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Richard A. Mann

Michael J. Phillips

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Cover Page Footnote

*Assistant Professor of Business Law, School of Business Administration, University of North Carolina at Chapel Hill. Professor Mann received his B.S. from the University of North Carolina in 1968 and his J.D. from Yale University in 1973. **Assistant Professor of Business Law, School of Business, Indiana University. Professor Phillips received his B.A. from Johns Hopkins University in 1968, his J.D. from the Columbia University School of Law in 1973, and his LL.M. from the National Law Center, George Washington University in 1975.

IN RE FEDERAL'S, INC., ANOTHER ROUND IN THE BATTLE BETWEEN THE RECLAIMING CREDIT SELLER AND THE BANKRUPTCY TRUSTEE

RICHARD A. MANN* AND MICHAEL J. PHILLIPS**

I. INTRODUCTION

Since its inception fifteen years ago, section 2-702 of the Uniform Commercial Code (U.C.C.) has generated a lively judicial and academic debate concerning the relative rights of the reclaiming credit seller and the trustee in bankruptcy.¹ This debate to some degree results from the difficult technical legal issues produced by the U.C.C.'s intrusion into this area,² but, more generally, reflects a basic underlying policy conflict between the seller's interests and those of the trustee, a conflict indicative of quite tangible financial interests.³ The

* Assistant Professor of Business Law, School of Business Administration, University of North Carolina at Chapel Hill. Professor Mann received his B.S. from the University of North Carolina in 1968 and his J.D. from Yale University in 1973.

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1. See, e.g., Ashe, *Reclamation Under UCC—An Exercise in Futility: Defrauded Seller v. Trustee in Bankruptcy*, 43 Ref. J. 78 (1969); Bjornstad, *Reclamation of Goods by Unsecured Sellers in Bankruptcy Proceedings*, 24 Drake L. Rev. 357 (1975); Braucher, *Reclamation of Goods from a Fraudulent Buyer*, 65 Mich. L. Rev. 1281 (1967); Countryman, *Buyers and Sellers of Goods in Bankruptcy*, 1 N.M.L. Rev. 435 (1971); Hawkland, *The Relative Rights of Lien Creditors and Defrauded Sellers—Amending the Uniform Commercial Code To Conform to the Kravitz Case*, 67 Com. L.J. 86 (1962); Henson, *Reclamation Rights of Sellers Under Section 2-702*, 21 N.Y.L.F. 41 (1975); Kennedy, *The Interest of a Reclaiming Seller Under Article 2 of the Code*, 30 Bus. Law. 833 (1975); King, *Reclamation Petition Granted: In Defense of the Defrauded Seller*, 44 Ref. J. 81 (1970); Shanker, *Bankruptcy and Article 2 of the Uniform Commercial Code*, 40 Ref. J. 37 (1966) [hereinafter cited as Shanker]; Shanker, *A Reply to the Proposed Amendment of UCC Section 2-702(3): Another View of Lien Creditor's Rights vs. Rights of a Seller to an Insolvent*, 14 W. Res. L. Rev. 93 (1962) [hereinafter cited as Shanker-Reply]; Note, *Bankruptcy and Article Two of the Uniform Commercial Code: The Right To Recover the Goods Upon Insolvency*, 79 Harv. L. Rev. 598 (1966). See generally, 3-4A Collier on Bankruptcy (14th ed. 1976) [hereinafter cited as Collier] (containing considerable material bearing on this problem). See also 3A R. Dusenbery & L. King, *Sales & Bulk Transfers Under the Uniform Commercial Code* § 13.03 (1966); R. Nordstrom, *Handbook of the Law of Sales* §§ 167-69 (1970); J. White & R. Summers, *Handbook of the Law Under the Uniform Commercial Code* § 7-15 (1972). This listing is by no means exhaustive.

2. It is possible that the proposed revision of the Bankruptcy Act presently before Congress could rectify this situation. For a discussion of this possibility, see Edelman & Weintraub, *Seller's Right To Reclaim Property Under Section 2-702(2) of the Code Under the Bankruptcy Act: Fact or Fancy*, 32 Bus. Law. 1165 (1977).

3. Professor Henson has concluded from official 1969 statistics that the unsecured creditor

conflict between the seller and the trustee has generally⁴ arisen in the situation where a seller delivers goods on credit to an insolvent buyer who goes into bankruptcy after their receipt but before the seller can demand their reclamation. The Sixth Circuit's recent decision in the case of *In re Federal's, Inc.*,⁵ displays all of the complex issues involved in this particular situation while adding a few twists of its own.

This Article is intended to assess the impact of the *Federal's* decision, the fourth circuit court case to deal with the credit seller-trustee controversy.⁶ This requires some treatment of the historical bases and dimensions of the controversy. Thus, this Article will begin with a brief description of the pre-Code remedies traditionally available to the credit seller.⁷ An historical introduction is necessary for two reasons. First, the Code draftsmen were clearly not writing on a *tabula rasa* when devising section 2-702, and the exact relationship between that section and its common law predecessors is crucial to many of the cases to be discussed. Second, many other such cases have utilized, or have permitted the option of utilizing, pre-Code law to determine the rights of the 2-702 seller as against the trustee. Next, this Article will examine the procedural requirements for a reclamation under section 2-702.⁸ It will then suggest several possible characterizations of the 2-702 reclamation right—characterizations which are often decisive in the cases involving the clash between the seller and the trustee.⁹ Following this, the Article will examine section 2-702's interaction with the Bankruptcy Act in the three basic bankruptcy contexts in which this clash has arisen, those involving sections 70(c), 67c(1)(A), and 64(a) of the Act.¹⁰ After this, it will undertake a detailed examination of the *Federal's* litigation at the bankruptcy, district, and circuit court levels.¹¹ Finally, a concluding section will attempt to assess the impact

(e.g., a § 2-702 claimant who could not prevail against the trustee) "in an average asset case would receive less than eight cents per dollar claimed, and about 90 percent of all bankruptcies are no-asset cases." Henson, *supra* note 1, at 51 n.37.

4. For an overview of all the dimensions of the clash between seller and trustee, see Mann & Phillips, *The Reclaiming Seller and the Bankruptcy Act: A Roadmap of the Strategies*, 18 B.C. Indus. & Com. L. Rev. 609 (1977).

5. 553 F.2d 509 (6th Cir. 1977), *rev'g* 402 F. Supp. 1357 (E.D. Mich. 1975).

6. See *In re Telemart Enterprises, Inc.*, 524 F.2d 761 (9th Cir. 1975), *cert. denied*, 424 U.S. 969 (1976); *In re Mel Golde Shoes, Inc.*, 403 F.2d 658 (6th Cir. 1968); *In re Kravitz*, 278 F.2d 820 (3d Cir. 1960).

7. See notes 13-28 *infra* and accompanying text.

8. See notes 29-51 *infra* and accompanying text.

9. See notes 52-62 *infra* and accompanying text.

10. See notes 63-121 *infra* and accompanying text.

11. See notes 122-79 *infra* and accompanying text.

of the Sixth Circuit's *Federal's* decision on this long, involved, and as yet unresolved controversy.¹²

II. BACKGROUND

A. Common Law Antecedents

At common law the unpaid credit seller could avail himself of a variety of remedies, one of which was an action for the price.¹³ Another remedy—which, when available, was of greater utility against an insolvent buyer—was to rescind the sale upon the ground of fraud and attempt to recover the goods.¹⁴ Under this remedy the buyer was considered to have received merely a voidable title. As a result, the parties could be restored to their original precontractual position by an equitable operation in which full title to the goods was viewed as never having passed.¹⁵ However, the buyer's voidable title enabled him to pass full title to a good faith purchaser for value, from whom the seller could not reclaim the goods.¹⁶ On the other hand, the seller who rescinded usually had rights superior to those of an attaching lien creditor.¹⁷ In addition, the seller's right to rescind and reclaim survived the debtor's going into bankruptcy because the trustee was deemed to have taken title to the bankrupt's property subject to the retroactive divestment effected by such a rescission.¹⁸

Despite considerable variation among the states, the courts appear to have granted the seller the right to rescind and reclaim the goods in two basic situations:¹⁹ (1) when the buyer received the goods without the intent to pay for them;²⁰ and (2) when the buyer made material misrepresentations of solvency and thereby induced the sale.²¹ Circumstantial evidence, including proof of the buyer's insolvency at the

12. See notes 180-88 *infra* and accompanying text.

13. See 3 Williston on Sales § 561 (rev. ed. 1948).

14. See, e.g., L. Vold, Handbook of the Law of Sales § 79, at 397 (2d ed. 1959); 77 C.J.S. Sales §§ 45-51 (1952).

15. See, e.g., Vold, *supra* note 14, § 79, at 397-98.

16. E.g., *id.* at 400-01.

17. See, e.g., Thaxter v. Foster, 153 Mass. 151, 26 N.E. 434 (1891). See also note 185 *infra*.

18. See, e.g., Fisher v. Shreve, Crump & Low Co., 7 F.2d 159 (D. Mass. 1925); Mulroney Mfg. Co. v. Weeks, 185 Iowa 714, 171 N.W. 36 (1919). See generally, Annot., 59 A.L.R. 418 (1929).

19. For cases explicitly making this distinction, see O'Rieley v. Endicott-Johnson Corp., 297 F.2d 1, 5 (8th Cir. 1961); Manly v. Ohio Shoe Co., 25 F.2d 384, 385 (4th Cir. 1928); *In re Gurvitz*, 276 F. 931, 932 (D. Mass. 1921). See also Annot., 59 A.L.R. 418 (1929).

