218</sup> at the instance of the trustee.<sup>219</sup> There is, however, a short limitations period that constrains which

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213. Cf. *supra* note 19 and accompanying text for a discussion of transferee's liability despite lack of knowledge.

214. 803 F.2d at 1295.

215. Revised U.C.C. § 6-102(2)(c) adopts the definition of good faith in U.C.C. § 1-201(19) (1989) comment. The Code requires not only subjective good faith but also that the effort to comply with Article 6 be "commercially reasonable." See also Revised U.C.C. § 6-107 (3)(a). This requirement of both good faith, or honesty in fact, and commercial reasonableness is in effect an adoption of the objective Article 2 definition of good faith for merchants. See U.C.C. § 2-103(1)(b) (1989).

216. Cf. *Alces*, *supra* note 11, at 852-59 (discusses fraudulent disposition paradigms applicable in leveraged business acquisition setting).

217. 60 Bankr. 808 (W.D. Mo. 1985).

218. See 11 U.S.C. § 547 (1988). Though preferences are generally a matter of federal law, some preferential transfers are avoidable under state law as fraudulent dispositions. See UFCA § 3 (fair consideration requires transfer of fair equivalent in good faith). The good faith element has significance independent of the fair equivalence requirement. Thus, preferential exchanges made for a fair equivalent still may be challenged for lack of good faith. Good faith has been found lacking in the case of preferential transfers to insiders. See, e.g., *Tacoma Ass'n of Credit Men v. Lester*, 72 Wash. 2d 453, 433 P.2d 901 (1967) (transfer from corporation to president fraudulent conveyance irrespective whether for fair equivalence). While the good faith element of fair consideration was deleted in the UFTA, § 5(b) was included to address specifically the problem of preferential transfers to insiders. Kennedy, *supra* note 43, at 204-05.

219. 11 U.S.C. § 547. Section 547(b) states the elements of a preference: (1) a transfer of the debtor's property interest; (2) "to or for the benefit of a creditor;" (3) "on account of an antecedent debt;" (4) "while the debtor was insolvent;" (5) within ninety days of the bankruptcy petition (or one year if the transferee-creditor was an insider); (6) which allows the creditor to receive more than he would in a liquidation of debtor's assets. See generally P. *ALCES*, *supra* note 11, at Ch. 6; 4 COLLIER ON BANKRUPTCY ¶ 547 (15th ed. 1990).



transfers are deemed preferential. The trustee may recover only those preferential transfers effected within ninety days of the bankruptcy petition. In the case of preferential transfers to an "insider,"<sup>220</sup> transfers made within the year prior to bankruptcy may be voidable.

In *Kidder Skis*, the court considered the trustee's preference attack against a transferee who acquired the property allegedly preferentially transferred ninety-one days before the debtor filed its voluntary bankruptcy petition.<sup>221</sup> A hint of collusion was in the air.<sup>222</sup> Given the ninety-day limitation and the fact that the transferee was not an insider, the court was faced with the real possibility that the transfer would not be avoidable notwithstanding the fact that the prejudicial impact of a preference was in evidence. Further, the bases of constructive fraudulent disposition avoidance under section 548 were not satisfied.

The court was left with only one remaining option: void the transfer as one effected with the actual intent to hinder, delay, or defraud the creditors of the transferor-debtor.<sup>223</sup> The language of the court's opinion echoes that highlighted in *Tabor Court Realty* in terms that emphasize the potential coincidence of the constructive and actual fraud actions:

There is no doubt that the transfer was with the intent to hinder, delay or defraud the secured creditor. . . .

Although *Kidder* may have given value for the transfer, the Court agrees with the bankruptcy judge that it did not take the merchandise in good faith. The bankruptcy judge noted that the debtor had a closer financial relationship with *Kidder* than with other creditors. Also, *Kidder* knew that the debtor was in financial trouble and unable to pay for his inventory.<sup>224</sup>

The *Kidder Skis* decision suggests that even the most subjective measure of good faith may be construed in terms that would provide the basis of avoidance under the Revision. More importantly, *Kidder Skis* confirms that the same facts compromising a good faith finding can provide the predicate for an actual intent to defraud action.

