Uniform Commercial Code -- § 2-702: Conflict with § 67c(1)(A) of the Federal Bankruptcy Act

Dianne Seitz Cauble
Finally, the Merchants National decision has an impact upon estate tax planning. When the planner cannot rely exclusively on the actuarial tables, his client's ultimate tax liability is unnecessarily speculative. An example of the planning ramifications of the method used for valuation can be seen in the establishment of a private annuity agreement. Whether the actuarial tables will be strictly used is very important for the estate planning of the transferor. The estate and gift tax advantages of the annuity agreement may be preserved only if the present value of the annuity promise equals the fair market value of the property at the time of the transfer. Only by relying on the tables can the planner ascertain such present value with certainty. If property worth 100,000 dollars is transferred in exchange for an annuity promise worth 50,000 dollars, a potentially taxable gift of 50,000 dollars has been made. Consequently, it is important for the planner to know how the Commissioner will determine present value. Likewise, a planner cannot satisfactorily advise a client concerning disposition to a disabled relative if he cannot rely on the conclusiveness of the Regulation tables.

Hopefully, the courts will transpose the presumptive correctness of the Treasury's actuarial tables into a conclusive presumption of law. In light of the administrative convenience that would be fostered, the reliability of the new tables and the boon to estate planning that would result, the courts have ample reasons to do so.

Hugh F. Oates, Jr.

Uniform Commercial Code—§ 2-702: Conflict with § 67c(1)(A) of the Federal Bankruptcy Act

In the recent case of In re Federal's, Inc. the question of whether section 2-702(2) of the Uniform Commercial Code creates a statutory lien that is invalid against the trustee in bankruptcy was before the court. Section 2-702(2) of the Uniform Commercial Code per-

48. Estate tax liability is always indefinite at the planning stage. But, if the tables may be relied upon conclusively, the planner at least has an idea of the outer limits of tax liability.
49. Lyon, supra note 39, at 677.
mits the seller of goods on credit to reclaim such goods from the buyer "upon demand made within ten days after the receipt" when the seller "discovers that the buyer has received goods on credit while insolvent." The Bankruptcy Act in section 67c(1)(A)\(^2\) declares invalid, against the trustee in bankruptcy, "every statutory lien which first becomes effective upon the insolvency of the debtor." Traditionally, the law of contracts in most states permitted rescission by a party who was induced to enter into a contract by a fraudulent or innocent misrepresentation. When property had been transferred pursuant to a contract fraudulently induced, the defrauded party was entitled to restoration if no innocent party had acquired an interest in it.\(^3\) This right of reclamation by the defrauded seller has been recognized in bankruptcy since only the defeasible title of the bankrupt passes to the trustee.\(^4\) Thus the issue raised by In re Federal's, Inc. was whether section 2-702(2) of the Code is merely a statutory definition of the seller's common law right of rescission for fraud or whether that section grants such seller a statutory lien.

On August 10, 1972 Panasonic, Inc. sold and delivered to Federal's, Inc. certain electronic equipment. On August 16, 1972 Federal's filed a petition for arrangement pursuant to chapter XI of the Bankruptcy Act, and subsequently a receiver was appointed to operate the business. On August 18, 1972, within ten days of Federal's receipt of the goods, Panasonic demanded their return.

Panasonic's petition for reclamation was heard before the Referee in Bankruptcy for the Eastern District of Michigan. At the trial Panasonic conceded that Federal's intended to pay for the merchandise ordered and received.\(^5\) The court determined that under section 2-702(2) Panasonic had the right to reclaim the equipment from Federal's.\(^6\)

