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# 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

Morris G. Shanker

Under section 2-702 of the Uniform Commercial Code, a seller of goods to a buyer who was insolvent at the time of their receipt may reclaim them. To do so, the seller must make appropriate demand within ten days of the delivery.<sup>1</sup> A

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major legal controversy, however, has arisen regarding the power of a lien creditor or bankruptcy trustee to cut off the seller's reclamation right.<sup>2</sup> Seemingly, subsection 3 of section 2-702 gives that power to

the lien creditor. It states:

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) . . . . (Emphasis added.)

Indeed, in the now famous *Kravitz* case,<sup>3</sup> the Court of Appeals for the Third Circuit held that a trustee in bankruptcy who was recognized as a lien creditor, both by section 70(c) of the Bankruptcy Act and by section 9-301(3) of the Uniform Commercial Code, could defeat the seller's reclamation rights.

1. The ten-day limitation is not applicable where the buyer misrepresented his solvency in writing within three months before the delivery of the goods. UCC § 2-702(3).

2. Under UNIFORM COMMERCIAL CODE § 2-702(3), the lien creditor's rights (whatever they may be) are the same regardless whether the buyer misrepresented his solvency in writing, orally, or not at all. In the opinion of this writer, it was unfortunate that the Commercial Code did not seek to distinguish the various situations. In this writer's view, different underlying policy considerations may apply in each of these various situations.

Since most of the problems under UNIFORM COMMERCIAL CODE § 2-702 will probably arise from sellers seeking reclamation under the ten-day rule (no written misrepresentations involved), this article will be primarily directed to that situation.

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

Several leading commentators<sup>4</sup> have suggested that the decision in the *Kravitz* case is explainable only by reason of the peculiar Pennsylvania cases antedating the Commercial Code which had given to a lien creditor superior rights in goods delivered by a defrauded seller.<sup>5</sup> Accordingly, these commentators have concluded that the *Kravitz* case is not authority in other states which have enacted the Commercial Code for the proposition that a trustee in bankruptcy can invariably defeat the defrauded seller; that this will be true only in those very few jurisdictions, such as Pennsylvania, whose law prior to the Code favored a lien creditor over the defrauded seller. In all other jurisdictions whose pre-Code law was otherwise, the reclaiming seller would defeat the bankruptcy trustee.<sup>6</sup>

One of these commentators, Professor Hawkland, has gone much farther than merely writing an article. Fearful that the *Kravitz* case might be interpreted as standing for the proposition that a bankruptcy trustee invariably defeats the seller to an insolvent buyer in other states which have adopted the Commercial Code, a result which he concludes was never intended by the authors of the Commercial Code, Professor Hawkland has urged the New Jersey Legislature<sup>7</sup> to amend unilaterally section 2-702(3) by deleting the words "or lien creditor under this Article (Section 2-403)." He points out that Illinois has already taken this unilateral action.<sup>8</sup>

It should be noted that New Mexico<sup>9</sup> and New York<sup>10</sup> also have taken similar action. Further, proposals will apparently soon be made

4. 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); Kennedy, *The Trustee in Bankruptcy under the Uniform Commercial Code: Some Problems Suggested by Articles 2 and 9*, 14 RUTGERS L. REV. 518, 549-56 (1960). See also Note, *Bankruptcy: The Status and Rights of the Trustee under Section 70(c) of the Bankruptcy Act as against the Rights of a Defrauded Seller under Section 2-702(1)(b) of the Uniform Commercial Code: In the Matter of Kravitz*, 45 CORNELL L.Q. 566 (1959). *But cf.* MacLachlan, *Two Wrongs Make a Right*, 37 TEXAS L. REV. 676, 680 (1959); Williston, *The Law of Sales in the Proposed Uniform Commercial Code*, 63 HARV. L. REV. 561, 585 (1950).

5. *Schwartz v. McCloskey*, 156 Pa. 258, 27 Atl. 300 (1893); *Smith v. Smith*, 21 Pa. 367 (1853); *Mann v. Salsberg*, 17 Pa. Super. 280 (1901). The court did, in fact, cite these cases as a basis for its decision in the *Kravitz* case. The court then stated: "The Uniform Commercial Code does not change this [Pennsylvania] rule," citing UNIFORM COMMERCIAL CODE § 1-103 in support of this statement. *In re Kravitz*, 278 F.2d 820, 822 (3d Cir. 1960). This article will seek to show that the court's reliance on these pre-Code cases was unnecessary in light of the Commercial Code's express language and official commentary.

6. See Kennedy, *supra* note 4, at 552 n.144, where the author cites decisions in Maine, Massachusetts, and New Hampshire which followed the pre-Code Pennsylvania view. Professor Kennedy points out, however, that the overwhelming view in this country prior to the Commercial Code favored the defrauded seller over the lien creditor, and cites VOLD, SALES § 79 (2d ed. 1959), and Annot., 21 A.L.R. 1031, 1033 (1922). *Ibid.*

7. Professor Hawkland was the director of the New Jersey study of the Uniform Commercial Code.

8. See Hawkland, *supra* note 4, at 88 n.15.

9. N.M. STAT. ANN. § 50A-2-702(3) (1953).

10. N.Y. UNCONSOL. LAWS § 2-702(3) (McKinney 1962), *eff.* Sept. 27, 1964.

urging the American Law Institute and the Permanent Editorial Board of the Uniform Commercial Code<sup>11</sup> to recommend such an amendment to all other states which have enacted the Commercial Code or which are considering it for adoption.<sup>12</sup>

It is the purpose of this article to take issue with these commentators respecting their conclusion that the *Kravitz* decision depends solely on the peculiar Pennsylvania pre-Code law. It is this writer's opinion that the *Kravitz* decision is actually required by the language of the Commercial Code, that such language probably carries out the actual intention of the drafters of the Commercial Code, that a lien creditor or bankruptcy trustee should invariably defeat a seller's reclamation right under section 2-702, and that the result reached in *Kravitz* is the one that should be reached in all states which have enacted the official 1958 version of the Uniform Commercial Code.

Further, this article will also seek to show that the policy considerations favoring the lien creditor or bankruptcy trustee outweigh those in favor of the seller's rights to reclaim from an insolvent buyer. Thus, it is the opinion of this writer that the Illinois, New Mexico, and New York amendment to section 2-702(3) deleting the reference to "lien creditors" was unfortunate and that efforts to have other states accept a similar amendment should be defeated.

#### SOME TROUBLING PROBLEMS

The commentators who urge that the decision in the *Kravitz* case is explainable solely by reason of the Pennsylvania case law prior to the Code rather than by the language of the Commercial Code itself leave unanswered some troubling problems which must follow from this point of view.