### c. Objectification of Commercial Fraud Law

Cases such as *Tabor Court Realty* and *Kidder Skis* demonstrate the courts' ability and willingness to find the elements of actual fraud in settings generally construed as giving rise to only constructive fraud liability. There is no dearth of authority recognizing that transactors are chargeable with knowledge of the necessary consequences of their actions.<sup>225</sup> In the bulk sales or fraudulent dis-

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220. "Insider" is defined in the Bankruptcy Code at 11 U.S.C. § 101(30) (1988).

221. *Kidder Skis Int'l v. Williams*, 60 Bankr. 808, 809 (W.D. Mo. 1985).

222. *Id.* at 809-10.

223. The symbiotic relationship between the preference and fraudulent disposition law has existed for some time. See *Twyne's Case*, 3 Coke Rep. 80b, 76 Eng. Rep. 809 (Star Chamber 1601) (secret conveyance of goods to avoid debt action fraudulent). Although *Twyne's Case* is viewed as a fraudulent conveyance case, it was in fact a preference action.

224. 60 Bankr. at 809-10.

225. See *National Bank v. Yegen*, 83 Mont. 265, 271 P. 612 (1928) (transferor deemed to have

position contexts, it will be difficult for transferees to protest their good faith when the reasonable inference may be drawn that the transferee was aware of the consequences of the transfer.<sup>226</sup>

Additional developments in the commercial fraud case law support the conclusion that an increasing number of transfers may be subject to avoidance using actual fraud principles. One compelling recent decision, *Levit v. Ingersoll Rand Financial Corp.*,<sup>227</sup> considered a bankruptcy trustee's avoidance of a preferential transfer made more than ninety days but less than one year prior to the initiation of the bankruptcy proceeding.<sup>228</sup> For such transfers to be recoverable, the Code requires that the transfer must have been made to or for the benefit of an insider of the debtor.<sup>229</sup> In *Levit*, the debtor paid an obligation that had been guaranteed by an insider. The United States Court of Appeals for the Seventh Circuit found that, because the payment effected the release of the insider-guarantor, it inured to the benefit of the insider and was recoverable from the non-insider creditor by operation of Bankruptcy Code section 550(a).<sup>230</sup>

In reaching his decision, Judge Easterbrook recognized that the focus of the preference law, like the focus of constructive fraud law, is on the impact the transfer had on the interests of the debtor and the creditors of the debtor. Most telling, however, was the court's appreciation of the commercial dynamic surrounding the recovery of such preferential transfers. Given the special risks that insider transactions present for outsider creditors, the preference law makes special provision to expand the period during which transfers to insiders may be recovered as preferential. That expanded preference period constitutes a recognition that insiders are well postured to take advantage of the debtor and, derivatively, the creditors of the debtor. To thwart that type of fraudulent posturing,

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intended inevitable consequences of her act in making conveyance). *See also* *Prisbrey v. Noble*, 505 F.2d 170, 174-75 (10th Cir. 1974) (intent may be found in facts surrounding transaction); *Life Science Church v. Personette (In re Life Science Church)*, 34 Bankr. 529, 534 (Bankr. N.D. Ind. 1983) (transferor actions support conclusion that transfer was fraudulent).

226. *Cf. supra* notes 98-112 and accompanying text for a discussion of concealment cases.

227. 874 F.2d 1186 (7th Cir. 1989).

228. *Id.* at 1188.

229. 11 U.S.C. § 547(b)(4) provides:

[T]he trustee may avoid any transfer of an interest of the debtor in property -

. . .

(4) made -

(A) on or within 90 days before the date of the filing of the petition; or

(B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider.

