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CASES NOTED

BULK TRANSFER: THE SIGNIFICANCE OF THE DISTINCTION BETWEEN SALE OF GOODS AND SALE OF SERVICES

The plaintiff sold the entire corporate stock of a restaurant. The purchaser executed a promissory note in favor of the plaintiff, which was secured by the corporate stock held in escrow under a pledge agreement. The purchaser subsequently sold the corporate stock to a buyer who expressly assumed the promissory note obligation. The entire assets of the restaurant were thereafter resold on three different occasions. The last two purchasers expressly refused to assume the obligation represented by the promissory note. The defendant was the final purchaser of the assets. When the promissory note became delinquent, the plaintiff brought suit against the defendant, among others. The trial court entered an order in favor of the plaintiff on the note. The defendant appealed, arguing that he could not be held liable for an obligation that he did not assume. The plaintiff argued that the bulk transfer provisions of the Uniform Commercial Code¹ applied to the purchase of the assets and that, as a creditor of defendant's remote transferor, he was entitled to the statutory protection.² The District Court of Appeal, Third District, *held*, reversed and remanded: The sale of a restaurant, a business whose principal function is to provide services, is not subject to the Florida Bulk Transfer Act. *De La Rosa v. Tropical Sandwiches, Inc.*, 298 So. 2d 471 (Fla. 3d Dist. 1974).³

Florida Statute, section 676.102 defines the scope of the Bulk Transfer Act:

(1) A "bulk transfer" is any transfer in bulk and not in the ordinary course of the transferor's business of a major part of the materials, supplies, merchandise or other inventory.⁴

1. FLA. STAT. §§ 676.101 *et seq.* (1973).

2. The Florida Bulk Transfer Act imposes significant responsibilities on the transferee of the assets of a business. FLA. STAT. § 676.104 (1973) requires the transferee to obtain a schedule of property transferred, together with a list of the transferor's creditors. The schedule must be made available to creditors of the transferor.

FLA. STAT. § 676.105 (1973) requires the transferee to notify the creditors of the proposed transfer at least 10 days prior to sale.

FLA. STAT. § 676.106 (1973) requires the transferee to insure that the proceeds of the sale are applied to payment of the debts of the transferor. The inclusion of this optional provision is a major departure from the pre-Code Florida Bulk Sales Act. REV. GEN. STAT. §§ 3865 *et seq.* (1920).

The sections cited above provide that transfers of inventory and equipment, subject to, but not in compliance with the provisions of this chapter, are ineffective against any creditor of the transferor. Any such creditor could disregard the transfer and levy on the goods as still belonging to the transferor.

3. Hereinafter referred to as *De La Rosa*.

4. FLA. STAT. § 679.109(4) (1973) defines inventory as goods "held by a person who holds them for sale or lease or to be furnished under contracts of service"

(2) A transfer of a substantial part of the equipment of such an enterprise is a bulk transfer if it is made in connection with a bulk transfer of inventory, but not otherwise.⁵

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

In reaching its decision, the Third District relied on the Official Comments:

The businesses covered . . . do not include farming or contracting nor professional services, nor such things as cleaning shops, barber shops, pool halls, hotels, restaurants and the like whose principal business is the sale not of merchandise but of services.⁶

The transfers included are of "materials, supplies, merchandise or other inventory" that is, of goods . . .⁷ . . . they [the included businesses] are believed to be those that carry the major bulk sales risks.⁸

Article 6 of the U.C.C. was drafted to protect creditors from merchant debtors who would sell out their stock-in-trade, often at a price well below fair market value, then pocket the proceeds and disappear, leaving their creditors unpaid.⁹ At common law, prior to the passage of the various state bulk sales acts, creditors had no recourse against the buyer in such cases unless they could show that the buyer had a fraudulent intent. "Fraudulent intent" was established by showing actual or constructive knowledge on the buyer's part of the intended fraud as to the seller's creditors. In many instances, this proved impossible and creditors were left without a remedy.¹⁰ The drafters of Article 6 noted that while there may be some bulk sales risk in the excluded enterprises, generally it can be said that unsecured credit is not commonly extended in reliance on the assets of the excluded businesses.¹¹

De La Rosa is the first Florida decision to consider the scope of the present Florida Bulk Transfer Act.¹² In this decision the court embraced the distinction between "sales" enterprises and "service" enterprises. Those businesses engaged in the sale of goods from stock

5. This equipment provision is very important, especially in situations similar to that presented in the instant case, where one can expect the value of equipment to greatly exceed the value of any inventory transferred. The creditor of the transferor can reach the equipment by arguing that its transfer was accompanied by a transfer of the inventory.