20. See, e.g., O'Rieley v. Endicott-Johnson Corp., 297 F.2d 1, 5 (8th Cir. 1961); 77 C.J.S. Sales § 50 (1952).

21. E.g., Annot., 59 A.L.R. 418, 418-24 (1929).

time of receiving the goods,²² could be introduced to demonstrate the intent not to pay required in the first situation. However, this was usually regarded as only presumptive proof of the intent to defraud,²³ and could be rebutted by showing the buyer's good faith intent to pay for the goods and a reasonable basis for his belief that he could do so.²⁴ Although in the second situation the misrepresentation need not have been intentional,²⁵ it was usually required that it be one of present fact—not an expression of opinion or promise²⁶—and that the seller have relied upon the misrepresentation.²⁷ Furthermore, in some states there was the additional requirement that the seller's reliance have been reasonable under the circumstances, or that he have exercised reasonable prudence, including appropriate investigations, in so relying.²⁸

B. *The Reclamation Right Under Section 2-702*

Under the Uniform Commercial Code, the credit seller who has not received payment can pursue the variety of remedies listed in section 2-703.²⁹ After delivery of the goods far fewer remedies remain available to the seller, who then has only an action for the price³⁰ and possibly for incidental damages.³¹

However, in order to recover the specific goods sold, the seller must proceed under section 2-702(2), which provides:

Where the seller discovers that the buyer has received goods on credit while insolvent he may reclaim the goods upon demand made within ten days after the receipt, but if misrepresentation of solvency has been made to the particular seller in writing within

22. *See id.* at 426-28.

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

24. *E.g.*, *In re Empire Grocery Co.*, 277 F. 73 (D. Mass. 1921); 77 C.J.S. *Sales* § 52 (1952). Where the buyer honestly intended to pay but had no reasonable basis for expecting to be able to do so, the seller typically was able to rescind. *See, e.g.*, *In re Gurvitz*, 276 F. 931, 932 (D. Mass. 1921).

25. *E.g.*, *Manly v. Ohio Shoe Co.*, 25 F.2d 384, 385 (4th Cir. 1928).

26. *See, e.g.*, *Vold*, *supra* note 14, § 79, at 399-400; 77 C.J.S. *Sales* §§ 46, 48 (1952).

27. *See, e.g.*, 77 C.J.S. *Sales* § 48 (1952). There was often some disagreement as to the degree of reliance required, however. *Compare, e.g.*, *O'Rieley v. Endicott-Johnson Corp.*, 297 F.2d 1, 5 (8th Cir. 1961), *with* *National Shawmut Bank v. Johnson*, 317 Mass. 485, 490, 58 N.E.2d 849, 852 (1945), *and* *Butler v. Martin*, 247 Mass. 169, 173, 142 N.E. 42, 43 (1923).

28. *See, e.g.*, *Wead v. Ganzhorn*, 216 Iowa 478, 480-82, 249 N.W. 271, 272-73 (1933); 77 C.J.S. *Sales* § 48, at 684 (1952).

29. These include: withholding delivery of the goods, stoppage of delivery in transit (U.C.C. § 2-705), identification of goods to the contract (U.C.C. § 2-704), resale and recovery of the difference between the resale price and the contract price (U.C.C. § 2-706), damages for non-acceptance or repudiation (U.C.C. § 2-708), an action for the price (U.C.C. § 2-709), and cancellation.

30. *Id.* § 2-709.

31. *Id.* § 2-710.

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.³²

In addition, the current Code expressly subordinates this reclamation right to the rights of a buyer in ordinary course or other good faith purchaser.³³

In order to take advantage of the reclamation right provided by section 2-702(2), the seller must meet a number of technical requirements imposed by this section. First, the seller must discover that the buyer had received the goods while "insolvent." An insolvent party is defined as one "who either has ceased to pay his debts in the ordinary course of business or cannot pay his debts as they become due or is insolvent within the meaning of the federal bankruptcy law."³⁴ Second, the seller must demand the goods within ten days of their receipt by the buyer unless there is a written misrepresentation of solvency within three months of delivery.³⁵ This ten-day period has been held to run from the day after the goods have been received until the tenth day after such receipt.³⁶ It would seem likely that actual physical repossession of the goods within the ten-day period is not required,³⁷ but the cases diverge sharply as to what minimum action must be taken by the seller. One case has suggested in dictum that "an act of demanding or asking"³⁸ may be enough. Another case—again in dictum—appears to have considered a telephone call to be sufficient.³⁹ However, some decisions have treated a bare oral demand as inadequate, stating that some sort of "follow-up" is required.⁴⁰ It is uncertain what is involved in a follow-up,⁴¹ but one case has implied that a reclamation petition filed in bankruptcy, even though entered more than ten days after receipt of the goods, may be sufficient to satisfy this requirement.⁴²

32. *Id.* § 2-702(2).

33. *Id.* § 2-702(3). The 1962 version of § 2-702(3) also subordinated the seller to the rights of a lien creditor. See note 68 *infra* and accompanying text.

34. U.C.C. § 1-201(23).

35. *Id.* § 2-702(2).

36. *In re Behring & Behring*, 5 U.C.C. Rep. Serv. 600, 606 (N.D. Tex. 1968).

37. See, e.g., *White & Summers*, *supra* note 1, § 7-15, at 242.

38. *In re Childress*, 6 U.C.C. Rep. Serv. 505, 507 (E.D. Tenn. 1969) (quoting Webster's dictionary as to the meaning of the term "demand").

39. *Metropolitan Distribs. v. Eastern Supply Co.*, 21 Pa. D. & C. 2d 128, 134 (C. P. Allegheny County 1959).

40. *In re Colacci's of America, Inc.*, 490 F.2d 1118, 1120-21 (10th Cir. 1974); *In re Behring & Behring*, 5 U.C.C. Rep. Serv. 600, 606 (N.D. Tex. 1968).

41. *In re Colacci's of America, Inc.*, 490 F.2d 1118 (10th Cir. 1974), spoke of "a regaining of possession or a bona fide attempt to do so." *Id.* at 1121. *In re Behring & Behring*, 5 U.C.C. Rep. Serv. 600 (N.D. Tex. 1968), spoke of "any type of legal action or effort to regain peaceable repossession without legal action." *Id.* at 606.

42. See *In re Behring & Behring*, 5 U.C.C. Rep. Serv. 600, 606-07 (N.D. Tex. 1968).

However, the ten-day limitation has no application "if misrepresentation of solvency has been made to the particular seller in writing within three months before delivery."⁴³ A Code Comment states that in order for this exception to come into effect "the statement of solvency must be in writing, addressed to the particular seller and dated within three months of the delivery."⁴⁴ However, the last requirement has been ignored by a case holding that the writing need only have been *presented to* the seller within three months of the delivery.⁴⁵ The courts have also held a signed purchase order⁴⁶ and a letter virtually admitting insolvency, but setting out a schedule of payments,⁴⁷ not to be "writings," while generally regarding a check as fitting within this category.⁴⁸ Notwithstanding the absence of such a requirement in the language of section 2-702(2), it has further been held that the seller must have relied upon the writing.⁴⁹ Moreover, some cases have stated that the seller must have been acting with the prudence of an ordinary businessman in so relying.⁵⁰ Finally, it has been explicitly stated that the Code's requirement of good faith applies to the seller's conduct in this situation.⁵¹

C. Possible Characterizations of Section 2-702(2)

As will be seen, the manner in which section 2-702 is characterized is often determinative of whether the reclaiming credit seller succeeds in reclaiming goods from the trustee. There are three possible characterizations of section 2-702 that could be decisive:⁵² (1) as a codification of the common law remedy of rescission for fraud, (2) as an article 2 security interest,⁵³ or (3) as a statutory lien. The first of these characterizations would seem the most significant in light of the defrauded

43. U.C.C. § 2-702(2).

44. *Id.*, Comment 2.

45. *In re Bel Air Carpets, Inc.*, 452 F.2d 1210, 1212 (9th Cir. 1971).

46. *See In re Regency Furniture, Inc.*, 7 U.C.C. Rep. Serv. 1381 (E.D. Tenn. 1970).

47. *See In re Units, Inc.*, 3 U.C.C. Rep. Serv. 46 (D. Conn. 1965).

48. *See, e.g., In re Creative Bldgs., Inc.*, 498 F.2d 1 (7th Cir. 1974); *Amoco Pipeline Co. v. Admiral Crude Oil Corp.*, 490 F.2d 114, 117 (10th Cir. 1974); *Theo. Hamm Brewing Co. v. First Trust & Sav. Bank*, 103 Ill. App. 2d 190, 195, 242 N.E.2d 911, 915 (1968); *In re Bar-Wood, Inc.*, 15 U.C.C. Rep. Serv. 828 (S.D. Fla. 1974); *In re Fairfield Elevator Co.*, 14 U.C.C. Rep. Serv. 96, 107-08 (S.D. Iowa 1973).

49. *See In re Creative Bldgs., Inc.*, 498 F.2d 1, 4 (7th Cir. 1974); *In re Fairfield Elevator Co.*, 14 U.C.C. Rep. Serv. 96, 107-08 (S.D. Iowa 1973); *Theo. Hamm Brewing Co. v. First Trust & Sav. Bank*, 103 Ill. App. 2d 190, 195, 242 N.E.2d 911, 915 (1968).

50. *See cases cited note 49 supra.*

51. *Id.*

52. Here we are concerned with characterizations of § 2-702 arising independently of Bankruptcy Act definitions. Thus, its possible characterization as a "priority" will not be discussed here. *See notes 107-12 infra* and accompanying text.

