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# CONTRACTS - SALES - EFFECT OF REASONABLE BELIEF IN BUYER'S INSOLVENCY ON SELLER'S DUTY TO PERFORM

W. Wallace Kent
*University of Michigan Law School*

CONTRACTS — SALES — EFFECT OF REASONABLE BELIEF IN BUYER'S INSOLVENCY ON SELLER'S DUTY TO PERFORM — The plaintiff ordered goods from the defendant, for immediate delivery, terms $1,500 down, balance covered by notes of three and six months. The check given for the down payment was dishonored because of insufficient funds but was subsequently honored. On investigation the defendant discovered that there were unpaid judgments outstanding against the plaintiff, some of which were upwards of three years old. Inferring that the plaintiff was insolvent, the defendant refused to deliver the goods unless cash was paid therefor and when plaintiff refused this offer defendant attempted to return the down payment. *Held*, plaintiff's affairs were in such condition that any reasonable business man would be justified in believing him to be insolvent. A reasonable belief in the buyer's insolvency is sufficient to excuse the seller from performing a contract to sell goods on credit. *Leopold v. Rock-Ola Mfg. Corp.*, (C. C. A. 5th, 1940) 109 F. (2d) 611.

The principal case lays down a rule which is broader than that accepted

generally and even broader than that stated by this same court when this case was decided on a previous appeal.[1] Careful search has failed to reveal any other case in which it has been held that a reasonable belief in the buyer's insolvency is sufficient to excuse the seller from performing a credit contract for the sale of goods.[2] The rule generally accepted has been that a contractor need not trust to the credit of the other party whom he finds to be insolvent, even though he had agreed to make the sale on credit.[3] And even this rule has been qualified to permit the insolvent's representative to adopt the contract (unless it be of too personal a nature to be performed by other than the contracting party).[4] The three cases cited by the court in the principal case are not authority for the broad rule stated in the decision. *Hunter v. Talbot* [5] was concerned with actual insolvency; *Diem v. Koblitz* [6] was also a case of actual insolvency although there is some dicta [7] to support the rule of the principal case; and in *H. Muehlstein & Co. v. Hickman*,[8] bankruptcy was admitted and the question was as to the buyer's liability for refusing to pay cash when the goods were offered on that basis. Thus it is apparent that the principal case, without support, has extended a generally accepted rule beyond its usual confines. Even in those jurisdictions in which the narrower statement of the rule is accepted, a difficult question arises in determining what constitutes "insolvency" sufficient to excuse the seller. "Insolvency" has generally been accorded two meanings.[9] First is the popular meaning which has been incorporated into the Bankruptcy Act: "A person shall be deemed insolvent within the provisions of this act whenever the aggregate of his property . . . shall not, at a fair valuation, be sufficient in amount to pay his debts." [10] It is clear that this definition would be useless for the purposes of the rule under discussion because in most cases such a definition would necessitate a probe into the buyer's affairs to an extent which would be impractical, if not impossible, for the seller with the ordinary sources of knowledge and the usual

[1] Rock-Ola Mfg. Corp. v. Leopold, (C. C. A. 5th, 1938) 98 F. (2d) 196, discussed in 37 MICH. L. REV. 979 (1939).

[2] But see Mihills Mfg. Co. v. Day Bros., 50 Iowa 250 (1878).

[3] CONTRACTS RESTATEMENT, § 287 (1932); Pardee v. Kanady, 100 N. Y. 121, 2 N. E. 885 (1885); Rappleye v. Racine Seeder Co., 79 Iowa 220, 44 N. W. 363 (1890); Hunter v. Talbot, 3 Smedes & M. (11 Miss.) 754 (1844); Ullman, Lewis & Co. v. Babcock, 63 Tex. 68 (1885); Trescott v. Gross, 29 Ill. App. 543 (1889); 55 C. J. 481 (1931). In F. W. Kavanaugh Mfg. Co. v. Rosen, 132 Mich. 44, 92 N. W. 788 (1902), it was held that a reasonable belief in the buyer's insolvency was not sufficient to excuse the seller, that such a rule would leave the buyer at the entire mercy of the seller. And see § 65 of the Uniform Sales Act.

[4] Re Niagara Radiator Co., (D. C. N. Y. 1908) 164 F. 102; Sprague, Warner & Co. v. Iowa Mercantile Co., 186 Iowa 488, 172 N. W. 637 (1919).

[5] 3 Smedes & M. (11 Miss.) 754 (1844).