\(^3\) 4A W. Collier, Bankruptcy ¶ 70.41, at 483 (14th ed. 1973).
\(^4\) Donaldson v. Farwell, 93 U.S. 631 (1876).
\(^5\) 12 UCC Rep. Serv. at 1144.
\(^6\) Id. at 1150. The finding that Panasonic had the right to reclaim from the trustee was reached in a circuitous manner: In Michigan, Mich. Stat. Ann. § 19.2702 (3) (1964), provides that "[i]t [the seller's right to reclaim under subsection (2) is subject to the rights of a buyer in ordinary course or other good faith purchaser or lien creditor under this Article." In section 9-301(3) the Code defines a "lien creditor" as including a trustee in bankruptcy. The rights of a trustee in bankruptcy as against a reclaiming seller are not defined in the Article on sales. Therefore, a dispute arose over the meaning of the words "subject to the rights of [a] lien creditor under this Article." The court in In re Federal's followed the precedent established in In re Mel Golde Shoes, Inc., 403 F.2d 658 (6th Cir. 1968) in holding that, since the Code itself did not define the relative rights of the trustee and the reclaiming seller, the court must look to non-Code, Michigan common law to define these rights. Under Michigan common law, the
The court found, however, that this right to reclaim was a statutory lien, and, because the right arose only on the insolvency of the debtor, it was invalid against the trustee under section 67c(1)(A) of the Bankruptcy Act.\(^7\)

The Bankruptcy Act provides little guidance in defining "statutory lien." Although the Act defines the term, this definition merely distinguishes a statutory lien from a consensual lien.\(^8\) Nevertheless, the Act does provide two standards for testing the validity of a statutory lien against the trustee in bankruptcy: first, does the lien arise apart from the insolvency of the debtor, and secondly, is the lien perfected or enforceable against a bona fide purchaser? If both questions are answered affirmatively, the lien will be valid against the trustee.\(^9\) Statutory liens arising only on insolvency are invalidated by the present Act.

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\(^7\) The defrauded seller prevailed over the trustee in bankruptcy; therefore, the court reasoned, under section 2-702 the reclaiming seller must prevail. Since the court found that section 2-702 created an invalid statutory lien, however, this section was not applied by the court. Under Michigan common law the seller was required to prove the buyer's lack of intent to pay in order to establish fraud. Panasonic therefore did not prevail.

Many commentators objected strenuously to the approach taken in cases holding that the relative rights of the reclaiming seller and the trustee must be defined by reference to non-Code law. Those commentators felt that since the relative rights of the trustee and reclaiming seller were not defined in the Code, the words "subject to the rights of a . . . lien creditor under this Article" should be given their literal meaning and the trustee should prevail. See, e.g., Countryman, Buyers and Sellers of Goods in Bankruptcy, 1 New Mex. L. Rev. 435, 457 (1971); Shanker, A Reply to the Proposed Amendment of the UCC Section 2-702(3): Another View of Lien Creditors Rights vs. Rights of a Seller to an Insolvent, 14 W. Res. L. Rev. 93 (1962).

Because of the controversy which arose as to the meaning of the words "subject to the rights of a . . . lien creditor," the 1966 amendments to the official text of section 2-702 deleted these words. Like Michigan, however, many states still retain the original wording. See, e.g., GA. CODE ANN. § 109A-2-702(3) (1973); IOWA CODE ANN. § 554.2702(3) (1967); MASS. ANN. LAWS ch. 106, § 2-702(3) (1958).

7. 12 UCC Rep. Serv. at 1152.
8. 11 U.S.C. § 1(29a) (1970) defines "statutory lien" as follows:

Statutory lien shall mean 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.

The Senate Report on this section indicates that its purpose is "to assure that consensual securities are not subjected to any of the tests of validity prescribed by the new 67(c)." S. Rep. No. 1159, 89th Cong., 2d Sess. 6 (1966).

9. 11 U.S.C. §§ 107(c)(1)(A)-(B) (1970). A different test for determining the validity of a statutory lien on personal property was employed in section 67(c) of the 1932 Bankruptcy Act. That section asked whether the lien was accompanied by possession of, levy upon, sequestration of or distraint of the property. If not, the lien would be invalid against the trustee. Act of July 7, 1952, ch. 579, § 21(d), 66 Stat. 420, 427-28. The Senate Report on 11 U.S.C. § 107(c) (1970) points out the reason for the alteration: "Some liens which are genuine property rights are affected [by the standard of possession] and others which were essentially state created priorities escape." S. Rep. No. 1159, supra note 8, at 6.
because they were felt to be nothing more than disguised priorities constituting an invalid attempt by the state to determine the order of distribution on insolvency.\textsuperscript{10}

Whether a lien exists within the meaning of the Bankruptcy Act is ordinarily said to be determined by reference to state law.\textsuperscript{11} However, since the substance of the right created by the state rather than its form is the concern of the Bankruptcy Act, a court will occasionally be compelled to determine the nature of the right created regardless of the label attached by the state.\textsuperscript{12} Therefore, the determinative issue presented by \textit{In re Federal's, Inc.} is whether in substance the right created by section 2-702 is a lien (as it has been traditionally defined by state law) or a statutorily created right of rescission for fraud.