53. *See U.C.C. § 9-113 and Comments 1-5.*

seller's ability to recover against the trustee under the pre-Code law of most jurisdictions.⁵⁴ To begin with, it is clear that the section 2-702(2) reclamation right was not created *ex nihilo*; it has an obvious historical antecedent in the common law rescission right. In particular, its "ten day demand" and "written misrepresentation" provisions would seem to derive from the two situations giving rise to the right of rescission at common law.⁵⁵ Nonetheless, section 2-702 differs from the pre-Code remedy in some fairly significant respects. First, its ten-day and three-month time limitations did not exist at common law. Second, section 2-702(2) eases to a considerable extent the evidentiary burden on the seller. Under prior law, the buyer's receipt of the goods while insolvent usually established only a rebuttable presumption of fraud,⁵⁶ while according to the Code comment, section 2-702(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."⁵⁷ Finally, under pre-Code law a seller who based his recovery for fraud on the buyer's misrepresentation was required to show that he had justifiably relied upon the misrepresentation.⁵⁸ Section 2-702(2) does not explicitly include such a requirement, although certain cases decided under the Code have grafted this requirement onto the section.⁵⁹

On the other hand, section 2-702 might be characterized as a security interest or a statutory lien. The U.C.C. defines the term "security interest" as "an interest in personal property or fixtures which secures payment or performance of an obligation."⁶⁰ Although this definition would seem sufficiently broad to include the section 2-702(2) reclamation right, there is authority to the contrary.⁶¹ The remaining possibility is that section 2-702(2) might be regarded as sufficiently similar to the host of legislatively created state liens benefitting certain classes of parties supplying goods or services to be classed as a "statutory lien." The determination of the appropriateness of this

54. See note 18 *supra* and accompanying text.

55. See notes 19-28 *supra* and accompanying text.

56. See notes 22-24 *supra* and accompanying text.

57. U.C.C. § 2-702, Comment 2.

58. See notes 27-28 *supra* and accompanying text.

59. See notes 49-50 *supra* and accompanying text.

60. U.C.C. § 1-201(37).

61. See, e.g., *In re Mel Golde Shoes, Inc.*, 403 F.2d 658, 660 (6th Cir. 1968); *Ranchers & Farmers Livestock Auction Co. v. First State Bank*, 531 S.W.2d 167, 170 (Tex. Civ. App. 1975). See also the authorities cited in Note, *Uniform Commercial Code—§ 2-702: Conflict with § 67c(1)(A) of the Federal Bankruptcy Act*, 53 N.C.L. Rev. 169, 174 n.24 (1974).

characterization depends largely upon whether the section is considered predominately a codification of the common law fraud remedy. The basis and implications of such a determination will receive closer attention under the treatment of section 67c(1)(A) of the Bankruptcy Act.⁶²

III. CONFLICTS BETWEEN SECTION 2-702 AND THE BANKRUPTCY ACT

When the seller attempts to reclaim the goods after the petition in bankruptcy has been filed he will face a trustee who will assert that the 2-702(2) reclamation right is either subordinate to the trustee's title to the bankrupt's property or invalidated by some provision of the Bankruptcy Act. If the trustee's contention prevails, the seller is relegated to the status of an unsecured creditor who must share pro rata with the hordes of other creditors. On the other hand, if the seller's reclamation right survives the trustee's attacks, he will recover the goods, which, even if they have depreciated, will usually greatly exceed in value the seller's recovery as a general creditor. These financial stakes, coupled with the uncertain characterization of the reclamation right, have produced considerable litigation—and utter confusion—as to the relative rights of the seller and the trustee. The provisions of the Bankruptcy Act that a trustee will most likely utilize against the seller who demands the goods after bankruptcy are sections 70(c), 67c(1)(A), and 64(a).

A. Section 70(c)

Section 70(c) of the Bankruptcy Act provides in relevant part that

[t]he trustee shall have as of the date of bankruptcy the rights and powers of . . . a creditor who upon the date of bankruptcy obtained a lien by legal or equitable proceedings upon all property . . . upon which a creditor of the bankrupt upon a simple contract could have obtained such a lien, whether or not such a creditor exists.⁶³

Section 70(c) provides the trustee with the rights of an "ideal lien creditor" who is "armed cap-a-pie with every right and power which is conferred by the law of the state upon its most favored creditor who has acquired a lien by legal or equitable proceedings."⁶⁴ However, the trustee is considered to have perfected his lien on the date of bank-

62. See notes 83-106 *infra* and accompanying text.

63. 11 U.S.C. § 110(c) (1970).

64. *In re Kravitz*, 278 F.2d 820, 822 (3d Cir. 1960) (quoting *In re Waynesboro Motor Co.*, 60 F.2d 668, 669 (S.D. Miss. 1932)). For this reason, § 70(c) has been called the "strong-arm" clause of the Bankruptcy Act. *Id.*

ruptcy,⁶⁵ and is thus precluded from superseding the claims of preceding lienholders or other interested parties by choosing the optimal time(s) to have perfected his hypothetical lien. Nonetheless, section 70(c) does not require the trustee to locate an actual, existing party who could have asserted the right assumed by the trustee,⁶⁶ although there are cases to the contrary.⁶⁷

The rights of an "ideal lien creditor" are determined by state law, which in this context is the Uniform Commercial Code. An earlier version of section 2-702(3) provided a seemingly lucid pronouncement regarding the rights of lien creditors against the reclaiming seller: "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)."⁶⁸ Taken together with section 70(c) of the Bankruptcy Act, this statement would appear to provide that the trustee should invariably defeat the reclaiming 2-702 seller. However, the Third Circuit's famous and controversial decision in *In re Kravitz*⁶⁹ read this language quite differently. Its conclusions have generated a raging polemic among commercial and bankruptcy law commentators with the result that serious code ambiguities and omissions in this area have been exposed.

Kravitz involved the competing rights of the seller and the trustee to goods delivered on credit to the buyer three days before the buyer's involuntary petition in bankruptcy. One day after the filing of the petition the seller attempted to rescind the sale in a manner that presumably satisfied the requirements of section 2-702(2). However, both the bankruptcy referee and the district court denied the seller's claim, and the court of appeals affirmed.⁷⁰ After pursuing the effect of

65. See *Lewis v. Manufacturers Nat'l Bank*, 364 U.S. 603 (1961). "[I]f we construe § 70c as petitioner does, there would be no period of repose. Security transactions entered into in good faith years before the bankruptcy could be upset if the trustee were ingenious enough to conjure up a hypothetical situation in which a hypothetical creditor might have had such a right." *Id.* at 609. See also notes 166-69 *infra* and accompanying text.

66. See 4A Collier, *supra* note 1, ¶ 70.50, at 609-14.

67. See, e.g., *Pacific Fin. Corp. v. Edwards*, 304 F.2d 224, 228-29 (9th Cir. 1962).

68. U.C.C. § 2-702 (1962 version).

69. 278 F.2d 820 (3d Cir. 1960).

70. *In re Kravitz*, 278 F.2d 820 (3d Cir. 1960). Neither the referee's decision nor the district court decision has been published. However, Professor Morris Shanker, who personally examined the full *Kravitz* file, has concluded that: 1) *Kravitz* was decided under an earlier version of § 2-702(2) which lacked the current exclusion of the common law fraud remedy (on the latter, see notes 115-19 *infra* and accompanying text); 2) the district court opinion seemed to hold that the § 2-702 reclamation right would be unavailable to the seller because of its subordination to a lien creditor via what is now § 2-702(3); 3) counsel for the seller definitely advanced a common law fraud theory before the referee; and 4) the case therefore proceeded largely under a common

section 2-702(3)'s reference to section 2-403 upon the lien creditor's rights, the court concluded that "Section 2-403(4) refers the rights of lien creditors to, *inter alia*, Article 9 and Section 9-301(3) says that the term 'lien creditor' includes 'a trustee in bankruptcy from the date of the filing of the petition. . . .'"⁷¹ After a discussion of Section 70(c) of the Bankruptcy Act, the court reconciled the two provisions in the following fashion:

We think the correct way to put the matter is that by federal law the trustee in bankruptcy is made a lien creditor and that this right thus given him is recognized by the Uniform Commercial Code which simply states the power of the trustee as created by the prevailing law, that is, the federal law of bankruptcy.⁷²

But, while the *Kravitz* court found no inconsistency within the Code or between the Code and the Bankruptcy Act—thus effectively subsuming section 2-702(3)'s "lien creditor" language under section 70(c)—it apparently did not regard the Code as dispositive on the rights of a lien creditor as against the reclaiming seller. Instead, the court resorted to pre-Code Pennsylvania law,⁷³ which held that the reclaiming seller—even when defrauded—could not triumph over certain lien creditors.⁷⁴ On this basis, the court found for the trustee.⁷⁵

The reaction to *Kravitz* came quickly. By 1962 at least two states had amended or enacted section 2-702(3) to eliminate the "lien creditor" language.⁷⁶ In commenting on this reaction, Professor William Hawkland took note that *Kravitz* did *not* mean that the trustee would inevitably triumph through the operation of Code sections 2-702(3), 2-403(4), and 9-301(3), because that case was "an anomaly peculiar to Pennsylvania" resulting from that state's unusual pre-Code rule regarding the relative rights of the reclaiming seller and a lien creditor.⁷⁷ Although he maintained that the legislative history of section 2-702 really made such a change unnecessary, he nonetheless advocated an amendment to section 2-702(3) deleting its "or lien creditor" lan-

law fraud theory before the lower courts. *See* Shanker, *supra* note 1, at 42. However, the court of appeals, while not completely clear as to the theory under which it was proceeding, did give considerable attention to § 2-702, as the following discussion should indicate.

71. *In re Kravitz*, 278 F.2d 820, 821-22 (3d Cir. 1960).

72. *Id.* at 822.

73. The cases relied on were *Schwartz v. McCloskey*, 156 Pa. 258, 27 A. 300 (1893), and *Mann v. Salsberg*, 17 Pa. Super. 280 (1901). *See* note 169 *infra*.

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

75. *Id.*

76. *See* 1961 Ill. Laws 2147 (codified at Ill. Ann. Stat. ch. 26, § 2-702 (Smith-Hurd 1974)); ch. 96, 1961 N.M. Laws (codified at N.M. Stat. Ann. § 50A-2-702 (1962)).