The first such problem is that each state which has adopted the Uniform Commercial Code would, nonetheless, remain free to make its own determination respecting a lien creditor's rights as against a seller to an insolvent. Obviously, this will lead to lack of uniformity among the states in this area.

Non-uniformity was an anathema so far as the drafters of the Commercial Code were concerned. As stated officially in their opening comment: "Uniformity throughout American jurisdictions is one of the main objectives of this Code . . ." <sup>13</sup> Nor can it be doubted that the desire for uniformity was one of the primary objectives which motivated the various

11. [See also Braucher, *The Uniform Commercial Code — A Third Look?*, 14 W. REV. L. REV. 16 (1962), for a detailed discussion of this and other amendments which the Editorial Board is considering. — *Ed.*]

12. Personal communication from Professor Hawkland to this writer, dated May 31, 1962.

13. See *Uniform Commercial Code, 1958 Official Text* at 1.

state legislatures in adopting the Commercial Code. Indeed, section 1-102 (1)(c) expressly directs that the construction of the Commercial Code should be such as to "make uniform the law among various jurisdictions." It would seem mandatory, therefore, that an interpretation of section 2-702 which seeks to foster uniformity should be sought. Indeed, official comment 1 following section 1-102 of the Commercial Code states:

The Act should be construed in accordance with its underlying purposes and policies. The text of each section should be read in the light of the purpose and policy of the rule or principle in question, as also of the Act as a whole, and the application of the language should be construed narrowly or broadly, as the case may be, in conformity with the purposes and policies involved.

The second troubling problem arising from the commentators' interpretation of *Kravitz* is that article 2 of the Commercial Code is not a complete statement of the law of sales. Instead, some portions of the basic sales law must be found in sources beyond article 2 itself.

Again, the official commentary seems to suggest the contrary. By way of example, the official comments following the title to the Commercial Code read:

This Act purports to deal with *all* the phases which may ordinarily arise in the handling of a commercial transaction, from start to finish.<sup>14</sup> (Emphasis added.)

The official comment following section 2-101 reads as follows:

This Article is a *complete* revision and modernization of the Uniform Sales Act . . . .

The coverage of the present Article is *much more extensive* than that of the old Sales Act *and extends to various bodies of case law which have been developed both outside of and under the latter . . . .* (Emphasis added.)

In light of the above, one should be most cautious in urging that article 2 is not a complete statement of the law of sales,<sup>15</sup> particularly in the fairly common situation involving the rights of creditors versus the rights of sellers. Thus, if a reasonable solution for this problem can be found within the Commercial Code itself, clearly that is preferable than one found elsewhere.

What is more, the *Kravitz* interpretation suggested by the commentators seems to fly in the face of the express language of section 2-702(3) itself, which reads: "The seller's right to reclaim . . . is subject to the rights of a . . . lien creditor *under this Article*." The impact of the statutory language "*under this Article*" does not seem to have been satisfac-

14. *Id.* at 3.

15. See Note, 45 CORNELL L.Q., *supra* note 4, at 568 n.10.

torily dealt with by the commentators. Notwithstanding that this language seems to require the answers to be found in the sales article, the commentators, instead, have concluded that they may be found beyond it.

In other areas involving creditors' rights in "fraud" situations, the drafters of the Code have expressly stated where they intended the use of legal sources beyond the Code itself.<sup>16</sup> One wonders, then, why this was not also done in section 2-702(3) if, in fact, that was the true intention of the Code drafters.

Indeed, one may ask just why the words "lien creditor" were even used in section 2-702(3). Under the commentators' view of *Kravitz*, the lien creditor will be defeated in just about every jurisdiction in the United States.<sup>17</sup> If this were the true intention of the Code drafters, it seems strange that they would have, in section 2-702(3), expressly referred to lien creditor's rights which, from an overall national viewpoint, were non-existent.

Can an explanation for *Kravitz* be found within the Commercial Code which avoids the above troubling problems? The next portion of this article will analyze the statutory language and related official commentary to show that the answer is "yes."<sup>18</sup>

#### ANALYSIS OF STATUTORY LANGUAGE OF COMMERCIAL CODE AND RELATED OFFICIAL COMMENTARY

##### *Lien Creditors' Rights under Section 2-702*

The commentators seem to have overlooked the possibility that the rights of lien creditors may actually be found directly within section 2-702(3). Perhaps, understandably, the commentators have invariably read that section in the following fashion:

16. See UNIFORM COMMERCIAL CODE § 2-402(3) (b), dealing with the rights of creditors where goods are fraudulently retained by the buyer. This section expressly states that the fraud law "apart from this article" determines the creditor's rights in such a situation. (Emphasis added.)

17. See Kennedy, *supra* note 4, at 552 n.144; Note, 45 CORNELL L.Q., *supra* note 4, at 568.

18. The commentators claim that their conclusions are supported by the legislative history of UNIFORM COMMERCIAL CODE § 2-702(3). See Hawkland, *supra* note 4, at 88; Note, 45 CORNELL L.Q., *supra* note 4, at 569.

In particular, these commentators refer to a memorandum from Professor Llewellyn, the chief reporter for the Code, replying to certain questions raised by the Report and Memorandum of Task Group One of the Special Committee of the Commerce and Industry Association of New York Incorporated on the Uniform Commercial Code. See 1 1954 *State of New York Law Revision Commission Report, Hearings on the Uniform Commercial Code*, 106, 126. Even if such a memorandum may be considered valid legislative history, nothing contained therein indicates that Professor Llewellyn was directing his attention to the situation of a bankruptcy trustee obtaining a lien creditor's right by reason of bankruptcy intervening before the seller actually reclaimed the goods. On the contrary, his only reference to bankruptcy was directed to a question raised by the Task Force whether a seller who had reclaimed goods before bankruptcy might have to disgorge them as a preference in a later bankruptcy. See 1 1954 *State of New York Law Revision Commission Report, Hearings on the Uniform*

The seller's right to reclaim under subsection (2) is subject to the rights of a . . . lien creditor [*whose rights are found elsewhere*] under this Article (Section 2-403) . . . .

Under such a reading, the commentators then look for rights which may be given to a lien creditor under section 2-403. They claim to find none there, but, instead, only a confusing cross-reference to article 9. They, then, claim that article 9 can have no application to the situation of a "defrauded" seller. Ergo, neither article 9 nor article 2 are applicable; and one must, therefore, look to other sources, particularly the pre-Code case law, to solve the problem.<sup>19</sup>

Cannot section 2-702(3) also be read as follows:

The seller's right to reclaim under subsection (2) is subject to the rights of a . . . lien creditor [*whose definition is that found*] under this Article (Section 2-403) . . . .

