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### UCC 2-702(2) and the Bankruptcy Act: To Lien, or Not to Lien

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## UCC 2-702(2) AND THE BANKRUPTCY ACT: TO LIEN, OR NOT TO LIEN

Section 2-702(2) of the Uniform Commercial Code<sup>1</sup> provides that upon discovery of a buyer's insolvency, a seller of goods on credit may reclaim the goods within 10 days of receipt by the insolvent buyer. The Federal Bankruptcy Act<sup>2</sup> invalidates against a trustee in bankruptcy all statutory liens which take effect upon insolvency.<sup>3</sup> The possibility of conflict between the Bankruptcy Act and section 2-702(2) was first noted during the debates preceding general acceptance of the Code.<sup>4</sup> Since it is a settled principle of

<sup>1</sup> UNIFORM COMMERCIAL CODE § 2-702(2) (1972 version) provides:

Where the seller discovers that the buyer has received goods on credit while insolvent he may reclaim the goods upon demand made within ten days after the receipt, but if misrepresentation of solvency has been made to the particular seller in writing within three months before delivery the ten day limitation does not apply. Except as provided in this subsection the seller may not base a right to reclaim goods on the buyer's fraudulent or innocent misrepresentation of solvency or of intent to pay.

Prior to 1966, the official version of the Code provided that the rights of the reclaiming seller were subject to the rights of a lien creditor. UNIFORM COMMERCIAL CODE § 2-702(3) (1962 version). This provision was deleted as a result of the controversial decision in *In re Kravitz*, 278 F.2d 820 (3d Cir. 1960). In *Kravitz*, the Court of Appeals for the Third Circuit held that since a trustee in bankruptcy is given the status of a lien creditor by § 70(c) of the Bankruptcy Act, 11 U.S.C. § 110(c) (1970), the trustee would prevail over a reclaiming seller if a lien creditor would so prevail. Finding that the relative rights of a reclaiming seller and a lien creditor were not delineated within the Code, the court turned to pre-Code state law to find the answer. Because under Pennsylvania law a lien creditor would defeat a reclaiming seller, reclamation was denied. This decision has been the subject of extensive commentary, including some criticism. See, e.g., Forman, *Bankruptcy Trustee Defeats Seller's Right of Reclamation Under Commercial Code*, 65 COM. L.J. 365 (1960); 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); Shanker, *A Reply to the Proposed Amendment of UCC Section 2-702(3): Another View of Lien Creditor's Rights vs. Rights of a Seller to an Insolvent*, 14 W. RES. L. REV. 93 (1962); Comment, *Bankruptcy — Reclamation and the Uniform Commercial Code*, 33 MO. L. REV. 262 (1968); 45 CORNELL L.Q. 566 (1960). Most courts, however, have followed the *Kravitz* rationale to the extent of applying pre-Code state law in determining the comparative rights of a reclaiming seller and a lien creditor. See, e.g., *In re Mel Golde Shoes, Inc.*, 403 F.2d 658 (6th Cir. 1968) (applying Kentucky pre-Code law); *In re Federal's, Inc.*, 402 F. Supp. 1357 (E.D. Mich. 1975) (applying pre-Code Michigan law); cf. Braucher, *The Uniform Commercial Code — A Third Look?*, 14 W. RES. L. REV. 7, 16 (1962); Henson, *Reclamation Rights of Sellers Under Section 2-702*, 21 N.Y.L.J. 41, 43 (1975). To avoid the disparities resulting from the vagaries of pre-Code state law, the official version of the Code was amended and the lien creditor provision deleted. UNIFORM COMMERCIAL CODE § 2-702, Note on 1966 Amendment. Many states, however, have failed to follow suit and have retained the lien creditor provision. See, e.g., ALA. CODE tit. 7A, § 2-702(3) (1966); ARIZ. REV. STAT. ANN. § 44-2381(3) (1967); IND. ANN. STAT. § 26-1-2-702(3) (Burns 1974); MICH. STAT. ANN. § 19.2702(3) (1975). Thus, the controversy generated by the *Kravitz* decision is still significant in many jurisdictions. For an excellent discussion of the requirements for reclamation under § 2-702(2), see Leibowitz, *Bankruptcy Practice*, 173 N.Y.L.J. 120, June 23, 1975, at 1, col. 1.

<sup>2</sup> 11 U.S.C. §§ 1 *et seq.* (1970).

<sup>3</sup> Bankruptcy Act § 67c(1)(A), 11 U.S.C. § 107(c)(1)(A) (1970). See note 40 *infra*.

<sup>4</sup> Initially adopted in Pennsylvania, the Code has since been enacted with some variations in every state. A study of the Code initiated by the Pennsylvania Bar Association prior to its enactment in 1953 warned that "[a]llowing reclamation for actual fraud is not inconsistent with bankruptcy legislation. The proposed reclamation for 'presumed' fraud might, however, encounter difficulty." *Pennsylvania Bar Association Notes — 1953, appearing in PENN.*

law that the operation of the Bankruptcy Act supercedes any conflicting state law,<sup>5</sup> should a conflict in fact exist, the provisions of the Bankruptcy Act must inevitably prevail. Several recent decisions have found just such a conflict, ruling that section 2-702(2) creates a statutory lien invalid against the trustee in bankruptcy.<sup>6</sup> If these decisions are followed consistently, the import of section 2-702(2) will be rendered practically nugatory, since it is most often applicable in bankruptcy situations.<sup>7</sup> Moreover, since section 2-702(2) is, by its own terms, the sole remedy for the defrauded seller, invalidation of the section in bankruptcy might preclude reclamation altogether.

#### THE BANKRUPTCY ACT: PRIORITIES, LIENS, AND STATUTORY LIENS

The primary purpose of the Bankruptcy Act is to ensure a uniform and equitable distribution of the bankrupt's assets among

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STAT. ANN. tit. 12A, § 2-702 at 473 (1970) (citations omitted). This possibility was also noted in an influential New York study of the Code. Honnold, *Analysis of Sections of Article 2*, 1 N.Y. LAW REVISION COMM'N, REPORT ON THE UNIFORM COMMERCIAL CODE 547-49, Leg. Doc. No. 65(C) (1955); *Memorandum of Task Group of the Special Comm. of the Commerce and Indus. Ass'n of N.Y., Inc.*, 1 N.Y. LAW REVISION COMM'N, REPORT ON THE UNIFORM COMMERCIAL CODE 105, Leg. Doc. No. 65(B) (1954).

<sup>5</sup> U.S. CONST. art. I, § 8, cl. 4 grants Congress the power "[t]o establish . . . uniform Laws on the subject of Bankruptcies throughout the United States . . ." The supremacy clause states in part that "[t]his Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." These two provisions have authoritatively been interpreted to mean that a valid provision of the Bankruptcy Act will prevail over any state legislation which tends to interfere with the effectiveness of the federal law. In *Perez v. Campbell*, 402 U.S. 637 (1971), for example, the Supreme Court invalidated that part of an Arizona statute which provided for revocation of drivers' licenses for failure to pay a judgment based on an automobile accident. The challenged section provided for continued revocation after discharge in bankruptcy. The Court found this provision of the statute to be in conflict with one of the major purposes of the Bankruptcy Act, providing the debtor with a fresh start, and therefore invalidated it. *Accord*, *International Shoe Co. v. Pinkus*, 278 U.S. 261 (1929) (federal bankruptcy law supercedes state insolvency law).

<sup>6</sup> *In re Federal's, Inc.*, 402 F. Supp. 1357 (E.D. Mich. 1975), *aff'g* 12 UCC Rep. Serv. 1142 (Bankr. Ct. E.D. Mich. 1973); *Carnation Plastic Mfg. Co. v. Giltex, Inc.*, 17 UCC Rep. Serv. 887 (S.D.N.Y. 1975); *In re Good Deal Supermarkets, Inc.*, 384 F. Supp. 887 (D.N.J. 1974); *Suzy Curtains, Inc. v. W.T. Grant Co.*, 7 Collier Bankr. Cas. 308 (Bankr. Ct. S.D.N.Y. Nov. 14, 1975); *Ray-O-Vac v. Daylin, Inc.*, 5 Collier Bankr. Cas. 570 (Bankr. Ct. C.D. Cal. 1975); *Queensboro Farm Prods., Inc. v. Wetson's Corp.*, 4 Collier Bankr. Cas. 796 (Bankr. Ct. S.D.N.Y. 1975). The opposite result, however, was reached in *Alfred M. Lewis, Inc. v. Holzman*, 524 F.2d 761 (9th Cir. 1975), *cert. denied*, 96 S. Ct. 1466 (1976). There, the court held that § 2-702(2) does not create a statutory lien and is therefore valid against a trustee. Application of § 2-702 in a bankruptcy proceeding was also apparently approved in *In re National Bellas Hess, Inc.*, 4 Collier Bankr. Cas. 792 (Bankr. Ct. S.D.N.Y. 1975). The author of the *National Bellas* opinion, however, later indicated in another decision that § 2-702(2) is applicable only in situations involving a written misrepresentation of solvency. *Suzy Curtains, Inc. v. W.T. Grant Co.*, 7 Collier Bankr. Cas. 308 (Bankr. Ct. S.D.N.Y. Nov. 14, 1975).

<sup>7</sup> In fact, it is usually the filing of a petition for bankruptcy which alerts the seller to the buyer's insolvency. See *In re Federal's, Inc.*, 12 UCC Rep. Serv. 1142, 1152 n.22 (Bankr. Ct. E.D. Mich. 1973), *aff'd*, 402 F. Supp. 1357 (E.D. Mich. 1975).

his creditors.<sup>8</sup> In operation, this purpose is effectuated through the trustee in bankruptcy,<sup>9</sup> who takes title to the bankrupt's assets,<sup>10</sup> liquidates the bankrupt estate, and distributes the proceeds to the creditors.<sup>11</sup> Creditors are classified as either secured or unsecured. The secured creditor has a security interest in, or a lien against, specific property of the bankrupt, and is entitled to payment of his debt from the proceeds of a sale of that property. If the sale produces an amount in excess of the secured debt, the excess is retained by the trustee for distribution to unsecured creditors. If the proceeds of the sale are insufficient to pay the debt, the secured creditor may enter a claim for any deficiency as an unsecured creditor. An unsecured creditor is, as the name suggests, a creditor without a security interest in the bankrupt's property. As a general rule, in the absence of a specific agreement between themselves, unsecured creditors are entitled to a pro rata share in that portion of the bankrupt's assets not encumbered by security interests.<sup>12</sup>

### *Priorities*

In addition to the differentiation between secured and unsecured creditors, variations exist in the treatment afforded unse-

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<sup>8</sup> As was noted by the Supreme Court in *Young v. Higbee Co.*, 324 U.S. 204 (1945): "[H]istorically, one of the prime purposes of the bankruptcy law has been to bring about a ratable distribution among creditors of a bankrupt's assets; to protect the creditors from one another." *Id.* at 210 (footnote omitted). See *Texaco, Inc. v. Liberty Nat'l Bank & Trust Co.*, 464 F.2d 389, 392 (10th Cir. 1972), wherein it was stated that a primary purpose of a bankruptcy proceeding is to distribute the bankrupt's assets "among his creditors without preference." *Accord, In re Kanter*, 345 F. Supp. 1151, 1156 (C.D. Cal. 1972), *aff'd*, 505 F.2d 228 (9th Cir. 1974); 4 COLLIER, BANKRUPTCY ¶ 67.01, at 15 (14th ed. 1975); C. NADLER, THE LAW OF BANKRUPTCY § 14 (2d ed. S. Nadler & M. Nadler 1972); H. REMINGTON, A TREATISE ON THE BANKRUPTCY LAW OF THE UNITED STATES § 1, at 5 (5th ed. J. Henderson 1950); McLaughlin, *Aspects of the Chandler Bill to Amend the Bankruptcy Act*, 4 U. CHI. L. REV. 369 (1937).

Another major purpose of the Bankruptcy Act is to provide the debtor with a fresh start in life, free from liabilities incurred prior to his discharge. *Perez v. Campbell*, 402 U.S. 637, 648 (1971). See C. NADLER, THE LAW OF BANKRUPTCY § 1 (2d ed. S. Nadler & M. Nadler 1972); C. NADLER, THE LAW OF DEBTOR RELIEF § 121 (2d ed. W. Phillips 1972).

<sup>9</sup> The trustee is elected by the creditors at a general meeting shortly after bankruptcy is declared. If no trustee is elected by the creditors, or if the elected trustee fails to qualify, a trustee is chosen by the bankruptcy court. In order to qualify as trustee, an individual must be competent to fulfill the duties of the position and must not have any interests adverse to the bankrupt estate. BANKR. R. 209. The trustee is ordinarily required to post a bond assuring faithful performance of his office. *Id.* 212.