*Id.*

230. 874 F.2d at 1194-98. *See also* 11 U.S.C. § 550(a)(1) which provides:

[T]o the extent that a transfer is avoided under section [547] of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from -

(1) the initial transferee of such transfer or the entity for whose benefit such transfer was made . . .

*Id.*



it is necessary to expose insider transactions to closer scrutiny.<sup>231</sup> Commercial fraud principles justify such scrutiny of insider preferences. *Levit* supports the imposition of liability on non-insider creditors to vindicate those principles. Accordingly, the *Levit* decision provides analogous support for the thesis of this essay:<sup>232</sup> because bulk transferees are or should be aware of the consequences of their actions, it is not inappropriate for the fraudulent disposition law to provide the means to avoid bulk sales that operate to the prejudice of the transferor's creditors.

This objectification of commercial fraud law has been recognized by the commentators. In a recent piece, Professor Steve Nickles reviewed seminal lender liability cases and discerned "The Objectification of Debtor-Creditor Relations."<sup>233</sup> He found that cases such as *Peoples Bank & Trust Co. v. Lala*,<sup>234</sup> *K.M.C. Co. v. Irving Trust Co.*,<sup>235</sup> and *State National Bank v. Farah Manufacturing Co.*<sup>236</sup> represent "another instance of tort swallowing contract."<sup>237</sup> The courts, according to Nickles, have replaced contractual standards with external standards and thereby have found the means to upset transactions previously subject only to scrutiny under contract law. He concluded that in each of the three cases the debtor's dependency on the creditor gave rise to "higher duties that transcend the contract between the parties."<sup>238</sup> In that light, the concern of the drafters of the Alternatives that the bulk sales law may "imped[e] normal business practices" seems shallow.<sup>239</sup> The expectations developed by contract as well as those developed by reference to normal business practices may be transcended by pervasive commercial fraud principles.

Another setting for this type of objectification is in the application of fraudulent disposition law to the foreclosure of collateral interests, such as Article 9 security interests. In an article defending the rule of *Durrett v. Washington National Insurance Co.*,<sup>240</sup> Professor Frank Kennedy recognized this objectifica-

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231. Loans from insiders to their firms are not the only, or even the most important, concern of outside creditors. Insiders frequently guarantee other loans. See *Levit*, 874 F.2d at 1195 (insiders may induce firm to pay guaranteed loans preferentially; if the preference-recovery period for such payments were identical to period for outside debts, this would be attractive device for insiders).

232. See *Ray v. City Bank & Trust Co. (In re C-L Cartage Co.)*, 899 F.2d 1490, 1494-95 (6th Cir. 1990) (*Levit* court analysis followed).

233. Nickles, *The Objectification of Debtor-Creditor Relations*, 74 MINN. L. REV. 371 (1989).

234. 392 N.W.2d 179 (Iowa Ct. App. 1986) (in debtor-creditor relationship, deal between parties lacking confidential relation still subject to review for substantive fairness).

235. 757 F.2d 752 (6th Cir. 1985) (though state law only required subjective good faith on part of bank, court allowed application of objective standard which imposed duty on bank to lend beyond amount contracted for).

236. 678 S.W.2d 661 (Tex. Ct. App. 1984) (management clause precluding former CEO's return to control of corporation and fixing bank's and corporation's own contractual standard of conduct, displaced by external standard of conduct tort of interference with prospective economic advantage).

237. Nickles, *supra* note 233, at 374.

238. *Id.* at 381.