Under this equally plausible reading of the statute, it is the *definition* of a "lien creditor" and not his rights which is found elsewhere in article 2, particularly in section 2-403. Then, the cross-reference by section 2-403 to article 9 becomes less confusing since article 9 clearly defines a lien creditor.<sup>20</sup>

The actual right of the lien creditor to defeat the seller's reclamation right, however, is given by the language of section 2-702(3), itself.<sup>21</sup> It is merely the definition of a lien creditor which is found elsewhere.

Such a view seems completely consistent with the language of section 2-702(3). Further, it obviates the serious problems which arise when one looks for lien creditors' rights in sources beyond the Code. Perhaps, it is the complete and simple solution to the knotty problem raised by the fact situation presented in *Kravitz*.

#### *Lien Creditors' Rights Under Section 2-326*

If the above solution is incorrect and one is required to find the basic rights of lien creditors elsewhere than in section 2-702, it does not follow that one must necessarily go beyond the Commercial Code to the case law to do so. Under this hypothesis, section 2-702(3) states that rights of lien creditors are those found "under this Article (Section 2-403)." The

*Commercial Code* 41. As such, it is doubtful that Professor Llewellyn's memorandum supports the commentators' view that a trustee in bankruptcy has no rights against the seller to the insolvent where the bankruptcy occurred before the seller's reclamation. Further, before looking to legislative history, interpretation of a statute should probably first be sought from the language of the statute itself, by applying the express rules of construction set out in the statute, and by referring to the official comments adopted for the express purpose of explaining the statute.

19. Kennedy, *supra* note 4, at 551; Note, 45 CORNELL L.Q., *supra* note 4, at 567.

20. Under UNIFORM COMMERCIAL CODE § 9-301(2), a "lien creditor" is defined as one who acquires a lien on property by attachment, levy, or the like and includes a representative of creditors, such as an assignee for the benefit of creditors, a trustee in bankruptcy, or a receiver in equity.

21. This view was apparently adopted by the district court in the *Kravitz* case. See Note, 45 CORNELL L.Q., *supra* note 4, at 567.

parenthetical reference "(Section 2-403)" is ambiguous. Does it limit one to section 2-403 in finding the rights of lien creditors? Or, does the parenthetical reference merely suggest section 2-403 as one section which may be consulted but yet leave one free to consult other sections of article 2 as well?

There seems no more reason to eliminate the word "Article" from section 2-702(3) than to eliminate the parenthetical clause "(Section 2-402)." If anything, the use of parenthesis around "(Section 2-403)" suggests that it is the subservient language and that the word "Article" is dominant. Thus, it seems likely that article 2 in its entirety is available in seeking the rights of a "lien creditor," and not merely section 2-403 alone. If so, section 2-326 deserves attention. That section contains four subsections. Only the first three, however, appear relevant to the problem of this article.

Subsection 1 of section 2-326 defines, *inter alia*, when goods delivered to a buyer are on "sale or return." Specifically, they will be on "sale or return" when (1) the goods are delivered primarily for resale and (2) the buyer may return them even though they conform to the contract.

Subsection 2 of section 2-326 then states that goods held on "sale or return" (as defined in subsection 1) are subject to the claims of the buyer's creditors so long as they remain in the buyer's possession.

Subsection 3 of section 2-326 is the crucial one for this discussion. It states that certain deliveries of goods are "deemed" sale and return transactions "*with respect to claims of creditors of the person conducting the business.*" (Emphasis added.) In other words, goods so delivered are subject to the claims of the buyer's creditors so long as they are in the buyer's possession. In order for a delivery of goods to be so "deemed" a sale or return transaction, two elements must co-exist: (1) the goods must be delivered to a person for sale, and (2) the person who receives the goods must maintain a place of business at which he deals in goods of this kind,<sup>22</sup> under a name other than the name of the person making the delivery.

It would appear that goods delivered by a seller to an insolvent buyer usually meet both of these conditions: (1) they are delivered to the buyer for sale, and (2) the buyer typically deals in goods of this kind in his own name. It would seem to follow, therefore, that such goods are subject to the claims of a lien creditor so long as they remain in the buyer's possession.<sup>23</sup> One commentator, Professor Kennedy, seems to concede

22. This condition probably limits the scope of UNIFORM COMMERCIAL CODE § 2-326(3) to the delivery of inventory items.

23. UNIFORM COMMERCIAL CODE § 2-326(3) would permit the seller to protect against creditors' claims by (1) filing under article 9, (2) proving that creditors knew that the buyer was dealing in the goods of others, or (3) complying with any local law permitting his interest to be evidenced by a sign.



that the language of subsection 3 of section 2-326 is sufficiently broad to cover goods delivered to an insolvent buyer. He states, however, that subsection 3 is not applicable to this problem because "the context makes clear that a 'sale or return' transaction occurs only if delivered goods may be returned by the buyer even though they conform to the contract."<sup>24</sup> He then points out that the insolvent buyer has no right to return the goods even though the seller may have the right to reclaim them.<sup>25</sup>

One may wonder whether clear statutory language can be so lightly brushed aside by a "context" argument. Further, does the "context" really support Professor Kennedy's view that goods delivered to an insolvent buyer are not covered by subsection 3 of section 2-326?

It is quite true that under subsection 1 of section 2-326, an *express* "sale or return" transaction arises where merchandise delivered for sale may be returned by the buyer even though they conform to the sales contract. Such *express* "sale or return" items are then made subject to claims of creditors by subsection 2.

Subsection 3, however, seems to sweep with a much broader brush. By its language, certain kinds of deliveries are made the *equivalent* of "sale or return" transactions. There is no hint in the statutory language that this equivalence depends upon the buyer's right of return. Unlike subsection 1, subsection 3 does not say that deliveries which fall within its terms are *express* "sale or return" merchandise which may be returned by the buyer. Subsection 3 merely states that where its conditions are met (apparently so in the case of goods delivered to an insolvent buyer), then such merchandise is *deemed* to be the equivalent of a "sale or return" situation only *for the purpose of determining the rights of creditors of the possessor*.

If subsection 3 had been intended to cover only "sale or return" goods as defined in subsection 1, then subsection 3 would merely be repetitious of subsection 1. It would serve no apparent useful purpose, since the rights of creditors to reach subsection 1 goods are completely covered by subsection 2. Instead, subsection 3 deliberately seems intended to cover deliveries beyond the *express* "sale or return" situation defined in subsection 1, so far as giving rights to creditors. Since goods delivered to an insolvent buyer meet the conditions of subsection 3, it follows that lien creditors<sup>26</sup> of the buyer may defeat the seller's reclamation right.<sup>27</sup>

24. Kennedy, *supra* note 4, at 518 n.137.

25. *Ibid.*

26. UNIFORM COMMERCIAL CODE § 2-326 only speaks of the rights of "creditors." However, the word "creditor" as used in the Commercial Code is defined to include a lien creditor. UCC § 1-201(12).

