Notes

THE VALIDITY OF A SELLER'S RIGHT TO RECLAIM PROPERTY UNDER SECTION 2-702(2) OF THE U.C.C. AGAINST THE TRUSTEE IN BANKRUPTCY: THE PROBLEM CONTINUES

I. INTRODUCTION

A certain amount of confusion has existed as to the rights of a reclaiming seller under section 2-702 of the Uniform Commercial Code[1] against a trustee in bankruptcy. Currently, a determination of the prevailing party is dependent upon in which circuit the action for reclamation was brought and in which state the purchase transaction took place.[2] The usual fact pattern involves a seller who has sold goods to a buyer on credit while the buyer is insolvent and who at no time takes a security interest in the goods. If the seller learns of the true nature of the buyer's financial condition, he may exercise rights granted him under Article 2, section 702(2) and (3) of the Uniform Commercial Code.[3] Specifically, these sections provide:

> (2) Where the seller discovers that the buyer has received goods on credit while insolvent he may reclaim the goods upon demand made within ten days after the receipt, but if misrepresentation of solvency has been made to the particular seller in writing within three months before delivery the ten day limitation does not apply. Except as provided in this subsection the seller may not base a right to reclaim goods on the buyer's fraudulent or innocent misrepresentation of solvency or of intent to pay.
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> (3) The seller's right to reclaim under subsection (2) is subject to the rights of a buyer in ordinary course or other good faith purchaser or lien creditor under this Article (Section 2-403). Successful reclamation of goods excludes all other remedies with respect to them.[4]

Under these sections of Article 2, a seller who has delivered goods to a buyer who is insolvent is afforded the right to reclaim such goods

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1. U.C.C. § 2-702. All references to the U.C.C. will be to the 1962 Official text. Iowa adopted § 2-702 in 1965. IOWA CODE § 554.2702 (1977). However, § 554.2702(3) was amended by the Legislature in 1974 to delete the words "or lien creditor." 1974 Iowa Acts ch. 1249, § 20.

2. *In re* Federal's, Inc., 553 F.2d 509 (6th Cir. 1977) (holding for the seller based in part on Michigan common law). Stowers v. Mahon (*In re* Samuels & Co., Inc.), 526 F.2d 1238 (5th Cir.), *cert. denied*, 429 U.S. 834 (1976) (holding for the trustee); Lewis v. Holzman (*In re* Telemart Enterprises, Inc.), 524 F.2d 761 (9th Cir. 1975) (holding for the seller); *In re* Kravitz, 278 F.2d 820 (3d Cir. 1960) (holding for the trustee based on Pennsylvania common law).

3. U.C.C. §§ 2-702(2)-(3).

4. *Id.*

within ten days after their receipt by the buyer. If such demand for reclamation is made within ten days and no third parties are involved (such as secured creditors or a trustee in bankruptcy) then the seller would unquestionably prevail. However, when the buyer has become a bankrupt and a trustee has been appointed, a problem arises for the seller who has made his demand for reclamation within the ten days.[5] At this juncture the trustee will attempt to defeat reclamation by the seller through asserting certain rights which the trustee believes to be superior.[6] It is these rights, and the dispute as to who has superior rights, which is the subject of this Note. The outcome of the litigation[7] between the seller and trustee in determining the nature of the relationship between the reclaiming section 2-702 seller and the trustee is unfortunately, as noted above, dependent upon the circuit and state in which the action is brought.[8]

Furthermore, the confusion as to the nature of the relationship between the reclaiming section 2-702 seller and the trustee was not alleviated on April 19, 1977, when the Sixth Circuit Court of Appeals rendered a decision on the appeal from *In re Federal's, Inc.*[9] The district court, in *In re Federal's, Inc.*, had held that a section 2-702 seller could not prevail against a trustee in bankruptcy.[10] The Sixth Circuit reversed the district court judge and held that a section 2-702 seller does prevail over the trustee;[11] furthermore, the Sixth Circuit's opinion directly contradicts the decision of the Fifth Circuit in *Stowers v. Mahon* (*In re*

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5. 3A BENDER'S U.C.C. SERVICE, R. DUSENBERG & L. KING, SALES AND BULK TRANSFERS § 13.03(4) (Mathew Bender & Co. 1973) [hereinafter cited as DUSENBERG AND KING].

6. Among the arguments the trustee may advance are: (1) status as a hypothetical lien creditor, *see* Stowers v. Mahon (*In re* Samuels & Co., Inc.), 526 F.2d 1238, 1248 (5th Cir.), *cert. denied*, 429 U.S. 834 (1976); (2) that seller's rights under U.C.C. § 2-702(2) amount to a statutory lien void against the trustee under Bankruptcy Act § 67c(1)(A), 11 U.S.C. § 107(c)(1)(A) (1970), *see* Alfred M. Lewis, Inc. v. Holzman (*In re* Telemart Enterprises), 524 F.2d 761, 764 (9th Cir. 1975); (3) U.C.C. § 2-702(2) is a state created priority in conflict with Bankruptcy Act § 64, 11 U.C.C. § 104 (1970), *see In re* Federal's, Inc., 553 F.2d 509 (6th Cir. 1977).

7. *See generally*, Countryman, *Buyers and Sellers of Goods in Bankruptcy*, 1 N. MEX. L. REV. 435 (1971) [hereinafter cited as Countryman]; Braucher, *Reclamation of Goods From a Fraudulent Buyer*, 65 MICH. L. REV. 1281 (1967); Kennedy, *The Interest of a Reclaiming Seller Under Article 2 of the Code*, 30 BUS. LAW. 833 (1975) [hereinafter cited as Kennedy]; Bjornstad, *Reclamation of Goods by Unsecured Sellers in Bankruptcy Proceedings*, 24 DRAKE L. REV. 357, 361-62 (1975) [hereinafter cited as Bjornstad]; Comment, *In Re Federal's, Inc.: A New Way for the Trustee in Bankruptcy to Defeat A Reclaiming Seller*, 35 U. PITT. L. REV. 922 (1974); Note, *Bankruptcy and Article Two of the Uniform Commercial Code: The Right to Recover the Goods Upon Insolvency*, 79 HARV. L. REV. 598 (1966).

8. *See* note 2 *supra*.

9. 402 F. Supp. 1357 (E.D. Mich. 1975), *rev'd*, 553 F.2d 509 (6th Cir. 1977).

10. *In re* Federal's, Inc., 402 F. Supp. 1357 (E.D. Mich. 1975), *rev'd*, 553 F.2d 509 (6th Cir. 1977).

11. *In re* Federal's, Inc., 553 F.2d 509 (6th Cir. 1977).

Samuels & Co., Inc.).[12] Within the Second Circuit the confusion is even greater, as the rights of a section 2-702 reclaiming seller vis-a-vis the trustee can ultimately depend upon which bankruptcy judge presides over the case.[13]

In this Note an examination will be made of the three main methods of attack a trustee can assert to prevail over the section 2-702 seller, the present conflict between the circuits as to whether under any or all of these attacks the trustee should prevail, and the reasoning or methodology adopted by the circuits in defining the relationship between a section 2-702 seller and trustee. The purpose of this Note is to suggest which method should be adopted by all the circuits. However, as the conflict between the decisions of the Fifth and Sixth Circuits best illustrate the primary divergence in reasoning in this area, those decisions will provide the framework for the discussion. Not all the federal circuit courts have yet ruled on the nature of the relationship between the section 2-702 reclaiming seller and the trustee in bankruptcy.[14]

Prior to the drafting of the U.C.C., a defrauded seller generally prevailed in an action for reclamation against the trustee in bankruptcy. However, several arguments have since been asserted in favor of the trustee. Initially, in *In re Kravitz*,[15] the Third Circuit held that the trustee had, by virtue of the lien creditor status accorded him under section 70c of the Bankruptcy Act[16] and the resulting priority under common law, an interest in the goods sold superior to that of the seller asserting a claim under U.C.C. section 2-702.[17] A second method of defeating the seller's action for reclamation under U.C.C. section 2-702 is illustrated by *In re Good Deal Supermarkets, Inc.*,[18] wherein the court held that section 2-702(2) creates a statutory lien which is void against the trustee under

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12. 526 F.2d 1238 (5th Cir. 1976).

