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NOTES

Bulk Sales—Transferee’s Duty to Make Careful Inquiry of the Transferor’s Creditors Abolished

In Adrian Tabin Corp. v. Climax Boutique, Inc., the New York Supreme Court, Appellate Division, held that under section 6-104(3) of the Uniform Commercial Code a transferee in a bulk transfer, who receives an affidavit stating that the transferor has no creditors and who is without actual knowledge of any, can rely upon the affidavit without having to make careful inquiry into the possible existence of any creditors. This holding abolished New York’s long-standing “careful inquiry” requirement and dispensed with the notification requirement of section 6-105.


The major purposes of Article 6 of the Uniform Commercial Code are stated in the Official Comment to section 6-101 as follows:

1. This Article attempts to simplify and make uniform the bulk sales laws of the states.
2. Their central purpose is to deal with two common forms of commercial fraud, namely:
   (a) The merchant who sells out his stock in trade to a friend for less than it is worth, pays his creditors less than he owes them and hopes to come back into the business.
   (b) The merchant who sells out his stock in trade, pockets the proceeds, and disappears leaving his creditors unpaid.

Section 6-104 places responsibilities upon the parties to a bulk transfer as follows:

1. A bulk transfer subject to this Article is ineffective against any creditor of the transferor unless:
   (a) The transferee requires the transferor to furnish a list of his existing creditors prepared as stated in this section; and
   (2) The list of creditors must be signed and sworn to or affirmed by the transferor or his agent. It must contain the names and business addresses of all creditors of the transferor.
   (3) Responsibility for the completeness and accuracy of the list of creditors rests on the transferor, and the transfer is not rendered ineffective by errors or omissions therein unless the transferee is shown to have had knowledge.

The cases constituting authority for the careful inquiry requirement are: Klein v. Schwartz, 128 N.Y.S.2d 177 (Sup. Ct. 1953); Willner Butter & Egg Corp. v. Roth, 192 Misc. 970, 83 N.Y.S.2d 16 (Sup. Ct. 1948); Carl Ahlers, Inc. v. Dingott, 173 Misc. 873, 18 N.Y.S.2d 434 (Sup. Ct. 1940); Marcus v. Knitzer, 168 Misc. 9, 4 N.Y.S.2d 308 (Sup. Ct. 1938); Heilmann v. Powelson, 101 Misc. 230, 167 N.Y.S. 662 (Sup. Ct. 1917). All of these cases were decided before the Uniform Commercial Code was adopted in New York.

1Uniform COMMERCIAL CODE § 6-105 [hereinafter cited as UCC] provides in pertinent part as follows: “In addition to the requirements of the preceding section, any bulk transfer subject to
Plaintiff Adrian Tabin Corp. was a creditor of L.D.J. Dresses, Inc. (the transferor) which sold its business in bulk to defendant Warman, who then resold the same to defendant Climax Boutique, Inc. (the transferee). Prior to the consummation of the sale the transferee received an affidavit signed by the transferor's president which stated that the transferor had no creditors. Creditor Adrian Tabin Corp., upon learning of the sale, brought an action to have the sale set aside for failure to receive notice of the transaction from the transferee as required under section 6-105. The trial court voided the sale, holding that a transferee must make a careful inquiry into the existence of creditors of the transferor by examining the transferor's books and questioning the transferor as to the source of the items transferred in bulk. Since the transferee here failed to make such an inquiry, the court held the sale was ineffective.

The appellate court reversed, holding that a transferee is under no duty to make a careful inquiry. The court found that even though New York had required such an inquiry under its pre-UCC bulk sales act, section 6-104(3), which had no counterpart under the pre-UCC law, places the responsibility for the completeness and accuracy of the list of creditors upon the transferor. A transfer is not rendered ineffective by errors in the list unless the transferee has knowledge of them. Since here the transferee lacked knowledge of the plaintiff creditor, he had complied with the requirement of notification of creditors by obtaining an affidavit from the transferor stating that he had none.