239. Revised U.C.C. Art. 6, Prefatory Note.

240. 621 F.2d 201 (5th Cir. 1980). At issue in *Durrett* was whether the sale of real property in a foreclosure sale was voidable under § 67(d) of the Bankruptcy Code (now § 548). The fair market

tion.<sup>241</sup> He noted that the objectification of fraudulent disposition law began with the cases construing the Statute of 13 Elizabeth: "While every statute derived from the Statute of 13 Elizabeth reaches transfers made 'with intent to hinder, delay, or defraud creditors,' legislative codification of the law of fraudulent transfers has generally added provisions particularizing circumstances that warrant avoidance of certain transfers without regard to the parties' intent."<sup>242</sup> The *Durrett* decision, according to Kennedy, was the necessary result of that process of objectification. Indeed, Kennedy's thesis in that article is that *Durrett* does not change fraudulent transfer law. Rather, it represents the application of established fraudulent disposition principles in the foreclosure context.<sup>243</sup>

If the current commercial law climate has accommodated the development and successful prosecution of fraudulent disposition actions premised on objective criteria, then adjustments of the bulk sales regime, a body of objective, constructive, fraud law, should be understood in terms of that climate. Fraudulent disposition law has matured to the point where it may be construed to afford a means for creditors to avoid a bulk sale on fraudulent disposition bases. In fact, there are reasons that the fraudulent disposition law would be more attractive than current Article 6 to creditors of the transferor and trustees in bankruptcy. Consequently, the abrogation or limitation of bulk sales law may not yield the result intended by the drafters of the new law.

## 2. Consequences of Repeal/Revision

Under the current bulk sales formulation, a noncomplying transfer is "ineffective"<sup>244</sup> and a trustee in bankruptcy of the transferor may recover the property transferred in bulk, to the full extent contemplated by operation of the *Moore v. Bay* rule.<sup>245</sup> The design of Alternative A, the repealer, is to preempt the bulk sales avoidance theory altogether. The revision, Alternative B, substantially curtails the bases of avoidance. Moreover, it formulates the right of certain creditors to recover only in personam damages against the bulk transferee. The avoidance option under current Article 6, an in rem remedy, is wholly abrogated by section 6-107(8) of the Revision.<sup>246</sup>

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value of the property was \$200,000, but it was sold for only \$115,400. *Id.* at 203. The *Durrett* court held that a foreclosure sale constituted a transfer under § 67(d). *Id.* at 204. The court further held that the consideration paid was not a "fair equivalent" for the property transferred and that, therefore, the transfer was voidable as a constructive fraud. *Id.* at 203. *See also* Kennedy, *Involuntary Fraudulent Transfers*, 9 CARDOZO L. REV. 531, 532 (1987) (foreclosure sale in *Durrett* worked constructive fraud on unsecured creditors of mortgagor; *Durrett* court correct in finding foreclosure sale is transfer under bankruptcy law).

241. Kennedy, *supra* note 240, at 575-77.

242. *Id.* at 537-38 & n.26 (citing 11 U.S.C. §§ 548(a)(2)(B)(ii), 548(b) (1982 & Supp. III 1985); Chandler Act, ch. 575, 52 Stat. 840, 877 (repealed 1978); U.C.C. § 6-104(1) (1986); UFTA §§ 4, 5, 7A U.L.A. 643, 652-53, 657 (1985); UFCA §§ 4, 5, 8, 7A U.L.A. 474, 504, 576 (1985)).

243. Kennedy, *supra* note 240, at 576.

244. U.C.C. § 6-105.

245. *See supra* notes 164-90 and accompanying text for a discussion of *Moore v. Bay*.

246. *See supra* notes 191-202 and accompanying text for a discussion of Revised U.C.C. § 6-107.



Further, under the Revision, a complaining creditor would be able to recover in personam damages only if the bulk buyer had not acted in good faith.<sup>247</sup> If the buyer is not able to establish its good faith,<sup>248</sup> the plaintiff-creditor may recover an amount equal to twice the net contract price for the purchase of the assets transferred in bulk.<sup>249</sup> Thus, from the perspective of the complaining creditor, there is a substantial showing prerequisite to the recovery of damages and no possibility to avoid the transfer completely. A plaintiff's recovery is further reduced by any portion of the contract price that has been "paid to or applied for the benefit of the seller or a creditor" of the bulk seller. That savings provision applies despite any bad faith on the part of the bulk buyer.