The word "lien" is given a variety of definitions by state cases, but is generally recognized as a "hold which one person, the creditor or lienor, has upon the property of another, the debtor, as security for the performance by the latter of some duty or obligation owed to the former."\textsuperscript{13} "Lien" is usually defined as a means of collecting a debt, or as security for a debt, rather than as a property interest.\textsuperscript{14}

Since the debt is the point of reference for most state created lien rights, the creditor may normally sell the property subject to the lien to satisfy the indebtedness and in addition may claim any deficiency from the debtor as an unsecured creditor.\textsuperscript{15} The right of a lien creditor to collect a deficiency judgment is recognized in bankruptcy by section

\begin{footnotes}
\item[11] E.g., City of New York v. Hall, 139 F.2d 935, 936 (2d Cir. 1944); Commercial Credit Co. v. Davidson, 112 F.2d 54, 55 (5th Cir. 1940).
\item[14] See, e.g., Springer v. J.R. Clark Co., 138 F.2d 722, 726 (8th Cir. 1943) ("A lien is distinguished from an assignment in that it is a charge upon property, while an assignment creates an interest in property."); Hotchkiss v. National City Bank, 200 F. 287, 291 (S.D.N.Y. 1911) (A lien is a lienor's "right to take his debt out of some specified res."); Page v. Francis, 196 Ark. 822, 826, 120 S.W.2d 161, 164 (1938) ("A lien gives the creditor the right to enforce his claim against specific property."); Hurley v. Boston R.R. Holding Co., 315 Mass. 591, 608, 54 N.E.2d 183, 193 (1944) ("A lien is ordinarily security for a debt, duty or other obligation."); J.T. Evans Co. v. Fanelli, 59 N.J. Super. 19, 23, 157 A.2d 36, 38 (Super. Ct. 1959) (A lien is "generally recognized as a charge upon a particular piece of property . . . for the payment or discharge of a particular debt or duty."); Frick & Co. v. Hilliard, 95 N.C. 117, 122 (1886) ("A lien is a right by which a person is entitled to obtain satisfaction of a debt, by means of property belonging to the person indebted to him.").
\item[15] 4A W. Collier, supra note 3, ¶ 70.41, at 492-93.
\end{footnotes}
This section allows the secured creditor to participate as a general creditor in the distribution of the bankrupt's assets for the difference between the value of his security and the amount of his claim.\textsuperscript{17}

The statutory lien is of a different origin than other types of liens: consensual, equitable or common law. Yet, normally the rights conferred by a statutory lien coincide with those rights accompanying liens in general\textsuperscript{18} because a statutory lien is "a lien created by statute."\textsuperscript{19} The statutory lien evolved from the common law possessory lien that permitted the furnisher of services to retain possession of his customer's goods to secure payment for those services.\textsuperscript{20} During the nineteenth century the common law possessory lien was gradually defined by statute. As a result, statutes in most states now provide liens in favor of various service industries that are, or at one time were, important to the local economy.\textsuperscript{21} These liens are given to certain classes of individuals upon the rendition of their services or upon the furnishing of other valuable consideration.\textsuperscript{22} Section 2-702 satisfies the criterion that a statutory lien is a lien given by statute to a certain class of individuals (in this case, the seller of goods) upon the furnishing of valuable consideration (in this case, the goods delivered on credit to the insolvent buyer).