27. If this analysis is correct, do lien creditors still have the right to reach inventory items sold by a seller to an insolvent buyer even under the Illinois, New Mexico, and New York amendment deleting the "lien creditor" language from UNIFORM COMMERCIAL CODE §

*Lien Creditors' Rights under Section 2-403: The Lien Creditor  
as a Good Faith Purchaser*

If the parenthetical reference in section 2-702 limits the search for the lien creditor's rights solely to section 2-403<sup>28</sup> it would still seem to follow that the lien creditor would prevail over the seller to the insolvent buyer.

While section 2-403 does not itself expressly define the right of a lien creditor, it does specifically define the rights of a purchaser of goods. In particular, section 2-403 (1) states, *inter alia*: "a person with voidable title has power to transfer a good title to a good faith purchaser for value."

An insolvent buyer has traditionally been considered to have at least a "voidable" title to the goods.<sup>29</sup> Under the Commercial Code, a "purchaser" is defined as one who takes "by sale . . . *lien* . . . or any other voluntary transaction creating an interest in property."<sup>30</sup> "Value" is defined as acquiring rights "as security for . . . a pre-existing claim."<sup>31</sup>

In light of these definitions, one might make the interesting argument that a lien creditor is actually a good faith purchaser for value and thus obtains a good title under the express language of section 2-403. The argument would run that the lien creditor takes by "lien" when he levies upon the goods, and thus is a "purchaser" under section 1-201 (32). He gives "value" as defined by section 1-201 (44) (b) by obtaining the lien to secure his pre-existing judgment debt.

On the other hand, the final phrase contained in the Code's definition of a "purchaser"<sup>32</sup> shows an intent to cover only voluntary transfers of property and not the involuntary transfer brought about by a creditor's levy.<sup>33</sup> Further, the use of the conjunctive "and" in subsection 4 of sec-

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2-702(3)? UNIFORM COMMERCIAL CODE § 2-326 seems broad enough by itself to give the rights to lien creditors whether or not such lien creditors also have rights under UNIFORM COMMERCIAL CODE § 2-702.

28. This may be required under the Ohio version of the Commercial Code. Apparently, Ohio never adopted parenthetical references in its version of the Code. Instead, it eliminated the earlier word and adopted the parenthetical reference as the main body of the statute. Thus, the Ohio version of UNIFORM COMMERCIAL CODE § 2-702(3) is as follows: "The seller's right to reclaim under division (B) of this section is subject to the rights of a . . . lien creditor under section 1302.44 [UNIFORM COMMERCIAL CODE § 2-403] of the Revised Code." OHIO REV. CODE § 1302.76(C) (1962).

29. See 46 AM. JUR. *Sales* §§ 470-71 (1943).

30. UCC § 1-201 (32), (33), (Emphasis added.)

31. UCC § 1-201 (44) (b).

32. "Purchase includes taking by sale, discount, negotiation, mortgage, pledge, lien, issue, or reissue, gift or any other voluntary transaction creating an interest in property." UCC § 1-201 (32). (Emphasis added.)

33. Query, does a creditor who persuades his debtor to give a security interest to secure the payment of the debt become a "purchaser for value"? Under the Commercial Code definitions of "purchaser" and "value," it would seem rather clear that he does. UCC § 1-201 (33), (44).

tion 2-403<sup>34</sup> suggests that the rights of lien creditors as a class are to be distinguished for purposes of section 2-403 from those of "purchasers" of goods. Nonetheless, the possibility remains that a lien creditor is, in fact, a "purchaser for value" for purposes of section 2-403 and for that reason may defeat the seller's reclamation right.

*Lien Creditors' Rights under Article 9: The Seller's Reclamation Right as an Unperfected Security Interest*

If the lien creditor is not a "purchaser for value" under section 2-403, then that section cross-refers whatever right he may have to either article 9 (secured transactions), article 6 (bulk transfers), or article 7 (documents of title). Article 9 seems to be the only relevant article of the three in that it alone contains a reference to the rights of lien creditors. In particular, section 9-301(3) defines a "lien creditor" as one

. . . who has acquired a lien on the property involved by attachment, levy, or the like and includes an assignee for the benefit of creditors . . . , a trustee in bankruptcy . . . , or a receiver in equity . . . .

Under section 9-301(1)(b), such a lien creditor will defeat an unperfected security interest if he is without knowledge thereof.

This immediately raises the question whether the rights of a seller to recover goods from an insolvent buyer under section 2-702 are tantamount to a security interest. If so, it would follow that they may be defeated by a lien creditor prior to their being "perfected."

The commentators have been unwilling to equate the reclamation rights of the seller to an insolvent buyer with that of a security interest. Primarily, they argue that to do so would require a

. . . result [which] would in effect negate 2-701(1)(b) [now Uniform Commercial Code section 2-702(2),(3)] by requiring the seller to comply with formalities which by the very nature of the situation are not to be expected of him.<sup>35</sup>

In particular, the formality which the commentators find so burdensome is the requirement that the seller obtain and file a financing statement.<sup>36</sup>

These commentators have apparently overlooked that security interests under article 9 can be perfected not only by the filing of a financing statement but, also, by taking possession of the goods.<sup>37</sup> The implications of the seller taking possession of the goods will be discussed shortly.

34. "The rights of other purchasers of goods and of lien creditors are governed by the Articles on Secured Transactions (Article 9), Bulk Transfers (Article 6) and Documents of Title (Article 7)." UCC § 2-403(4). (Emphasis added.)

35. Note, 45 CORNELL L.Q., *supra* note 4, at 567.

36. Kennedy, *supra* note 4, at 551.

37. UCC § 9-302(1)(a).

First, however, it is necessary to determine whether the seller's reclamation rights under section 2-702 are, in fact, a security interest which must be "perfected" to protect against lien creditors.<sup>38</sup>

Section 9-113 is important in solving this problem, since it specifically deals with security interests arising under the sales article of which section 2-702 is a part. Official comment 1 following section 9-113 suggests that such sales article security interests arise from two kinds of situations: (1) where some section in the sales article specifically states or reserves a security interest,<sup>39</sup> or (2) where some section in article 2 gives to a seller rights "which are similar to those of secured party" under article 9, even though article 2 may not authorize the reservation of a security interest nor specifically describe those rights as a security interest. Specifically, the comments refer to the seller's rights of resale and stoppage under sections 2-703, 2-705, and 2-706 as rights equivalent to those of a secured party which fall in this second category.