The dissent insisted that section 6-104(3) did not remove the careful inquiry requirement. The dissenter relied upon New York annotations to section 6-104 stating that subsection three was merely declaratory of prior New York law and citing the cases invoking the careful inquiry requirement. Furthermore, the dissent argued, a transferee of an entire...
business knows that the transferor probably has some creditors, and without an inquiry, at least into the sources of the inventory, "the opportunity for fraud upon creditors is too great."

**THE NEW YORK EXPERIENCE**

As mentioned above, cases interpreting the pre-UCC New York bulk sales act had held that the transferee could rely upon an affidavit of the transferor that the latter had no creditors if the transferee made a careful inquiry and he otherwise lacked knowledge of any such creditors. However, close examination discloses that the careful inquiry requirement was adopted and subsequently affirmed on the basis of mistaken use of precedent. The original New York bulk sales act obligated the transferee to notify any creditors discoverable by the exercise of "reasonable diligence." That first statute was declared unconstitutional in *Wright v. Hart.* In a dissenting opinion to *Wright*, Judge Vann stated not only that the bulk sales act was constitutional, but also that a transferee was thereby under a duty to make "careful inquiry" as to the existence of creditors of the transferor. When the New York legislature passed a second bulk sales act, it did not include the reasonable diligence provision of the original act, only requiring the transferee

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104(3) is "[n]ew to the statute, but declaratory of the New York law . . ." citing most of the cases cited note 3 supra.

104App. Div. 2d at 338 N.Y.S.2d at 63.


15Cases cited note 3 supra.

16The text of that law provided in relevant part as follows:

Section 1. A sale of any portion of a stock of merchandise other than in the ordinary course of trade of the seller's business . . . shall be fraudulent and void as against the creditors of the seller, unless . . . the seller and the purchaser shall . . . make full, explicit inquiry of the seller as to name and place of residence . . . of each and every creditor of the seller . . . and . . . in good faith notify . . . each of the seller's creditor's of whom the purchaser has knowledge, or can with the exercise of reasonable diligence acquire knowledge, of such proposed sale. . . .


182 N.Y. 330, 75 N.E. 404 (1905).

1Id. at 356, 75 N.E. at 414.

1The text of that law provided in relevant part as follows:

§ 44. Transfer of goods in bulk. 1. The sale, transfer or assignment in bulk of any part or the whole of a stock of merchandise, otherwise than in the ordinary course of trade . . . shall be void as against the creditors of the seller . . . unless the purchaser . . . demand and receive from the seller . . . a written list of the names and addresses of the creditors of the seller . . . certified . . . under oath to be a full, accurate and complete list of his creditors . . . and . . . notify . . . every creditor whose name and address are stated in said list, or of which he has knowledge . . . .
to notify the creditors listed or known to him. The new act was held constitutional in *Klein v. Maravelas*. Speaking for the majority in *Klein*, Judge Cardozo stated that the court was adopting the "argument and the conclusion" of Judge Vann’s dissent in *Wright*, but Cardozo neither recited the careful inquiry requirement nor specifically said that the court was adopting that part of the dissent. When stated by Judge Vann, the careful inquiry requirement had a statutory basis, the reasonable diligence requirement, but it had no such basis under the newer law. Judge Cardozo seemingly only intended to state his concurrence with the *Wright* dissenter’s argument and conclusion that the provisions of a bulk sales act did not deny equal protection. Yet all the subsequent cases speaking on the issue have either directly or indirectly relied upon the *Wright* dissent and *Klein* as precedent for the careful inquiry requirement without examining the statutory basis or the merits of the requirement. The court in *Adrian Tabin* did not base its holding on this chain of misunderstanding, but held simply that section 6-104(3) of the UCC made careful inquiry unnecessary.