These results contrast in several ways from those provided under the uniform state or federal bankruptcy law. First, the recovery under fraudulent disposition law is in rem, not in personam. A trustee in bankruptcy could avoid the transfer and, via *Moore v. Bay*, recover all of the property transferred in bulk, unlimited by the extent of any existing creditor's claim.

Second, under the revision, the class of potential plaintiffs could increase dramatically. If the good faith of the bulk buyer-transferee is not established under Revised Article 6, then arguably the buyer acted in bad faith. The difference between bad faith and intent is difficult to discern. Thus, in cases where there would be *any* bulk sales cause of action under the revision, the plaintiff might also be able to establish the actual intent to defraud contemplated by every incarnation of the fraudulent disposition law.<sup>250</sup> Under the actual intent to defraud provisions, the scope of potential plaintiffs is expansive. Not only may those creditors who held claims against the debtor at the time of the disposition initiate an action to set aside the transfer, those creditors whose claims arise some time after the disposition will also have standing to complain.<sup>251</sup>

Third, the savings clauses of the fraudulent disposition enactments differ from the savings clause of Revised section 6-107(4)(a).<sup>252</sup> In the proposed bulk sales law the buyer who has not acted in good faith may still limit the recovery of the plaintiff-creditor to the extent of any payments "paid to or applied for the

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247. See Revised U.C.C. § 6-107(3)(b) (1989). The section provides that "[a] buyer who . . . held a good faith and commercially reasonable belief that this Article does not apply to the particular sale is not liable to creditors for failure to comply with the requirements of Section 6-104." Thus, if a buyer acts in good faith, the creditor may not recover from the buyer.

248. See *id.* § 6-107(2) (buyer has burden of establishing good faith effort or belief).

249. *Id.* § 6-107(4).

250. See 11 U.S.C. § 548(a)(1) (1988); UFTA § 4(a)(1); UFCA § 7; 13 Eliz., ch. 5, § I (1570).

251. The future creditor's standing arises from the actions of the debtor that indicate an intent to avoid liability through the conveyance. Cf. 1 G. GLENN, *supra* note 28, § 340, at 588-90 (factors indicating intent to avoid tort claimants include validity of cause against debtor, amount of possible liability, debtor's expectation of litigation). See *Hemphill Co. v. Davis Knitting Co.*, 114 Pa. Super. 94, 96, 173 A. 704, 706 (1934) (plaintiff-future creditor would be able to avoid conveyance by showing it was made with view toward incurring liability or to provide against contingencies of hazardous business which gave rise to debts).

252. Compare UFCA § 9 and 11 U.S.C. § 548(c) with Revised U.C.C. § 6-107(4)(a). See *supra* note 56 and accompanying text for a discussion of the UFCA and Bankruptcy Code savings provisions; *supra* note 201 and accompanying text for a discussion of the Revised Article 6 savings clause. See also *infra* Appendix for text of Revised U.C.C. § 6-107(4)(a).



benefit of the seller or a creditor." There is no requirement that the bad faith payment inure in any way to the benefit of the party prejudiced by the bulk sale, the plaintiff-creditor. It is enough that the seller received the payment. Under the fraudulent disposition law, however, for the transferee to take advantage of the savings clause, the transferee must establish that she acted in good faith in making the payment to the debtor. It is difficult to see why a complaining creditor (including the trustee successor of that creditor) would pursue the bulk sales action with its relatively limited recovery under Revised Article 6, rather than construe the buyer's bad faith as tantamount to fraudulent intent to proceed under the state or federal fraudulent disposition law.