The cross-references given in the comments are not exclusive but are intended only as examples of the kinds of situations meant to be covered.<sup>40</sup> Thus, the specific use of section 2-705 as an example of a right covered by section 9-113 because it is similar to the right of a secured party is particularly illuminating. Section 2-705 permits the seller to an insolvent buyer to stop delivery of such goods in transit. *Notice, that this is the very same seller who has the right to reclaim the goods under section 2-702.*

If the seller's right to stop goods in transit before delivery to an insolvent buyer is considered the equivalent of a secured party's rights under article 9, it is not a long step to say that this same seller's right to reclaim those goods under section 2-702 is also the equivalent of a security interest. Indeed, the seller's right of reclamation actually amounts to nothing more than (1) a right to repossess the goods, and (2) the right to retain them in satisfaction of the obligation existing between the seller and the buyer. These are substantially the same rights given to secured parties under article 9.<sup>41</sup> From the above, it would seem to follow that the seller's reclamation right under section 2-702 is the equiva-

38. If sales to an insolvent are covered by UNIFORM COMMERCIAL CODE § 2-326(3), then no problem arises. By the express language of this section, such goods are subject to the claims of creditors unless there is a filing under article 9 or some other authorized form of actual or constructive notice. See discussion in text at 98-100 *supra*.

39. Specifically, the official comments point to UNIFORM COMMERCIAL CODE § 2-401 (which limits to a security interest the retention or reservation by the seller of the title [property] in goods shipped or delivered to the buyer); and to UNIFORM COMMERCIAL CODE § 2-505 (dealing with a security interest arising upon a seller's shipment of goods under reservation.)

40. Note, 45 CORNELL L.Q., *supra* note 4, at 567 n.5.

41. UNIFORM COMMERCIAL CODE § 9-503 gives to the secured party the right to repossess goods after default, and UNIFORM COMMERCIAL CODE § 9-505 gives to the secured party the right to retain the goods, under certain circumstances, in satisfaction of the obligation.

lent of a security interest under article 9 and, therefore, expressly made subject to article 9 by section 9-113. To the extent that the seller's reclamation right (now equivalent to a security interest) is unperfected, it may be defeated by a lien creditor under section 9-301(1)(b).

One might argue that the section 2-702 equivalent security interest is a purchase money security interest in that the seller actually furnished the goods to the buyer. If so, under section 9-301(2), such a purchase money security interest will defeat a lien creditor if filed within ten days after the collateral comes into the possession of the buyer.

It is doubtful that the seller's reclamation rights under section 2-702 fall within the definition of a purchase-money security interest set out in section 9-107 as one "taken or retained by the seller of the collateral to secure all or part of its price."

First, one may question whether section 2-702 technically gives reclamation rights as "security" for the purchase price, even though the exercise of the reclamation right may discharge the obligation between the buyer and seller. Second, and perhaps more important, the words in section 9-107, "taken or retained by the seller," seem to require that the purchase money security interest be one created by the seller's actions. In a section 2-702 situation, the seller's reclamation rights arise not because the seller acted to create them. Rather, they arise by operation of law.

Even if this analysis is incorrect and the seller's reclamation right under section 2-702 may be considered a purchase money security interest as defined in section 9-107, practical considerations make it unlikely that this will ever be of much help to the seller. Under section 9-301(2), a ten-day grace period is allowed for filing the purchase money security interest. However, the purchase money security interest is not necessarily a perfected one during this ten-day period.<sup>42</sup>

The effect of section 9-301(2) merely is to permit a late filing which, if done, will defeat an intervening lien creditor. However, if the seller fails to file within the ten-day period, then whatever rights he might have obtained from section 9-301(2) will be lost. Practically, it seems unlikely that the seller could persuade his buyer to sign and deliver to him for filing a proper financing statement within the crucial ten-day grace period.

Section 9-113 will excuse the necessity of a formal security agreement and the filing of a financing statement to obtain perfection in all sales article security interests or their equivalents "so long as the debtor [in-

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42. See UNIFORM COMMERCIAL CODE § 9-302, which points out that a financing statement must be filed to obtain perfection in all cases other than those listed. Only purchase money security interests in farm equipment and consumer goods are perfected without filing.

solvent buyer in the section 2-702 situation] does not have or does not lawfully obtain possession of the goods."<sup>43</sup>

An argument may be made that the buyer's possession is, in fact, tainted by reason of his "fraud" in obtaining the goods. As such, he does not hold the goods lawfully, and the special provisions of section 9-113 apply, excusing the necessity for the usual formalities of a security agreement and the filing of a financing statement.<sup>44</sup>

This argument has plausibility. However, the goods were voluntarily and freely delivered to the buyer by the seller, and the buyer may continue to keep them until the seller formally takes action to reclaim them. As such, it seems likely that the buyer has lawfully obtained possession of the goods in the section 9-113 sense. If so, the formal requirements of article 9 must be complied with if the seller wishes to defeat lien creditors.

This does not mean that the section 2-702 seller is helpless unless his insolvent buyer is willing to sign a formal security agreement and financing statement. *It does mean that he must promptly obtain possession of the goods to defeat lien creditors.* Until such possession is obtained, the seller however, has nothing more than an unperfected security interest subject to defeat by a lien creditor under section 9-301(3).

When the seller obtains possession, it will serve a dual purpose. First, it will actually complete the reclamation rights given to him under section 2-702. Second, it will destroy the buyer's possession,<sup>45</sup> and, thereby, give to the seller the special rights under section 9-113 of a perfected article 2 security interest without the necessity of a formal security agreement or filed financing statement.<sup>46</sup>

Clearly, this approach puts a premium on prompt action by the seller when he learns of the buyer's insolvency. Failure by the seller to obtain possession of the goods gives rise to the possibility that reclamation rights will be defeated by intervening third parties, including lien creditors. But, then, should not the law insist that the seller move promptly to reclaim his goods when he learns of the buyer's insolvency; thereby eliminating the possibility that innocent third parties may rely on the apparent

43. The bracketed language does not appear in UNIFORM COMMERCIAL CODE § 9-113, but has been added for the purpose of clarification.

44. See Hogan, *The Marriage of Sales to Chattel Security in the Uniform Commercial Code: Massachusetts Variety*, 38 B.U.L. REV. 571, 579 (1918). See Note, 45 CORNELL L. Q., *supra* note 4, at 567 n.5, for a comment on Professor Hogan's viewpoint.

45. If the suit is one of replevin or attachment, the possession may actually be that of the sheriff or of the court. Nonetheless, it will no longer be that of the buyer.

46. It might also be urged that when the seller obtains possession of the goods, he will have a "perfected" security interest under UNIFORM COMMERCIAL CODE § 9-302(1)(a). However, even such a security interest must be supported by an underlying security agreement. UCC § 9-204(1). It is rare that the seller could show any such agreement with his buyer. Thus, the seller is more likely to rely on UNIFORM COMMERCIAL CODE § 9-113, which gives him perfection without a security agreement.

situation that the goods are owned by the buyer? To the extent that the seller does not do so, either because of negligence or because of actual ignorance of his rights, it is submitted that the Commercial Code gives priority to innocent third parties, including lien creditors, who obtained rights in the goods on the justifiable belief that they belonged to the buyer.