6. FLA. STAT. ANN. § 676.6-102, Comment 2 (1973).

7. FLA. STAT. ANN. § 676.6-102, Comment 3 (1973).

8. FLA. STAT. ANN. § 676.6-102, Comment 4 (1973).

9. FLA. STAT. ANN. § 676.6-101, Comment 2 (1973).

10. Billig, *Bulk Sales Laws: A Study in Economic Adjustment*, 77 U. PA. L. REV. 72, 80 (1928).

11. FLA. STAT. ANN. § 676.6-102, Comment 2 (1973).

12. FLA. STAT. §§ 676.101 *et seq.* (1973).

were deemed subject to the provisions of the Act, while enterprises engaged in the furnishing of services were not.

The court noted that a similar result would have obtained under the pre-code Florida Bulk Sales Law.¹³ The court cited *Atlas Rock Co. v. Miami Beach Builders Supply Co.*,¹⁴ which dealt with the sale of certain assets of a construction company, namely, a towboat, a barge, rock crushers and piles of rock. The creditor of the transferor argued that the transferee had failed to comply with the Florida Bulk Sales Law and that the sale, as to him, was therefore ineffective. The Supreme Court of Florida held that the sale of a construction company was not subject to the Act, as the transferor was neither a wholesale nor a retail merchant. The court placed considerable emphasis on certain language in the statute itself, which at least implied that the Act dealt with wholesale or retail businesses only.¹⁵ The court's decision in *Atlas*, although not enunciating the sale of goods/sale of services distinction, does indicate that the prior statute was aimed at the same problem with which the drafters of Article 6 were concerned, *i.e.* the defrauding of creditors of wholesale and retail merchants.

Florida's early Bulk Sales Act was not unlike those adopted in other states. Despite the wide variety of language utilized in the various state bulk sales statutes, most acts apparently applied to both retail and wholesale businesses.¹⁶ But unless specifically included, the transfer of restaurants was generally deemed not to be subject to the bulk sales acts.

The principal rationale utilized by the courts in excluding such transfers from the purview of the acts was that the value of restaurant inventory was typically so low due to the perishable nature of the stock that it was unlikely that any credit was extended in reliance thereon.¹⁷

Although the question of the applicability of Article 6 of the Uniform Commercial Code to the transfer of restaurants has been extensively litigated outside of Florida, those courts which have considered the question have generally reached the same result as *De La Rosa*. In *Kane-Miller Corp. v. Tip Tree Corp.*,¹⁸ a New York court relied on the language of U.C.C. section 6-102(3) and the Official Comments thereto in holding that the sale of a restaurant, hotel and taproom was beyond the reach of Article 6. Regretably, the court

13. FLA. STAT. §§ 726.01 *et seq.* (1953).

14. 89 Fla. 340, 103 So. 615 (1925).

15. The court referred to the language of the early version of the Florida Bulk Sales Act, REV. GEN. STAT. §§ 3865 *et seq.* (1920) which required compliance with the Act, regardless of whether the vendor was a "wholesale or retail merchant." The Act was subsequently amended, ch. 22858, § 7, [1945] Fla. Laws 860, but retained the language relied upon by the Supreme Court of Florida in *Atlas Rock Co. v. Miami Beach Builders Supply Co.*, 89 Fla. 340, 103 So. 615 (1925).

16. Miller, *Bulk Sales Laws: Businesses Included*, 1954 WASH. U.L.Q. 1, 9, 14.

17. *Id.* at 16.

18. 60 Misc. 2d 776, 303 N.Y.S.2d 273 (Sup. Ct. 1969).

offered little in the way of analysis to justify its decision. *Silco-Automatic Vending Co., Inc. v. Howell*,¹⁹ offered considerably more analysis. There, a New Jersey court held that the sale of a tavern was not subject to the state's bulk transfer provisions.²⁰ The court, citing the Official Comments to Article 6, noted that the bulk transfer provisions applied only to those enterprises whose principal business was the sale of merchandise from stock. The court did not, however, rest its decision entirely on that observation. It placed great weight on the fact that, in this particular sale, the inventory sold accounted for only \$185.73, out of a total sales price of \$16,738.23. Thus, the court felt that

[t]he nature of the transactions under examination here establish beyond peradventure that plaintiff at no time relied upon the inventory of Al's Cozy Inn, Inc. when it either entered into the agreement in question or advanced the loan under the second agreement.²¹

The decision was ultimately based on this "value of inventory" factor; since the creditor had not extended credit in reliance on inventory, he was in no way prejudiced by the transfer of that inventory.

Pennsylvania is the only state which applies Article 6 to the transfer of a restaurant without a specific statutory provision.²² In *Uhr v. 3361, Inc.*,²³ the court held that the sale of a restaurant and taproom business violated Pennsylvania's bulk sales law.²⁴ The court offered little analysis; instead, it relied exclusively on two earlier trial court decisions; *Stein v. Goldberg*²⁵ and *Brooks v. Lambert*.²⁶ However, a close reading of these two cases reveals that the *Uhr* court's reliance may have been misplaced. *Stein* was actually decided under the pre-Code Pennsylvania Bulk Sales Act,²⁷ a statute so worded as to

19. 102 N.J. Super. 243, 245 A.2d 765 (Super. Ct. 1968) [hereinafter referred to as *Silco*].