<sup>10</sup> Title to the bankrupt's property is vested in the trustee by Bankruptcy Act § 70(a), 11 U.S.C. § 110(a) (1970). Certain property, however, is exempted from this provision and remains the property of the bankrupt. *Id.* § 6, 11 U.S.C. § 24 (1970). The determination of just what property is exempted is, subject to certain limitations, a matter of state law. See *id.*; 1A COLLIER, BANKRUPTCY ¶ 6.03[2] (14th ed. 1975).

<sup>11</sup> The duties of the trustee are set forth in Bankruptcy Act § 47, 11 U.S.C. § 75 (1970).

<sup>12</sup> For further discussion of the general principles of distribution, see C. NADLER, THE LAW OF BANKRUPTCY §§ 182-87 (2d ed. S. Nadler & M. Nadler 1972).

cured creditors as amongst themselves. Congress, having determined that complete equality of distribution is not feasible,<sup>13</sup> has established an order of priority that provides for the payment of certain types of unsecured claims prior to pro rata distribution of the bankrupt's unencumbered assets among the remaining unsecured creditors.<sup>14</sup>

The historical development of federal bankruptcy law evidences increasing concern by Congress with the disruption of the federally created order of priorities by state-created priorities. The Bankruptcy Act of 1898<sup>15</sup> explicitly recognized the validity of state priorities, giving priority over unsecured creditors to "any person who by the laws of the States . . . is entitled to priority."<sup>16</sup> This sanction resulted in rapid depletion of bankrupt estates to the detriment of general unsecured creditors as state legislatures created numerous priorities for favored classes of creditors.<sup>17</sup> In response to this unfortunate situation, in 1938 Congress amended the Bankruptcy Act to give effect only to those state-created priorities in favor of landlords.<sup>18</sup> It was hoped that this clear congressional mandate would forever put to rest any unwarranted state disruption of the federal order of priorities. Invalid state priorities were soon replaced, however, by yet another state legislative creation, the statutory lien, which allowed resourceful creditors to rapidly regain their favored distributive position.<sup>19</sup>

<sup>13</sup> Although theoretically, complete equality would seem to be the most equitable method of distribution, certain claims have traditionally been favored over others for various policy reasons. For example, payment of the expenses incurred in the administration of the bankrupt estate is given first priority in order to ensure efficient administration of the estate. Bankruptcy Act § 64, 11 U.S.C. § 104(a) (1970); see 3A COLLIER, BANKRUPTCY ¶ 64.02[1] (14th ed. 1975).

<sup>14</sup> Bankruptcy Act § 64, 11 U.S.C. § 104 (1970) enumerates those claims which are to be granted priority over the claims of other unsecured creditors. The order of the priorities is: (1) administration expenses; (2) certain wage claims; (3) the cost of a successful attack upon a wage earner plan, an arrangement, or a discharge; (4) certain tax claims; (5) debts given priority by federal law and certain rent claims. *Id.*

<sup>15</sup> Act of July 1, 1898, ch. 541, 30 Stat. 544 (now 11 U.S.C. §§ 1 *et seq.* (1970)).

<sup>16</sup> *Id.* § 64(b)(5), 30 Stat. 563 (repealed 1938).

<sup>17</sup> See 3A COLLIER, BANKRUPTCY ¶ 64.501[2.2] (14th ed. 1975).

<sup>18</sup> Act of June 22, 1938, ch. 575, § 64, 52 Stat. 874, amending 11 U.S.C. § 104 (Supp. III, 1937).

<sup>19</sup> *Queensboro Farm Prods., Inc. v. Wetson's Corp.*, 4 Collier Bankr. Cas. 796, 799 (Bankr. Ct. S.D.N.Y. 1975) (discussing the history of statutory liens). See 4 COLLIER, BANKRUPTCY ¶¶ 67.20[3], at 223, 67.281[1], at 413 (14th ed. 1975). The possibility that recognition in bankruptcy of all statutory liens would lead to abuses was noted by one of the draftsmen of the 1938 amendments, who stated that if the possibility should become a reality additional amendments would be required to prevent further disruption of the federal order of priorities. McLaughlin, *Aspects of the Chandler Bill to Amend the Bankruptcy Act*, 4 U. CHI. L. REV. 369, 395 (1937).

*Liens*

Traditional bankruptcy law subjects the “[a]ssets of the bankrupt in the trustee’s hands . . . to all of the equities, liens and incumbrances in favor of third persons that exist at the date of bankruptcy and are not invalidated by the terms of the Act.”<sup>20</sup> The trustee in bankruptcy has often been said to stand in the shoes of the bankrupt in that he takes title to the bankrupt’s property subject to preexisting property rights and security interests of third parties.<sup>21</sup> Nevertheless, since the Bankruptcy Act provides the trustee with the power to avoid certain of these interests,<sup>22</sup> claims valid against the bankrupt are not necessarily valid against the trustee. As a result of the trustee’s successful exercise of this power of avoidance, the previously secured creditor is sometimes relegated to the position of an unsecured creditor and forced to share in the distribution of the property in question with the unsecured creditors. The continuing development of federal bankruptcy law indicates a trend in the direction of increasing the trustee’s power to avoid state-created liens in order to foster a more equitable distribution of the bankrupt estate.<sup>23</sup>

Prior to 1867, property in the hands of the trustee was subject to all liens upon that property.<sup>24</sup> This created a mad “race to the courthouse,” as each creditor sought the protection of a judicial lien whenever his debtor’s financial status became uncertain. All too often, the result was that the bankrupt’s estate was completely encumbered by such liens. Unfortunately, any creditor who failed to obtain a lien was forced to write off the debt completely, since after satisfaction of the liens, there simply was no property remaining for distribution among the unsecured creditors.<sup>25</sup> The draftsmen of the Bankruptcy Act of 1867<sup>26</sup> attempted to solve this problem by invalidating judicial liens created within 4 months prior to bankruptcy.<sup>27</sup> This provision was designed to prevent the obvi-

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<sup>20</sup> 3A COLLIER, BANKRUPTCY ¶ 64.02[2], at 2065 (14th ed. 1975) (footnote omitted).

<sup>21</sup> *Dodd v. San Joaquin Lumber Co.*, 295 F. 311, 313 (9th Cir. 1924).

<sup>22</sup> Bankruptcy Act § 70, 11 U.S.C. § 110 (1970). For example, the Bankruptcy Act grants the trustee title to the bankrupt’s property and the power to reject the bankrupt’s executory contracts and also provides him with the rights of both a judgment creditor and a lien creditor as of the date of bankruptcy. *Id.* For a discussion of the powers granted to the trustee, see 4A COLLIER, BANKRUPTCY ¶ 70.01 (14th ed. 1975).

<sup>23</sup> See 4A COLLIER, BANKRUPTCY ¶¶ 70.01-03 (14th ed. 1975); note 28 *supra*.

<sup>24</sup> See 4 COLLIER, BANKRUPTCY ¶ 67.02, at 18-19 (14th ed. 1975).

<sup>25</sup> *Id.*

<sup>26</sup> Act of March 2, 1867, ch. 176, 14 Stat. 517 (repealed 1878).

<sup>27</sup> *Id.* § 14, 14 Stat. 522. See 4 COLLIER, BANKRUPTCY ¶ 67.02, at 18-19 (14th ed. 1975).

ous inequities inherent in a distribution system which, for all practical purposes, was determined by the results of the race to the courthouse. Beginning with implementation of the 1867 Act, the trustee, as the representative of the creditors, has since been given greater power to avoid preexisting interests in the bankrupt's property.<sup>28</sup>

### *Statutory Liens*

One variety of lien traditionally recognized in bankruptcy is the statutory lien. Essentially, a statutory lien is a lien superimposed by statute upon certain economic relationships.<sup>29</sup> Statutory liens in favor of artisans,<sup>30</sup> mechanics,<sup>31</sup> landlords,<sup>32</sup> employees,<sup>33</sup> and similar classes of people exist in most states, as do a wide variety of tax liens.<sup>34</sup> There is no reason to invalidate in bankruptcy those statutory liens enacted in furtherance of valid public interests such as the collection of public revenues or the protection of classes of people who have enhanced the estate of the bankrupt.<sup>35</sup> Due to the fact that prior to 1938, when the Bankruptcy Act was amended, most statutory liens fell within these categories, the enforcement of such liens in bankruptcy was both reasonable and proper.<sup>36</sup>

<sup>28</sup> The powers of the trustee were increased by the Bankruptcy Act of 1898, Act of July 1, 1898, ch. 541, 30 Stat. 544, which provided that any lien that was invalid against another creditor under state law was invalid against the trustee in bankruptcy. *Id.* § 67(a), 30 Stat. 564. This provision permitted the trustee to invalidate a lien by showing, for example, that the lien had not been recorded in accord with the requirements of state law. The Act further provided that the trustee was subrogated to the rights of a creditor who had been prevented from enforcing his rights against a lien created by the bankrupt prior to bankruptcy. *Id.* § 67(b), 30 Stat. 564. Thus, the trustee, in effect, was allowed to challenge a lien on any grounds available to a creditor who could have challenged the lien but for the intervention of bankruptcy. The Act also dissolved those liens created within 4 months of bankruptcy as a result of the race to the courthouse. *Id.* § 67(c), 30 Stat. 564. Exempted from the operation of the Act, however, were all liens "given and accepted in good faith . . ." *Id.* § 67(d), 30 Stat. 564. In construing these provisions, the courts determined that liens valid under state law were valid in bankruptcy unless the Bankruptcy Act invalidated them either expressly or by necessary implication. 4 COLLIER, BANKRUPTCY ¶¶ 67.02[3], at 51, 67.20[1], at 211 (14th ed. 1975). *See, e.g.*, Norris v. Trenholm, 209 F. 827 (5th Cir. 1913) (vendor's lien held valid). The present versions of these provisions are codified in Bankruptcy Act §§ 67, 70, 11 U.S.C. §§ 107, 110 (1970).

<sup>29</sup> *See* notes 57-59 and accompanying text *infra*.

<sup>30</sup> *E.g.*, ARK. STAT. ANN. § 51-401 (1971); N.Y. LIEN LAW § 180 (McKinney Supp. 1975).

<sup>31</sup> *E.g.*, GA. CODE ANN. § 67-2001 (1967), as amended, (Supp. 1975); IDAHO CODE § 45-501 (Supp. 1975); KY. REV. STAT. ANN. § 376.010 (Supp. 1974).

<sup>32</sup> *E.g.*, FLA. STAT. ANN. § 83.08 (Supp. 1975); GA. CODE ANN. § 61-203 (1966).

<sup>33</sup> *E.g.*, GA. CODE ANN. § 67-1801 (1967); KY. REV. STAT. ANN. § 376.150 (1970).

<sup>34</sup> *E.g.*, FLA. STAT. ANN. § 330.16 (1968) (aircraft registration tax lien); GA. CODE ANN. § 92-8444 (Supp. 1975) (general tax lien); IDAHO CODE § 40-1641 (1961) (highway tax lien); N.Y. TAX LAW § 692 (McKinney 1975) (income tax lien).

<sup>35</sup> 4 COLLIER, BANKRUPTCY ¶ 67.20[2], at 221 (14th ed. 1975); *see* 87 U. PA. L. REV. 317, 321-22 (1939).

<sup>36</sup> Most statutory liens were found valid under the Bankruptcy Act of 1898. *See, e.g.*, Henderson v. Mayer, 225 U.S. 631 (1912) (statutory landlord's lien upheld); *cf.* City of

The recognition afforded statutory liens in bankruptcy, however, inevitably led to certain abuses. Following passage of the 1938 amendments,<sup>37</sup> many creditors previously protected by state priorities convinced their state legislatures to create a multitude of new statutory liens<sup>38</sup> designed to replace the priorities vitiated by the 1938 Act. The end result of this action was continued depletion of bankrupt estates to the detriment of many unsecured creditors and the concomitant disruption of the federal order of priorities.

Undaunted by this stubborn resistance to the purposes of the Bankruptcy Act, Congress, in 1952, enacted legislation intended to differentiate between valid statutory liens and disguised state priorities.<sup>39</sup> The contemporary version of this legislation, section

Richmond v. Bird, 249 U.S. 174, 175-76 (1919) (typical statutory lien simply assumed to be valid).