Such analysis is incomplete, however, and the critical question remains—is the section 2-702 right in substance a lien? In order to answer this question, it must first be ascertained whether the Code itself contemplates the creation of a lien in section 2-702. As was shown earlier, a lien has been defined generally as security for a debt.\textsuperscript{23} The definition of "security interest" in section 1-201(37) of the Uniform Commercial Code ("an interest in personal property or fixtures which secures payment or performance of an obligation") is sufficiently analogous to the common law definitions of a lien to suggest that a lien

\textsuperscript{17} Id. provides in pertinent part: "The value of securities held by secured creditors shall be determined by converting the same into money . . . and the amount of such value shall be credited upon such claims, and a dividend shall be paid only on the unpaid balance."
\textsuperscript{18} See definitions in note 14 supra.
\textsuperscript{19} 53 C.J.S. Liens § 1 (1948).
\textsuperscript{21} Id. at 874.
\textsuperscript{22} 4 W. Collier, supra note 3, ¶ 67.20, at 214; see In re Tele-Tone Radio Corp., 133 F. Supp. 739, 747 (D.N.J. 1955).
\textsuperscript{23} See text accompanying notes 13-14 supra.
would be a "security interest" under the Code. Most of the cases and commentators, however, are in agreement that the right created by section 2-702 is not a "security interest" under the Code, and, therefore, arguably not a lien.

The reasoning usually given for this conclusion is that section 9-203 of the Uniform Commercial Code provides that a security interest arising under the Code is only enforceable against the debtor or a third party if the collateral is in the possession of the secured party or if the debtor has signed a security agreement. This general rule is subject only to the exception provided by section 9-113 for security interests arising under the article on sales. Section 9-113 provides that such a security interest is enforceable without a signed security agreement if the debtor "does not have or does not lawfully obtain possession of the goods." Applying these sections to the right created by section 2-702 reveals that a security interest within the meaning of the Code is not created by that section.

First, section 2-702 gives the seller a right to reclaim goods that are no longer in his possession. In addition, this section clearly indicates that the seller's right to reclaim is enforceable against the debtor without a signed security agreement because section 2-702 applies only to sellers of goods "on credit." Thus under the criterion established by section 9-203 this right of reclamation will be a security interest only if the exception provided by section 9-113 is applicable.

Arguably, a buyer who obtains goods on credit while insolvent does not "lawfully obtain possession" of these goods and, therefore, a security interest requiring no security agreement is created. The official comment to section 2-702, however, states that "any receipt of goods on credit by an insolvent buyer amounts to a tacit business misrepresentation of solvency and therefore is fraudulent as against the particular seller." Since the buyer's fraudulent misrepresentation of solvency has traditionally rendered the contract voidable rather than void, the

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seller is given the option to rescind the contract. The proposition that
the buyer does not lawfully obtain possession under these circum-
stances is difficult to support. Moreover, the official comment to sec-
tion 9-113 makes no reference to section 2-702, but rather refers to
sections 2-703, 2-705 and 2-706 as instances in which the buyer does
not have or lawfully obtain possession of the goods. Each of these
sections gives the seller rights with respect to goods that are still in his
possession or goods that have not yet reached the buyer. Clearly,
therefore, the dispensation created by section 9-113 does not apply to
section 2-702 and the right created by section 2-702 is not a "security
interest" within the meaning of the Code.

However, because the substance of the right rather than its form
is the concern of the Bankruptcy Act, a determination must be made
of whether the right created by the Uniform Commercial Code in sec-
tion 2-702 will be construed to be a lien even though it is not labeled
a "security interest" by the Code. It has been asserted that under sec-
tion 2-702 a seller on credit "is given the same rights that a secured
creditor would have, namely, the right to repossess the goods." Under
this reasoning the section 2-702 right would be in substance a lien
and, therefore, invalid against the trustee. This was the conclusion
reached by the court in Federal's.