Finally, Revised Article 6 includes a relatively short statute of limitations. Revised section 6-110 provides a one year limitations period, which runs from the time of the bulk sale, or, in the case of concealment, one year from the time the sale is discovered or should have been discovered. The section also provides that the buyer's mere failure to comply with Article 6 does not constitute concealment sufficient to toll the limitations period. The relevant limitations period under the state fraudulent disposition law may be longer than one year in some cases.<sup>253</sup> Indeed, it is the existence of those longer limitations periods that guides the bankruptcy trustee's decision to proceed via section 544(b) under the state fraudulent disposition law rather than under Bankruptcy Code section 548 which provides a one year limitations period.<sup>254</sup>

#### CONCLUSION

This article has tried to convince the reader that, while the sky may not yet be falling, the abrogation or substantial revision of bulk sales law could occasion cracks in the ceiling. It may be unrealistic to assume that creditors who would have a cause of action under existing Article 6 would demurely relent once Article 6 is repealed or revised, without first considering the application of developing commercial fraud principles. The article has described the symbiotic relationship between constructive and actual fraud and has characterized current Article 6 in terms that may inform application of the law under the proposed Alternatives.

The object is not to apprise plaintiffs' counsel of theories they may not have considered yet; instead, the object is to urge careful consideration of bulk sales principles in the commercial fraud law pedagogy. Only if the commercial community understands bulk sales law and fraudulent disposition law in the terms described here, may informed investigation of the black hole left by the Alternatives proceed.

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253. See, e.g., UFTA §§ 9(a), (b) (actions to avoid constructively fraudulent conveyances must be brought within four years of transaction; actions against actual fraudulent conveyances must be brought within later of four years or within one year of when transfer reasonably could have been discovered). Maine, for example, has extended this period even further by replacing the four year period provided for in the uniform version with a period of six years. ME. REV. STAT. ANN. tit. 14, § 3580 (Supp. 1990).

254. 4 COLLIER ON BANKRUPTCY *supra* note 219, ¶ 544.03, at 544-16 (trustee's powers of avoidance under § 544(b) not circumscribed by time period or other restrictions found in § 548).



APPENDIX  
ARTICLE 6 - BULK TRANSFERS

## SECTION

- 6-101. Short Title.
- 6-102. "Bulk Transfers"; Transfers of Equipment; Enterprises Subject to This Article; Bulk Transfers Subject to This Article.
- 6-103. Transfers Excepted From This Article.
- 6-104. Schedule of Property, List of Creditors.
- 6-105. Notice to Creditors.
- 6-106. Application of the Proceeds.
- 6-107. The Notice.
- 6-108. Auction Sales; "Auctioneer".
- 6-109. What Creditors Protected; [Credit for Payment to Particular Creditors].
- 6-110. Subsequent Transfers.
- 6-111. Limitation of Actions and Levies.

**§ 6-101. Short Title**

This Article shall be known and may be cited as Uniform Commercial Code—Bulk Transfers.

**§ 6-102. "Bulk Transfers"; Transfers of Equipment; Enterprises Subject to This Article; Bulk Transfers Subject to This Article**

(1) A "bulk transfer" is any transfer in bulk and not in the ordinary course of the transferor's business of a major 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.

(3) The enterprises subject to this Article are all those whose principal business is the sale of merchandise from stock, including those who manufacture what they sell.

(4) Except as limited by the following section all bulk transfers of goods located within this state are subject to this Article.

**§ 6-103. Transfers Excepted From This Article**

The following transfers are not subject to this Article:

- (1) Those made to give security for the performance of an obligation;
- (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 interests;
- (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;

(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.

Public notice under subsection (6) or subsection (7) may be given by publishing once a week for two consecutive weeks in a newspaper of general circulation where the transferor had its principal place of business in this state an advertisement including the names and addresses of the transferor and transferee and the effective date of the transfer.

As amended in 1962.

#### **§ 6-104. Schedule of Property, List of Creditors**

(1) Except as provided with respect to auction sales (Section 6-108), a bulk transfer subject to this Article is ineffective against any creditor of the transferor unless:

- (a) The transferee requires the transferor to furnish a list of his existing creditors prepared as stated in this section; and
- (b) The parties prepare a schedule of the property transferred sufficient to identify it; and
- (c) The transferee preserves the list and schedule for six months next following the transfer and permits inspection of either or both and copying therefrom at all reasonable hours by any creditor of the transferor, or files the list and schedule in (a public office to be here identified).