<sup>37</sup> See text accompanying notes 18-19 *supra*. These amendments, while invalidating most state priorities, merely codified existing case law with respect to most statutory liens. 4 COLLIER, BANKRUPTCY ¶¶ 67.02[3], at 52, 67.20[2], at 212 (14th ed. 1975). The amendments validated most statutory liens as against the trustee, protected them from attack as voidable preferences, and even permitted them to be perfected after bankruptcy, subject to the time limitations of state law. Act of June 22, 1938, ch. 575, § 67, 52 Stat. 875, amending 11 U.S.C. § 107 (1934). The 1938 amendments did, however, subordinate statutory liens on personalty unaccompanied by possession to the payment of administration expenses and certain wage claims. *Id.* § 67(c), 52 Stat. 877. The rationale for continued enforcement of most statutory liens in bankruptcy was the belief that such liens merely codified the protection traditionally accorded valid property interests. See generally 4 COLLIER, BANKRUPTCY ¶¶ 67.20[1], [2] (14th ed. 1975); cf. S. REP. NO. 1159, 89th Cong., 2d Sess. 2 (1966), quoting H.R. REP. NO. 686, 89th Cong., 1st Sess. 2 (1965).

<sup>38</sup> See note 19 and accompanying text *supra*; H.R. REP. NO. 2320, 82d Cong., 2d Sess. 13 (1952); S. REP. NO. 1159, 89th Cong., 2d Sess. 2 (1966), quoting H.R. REP. NO. 686, 89th Cong., 1st Sess. 2 (1965).

From a creditor's point of view, a statutory lien was in some situations preferable to a priority. If the property subject to the lien was sufficiently valuable to cover the amount of the debt, the creditor with a statutory lien would recover the entire amount of his debt. A priority creditor, however, would be unable to recover any part of his debt until all secured creditors and those creditors with a higher priority were paid. Since it was quite possible that payment of all secured and higher priority creditors would completely deplete the bankrupt estate, the priority creditor might well recover nothing.

<sup>39</sup> Act of July 7, 1952, ch. 579, § 21(d), 66 Stat. 427, amending 11 U.S.C. § 107(c) (1946). The 1952 amendments invalidated against the trustee of an insolvent bankrupt estate those statutory liens on personalty which were not accompanied by possession, levy, sequestration, or distraint. *Id.* Under these provisions, statutory liens on realty were valid, as were statutory liens on personalty accompanied by possession, levy, sequestration, or distraint. It was believed that these provisions would distinguish effectively between statutory liens valid in the absence of bankruptcy and those inchoate "liens" which were contingent upon bankruptcy. See generally H.R. REP. NO. 2320, 82d Cong., 2d Sess. 13 (1952). The "possession" test applied under these provisions, however, proved rather unwieldy, and did not adequately differentiate between valid liens and disguised priorities. Unfortunately, the failure of traditionally valid liens to meet the requirements of this test was quite possible, whereas certain disguised priorities could readily do so. See H.R. REP. NO. 686, 89th Cong., 1st Sess. 5 (1965). In response to the failure of the 1952 amendments to achieve their purpose, Congress, in 1966, enacted the present version of these provisions. Act of July 5, 1966, Pub. L. No. 89-495, §§ 3-4, 80 Stat. 268, amending 11 U.S.C. §§ 107 (b)-(c) (1964) (codified at 11 U.S.C. §§ 107(b)-(c) (1970)). The reports of both Houses of Congress on the 1966 amendments state that the purpose of these changes was to invalidate "liens which merely determine the order of distribution . . . [and do not assert] a specific property right which may be



67c(1)(A) of the Bankruptcy Act,<sup>40</sup> invalidates any statutory lien taking effect upon insolvency of the debtor or distribution of the bankrupt estate. Section 67c(1)(B)<sup>41</sup> applies yet another test to any statutory lien not invalidated by section 67c(1)(A). This section invalidates against the trustee any statutory lien which, pursuant to state law, could not be successfully asserted against a bona fide purchaser from the bankrupt.

In applying section 67c(1)(A), several courts have found that section 2-702(2) of the Uniform Commercial Code creates a disguised state priority, and consequently, have held it inapplicable in bankruptcy as a statutory lien.<sup>42</sup> This result was first reached in *In re Federal's, Inc.*<sup>43</sup> The *Federal's* court was presented with a fact pattern which fit neatly within the ambit of section 2-702(2). The buyer had filed a petition in the bankruptcy court 6 days after delivery of the goods; and the seller had made his demand for return of the goods 2 days later. There had been no explicit misrepresentation of solvency, and the seller himself conceded that the buyer had intended to pay for the goods. Thus, the court was faced with a pure question of law,<sup>44</sup> that is, whether a seller who had met all the requirements of section 2-702(2) could recover the goods notwithstanding the provisions of the Bankruptcy Act. After reviewing the purpose and history of section 67c(1)(A), the court declared that whether the section is applicable to a particular statute is "determined by the practical effect of such [a state statute] and not merely by reference to the terminology employed."<sup>45</sup> The court concluded that although section 2-702(2) does not purport to create a statutory lien, it must be viewed as such because its effect is

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asserted independently of a general distribution . . ." S. REP. NO. 1159, 89th Cong., 2d Sess. 7 (1966), quoting H.R. REP. NO. 686, 89th Cong., 1st Sess. 6 (1965). See 4 COLLIER, BANKRUPTCY ¶ 67.20[2], at 221 (14th ed. 1975).

<sup>40</sup> Bankruptcy Act § 67c(1)(A), 11 U.S.C. § 107(c)(1)(A) (1970) invalidates against the trustee "every statutory lien which first becomes effective upon the insolvency of the debtor, or upon distribution or liquidation of his property, or upon execution against his property levied at the instance of one other than the lienor . . ."

<sup>41</sup> Bankruptcy Act § 67c(1)(B), 11 U.S.C. § 107(c)(1)(B) (1970), invalidates against the trustee "every statutory lien which is not perfected or enforceable at the date of bankruptcy against one acquiring the rights of a bona fide purchaser from the debtor on that date, whether or not such purchaser exists . . ." This seemingly extensive invalidation is curtailed somewhat by the next clause of the subsection, which validates such liens against the trustee if they are perfected as against a bona fide purchaser within the time limitations of state law, even though such perfection does not take place until after the date of bankruptcy. *Id.*

<sup>42</sup> See note 6 and accompanying text *supra*; note 47 *infra*.

<sup>43</sup> 12 UCC Rep. Serv. 1142 (Bankr. Ct. E.D. Mich. 1973), *aff'd*, 402 F. Supp. 1357 (E.D. Mich. 1975).

<sup>44</sup> Apparently the only factual question not yet settled was whether the buyer was insolvent as of the date of delivery. Determination of this question was reserved by the parties until the questions of law were decided. 12 UCC Rep. Serv. at 1144.

<sup>45</sup> *Id.* at 1153.

the same. Accordingly, reclamation was denied.<sup>46</sup> A similar result has been reached by the majority of courts presented with this issue.<sup>47</sup>

The opposite result was reached, however, by the only court of appeals presented with a direct challenge to the validity of section 2-702(2) in bankruptcy. In *Alfred M. Lewis, Inc. v. Holzman*,<sup>48</sup> the Court of Appeals for the Ninth Circuit utilized an extremely technical approach in arriving at its conclusion that section 2-702(2) creates neither a statutory lien nor a disguised state priority, and is therefore applicable in bankruptcy.<sup>49</sup> Conceding that this result

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<sup>46</sup> *Id.* Since there had been neither a specific misrepresentation of solvency nor a lack of intent to pay for the goods, the seller could not have reclaimed on the ground of common law fraud. *Id.* See notes 71-81 and accompanying text *infra*.

<sup>47</sup> In *In re Good Deal Supermarkets, Inc.*, 384 F. Supp. 887 (D.N.J. 1974), Judge Whipple declared that "when viewed realistically, [§ 2-702(2)] is indeed a statutory lien." *Id.* at 889. In reaching this decision, he looked to both the practical effect of § 2-702(2) and the purpose of § 67c(1)(A), and found that "[t]he Seller's right under [§ 2-702(2)] disrupts the federally created order of priorities just as surely as those state created priorities specifically designated as 'liens.'" *Id.* A similar rationale has been applied by several other courts which have held § 2-702(2) to be an invalid state priority. See *In re Federal's, Inc.*, 402 F. Supp. 1357 (E.D. Mich. 1975), *aff'g* 12 UCC Rep. Serv. 1142 (Bankr. Ct. E.D. Mich. 1973); *Carnation Plastic Mfg. Co. v. Giltex, Inc.*, 17 UCC Rep. Serv. 887 (S.D.N.Y. 1975); *Suzy Curtains, Inc. v. W.T. Grant Co.*, 7 Collier Bankr. Cas. (Bankr. Ct. S.D.N.Y. Nov. 14, 1975); *Ray-O-Vac v. Daylin, Inc.*, 5 Collier Bankr. Cas. 570 (Bankr. Ct. C.D. Cal. 1975); *Queensboro Farm Prods., Inc. v. Wetson's Corp.*, 4 Collier Bankr. Cas. 796 (Bankr. Ct. S.D.N.Y. 1975). In *In re National Bellas Hess, Inc.*, 4 Collier Bankr. Cas. 792 (Bankr. Ct. S.D.N.Y. 1975), however, Bankruptcy Judge Galgay apparently reached a different conclusion, declaring that § 2-702(2) was neither statutory nor a lien. See notes 58-60 and accompanying text *infra*.

Decisions holding that § 2-702(2) creates a statutory lien receive some support from cases dealing with analogous provisions in Louisiana and Puerto Rico. In *In re Trahan*, 283 F. Supp. 620 (W.D. La.), *aff'd per curiam*, 402 F.2d 796 (5th Cir. 1968), *cert. denied*, 394 U.S. 930 (1969), the court held that the Louisiana vendor's privilege creates a statutory lien. The statute in question provides that "[h]e who has sold to another any movable property, which is not paid for, has a preference on the price of his property . . ." LA. CIV. CODE ANN. art. 3227 (West 1952). The *Trahan* court looked to the nature of the right granted, rather than the terminology of the statute granting the right, and decided that it was a statutory lien. 283 F. Supp. at 623. *Trahan* was subsequently cited by the Court of Appeals for the First Circuit in *In re J.R. Nieves & Co.*, 446 F.2d 188, 189-90 (1st Cir. 1971). The *Nieves* panel simply assumed that a statutory lien was created by a Puerto Rican statute granting a preference on specified personal property for "[c]redits for . . . the amount of the sale of personal property which may be in the possession of the debtor to the extent of the value of the same." P.R. LAWS ANN. tit. 31, § 5192(1) (1968). Thus, it seems well settled that it is the nature and effect of the right granted, rather than the statutory language used to create the right, which determines the existence of a statutory lien.

<sup>48</sup> 524 F.2d 761 (9th Cir. 1975), *cert. denied*, 96 S. Ct. 1466 (1976).

<sup>49</sup> The *Lewis* panel chose to treat separately the trustee's contentions that § 2-702(2) creates an invalid statutory lien and an invalid state priority. For a discussion of the *Lewis* court's treatment of the state priority argument, see note 104 *infra*. In holding that § 2-702(2) does not create an invalid statutory lien, the court indicated that a state statute will be struck down as an invalid statutory lien only if it falls within the definition of preference contained in § 60 of the Bankruptcy Act, 11 U.S.C. § 96 (1970). This conclusion was based on a unique and somewhat tenuous interpretation of the legislative history of § 67 of the Bankruptcy Act, 11 U.S.C. 107 (1970).

Section 60 allows the trustee to avoid certain preferences. Preferences are defined by §

does conflict with the spirit of the Bankruptcy Act, the *Lewis* court nevertheless declared that this "loophole" could be eliminated only by Congress.<sup>50</sup>

### INVALIDATION UNDER SECTION 67c(1)(A)

Section 67c(1)(A) establishes a two-pronged test of invalidity: First, the property interest that is invalidated must take effect upon insolvency; and second, it must be a statutory lien.

#### *The Insolvency Requirement*

There is little doubt but that section 2-702(2) meets the first requirement, for by its very language it is applicable only upon the insolvency of the buyer.<sup>51</sup> It has been suggested, however, that

60 as any transfer to a creditor of the debtor's property made within 4 months prior to bankruptcy on account of an antecedent debt made while the debtor is insolvent. The term "transfer," as defined in § 1(30) of the Bankruptcy Act, 11 U.S.C. § 1(30) (1970), includes all liens. Realizing that § 60 would allow the trustee to avoid many statutory liens, the draftsmen of the 1938 amendments to the Bankruptcy Act enacted § 67b of the Bankruptcy Act, Act of June 22, 1938, ch. 575, § 67(b), 52 Stat. 876, as amended 11 U.S.C. § 107(b) (1970), which exempts all statutory liens from the operation of § 60. This legislation was in furtherance of the general policy of the 1938 draftsmen to protect most statutory liens. See note 37 *supra*. Subsequent amendments to the Act, however, invalidated against the trustee certain statutory liens which were in reality disguised state priorities. See notes 39-41 and accompanying text *supra*.