**TREATMENT OF THE ADRIAN TABIN ISSUE BY OTHER STATES**

Nearly all of the states had enacted bulk sales acts prior to their adoption of Article 6. Although they varied in detail, the statutes in approximately two-thirds of the states were modeled after the New York statute; the remainder followed the Pennsylvania statute, which included a provision making the transferee responsible for the application of the purchase money pro rata among the creditors. The overwhelming majority of cases held that where the transferor omitted one or more creditors from the list, a transferee acting in good faith could rely upon the list and was not responsible for notifying the omitted creditors. The commentators agreed. Where a transferee received a

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transferor's affidavit that he had no creditors, some courts held that such an affidavit would not suffice as a "list of creditors." But the courts that did accept the no-creditor affidavit as a list of creditors held that the transferee unaware of creditors could rely upon the affidavit's correctness and notify no one.

After the adoption of Article 6, several commentators have concurred that if the transferee receives a no-creditor affidavit and is unaware of creditors, he can rely upon the sworn statement of the transferor that there are no creditors to notify. As for judicial resolution of the issue, there is only one other reported case, in addition to Adrian Tabin. In Silco Automatic Vending Co. v. Howells, the court held that where the transferee in a bulk sale of a tavern business received in affidavit form a list of creditors on which the word "none" appeared in the space for names, the only issue was whether the transferee otherwise knew that the plaintiff was a creditor. The court concluded that the UCC did not even apply to the contested transfer. Nevertheless, the court stated that assuming the provisions of Article 6 did apply, the defendant transferees did not have sufficient notice that plaintiff was a creditor of the transferor for the transaction to be set aside for failure to give notification.

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See text accompanying notes 41-43 infra.


Id. at 250, 245 A.2d at 769.

Id. at 247, 245 A.2d at 768. The court cited "N.J.S. 12A: 6-104(3)," the New Jersey codification of UCC § 6-104(3). Id. Therefore since the defendant transferees did not have sufficient notice of plaintiff creditor, they were not responsible for the inaccuracy of the transferor's no-creditor affidavit.
THE TWO BASIC ISSUES UNDER SECTION 6-104

What kind of "knowledge" must the transferee have under section 6-104(3)? Section 1-201(25) defines "knowledge" as "actual knowledge" rather than mere "notice" that exists when one has reason to know a fact from all surrounding circumstances. Thus, as White and Summers have concluded, even if most of the inventory had been purchased by the transferor from a single supplier, the transferee has no duty to inquire whether that supplier has been paid if his name was omitted from the list of creditors or if the transferee received a no-creditor affidavit, unless the transferee actually knows that the supplier is a creditor of the transferor. The implication has been made that because the definitional cross references following section 6-104 do not refer to section 1-201(25), yet do refer to other definitions under section 1-201, the Code definition of "knowledge" as "actual knowledge" might not apply. But this exclusion is only of nominal significance; UCC experts argue that such references are not meant to be exhaustive.

Therefore those cases holding under pre-UCC bulk sales acts that the transferee must notify all creditors of whom he should have reason to know as well as creditors actually known and creditors listed seem to be in direct conflict with section 1-201(25) by allowing "notice" to suffice as "knowledge."

It has also been argued that section 6-104(3) might not apply to a transfer in which a no-creditor affidavit instead of a list of creditors is

34UCC § 1-201(25) provides:
A person has "notice" of a fact when
(a) he has actual knowledge of it; or
(b) he has received a notice or notification of it;
(c) from all the facts and circumstances known to him at the time in question he has reason to know that it exists.
A person "knows" or has "knowledge" of a fact when he has actual knowledge of it.

35White & Summers § 19-3, at 650.

36As Professor Hawkland states, the very reason for section 6-104(3) is that the transferee cannot normally know if the list of creditors is accurate. W. Hawkland, Sales and Bulk Sales 168 (2d ed. 1958).

37N.Y.U.C.C. § 6-101 (McKinney 1964), Practice Commentary, pt. IV, § B.