20. New Jersey adopted the official version of Article 6 of the Uniform Commercial Code without modification. N.J. STAT. ANN. §§ 12A: 6-101 *et seq.* (1962).

21. *Silco-Automatic Vending Co., Inc. v. Howell*, 102 N.J. Super. 243, 250, 245 A.2d 765, 769 (Super. Ct. 1968).

22. Certain other states, in enacting Article 6 of the Uniform Commercial Code, have modified that Article so as to bring restaurants and other "service" businesses within the reach of the Code. California modified the language of U.C.C. section 6-102(3) to achieve this result: "The enterprises subject to this division are all those whose principal business is that of a baker, cafe or restaurant owner, garage owner, cleaner or dyer, or retail or wholesale merchant." Cal. Comm. Code § 6102(3) (West 1964).

The legislatures of Idaho, Oregon and Washington have also specifically included restaurants among those enterprises subject to the bulk transfer provisions. The existence of such statutory modifications exhibit legislative acknowledgment that the original Article 6 provisions of the Uniform Commercial Code do not reach restaurants. Nevertheless the Pennsylvania Statutes, sections 6-101 *et seq.* (1974), contain no such modifications.

23. 21 Pa. D. & C.2d 348 (Phila. County Ct. 1960).

24. PA. STAT. ANN. §§ 6-101 *et seq.* (1953).

25. 2 Pa. D. & C.2d 562 (Phila. County Ct. 1954) [hereinafter referred to as *Stein*].

26. 10 Pa. D. & C.2d 237 (Del. City Ct. 1956) [hereinafter referred to as *Brooks*].

27. No. 97 [1939] Pa. Laws 189-90 (repealed). The current Pennsylvania Act is PA. STAT. ANN. tit. 12A, §§ 6-101 *et seq.* (1954).

include the transfer or sale of goods, wares, fixtures or merchandise of any kind. While the *Brooks* case was decided under Article 6 of the Uniform Commercial Code, as adopted in Pennsylvania, the court relied on case law developed under the earlier Pennsylvania statute.

The importance of the changes in statutory language was noted in another Pennsylvania decision which strongly suggested that the restricted language of the new Pennsylvania statute would exclude the transfer of restaurants from those enterprises subject to the bulk transfer provisions.²⁸

In the usual case, the sale of goods/sale of services distinction is an adequate test by which to determine the applicability of the bulk transfer statute. Some businesses clearly sell services, not goods.²⁹ However, other businesses do not fit clearly into either category. Some businesses are simultaneously engaged in the sale of goods from stock and the sale of services.³⁰ The *De La Rosa* decision offers the Florida practitioner little assistance in predicting when the sale of such a business will require compliance with the statute.³¹ Courts, when dealing with businesses which fall into this gray area, may profitably adopt the following two step analysis: (1) Is the business engaged in the sale of merchandise from stock? This is essentially a question of fact. (2) Did the creditors advance funds in reliance on the inventory? In answering this question, note should be taken of the value of the transferred inventory. If it is relatively small, especially when compared to the size of the loan, there should be a presumption that the creditors did not so rely.³² An affirmative answer to both questions indicates that the transaction should fall within the scope of the bulk sales act.

The adoption of this "sale of goods/reliance on inventory" analysis has the advantage of dealing with the specific problem to which both the Code and the original bulk transfer acts were addressed, *i.e.*, that debtors would make a bad faith transfer of inventory on which their creditors had relied in extending credit. The adoption of this approach would result in the development of case law effectuating the stated intentions of the drafters, while at the same time reasonably limiting the reach of the Act.

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28. *Miskeiel v. Hide-Away Hut Inc.*, 12 Bucks Co. L. Rep. 756 (Pa. 1963).

29. *See, e.g.*, *Yarbrough v. Rogers*, 300 So. 2d 286 (Fla. 4th Dist. 1974) (a beauty salon, unless primarily engaged in selling cosmetics, would be a purely service type enterprise and therefore not subject to bulk transfer laws).

30. Among such businesses are auto repair garages which sell and install parts, and marine repair and outfitting businesses which build and repair boats. Both businesses carry large inventories of parts, which they sell; however, at the same time, they provide important services.

31. Although the court in *De La Rosa* held this restaurant to be engaged in the sale of services, it should be noted that the U.C.C. as adopted by Florida, indicates that food falls within the definition of goods. FLA. STAT. § 672.105(1)(1973). Additionally, FLA. STAT. § 672.314(1) (1973) implies that the sale of food is a sale of goods.

32. *See Silco-Automatic Vending Co., Inc. v. Howell*, 102 N.J. Super. 243, 245 A.2d 765 (1968); for further information see notes 19-21 *supra* and accompanying text.