77. Hawkland, *supra* note 1, at 88.

guage.⁷⁸ In 1966, the Permanent Editorial Board for the Uniform Commercial Code adopted this change, although a considerable majority of the states still preserve the pre-1966 version.⁷⁹

In the wake of *Kravitz* and the 1966 amendment, however, a variety of other approaches to this problem have emerged among the courts and the commentators. In those states which have not adopted the 1966 amendment, there have been two basic approaches. The first of these essentially supports the *Kravitz* result: utilization of pre-Code law to determine the relative rights of seller and lien creditor.⁸⁰ In most states,⁸¹ this should enable the seller to defeat the lien creditor/trustee. The second approach views the Code as a self-contained body of law in which the seller is expressly subordinated to a lien creditor by section 2-702(3), without any cross references to section 2-403 and to article 9.⁸² This approach should result in a triumph for the trustee in all states retaining the original section 2-702(3) language.

On the other hand, in states which have adopted the 1966 amendment the seller is almost always likely to win. If, as seems most probable, the amendment is construed as eliminating from the Code

78. "[T]here is no indication whatsoever from the legislative history of the Uniform Commercial Code that 2-702 was intended to give the trustee more rights vis-a-vis the defrauded seller than he was accorded under previous law. Because 2-702(3), however, can be read as doing precisely what its draftsmen manifestly did not want done, an amendment to the section seems in order. . . .

"The amendment to 2-702(3), of course, should not be considered as legislative history for the conclusion that the defrauded seller necessarily prevails over the trustee in bankruptcy. Its intention is merely to adopt the rule of the *Kravitz Case*, as correctly read and applied." *Id.*

79. For a more or less current listing, see Uniform Laws Annotated, Uniform Commercial Code § 2-702, at 350 (1976). According to that listing, sixteen states have adopted the new language.

80. See, e.g., *In re Mel Golde Shoes, Inc.*, 403 F.2d 658 (6th Cir. 1968); *In re Royalty Homes, Inc.*, 8 U.C.C. Rep. Serv. 61, 63-64 (E.D. Tenn. 1970); notes 124-26, 142, 163 *infra* and accompanying text.

81. See, e.g., *Countryman, supra* note 1, at 457; *Hawkland, supra* note 1, at 88. See also note 185 *infra*.

82. See *Shanker-Reply, supra* note 1, at 96-98; *Shanker, supra* note 1, at 40-41; *Countryman, supra* note 1, at 457. This view seems to have been followed in several cases. See *In re Goodson Steel Corp.*, 10 U.C.C. Rep. Serv. 387, 391-93 (S.D. Tex. 1968); *In re Behring & Behring*, 5 U.C.C. Rep. Serv. 600, 606-07 (N.D. Tex. 1968); *In re Units, Inc.*, 3 U.C.C. Rep. Serv. 46, 48-49 (D. Conn. 1965); *In re Eastern Supply Co.*, 1 U.C.C. Rep. Serv. 151, 153-54 (W.D. Pa. 1963), *aff'd*, 331 F.2d 852 (3d Cir. 1964). See also notes 124, 142 *infra* and accompanying text.

Also, Professor Shanker has argued that the § 2-702(2) seller should be subordinated to the trustee because goods now should be deemed "on sale or return" under § 2-326, and because the § 2-702 reclamation right is an unperfected security interest subject to a lien creditor under § 9-301(1)(b). *Shanker-Reply, supra* note 1, at 98-106. *But see* note 61 *supra* and accompanying text (citing cases indicating that the § 2-702 reclamation right is not an article nine security interest).

any pretense of determining the relative rights of seller and lien creditor, recourse to pre-Code law will be unavoidable. As has been discussed, this should enable the credit seller to recover from the trustee in most states. However, the amendment might also be viewed in the light of its history as a positive assertion that the seller is to triumph over the lien creditor in all situations, including those in which the state's rule at common law would have favored the lien creditor.

B. Section 67c(1)

Even if the seller attempting to reclaim after bankruptcy is not frustrated by section 70(c) of the Bankruptcy Act, he may still run afoul of section 67c(1)(A)⁸³ thereof, which in relevant part states that "every statutory lien which first becomes effective upon the insolvency of the debtor" will be "invalid against the trustee."⁸⁴ Since the 2-702(2) reclamation right depends upon the seller's discovery of the buyer's insolvency, it would seem to satisfy that requirement of section 67c(1)(A).⁸⁵ Thus, the crucial question is whether section 2-702 is a "statutory lien."⁸⁶ The cases that have dealt with this issue have

83. 11 U.S.C. § 107(c)(1)(A) (1970). Commentary on the relationship between § 2-702(2) and § 67c of the Bankruptcy Act includes: Henson, *Reclamation Rights of Sellers Under Section 2-702*, 21 N.Y.L.F. 41 (1975); Note, *In Re Good Deal Supermarkets, Inc.: A Hasty Invalidation of UCC § 2-702(2) as a Statutory Lien Under § 67(c)(1)(A) of the Bankruptcy Act*, 32 Wash. & Lee L. Rev. 1001 (1975); Note, *Uniform Commercial Code—§ 2-702: Conflict with § 67c(1)(A) of the Federal Bankruptcy Act*, 53 N.C.L. Rev. 169 (1974); Note, *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).

84. 11 U.S.C. § 107(c)(1)(A) (1970).

85. The Bankruptcy Act states that "[a] person shall be deemed insolvent within the provisions of this title whenever the aggregate of his property, exclusive of any property which he may have conveyed, transferred, concealed, removed, or permitted to be concealed or removed, with intent to defraud, hinder, or delay his creditors, shall not at a fair valuation be sufficient in amount to pay his debts." *Id.* § 1(19) (1970). The Uniform Commercial Code, on the other hand, states that "[a] person is 'insolvent' who either has ceased to pay his debts in the ordinary course of business or cannot pay his debts as they become due or is insolvent within the meaning of the federal bankruptcy law." U.C.C. § 1-201(23). Obviously, the Code definition of insolvency is broader than that of the Bankruptcy Act, and for this reason there may be instances in which a valid demand under § 2-702 may not become "effective upon the insolvency of the debtor" in the bankruptcy sense. *But see* 4 Collier, *supra* note 1, ¶ 67.281[2.1], at 419-20 (suggesting that the state law definition of insolvency should apply in case of a discrepancy).

Also, it might be argued that the 2-702(2) reclamation right is conditioned on a host of factors other than the debtor's insolvency. *See* Note, *In Re Good Deal Supermarkets, Inc.: A Hasty Invalidation of UCC § 2-702(2) as a Statutory Lien Under § 67(c)(1)(A) of the Bankruptcy Act*, 32 Wash. & Lee L. Rev. 1001, 1014 (1975).

86. For cases holding that § 2-702(2) is a statutory lien, see *In re Good Deal Supermarkets, Inc.*, 384 F. Supp. 887 (D.N.J. 1974); *In re Perskey & Wolf, Inc.*, 19 U.C.C. Rep. Serv. 812

usually raised three basic questions: (1) whether the section 2-702 remedy is actually "statutory"; (2) whether the 2-702 reclamation right is a "lien"; and (3) the legislative intent and purpose of section 67c.

With respect to the first of these issues, section 1(29a) of the Bankruptcy Act defines a "statutory lien" as

a lien arising solely by force of statute upon specified circumstances or conditions, but [it] shall not include any lien provided by or dependent upon an agreement to give security, whether or not such lien is also provided by or is also dependent upon statute and whether or not the agreement or lien is made fully effective by statute.⁸⁷

The 2-702(2) reclamation right clearly arises "by force of statute upon specified circumstances or conditions," but one court, stressing section 2-702's relationship with the common law remedy of rescission for fraud and Official Code Comment 2,⁸⁸ has argued that it does not "solely" so arise.⁸⁹ However, the cases reaching the contrary conclusion have done so by emphasizing the differences between section 2-702(2) and the traditional fraud remedy.⁹⁰

The definition of the term "statutory lien" in section 1(29a) seems to assume the existence of a recognized meaning for the term "lien," despite the fact that neither the Code nor the Bankruptcy Act defines the term. As a general matter, a "lien" seems to be regarded as a hold or claim on property for the payment of some debt, obligation, or duty.⁹¹ This definition implies that upon payment of the debt the lien

(N.D. Ohio 1976); *In re Giltex, Inc.*, 17 U.C.C. Rep. Serv. 887 (S.D.N.Y. 1975); *In re Wetson's Corp.*, 17 U.C.C. Rep. Serv. 423 (S.D.N.Y. 1975). See also *In re Nieves*, 446 F.2d 188 (1st Cir. 1971); *In re Trahan*, 283 F. Supp. 620 (W.D. La.), *aff'd*, 402 F.2d 796 (5th Cir. 1968); notes 134-35, 151-54, 158-61 *infra* and accompanying text. But see *In re Telemart Enterprises, Inc.*, 524 F.2d 761 (9th Cir. 1975), *cert. denied*, 424 U.S. 969 (1976); *In re National Bellas Hess, Inc.*, 17 U.C.C. Rep. Serv. 430 (S.D.N.Y. 1975).

87. 11 U.S.C. § 1(29a) (1970).

88. "Subsection (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." U.C.C. § 2-702, Comment 2; see notes 56-59 *supra* and accompanying text.

89. See *In re National Bellas Hess, Inc.*, 17 U.C.C. Rep. Serv. 430, 431-32 (S.D.N.Y. 1975). One commentator, however, has suggested that this argument should not be utilized, principally because it would involve a burdensome comparison of the alleged lien with various possible common law antecedents in order to determine its status as "solely statutory." See Note, *In Re Good Deal Supermarkets, Inc.: A Hasty Invalidation of UCC § 2-702(2) as a Statutory Lien Under § 67(c)(1)(A) of the Bankruptcy Act*, 32 Wash. & Lee L. Rev. 1001, 1009-10 (1975).

90. See *In re Giltex, Inc.*, 17 U.C.C. Rep. Serv. 887, 889-90 (S.D.N.Y. 1975); *In re Wetson's Corp.*, 17 U.C.C. Rep. Serv. 423, 426 (S.D.N.Y. 1975). See also notes 151-54 *infra* and accompanying text.