(2) The list of creditors must be signed and sworn to or affirmed by the transferor or his agent. It must contain the names and business addresses of all creditors of the transferor, with the amounts when known, and also the names of all persons who are known to the transferor to assert claims against him even though such claims are disputed. If the transferor is the obligor of an outstanding issue of bonds, debentures or the like as to which there is an indenture trustee, the list of creditors need include only the name and address of the indenture trustee and the aggregate outstanding principal amount of the issue.

(3) Responsibility for the completeness and accuracy of the list of creditors rests on the transferor, and the transfer is not rendered ineffective by errors or omissions therein unless the transferee is shown to have had knowledge.

As amended in 1962.

#### **§ 6-105. Notice to Creditors**

In addition to the requirements of the preceding section, any bulk transfer subject to this Article except one made by auction sale (Section 6-108) is ineffec-



tive against any creditor of the transferor unless at least ten days before he takes possession of the goods or pays for them, whichever happens first, the transferee gives notice of the transfer in the manner and to the persons hereafter provided (Section 6-107).

**[§ 6-106. Application of the Proceeds]**

In addition to the requirements of the two preceding sections:

(1) Upon every bulk transfer subject to this Article for which new consideration becomes payable except those made by sale at auction it is the duty of the transferee to assure that such consideration is applied so far as necessary to pay those debts of the transferor which are either shown on the list furnished by the transferor (Section 6-104) or filed in writing in the place stated in the notice (Section 6-107) within thirty days after the mailing of such notice. This duty of the transferee runs to all the holders of such debts, and may be enforced by any of them for the benefit of all.

(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.]

*Note: This section is bracketed to indicate division of opinion as to whether or not it is a wise provision, and to suggest that this is a point on which State enactments may differ without serious damage to the principle of uniformity.*

*In any State where this section is omitted, the following parts of sections, also bracketed in the text, should also be omitted, namely:*

*Section 6-107(2) (e).*

*6-108(3) (c).*

*6-109(2).*

*In any State where this section is enacted, these other provisions should be also.*

**Optional Subsection (4)**

[(4) The transferee may within ten days after he takes possession of the goods pay the consideration into the (specify court) in the county where the transferor had its principal place of business in this state and thereafter may discharge his duty under this section by giving notice by registered or certified mail to all the persons to whom the duty runs that the consideration has been paid into that court and that they should file their claims there. On motion of any interested party, the court may order the distribution of the consideration to the persons entitled to it.]

*Note: Optional subsection (4) is recommended for those states which do not have a general statute providing for payment of money into court.*

As amended in 1962.

**§ 6-107. The Notice**

(1) The notice to creditors (Section 6-105) shall state:

(a) that a bulk transfer is about to be made; and

(b) the names and business addresses of the transferor and transferee,

and all other business names and addresses used by the transferor within three years last past so far as known to the transferee; and

- (c) whether or not all the debts of the transferor are to be paid in full as they fall due as a result of the transaction, and if so, the address to which creditors should send their bills.

(2) If the debts of the transferor are not to be paid in full as they fall due or if the transferee is in doubt on that point then the notice shall state further:

- (a) the location and general description of the property to be transferred and the estimated total of the transferor's debts;
- (b) the address where the schedule of property and list of creditors (Section 6-104) may be inspected;
- (c) whether the transfer is to pay existing debts and if so the amount of such debts and to whom owing;
- (d) whether the transfer is for new consideration and if so the amount of such consideration and the time and place of payment; [and]
- [(e) if for new consideration the time and place where creditors of the transferor are to file their claims.]

(3) The notice in any case shall be delivered personally or sent by registered or certified mail to all the persons shown on the list of creditors furnished by the transferor (Section 6-104) and to all other persons who are known to the transferee to hold or assert claims against the transferor.