[6] 49 Ohio St. 41, 29 N. E. 1124 (1892).

[7] "It is sufficient if . . . he [the buyer] was either in fact insolvent, or had, by his conduct in business, afforded the ordinary apparent evidences of insolvency." Id., 49 Ohio St. at 51.

[8] (C. C. A. 8th, 1928) 26 F. (2d) 40.

[9] 14 R. C. L. 628 (1916); 32 C. J. 805-806 (1923).

[10] 11 U. S. C. (1934), § 1 (15).

limited time for investigation. The other definition of insolvency is the inability of the person in question to pay his debts as they become due in the ordinary course of business.[11] It has been suggested that this is the meaning which is intended when speaking of traders and merchants.[12] This definition has been adopted in the Uniform Sales Act [13] and also in the English Sale of Goods Act.[14] The cases in general have followed this view in holding that a seller is excused from delivering goods to a buyer who is "insolvent" except for cash on delivery.[15] Such a rule would seem to be more in accord with business practice and with the theory that the buyer is bound to maintain his credit, as a condition precedent to the seller's duty to perform.[16] The most recent English text on the subject suggests that insolvency, in itself, is not sufficient to give the seller a right to refuse to deliver but rather takes the position that notice of insolvency is necessary and that such notice may be treated by the seller as a repudiation of the contract.[17] This falls far short of the rule stated by most of the American courts, which have gone so far as to permit the seller to stop goods in transitu when knowledge of the buyer's insolvency reaches him (the seller).[18] It is submitted that the better rule is that adopted generally by the American cases, permitting the seller to refuse to deliver goods to a buyer after he becomes insolvent; and that the test of insolvency, for practical application, should be that followed by most cases and incorporated into the Sales Acts, namely, whether the buyer is able to pay his debts as they become due in the ordinary course of business. Perhaps this is what was meant by the court in the principal case by a "reasonable belief"

[11] Cunningham v. Norton, 125 U. S. 77, 8 S. Ct. 804 (1888); Dewey v. St. Albans Trust Co., 56 Vt. 476 (1884); Mitchell v. Bradstreet Co., 116 Mo. 226, 22 S. W. 358 (1893); H. Muehlstein & Co. v. Hickman, (C. C. A. 8th, 1928) 26 F. (2d) 40; Steele v. Bank Commissioner, 240 Mass. 394, 134 N. E. 401 (1921).

[12] Dewey v. St. Albans Trust Co., 56 Vt. 476 (1884); 14 R. C. L. 628 (1916).

[13] "A person is 'insolvent' within the meaning of this act who either has ceased to pay his debts in the ordinary course of business or cannot pay his debts as they become due, whether he has committed an act of bankruptcy or not, and whether he is insolvent within the meaning of the federal bankruptcy law or not." Uniform Sales Act, § 76 (3).

[14] "A person is deemed to be insolvent within the meaning of this Act who either has ceased to pay his debts as they become due, whether he has committed an act of bankruptcy or not, and whether he has become a notour bankrupt or not." Sale of Goods Act of 1893, 56 & 57 Vict., c. 71, § 62 (3).

[15] See cases cited in note 3, supra, and H. Muehlstein & Co. v. Hickman, (C. C. A. 8th, 1928) 26 F. (2d) 40.

[16] "When the sale is upon credit, it is one of the implied conditions of the contract that the vendee shall keep his credit good. . . ." Diem v. Koblitz, 49 Ohio St. 41 at 55, 29 N. E. 1124 (1892).

[17] "Although the buyer's insolvency does not *per se* put an end to the contract, yet if the buyer has given to the seller such a *notice* of his insolvency as amounts to a declaration of his inability or unwillingness to pay for the goods, the seller is justified in treating the notice as a repudiation of the contract. . . ." BENJAMIN, SALE, 7th ed., 856 (1931).

[18] Benedict v. Schaettle, 12 Ohio St. 515 (1861); Durgy Cement & Umber Co. v. O'Brien, 123 Mass. 12 (1877); Diem v. Koblitz, 49 Ohio St. 41, 29 N. E. 1124 (1892); 35 CYC. 495 (1910).

in the buyer's insolvency. At least, it should be pointed out that on the basis suggested the principal case could be sustained because the plaintiff-buyer had allowed unpaid judgments to remain outstanding for three years and this would certainly never constitute payment of his bills by the buyer "as they become due in the ordinary course of business." Also, as a matter of policy, a seller should not be forced to deliver goods to a buyer who is so unwilling or unable to pay his just debts.

*W. Wallace Kent*