The *Lewis* court declared that § 67c(1)(A) of the Bankruptcy Act, 11 U.S.C. § 107(c)(1)(A), which presently provides for the invalidation of certain statutory liens, is not an independent method of invalidation, but rather is "a remedial trimming-back of the special exemption conferred on statutory liens by section 67b." 524 F.2d at 764. Reasoning that § 67c(1)(A) was intended to invalidate only those statutory liens which were saved from avoidance as preferences by the operation of § 67b, the Ninth Circuit held that § 2-702(2) is valid since it does not meet the "antecedent debt" requirement of § 60.

It is submitted that this analysis is incorrect. The *Lewis* rationale in effect treats § 67b as a definitional statute, and limits the use of the term "statutory lien" in § 67c(1)(A) to those statutory liens protected by § 67b. Section 67b, however, was not intended to, and in fact does not deal with the definition of statutory liens. It simply protects those statutory liens which would otherwise be subject to avoidance as preferences. See 4 COLLIER, BANKRUPTCY ¶ 67.20[2], at 214 (14th ed. 1975); 3 *id.* ¶¶ 60.12, 60.47. Although many statutory liens invalidated by § 67c(1)(A) undoubtedly could be avoided as preferences by § 60 were it not for § 67b, it does not follow that *only* these statutory liens are invalidated by § 67c(1)(A). Section 67c(1)(A) was intended to invalidate all priorities disguised as statutory liens, and not merely those which also may be classified by § 60 as preferences.

The *Lewis* court has taken two statutes enacted at different times for different reasons, and read into the prior provision a limitation upon the subsequent provision which is not indicated in either the language of the provisions or their histories. Section 67c(1)(A) operates to invalidate certain statutory liens which are in reality priorities, whereas § 67b operates to exempt from the operation of § 60 those statutory liens which fall within the statutory definition of preferences. Had Congress intended to invalidate only those state enactments which fulfill the requirements of both § 67c(1)(A) and § 60, it would have so stated, just as it has stated in § 67b that statutory liens protected thereby from the operation of § 60 may nonetheless be invalidated by § 67c(1)(A). See Bankruptcy Act § 67b, 11 U.S.C. § 107(b) (1970), which provides in part for the protection of statutory liens "except as otherwise provided in subdivision c of this section . . . ."

<sup>50</sup> 524 F.2d at 766.

<sup>51</sup> See note 1 *supra*.

since the definition of insolvency within the Code<sup>52</sup> is broader than the definition of insolvency within the Bankruptcy Act,<sup>53</sup> section 2-702(2) does not necessarily take effect upon "insolvency" within the meaning of the Bankruptcy Act and is therefore not invalidated by section 67c(1)(A).<sup>54</sup> This line of reasoning, however, is rather strained, and to accept it would be to obstruct the operation and intent of the Bankruptcy Act by allowing any state to enact an otherwise invalid statutory lien and assure its effectiveness by simply expanding the definition of insolvency.<sup>55</sup> Thus, it seems certain that if section 2-702(2) does create a statutory lien, it is invalidated by section 67c(1)(A), since it takes effect upon the insolvency of the buyer.<sup>56</sup>

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<sup>52</sup> UNIFORM COMMERCIAL CODE § 1-201(23) provides:

A person is "insolvent" who has either ceased to pay his debts in the ordinary course of business or cannot pay his debts as they become due or is insolvent within the meaning of the federal bankruptcy law.

<sup>53</sup> Bankruptcy Act § 1(19), 11 U.S.C. § 1(19) (1970) provides:

A person shall be deemed insolvent within the provisions of this title whenever the aggregate of his property, exclusive of any property which he may have conveyed, transferred, concealed, removed, or permitted to be concealed or removed, with intent to defraud, hinder, or delay his creditors, shall not at a fair valuation be sufficient in amount to pay his debts . . . .

Since the Code definition is concerned mainly with present ability to pay debts, whereas the bankruptcy definition turns upon a discrepancy between total assets and total liabilities, it is certainly possible for an individual with nonliquid assets to be insolvent within the meaning of the Code but not within the meaning of the Act.

<sup>54</sup> Henson, *Reclamation Rights of Sellers Under Section 2-702*, 21 N.Y.L.F. 41, 43, 52-53 (1975). Professor Henson contends that not only are the two statutory definitions different, but also that "[t]he triggering event of the seller's right of reclamation is not the buyer's insolvency (in the Code sense), but the receipt of goods while insolvent." *Id.* at 43. The basis of this argument would seem to be that since it is not merely insolvency, but rather insolvency plus delivery of the goods which "triggers" § 2-702(2), the insolvency requirement of the Bankruptcy Act is not met. Section 67c(1)(A), however, does not require that insolvency be the sole activating force. Rather, the section is applicable to statutory liens which do not take effect absent insolvency. Every statutory lien requires some underlying relationship which must be present for the lien to be "triggered." Acceptance of Professor Henson's argument would effectively vitiate § 67c(1)(A) in all situations, since there is *always* something more than mere insolvency involved; namely, that transaction or event which originally creates the debtor-creditor relationship.

<sup>55</sup> One eminent authority, noting the possibility that § 67c(1)(A) would not invalidate a state statutory lien based on an expanded definition of insolvency, nevertheless advocates the invalidation of such a lien to effectuate the purpose of the section. 4 COLLIER, BANKRUPTCY ¶ 67.281, at 419-20 (14th ed. 1975). Most commentators, including those who believe § 2-702(2) does not create a statutory lien, have apparently assumed that it does take effect upon insolvency. *See, e.g.,* Leibowitz, *Bankruptcy Practice*, 174 N.Y.L.J. 19, July 28, 1975, at 1, col. 1; Comment, *Statutory Liens Under Section 67c of the Bankruptcy Act: Some Problems of Definition*, 43 TUL. L. REV. 305, 328-29 (1969).

<sup>56</sup> Assuming for a moment that § 2-702(2) is a statutory lien, but that it does not meet the insolvency criterion of § 67c(1)(A), it would then presumably be invalidated by § 67c(1)(B). UNIFORM COMMERCIAL CODE § 2-702(3) (1972 version) subjects the right granted a seller by § 2-702(2) "to the rights of a buyer in ordinary course or other good faith purchaser under this Article (Section 2-403)." UNIFORM COMMERCIAL CODE § 2-403(1) (1972 version) provides, *inter alia*, that "[a] person with voidable title has power to transfer a good title to a good faith purchaser for value." Bankruptcy Act § 67c(1)(B), 11 U.S.C. § 107(c)(1)(B) (1970), invalidates against the trustee a statutory lien which could be defeated by a bona fide

### The Statutory Lien Requirement

The Bankruptcy Act defines a statutory lien as:

[A] lien arising solely by force of statute upon specified circumstances or conditions, but shall not include any lien provided by or dependent upon an agreement to give security, whether or not such lien is also provided by or is also dependent upon statute and whether or not the agreement or lien is made fully effective by statute.<sup>57</sup>

In *In re National Bellas Hess, Inc.*,<sup>58</sup> a bankruptcy judge apparently held that since section 2-702(2) merely codifies a common law right of action for fraud, it does not fall within the parameters of this definition. This decision appears incorrect for several reasons. The language and the history surrounding the enactment of this statutory definition suggests that its purpose is merely to distinguish between statutory and consensual liens, and therefore, codified common law liens may very well fall within the definition.<sup>59</sup> Re-

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purchaser. Thus, it would seem that if § 2-702(2) does create a statutory lien, the fact that it is subject to § 2-403(1) would invalidate § 2-702(2) against the trustee even if it does not take effect upon insolvency. See Kennedy, *The Interest of a Reclaiming Seller Under Article 2 of the Code*, 30 Bus. Law. 833, 841-42 (1975).

<sup>57</sup> Bankruptcy Act § 1(29a), 11 U.S.C. § 1(29a) (1970).

<sup>58</sup> 4 Collier Bankr. Cas. 792 (Bankr. Ct. S.D.N.Y. 1975). In *National Bellas*, Bankruptcy Judge Galgay declared that the right granted by § 2-702(2) is not statutory, and probably does not create a lien. *Id.* at 795-96. This case is, however, distinguishable from those cases holding that § 2-702(2) creates a statutory lien, since the seller in *National Bellas* fell within the written misrepresentation exception to the 10-day limit otherwise provided by § 2-702(2). See note 1 *supra*. An explicit misrepresentation of solvency, even if innocent, when relied upon by the seller, was sufficient to prove fraud under the common law in most jurisdictions. See, e.g., *Turner v. Ward*, 154 U.S. 618 (1876) (allowing reclamation in equity as a result of an innocent misrepresentation); *Manly v. Ohio Shoe Co.*, 25 F.2d 384, 385 (4th Cir. 1928) (stating in the course of an excellent discussion of reclamation that innocent misrepresentation is usually sufficient). *But see In re Woerderhoff Shoe Co.*, 184 F. Supp. 479, 487 (N.D. Iowa 1960), *aff'd sub nom. O'Rieley v. Endicott-Johnson Corp.*, 297 F.2d 1 (8th Cir. 1966) (knowledge of false misrepresentation required). Thus, the written misrepresentation provision of § 2-702(2) apparently codifies only the common law right of reclamation based upon proof of fraud. The similarity between these two causes of action is further enhanced by several cases which have interpreted the misrepresentation provision of § 2-702(2) as requiring that the seller actually rely upon the written misrepresentation, although the language of the section itself does not explicitly require reliance. See, e.g., *In re Hardin*, 458 F.2d 938, 940-41 (7th Cir. 1972) (assignee of seller cannot rely upon § 2-702(2) because assignee did not rely upon the misrepresentation); *Theo. Hamm Brewing Co. v. First Trust & Sav. Bank*, 103 Ill. App. 2d 190, 242 N.E.2d 911 (1968) (reliance upon the written misrepresentation is required). Such reliance has traditionally been an element of common law fraud. See, e.g., *Community Bank v. Bank of Hallandale & Trust Co.*, 482 F.2d 1124, 1126 (5th Cir. 1973); *Ochs v. Woods*, 221 N.Y. 335, 117 N.E. 305 (1917).

Indeed, in a subsequent decision, Bankruptcy Judge Galgay, the author of the *National Bellas* opinion, ruled that absent actual fraud, § 2-702(2) does create an invalid statutory lien. *Suzy Curtains, Inc. v. W. T. Grant Co.*, 7 Collier Bankr. Cas. 308 (Bankr. Ct. S.D.N.Y. Nov. 14, 1975).

