Marquette Law Review

Volume 43
Issue 4 *Spring 1960*

Article 8

Sales: Rights of Buyer's Judgement Creditors Under Fraudulent Bulk Sale

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RECENT DECISIONS

Sales: Rights of buyer's judgment creditors under a fraudulent bulk sale—An Illinois Corporation, Central Metallic Casket Co., physically transferred its assets to Wisconsin between May 20*th* and June 1*st* of 1955. The directors of the Wisconsin Corporation, who were the same as those of the Illinois Corporation, assumed all the debts and obligations of the Illinois Corporation. There was no compliance with the Bulk Sales Act of Illinois. The Wisconsin Corporation was forced into bankruptcy on April 3, 1956, following a petition filed against it by creditors of the Illinois Corporation. Plaintiffs, the creditors of the Illinois Corporation, claimed that the transfer to the Wisconsin Corporation was "void" as to them under the Bulk Sales Act. Therefore, the Wisconsin Corporation as transferee obtained no title to the property, and the trustee could obtain no lien against the property to which the bankrupt had no title.

The referee concluded that Illinois law governed, and that the Bulk Sales Act was not complied with. But this noncompliance made the transfer "voidable" rather than "void," and as the plaintiffs filed their claims against the Wisconsin Corporation, they waived their rights under the Bulk Sales Act, and are now estopped to assert a lien on the goods in the hands of the trustee, who is a hypothetical lien holder.

The District Court affirmed the referee.[1] It held that creditors of the fraudulent transferor do not have a lien, but a mere "inchoate right until asserted and ripened by appropriate judicial proceedings."[2] The Court then held that innocent creditors of a fraudulent grantee[3] who have levied on property before any action is taken by the creditors of the fraudulent grantor, have a superior right over the latter.

Even though the Bulk Sales Act uses the word "void" instead of "voidable," the Court following serevad New York decisions, held "void" in fraudulent conveyance statutes to mean "voidable," as any different holding would cause "a material variation in the rights of bona fide purchasers from a fraudulent grantee, under the Fraudulent Conveyance Act." Therefore, as the transfer was voidable, the plaintiff's rights were cut off by the rights of the trustee in bankruptcy as attaching lienholder.[5]

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[1] In Re Central Metallic Casket Co., 170 F. Supp. 320 (E. D. Wis. 1959).

[2] *Id.* at 324.

[3] Under Section 70 (c) of the Bankruptcy Act, Title 11 U.S.C.A. §110 (c) (1952), the trustee has the status of an attaching creditor without notice of an unrecorded prior lien.

[4] In Re Central Metallic Casket Co., *supra* note 1, at 326.

[5] The United States Court of Appeals, in affirming the decision of the District Court, did not deal with the issue presented in this article. The Court held that the physical transfer of the assets to Wisconsin was not the sale itself; the sale took place when the Wisconsin Corporation was formed, and therefore since this was a Wisconsin sale, the Wisconsin Bulk Sales Act should be applied. Under Wisconsin law, the Bulk Sales Act applies only to transfers

The rule layed down in the principal case is the rule applied generally to fraudulent conveyances.[6] This rule was first enunciated in *In Re Mullen,*[7] and a simple statement of the rule is found in *Brill v. Forshay:*

> Innocent creditors of a fraudulent grantee, who have acquired a lien and levied on property before any steps have been taken by the creditors of the fraudulent grantor will hold the property as against such other creditors though not as against prior lien creditors.[8]

The reasoning upon which this rule was based is that, as between the creditors of the fraudulent grantor and the innocent creditors of the grantee, the equities with resepect to the fraudulently conveyed property are equal; therefore, the first to perfect his lien should take precedence. Of course, where the creditors of the grantee had knowledge of the fraud, actual or constructive, they could not recover.[9] Also, some distinction appears to be made on whether or not the creditor had given fresh consideration in reliance on the grantee's apparent ownership of the property or is merely endeavoring to subject the property to a debt against him antedating the conveyance or otherwise not incurred in reliance on the apparent ownership of the property.[10] However, with these exceptions, the majority opinion seems to follow the rule stated above.[11]

The first application of the general rule of fraudulent conveyances to bulk sales transactions is found in *City of New York v. Johnson,*[12] upon which the District Court in the principal case relied so heavily. This case specifically applied the fraudulent conveyance doctrine to the grantee's attaching creditors under the Bulk Sales Act, in holding:

> We are referred to no authority and can see no reason for holding that the word "void" means more than "voidable" where the

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of property held for sale at retail, and therefore the case could easily be disposed of. In Re Central Metallic Casket Co., 273 F. 2d 506 (7th Cir. 1960).

[6] In Re Central Metallic Casket Co., *supra* note 1, at 324.

[7] In Re Mullen, 101 Fed. 413, 416, 417 (D.C. Cir. 1900).

[8] Brill v. Forshay, 65 F. 2d 420 (8th Cir. 1933).