13. *See* Queensboro Farm Products, Inc. v. Wetson's Corp. (*In re* Wetson's Corp.), 17 U.C.C. REP. SERV. 423 (Ref. D., S.D.N.Y. 1975) (Bankruptcy Judge Herzog held in favor of the trustee); *In re* National Bellas Hess, Inc., 17 U.C.C. Rep. Serv. 430 (Ref. D., S.D.N.Y. 1975) (Bankruptcy Judge Galgay held in favor of the reclaiming seller).

14. A search has failed to reveal any reported rulings by the First, Second, Fourth, Eighth, or Tenth Circuits on the question of the relationship of rights between the § 2-702(2) seller and the trustee in bankruptcy.

15. 278 F.2d 820 (3d Cir. 1960).

16. Bankruptcy Act § 70c provides in relevant part:

> [T]he trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such creditor actually exists.

Bankruptcy Act § 70c, 11 U.S.C. § 110(c) (1970).

17. *In re* Kravitz, 278 F.2d 820 (3d Cir. 1960).

18. 384 F. Supp. 887 (D.N.J. 1974).

section 67c(1)(A) of the Bankruptcy Act.[19] Recently a third method of defeating a seller's right of action under section 2-702 was developed by the Fifth Circuit in *Stowers v. Mahon* (*In re Samuels & Co., Inc.*).[20] In that case, the Fifth Circuit read Articles Two and Nine together and held that a seller who had failed to perfect a security interest in the goods sold could not defeat the trustee in an action for reclamation under section 2-702.[21]

II. Pre-Code Considerations

Before examining the current status of these three attacks on section 2-702(2), it is necessary to examine the pre-Code rights that were accorded a reclaiming seller against an insolvent buyer, as the common law plays an important role in the decisions of some of the courts.[22] Certain authorities adhere to the theory that the rights of a section 2-702(2) reclaiming seller against the trustee in bankruptcy are not defined in the U.C.C., thus the relationship must be defined by pre-Code state law.[23]

At common law the seller had an action against the trustee in bankruptcy for reclamation of goods if the seller was induced to make the sale through fraud on the part of the buyer.[24] Collier indicates three types of conduct which furnished grounds for reclamation once the sale contract was rescinded for fraud:

> (1) The bankrupt induced the petitioner to contract with him by actively or tacitly concealing insolvency known to himself and with demonstrable intention not to pay for the goods to be transferred; (2) the bankrupt induced petitioner to contract with him by actively or tacitly concealing a known insolvency although intent not to pay cannot be demonstrated; or (3) the bankrupt, although not insolvent, induced petitioner to contract with him by making in bad faith a false, material representation of his financial status. Any of these three types of fraudulent representation is recognized as a ground for rescission which

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19. Bankruptcy Act § 67c(1)(A) provides in relevant part: "The following liens shall be invalid against the trustee: (A) every statutory lien which first becomes effective upon the insolvency of the debtor, or upon distribution or liquidation of his property, or upon execution against his property levied at the instance of one other than the lienor. . . ." Bankruptcy Act § 67c(1)(A), 11 U.S.C. § 107(c)(1)(A) (1970).

20. 526 F.2d 1238 (5th Cir. 1976).

21. Stowers v. Mahon (*In re* Samuels & Co., Inc.), 526 F.2d 1238 (5th Cir. 1975), *cert. denied*, 429 U.S. 834 (1976). *See* text accompanying notes 82-89 *infra*.

22. *In re* Federal's Inc., 553 F.2d 509 (6th Cir. 1977), was decided in large measure upon the common law.

23. *In re* Federal's, Inc., 553 F.2d 509 (6th Cir. 1977); Johnston & Murphy Shoes, Inc. v. Meinhard Commercial Corp. (*In re* Mel Golde Shoes, Inc.), 403 F.2d 658, 660 (6th Cir. 1968); *In re* Kravitz, 278 F.2d 820, 822 (3d Cir. 1960); *In re* Royalty Homes, Inc., 8 U.C.C. Rep. Serv. 61, 65 (Ref. D., E.D. Tenn. 1970). *See* Bjornstad, *supra* note 7, at 361-62.

24. 4A Collier on Bankruptcy ¶ 70.41(1) (1976) [hereinafter cited as 4A Collier].

> operates retroactively to divest the trustee's title to goods or funds thereby obtained by the bankrupt.[25]

Collier notes that innocent misrepresentation existed to a limited extent as a fourth ground for rescission.[26] Thus at common law, if the seller could prove fraud on the part of the buyer then the intervention of bankruptcy between receipt of the goods and demand for rescission did not allow the trustee to defeat the seller's right to rescind and reclaim. The trustee received a title to the bankrupt's property which was subject to defeasance through a defrauded seller's action for reclamation. Thus in most jurisdictions, the defrauded seller had rights superior to the trustee, even where the trustee asserted his lien creditor status under section 70c of the Bankruptcy Act.[27] Although it is true that all states did not and do not have exactly the same requirements for proof of fraud on the part of the buyer,[28] Williston does make this statement about common law fraud in sales of goods.

> [M]ere insolvency, unless either accompanied with an intent not to pay, or of so hopeless a character that no reasonable person in the buyer's position could expect to pay, does not amount to fraud. The true ground for rescission is the fraudulent intent, of which hopeless insolvency is the sufficient and often the only available evidence.[29]

Therefore, at common law mere insolvency, without proof of some element of intent or proof of hopeless financial condition, would not be sufficient to grant the seller rescission and reclamation.

The common law basis for rescission for the buyer's fraud was not adopted by the drafters of the U.C.C. Section 2-702(2) creates a cause of action for reclamation based upon mere insolvency, with a showing of intent being unnecessary. Specifically, U.C.C. section 2-702 permits an action for reclamation "where the seller discovers that the buyer has received goods on credit while insolvent. . . ."[30] The official comment to section 2-702(2) states that "[s]ubsection (2) takes as its base line the proposition that any receipt of goods on credit by an insolvent buyer amounts to a tacit business misrepresentation of solvency and therefore is fraudulent as against the particular seller."[31]

It is apparent, then, that section 2-702(2) is not a mere codification of the pre-existing common law rights granted a seller against a buyer for

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25. *Id.* at 487.
26. *Id.*
27. *Id.* at 483-86.
28. *Id.* at 486.
29. 3 S. WILLISTON ON SALES § 637, at 455-57 (1948).
30. U.C.C. § 2-702(2).
31. U.C.C. § 2-702, Official Comment #2.

fraudulent misrepresentations of solvency. This fact is confirmed by Professor Kennedy who writes:

> Section 2-702(2) undertakes to cut a clean, new path in dealing with a seller's right to recover goods for fraud after they have been delivered to a buyer. . . . A diverse undergrowth has developed under the Uniform [Sales] Act and the common law which permits rescission by a seller for varying forms of misrepresentation of financial condition and intention to pay on the part of the buyer.[32]

Professor Kennedy may be correct in assuming section 2-702 represents an *attempt* by the drafters of the Code to "cut a clean, new path" by synthesizing and clarifying the seller's rights to recover goods for fraud by the buyer. However, section 2-702 has actually brought about a substantial expansion of the seller's rights without a corresponding pre-Code base. Nor will one find a section in the Uniform Sales Act corresponding even remotely to section 2-702.[33] The pre-Code law does not exist in section 2-702 today.