<sup>59</sup> This definition of statutory lien was added to the Bankruptcy Act in 1966. Act of July 5, 1966, Pub. L. No. 89-495, § 1, 80 Stat. 268, *amending* 11 U.S.C. § 1 (1964). The congressional reports accompanying the amendment indicate that it was enacted to clarify

ardless of its origins, section 2-702(2) in its present form arises from operation of law rather than from any agreement between the parties. Moreover, to state that section 2-702(2) is merely a codification of a common law right is to ignore the significant differences between section 2-702(2) and the common law right it was intended to supplant.<sup>60</sup> It would seem clear then that section 2-702(2) does fall squarely within the ambit of the definition of a statutory lien furnished by the Bankruptcy Act. This conclusion is not dispositive of the issue, however, for the Bankruptcy Act definition of a statutory lien is actually a definition of the term "statutory" and not a definition of the word "lien."<sup>61</sup> In fact, a "lien" is nowhere defined within the Bankruptcy Act. Thus, it is appropriate to consider whether section 2-702(2) does, in fact, create a lien.<sup>62</sup>

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distinctions that evolved in the courts between statutory and consensual liens. See S. REP. NO. 1159, 89th Cong., 2d Sess. 6 (1966), quoting H.R. REP. NO. 686, 89th Cong., 1st Sess. 5 (1965). Prior to the enactment of the amendment, the Bankruptcy Act contained no definition of a statutory lien. Courts usually considered a statutory lien to be a lien arising from an economic relationship defined by the legislature and taking effect upon the occurrence of certain specified circumstances, rather than from an agreement between the parties or as a result of judicial proceedings. *In re Higgins*, 304 F. Supp. 108, 113 (D.S.D. 1969). Generally, three distinct types of lien were thought to exist: statutory, consensual, and judicial. See *Commercial Credit Co. v. Davidson*, 112 F.2d 54, 57 (5th Cir. 1940) (distinguishing among three types of lien); *Garrison v. Johnson*, 66 F.2d 227 (10th Cir.), cert. denied, 290 U.S. 668 (1933) (distinguishing between a statutory lien and a judicial lien); *In re Pioneer Oil & Gas Co.*, 333 F. Supp. 1055, 1059-60 (E.D. La. 1971) (a garnishment lien is not a statutory lien). In a decision holding that a landlord's lien is a statutory lien, the Court of Appeals for the Fifth Circuit stated that "most statutory liens are but incidents which the law annexes to a contract." *In re Brannon*, 62 F.2d 959, 961 (5th Cir.), cert. denied, 289 U.S. 742 (1933). It is the way in which a particular lien arises, rather than its historical origin, which determines whether a lien is statutory. For example, in *Goggin v. Bank of America Nat'l Trust & Sav. Ass'n*, 183 F.2d 322 (9th Cir.), cert. denied, 340 U.S. 877 (1950), the Court of Appeals for the Ninth Circuit held that a banker's lien which arose simply by operation of law was a statutory lien although the statute involved merely codified the common law banker's lien. Furthermore, if a lien is agreed to by the parties it is a consensual lien rather than a statutory lien, although the same lien would have arisen by statute absent any agreement. In *Savage v. McNeany*, 372 F.2d 199, 202 (10th Cir. 1967), a lease incorporating by reference a statutory landlord's lien was found to create a consensual rather than a statutory lien. *Accord*, *In re New Haven Clock & Watch Co.*, 253 F.2d 577 (2d Cir. 1958) (lien arose not from a statute, but from a contractual provision); *In re Tele-Tone Radio Corp.*, 133 F. Supp. 739 (D.N.J. 1955) (statute allowing parties to enter into a lien does not create a statutory lien).

<sup>60</sup> See text accompanying notes 82, 83, 95 & 107 *infra*.

<sup>61</sup> Bankruptcy Act § 1(29a), 11 U.S.C. § 1(29a) (1970), distinguishes between a statutory lien and a consensual lien, but does not define the meaning of the term lien. See text accompanying note 57 *supra*; 4 COLLIER, BANKRUPTCY ¶ 67.281[2.1], at 420 (14th ed. 1975).

<sup>62</sup> Indeed, it has been suggested that the answer to this question is determinative. See 2 R. ANDERSON, ON THE UNIFORM COMMERCIAL CODE § 2-702:4 (2d ed. 1970-1974 Cum. Supp.); 4 COLLIER, BANKRUPTCY ¶ 67.281[2.1], at 420 (14th ed. 1975); 4A *id.* ¶ 70.41, at 492; 3A R. DUESENBERG & L. KING, SALES AND BULK TRANSFERS UNDER THE UNIFORM COMMERCIAL CODE § 13.03[4][d][iv] n.80.1 (Supp. 1975); King, *Statutory Liens Under New § 67c of the Bankruptcy Act*, 42 REF. J. 11, 12 (1968). Yet this question may actually serve to obscure the basic issue. Even if § 2-702(2) does not create a lien within the traditional meaning of the term, it may still be subject to invalidation as a disguised priority. See the trust cases discussed in note 108 *infra*. Since § 67c(1)(A) was enacted to invalidate disguised state priorities, it

The term "lien" has been defined almost as often as it has been used.<sup>63</sup> As one legal scholar has noted, it "is one of the most amorphous concepts in law."<sup>64</sup> One commonly used definition states that a lien is "a charge or encumbrance upon property to secure the payment or performance of a debt, duty, or other obligation."<sup>65</sup> Although it has at times been classified as a property interest,<sup>66</sup> a lien is usually distinguished from either a direct ownership interest in or a right of action for property.<sup>67</sup> It is essentially a security interest in property.

In determining whether section 2-702(2) creates a statutory lien, the courts must consider its common law predecessor, the intent of the authors of the statute, and the effect its application has upon the effective operation of the Bankruptcy Act.<sup>68</sup> Section 2-702(2) is based upon a common law action for rescission of a fraudulently induced contract.<sup>69</sup> At common law, a seller could reclaim property sold to an insolvent upon proof that the contract had been fraudulently induced.<sup>70</sup> In order to succeed in a reclamation proceeding, it was necessary for the seller to prove actual fraud.<sup>71</sup> This could be done by showing either reliance by the seller

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purpose can best be effectuated by not limiting the term "statutory lien" to traditional liens. See note 97 *infra*.

<sup>63</sup> See BLACK'S LAW DICTIONARY 1072 (rev. 4th ed. 1968).

<sup>64</sup> Hanna, *Preferences as Affected by Section 60c and Section 67b of the Bankruptcy Law*, 25 WASH. L. REV. & ST. B.J. 1, 5 (1950) (footnote omitted).

<sup>65</sup> United States v. Phillips, 267 F.2d 374, 377 (5th Cir. 1959). See 53 C.J.S. *Liens* § 1, at 826 (1948); Hanna, *Preferences as Affected by Section 60c and Section 67b of the Bankruptcy Law*, 25 WASH. L. REV. & ST. B.J. 1, 5 n.5 (1950).

<sup>66</sup> See, e.g., *In re Pennsylvania Cent. Brewing Co.*, 135 F.2d 60, 63 (3d Cir. 1943) ("liens are property rights").

<sup>67</sup> See, e.g., *The Poznan*, 9 F.2d 838 (2d Cir. 1925), *rev'd on other grounds sub nom. New York Dock Co. v. Steamship Poznan*, 274 U.S. 117 (1927) (lien is not a property interest in the thing itself); *Powers v. Fidelity & Deposit Co.*, 180 S.C. 501, 186 S.E. 523 (1936) (lien does not constitute a right of action in the thing).

<sup>68</sup> See note 112 and accompanying text *infra*.

<sup>69</sup> Hogan, *The Marriage of Sales to Chattel Security in the Uniform Commercial Code: Massachusetts Variety*, 38 BOSTON U.L. REV. 571, 578-81 (1958); Manello, *An Illusory Remedy Under Section 2-702 of the Uniform Commercial Code*, 44 MASS. L.Q., Dec. 1959, at 109.

<sup>70</sup> See, e.g., *Donaldson v. Farwell*, 93 U.S. 631 (1877); *California Conserving Co. v. D'Avanzo*, 62 F.2d 528 (2d Cir. 1933); *Manly v. Ohio Shoe Co.*, 25 F.2d 384 (4th Cir. 1928); *In re Woerderhoff Shoe Co.*, 184 F. Supp. 479 (N.D. Iowa 1960), *aff'd sub nom. O'Riely v. Endicott-Johnson Corp.*, 297 F.2d 1 (8th Cir. 1961); *In re Monson*, 127 F. Supp. 625 (W.D. Ky. 1955); *In re Stridacchio*, 107 F. Supp. 486 (D.N.J. 1952); *In re Penn Table Co.*, 26 F. Supp. 887 (S.D.W. Va. 1939); *In re A.C. Kelly & Co.*, 6 F. Supp. 221 (S.D.N.Y. 1933); *Haywood Co. v. Pittsburgh Indus. Iron Works*, 163 F. 799 (W.D. Pa. 1908); *In re Hamilton Furniture & Carpet Co.*, 117 F. 774 (D. Ind. 1902); *cf. Montgomery v. Bucyrus Mach. Works*, 92 U.S. 257 (1875) (trustee cannot reclaim as a preference property voluntarily returned to defrauded seller by insolvent buyer); *Fisher v. Shreve, Crump & Low Co.*, 7 F.2d 159 (D. Mass. 1925) (voluntary return of goods to seller who could have reclaimed is not a preference).

<sup>71</sup> A seller who was unable to prove fraud could not reclaim the goods and was relegated to the status of a general unsecured creditor. For example, in *In re Sherman*, 13 F.2d 121 (2d Cir. 1926) (*per curiam*), although the bankrupt was aware that he was insolvent at the time of the sale and concealed that fact from the seller, reclamation was denied since the

upon the buyer's explicit misrepresentation of solvency,<sup>72</sup> or a lack of intent to pay for the goods at the time of the transaction.<sup>73</sup> Although several inferences were utilized to facilitate a finding of fraud,<sup>74</sup> mere proof that the buyer was insolvent at the time of the transaction was usually not sufficient.<sup>75</sup> Indeed, even proof that the buyer was aware of his own insolvency at the time of the transaction was not always sufficient.<sup>76</sup>

Underlying the common law right of reclamation was the theory that a sale of property induced by fraud transferred, at most, voidable title to the buyer.<sup>77</sup> A defrauded seller had a choice between two mutually exclusive remedies: he could either rescind the contract and reclaim the goods, or he could affirm the contract and sue for any damages resulting from the buyer's fraudulent

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seller was unable to prove either an explicit misrepresentation of solvency or a lack of intent to pay. *Accord*, *In re Bentzel*, 161 F. Supp. 219 (D. Md. 1958) (reclamation denied because of insufficient proof of fraud). *In re Tate-Jones & Co.*, 85 F. Supp. 971 (W.D. Pa. 1949), the court refused to allow a purchaser to recover his down payment from a bankrupt seller because of insufficient proof of fraud. In so holding, the court stated that "the intent not to pay is not a necessary inference from mere insolvency." *Id.* at 983. In those cases permitting reclamation, the courts clearly indicated that proof of fraud was a necessary element. *See*, e.g., *Manly v. Ohio Shoe Co.*, 25 F.2d 384, 385 (4th Cir. 1928) ("in every case the fraud must be established to the satisfaction of the court by evidence clear, unequivocal and convincing."); *O'Rieley v. Endicott-Johnson Corp.*, 297 F.2d 1, 4 (8th Cir. 1961) ("[f]raud is not to be presumed.") (citation omitted); *In re A.C. Kelly & Co.*, 6 F. Supp. 221 (S.D.N.Y. 1933) (mere insolvency, absent other circumstances indicating lack of intent to pay, does not allow an inference of fraud).

<sup>72</sup> *See*, e.g., *In re Hamilton Furniture & Carpet Co.*, 117 F. 774 (D. Ind. 1902).

<sup>73</sup> As was stated by the Supreme Court in *Donaldson v. Farwell*, 93 U.S. 631, 633 (1877), "a party not intending to pay . . . is guilty of a fraud which entitles the vendor . . . to disaffirm the contract and recover the goods." (citations omitted). *Accord*, *California Conserving Co. v. D'Avanzo*, 62 F.2d 528, 530 (2d Cir. 1933); *In re Penn Table Co.*, 26 F. Supp. 887, 889 (S.D.W. Va. 1939).

<sup>74</sup> The courts allowed reclamation when the facts and circumstances required that the inference of a lack of intent to pay be drawn. For example, in *Haywood Co. v. Pittsburgh Indus. Iron Works*, 163 F. 799 (W.D. Pa. 1908), the goods were delivered while the buyer was admittedly insolvent and had already notified all other creditors of his insolvency. The court allowed reclamation, stating that there was no reasonable possibility of payment and it was highly unlikely that the buyer was not aware of this. *Accord*, *In re Penn Table Co.*, 26 F. Supp. 887 (S.D.W. Va. 1939) (reclamation permitted since buyer could have had no reasonable expectation of paying).

<sup>75</sup> *See* note 71 *supra*.

<sup>76</sup> *See*, e.g., *In re Sherman*, 13 F.2d 121 (2d Cir. 1926) (per curiam) (reclamation denied although buyer was aware of his own insolvency). It was noted in *In re Tate-Jones & Co.*, 85 F. Supp. 971, 983 (W.D. Pa. 1949) that "[e]ven an insolvent person may expect to extricate himself and have an honest intent to pay." In deciding whether a buyer had the intent to pay, the courts apparently looked to the extent of the insolvency, specifically at whether a person in such circumstances could entertain an honest and reasonable hope of improving his financial condition. *See*, e.g., *In re Penn Table Co.*, 26 F. Supp. 887 (S.D.W. Va. 1939) (reclamation allowed because buyer could not have had any reasonable expectation of extricating himself).

<sup>77</sup> *See*, e.g., *Manly v. Ohio Shoe Co.*, 25 F.2d 384, 385 (4th Cir. 1928) ("fraud renders all contracts voidable . . ."); *In re Stridacchio*, 107 F. Supp. 486 (D.N.J. 1952) (reclamation does not create a preference because seller is merely retaking his own property); *Fisher v. Shreve, Crump & Low Co.*, 7 F.2d 159 (D. Mass. 1925) (fraud entitles defrauded party to rescind the contract and reclaim his property).



conduct.<sup>78</sup> Clearly, the latter remedy was fruitless when the fraudulent party was bankrupt.