91. See, e.g., 51 Am. Jur. 2d *Liens* § 1 (1970); Black's Law Dictionary 1072-73 (4th ed. rev.

should terminate. Some courts have seized upon this implication and have maintained that since the 2-702(2) right similarly terminates upon successful reclamation, it is in effect a "lien."⁹² However, another court found the exclusivity of the 2-702 remedy⁹³ to differentiate it from the typical lien, since a lien-holder can sell the property and recover any deficiency from the debtor as an unsecured creditor, whereas the 2-702 seller may not.⁹⁴ Finally, if section 2-702(2) is viewed as a codification of the common law fraud remedy, it should not be considered a lien.

With respect to the legislative history, the usual tendency of courts which hold that section 67c(1)(A) invalidates the 2-702(2) reclamation right in bankruptcy is to view the 1966 amendments to section 67⁹⁵ as part of an ongoing process⁹⁶ by which the trustee's powers to invalidate an ever-expanding collection of state priorities-disguised-as-liens⁹⁷ have been augmented so as to keep pace with this expansion.⁹⁸ However, the legislative history accompanying these amendments⁹⁹ makes no reference either to section 2-702 of the Code or to the *Kravitz*

1968). For a compendium of definitions of this term, see Note, *Uniform Commercial Code—§ 2-702: Conflict with § 67c(1)(A) of the Federal Bankruptcy Act*, 53 N.C.L. Rev. 169, 172 (1974).

92. *In re Giltex, Inc.*, 17 U.C.C. Rep. Serv. 887, 890-91 (S.D.N.Y. 1975); *In re Wetson's Corp.*, 17 U.C.C. Rep. Serv. 423, 426-27 (S.D.N.Y. 1975).

93. "Successful reclamation of goods excludes all other remedies with respect to them." U.C.C. § 2-702(3).

94. *In re National Bellas Hess, Inc.*, 17 U.C.C. Rep. Serv. 430, 432-33 (S.D.N.Y. 1975). *But see* notes 158-59 *infra* and accompanying text.

95. Act of July 5, 1966, Pub. L. No. 89-495, §§ 3, 4, 80 Stat. 268 (codified at 11 U.S.C. § 107(b), (c) (1970)).

96. In 1938, § 64 of the Act was amended to eliminate the general recognition in bankruptcy of state-created priorities. Act of June 22, 1938, ch. 575, § 64, 52 Stat. 874. This led to a variety of state efforts to cast what arguably were actual priorities in the guise of liens, thus ensuring such otherwise-invalid priorities an enhanced payment status. *See, e.g., In re Giltex, Inc.*, 17 U.C.C. Rep. Serv. 887, 892 (S.D.N.Y. 1975). Thus, in 1966, § 67 was amended to expand the list of statutory liens specifically declared invalid in bankruptcy, mainly by means of new § 67c (1)(A), (B), and (C). Act of July 5, 1966, Pub. L. No. 89-495, §§ 3, 4, 80 Stat. 268 (codified at 11 U.S.C. § 107(b), (c) (1970)). The general recognition of state-created statutory liens was retained in the new § 67b. *Id.*

97. On the distinction between priorities and liens, see 3A Collier, *supra* note 1, ¶ 64.02[2], at 2065-69.

98. *See In re Giltex, Inc.*, 17 U.C.C. Rep. Serv. 887, 892-95 (S.D.N.Y. 1975); *In re Wetson's Corp.*, 17 U.C.C. Rep. Serv. 423, 427-29 (S.D.N.Y. 1975); *In re Good Deal Supermarkets, Inc.*, 384 F. Supp. 887, 889 (D.N.J. 1974).

99. Relevant here are S. Rep. No. 1159, 89th Cong., 2d Sess. (1966), *reprinted in* [1966] U.S. Code Cong. & Ad. News 2456; S. Rep. No. 999, 89th Cong., 2d Sess. (1966), *reprinted in* [1966] U.S. Code Cong. & Ad. News 2442; and H.R. Rep. No. 686, 89th Cong., 1st Sess. (1965), *reprinted in* [1966] U.S. Code Cong. & Ad. News 2442.

problem. Notwithstanding this, the history does reveal a congressional concern to invalidate both "liens creating a noncontingent property interest in a specific asset" (section 2-702(2) clearly gives a right to specific goods) and "liens which became effective only in the event of insolvency" (section 2-702(2) by its terms, should apply only in this case).¹⁰⁰ Nevertheless, it appears that the history excepts from the purview of section 67c(1)(A) "a specific property right which may be asserted independently of a general distribution and regardless of the transfer of the property."¹⁰¹ Although section 2-702(2) applies only in the event of insolvency—or, more precisely, the seller's discovery thereof—and thus could operate "independently of a general distribution"¹⁰² if there were no such distribution, it could not operate "regardless of the transfer of the property"¹⁰³ since section 2-702(3) expressly subordinates the seller to a "buyer in ordinary course or other good faith purchaser."¹⁰⁴ All of this¹⁰⁵ notwithstanding, it has also been held that section 2-702's alleged basis in the common law of fraud places it outside the legislative purpose of section 67c.¹⁰⁶ This indicates once more the wide-ranging impact of the basic problem of characterizing section 2-702(2)'s genesis and nature.

100. S. Rep. No. 1159, 89th Cong., 2d Sess. (1966), *reprinted in* [1966] U.S. Code Cong. & Ad. News 2456, 2457.

101. *Id.* at 2461.

102. *Id.*

103. *Id.*

104. U.C.C. § 2-702(3).

105. The foregoing discussion of § 67c's legislative history should be compared with the discussion in *In re Giltex, Inc.*, 17 U.C.C. Rep. Serv. 887, 892-95 (S.D.N.Y. 1975).

106. See *In re Telemart Enterprises, Inc.*, 524 F.2d 761 (9th Cir. 1975), *cert. denied*, 424 U.S. 969 (1976). As the court there stated: "Section 67c, as amended in 1966, is 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.

"Section 67c is thus a remedial trimming-back of the special exemption conferred on statutory liens by section 67b. It was not intended to serve as a new tool by which the trustee could cut down provisions of state law obviously not entitled to the benefits of section 67b. As discussed below, under section 2-702(2) receipt of goods on credit while insolvent is deemed a fraud on the creditor rendering the sale voidable. The sale thus is defective from its inception. Clearly no new security has been given for an antecedent debt; the 'lien,' if it is conceived as such, attached at the instant the debt was created. . . . Section 2-702(2) clearly, therefore, was not an attempt to escape the effect of section 60 by creating a spurious statutory lien, and enactment of section 2-702(2) did not present the abuse which section 67c was designed to combat." *Id.* at 764 (citations omitted). The *Telemart* court's references to § 60 of the Bankruptcy Act seem principally intended to illuminate the intent and purpose of Congress in amending § 67. The case did not involve anything like a preferential transfer, and none of the other 67c cases cited above pursue this line of argument.

C. Section 64(a)

The question of whether section 2-702 of the Code should be characterized as a codification of the common law fraud remedy is critical to yet another attack by the trustee—the challenge under section 64 of the Bankruptcy Act,¹⁰⁷ which invalidates state-created priorities. Before 1938, the Act gave priority to debts of the bankrupt owing to any persons who by the laws of any state or of the United States were entitled thereto.¹⁰⁸ The 1938 amendment to section 64 eliminated this general recognition, usually consigning the party owed such a debt to general creditor status.¹⁰⁹ In *Federal's*,¹¹⁰ the bankruptcy and district courts had held that section 2-702, whose employment by the seller was felt to be practically, if not legally, tied to the buyer's petition in bankruptcy, was in effect a state-created priority in clear defiance of the federal standards set out by section 64.¹¹¹ In *In re Telemart Enterprises, Inc.*,¹¹² however, the Ninth Circuit held section 2-702 *not* to be in conflict with section 64, essentially because of the former's alleged basis in common law fraud, under which the seller could recover from the trustee.

IV. A REVERSION TO COMMON LAW FRAUD

Two recent cases¹¹³ have presented a new development which would dramatically affect the success of credit sellers attempting to reclaim in bankruptcy proceedings. Both cases involved the invalidation of section 2-702 as a statutory lien under section 67c(1)(A) of the Bankruptcy Act. In the first case, *In re Wetson's*,¹¹⁴ Judge Herzog found the exclusivity provision of section 2-702(2)¹¹⁵ inapplicable by the following reasoning:

107. 11 U.S.C. § 104(a) (1970).

108. Act of July 1, 1898, ch. 541, § 64, 30 Stat. 563 (current version at 11 U.S.C. § 104(a) (1970)).

109. Act of June 22, 1938, ch. 575, § 64, 52 Stat. 874 (codified at 11 U.S.C. § 104(a) (1970)).

110. 12 U.C.C. Rep. Serv. 1142 (E.D. Mich. 1973), *aff'd*, 402 F. Supp. 1357 (E.D. Mich. 1975), *rev'd*, 553 F.2d 509 (6th Cir. 1977).

111. See notes 130-33, 151-57 *infra* and accompanying text. See also *In re Perskey & Wolf, Inc.*, 19 U.C.C. Rep. Serv. 812 (N.D. Ohio 1976).

112. 524 F.2d 761, 764 (9th Cir. 1975), *cert. denied*, 424 U.S. 969 (1976).

113. *In re Wetson's Corp.*, 17 U.C.C. Rep. Serv. 423, 429 (S.D.N.Y. 1975); *In re Giltex, Inc.*, 17 U.C.C. Rep. Serv. 887, 896 (S.D.N.Y. 1975). See also notes 136-40, 161 *infra* and accompanying text.

114. 17 U.C.C. Rep. Serv. 423 (S.D.N.Y. 1975).

115. "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." U.C.C. § 2-702(2).

Equitable considerations require that I reject the argument that since § 2-702 is by its final sentence, made an exclusive remedy, once it is invalidated by § 67c(1)(A), the seller is left without a remedy. I find the argument specious and the notion abhorrent to a court of equity. Surely § 2-702 must be read together and the last sentence of subsection (2) must be taken to mean that § 2-702 is the exclusive remedy if it survives attack by the trustee, and if invalidated by § 67c(1)(A) the seller is not to be deprived of any pre-Code remedy he may have had.¹¹⁶

In *In re Giltex*,¹¹⁷ the court followed Judge Herzog's reasoning.