Upon close examination, however, the seller's right of reclamation
under section 2-702 differs significantly from a traditional lien. The
seller under section 2-702 has a right to reclaim his property rather than
a right to satisfy his debt out of this property. Thus, section 2-702 states
that the seller "may reclaim the goods upon demand." When the
seller reclaims goods under section 2-702(2), he forfeits all other rem-
edies with respect to those goods, particularly the right to recover
the difference between the resale price and the contract price. Thus

26. 3 S. Williston, The Law Governing Sales of Goods at Common Law and
27. Section 2-705 of the Uniform Commercial Code gives the seller of goods the
right to stop goods in transit when he discovers the buyer to be insolvent. It is interest-
ing that the predecessor to section 2-705, sections 53 and 57 of the Uniform Sales Act,
referred to the right of a seller to stop goods in transit upon discovery of insolvency
as a "lien."
28. See note 12 and accompanying text supra.
29. In re Hardin, 8 UCC Rep. Serv. 857, 862 (E.D. Wis. 1971), aff'd, 458 F.2d
938 (7th Cir. 1972).
30. Emphasis added. See definitions of "lien" in notes 13-14 and accompanying
text supra.
31. 4A W. Collier, supra note 3, ¶ 70.41, at 492-93. Compare Uniform
Commercial Code § 2-702(3), with id. § 2-706(1).
section 2-702 withholds from the reclaiming seller one important right of the traditional lienor: the right to claim a deficiency judgment.

Without considering these arguments, the court in *In re Federal's, Inc.* held that "[t]he right to reclaim conferred by section 2-702(2) realistically viewed is a statutory lien . . . ."\(^\text{32}\) Two cases were relied on by the referee in support of his conclusion. First, in *In re Trahan\(^\text{33}\)* the court held that the "nature of [the Louisiana vendor's] privilege . . . is close to that of a statutory lien\(^\text{34}\)" and that this "privilege cannot be excluded from definitional coverage under [the Bankruptcy Act] . . . merely because Article 3227 [of the Louisiana statute] uses the word 'privilege' instead of 'lien'. . . .\(^\text{35}\)" The statute that was the subject of the decision in *Trahan* provides in pertinent part: "He who sold to another any movable property, which is not paid for, has a preference on the price of his property, over the other creditors of the purchaser . . . .\(^\text{36}\)

This statute differs from section 2-702 in several significant respects. The seller is not given a right to the return of the property sold, but rather a "preference on the price" of that property. In addition, the word "price" in this statute refers back to the original agreement between buyer and seller, whereas under section 2-702 the buyer, in reclaiming his property, relinquishes any further right of action on the contract. Moreover, the Louisiana statute does not forbid a deficiency judgment, and because it refers to "price," any action under this statute is taken with reference to the original debt.

A similar provision in the Puerto Rico Code was found to be a statutory lien in *In re J. R. Nieves & Co.,\(^\text{37}\)" the second case relied on in *Federal's*. The Puerto Rico statute provides the seller with a preferred credit "for the amount of the sale of personal property which may be in the possession of the debtor to the extent of value of the same."\(^\text{38}\) The seller's credit for the price of his property is "preferred" to the extent of the value of this property. This statute does not limit the seller's remedy to recovery of the goods sold, however, nor to the "value of the same," and in these respects, differs from section 2-702.

\(^{32}\) 12 UCC Rep. Serv. at 1153.
\(^{34}\) Id. at 623.
\(^{35}\) Id.
\(^{36}\) LA. CIV. CODE ANN. art. 3227 (West 1952).
\(^{37}\) 446 F.2d 188 (1st Cir. 1971).
\(^{38}\) P.R. LAWS ANN. tit. 31, § 5192 (1968).
The above statutes, found by the courts to create statutory liens, have reference to the original debt and do not forbid deficiency judgments. The rights created by these statutes are, therefore, closer in nature to traditional lien remedies than is the right created by section 2-702. Thus, Federal's reliance on these cases seems unwarranted.

Before the court's opinion can be criticized, however, consideration must be given to the further question of whether the 2-702 right more closely resembles a right of reclamation for fraud, than it does a statutory lien. The right of rescission and reclamation by the seller for fraud, permitted at common law in most states, is generally recognized in bankruptcy. This recognition is based either on the theory that only the defeasible title of the bankrupt passes to the trustee or on the theory that the bankrupt's other creditors cannot lawfully profit from the bankrupt's fraud. In determining whether the seller is permitted to reclaim the goods in bankruptcy, the primary consideration is whether the act complained of gives a right to rescission for fraud under state law.