Reclamation was allowed in bankruptcy under the equitable theory that it would be as unjust to allow a bankrupt's other creditors to profit by his fraud as it would be to allow the bankrupt himself to profit by it.<sup>79</sup> Furthermore, since the trustee took title only to that which the bankrupt had, the trustee was considered to have only that voidable title which the bankrupt possessed.<sup>80</sup> Based upon these premises, bankruptcy courts granted reclamation in those situations where rescission was appropriate under state law.<sup>81</sup>

Section 2-702(2) modifies this common law action for rescission of a fraudulently induced contract by establishing an irrebuttable presumption of fraud if the bankrupt is insolvent when the goods are delivered, the seller learns of this, and is able to demand return of the goods within 10 days of delivery.<sup>82</sup> The stated purpose of the draftsmen of section 2-702(2) was to extend the protection afforded a seller of goods on credit by relieving him of the necessity of proving fraud.<sup>83</sup> It has been maintained, however, that in so doing the draftsmen failed to properly evaluate the relationship between common law reclamation and federal bankruptcy law.<sup>84</sup>

<sup>78</sup> This choice of remedies was thought to be dictated by the contradictory theories upon which these remedies were based, *i.e.*, by reclaiming the goods, the seller disaffirmed the contract, whereas by suing for damages he affirmed the contract. *See, e.g.*, *Walker v. L. Maxcy, Inc.*, 103 F.2d 24, 26 (5th Cir.), *cert. denied*, 308 U.S. 564 (1939) (defrauded party cannot pursue both remedies).

<sup>79</sup> For example, in *Manly v. Ohio Shoe Co.*, 25 F.2d 384 (4th Cir. 1928), the Court of Appeals for the Fourth Circuit declared:

[N]either in law nor in morals would the trustee be justified in holding goods obtained by the fraud of the bankrupt for the benefit of other creditors. Such creditors have no right to profit by the fraud of the bankrupt to the wrong and injury of the party who has been deceived and defrauded.

*Id.* at 385 (citations omitted). *Accord, In re Penn Table Co.*, 26 F. Supp. 887, 890 (S.D.W. Va. 1939).

<sup>80</sup> *See* 3 COLLIER, BANKRUPTCY ¶ 60.18 (14th ed. 1975).

<sup>81</sup> *See In re Woerderhoff Shoe Co.*, 184 F. Supp. 479, 482 (N.D. Iowa 1960), *aff'd sub nom. O'Rieley v. Endicott-Johnson Corp.*, 297 F.2d 1 (8th Cir. 1961) ("[w]hether or not the petitioner is entitled to rescind . . . is a question to be determined under [state] law." (citation omitted)); *In re Tate-Jones & Co.*, 85 F. Supp. 971 (W.D. Pa. 1949) (property rights are normally determined by state law); Comment, *Bankruptcy—Reclamation and the Uniform Commercial Code*, 33 Mo. L. Rev. 262, 266-67 (1968) (discussing the common law right of reclamation). *See also* MacLachlan, *The Title and Rights of the Trustee in Bankruptcy*, 14 RUTGERS L. REV. 653 (1960).

<sup>82</sup> *See* UNIFORM COMMERCIAL CODE § 2-702, Comment.

<sup>83</sup> *Id.*

<sup>84</sup> Countryman, *Buyers and Sellers of Goods in Bankruptcy*, 1 N.M.L. Rev. 435 (1971). The possibility that § 2-702(2) conflicts with the Bankruptcy Act has been noted by a number of commentators. *See* note 4 *supra*; 4 COLLIER, BANKRUPTCY ¶ 67.281[2.1], at 420-21 (14th ed. 1975) (§ 2-702(2) may be invalidated by § 67c(1)(A)); 4A *id.* ¶ 70.41, at 492-93 (it is uncertain whether § 2-702(2) creates a lien); Ashe, *Reclamation Under the UCC—An Exercise in Futility*, 43 REF. J. 78 (1969) (§ 2-702(2) does not afford sufficient protection for the seller). Most commentators have merely assumed, however, that § 2-702(2) is valid in bankruptcy. *See*,

This line of reasoning suggests that they should have taken into account the fact that reclamation is not favored in bankruptcy, and is allowed only because of the inequity which would necessarily result if creditors were able to profit by the fraudulent behavior of the bankrupt.<sup>85</sup>

It is absurd to suggest that the common law cause of action created a statutory lien. The common law action was based not upon the insolvency of the buyer and the purely fortuitous circumstance that the seller learned of his insolvency within a few days of delivery, but rather upon the fraudulent conduct of the buyer.

Indeed, common law reclamation could not be classified as any type of lien. The distinction between a reclamation proceeding and a lien is clear. The right of reclamation is based upon the traditional concept of title. Although title normally passed upon receipt of the goods by the purchaser, such title was voidable if the sale was induced by fraud.<sup>86</sup> In reclaiming the goods, the seller was merely vitiating the buyer's voidable title and reasserting his own title to the goods. A lien, in contradistinction, is a security interest in property,<sup>87</sup> and as such, is not based on passage of title. The lienor's interest is not in the goods themselves, but is grounded on the underlying debt or obligation.<sup>88</sup>

Successful reclamation of the goods at common law was an exclusive remedy. The reclaiming seller was required to return any payment he may have received for the goods and was unable to institute an action to recover any damages he may have suffered as

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*e.g.*, Braucher, *Reclamation of Goods from a Fraudulent Buyer*, 65 MICH. L. REV. 1281, 1290, 1295 (1967) (§ 2-702(2) clearly involves a right to rescind rather than a statutory lien); King, *Statutory Liens Under New § 67c of the Bankruptcy Act*, 42 REF. J. 11, 12 (1968) (§ 2-702(2) is valid because the legislative history of the Bankruptcy Act suggests no intent to invalidate it); King, *Reclamation Petition Granted: In Defense of the Defrauded Seller*, 44 REF. J. 81 (1970) (suggesting that while § 2-702(2) may be invalid in theory, it will still be applied as a mere codification of existing law); Murphy, *Some Problems Concerning Sellers' Remedies Under the Amended Uniform Commercial Code in Pennsylvania*, 33 TEMP. L.Q. 273, 279-80 (1960) (§ 2-702(2) limits rather than extends the seller's rights). Professor Countryman, in an article written prior to the development of any case law in this area, was the first commentator to seriously maintain that § 2-702(2) is invalid in bankruptcy. Countryman, *Buyers and Sellers of Goods in Bankruptcy*, 1 N.M.L. REV. 435, 451-59 (1971). After first suggesting that there is little reason for the unsecured seller of goods on credit to be favored above other creditors, *id.* at 435, he then declared that by relieving the seller of the burden of fraud, the Code changed the common law right of reclamation into a disguised state priority. *Id.* at 452.

<sup>85</sup> See notes 79, 105 & 106 and accompanying text *infra*.

<sup>86</sup> See note 77 and accompanying text *supra*.

<sup>87</sup> See notes 65-67 and accompanying text *supra*.

<sup>88</sup> See, *e.g.*, *Springer v. J.R. Clark Co.*, 138 F.2d 722, 726 (8th Cir. 1943) (a lien is a "charge upon property," rather than an "interest in property."); *Terry Contracting, Inc. v. State*, 51 Misc.2d 545, 548, 273 N.Y.S.2d 528, 532 (Ct. Cl. 1966), *rev'd on other grounds*, 27 App. Div. 2d 499, 280 N.Y.S.2d 450 (3d Dep't 1967) (a lien is a charge or security upon property, not an interest in property).

a result of the transaction.<sup>89</sup> In comparison, the attachment and sale of property subject to a lien is not an exclusive remedy; the lienor is entitled to a deficiency judgment for the remainder of the underlying obligation.<sup>90</sup> Thus, the common law right of reclamation clearly was not a lien, and if section 2-702(2) merely codified this right of action, a statutory lien would not be created.

This rationale was apparently adopted by the bankruptcy court in *In re National Bellas Hess, Inc.*<sup>91</sup> There, Bankruptcy Judge Galgay simply identified section 2-702(2) with the common law right of reclamation and held that its operation did not create a statutory lien.<sup>92</sup> Significantly, in *National Bellas*, the buyer had made an explicit misrepresentation of solvency;<sup>93</sup> thus, the seller could have reclaimed under common law.<sup>94</sup> In the typical section 2-702(2) case, however, there is no explicit misrepresentation.

Section 2-702(2) was *not* intended to, and in fact, does not simply codify the common law right of action for reclamation on the ground of fraud. Rather, it was intended to extend the protection afforded the seller of goods on credit by the common law.<sup>95</sup> Hence, simply showing that the common law right did not create a statutory lien is not determinative of the status of section 2-702(2) in bankruptcy. In determining whether section 2-702(2) is invalid in bankruptcy, the courts must take into account the purpose of section 67c(1)(A) as well. Section 67c(1)(A) was not intended to invalidate the traditional type of lien, from which the common law right of reclamation is easily distinguished, but rather was intended to invalidate priorities disguised as liens.<sup>96</sup> It is submitted that

<sup>89</sup> Underlying this result was the theory that reclamation was based on rescission, a remedy which necessarily involved a disaffirmance of the contract. Once the contract was disaffirmed, nothing remained upon which an action for damages could be brought. See note 78 and accompanying text *supra*.

<sup>90</sup> See, e.g., *Schmidtman v. Atlantic Phosphate & Oil Corp.*, 230 F. 769, 771 (2d Cir. 1916).

<sup>91</sup> 4 Collier Bankr. Cas. 792 (Bankr. Ct. S.D.N.Y. 1975).

<sup>92</sup> *Id.* at 795.

<sup>93</sup> *Id.* at 793.

<sup>94</sup> See note 58 *supra*.

<sup>95</sup> UNIFORM COMMERCIAL CODE § 2-702(2), Comment.

<sup>96</sup> See note 39 and accompanying text *supra*; *In re Chesterfield Developers, Inc.*, 285 F. Supp. 689, 690 (S.D.N.Y. 1968) ("[t]he purpose of [§ 67c(1)(A)] is to invalidate an attempt by a State statute to force a priority system upon a bankruptcy administration." (citation omitted)).

It has been suggested that since § 2-702(2) had been enacted in many jurisdictions at the time of the 1966 amendments to the Bankruptcy Act, the failure to specifically invalidate § 2-702(2) by a new amendment implies an intent to validate it. See King, *Statutory Liens Under New § 67c of the Bankruptcy Act*, 42 REF. J. 11, 12 (1968); Leibowitz, *Bankruptcy Practice*, 174 N.Y.L.J. 19, July 28, 1975, at 4, cols. 1-2; cf. Henson, *Reclamation Rights of Sellers Under Section 2-702(2)*, 21 N.Y.L.F. 41, 51 (1975). This argument, however, is unconvincing. There

section 2-702(2) creates exactly that sort of state priority which section 67c(1)(A) was intended to invalidate.<sup>97</sup>

In *Manly v. Ohio Shoe Co.*,<sup>98</sup> a trustee in bankruptcy attempted to defeat a defrauded seller's common law reclamation petition by contending that reclamation would be an invalid preference. In rejecting this contention, the Court of Appeals for the Fourth Circuit declared that reclamation could not create an improper preference because "in every case the fraud must be established to the satisfaction of the court by evidence clear, unequivocal, and convincing."<sup>99</sup> Thus, it is clear that it was the requirement that fraud be proven which justified reclamation from the bankrupt estate.

Numerous commentators urge that section 2-702(2) should be viewed as merely a codification of this common law cause of action, and should therefore be granted the same privileged position in bankruptcy law.<sup>100</sup> Those who have adopted this argument suggest that the replacement of the common law fraud requirement by section 2-702(2)'s irrebuttable presumption be construed as either a

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seems to have been no specific consideration given either to § 2-702(2) or to the seller's right of reclamation by the draftsmen of the 1966 amendments. See S. REP. NO. 1159, 89th Cong., 2d Sess. (1966); H.R. REP. NO. 686, 89th Cong., 1st Sess. (1965). It would be tenuous at best to claim the existence of an intent to validate this section in view of the lack of attention given this potential conflict. Since § 2-702(2) was not specifically considered, any argument turning on legislative intent must be based on the general principles embodied in the amendments, as well as the general intent of the draftsmen. As was discussed previously, the primary purpose motivating the framers of the amendment was the invalidation of disguised state priorities. Section 67c(1)(A) was aimed not merely at specific statutes that had been enacted at the time of the amendment, but at a general class of statutes, *viz.*, statutes which created state priorities. If § 2-702(2) is a member of this class, the fact that the draftsmen of § 67c(1)(A) did not have § 2-702(2) before them is immaterial. Undoubtedly, the same could be said of many statutory liens.