Thus one of the main problems generated by U.C.C. section 2-702 is now apparent. Section 2-702(3) provides that the rights accorded a section 2-702(2) seller to reclaim is subject to the rights of a lien creditor.[34] Under section 70c of the Bankruptcy Act[35] the trustee is vested with the powers of a lien creditor as of the date of bankruptcy.[36] The question then becomes what, under the Code, is the right of a section 2-702 seller against a trustee asserting lien creditor status. Two means of answering this question exist: (1) examine the U.C.C. up to the point at which the trustee is given status as a lien creditor, and then revert to pre-Code state law to determine the priority of a lien creditor;[37] or (2) examine the U.C.C. alone to determine the priority between the reclaiming seller and the trustee, through a process referred to as code methodology.[38]

III. Going Beyond The Code

Both the Third and the Sixth Circuits have adopted the first means of defining the rights of a reclaiming seller against the lien creditor. In *In re Kravitz*[39] the Third Circuit followed the cross reference in section

32. Kennedy, *Trustee in Bankruptcy Under the Uniform Commercial Code: Some Problems Suggested by Articles 2 and 9*, 1 Bender's U.C.C. Service; Coogan-Hogan-Vagts, Secured Transactions Under U.C.C. § 10.04, at 1091 (Mathew Bender & Co. 1973).

33. Dusenberg & King, *supra* note 5, § 13.03(4)(a), at 13-16.

34. U.C.C. § 2-702(3).

35. Bankruptcy Act § 70c, 11 U.S.C. § 110(c) (1970).

36. *Id.*

37. Follow the cross reference in U.C.C. § 2-702(3) to § 2-403; U.C.C. § 2-403(4) refers the reader to Article Nine, wherein U.C.C. § 9-301(3) states that a lien creditor includes a trustee in bankruptcy. 4A Collier, *supra* note 24, ¶ 70.62A, at 722. *See* Part III *infra*.

38. *See* Hawkland, *Uniform Commercial Code Methodology*, 1962 U. Ill. L. Forum 291 (1962) [hereinafter cited as Hawkland]; *see* Part IV *infra*.

39. 278 F.2d 820 (3d Cir. 1960).

2-702(3) to section 2-403, which in turn provides that lien creditors' rights are governed by Article Nine. Under Article Nine the court referred to section 9-301, which provides that a lien creditor includes the trustee in bankruptcy.[40] Having established that the trustee has the rights of a lien creditor, the court held that the rights of a trustee as lien creditor against a section 2-702(2) reclaiming seller are governed by state law, and under the applicable state law the trustee as lien creditor had rights superior to the section 2-702(2) seller.[41] The court cited U.C.C. section 1-103 as authority for referring to pre-Code state law to define the rights of a lien creditor.[42] Section 1-103 permits reference to existing principles of law or equity to supplement the provisions of the U.C.C. *unless those provisions displace such principles.*[43] By applying Pennsylvania common law, the court in *In re Kravitz* determined that the section 2-702 seller had rights inferior to those of the trustee in bankruptcy asserting his status as a lien creditor.[44]

The Sixth Circuit adopted the same process that the Third Circuit followed but ultimately arrived at a different result. In *Johnston & Murphy Shoes, Inc. v. Meinhard Commercial Corp.* (*In re Mel Golde Shoes*),[45] the Sixth Circuit held that since the U.C.C. does not contain any provisions defining the priority between a reclaiming seller and a lien creditor, then resort must be had (via section 1-103) to the common law of Kentucky. However, the Sixth Circuit found that under the common law of Kentucky the reclaiming seller had rights superior to a lien creditor.[46] Hence there exist two circuits which interpret the U.C.C. in the same manner, but arrive at different results.

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40. The court also found that § 70c of the Bankruptcy Act makes a trustee a lien creditor. The court concluded that the trustee's status as determined by federal law (the Bankruptcy Act) was controlling, and that U.C.C. § 9-301(3) was an acknowledgment of "the power of the trustee as created by the prevailing law, that is, the federal law of bankruptcy." *In re* Kravitz, 278 F.2d 820, 822 (3d Cir. 1960).

41. *Id.*

42. *Id.* at 822 n.3. U.C.C. § 1-103 provides:

> Unless displaced by the particular provisions of this Act, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions.

43. U.C.C. § 1-103 (1962). The court in *Kravitz* stated that "[w]e do not think that the principle that a reclamation seller's interest is subordinate to that of a lien creditor who extended credit subsequent to the sale is 'displaced by the particular provisions' of section 2-702. Cf. Collier, Bankruptcy ¶ 70.41 n.16 at 1322-23 (14th ed. 1959)." *In re* Kravitz, 278 F.2d 820, 822 n.3 (3d Cir. 1960).

44. *In re* Kravitz, 278 F.2d 820, 822 (3d Cir. 1960).

45. 403 F.2d 658 (6th Cir. 1968).

46. Johnston & Murphy Shoes, Inc. v. Meinhard Commercial Corp. (*In re* Mel Golde Shoes, Inc.), 403 F.2d 658, 661 (6th Cir. 1968).

In re Federal's, Inc.,[47] highlights the confusion inherent in determining the relative rights between the section 2-702(2) seller and the trustee by reference to law outside the U.C.C. The district court in *In re Federal's, Inc.*[48] held against the reclaiming seller, in part because the district court found that pre-Code Michigan law indicated the section 2-702(2) seller had rights inferior to a lien creditor. The district court followed *In re Mel Golde Shoes* for the method of determining the relative rights of the lien creditor against the section 2-702 seller.[49] The district court noted a problem with using pre-Code law, however, as "there are no reported cases in Michigan involving the competing claims of a buyer's judicial lien creditor and a reclaiming seller. . . . It thus becomes the task of the court to determine what the Michigan courts would have done if faced with this question."[50]

On appeal the Sixth Circuit, applying the *In re Mel Golde Shoes* method of ascertaining the relative rights of the reclaiming seller against the lien creditor, reversed the district court's holding.[51] The court found that although there were no reported cases under Michigan law setting forth the relationship of a judicial lien creditor and a reclaiming seller, the circuit court's reading of the Michigan common law indicated that cases pertaining to an execution sale were more analogous to the problem at bar than were the cases cited by the district court.[52] Under Michigan common law an execution sale passes whatever title the judgment debtor had subject to whatever equities the debtor cannot resist.[53] The court wrote:

> [W]hile it is true that the cases cited by the district court indicate that the rights of a defrauded vendor may be inferior to those of a chattel mortgagee who without notice obtained his mortgage for present value from the purchaser, nevertheless it is significant that, with the possible exception of *Hoffman v. Lake & Michigan Southern R.R.*,[54] each case involved not a judicial lien, but rather a consensual lien granted by the bankrupt to one who, without knowledge of the rights of the defrauded seller, had advanced present consideration. However, [section] 70c requires us to look to the assumed powers of the trustee based on liens obtained by legal proceedings, not liens obtained consensually.
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> The common law of Michigan is generally that an execution sale passes only whatever title the judgment debtor had in the property.[55]

Hence if a judgment debtor procured title fraudulently and the seller had a right in equity to recover title, then the execution sale passed title sub-

47. 553 F.2d 509 (6th Cir. 1977).
48. 402 F. Supp. 1357 (E.D. Mich. 1975).
49. *In re* Federal's, Inc., 402 F. Supp. 1357, 1359 (E.D. Mich. 1975).
50. *Id.* at 1360.
51. *In re* Federal's, Inc., 553 F.2d 509 (6th Cir. 1977).
52. *Id.* at 515.
53. *Id.*
54. 125 Mich. 201, 84 N.W. 55 (1900).
55. *In re* Federal's, Inc., 553 F.2d 509, 515 (6th Cir. 1977).

ject to the seller's right. The circuit court concluded that if a buyer procures goods while insolvent and the seller has a right under section 2-702(2) to reclaim the goods, then the trustee, similar to a purchaser at an execution sale, takes title subject to the seller's rights.[56] Thus the seller prevails over the trustee.