38Other definitional cross references to section 1-201 are: "Creditor," "Party," "Person," "Signed."


furnished, because a no-creditor affidavit is not a list of creditors. In fact, several pre-UCC cases apparently accepted this argument and carefully scrutinized the language of no-creditor affidavits to determine whether the affidavit covered all the creditors contemplated under the bulk sales acts. In *Interstate Shirt & Collar Co. v. Windham,* the transferor's affidavit stated that the inventory was entirely free from debt, yet the court held that the affidavit was limited to certain creditors and thus not in compliance with the statute. Also in *Romeo & Co. v. Nassif,* it was held that the transferor's affidavit that he had no creditors connected with his trade was not broad enough to comprise a full list of his creditors. Even though the above cases seem correct where a limiting no-creditor affidavit is involved, it also appears logical to assert that a truthful affidavit by a transferor that he absolutely has no creditors is in fact a list of creditors, and even a false no-creditor affidavit is merely a list of his creditors with all creditors' names omitted.

**Conclusion**

The UCC and the New York cases state that the Code should be liberally construed to promote its underlying purpose and policies. However, the language of section 6-104(3) is simple and unambiguous. Even though *Adrian Tabin* gives a reasonable construction to section 6-104(3), the decision causes a drastic and undesirable change in New York bulk sales law and uncovers a significant loophole for those transferees who wish to defraud their creditors. Furthermore, it seems likely that no reasonable court could construe section 6-104(3) differently from the *Adrian Tabin* court. Thus through section 6-104(3), the main purpose of Article 6 can be frustrated.

Section 6-104 should be amended to place a greater burden upon the transferee. This might be accomplished in one of two ways: first, by requiring the transferee to take a more active part in ascertaining the transferor's creditors, such as by requiring him to examine the transferor's books or to make inquiry of the transferor as to the vendor of the inventory; or secondly, by lowering the standard of awareness of

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41 N.Y.U.C.C. § 6-101 (McKinney 1964), Practice Commentary, pt. IV, § B.
42 165 Mich. 648, 131 N.W. 102 (1911).
43 7 Ohio App. 382 (1917).
44 UCC § 1-102(1).
46 UCC § 6-101, Comment 2, quoted note 2 supra.
those creditors from "knowledge" to "notice." The first proposal differs only slightly from the careful inquiry actions suggested by the trial court and the dissent in Adrian Tabin. The second proposal has the merits of being simple and easy to effectuate. Either would greatly reduce the possibility of bulk transfers in defraud of creditors. In the last analysis, Adrian Tabin is truly a fulfillment of the prophecy of White and Summers that section 6-104(3) "may prove to be unwise."48

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Constitutional Law—The Indigent and Access to the Civil Courts

Recent decisions in state and federal courts have attempted to define the scope of an indigent's right to obtain free access to civil courts.1 The United States Supreme Court responded to the confusion created by several of these decisions with United States v. Kras,2 which presented a constitutional challenge to the filing fee requirement for the initiation of bankruptcy proceedings. The Court refused to extend its holding in Boddie v. Connecticut3 to bankruptcy actions and rejected the indigent petitioner's constitutional attack on mandatory filing fees.4 This decision not only upholds the constitutionality of filing fees in bankruptcy proceedings but also provides some guidelines for determining the constitutionality of similar fees in other areas of civil litigation.

Robert W. Kras submitted his petition in bankruptcy to the United

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1See UCC § 1-201(25).
2"WHITE & SUMMERS § 19-3, at 650. Before one assumes from the Adrian Tabin decision that such a transferor consequently escapes the criminal laws and the grasp of his creditors, two points are of noteworthy significance. First, UCC § 6-104, Comment 3, states that "the sanction for the accuracy of the list of creditors is the criminal law of the state relative to false swearing . . . ." Second, other creditors' remedies such as attachment and execution pursuant to judgment on other assets of the transferor are available. Furthermore, no provision in Article 6 precludes an attack on a bulk transfer as a fraudulent conveyance.
401 U.S. 371 (1971). The Court held filing fees in divorce actions unconstitutional as applied to indigents.
509 U.S. at 443-50.