<sup>97</sup> This conclusion was reached by the court in *Queensboro Farm Prods., Inc. v. Wetson's Corp.*, 4 Collier Bankr. Cas. 796 (Bankr. Ct. S.D.N.Y. 1975). After reviewing the history of § 67c(1)(A) and determining that its chief purpose is to invalidate disguised priorities, Bankruptcy Judge Herzog stated that "a loose definition should be given the term 'lien' so that as many state-created priorities as possible can be invalidated." *Id.* at 801. He then held § 2-702(2) invalid as both a statutory lien taking effect upon insolvency and as a state-created priority. *Id.* at 802. A similar rationale was applied by the district court in *In re Federal's, Inc.*, 402 F. Supp. 1357 (E.D. Mich. 1975). The *Federal's* court declared that § 2-702(2) creates an invalid statutory lien which "plainly operates as a priority in derogation of the scheme of distribution provided by the Bankruptcy Act." *Id.* at 1368.

<sup>98</sup> 25 F.2d 384 (4th Cir. 1928).

<sup>99</sup> *Id.* at 385. See notes 70-76 and accompanying text *supra*.

<sup>100</sup> See 3A R. DUESENBERG & L. KING, SALES AND BULK TRANSFERS UNDER THE UNIFORM COMMERCIAL CODE § 13.03[4][d][iv] n.80.1 (Supp. 1975); J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE § 7-15 (1972); Henson, *Reclamation Rights of Sellers Under Section 2-702*, 21 N.Y.L.F. 41 (1975); Leibowitz, *Bankruptcy Practice*, 174 N.Y.L.J. 19, July 28, 1975, at 4, col. 2; Note, *Bankruptcy and Article Two of the Uniform Commercial Code*, 79 HARV. L. REV. 598 (1966); 53 N.C.L. REV. 169 (1974); Comment, *Statutory Liens Under Section 67c of the Bankruptcy Act: Some Problems of Definition*, 43 TUL. L. REV. 305 (1969).

mere change in the rules of evidence<sup>101</sup> or an expansion of the meaning of the term fraud.<sup>102</sup>

A similar rationale was adopted by the Court of Appeals for the Ninth Circuit in *Alfred M. Lewis, Inc. v. Holzman*.<sup>103</sup> Realizing that section 2-702(2) involves more than a mere codification of the common law right of reclamation, a unanimous panel interpreted this section as creating a new ground for rescission of a contract — receipt of goods while insolvent. The court viewed the Bankruptcy Act as embodying two contradictory policies: First, pro rata distribution to all creditors, and second, the acceptance of state property law unless specifically proscribed. Since the Act does not specifically forbid the recognition of novel state grounds for rescission, the *Lewis* court found it necessary to uphold the application of section 2-702(2).<sup>104</sup>

The fallacy present in this analysis stems from the failure to perceive that absent actual fraud,<sup>105</sup> there would appear to be no equitable justification for depleting the bankrupt estate to the detriment of the general creditors. Reclamation proceedings are not viewed with favor in bankruptcy,<sup>106</sup> and were traditionally allowed only because it was considered unjust to grant the bankrupt estate title to that which by both law and equity belonged to another. In some cases, however, the operation of section 2-702(2) disrupts the careful balance between the rights of the seller and those of other creditors.

In the name of uniformity, equity has been sacrificed to

<sup>101</sup> See, e.g., 1 N.Y. LAW REVISION COMM'N, REPORT ON THE UNIFORM COMMERCIAL CODE 126, Leg. Doc. No. 65(B) (1954) (memorandum of Professor K.N. Llewellyn) (§ 2-702(2) "merely standardizes the misrepresentation of solvency . . ."); 3A R. DUESENBERG & L. KING, SALES AND BULK TRANSFERS UNDER THE UNIFORM COMMERCIAL CODE § 13.03[4][d][iv] n.80.1 (Supp. 1975) (§ 2-702(2) merely changes the rules of evidence); Note, *Bankruptcy and Article Two of the Uniform Commercial Code*, 79 HARV. L. REV. 598, 611-12 (1966) (§ 2-702(2) merely changes the burden of proof in rescission actions).

<sup>102</sup> It has been argued that § 2-702(2) "allows reclamation on the basis of an expanded definition of fraud rather than on the basis of a non-fraudulent ground." 45 CORNELL L.Q. 566, 569 (1960).

<sup>103</sup> 524 F.2d 761 (9th Cir. 1975), cert. denied, 96 S. Ct. 1466 (1976). For a discussion of another aspect of the *Lewis* decision, see note 49 *supra*.

<sup>104</sup> 524 F.2d at 766. Having accepted the validity of this novel ground for rescission, the *Lewis* panel utilized traditional property concepts to explain the legal effect of reclamation under § 2-702(2). The court declared that since the contract could be rescinded, the insolvent buyer received at most voidable title to the goods. *Id.* at 765. Holding that a state-created right is an invalid priority only if it attaches to property which the bankrupt holds by a nondefeasible title, the court thereby concluded that § 2-702(2) could not create an invalid state priority. *Id.* at 765-66.

<sup>105</sup> See note 79 and accompanying text *supra*. The proof of fraud requirement was so basic to common law reclamation that one court interpreting § 2-702(2) has stated that "[t]he reclamation remedy provided by [§ 2-702(2)] requires a showing of fraud or deceit . . ." *In re Food Center of Delhi, Inc.*, 353 F. Supp. 502, 503 (W.D. La. 1973).

<sup>106</sup> *O'Rieley v. Endicott-Johnson Corp.*, 297 F.2d 1, 4 (8th Cir. 1961).

achieve administrative simplicity and ease of application<sup>107</sup> to the detriment of a significant number of both unsecured creditors and defrauded sellers. The establishment of an irrebuttable presumption of fraud permits sellers who were *not* defrauded to reclaim property which otherwise would be available for distribution among all of the unsecured creditors. The Code limits the utilization of this rebuttable presumption to those sellers who fortuitously learn of the buyer's insolvency and are able to take effective action within 10 days of delivery. Consequently, its effect is to provide for the distribution among unsecured creditors of property which properly belongs to those sellers who, although they did not learn of the buyer's insolvency within 10 days, could prove fraud if given the opportunity.

These results are incompatible with both the purpose of the Bankruptcy Act and the nature of a court of equity. The establishment of an irrebuttable presumption of fraud if goods are reclaimed from an insolvent buyer within 10 days of receipt is more than a mere change in the rules of evidence. It is a substantive change in the law. While a state can regulate the ownership of property within constitutional limits, it is clear that any state law which interferes with the full effectiveness of federal bankruptcy law is inapplicable once bankruptcy has intervened.<sup>108</sup>

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<sup>107</sup> Pursuant to § 2-702(2), the court need only determine that the bankrupt was insolvent at the date of delivery and that the seller began his attempt to reclaim within 10 days of delivery. This is obviously a much simpler determination than an inquiry into whether fraud has been committed. For a discussion of the reclamation requirements under § 2-702(2), see Leibowitz, *Bankruptcy Practice*, 173 N.Y.L.J. 120, June 23, 1975, at 1, col. 1.

<sup>108</sup> See note 5 and accompanying text *supra*; note 112 *infra*. For a thoughtful analysis of the validity of state law in bankruptcy, see Hill, *The Erie Doctrine in Bankruptcy*, 66 HARV. L. REV. 1013 (1953).

Similar to the considerations found in a discussion of § 2-702(2) are those present in cases dealing with the reclamation of trust funds from a bankrupt. It has long been accepted that funds held by the bankrupt in trust for another are not property of the bankrupt and may be reclaimed by the beneficiaries. See, e.g., *Todd v. Pettit*, 108 F.2d 139, 140 (5th Cir. 1939). Successful reclamation of trust funds requires not only proof of the existence of a trust, but also sufficient identification of the trust funds. If the trust funds have been mingled with the bankrupt's property, the claimant must trace the trust funds. Absent sufficient identification, reclamation will be denied. E.g., *American Serv. Co. v. Henderson*, 120 F.2d 525, 530-31 (4th Cir. 1941). Although the valid establishment of a trust is normally a matter of state law, attempts by a state to impose a lien on trust funds without requiring sufficient identification of the funds have been invalidated in bankruptcy. For example, in *Elliott v. Bumb*, 356 F.2d 759 (9th Cir. 1966), the Court of Appeals for the Ninth Circuit refused to apply in bankruptcy a state law that purported to create a lien against the bankrupt's assets in favor of the beneficiaries of a trust without imposing an identification of funds requirement. In so holding, the court declared that state law cannot remove the burden of identifying and tracing trust funds, since the effect of this would be to create a state priority analogous to a statutory lien. *Accord*, *Lusk Corp. v. Arizona State Tax Comm'n*, 462 F.2d 187, 189 (9th Cir. 1972) (state cannot vitiate the tracing requirement); cf. *United States v. Randall*, 401 U.S. 513 (1971) (trust established by federal tax law invalid absent tracing of funds). For a more detailed discussion of trust funds in bankruptcy situations, see

The Bankruptcy Act should be interpreted liberally in order to effectuate its principal purpose, that is, equitable distribution of the assets of the bankrupt.<sup>109</sup> Although section 2-702(2) does not create a lien within the traditional meaning of the term,<sup>110</sup> what it does create has the same effect in a bankruptcy situation as does a statutory lien. By favoring a particular class of creditors at the expense of the general creditors, section 2-702(2) results in a state-created priority.<sup>111</sup> When a state law is challenged on the basis of an alleged conflict with federal bankruptcy law, a federal court must look to the purpose of the federal law and the effect operation of the state law has upon the achievement of this purpose. If as a result of this inquiry, the court finds that application of the state law will frustrate "the full effectiveness of federal law," it must strike down the state law.<sup>112</sup>

It is at this point that the *Lewis* analysis of section 2-702(2) falters. Although the adoption of novel grounds for rescission is not specifically forbidden by the Bankruptcy Act, the application of such new grounds in bankruptcy must surely interfere with the "full effectiveness" of the Act. Thus, it seems clear that section 2-702(2) should indeed be invalid against a trustee in bankruptcy.<sup>113</sup>

4A COLLIER, BANKRUPTCY ¶ 70.25 (14th ed. 1975). Although the relationship between state trust law and federal bankruptcy law is not yet completely clear, the proper approach would seem to require application of state law unless this would result in the enforcement of a state priority. *Id.*, at 363-64. It seems appropriate that the same standard be applied in evaluating § 2-702(2).

<sup>109</sup> See, e.g., *Williams v. United States Fidelity & Guar. Co.*, 236 U.S. 549, 554-55 (1915).

<sup>110</sup> Section 2-702(2) is theoretically distinguishable from a traditional lien in much the same way as is the common law right of action for rescission. See text accompanying notes 86-90 *supra*. For example, under § 2-702(2), the seller's interest lies in the recovery of the goods themselves rather than in the underlying debt, and recovery, if successful, is an exclusive remedy. See UNIFORM COMMERCIAL CODE § 2-702(3) (1972 version).

<sup>111</sup> See, e.g., *In re Good Deal Supermarkets, Inc.*, 384 F. Supp. 887, 889 (D.N.J. 1974), discussed in note 47 *supra*; 4A COLLIER, BANKRUPTCY ¶ 70.41, at 492-93 (14th ed. 1975).

<sup>112</sup> In *Hines v. Davidowitz*, 312 U.S. 52 (1941), the Supreme Court, in holding that a Pennsylvania alien registration law had been superseded by federal law, stated:

In the final analysis there can be no crystal clear distinctly marked formula. Our primary function is to determine whether . . . [state] law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.

*Id.* at 67-68 (footnotes omitted). This test has since been applied to determine whether a conflict exists between state law and federal bankruptcy law. In *Perez v. Campbell*, 402 U.S. 637 (1971), the Court invalidated a state statute which provided that the revocation of a driver's license due to an unpaid judgment would not be terminated by a discharge in bankruptcy. In ruling that the statute was invalid, the court applied "the controlling principle that any state legislation which frustrates the full effectiveness of federal law is rendered invalid by the Supremacy Clause." *Id.* at 652.

<sup>113</sup> The practical effect of the operation of § 2-702(2) is to impose a state-created priority upon the bankrupt estate, something which clearly interferes with the federal scheme of distribution contemplated by the Bankruptcy Act. See note 47 *supra*.