The problems inherent in the Sixth Circuit's holding that Michigan common law would favor the seller are two-fold. First, the court's choice of the rights passing under an execution sale as analagous to the interest received by a trustee in bankruptcy is questionable. The court disregarded *Hoffman v. Lake Shore & Michigan Southern R.R.*,[57] wherein the Michigan Supreme Court held that a common carrier possessory lien holder had an interest in goods superior to that asserted by defrauded sellers. In determining the priority between the defrauded sellers and the lien holder, the Michigan Supreme Court reasoned that, "where one of two innocent parties must suffer for the wrong of a third person, that one ([the] seller) shall bear the loss who has placed it in the power of the wrongdoer to work the injury. . . ."[58] Although *Hoffman* does not deal with a judicial lien, neither is it a consensual lien; rather, it is a statutory lien. Furthermore, the *Hoffman* case speaks directly to the relation between a seller seeking reclamation for fraud and a lien holder, and clearly favors the lienholder over the seller. Yet the Sixth Circuit chose to ignore *Hoffman* and base its decision on the nature of the title passed in an execution sale. The Sixth Circuit appears to be the sole authority to adopt reasoning based on such an analogy.

The second question raised by the Sixth Circuit's decision in *In re Federal's* is whether it was the intention of the drafters that law outside the U.C.C. be utilized to define the rights of the section 2-702(2) seller against the trustee in bankruptcy. Collier indicates that the intention of the drafters is uncertain, but if it was their intention that law outside the U.C.C. be relied upon, then the uniformity of law which the U.C.C. has as a purpose is lost.[59] The conflicting holdings of the Third and Sixth Circuits,[60] and within the Sixth Circuit itself,[61] are obvious examples of the

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56. The Sixth circuit has previously held that the trustee in bankruptcy " 'has the lien of an execution creditor, which is about the lowest form of security.' " *Id.* at 513, *quoting In re* Richards, 455 F.2d 281, 284 (6th Cir. 1972). *See In re* Clemens, 472 F.2d 939, 942 (6th Cir. 1972); *In re* Alikasovich, 275 F.2d 454, 457 (6th Cir. 1960), *aff'd sub nom*, Lewis v. Manufacturer's Nat'l Bank, 364 U.S. 603 (1961). *See also In re* Troy, 490 F.2d 1061 (6th Cir. 1974); *In re* Easy Living, Inc., 407 F.2d 142 (6th Cir. 1969).

57. 125 Mich. 201, 84 N.W. 55 (1900).

58. Hoffman v. Lake Shore & Michigan So. Ry. Co., 125 Mich. 201, 203, 84 N.W. 55, 57 (1900).

59. 4A COLLIER, *supra* note 24, ¶ 70.62A, at 722; U.C.C. § 1-102 states that one of the underlying purposes of the Code is "to make uniform the law among the various jurisdictions." U.C.C. § 1-102(2)(c).

60. *In re* Federal's, Inc., 553 F.2d 509 (6th Cir. 1977); Johnston & Murphy Shoes, Inc. v. Meinhard Commercial Corp. (*In re* Mel Golde Shoes, Inc.), 403 F.2d 658 (6th Cir. 1968); *In re* Kravitz, 278 F.2d 820 (3d Cir. 1960).

resultant lack of uniformity. The intent of the drafters seems obvious from the very language of the U.C.C. As noted above, section 1-103 provides that the particular provisions of the U.C.C. may be supplemented, but not displaced, by law outside the U.C.C.[62] The threshold question, therefore, is whether pre-Code law is displaced by section 2-702(2) and thus rendered inapplicable by section 1-103.

In the situation presented by *In re Federal's*, this question is answered by examining the common law of Michigan. It is quite clear under Michigan common law that a seller could rescind and reclaim only where the buyer was insolvent at the time of the sale and had an intention not to pay.[63] The Michigan Supreme Court has held that if a buyer makes no misrepresentation when he purchases goods, his insolvency alone will not make the transaction fraudulent and hence the seller will not be entitled to rescind.[64] However, section 2-702 makes mere receipt of the goods while insolvent a "tacit business misrepresentation of solvency and therefore . . . fraudulent as against that particular seller."[65] It is quite clear, then, that in Michigan, section 2-702 does not merely codify but rather *displaces* existing law, as section 2-702 creates an action for reclamation unavailable in Michigan prior to the adoption of the U.C.C. Thus in Michigan section 1-103 prohibits the use of the common law definition of the rights of a defrauded seller to supplement section 2-702.

The seller's common law action for reclamation in Michigan is fairly representative of the common law action available in other jurisdictions.[66] Thus, because reference to common law is both inconsistent with the purpose of the U.C.C. and prohibited by section 1-103, the question of priority between a reclaiming seller and the trustee/lien creditor must be answered solely by the provisions of the U.C.C.

IV. The U.C.C. as a Source of Law

The alternative means of defining the rights of a seller against a lien creditor is through code methodology—looking within the Code itself. This course of action is mandated by section 1-102 which sets forth the purposes and rules of construction regarding the Code.[67] Two of the important pur-

61. *In re* Federal's, Inc., 402 F. Supp. 1357 (E.D. Mich. 1975), *rev'd*, 553 F.2d 509 (6th Cir. 1977).

62. U.C.C. § 1-103. *See* text accompanying note 43 *supra*.

63. *See* Skinner v. Michigan Hoop Co., 119 Mich. 467, 78 N.W. 547 (1899); Reeder Bros. Shoe Co. v. Prylinski, 102 Mich. 468, 60 N.W. 69 (1894); Doyle v. Mizner, 40 Mich. 160 (1879).

64. Kirschbaum v. Jasspon, 123 Mich. 314, 82 N.W. 69 (1900).

65. U.C.C. § 2-702, Official Comment #2. *See* text accompaning notes 30-31 *supra*.

66. *See* text accompanying notes 22-29 *supra*.

67. U.C.C. § 1-102. Section 1-102 provides in part:

(1) This Act shall be liberally construed and applied to promote its underlying purposes and policies.

(2) Underlying purposes and policies of this Act are

poses of the U.C.C. articulated in this section are modernization and unification of the laws.[68] Hawkland notes that "[w]hile [section 1-102] may appear almost banal to most American lawyers, those familiar with the civil law and the construction of codes attach high importance to it."[69] Hawkland goes on to adopt the views of Professor Franklin on section 1-102:

> The effect of this language is that the Code not only has the force of law, but is itself a source of law. The formulation of fragment 1 of Section 1-102 signifies that if the text of the Code falls short of deciding the controversy or problem, the Code may itself be developed or applied to promote its underlying reasons, purposes and policies.[70]

Hawkland further comments that a failure to adhere to section 1-102 is apt to yield a harsh result:

> It has been observed that courts, torn between the duties of staying within the law or getting a just result, frequently accomodate the latter by manipulating the former. It was to this well established process that Holmes directed his epigrammatic remark, "Hard cases make bad law." He was right. Decisions arrived at through the semicovert techniques of manipulation and adverse construction may result in justice for the immediate parties, but they leave in their wake a twisted law to haunt the counselor and confuse the magistrate in subsequent situations not involving the same "fireside equities."[71]

(a) to simplify, clarify and modernize the law governing commercial transactions;

(b) to permit the continued expansion of commercial practices through custom, usage and agreement of the parties;

(c) to make uniform the law among the various jurisdictions.

Id.

68. *Id.*

69. Hawkland, *supra* note 38, at 303.

70. *Id.*, *quoting* Franklin, *On the Legal Method of the Uniform Commercial Code*, 16 LAW & CONTEMP. PROB. 330, 333 (1951).