[9] Wilkinson v. Livingston, 45 F. 2d 465 (8th Cir. 1930); Goldberg, B. and Co. v. Demick, 77 Cal. App. 535, 247 Pac. 261 (1926); Powell v. Ivey, 88 N.C. 256 (1883).

[10] Applegate v. Applegate, 107 Iowa 312, 78 N.W. 34 (1899); Hull v. Angster, 107 N.J. 454, 153 Atl. 93 (1931); Lowenthal v. Standard Oil Co., 114 N.J. 375, 168 Atl. 857 (1933). But see Manhattan Co. v. Evertson, 6 Paige (N.Y.) 457 (1837)) for case upholding grantee's creditor even though the claim against the property was based on an antecedent debt.

[11] 148 A.L.R. 521 (1944). For cases following majority rule, see: In Re Mullen, *supra* note 7, at 413; Brill v. Forshay, *supra* note 8, at 420; Standard National Bank v. Garfield National Bank, 67 N.Y.S. 472, 56 App. Div. 43 (1900); Booth v. Bunce, 24 N.Y. 592 (1862); Parker v. Freeman, 2 Tenn. Ch. 612 (1876). However, for cases *contra* the majority rule, see: Westervelt v. Hagge, 61 Neb. 647, 85 N.W. 852 (1901); Manhattan Co. v. Evertson, *supra* note 10, at 457.

[12] City of New York v. Johnson, 137 F. 2d 163 (2d Cir. 1943).

> remedies given by the Act are invoked, or that the consequences to a bona fide purchaser from a fraudulent grantee are materially different under the Bulk Sales Act from such consequences under the Fraudulent Conveyance Act.[13]

This language was relied on by a subsequent New York case,[14] and the principal case[15] in coming to their conclusion. The reason given in the *Johnson* case for applying the "fraudulent conveyance" rule to bulk sales transactions, as shown above, was that no "authority" or "reason" could be given for holding otherwise.

It appears to this writer, however, that there is both "authority" and "reason" for holding otherwise. In an early Texas case, *Midland Shoe Co. v. A. L. and K. Dry Goods Case.*,[16] the plaintiffs were creditors of the fraudulent grantee, who sold stock in trade in violation of the Bulk Sales Act, and the defendants were judgment creditors of the grantee. The court held that "the statute expressly provides that a bulk sale shall be 'void' as to creditors unless its provisions are complied with."[17] It was said that there can be no bona fide purchasers because the original transaction was void. Several other cases, decided before *New York v. Johnson,* agree with the *Midland Shoe Co.* case.[18] One of these,[19] in holding that a sale to a subsequent vendee was invalid as against attaching creditors of the bulk seller, stated, "The general policy and purpose of the Act [Bulk Sales Act], is to render the alleged sale null and void *ab initio* as against creditors of the seller."[20] Thus it can be seen that there was no lack of authority as stated in the *Johnson* case.

The *Johnson* case, and the cases which relied on it, held that a trustee in bankruptcy not only had the rights of an attaching creditor, but also that an attaching creditor had the rights of a "bona fide purchaser for value."[21] It has long been established that, even under the Bulk Sales Act, a "bona fide purchaser for value" takes as against creditors of the fraudulent grantor.[22] But the problem is that most

[13] *Id.* at 166, 167.
[14] In Re Vanity Fair Shoe Co., 84 F. Supp. 533 (S.D.N.Y. 1949), *affirmed,* Schwartz v. A. J. Armstrong Co., Inc., 179 F. 2d 766 (2d Cir. 1950).
[15] The identical language was used in In Re Central Metallic Casket Co., *supra* note 1, at 325-326.
[16] Midland Shoe Co. v. A. L. and K. Dry Goods Co., 281, S.W. 344 (Tex. Civ. App. 1926).
[17] *Id* at 345.
[18] Kett v. Masker, 86 N.J.L. 97, 90 Atl. 243 (1914); Sampsell v. Imperial Paper Co., 313 U.S. 215, (1941); Owosso Carriage and Sleigh Co. v. McIntosh & Warren, 107 Tex. 307, 179 S.W. 257 (1915).
[19] Kett v. Masker, *supra* note 18, at 245.
[20] *Id.* at 246.
[21] City of N.Y. v. Johnson, *supra* note 12, at 165. The Court did not hold a trustee in bankruptcy had the rights of a bona fide purchaser, but held a judgment creditor did.
[22] Prokopovitz v. Kurkowski, 170 Wis. 190, 174 N.W. 448 (1919); McKelvey v. Schapp, etc. Drug Co., 143 Ark. 477, 220 S.W. 827 (1920); Grove Mfg. Co. v. Salter, 26 Ga. App. 369, 106 S.E. 208 (1921); Kelley Buckley Co. v. Cohen,

courts hold that judgment creditors do not have the rights of "bona fide purchasers for value."[23]

At the present time, there appears to be a lack of agreement as to the legal status of bulk transfers made without compliance with statutory provisions.[24] The Uniform Fraudulent Conveyance Act nowhere contains the word "void,"[25] and therefore the transfer of the construction of this statute to bulk sales legislation is certainly not obvious. Even if the "fraudulent conveyance" rule were applied, not all of the transferor's judgment creditors would be protected.[26] And, as the trend of cases has been generally, to liberally construe bulk sales acts to protect creditors of the seller from illegal transfers,[27] it would also seem logical for the courts to construe the meaning of the Acts in this situation in favor of the transferor's creditor's.