#### UNDERLYING POLICY CONSIDERATIONS

The above discussion has shown several methods of interpreting section 2-702 to favor a lien creditor (or the trustee in bankruptcy who has equivalent rights under section 70(c) of the Bankruptcy Act) over a seller's right to reclaim goods from an insolvent buyer. Each of these possibilities was based on the actual language of the Commercial Code itself. It was not necessary to go to sources beyond the Code which, of necessity, circumvent certain basic objectives of the Uniform Commercial Code and raise other troubling problems. Accordingly, it is felt that the interpretations suggested should be accepted in favor of these interpretations which must be supported by sources beyond the Commercial Code.<sup>47</sup>

A movement is now afoot, however, to delete the "lien creditor" language from section 2-702.<sup>48</sup> Thus, the next section of this article will consider the underlying policy considerations which came in conflict between a seller to an insolvent buyer and that buyer's lien creditors (or trustee in bankruptcy who has equivalent rights). It will seek to demonstrate that the policy considerations in favor of the lien creditor outweigh those of the seller. Thus, the analysis favoring the lien creditor which was developed in the previous section of this article is one which this writer believes was actually intended by the Code drafters. In any case, these policy considerations suggest that current attempts to eliminate the "lien creditor" language from section 2-702 are not well considered and should be defeated.

The underlying policy considerations which come in conflict between the seller of an insolvent buyer and that same buyer's lien creditors are probably the following.

The lien creditor urges that, while the goods are in the buyer's possession, he has no knowledge of the seller's special equities if, indeed, such equities exist at all. Goods apparently belonging to the buyer (as shown by his possession) and which the buyer may transfer or dispose of to third parties also ought to be subject to creditors' levies.

The seller's underlying policy argument is that his position should

47. See discussion in text, at 95 *supra*.

48. See discussion in text, at 94 *supra*.

be an exception to the general rule that persons selling on credit assume the risk of a buyer's solvency. In effect, the seller argues that he never was willing to undertake this particular risk. He had a right to assume that the buyer acted in good faith in purchasing the goods. Such good faith required that the buyer honestly believe that he could pay for the goods on the due date. If the buyer was insolvent at the time the goods were received, it is rather likely that this was not so.

It is pertinent to inquire whether either of these conflicting policy arguments find favor in the Commercial Code. In seeking this answer, the various situations under the Code (other than section 2-702) involving the right of lien creditors will be investigated.

Two sections of the Code at once come to mind.

(1) Under section 9-301(1)(b), a lien creditor without knowledge will defeat an unperfected security interest in the goods.<sup>49</sup>

(2) Under section 2-326, a lien creditor<sup>50</sup> will defeat the seller of merchandise delivered on "sale or return" unless: (a) the buyer has complied with applicable law authorizing a sign to be posted indicating the seller's rights, or (b) it is established that creditors knew that the buyer was known to be dealing in goods belonging to others, or (c) there was a filing under article 9 of the Code.

The above two situations clearly accept the policy arguments urged by the lien creditor, namely, that the lien creditor may rely upon the apparent ownership of goods by one who has possession of them and that this reliance may continue until the lien creditor has actual or constructive notice (by reason of a public filing or otherwise) of a third party's superior rights to the goods. That this was indeed intended as an underlying policy throughout the Code is suggested by official comment 2 following section 2-326. It states:

Pursuant to the *general policies of this Act* which require good faith not only between the parties to the sales contract, but as against interested third parties, subsection (3) resolves *all reasonable doubts as to the nature of the transaction in favor of the general creditors of the buyer . . . .* (Emphasis added.)

So far as the lien creditors are concerned, the goods delivered to an insolvent buyer appear to be no different than goods subject to an unperfected security interest or goods subject to an unpublicized sale or return transaction. In all three cases, goods are in the possession of the buyer, giving him the apparent ownership of them; the buyer has the

49. There is an exception to this rule for a ten-day period under UNIFORM COMMERCIAL CODE § 9-301(2) in favor of purchase money security interests. See note 66 *infra*.

50. UNIFORM COMMERCIAL CODE § 2-326 refers only to the rights of "creditors." However, "creditors" are defined by the Code to include a lien creditor. UCC § 1-201(12).



power to dispose of them to third parties;<sup>51</sup> and the lien creditor has no basis for knowing that some third party may claim superior rights in them.

If anything, it may be forcefully argued that the equities of the seller to an insolvent buyer to reclaim goods are substantially less than those of the secured party with an unperfected security interest or of the sale or return merchant who has failed to give actual or constructive notice of his rights. In the latter cases, the transferor of the goods was clearly unwilling to rely on the transferee's credit. Instead, the circumstances make clear that the transferor intended to have the security of the goods. Nonetheless, the transferor will lose that security to a lien creditor, at least until the transferor gives requisite notice (actual or constructive) of his rights to the goods.

On the other hand, the circumstances surrounding a credit sale make it clear that the seller intended to assume the risk of the buyer's insolvency.<sup>52</sup> The seller need not have relied upon the credit of the buyer. He might have demanded cash or security. If neither were forthcoming, the seller could have refused to sell.

Thus, two basic situations present themselves: (1) where the transferor of goods was unwilling to rely on the transferee's credit (the unperfected security interest and the unpublicized "sale or return" transaction), and (2) where the transferor voluntarily agreed to undertake a risk regarding his buyer's insolvency (the credit sale). If transferors can be defeated by lien creditors in the first situation, it is hard to understand why lien creditors should not prevail in the second situation with even more justification.

It is true that the seller to an insolvent does not have, at the inception of the transaction, the same opportunity to protect his interests by public filing or other requisite notice as did his brothers with an unpublicized sale or return transaction. The seller becomes aware of his predicament only when he learns of the buyer's insolvency. This is his first opportunity to take action to protect himself. By that time, the goods may be in the hands of the buyer and the rights of a third party may already have intervened.<sup>53</sup> Thus, if the seller's right to reclaim is to be at all meaningful, it might be argued that, of necessity, it must be superior to rights of, at least, some third parties.

However, is not the answer to this argument found in the willingness

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51. See UNIFORM COMMERCIAL CODE § 2-403, dealing with the power of a possessor of goods to dispose of them to third parties.

52. Professor Hawkland puts it this way: "In a credit economy, such as ours, sellers are expected to assume the risk that their buyers will remain solvent long enough to make payment." Hawkland, *supra* note 4, at 86.