Thus, by a kind of end run, two cases have permitted sellers to circumvent the many 2-702/Bankruptcy Act conflicts discussed above by allowing recourse to pre-Code fraud law where section 2-702 is invalidated in bankruptcy. Since this approach allows a reversion to nonuniform pre-Code remedies, it stands in ironic contrast to the fundamental proposition that article 2 of the Uniform Commercial Code was intended both to augment and to make uniform the various remedies available to aggrieved parties to a sales contract.¹¹⁸ Still, it is not clear whether this reasoning, if more widely accepted, would extend beyond the section 67c context to other bankruptcy provisions. Also, the view of section 2-702(2)'s exclusivity provision taken in the *Wetson's* case is, to say the least, uncertain.¹¹⁹ Moreover, the reclaiming seller's problems in proving common law fraud are likely to exceed his evidentiary difficulties under section 2-702,¹²⁰ although, if he can prove fraud, he could almost always triumph over the trustee.¹²¹ All things considered, it would seem that reclaiming credit sellers would be well advised to include a common law fraud count in their reclamation petitions.

V. *In re Federal's, Inc.*

A. *Before the Bankruptcy Judge*

While the facts giving rise to the *Federal's* litigation are fairly simple, they present the basic situation common to almost all of the cases involving the bankruptcy implications of section 2-702. On August 10, 1972, the Matsushita Electric Corporation ("Panasonic") sold and delivered electronic equipment to Federal's, Inc. ("Federal's"), a Michigan corporation, the sale being on a credit basis. On

116. *In re Wetson's Corp.*, 17 U.C.C. Rep. Serv. 423, 429 (S.D.N.Y. 1975) (footnote omitted).

117. 17 U.C.C. Rep. Serv. 887 (S.D.N.Y. 1975).

118. See, e.g., U.C.C. §§ 1-102(2), 2-703, Comment 1.

119. See *In re Goodson Steel Corp.*, 10 U.C.C. Rep. Serv. 387, 392 (S.D. Tex. 1968).

120. See notes 19-28 *supra* and accompanying text.

121. See note 18 *supra* and accompanying text.

August 16, Federal's filed a petition under Chapter XI of the Bankruptcy Act, and a receiver was appointed. Two days later, Panasonic demanded return of the equipment by letters and telegrams sent to Federal's and to its receiver. The goods, however, were not returned, and Panasonic then initiated a reclamation petition before Bankruptcy Judge George Brody.¹²²

Since the procedural requisites for utilizing section 2-702 were met, stipulated, or reserved,¹²³ the basic questions confronted by Judge Brody's opinion involved that section's interaction with sections 70(c), 64(a), and 67c of the Bankruptcy Act. With respect to section 70(c), Judge Brody expressed a personal preference for subordinating the seller to the lien creditor-trustee via section 2-702(3)'s "lien creditor" language,¹²⁴ but felt constrained to follow the Sixth Circuit's decision in *In re Mel Golde Shoes, Inc.*,¹²⁵ which compelled a reference to common law to determine the priority as between seller and lien creditor.¹²⁶ In looking to pre-Code law, however, he discussed decisions dealing only with the relative rights of the defrauded seller and the trustee *qua* representative of the debtor,¹²⁷ and not, as required by section 70(c), the relative rights of seller and *lien creditor*.¹²⁸ On the basis of these decisions, he concluded that, assuming insolvency upon receipt of the goods, Panasonic's petition would have to be granted were section 70(c) the only relevant bankruptcy provision.¹²⁹

However, Judge Brody then went on to consider section 2-702's status with respect to sections 64(a) and 67c(1)(A) of the Bankruptcy Act.¹³⁰ He reviewed the 1938 amendment to section 64(a) which removed state-created priorities from recognition in bankruptcy¹³¹ and concluded that Panasonic's claim would be defeated by that section,

122. *In re Federal's Inc.*, 12 U.C.C. Rep. Serv. 1142 (E.D. Mich. 1973), *aff'd*, 402 F. Supp. 1357 (E.D. Mich. 1975), *rev'd*, 553 F.2d 509 (6th Cir. 1977).

123. Panasonic clearly did make a sufficient demand for the goods within ten days of their receipt. In addition, the parties agreed to reserve the factual question whether Federal's received the goods while insolvent, although it would seem likely that Federal's did do so. *See* U.C.C. § 1-201(23). Also, Panasonic stipulated that Federal's intended to pay for the goods. *See* 12 U.C.C. Rep. Serv. at 1144. *See generally* notes 36-42 *supra* and accompanying text.

124. *See* note 82 *supra* and accompanying text.

125. 403 F.2d 658 (6th Cir. 1968).

126. 12 U.C.C. Rep. Serv. at 1144-49, especially at 1148; *see* note 80 *supra* and accompanying text.

127. That is, Judge Brody discussed only cases decided under Bankruptcy Act sections other than § 70(c). *See* 12 U.C.C. Rep. Serv. at 1150.

128. *Id.* at 1148.

129. *Id.*

130. *See generally* notes 83-112 *supra* and accompanying text.

131. *See* notes 96, 108-09 *supra* and accompanying text.

since "[s]ection 2.702 . . . read literally and practically gives to a specified class of creditors a priority over general creditors upon the insolvency of a debtor [and] confers upon a specified class of creditors 'preferential treatment as against the buyer's other creditors.'"¹³² In so doing, he made a special note of the close practical relationship between the bankruptcy petition and the reclamation petition in this and many other such cases.¹³³ In construing section 67c(1)(A), Judge Brody relied on two civil code cases¹³⁴ with statutory language somewhat similar to that of section 2-702(2). After noting that "[w]hether a given statutory enactment confers lien rights is to be determined by the practical effect of such legislation and not merely by reference to the terminology employed," he concluded that "[t]he right to reclaim conferred by § 2.702(2) realistically viewed is a statutory lien" ineffective in bankruptcy.¹³⁵

In Judge Brody's view, the effect of section 2-702's conflict with Bankruptcy Act sections 64(a) and 67c(1)(A) was to render that section totally inoperative in bankruptcy.¹³⁶ Perhaps for this reason, he circumvented 2-702's express exclusion of the common law fraud remedy¹³⁷ in stating that, since the Code was not applicable, Panasonic would have recourse to that remedy.¹³⁸ However, since pre-Code Michigan law required the buyer's intent to defraud, and since Panasonic stipulated that Federal's had intended to pay for the goods,¹³⁹ this option was disallowed, and Panasonic's reclamation petition was denied.¹⁴⁰

132. 12 U.C.C. Rep. Serv. at 1151-52 (quoting U.C.C. § 2-702, Comment 3).

133. "The event that generally triggers the demand for reclamation is the filing of a petition in bankruptcy. In all but one of the reclamation petitions filed in this case the demand for reclamation was not made until after the filing of the petition in bankruptcy." *Id.* at 1152 n.22. There were approximately 56 such petitions filed in the Federal's proceedings. *Id.* at 1144 n.3.

134. *In re J.R. Nieves & Co.*, 446 F.2d 188 (1st Cir. 1971) (Puerto Rico law); *In re Trahan*, 283 F. Supp. 620 (W.D. La.), *aff'd*, 402 F.2d 796 (5th Cir. 1968), *cert. denied*, 394 U.S. 930 (1969).

135. 12 U.C.C. Rep. Serv. at 1153.

136. "The Constitution of the United States confers upon Congress the right to establish Uniform Laws on the Subject of Bankruptcy. A State therefore is without power to 'pass or enforce laws to interfere with or complement the Bankruptcy Act, or to provide additional or auxiliary regulations.' If § 2.702 does therefore in fact conflict with the scheme of distribution prescribed by the Bankruptcy Act it can have no operative effect in a bankruptcy proceeding." *Id.* at 1151 (citations omitted).

137. "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." U.C.C. § 2-702(2). In fact, Judge Brody simply did not discuss this language.

138. See 12 U.C.C. Rep. Serv. at 1153. See also notes 113-21 *supra* and accompanying text.

139. See note 123 *supra*.

140. 12 U.C.C. Rep. Serv. at 1153.

B. *In the District Court*

On appeal to the District Court for the Eastern District of Michigan, the Bankruptcy Court decision favoring the receiver was affirmed,¹⁴¹ although the district court opinion presented significant departures from that of Judge Brody. On the 70(c) question, the district court, like Judge Brody, felt constrained to follow *Mel Golde*, but emphatically disagreed with his discussion of pre-Code Michigan law.¹⁴² After correctly noting that the decisions employed by Judge Brody did not involve the competing rights of defrauded seller and lien creditor as required by section 70(c), it declared itself unable to find any Michigan cases dealing with this precise point.¹⁴³ As a result, the district court felt constrained to examine Michigan decisions involving the competing rights of a defrauded seller and a chattel mortgagee of the buyer, noting that in such cases the chattel mortgagee who gave fresh consideration for a mortgage securing a preexisting debt and who acted in good faith reliance on the buyer's ostensible ownership of the goods would typically triumph over the seller.¹⁴⁴ It then attempted to draw an analogy between this situation and that of the lien creditor:

From the distinction . . . between the rights of one who takes a mortgage for an antecedent debt, and a mortgagee who gives fresh consideration, it seems most probable that the Michigan court would likewise have held that the rights of an attachment lien creditor, whose lien secured credit extended *after* the delivery of certain goods, were superior to a reclaiming seller whose demand for the goods followed the creditor's attachment of those goods by legal process. In such a situation the lien creditor may well have relied upon his debtor's ostensible ownership of the goods in making the loan. If his levy or attachment precedes the seller's demand for return of the goods, it is the lien creditor who has been the more diligent of the two and he should prevail.¹⁴⁵

Having thus established to its satisfaction that a lien creditor who extended credit (*i.e.*, gave value) *after* the transfer of the goods to the buyer but *before* the defrauded seller's attempt at reclamation would

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

142. *See id.* at 1359. However, the court, like Judge Brody, did express its preference for subordinating the seller to the lien creditor via 2-702(3). *Id.* at 1359-60 n.1.