## THE EFFECT OF INVALIDATION

Unfortunately, the invalidation of section 2-702(2) in bankruptcy presents one further question, namely, whether the seller may recover the goods via some other remedy. The last sentence of section 2-702(2) reads: "Except as provided in this subsection the seller may not base a right to reclaim goods on the buyer's fraudulent or innocent misrepresentation of solvency or of intent to pay."<sup>114</sup> According to several authorities, if section 2-702(2) is invalid against the trustee in bankruptcy, this sentence precludes reclamation by a defrauded seller.<sup>115</sup> This conclusion is based on the theory that it is merely the application of section 2-702(2) against the trustee in bankruptcy, rather than the section per se, which is invalidated.

This line of reasoning was decisively refuted in *Queensboro Farm Products, Inc. v. Wetson's Corp.*<sup>116</sup> After holding section 2-702(2) invalid in bankruptcy, Bankruptcy Judge Herzog declared that the section is an exclusive remedy only when it is not invalidated by the Bankruptcy Act. Stating that any other solution would be "abhorrent to a court of equity," he dismissed the seller's 2-702(2) suit without prejudice to the filing of a new complaint seeking reclamation on the basis of fraud.<sup>117</sup>

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<sup>114</sup> UNIFORM COMMERCIAL CODE § 2-702(2) (1972 version).

<sup>115</sup> See 3A R. DUESENBERG & L. KING, SALES AND BULK TRANSFERS UNDER THE UNIFORM COMMERCIAL CODE § 13.03[4][b] n.23.1 (Supp. 1975); 35 U. PITT. L. REV. 922, 933 (1974); cf. Kennedy, *The Interest of a Reclaiming Seller Under Article Two of the Code*, 30 BUS. LAW. 833, 842-43 (1975).

<sup>116</sup> 4 Collier Bankr. Cas. 796 (Bankr. Ct. S.D.N.Y. 1975), discussed in note 97 *supra*.

<sup>117</sup> 4 Collier Bankr. Cas. at 804. Judge Herzog's rationale was subsequently adopted in *Carnation Plastic Mfg. Co. v. Giltex, Inc.*, 17 UCC Rep. Serv. 887 (S.D.N.Y. 1975), wherein the court, after declaring § 2-702(2) to be an invalid statutory lien, stated that "the seller must be afforded an opportunity . . . to allege a cause of action for fraud . . ." *Id.* at 19. A similar result was reached in *In re Federal's*, 12 UCC Rep. Serv. 1142 (Bankr. Ct. E.D. Mich. 1973), *aff'd*, 402 F. Supp. 1357 (E.D. Mich. 1975). In *Federal's*, Bankruptcy Judge Brody, after deciding that § 2-702(2) is invalid in bankruptcy, simply assumed that the seller could recover under common law upon proof of fraud. Consequently, the court did not discuss the effect of the last sentence of § 2-702(2). Reclamation was denied, however, because under state law either an express misrepresentation of solvency or lack of intent to pay were prerequisites for reclamation, and both factors were concededly absent.

It is interesting to note that most commentators who insist that the invalidation of § 2-702(2) necessarily precludes reclamation rely on this argument to support its validity in bankruptcy. See, e.g., 2 R. ANDERSON, ON THE UNIFORM COMMERCIAL CODE § 2-702:(3) (2d ed. 1970-1974 Cum. Supp.); 3A R. DUESENBERG & L. KING, SALES AND BULK TRANSFERS UNDER THE UNIFORM COMMERCIAL CODE § 13.03[4][b] n.23.1 (Supp. 1975). But see 35 U. PITT. L. REV. 922, 933 (1974) (since § 2-702(2) is invalid, all possibility of recovery is precluded). It has been suggested that this argument is merely "a last-ditch attempt by proponents of the Code to reduce *ad absurdum* the conclusion that § 2-702 comes into headlong conflict with § 67c(1)(A) of the Act." *Queensboro Farm Prods., Inc. v. Wetson's Corp.*, 4 Collier Bankr. Cas. 796, 798 (Bankr. Ct. S.D.N.Y. 1975).



The *Watson's* decision finds strong support in both equitable considerations and general principles of statutory construction. The inequity of providing no remedy for fraud is obvious. Indeed, recognition of such inequity was the primary reason for originally allowing common law reclamation in bankruptcy situations.<sup>118</sup>

In determining whether invalidation of part of a statute precludes the application of the remainder, a court must decide whether the legislature would have enacted that part of the statute which remains without the invalid section.<sup>119</sup> This is basically a question of legislative intent, and although the existence of a severability clause in a statute offers some indication of legislative intent, such clauses are not in themselves determinative.<sup>120</sup> The Code contains a severability clause<sup>121</sup> providing that the invalidity of one provision of the Code will not invalidate any other provision which can be given separate effect. In view of the clear intent of the draftsmen of the Code to improve the plight of the seller of goods on credit,<sup>122</sup> it is evident that they would not have designed a statute which would totally abolish the right of reclamation. Thus, to apply the last sentence of section 2-702(2) after invalidation of the primary remedy provided in that section would lead to an unintended result.

Although there is no indication of the purpose of the last sentence of section 2-702(2) in the official comments accompanying the Code, it probably was intended to ensure a uniform and readily

<sup>118</sup> See note 106 *supra*; note 79 and accompanying text *supra*.

<sup>119</sup> See, e.g., *United States v. Jackson*, 390 U.S. 570, 585 (1968) (test is whether legislature would have enacted remainder standing alone); *Aiken v. Insull*, 122 F.2d 746, 754 (7th Cir. 1941), cert. denied, 315 U.S. 806 (1942) (test is whether the valid and invalid parts are so closely related that the legislature would not have passed the valid part alone); *Baird v. Davoren*, 346 F. Supp. 515, 522 (D. Mass. 1972) (test is whether the valid part can stand alone without destroying legislative intent); *Farmers' Loan & Trust Co. v. New York Cent. R.R.*, 134 Misc. 778, 781-82, 236 N.Y.S. 250, 254 (Sup. Ct. N.Y. County 1928), *aff'd without opinion*, 226 App. Div. 864, 234 N.Y.S. 785 (1st Dep't 1929), *rev'd on other grounds sub nom. City Bank Farmers' Trust Co. v. New York Cent. R.R.*, 253 N.Y. 49, 170 N.E. 489 (1930) (test is whether upholding the valid part would defeat the legislative intent); 2 J. SUTHERLAND, STATUTES AND STATUTORY CONSTRUCTION §§ 44.04, at 342, 44.07, at 347-48 (4th ed. C. Sands 1973).

<sup>120</sup> See, e.g., *Watson v. Buck*, 313 U.S. 387 (1941) (severability clause is not per se determinative); *DiPaola v. Reilly*, 22 App. Div. 2d 910, 911, 255 N.Y.S.2d 532, 534 (2d Dep't 1964) (mem.) (presence of a severability clause merely creates a rebuttable presumption of severability); *Badillo v. Katz*, 73 Misc. 2d 836, 844, 343 N.Y.S.2d 451, 459 (Sup. Ct. Bronx County), *modified per curiam*, 41 App. Div. 2d 829, 343 N.Y.S.2d 462 (1st Dep't), *modified mem.*, 32 N.Y.2d 825, 299 N.E.2d 258, 345 N.Y.S.2d 1014 (1973) (severability clause is merely "an aid to interpretation").

<sup>121</sup> UNIFORM COMMERCIAL CODE § 1-108 provides:

If any provision or clause of this Act or application thereof to any person or circumstances is held invalid, such invalidity shall not affect other provisions or applications of the Act which can be given effect without the invalid provision or application, and to this end the provisions of this Act are declared to be severable.

<sup>122</sup> UNIFORM COMMERCIAL CODE § 2-702, Comment.

ascertainable standard for reclamation. By limiting reclamation to those situations which meet the criteria required by section 2-702(2), the draftsmen precluded the possibility of divergent results due to differences in state laws pertaining to fraud.<sup>123</sup> Although application of the last sentence of the section without the remedy it was intended to limit would indeed lead to uniform results, the nature of those results would be quite different from that which was anticipated.

It is also probable that the last sentence of section 2-702(2) was intended to indicate that the section was designed to supplant only the common law cause of action for rescission due to fraudulent misrepresentation of solvency or fraudulent intent not to pay, and was not intended to preclude a cause of action for rescission based on some other fraudulent misrepresentation.<sup>124</sup>

### CONCLUSION

The laudable attempt by the draftsmen of the Uniform Commercial Code to establish uniformity among the states in the treatment afforded the unwitting vendor who sells goods on credit to an insolvent buyer seems to have foundered on the shoals of bankruptcy. The primary reason for the failure of section 2-702(2) in a bankruptcy situation is its establishment of an irrebuttable presumption of fraud. A presumption of this type necessarily results in the enrichment of any seller fortunate enough to act within the 10-day period even in situations in which no fraud has been perpetrated. If section 2-702(2) is indeed invalid against the trustee in bankruptcy, the seller's fate will depend upon the effectiveness of the last sentence of the section, which provides that the remedy furnished in the section is exclusive. If this sentence survives invalidation of the remedy provided by section 2-702(2), the seller will be precluded from any possibility of reclamation. Alternatively, if this sentence falls with invalidation of the remedy, the seller will be permitted to attempt to prove fraud under applicable state law. It is submitted that the latter result is the correct one absent amendment of either the Code or the Bankruptcy Act.<sup>125</sup>

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<sup>123</sup> For a discussion of the variations in state laws concerning fraud, see Braucher, *Reclamation of Goods from a Fraudulent Buyer*, 65 MICH. L. REV. 1281, 1282-84 (1967).

<sup>124</sup> The last sentence of § 2-702(2) was added following an influential study of the 1953 version of the Code. The study noted the possibility that the section, as it then stood, might be interpreted to exclude rescission based on fraud involving other than misrepresentation of solvency. See N.Y. LAW REVISION COMM'N, REPORT ON THE UNIFORM COMMERCIAL CODE 395, Leg. Doc. No. 65 (1956).

<sup>125</sup> There are presently pending in Congress two bills which would comprehensively revise the present Bankruptcy Act. Although both bills make certain basic changes in § 67c,

Since in its present form section 2-702(2) is incompatible with both the letter and the spirit of federal bankruptcy law, the most appropriate resolution of this conflict would be an amendment to the Code. As noted above, it is the irrebuttable presumption of fraud which is the most objectionable part of section 2-702(2). The 10-day limitation, however, also offends the equity traditionally sought in bankruptcy law. In order to remove these objections, while at the same time furthering the policy of national uniformity which is contained in both the Code and the Bankruptcy Act, it is suggested that the Code be amended to require proof of fraud and to allow recovery within a reasonable time. The requirements for proving fraud, however, should not be left to the vagaries of state law, but rather should be prescribed in the amended statute.

Although section 2-702(2) possesses the virtues of ease of application and certainty of result, its invalidation in bankruptcy renders it useless for most practical purposes. A requirement that fraud be proven, although obviously adding to the task of both the bankruptcy court and the seller, is not an unreasonable burden. The determination of the existence of fraud is a normal judicial function. It is a function which was required of bankruptcy courts in considering reclamation petitions prior to the adoption of the Code, and it is a function presently performed by bankruptcy courts in determining dischargeability.<sup>126</sup> It is submitted that such an amendment would result in a just and equitable resolution of the conflicting claims of all parties whose interests are affected by a reclamation proceeding, while at the same time avoiding disparate results in different states.

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neither would seem to affect the validity of § 2-702(2). The wording of the proposed replacement for § 67c is the same in both bills. Instead of invalidating statutory liens which take effect upon insolvency or which do not meet the bona fide purchaser test, the new section would invalidate *all* statutory or common law liens other than the following: (1) liens securing the repair or manufacture of property of the debtor; (2) liens securing the payment of *ad valorem* taxes; (3) liens securing the payment of special assessments; (4) liens securing the payment of attorneys' fees. See S. 236, 94th Cong., 1st Sess. § 4-606 (1975); H.R. 31, 94th Cong., 1st Sess. § 4-606 (1975); S. 235, 94th Cong., 1st Sess. § 4-606 (1975); H.R. 32, 94th Cong., 1st Sess. § 4-606 (1975). Since § 2-702(2) does not fit into any of the above categories, it would presumably remain invalid if it is a statutory lien.

<sup>126</sup> See, e.g., *In re Dolnick*, 374 F. Supp. 84 (N.D. Ill. 1974) (mem.) (bankruptcy judge must make positive finding of fraud before denying discharge); *In re Burns*, 357 F. Supp. 176 (D. Kan. 1972) (finding of fraud by a state court is not binding in subsequent bankruptcy proceeding).