To ascertain what actions on the part of the insolvent buyer will constitute fraud and enable the seller to reclaim goods from the insolvent buyer, two standards have been applied by the individual states. Some states require a showing by the seller of the buyer's actual intent not to pay at the time of purchase, while in others, a showing of an overt misstatement of financial condition is sufficient.

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39. 4A W. Collier, supra note 3, ¶ 70.41, at 483; S. Williston, supra note 26, §§ 647-48.
42. 4A W. Collier, supra note 3, ¶ 70.41, at 484; see, e.g., United Constr. Co. v. Milam, 124 F.2d 670, 672 (6th Cir. 1942), cert. denied, 317 U.S. 642 (1942); Elbro Knitting Mills v. Schwartz, 30 F.2d 10, 12 (6th Cir. 1929); Schroth v. Monarch Fence Co., 229 F. 549, 551 (6th Cir. 1916); 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); In re Perelstine, 19 F.2d 408, 410 (W.D. Pa. 1927).
44. E.g., In re Weissman, 19 F.2d 769 (2d Cir. 1927) (buyer submitted a false financial statement to a credit agency); In re Monson, 127 F. Supp. 625 (W.D. Ky. 1955) (false financial statement); In re Playton, 39 F. Supp. 774 (E.D.N.Y. 1941) (bankrupt told buyer he would pay promptly); In re Perelstine, 19 F.2d 408 (W.D. Pa. 1927) (false financial statement); Mulroney Mfg. Co. v. Weeks, 185 Iowa 714, 171 N.W. 36 (1919) (delivery of an N.S.F. check). For cases holding that either a false representation of financial condition or a showing of the buyer's intent not to pay is required to constitute fraud see In re New York Commercial Co., 228 F. 120 (2d Cir. 1915); In re Woerderhoff Shoe Co., 184 F. Supp. 479 (N.D. Iowa 1960); In re Tate-Jones & Co., 85 F. Supp. 971 (W.D. Pa. 1949).
In states applying the actual intent standard, a variety of presumptions are relied on in establishing a lack of intent to pay. Some courts have created a presumption of a lack of intent in cases in which the actual fact has a strong tendency to prove the presumed fact. For example, the purchaser's knowledge of his insolvent condition raises either a "persuasive legal presumption"\(^4\) or a conclusive presumption\(^5\) of a lack of intent to pay. Rebuttable presumptions of fraud have been created by some courts in cases in which there is a relatively weak probative connection between the actual fact and the presumed lack of intent. For example, purchases made by an insolvent have been held to be presumptively fraudulent because persons in business are presumed to know the financial condition of their businesses and to intend the natural consequences of their actions.\(^6\) Still other courts have created conclusive presumptions of fraud in cases in which the actual fact has a relatively weak tendency to prove the presumed fact. For example, insolvency at the time of purchase has created a conclusive presumption of fraud since the owners of the business must have known of their inability to pay.\(^7\)

Regardless of the standard employed, the reclaiming seller in bankruptcy has the burden of proving fraud, and, unless he meets this burden, allowing him to reclaim would constitute a voidable preference under the Bankruptcy Act.\(^8\) Yet, the creation of a variety of presumptions, including conclusive presumptions, in the various states has greatly eroded the reclaiming seller's burden of proof.\(^9\)

Can the seller's right under section 2-702 be regarded as simply a uniform statutory definition of the type of fraud entitling the seller to reclaim goods upon the buyer's insolvency?\(^10\) The official comment