*Note: The words in brackets are optional. See Note under § 6-106.*

As amended in 1962.

#### **§ 6-108. Auction Sales; "Auctioneer"**

(1) A bulk transfer is subject to this Article even though it is by sale at auction, but only in the manner and with the results stated in this section.

(2) The transferor shall furnish a list of his creditors and assist in the preparation of a schedule of the property to be sold, both prepared as before stated (Section 6-104).

(3) The person or persons other than the transferor who direct, control or are responsible for the auction are collectively called the "auctioneer". The auctioneer shall:

- (a) receive and retain the list of creditors and prepare and retain the schedule of property for the period stated in this Article (Section 6-104);
- (b) give notice of the auction personally or by registered or certified mail at least ten days before it occurs to all persons shown on the list of creditors and to all other persons who are known to him to hold or assert claims against the transferor; [and]
- [(c) assure that the net proceeds of the auction are applied as provided in this Article (Section 6-106).]

(4) Failure of the auctioneer to perform any of these duties does not affect the validity of the sale or the title of the purchasers, but if the auctioneer knows that the auction constitutes a bulk transfer such failure renders the auctioneer liable to the creditors of the transferor as a class for the sums owing to them



from the transferor up to but not exceeding the net proceeds of the auction. If the auctioneer consists of several persons their liability is joint and several.

*Note: The words in brackets are optional. See Note under § 6-106.*

As amended in 1962.

**§ 6-109. What Creditors Protected; [Credit for Payment to Particular Creditors]**

(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.]

*Note: The words in brackets are optional. See Note under § 6-106.*

**§ 6-110. Subsequent Transfers**

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.

**§ 6-111. Limitation of Actions and Levies**

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.

*Note to Article 6: Section 6-106 is bracketed to indicate division of opinion as to whether or not it is a wise provision, and to suggest that this is a point on which State enactments may differ without serious damage to the principle of uniformity.*

*In any State where Section 6-106 is not enacted, the following parts of sections, also bracketed in the text, should also be omitted, namely:*

*Sec. 6-107(2) (e).*

*6-108(3) (c).*

*6-109(2).*

*In any State where Section 6-106 is enacted, these other provisions should be also.*

## REVISED U.C.C. SECTION 6-107

Revised § 6-107 provides, in pertinent part:

**§ 6-107. Liability for Noncompliance.**

(1) Except as provided in subsection (3), and subject to the limitation in subsection (4):

- (a) a buyer who fails to comply with the requirements of Section 6-104(1)(e) with respect to a creditor is liable to the creditor for damages in the amount of the claim, reduced by any amount that the creditor would not have realized if the buyer had complied; and
- (b) a buyer who fails to comply with the requirements of any other subsection of Section 6-104 with respect to a claimant is liable to the claimant for damages in the amount of the claim, reduced by any amount that the claimant would not have realized if the buyer had complied.

(2) In an action under subsection (1), the creditor has the burden of establishing the validity and amount of the claim, and the buyer has the burden of establishing the amount that the creditor would not have realized if the buyer had complied.

(3) A buyer who:

- (a) made a good faith effort to comply with the requirements of Section 6-104(1) or to exclude the sale from the application of this Article under Section 6-103(3); or
- (b) on the date of the bulk-sale agreement held a good faith belief that this Article does not apply to the particular sale

is not liable to creditors for failure to comply with the requirements of Section 6-104. The buyer has the burden of establishing the good faith effort or belief.

(4) In a single bulk sale the cumulative liability of the buyer for failure to comply with the requirements of Section 6-104(1) may not exceed an amount equal to:

- (a) if the assets consist only of inventory and equipment, twice the net contract price, less the amount of any part of the net contract price paid to or applied for the benefit of the seller or a creditor; or
- (b) if the assets include property other than inventory and equipment, twice the net value of the inventory and equipment less the amount of the portion of any part of the net contract price paid to or applied for the benefit of the seller or a creditor which is allocable to the inventory and equipment.