71. Hawkland, *supra* note 38, at 304. In Stowers v. Mahon (*In re* Samuels & Co., Inc.), 510 F.2d 139 (5th Cir. 1975), *rev'd on rehearing*, 526 F.2d 1238 (5th Cir.), *cert. denied*, 429 U.S. 834 (1976), the original majority appeared to be influenced by the "fireside equities" involved. In that opinion Judge Ingraham wrote, "[w]e believe it inequitable to deny the claims of the stock farmers who produced and delivered the cattle, in favor of the mortgagee who refused to advance the money before bankruptcy." *Id.* at 153. In response to this statement and to the reasoning employed by the majority, Judge Godbold, dissenting, wrote:

> My brothers have not concealed that their orientation in the case before us is to somehow reach a result in favor of the sellers of cattle assumed by them to be "little fellows," and against a large corporate lender, because it seems to be the "fair" thing to do. . . . Doing what seems fair is heady stuff. But the next seller may be a tremendous corporate conglomerate engaged in the cattle feeding business, and the next lender a small town Texas bank. Today's heady draught may give the majority a euphoric feeling, but it can produce tomorrow's hangover.

Id. at 154 (Godbold, J., dissenting).

When confronted with the situation that the sellers seeking reclamation did not do so under the 10 day limit of either § 2-702 or § 2-507, the opinion states:

> While armed with a right to reclaim the cattle, the sellers failed to comply

Judge Godbold, in *Stowers v. Mahon (In re Samuels & Co., Inc.)*,[72] did use the U.C.C. as a source of law to define the relationship between a reclaiming seller and a trustee in bankruptcy. In *In re Samuels & Co., Inc.*, decided in 1975 by the Fifth Circuit and subsequently reversed on rehearing, Judges Ainsworth and Ingraham, with Judge Godbold dissenting, granted unpaid cattle sellers the right to reclaim the proceeds of their cattle from the trustee in bankruptcy.

The parties involved were an unpaid seller seeking reclamation, a secured creditor of the buyer and the buyer's trustee in bankruptcy. The majority originally held that the reclaiming seller prevailed over the secured creditor[73] and the trustee.[74] The majority found that because the particular facts involved a cash transaction between buyer and seller, U.C.C. section 2-507[75] applied. The court further found that section 2-507 and the accompanying comments "implicitly give the seller the right to reclaim, but [they] expressly subor[d]inate that right only to a good faith purchaser;"[76] thus, the trustee's status as a lien creditor was considered irrelevant inasmuch as the only concern to the court in regard to subordination was whether or not the party was a good faith purchaser.[77] Although the dissenting opinion of Judge Godbold—subsequently adopted as the majority opinion—recognized that the trustee could not prevail over the secured creditor, Judge Godbold more importantly pointed out that had the secured creditor withdrawn its claim, thus leaving the determination of rights between the trustee and the seller, the trustee, by asserting his lien creditor status, would have defeated the rights of the

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with the ten day limitation on that right. The record shows that the sellers did not file a petition for reclamation for almost a year. . . .

Although the sellers did not reclaim the property until sometime after the filing of Samuel's petition for bankruptcy, the purposes for imposing the limitation had been fulfilled.

Id. at 147. Hence the majority ignored the language of the two Code sections setting forth the 10 day limitation in order to grant the sellers reclamation. Such an interpretation renders the particular language of the U.C.C. meaningless.

72. 510 F.2d 139 (5th Cir. 1975), *rev'd on rehearing*, 526 F.2d 1238 (5th Cir.), *cert. denied*, 429 U.S. 834 (1976).

73. Stowers v. Mahon (*In re* Samuels & Co., Inc.), 510 F.2d 139, 144-52 (5th Cir. 1975), *rev'd on rehearing*, 526 F.2d 1238 (5th Cir.), *cert. denied*, 429 U.S. 834 (1976).

74. *Id.* at 152-53.

75. U.C.C. § 2-507. That section provides that,

(1) Tender of delivery is a condition to the buyer's duty to accept the goods and, unless otherwise agreed, to his duty to pay for them. Tender entitles the seller to acceptance of the goods and to payment according to the contract.

(2) Where payment is due and demanded on the delivery to the buyer of goods or documents of title, his right as against the seller to retain or dispose of them is conditional upon his making the payment due.

Id.

76. Stowers v. Mahon (*In re* Samuels & Co., Inc.), 510 F.2d 139, 152 (5th Cir. 1975), *rev'd on rehearing*, 526 F.2d 1238 (5th Cir.), *cert. denied*, 429 U.S. 834 (1976).

77. *Id.* at 153.

reclaiming seller.[78] Although the seller involved was a cash seller, the methodology employed by Judge Godbold is equally applicable to the situation wherein the seller asserts rights under section 2-702(2),[79] and should prove to be the most reasonable manner of determining the relative rights between the seller and the trustee.

In order to ascertain the rights of a reclaiming seller against either a secured creditor or the trustee in bankruptcy, Judge Godbold relied solely upon the particular provisions of the U.C.C. "My result is not the product of revealed truth, but rather of a meticulous and dispassionate reading of Articles Two and Nine and an understanding that the Code is an integrated statute whose Articles and Sections overlap and flow into one another in an effort to encourage specific types of commercial behavior."[80] The approach which Godbold adopts is in line with that espoused by Hawkland when dealing with a Code provision that displaces previous law.[81]

Judge Godbold's conclusions were reached in the following manner. Both the remedies afforded reclaiming sellers under either sections 2-702 or 2-507 are specifically limited by the interests of certain third parties who have dealt with the buyers, including the "good faith purchaser."[82] The rights accorded a good faith purchaser are described in U.C.C. section 2-403(1), which provides in part that such a purchaser receives good title to goods even if "the delivery was in exchange for a check which is later dishonored."[83] Thus the good faith purchaser is protected against the

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78. Stowers v. Mahon (*In re* Samuels & Co., Inc.), 526 F.2d 1238, 1248 (5th Cir.), *cert. denied*, 429 U.S. 834 (1976).

79. Judge Godbold relied upon Comment 3 to § 2-507, which states that the seller's action under § 2-507 shall "conform with the policy set forth in the bona fide purchase section of this Article [section 2-403]." U.C.C. § 2-507, Official Comment #3. Stowers v. Mahon (*In re* Samuels & Co., Inc.), 526 F.2d 1238, 1244 (5th Cir.), *cert. denied*, 429 U.S. 834 (1976). Section 2-702 similarly subordinates the rights of the seller seeking reclamation to those of a good faith purchaser, whose interests are set forth in § 2-403. U.C.C. § 2-702(3).

80. Stowers v. Mahon (*In re* Samuels & Co., Inc.), 526 F.2d 1238, 1241 (5th Cir.), *cert. denied*, 429 U.S. 834 (1976).

81. *See* text accompanying note 70 *supra*.

82. Section 2-702(3) provides that "[t]he seller's right to reclaim under subsection (2) is subject to the rights of a . . . good faith purchaser under this Article (section 2-403)." U.C.C. § 2-702(3). Comment 3 to § 2-507 provides, in part,

> [s]ubsection (2) deals with the effect of a conditional delivery by the seller and in such a situation makes the buyer's "right as against the seller" conditional upon payment. These words are used as words of limitation to conform with the policy set forth in the bona fide purchase sections of this Article.

U.C.C. § 2-507, Official Comment #3. U.C.C. § 2-403 deals with good faith purchasers.

83. U.C.C. § 2-403(1). That section provides:

> (1) A purchaser of goods acquires all title which his transferor had or had power to transfer except that a purchaser of a limited interest acquires rights only to the extent of the interest purchased. A person with voidable title has power to transfer a good title to a good faith purchaser for value. When goods have been delivered under a transaction of purchase the purchaser has such power even though

claims of section 2-702 sellers. The definition of a purchaser, found in U.C.C. sections 1-201(32) and (33),[84] encompasses not only one who takes by sale but also an Article Nine secured party.[85] Thus an Article Nine secured party is also a "good faith purchaser" and hence holds an interest superior to that of a reclaiming seller.