143. *Id.* at 1359-60.

144. *Id.* at 1360-61. This is basically an application of the pre-Code rules regarding the relative rights of a defrauded seller and a good faith purchaser for value. Under these rules, a secured party (who was treated like a good faith purchaser for this purpose) was required to give some sort of new consideration (*i.e.*, value) in exchange for the security obtained from the buyer to cover a preexisting debt. *See, e.g.*, Vold, *supra* note 14, §§ 75-76, at 379-84.

145. 402 F. Supp. at 1360-61.

defeat the seller under Michigan pre-Code law,¹⁴⁶ the court was forced to consider "when this hypothetical creditor [created by section 70(c)] must have extended to the bankrupt the credit which his lien secures"¹⁴⁷ in order to determine the trustee's status as against Panasonic. Relying on a decision¹⁴⁸ allegedly establishing that "the hypothetical lien creditor must be viewed to have extended the credit and secured his lien as of the date of the filing of the petition in bankruptcy,"¹⁴⁹ the district court reversed Judge Brody's decision on the 70(c) question, finding for the lien creditor/trustee:

In this case Federal's petition in bankruptcy was filed before Panasonic's demand and thus . . . the receiver must be viewed as an "intervening" lien creditor, i.e. one who extended credit and secured his lien between delivery and demand for reclamation. Because this Court has determined that the Michigan courts would have found an intervening lien creditor to have rights and equities superior to those of a reclaiming seller, Panasonic's reclamation petition in bankruptcy must be denied.¹⁵⁰

On the section 64(a) and 67c questions, however, the district court sided with Judge Brody, thus affirming his overall decision and finding for the trustee on three more or less independent bases. Significant in the resolution of both these questions was Panasonic's claim that section 2-702(2) was basically a reenactment of the common law remedy of rescission for fraud, and thus neither a true priority nor a "solely statutory" lien.¹⁵¹ However, since "at common law, there are no reported cases which hold that the mere receipt of goods by an insolvent, without more, was a fraud entitling the seller to rescind and reclaim, [the district court concluded that] § 2-702 must be regarded as a substantive change in the law of fraud and commercial transactions."¹⁵² With respect to the section 64(a) question, this enabled the court to conclude that "the equities which supported reclamation for fraud from the buyer's trustee at common law do not spring from the objective standards of § 2-702."¹⁵³ On the section 67c point, the court used this difference to justify its conclusion that section 2-702(2) was

146. The court also attempted to utilize U.C.C. § 2-326 by analogy to support this conclusion. *See id.* at 1361-62. *See also* note 82 *supra*.

147. 402 F. Supp. at 1362.

148. *Lewis v. Manufacturers Nat'l Bank*, 364 U.S. 603 (1961), *aff'g In re Alikasovich*, 275 F.2d 454 (6th Cir. 1960). *See also* notes 63-67 *supra* and accompanying text.

149. 402 F. Supp. at 1363.

150. *Id.* (footnote omitted).

151. *See* notes 52-59, 86-90, 110-12 *supra* and accompanying text.

152. 402 F. Supp. at 1365.

153. *Id.* at 1367.

not simply a reenactment of the common law remedy and was thus "a statutory creation."¹⁵⁴

In addition, the court addressed a number of other issues in reaching its conclusion on the 64(a) and 67c questions. With respect to the former, Panasonic had argued that the section 2-702(2) reclamation right differed from a priority in three respects: 1) it is asserted only against the insolvent buyer, while a priority is asserted against all creditors of the bankrupt; 2) it relates only to specific goods—those conveyed by the seller—while a priority applies to all of the buyer's assets; and 3) it arises independently of bankruptcy, while a priority is effective only upon institution of insolvency proceedings.¹⁵⁵ In response to all of this, the court reasoned as follows:

When viewed in the actual context of bankruptcy administration these distinctions are quite unpersuasive. It must be realized that all of a bankrupt's unsecured creditors (of which any reclaiming sellers are a part) are competing for a pro-rata share of the fund, if any, remaining after the satisfaction of all valid liens and § 64 priorities. If reclamation is permitted in bankruptcy it will reduce the bankrupt's estate at the obvious expense of all other unsecured creditors who do not enjoy the same standing to assert their claim by accident of the fact that the value which they extended to the bankrupt was something other than goods. Thus, reclamation clearly has the effect of a priority in the distribution of the bankrupt's assets as of the date of bankruptcy. As for Panasonic's third distinction, it is, of course, recognized that a seller's rights under § 2-702 may exist independent of proceedings in bankruptcy. However, here we are only concerned with the validity of § 2-702 within the context of bankruptcy.¹⁵⁶

With respect to Panasonic's last suggested distinction, the court also reemphasized Judge Brody's point that, practically speaking, the bankruptcy petition and the demand for goods are obviously closely related.¹⁵⁷

With regard to the section 67c question, Panasonic had also contended that, while the 2-702(2) remedy is expressly made exclusive,¹⁵⁸ a lienholder can also foreclose and obtain any balance between the security and the debt. In response to this, the court stressed the compensating "practical effect" of section 2-702 as a "powerful and effective security device" operating to the detriment of other creditors.¹⁵⁹ It also asserted that section 2-702 was the sort of state-created

154. *Id.*

155. *Id.* at 1366.

156. *Id.*

157. *Id.*; see notes 132-33 *supra* and accompanying text.

158. See note 93 *supra*.

159. 402 F. Supp. at 1367.

priority at which the 1938 amendments to the Bankruptcy Act were aimed.¹⁶⁰ Finally, the district court seemed tacitly to support Judge Brody's suggestion that section 2-702 was totally inoperative in bankruptcy and that the seller could thus attempt a reclamation based on common law fraud.¹⁶¹

C. In the Court of Appeals

The Sixth Circuit Court of Appeals reversed the district court's decision, and remanded *Federal's* for further proceedings consistent with its opinion.¹⁶² As was necessitated by the trustee's three-pronged claim, the circuit court decided contrary to the district court on each of the Bankruptcy Act questions presented.

On the section 70(c) issue the court of appeals once more applied *Mel Golde*, with its mandated reference to pre-Code state law to determine the relative rights of seller and lien creditor.¹⁶³ The court summarized the district court's reasoning on the question before it, and concluded that it was dissatisfied with the district court's approach on two allegedly independent grounds.¹⁶⁴ First, the Sixth Circuit rejected the district court's contention that the trustee could assume the position of a lien creditor who both extended credit *and* perfected his lien subsequent to the delivery of the goods but prior to the seller's demand for them.¹⁶⁵ Instead, it held that

the powers and rights of the hypothetical lien creditor under § 70c are . . . the powers of a creditor who obtains a lien upon the property of the debtor by legal or equitable proceedings at the date of bankruptcy, but they in no way elevate that status by any particular reference to the chronology of the underlying debt.¹⁶⁶

In so holding, the court relied principally upon its reading of the Supreme Court's decision in *Lewis v. Manufacturers National Bank*¹⁶⁷:

Under *Lewis* and by the terms of the statute, the lien creditor is deemed to have acquired that status "as of 'the date of bankruptcy'." It does not follow, however, that

160. *Id.* at 1367-68; see notes 108-09 *supra* and accompanying text.

161. This was not possible here because of the absence of the requisite intent to defraud. See 402 F. Supp. at 1363. See also notes 136-40 *supra* and accompanying text.

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

163. *Id.* at 511-12; see notes 80, 124-26, 142 *supra* and accompanying text.

164. 553 F.2d at 512-13. On the apparent intent to treat these two arguments as distinct bases for the decision, see *id.* at 513 ("it is in error in two respects") and *id.* at 514 ("Even if").

165. *Id.* at 513-14; see notes 147-50 *supra* and accompanying text.

166. 553 F.2d at 514.

167. 364 U.S. 603 (1961); see note 148 *supra* and accompanying text.

the underlying debt which may have furnished the basis for the hypothetical lien must also have been created precisely at that time, or at any other particular time. The prohibition in *Lewis* of the imaginary extension of credit at a *definite* time that accords a substantive right prior to the date of bankruptcy should not be construed as affecting the basic assumption that a trustee's lien is based on antecedent debt extended an *indeterminate* time prior to the date of bankruptcy.¹⁶⁸

In so holding, the Sixth Circuit also tacitly declared itself in conflict with the reading of section 70(c) implicitly adopted by the Third Circuit's 1960 *Kravitz* decision.¹⁶⁹

The court of appeals then went on to attack the district court's analysis of pre-Code Michigan law, but seemed to do so on the assumption that its interpretation of section 70(c) was sufficient by itself. The circuit court stated that, with one possible exception, the cases cited by the lower court involved consensual, rather than judicial, liens, and that section "70(c) requires us to look to the assumed powers of the trustee based on liens obtained by legal proceedings, not liens obtained consensually."¹⁷⁰ It then cited some general authority to

168. 553 F.2d at 514. The court also mentioned a proposed 1956 amendment by the National Bankruptcy Conference which would have had the same effect, but whose necessity was obviated by *Lewis*. See *id.*

169. *Id.* See generally notes 68-75 *supra* and accompanying text. Although *Kravitz* did not discuss the question in any detail, the pre-Code Pennsylvania cases on which it relied to support the lien creditor-trustee's triumph over the seller clearly adopted the view that an attaching creditor who had extended credit after the transfer of the goods was to be treated like a good faith purchaser for value, and could thus reclaim the goods as against the defrauded seller. See *Schwartz v. McCloskey*, 156 Pa. 258, 263-64, 27 A. 300, 301-02 (1893); *Smith v. Smith, Murphy & Co.*, 21 Pa. 367, 373 (1853); *Mann v. Salsberg*, 17 Pa. Super. 280, 285 (1901). This seems to have been based on the creditor's right to rely on the buyer's apparent absolute ownership of the goods. See *Schwartz v. McCloskey*, 156 Pa. 258, 263-64, 27 A. 300, 301-02 (1893). Thus, the *Kravitz* decision necessarily rested on assumptions as to the meaning of § 70(c) basically similar to those of the district court in *Federal's*, although it did not discuss the question in the same fashion. Of course, *Kravitz* did predate the Supreme Court's *Lewis* decision. In addition, the Pennsylvania pre-Code rule on the relative rights of defrauded seller and attaching creditor seems to be a minority position. See note 185 *infra*.