53. If the seller learns of the buyer's insolvency before delivery of the goods, then the seller has the right to stop delivery under UNIFORM COMMERCIAL CODE § 2-705.

of the seller to deal on credit? Was not the risk of insolvency precisely the one which the credit-seller assumed when he entered into the transaction? When that risk materializes can he, therefore, complain that it materialized too late? If anything, should not this seller be grateful that the law permits him to circumvent the risk of the buyer's insolvency — the very risk which he voluntarily assumed — in at least some cases, namely, those where he acts *before* the rights of third parties have intervened?

Rights of lien creditors are also involved in another section of the Commercial Code, section 2-402. Analysis thereof also seems to support the view that the Code drafters were generally motivated by the lien creditor's policy argument that he may rely on the apparent ownership which possession of goods suggest.

Section 2-402 deals with the rights of the seller's creditors to sell goods which still remain in the seller's possession. In a sense, it is the counterpart of section 2-702,<sup>54</sup> the basic topic of this article, which deals with the right of the buyer's creditors to certain kinds of goods which are in the buyer's possession.

Section 2-402(1), however, parenthetically refers to section 2-502 and the two sections apparently must be read *in pari materia*. Under section 2-502, a buyer of goods identified to a sales contract may recover these goods from the possession of an insolvent seller if the seller became insolvent within ten days after receipt of the first installment on their price.<sup>55</sup> However, the buyer's right to recover goods from the possession of an insolvent seller is apparently limited by section 2-402(1). Under section 2-402(1), the buyer's right under section 2-502 to recover the goods seems to be superior only to the claims of the seller's "*unsecured creditors*."<sup>56</sup> Traditionally, a lien creditor is not considered to be an "unsecured creditor."<sup>57</sup> Thus, the implication is that the buyer's right to recover goods from the possession of an insolvent seller can be defeated by the seller's lien creditors who justifiably assumed that these goods yet belong to the seller.

Possibly, one might argue that the words "unsecured creditors" as used in section 2-402(1) mean all creditors except those with a security interest under article 9 of the Code. This is based on the Commercial

54. The dovetailing is far from exact. See Kennedy, *supra* note 4, at 557 n.173.

55. To do so, the buyer must keep open a tender of any unpaid portion of the purchase price.

56. The exact language is as follows: "Except as provided in subsections (2) and (3), rights of *unsecured creditors* of the seller with respect to goods which have been identified to a contract for sale are subject to the buyer's rights to recover the goods under this Article (Sections 2-502 and 2-716)." UCC § 2-402(1). (Emphasis added.)

57. *In re Wojciechowski*, 27 F. Supp. 104 (M.D. Pa. 1939). See also HANNA & MACLACHLAN, *CASES ON CREDITOR'S RIGHTS* 36 (5th ed. 1957), where the authors point out that an attorney's major purpose in obtaining a levy is to "transform his client from an unsecured to a secured creditor after the judgment."

Code's definition of a "creditor" found at section 1-201(12) to include general creditors, lien creditors, secured creditors, and any representative of creditors. Thus, it may be urged that the words "unsecured creditors" cover all these creditors (including the lien creditor) except the "secured creditor."

This argument may have some plausibility. However, if that were the result intended, it seems a rather strained way of accomplishing it.<sup>58</sup> Further, a secured creditor under the Code is probably one who obtains security by complying with article 9. However, the rights of such secured creditors under article 9 are expressly dealt with and preserved by subsection 3(a) of this same section 2-402. Thus, there would seem to be no need to preserve it again by subsection 1. The context would, therefore, seem to make likely that the words "unsecured creditors" in subsection 1(a) were used in their conventional sense;<sup>59</sup> that is, to cover only those creditors whose debts are not secured by some lien or security interest. A lien creditor is usually not considered to be in that category.

Undoubtedly, this conclusion will meet with considerable disagreement. Subsection 1 of section 2-402 was not part of the original version of the Commercial Code, but first appeared in the 1957 Official Edition. The Editorial Board which proposed the subsection stated:

At the suggestion of the New York [Law Revision] Commission, a new subsection (1) was inserted to subordinate the rights of the seller's *creditors* to the buyer's possessory remedies.<sup>60</sup> (Emphasis added.)

Thus, it will be urged that all creditors, including lien creditors, were meant to be included.<sup>61</sup>

However, the Editorial Board's choice of the word "creditors" is clearly at odds with the statutory language which subordinates the rights only of "*unsecured* creditors" to the buyer's possessory remedies under section 2-502. Further, it may be significant that while the official commentary following section 2-402 was revised to conform with the official 1957 version of it, the Editorial Board's language was not adopted.<sup>62</sup>

The official New York Law Revision Commission Report gives little assistance in determining whether it favored a policy that a lien

58. Compare the language in UNIFORM COMMERCIAL CODE § 2-402(1) with that used in UNIFORM COMMERCIAL CODE § 9-301(2). If the intention were actually to defeat lien creditors, UNIFORM COMMERCIAL CODE § 9-301(2) suggests that the Code drafters knew how to draft clear language to accomplish that result.

59. Under UNIFORM COMMERCIAL CODE § 1-201, the given definitions are applicable "*unless the context other wise requires. . .*" (Emphasis added.)

60. *1956 Recommendations of the Editorial Board for the Uniform Commercial Code*, 52 (1952).

61. See UNIFORM COMMERCIAL CODE § 1-201(12), which defines a "creditor" to include a lien creditor. See also note 50 *supra* and accompanying text.

62. The official comment to UNIFORM COMMERCIAL CODE § 2-402, is entirely silent as to the impact of subsection 1. See *Uniform Commercial Code, 1958 Official Text* at 124.

creditor should or should not have the power to cut off the buyer's right to recover his identified goods. The Commission seemed most concerned about the confusion raised by the impact of article 9 on the then existing sections 2-402 and 2-502.<sup>63</sup> With respect to a bankruptcy situation, the Commission Report indicates that it was most concerned whether a recovery by a buyer under the then existing Code would constitute a preference in a later bankruptcy and not with the underlying policy consideration of whether a creditor's levy or bankruptcy occurring before the buyer's recovery should cut off the buyer's recovery right entirely.<sup>64</sup>

The buyer who advances money to a seller before receiving goods can gain a substantial measure of protection from a levying creditor or trustee in bankruptcy by obtaining and perfecting a security interest in the goods under article 9.<sup>65</sup> Accordingly, his failure to obtain such a security interest may be construed as a willingness to accept the risk of his buyer's insolvency.

If the above analyses are correct, then, in the three Commercial Code situations dealing with creditors' rights (other than section 2-702), we find that a lien creditor (at least those without knowledge) can rely on the apparent ownership brought about by possession of goods and may defeat the rights of third parties who claim superior interests in the goods. To repeat, these are the three situations.