Judge Godbold concluded, however, that the U.C.C. does provide a means for the rights of an aggrieved seller to become superior to those of a secured party. That means is through perfection under Article Nine. Section 2-403(4) expressly recognizes that "the rights of other purchasers of goods and of lien creditors are governed by [Article Nine]."[86] Hence "Article Two recognizes the continuous vitality and priority of an Article Nine interest over the rights of an aggrieved seller."[87] In other words, if the interests of a 2-702 seller are subordinate to those of a secured creditor, and the seller is not a lien creditor, then the only method by which a seller can defeat a secured creditor or a lien creditor is to perfect under Article Nine. Thus Judge Godbold reasoned that a reading of Articles Two and Nine together reveals that the seller is intended to be an unsecured creditor when he exercises only his section 2-702 rights and does not take a perfected interest.[88] What Judge Godbold has done by examining the rights of a good faith purchaser and the interplay between Articles Two and Nine is to define the nature of the relationship between a section 2-702 seller and an Article Nine secured party.

Judge Godbold next examines the interest of the trustee in bankruptcy in relation to the section 2-702 seller. Section 9-301(1)(b) of the U.C.C. provides that the interest of a lien creditor is superior to that of an unsecured party. A trustee in bankruptcy is a hypothetical lien creditor under section 70c of the Bankruptcy Act. Therefore, the interest of the trustee is superior to that of the section 2-702 seller who fails to perfect a security interest under Article Nine.[89]

(a) the transferor was deceived as to the identity of the purchaser, or
(b) the delivery was in exchange for a check which is later dishonored, or
(c) it was agreed that the transaction was to be a "cash sale", or
(d) the delivery was procured through fraud punishable as larcenous under the criminal law.

Id.

84. U.C.C. §§ 1-201(32), (33). These sections of the Code provide: "(32) 'Purchase' includes taking by sale, discount, negotiation, mortgage, pledge, lien, issue or re-issue, gift or any other voluntary transaction creating an interest in property;" "(33) 'Purchaser' means a person who takes by purchase." *Id.*

85. Stowers v. Mahon (*In re* Samuels & Co., Inc.), 526 F.2d 1238, 1242 (5th Cir.), *cert. denied*, 429 U.S. 834 (1976).

86. U.C.C. § 2-403(4).

87. Stowers v. Mahon (*In re* Samuels & Co., Inc.), 526 F.2d 1238, 1247 (5th Cir.), *cert. denied*, 429 U.S. 834 (1976).

88. *Id.* at 1247-48.

89. *Id.* at 1248. It should be noted that Texas has completely adopted the official version of the U.C.C., and has made changes only in subsection numbering. The reference in the

Thus, without resort to the common law, but rather by confining himself to a thorough search of the meaning and interplay of the Code as a whole, Judge Godbold demonstrated that a Code definition of the relationship of the rights between the section 2-702(2) seller and the trustee in bankruptcy can be supported.

Judge Godbold's interpretation and conclusions are supported by Collier.[90] Collier considers several solutions to the problem of defining the relationship between the reclaiming seller and the trustee in bankruptcy asserting his status as lien creditor. One of them is the following:

> Even the *Kravitz* rationale does not give full effect to the cross-references to [sections] 2-403(4) and 9-301(1)(b). Perhaps, the most reasonable interpretation of these sections, because of the otherwise misleading cross-references, is to say that [section] 2-702(2) gives the seller a right subject to defeasance by a lien creditor ([section] 2-403(4)) unless the seller files as if he were perfecting a security interest under Article 9 ([section] 9-301(1)(b), 9-113). It would then be unnecessary to resort to other laws in the state to resolve this conflict. This would appear to be in accord with the intent of the draftsmen as spelled out in Comment 3 to section 2-702. . . . It would seem, therefore, that the seller seeking to reclaim under section 2-702(2) must file a financing statement in compliance with Article 9 to perfect his security interest, i.e., his right to reclaim. If he does not do so prior to the filing of a bankruptcy petition, . . . , the trustee can defeat the seller's rights by asserting [section] 70c.[91]

Judge Godbold has arrived at a new line of reasoning which manifests that the seller does not have rights under the Code superior to the trustee as a lien creditor. His method and conclusions may be additionally valuable, as after the *Kravitz*[92] case was decided, and it was realized that section 2-702(3) subordinated the rights of a section 2-702(2) seller to a lien creditor, several states amended section 2-702(3) to omit the words "or lien creditor."[93] The legislatures attempted through such an amendment to bestow upon reclaiming sellers rights superior to those accorded the trustee by section 70c of the Bankruptcy Act.[94]

Unfortunately, Judge Godbold does not expressly indicate whether without the words "or lien creditor" in section 2-702(3) the reclaiming

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Texas statutes to § 9-301(a)(2) refers to U.C.C. § 9-301(1)(b). These sections provide in substance that a lien creditor, including the trustee in bankruptcy, has priority over an unsecured creditor. TEX. BUS. & COMM. CODE ANN. § 9-301(a)(2) (Supp. 1976).

90. *See* 4A COLLIER, *supra* note 24, ¶ 70.62A, at 722-23.

91. *Id.*

92. *See* text accompanying notes 39-44 *supra*.

93. Twelve states have so amended section 2-702(3). ARK. STAT. ANN. § 85-2-702(3) (Supp. 1975); CAL. COMM. CODE § 2702(3) (West 1964); CONN. GEN. STAT. ANN. § 42a-2-702(3) (West 1960 & Supp. 1977); IOWA CODE § 554.2702(3) (1977); KAN. U.C.C. ANN. § 84-2-702(3) (Vernon Supp. 1976); ME. REV. STAT. tit. 11 § 2-702(3) (1964); MISS. CODE ANN. § 75-2-702(3) (1973); N.J. STAT. ANN. § 50A-2-702(3) (1962); N.M. STAT. ANN. § 40A-2-702(3) (1962); N.Y.U.C.C. § 2-702(3) (McKinney 1964); N.C. GEN. STAT. § 25-2-702(3) (1965 & Supp. 1975).

94. 4A COLLIER, *supra* note 24, ¶ 70.62A, at 723.

seller would remain an unsecured creditor in relation to the trustee asserting his lien creditor status. However, the argument can be made that if the nature of the seller's position under section 2-702, as against the secured creditor/good faith purchaser, is that of an unsecured creditor, then does not the nature of that relationship govern the relationship between the seller and the trustee even where the words "lien creditor" have been deleted? If the nature of the seller's rights under section 2-702(2) in relation to Article Nine are those of an unsecured creditor, then whether or not section 2-702(3) states that the seller is subject to the rights of a lien creditor, the seller will be governed by section 9-301. Section 9-301 makes the seller's interest subject to that of the lien creditor, because under that section the seller, as an unsecured creditor, possesses rights inferior to those of a lien creditor. Hence, the conclusions of Judge Godbold could have added import, for according to his interpretation of the U.C.C., the trustee as a lien creditor defeats an unsecured seller whether or not section 2-702(3) contains a reference to lien creditors.

The overall result of the Fifth Circuit's holding in *In re Samuels & Co., Inc.* is to achieve a uniformity of decision which is lost following the method applied in *In re Federal's*, and to thus carry out the purpose of the U.C.C. as set forth in section 1-102. The Sixth Circuit's recent decision in *In re Federal's* only serves to continue the confusion as to what is the exact nature of the relationship between the seller and the trustee. Furthermore, the Sixth Circuit's decision fails to give any guidance to lower courts as to how to interpret pre-Code state law. The *Hoffman* case, which appears to be as applicable to the seller-lien creditor problem as any of the cases relied on by the district court, is disregarded without any explanation by the Sixth Circuit. This state of affairs only serves to strengthen Professor Hawkland and Judge Godbold's argument that the only proper source for interpreting the Code is the Code itself.