Also, assuming the correctness of the district court's view of pre-Code Michigan Law (as the circuit court, of course, did not), it is difficult to see how the Sixth Circuit's interpretation of § 70(c) can, by itself, justify the result it reached. If the trustee's powers under § 70(c) are merely those of a hypothetical creditor who obtains his lien upon the date of bankruptcy and who may have extended credit to the buyer at any time (or at no time) prior to that date, it is simply impossible to determine the relative rights of the seller and such a creditor. According to the district court's analysis, such a creditor would clearly have defeated the seller if he extended credit after the transfer of the goods, but quite possibly would not have so triumphed had he extended credit before that transfer. In order to answer the priority question, the trustee simply must assert the status of *one* of these hypothetical creditors, but the Sixth Circuit's reading of § 70(c) makes it impossible for him to do so.

170. 553 F.2d at 515.

the effect that a levy of execution conveyed to the creditor only such title as was possessed by the debtor.¹⁷¹ Since a buyer taking by fraud is universally assumed to take only voidable title,¹⁷² this is of course sufficient to support the court's contention that the defrauded seller could reclaim the goods against the lien creditor-trustee, and that Panasonic's claim was thus valid under section 70(c). Finally, it should be noted that this line of reasoning by itself supports the court's ultimate conclusion; in fact, it negates the need for its argument regarding the interpretation of section 70(c).

In its relatively brief discussion of the section 67c question, the Sixth Circuit utilized two basic arguments in holding that section 2-702(2) is not a statutory lien invalidated in bankruptcy. First, while conceding that section "2-702 is more than a mere codification of common law," it stated that "[b]ecause that right conceptually has its antecedents in the historical and equitable right of a defrauded seller to reclaim the goods he has sold to an insolvent buyer, we hold it cannot be said to arise 'solely by force of statute.'" ¹⁷³ Secondly, it emphasized the "total lack of reference to § 2-702 in the legislative history of the 1966 amendments"¹⁷⁴ to section 67c, arguing:

So extensive a provision of state law would hardly escape notice if it were one of the legitimate targets of the amendment. We attribute this absence of reference not to oversight, but to the more likely explanation that the Congress viewed the Code provision as did its authors: a basic updating of the equitable remedies of rescission.

The development of the Uniform Commercial Code, and its universal acceptance marks this provision as anything but spurious. The Code represents the combined empirical judgment of 49 states of the Union that the irrebuttable presumption of fraud in § 2-702(2) conforms to the experience in the majority of cases The Code is far more than a spurious state law created by special interests for their own special protection.¹⁷⁵

The court was similarly brief in disposing of the trustee's section 64(a) claim. Once more it stressed the common law genesis of section 2-702, stating that "the rights reserved to the defrauded seller under that section are the direct descendants of those historically preserved under the common law and so respected by the Bankruptcy Act."¹⁷⁶ Also, it maintained that the section 2-702(2) right is a right to particular goods.

171. *Id.*

172. *See* notes 14-17 *supra* and accompanying text.

173. 553 F.2d at 516 (footnote omitted). For the text of § 1(29a) of the Bankruptcy Act, which defines the term "statutory lien," see text accompanying note 87 *supra*.

174. 553 F.2d at 516; *see* notes 99-101 *supra* and accompanying text.

175. 553 F.2d at 516-17 (footnote omitted).

176. *Id.* at 518.

Thus, it is unlike a priority, which "contemplates a claim which is satisfied from the *general assets* of the bankrupt's estate and is asserted after the satisfaction of secured liens but before the debts of general creditors [and which] should not depend for its existence upon the contingency of whether specific assets are within the bankrupt's estate."¹⁷⁷ To the district court's contention that this argument involved form more than substance and obviously worked to the disadvantage of general creditors,¹⁷⁸ the court of appeals simply responded that this disadvantage inheres in all successful reclamation petitions.¹⁷⁹

VI. IMPLICATIONS

A. Section 70(c)

Despite the considerable attention it devoted to the section 70(c) issue, the Sixth Circuit's *Federal's* decision will probably be least significant with respect to that question. While its basic holding that resolution of the priority question demands a return to common law¹⁸⁰ is in accord with other circuit court decisions,¹⁸¹ and might tend to counteract a trend toward utilization of section 2-702(3) by some bankruptcy referees,¹⁸² in so holding the court was only following the Sixth Circuit rule formerly announced in *Mel Golde*. Moreover, because of its conclusion that pre-Code Michigan law actually followed the general rule favoring the defrauded seller over the lien creditor,¹⁸³ its labored discussion of *Lewis* and the proper interpretation of section 70(c)¹⁸⁴ will probably not produce many repercussions.¹⁸⁵ Finally, the

177. *Id.*

178. See note 156 *supra* and accompanying text.

179. 553 F.2d at 518.

180. See note 163 *supra* and accompanying text.

181. See *In re Mel Golde Shoes, Inc.*, 403 F.2d 658 (6th Cir. 1968); *In re Kravitz*, 278 F.2d 820 (3d Cir. 1960).

182. This return to the common law will generally mean that the seller who meets the requirements of § 2-702 will triumph over the trustee. See notes 81-82 *supra* and accompanying text.

183. See notes 170-72 *supra* and accompanying text. See also note 185 *infra*.

184. See notes 165-69 *supra* and accompanying text.

185. However, the court's reading of the *Lewis* decision could, if generally accepted, make it impossible for the trustee to defeat the seller in the few states allowing the lien creditor to triumph at common law, at least to the extent that such states rely on good faith purchaser-type "chronology of the debt" distinctions to do so. See notes 144-45, 169 *supra* and accompanying text. It remains to be seen whether its refusal to look to this chronology for § 70(c) purposes will be generally accepted, and, in any event, *Kravitz* still tacitly points the other way. See *id.* As just suggested, though, this whole question is probably rendered moot by the nearly unanimous common law view that the lien creditor should not be given good faith purchaser status and

Federal's decision obviously can do nothing to counteract the uncertainty in those states that have struck the "lien creditor" language from section 2-702(3).¹⁸⁶

B. *Sections 67c and 64(a)*

Although the court devoted somewhat less attention to the 67c and 64(a) questions, the impact of its decision may well be greatest in these areas. After the *Federal's* decision, the only two circuit court cases to consider these issues have ruled in favor of the section 2-702 seller.¹⁸⁷ Both decisions relied heavily on the generally persuasive theme of section 2-702(2)'s close relationship with the common law remedy of rescission for fraud, which traditionally was never confused with a statutory lien or a state-created priority. In addition, the *Federal's* court gave considerable attention to the rather glaring omission of any mention of section 2-702 from the legislative history accompanying the 1967 amendments to section 67c. The 67c and 64(a) questions have always had the air of bankruptcy referee-designed contrivances for avoiding the pro-seller implications of *Kravitz*,¹⁸⁸ and the Sixth Circuit's general disregard of the strained technicalities often employed by such forums could perhaps work decisively to diminish their influence.

In conclusion, despite possible reservations, the Sixth Circuit's *Federal's* decision is on the whole quite defensible, and almost certainly

should not defeat the defrauded seller. See J. Benjamin, *Law of Sales of Personal Property*, 477-78 (7th Am. ed. 1899); F. Burdick, *Law of Sales* 205 (3d ed. 1913); 2 F. Mechem, *Law of Sales* § 924 (1901); F. Tiffany, *Law of Sales* § 56, at 194 (2d ed. 1908); Vold, *supra* note 14, § 76, at 381. The basic reason for this view was that the attaching creditor gave no new value or consideration for his taking. Thus, good faith purchaser status being denied the lien creditor, he would lose to the defrauded seller because of the buyer's lack of full title. See notes 15-17 *supra* and accompanying text. It is perhaps not completely clear, however, whether this general rule was to apply to the lien creditor who took the goods on the basis of a debt incurred by, or credit extended to, the buyer after he fraudulently obtained them from the seller. See notes 144-45, 169 *supra* and accompanying text. The actual taking, of course, would never be accompanied by the giving of fresh consideration or value. The debt providing a basis for that taking would, however, typically have involved such consideration, and both the early Pennsylvania courts and the district court in *Federal's* seemed to regard the circumstances surrounding the creation of the obligation itself, and not those surrounding the subsequent attachment, as significant in determining whether a lien creditor should be regarded as a good faith purchaser for value entitled to recover as against the defrauded seller. See *id.*

186. See text accompanying note 83 *supra*.

187. See *In re Federal's, Inc.*, 553 F.2d 509 (6th Cir. 1977); *In re Telemart Enterprises, Inc.*, 524 F.2d 761 (9th Cir. 1975), *cert. denied*, 424 U.S. 969 (1976).

188. In *Kravitz*, of course, the trustee triumphed because of Pennsylvania's relatively unique common law rule. See notes 72-75, 169 *supra*. However, the *Kravitz* court's argument for recourse to common law would clearly favor the seller in most states. See notes 81, 185 *supra* and accompanying text.

will have some impact on the longstanding and variegated dispute regarding the relative rights of the section 2-702 seller and the bankruptcy trustee. As indicated, this influence is likely to be rather broad and diffuse, varying somewhat from issue to issue and context to context. But the *Federal's* decision is at least not likely to increase the prevailing confusion in the area, and may even work to reduce it to some degree. Unfortunately, this is not a claim which can be made for every decision affecting this troubled area of the law.