The language and purpose of the Bulk Sales Act seem to be the persuasive factors in arguing that the general rule of fraudulent conveyances does not apply. The purpose of the Act is to protect the rights of creditors of vendors of property in the sale and transfer of personal property.[28] And it is certainly a possibility that by using the word "void," the lawmakers meant just that and not "voidable."

It seems to this author, that if the purpose of the Bulk Sales Act is to be carried out, the defrauded creditors of the seller should be given the fullest possible protection. This purpose, plus the strict wording of the Act itself, seems to require that innocent creditors of the bulk seller take precedence over innocent creditors of the bulk buyer, at least where the latter creditors did not give up fresh consideration in reliance on the apparent ownership of the property.

The Uniform Commercial Code deals more explicitly with the issue. Section 6-104 (1) states that ". . . a bulk transfer is *ineffective* against any creditor of the transferor unless . . ."[29] certain requirements are complied with. The word "ineffective," in itself, seems more ambiguous than the term "void" as used in most Bulk Sales Acts. However, two other sections seem to solve the problem. Section 6-111 requires action by the transferor's creditors within six months of the transfer unless there has been concealment,[30] and Section 6-110 (2) allows a good

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195 Mass. 585, 81 N.E. 297 (1907); Markarian v. Whitmarsh, 78 N.H. 1, 95 Atl. 788 (1915); WILLISTON, SALES, §643, at 1117 (1924).

[23] 148 A.L.R. 533-535 (1944). Couse v. Columbia Powder Mfg. Co., 33 Atl. 297 (N.J.Eq. 1895); Richardson v. Gerle 54 Atl. 438 (N.J. Eq. 1903); In Re Mullen, *supra* note 7, at 417.

[24] 65 HARV. L. REV. 418, at 432 (1952).

[25] UNIFORM FRAUDULENT CONVEYANCE ACT, Wis. Stat. Ch. 242 (1959).

[26] See footnote 10.

[27] 28 TEXAS L. REV. 989, at 991 (1959).

[28] Hanson v. Knutson, 182 Wis. 459, 196 N.W. 831 (1924).

[29] UNIFORM COMMERCIAL CODE, §6-104 (1).

[30] UNIFORM COMMERCIAL CODE, §6-111.

faith purchaser for value to take free of the defect.[31] The broad definition given to "purchasers" would probably include any type of creditors.[32] Therefore, under the Uniform Commercial Code, the principal case would probably have been decided the same way.

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Sales: Liability of a manufacturer of ingredient to another food processor based on breach of warranty of fitness for human consumption—Plaintiff biscuit company used snow ice to reduce the temperature of the dough in its preparation of frozen biscuits to be sold to the public. Shipments of ice were delivered each day by a distributor, Crossland Ice Service, from defendant ice company. The defendant placed the shipping tags on the bags of ice and knew the destination and that the ice would be used by the biscuit company for preparing food for human consumption. Glass was discovered in several of the bags of ice after some frozen biscuits had already been prepared with part of the ice shipment. Plaintiff destroyed all dough that had been prepared with that shipment of ice and, being uncertain as to which day's shipment of ice contained the glass, recalled and destroyed those biscuits already distributed that may have been contaminated by the glass.

At the trial in district court[1] the jury made several findings: that the ice contained glass when sold and delivered; that the defendant knew it was to be used in the preparation of food for human consumption; and that the plaintiff had been injured as a result of the contamination of the ice with glass. The jury determined damages using as a basis the cost of biscuit materials destroyed, and the cost of distribution and recall of the biscuits. Nevertheless, the court denied recovery n.o.v. holding that the remedy for breach of implied warranty of fitness for human consumption was available only to a consumer.

Held, reversed on appeal.[2] It was determined that a food processor who discovers that his product has been adulterated by a deleterious substance in one of the ingredients supplied by another manufacturer may recover from that manufacturer (although there is no privity or allegation of negligence) on the ground that there has been a breach of warranty of fitness for human consumption.

The court found that the ice, if not a food in the nutritive sense,

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[32] UNIFORM COMMERCIAL CODE, §1-201 (33), and §1-201 (34).
[31] UNIFORM COMMERCIAL CODE, §6-110 (2).
[1] Gladiola Biscuit Company v. Southern Ice Company, 163 F. Supp. 570 (E.D. Tex. 1958).
[2] Gladiola Biscuit Company v. Southern Ice Company, 267 F. 2d 138 (5th Cir. 1959).