V. Section 2-702(2) and Section 67c(1)(A) of the Bankruptcy Act

The Sixth Circuit's decision in *In re Federal's* resolved two issues; the first, discussed above, concerned what rights, under section 2-702(2), the seller has against the trustee asserting section 70c. The second issue was whether section 2-702 of the Code is invalidated under section 67c(1)(A) of the Bankruptcy Act.[95] Section 67c(1)(A) provides that statutory liens arising upon the insolvency of the debtor are void against the trustee.[96] In the district court decision of *In re Federal's* the court held that the U.C.C. is not a mere codification of the pre-existing common law right of rescission and reclamation for fraud; rather the seller's right of

95. Bankruptcy Act § 67c(1)(A), 11 U.S.C. § 107(c)(1)(A) (1970).
96. *See supra* note 16.

reclamation has been significantly expanded by the Code.[97] Therefore, U.C.C. section 2-702 should be viewed as a substantive change in the law and hence as a state statutory lien designed to give the seller a means to circumvent the prohibition against state created priorities. The court concluded that it is exactly this type of situation that section 67c(1)(A) is directed against.[98] The Sixth Circuit reversed the district court on this issue and held[99] that it was in agreement with the result reached by the Ninth Circuit in *Alfred M. Lewis, Inc. v. Holzman (In re Telemart Enterprises).*[100]

In *In re Telemart Enterprises*, the Ninth Circuit held that section 2-702(2) was not an attempt to escape the Bankruptcy Act's prohibition against state created priorities[101] by creating a spurious lien; further, that section 2-702 did not present the abuse which section 67c was designed to reach—the upgrading of state statutory priorities among unsecured creditors to the status of liens to preserve a position enjoyed prior to their prohibition by the Bankruptcy Act.[102] The Ninth Circuit observed that some courts have treated section 2-702 as a statutory lien nullified by section 67c(1)(A).[103] The Ninth Circuit specifically cited *In re Good Deal Supermarkets, Inc.*[104] In *In re Good Deal Supermarkets* a New Jersey district court remarked that although the comment to section 2-702 suggests that the section is designed not to create a lien,

> the governing criterion must be the practical effect of the Code provision. . . . It is this court's opinion that when viewed realistically, [section 2-702]

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97. *In re* Federal's, Inc., 402 F. Supp. 1357, 1365 (E.D. Mich. 1975), *rev'd*, 553 F.2d 509 (6th Cir. 1977).

98. *Id.* at 1368.

99. *In re* Federal's, Inc., 553 F.2d 509, 515-16 (6th Cir. 1977).

100. 524 F.2d 760 (9th Cir. 1975).

101. The Bankruptcy Act was amended in 1938 to abolish state created priorities. *See* Sen. Rep. No. 1159, 89th Cong., 2nd Sess., *reprinted in* [1966] U.S. Code Cong. & Ad. News 2456, 2461. The history of the Bankruptcy Act's prohibition of state created priorities for unsecured creditors is outlined in Alfred M. Lewis, Inc. v. Holzman (*In re* Telemart Enterprises, Inc.), 524 F.2d 761, 763-64 (9th Cir. 1975). As the court pointed out, one of the principal aims of the Bankruptcy Act is an equal distribution of assets among a bankrupt's creditors. Some states sought to give certain creditors a favored position over other creditors by way of priorities. Since these priorities frustrated the aim of the Bankruptcy Act to distribute assets as equally as possible, the state priorities were abolished by § 64 of the Bankruptcy Act. Bankruptcy Act § 64, 11 U.S.C. § 104 (1970). Faced with losing their favored positions, creditor groups lobbied state legislatures to preserve their favored positions by turning the now abolished state priorities into state statutory liens. These state statutory liens frustrated the equitable distribution of assets just as the state priorities did. To remedy this, § 67c was enacted to carry out the original intent of Congress to abolish state created priorities. Bankruptcy Act § 67c, 11 U.S.C. § 107(c) (1970). *See* Alfred M. Lewis, Inc. v. Holzman (*In re* Telemart Enterprises, Inc.), 524 F.2d 761, 763-64 (9th Cir. 1975).

102. Alfred M. Lewis, Inc. v. Holzman (*In re* Telemart Enterprises, Inc.), 524 F.2d 761, 764 (9th Cir. 1975).

103. *Id.* at 763.

104. 384 F. Supp. 887 (D.N.J. 1974).

> is indeed a statutory lien. Like other state statutory liens the right established by [section 2-702] is for the benefit of a particular class of creditors and tends to promote a state created priority.[105]

Professor Countryman has similarly observed that "since the statutory recovery right serves essentially the same function as a statutory lien, it must fall under section 67c(1)(A). . . ."[106] He characterized this "same function" as the ability of the seller, like the statutory lien holder, to recover his goods upon the insolvency of the debtor.[107] However, balanced against this view is that of Professor Kennedy who contends that the rights granted under section 2-702(2) are rights to rescind the sale and to reclaim the goods instead of the cash, whereas a statutory lien which the Bankruptcy Act seeks to prohibit is a method of recovering payment of the price.[108] The issue can be best resolved through an examination of the type of interest section 67c is directed against.

The Ninth Circuit examined the legislative history of section 67c in depth, but failed to question whether the practical effect of section 2-702 constituted the type of state statutory lien Congress intended to prohibit. Section 2-702 enables the seller to recover his goods upon the insolvency of the debtor, while other unsecured creditors must wait. If the seller were not able to recover his goods upon insolvency, he would be forced to put his claim in along with other unsecured creditors. Therefore, the practical effect of section 2-702 is to give the reclaiming sellers rights prior to those of other unsecured creditors. The Ninth Circuit characterized section 67c as "an attempt to minimize state conflicts with federal priorities by invalidating as against the trustee some of the more obviously spurious liens, those which function more as priorities in bankruptcy than as property interests."[109] Although section 2-702 does not expressly create a creditor's lien, it most definitely functions as a priority. It seems then, that the practical effect of section 2-702 is precisely what the Ninth Circuit stated section 67c ultimately seeks to abrogate—spurious liens which function merely as state created priorities.

In re Giltex, Inc.[110] represents the other view that has been adopted by some courts. The district court there held that section 67c(1)(A) invalidates against the trustee "every statutory lien which first becomes effective upon the insolvency of the debtor," and the right of reclamation under section 2-702(2) is a statutory right, and not a mere codification of a

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105. *In re* Good Deal Supermarkets, Inc., 384 F. Supp. 887, 889 (D.N.J. 1974).
106. Countryman, *supra* note 7, at 444.
107. *Id.*
108. Kennedy, *supra* note 7, at 842.
109. Alfred M. Lewis, Inc. v. Holzman (*In re* Telemart Enterprises, Inc.), 524 F.2d 761, 764 (9th Cir. 1975).
110. 17 U.C.C. REP. SERV. 887 (S.D.N.Y. 1975).

common law right. The court reasoned that the interest which a reclaiming seller is given under section 2-702 may be seen to secure the buyer's payment of the price and hence constitutes a lien. In considering the legislative history of section 67c(1)(A) the court concluded that section 2-702 is the kind of priority statute which section 67c(1)(A) was designed to reach, as it confers upon one class of creditors—sellers—a preferential treatment which only comes about if the buyer becomes insolvent.[111]

The Sixth Circuit in *In re Federal's*, however, advanced the argument that the rights accorded by section 2-702 do not arise solely by force of statute, but have roots in the common law. The court contended that section 67c was intended to invalidate only those liens created by state legislatures intending to grant priorities in bankruptcy, and not interests existent under common law, and thus not the interests created by section 2-702.[112] The Sixth Circuit was unimpressed by the Michigan common law requirement of proof of both insolvency and intent not to pay on the part of the buyer.[113] Moreover, in the case at bar, the parties had stipulated that the buyer had intended to pay.[114] Thus in this case, under pre-Code Michigan law, the seller would not have been able to recover. The Sixth Circuit ignored the obvious, and found section 2-702 to be merely "an adaptation of the historical equitable remedy to modern commercial life."[115] However, it is one thing to adapt the law to modern requirements and it is quite another to completely change the law. In Michigan, particularly under the facts presented by *In re Federal's*, section 2-702 creates a purely *statutory* right of recovery, not adopted from, but totally unavailable under the common law. In light of its practical effect,[116] its operation as a priority in bankruptcy[117] and its statutory origin[118] the only possible conclusion is that section 2-702 operates as a statutory lien invalid under section 67c(1)(A) of the Bankruptcy Act.