(1) The secured party who failed to perfect his security interest in goods (section 9-301).<sup>66</sup>

63. See 1955 *State of New York Law Revision Commission Report, Study of the Uniform Commercial Code*, 453. "As the Code now stands, the relationship between the requirements of Article 9 and provisions of Article 2, such as Section 2-502, is a matter of considerable doubt." *Id.* at 467.

64. "If the buyer seeks to recover the goods under this section [UNIFORM COMMERCIAL CODE § 2-502], he is likely to meet the contention of the trustee in bankruptcy that such recovery would constitute a voidable preference under Section 60 of the Bankruptcy Act." *Id.* at 467.

65. To avoid preference in a later bankruptcy, Professor Kennedy also states that buyers of goods ". . . may be well advised to treat his interest in goods for which he has paid any part of the price in advance as a security interest to be timely perfected under Article 9." Kennedy *supra* note 4, at 559.

66. There is one exception to this rule. Under UNIFORM COMMERCIAL CODE § 9-301(2), a lien creditor will be defeated by a purchase money security interest if the secured party files a financing statement within ten days after the collateral is received. Undoubtedly, an argument might be made that the seller who made available to the insolvent the very goods which have been levied upon ought, by analogy, to have a similar ten-day grace period.

It is not clear just what policy reasons motivated the Code drafters in denying to creditors, yet retaining to most other third parties, the right to obtain superior rights in purchase money security interest collateral for a ten-day period. The official commentary suggests that this may have been an arbitrary compromise between various pre-Code statutory approaches to a grace period for late filing of security interests. Some statutes had denied any grace period; others had permitted a grace period which would cut off all intervening interests; still others had permitted a grace period that would cut off some but not all intervening interests. See UCC § 9-301, comment 5.

In any case, it should be borne in mind that the secured party never intended to rely on the credit of the debtor, nor did the secured party intend to take any risk respecting the debtor's

(2) The "sale or return" dealer who failed to give actual or constructive notice of his rights (section 2-326).

(3) The buyer who has paid for goods, but who left them in the possession of the seller (sections 2-402, 2-502).

It would appear, therefore, that the Code drafters were very much motivated by the policy considerations favoring a lien creditor without knowledge over third parties who claim those same goods. If this is so, one wonders why that policy should be rejected in the section 2-702 situation, involving the sale of goods to an insolvent buyer. It appears that this seller's equities are no better than his brothers' who have been listed above. If anything, they may be worse.<sup>67</sup>

Those who urge that the seller to an insolvent buyer should have a more favored position seem to reach this result because of a strict "legal" analysis of the former case law. However, it should be kept in mind that the Commercial Code was intended to codify modern business practices and thinking rather than necessarily perpetuating former rules of law.

Under traditional law prior to the Commercial Code, the seller's right to recover goods sold to an insolvent buyer was based on the tort of fraud. The theory was that a buyer who purchased goods knowing of his inability to pay for them had "defrauded" his seller. This being so, the seller had the option of rescinding the contract and recovering the goods.<sup>68</sup>

To a lawyer, the word "fraud" carries with it the connotation of a special kind of cheating or wrong. To the lawyer, it is close to a criminal act. As such, the lawyer feels that the law should be most willing to provide strong remedies to rectify the grave wrong.<sup>69</sup>

But, query, whether the business world accepts the notion that a seller to an insolvent buyer has any claims deserving special attention, or that such a seller has been subjected to a special kind of cheating or aggravated kind of wrong? In the business world, is it not the fact that all of the unsecured creditors involved in an insolvent situation have been equally wronged or equally defrauded? Each sold merchan-

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possible insolvency. On the other hand, the seller to the insolvent buyer clearly intended to assume such a risk. (See discussion in text, at 108 *supra*). As such, it is the writer's opinion that the secured party on a purchase money security interest has a better claim to favored treatment by way of a grace period than is true respecting the seller to the insolvent.

67. See discussion in text, at 108 *supra*.

68. Professor Hawkland cites 3 WILLISTON, SALES §§ 636-38 (rev. ed. 1949), to support this rule of law. Hawkland, *supra* note 4, at 86 n.1.

69. For example, "where the buyer's insolvency follows closely on the heels of a credit sale," Professor Hawkland states: "Fraud or gross misconduct is relatively easy to impute to the buyer in such case, and there is no reason to give his creditors a windfall based on his tortious conduct." *Id.* at 86.

dise or extended credit on the same tacit representation that he would be paid. In light of the buyer's insolvency, none will be paid in full. However, this is precisely the business risk which all assumed when they dealt on credit.

After insolvency, each creditor is left to his own devices in the race of diligence to seize the buyer's available assets. Or, all will obtain equal treatment by reason of a bankruptcy or other insolvency proceeding.

Is there any justifiable business reason to give a particular seller a special advantage or preference because he delivered goods within a ten-day period? From a business point of view, is he entitled to more solicitude than the seller whose account is more than ten days old; or a seller within a ten-day period who can no longer trace his goods; or a creditor whose account arises from other than the sale of goods?

Obviously, so long as the law permits the ten-day seller to obtain a preference, it is only human that a particular seller take advantage of his favored position. In this specific case, this particular seller is a "winner." However, in all other cases where this seller cannot bring himself within the ten-day rule, he will be a "loser," since the total assets available for distribution to him are depleted to the extent of the "winner's" reclamation. In other words, the seller is a "winner" if he learns of the insolvency within ten days after the delivery of the goods. He is a "loser" in all other cases. The long-run odds make it appear that sellers will "lose" more often than they can hope to "win." One wonders whether the commercial world is really anxious to play at this game of chance — particularly in the face of such unfavorable odds.

What is more, luck gets into this picture to a rather marked degree. If she smiles, the seller is assured of "winning." If not, the seller is almost certain to be a "loser."

Under the typical credit-sales arrangement, the seller will rarely become aware of an insolvency situation within a ten-day period from the delivery of the goods. If the seller has actually acted in good faith,<sup>70</sup> his file will probably be inactive until the end of the credit period, usually considerably in excess of ten days.

The fact of a buyer's insolvency will typically come to the attention of a seller within a ten-day period *only because of a creditor's levy or bankruptcy*. This, then, becomes a real stroke of luck for the seller. It is the happenstance of this levy or bankruptcy within the ten-day period which gives to the seller the requisite notice of insolvency which he needs to achieve a preferred status, a preferred status which he, otherwise, would never have achieved. Again, one wonders whether this

70. "Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement." UCC § 1-203.

game of chance is one which the commercial world is willing to play, or one which the law should encourage.

#### CONCLUSION

It is submitted that the policy considerations in favor of the lien creditor or bankruptcy trustee outweigh those in favor of a seller to an insolvent; that these policy considerations were probably accepted by the drafters of the Commercial Code in section 2-702; and that any attempt to delete the "lien creditor" language from section 2-702(3) should be defeated.