\(^5\) Manley v. Ohio Shoe Co., 25 F.2d 384 (4th Cir. 1928); Gillespie v. J.C. Piles & Co., 178 F. 886 (8th Cir. 1910); In re Whitewater Lumber Co., 7 F.2d 410 (M.D. Ala. 1925); In re P.H. Krauss & Co., 2 F.2d 999 (W.D. Tenn. 1924). These cases and In re Penn Table Co., 26 F. Supp. 887 (S.D.W. Va. 1939), indicated that the purchaser's financial condition was hopeless and that he was aware of this fact. This knowledge was held to raise a presumption of lack of intent to pay.
\(^6\) California Conserving Co. v. D'Avanzo, 62 F.2d 528 (2d Cir. 1933); In re Paper City Mill Supply Co., 28 F.2d 115 (D. Mass. 1928); cf. Gillespie v. J.C. Piles & Co., 178 F. 886 (8th Cir. 1910).
\(^7\) Sternberg v. American Snuff Co., 69 F.2d 307 (8th Cir. 1934); In re Indiana Concrete Pipe Co., 33 F.2d 594, 595 (N.D. Ind. 1929) (dictum); In re Gurvitz, 276 F. 931 (D. Mass. 1921); In re Spahn, 138 F. 819 (N.D. Ga. 1910).
\(^8\) National Silver Co. v. Nicholas, 205 F.2d 52 (5th Cir. 1953); Rochford v. New York Fruit Auction Corp., 116 F.2d 584 (2d Cir. 1940).
\(^9\) See text accompanying notes 45-48 supra.
\(^10\) Some authority exists to the effect that section 2-702 is well in line with traditional remedies for fraud. See In re Royalty Homes, Inc., 8 UCC Rep. Serv. 61 (E.D.
to section 2-702 in effect indicates that the purpose of this section is to create such a uniform definition by making the insolvent buyer's misrepresentation of solvency, rather than his lack of intent to pay, the test for fraud. Since misrepresentation of solvency is the test for fraud under the Code, in *Federal's* Panasonic could easily concede that Federal's intended to pay for the merchandise ordered and received.

Under section 2-702, however, the reclaiming seller need not prove actual misrepresentation of solvency. The official comment in effect indicates that the purpose of section 2-702 is to create a conclusive presumption that receipt of goods on credit while insolvent is "a tacit business misrepresentation of solvency." Presumptions have traditionally been accepted to establish fraud in bankruptcy. Receipt of goods by a hopelessly insolvent buyer has been held to raise a conclusive presumption of lack of intent entitling the seller to reclaim goods in bankruptcy. Section 2-702 requires no threshold degree of insolvency to entitle the seller to reclaim. Since misrepresentation of solvency may be either overt or covert, however, the probative connection between a buyer's receipt of goods on credit while insolvent and his misrepresentation of solvency is at least as strong as the probative connection between hopeless insolvency and lack of intent to pay.

It is clear that the purpose of section 2-702(2) is to replace traditional state remedies of rescission for fraud. The section states that: "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." In *Federal's*, by finding that section 2-702 creates a statutory lien, rejects the contention that section 2-702 merely modifies and makes uniform the seller's traditional right of reclamation for fraud.

**CONCLUSION**

Thus, section 2-702 in effect creates a uniform standard for allowing reclamation for fraud in bankruptcy. The desirability of creating

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52. See text accompanying note 25 supra.
53. See text accompanying note 5 supra.
54. See text accompanying note 25 supra.
55. See cases cited in note 48 supra.
such a uniform standard under the Federal Bankruptcy Act cannot be questioned. The intent of the Bankruptcy Act to prevent state created priorities must be balanced against the desirability of a uniform standard to determine whether section 2-702 conflicts with the Bankruptcy Act. If states were allowed to attach the label of fraud to transactions in no way fraudulent and thus allow a seller to reclaim goods in bankruptcy, such a right of reclamation would be nothing more than a forbidden priority. In accordance with long established practice, however, it seems permissible to allow some presumptions to be relied on in establishing fraud in bankruptcy.

In determining whether section 2-702 creates a permissible standard for fraud or a forbidden priority the question should be: does the buyer's receipt of goods on credit while insolvent have a tendency to prove fraud? The answer to this question seems to be that receipt of goods on credit while insolvent tends to prove misrepresentation of solvency since those in business can be reasonably presumed to know of its financial condition. Section 2-702 merely imposes on the insolvent buyer a duty to disclose his insolvency in good faith with the sanction that non-disclosure will constitute a covert misrepresentation of solvency, fraudulent as against a seller on credit.

Since receipt of goods on credit while insolvent could reasonably be termed fraudulent, section 2-702 should be upheld as creating a much needed uniform standard for fraud in bankruptcy.

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