Furthermore, the actions of those states in amending section 2-702(3) to omit the words "lien creditor"[119] strengthen the argument that section 2-702 is a statutory lien. In *In re Telemart*, the Ninth Circuit observed that creditors, whose state created priorities were threatened by certain provisions of the Bankruptcy Act, "quickly exerted pressure on state legislatures to preserve their favored position by upgrading their state

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111. Carnation Plastic Mfg. Co., Inc. v. Giltex Inc. (*In re* Giltex, Inc.), 17 U.C.C. REP. SERV. 887, 894 (S.D.N.Y. 1975).
112. *In re* Federal's, Inc., 553 F.2d 509, 516 (6th Cir. 1977).
113. Note 56, *supra*.
114. *In re* Federal's, Inc., 553 F.2d 509, 510 (6th Cir. 1977).
115. *Id.*
116. *See* notes 100-07 *supra* and accompanying text.
117. *See* note 109 *supra* and accompanying text.
118. *See* notes 22-23 *supra* and accompanying text.
119. Note 81, *supra*.

priorities to liens."[120] Similarly, when the priority accorded sellers under section 2-702 is threatened by the trustee's lien creditor status under section 70c of the Bankruptcy Act, sellers are seeking to eliminate from section 2-702 the express subordination of their rights to the interests of lien creditors. This is exactly the set of circumstances section 67c is directed against.[121] Section 67c is intended to frustrate the attempts of state legislatures to give certain of their citizens a favored position regarding the claims they hold against bankrupts. In deleting the words "or lien creditor" the legislatures are acting to restore to reclaiming sellers a priority against the trustee and other creditors in bankruptcy. However, it is quite clear that the U.C.C. provides an adequate means for the reclaiming seller to preserve his rights through perfection under Article Nine.

VI. CONCLUSION

The recent decision of the Sixth Circuit in *In re Federal's* has done nothing to lessen the conflict over what exactly the rights of a reclaiming seller are against the trustee in bankruptcy. The Sixth Circuit clung to a method that took the court outside the Code to a body of common law inconsistent with the Code, and reached a conclusion totally different from the district court as to what the common law priority was. Such a system of interpretation accomplishes neither predictability nor uniformity in the area of commercial law.

The Fifth Circuit, however, in its final holding in *In re Samuels*, employed a method of interpreting the Code that carries out the purpose of the Code as a whole. Because section 2-702 is not a mere codification of pre-existing law, resort must be had to the Code itself for a definition of the relationship between the seller and the trustee. It is clear after reading the Code provisions that the trustee is meant to prevail unless the seller files a security interest.[122]

It is equally clear that section 2-702 is without a base in the common law, and thus arises solely by force of statute. The remedy provided by that section is effective upon the insolvency of the debtor, and operates to give the seller a priority over other unsecured creditors. Thus, in a practical sense, section 2-702 functions as a spurious, statutory lien creating a mere priority among creditors. It is exactly this situation that section 67c was designed to prohibit.

The two methods discussed in this Note by which the trustee can prevail over the reclaiming seller without resorting to common law may

120. Alfred M. Lewis, Inc. v. Holzman (*In re* Telemart Enterprises, Inc.), 524 F.2d 761, 763 (9th Cir. 1975).

121. *Id.*

122. *See In re* Richardson Homes Corp., 18 U.C.C. REP. SERV. 384 (Ref. D., N.D. Ind. 1975) which holds that an unpaid seller under § 2-702 has the status of an unperfected creditor and may not reclaim from the trustee who has the status of a lien creditor.

be employed as alternative means of correctly resolving the issue of priority between the seller and the trustee.[123] To a large extent, the conflict among the circuits in dealing with the relationship of a section 2-702 seller and the trustee in bankruptcy is one of Code methodology. Some courts are reluctant to acknowledge that the U.C.C. in places is not just a codification of the common law but is new law. If common law is used as a basis to interpret the Code, a confusing and unpredictable result is achieved. The Code must, at times, be the source of its own interpretation, both in examining the practical effects of the rights created thereunder in relation to section 67c of the Bankruptcy Act, and in defining the relationship between the unsecured seller and the trustee in bankruptcy. The consequence of using the Code as a source of law, although invalidating the rights of a seller under section 2-702 as against the trustee in bankruptcy, will be to promote uniformity in interpretation of the seller's rights under both the Code and the Bankruptcy Act.

Robert J. Baudino, Jr.

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123. One must plead these theories in the alternative, since *pro forma* one cannot argue that, for the purposes of § 67c(1)(A) of the Bankruptcy Act, § 2-702(2) constitutes a statutory lien, and that § 2-702(2) gives the seller the status of an unsecured creditor against the trustee's hypothetical lien creditor status.

PREINDICTMENT DELAY IN THE EIGHTH CIRCUIT

I. INTRODUCTION

The scope of the due process clause in the fifth amendment[1] has been interpreted to include protection of citizens from unfair trials as a result of preindictment delays in prosecution, regardless of the fact the indictment is within the statute of limitations.[2] In 1971, the Supreme Court in *United States v. Marion*[3] recognized that there would be delays of the most necessary type which might cause prejudice to the defendant, but rejected the suggestion that "every delay-caused detriment to a defendant's case would abort a criminal prosecution."[4] The Court set forth the elements a defendant must establish to support a motion to dismiss an indictment for delay:

> [T]he Due Process Clause of the Fifth Amendment would require dismissal of the indictment if it were shown at trial that the preindictment delay in this case caused substantial prejudice to appellees' rights to a fair trial and that the delay was an intentional device to gain tactical advantage over the accused.[5]

Recognition of the need for preindictment delays came early in the decisions of the Eighth Circuit. As early as 1963, in *Crow v. United States*,[6] the Eighth Circuit endorsed the need to give the prosecution a reasonable time to investigate,[7] and extended some sympathy to the government because of its "heavy workload."[8] The question of what was a

1. The fifth amendment provides: "No person shall . . . be deprived of life, liberty, or property, without due process of law. . . ." U.S. CONST. amend. V.
2. United States v. Marion, 404 U.S. 307, 320 (1971).
3. 404 U.S. 307 (1971).
4. United States v. Marion, 404 U.S. 307, 324-25 (1971) (footnote omitted).
5. *Id.* at 324 (footnote omitted). Prior to *Marion*, the Supreme Court had not provided any criteria directly applicable to determination of preindictment delay charges. Although the Court briefly discussed the issue of preindictment delay in United States v. Ewell, 383 U.S. 116 (1966), it was only considered in the posture of a sixth amendment right to a speedy trial claim. United States v. Ewell, 383 U.S. 116, 122-23 (1966). In *Marion*, the Court initially held that the sixth amendment right to a speedy trial and Federal Rule of Criminal Procedure 48(b) were applicable only to post-arrest situations and that their purpose was not to be extended to cover a claim of prejudice from preindictment delay. Rule 48(b) provides:

> If there is unnecessary delay in presenting the charge to a grand jury or in filing an information against a defendant who has been held to answer to the district court, or if there is unnecesary delay in bringing a defendant to trial, the court may dismiss the indictment, information complaint.

FED. R. CRIM. P. 48(b).
6. 323 F.2d 888 (8th Cir. 1963).
7. Crow v. United States, 323 F.2d 888, 890 (8th Cir. 1963).
8. *Id.* at 891.