Bulk Transfers Under the Uniform Commercial Code

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BULK TRANSFERS

Under the Uniform Commercial Code

By DOUGLASS G. BOSHKOFF

ARTICLE 6 of the Uniform Commercial Code is an attempt to simplify and make uniform the law relating to bulk transfers of personal property. At present we have in Michigan two statutes pertinent to bulk transfers of interests in personal property, one relating to bulk sales and the second to bulk mortgages. If the Code were enacted in Michigan, article 6 would replace these two statutes but the actual changes made in Michigan law would not be too extensive. The changes proposed by article 6 would mainly clarify existing provisions or add new ones covering situations to which the current statutes are not addressed.

Perhaps the best way to approach article 6 is to first list the types of transactions which need not comply with the Code's bulk transfer provisions. There are eight types of transactions specifically excluded by section 6-103.

1. "Those made to give security for the performance of an obligation." Bulk mortgages fall under this heading. The current statute covering bulk mortgages would be repealed if the Code were adopted and there would no longer be restrictions on the creation of this type of a property interest. In an official comment to the Code it is stated, "There has been disagreement whether the bulk transfer laws should be applied to security as well as to sale transactions. In most states security transactions have not been covered; in a few states the opposite result has been reached either by judicial construction or by express statutory provision. Whatever the reasons may be, it seems to be true that the bulk transfer type of fraud has not often made its appearance in the security field; it may be that lenders of money are more inclined to investigate a potential borrower than are purchasers of retail stores to determine the true state of their vendor's affairs. Since compliance with the bulk transfer laws is onerous and expensive, legitimate financing transactions should not be required to comply when there is no reason to believe that other creditors will be prejudiced."

3. U.C.C. § 6-103(1). See also § 9-111.
(2) “General assignments for the benefit of all creditors of the transferor, and subsequent transfers by the assignee thereunder.” There is no current Michigan counterpart to this exclusion.

(3) “Transfers in settlement or realization of a lien or other security interest.” Under this provision, a chattel mortgage foreclosure sale would not have to be conducted in compliance with the bulk transfer provisions of the Code. The current Bulk Sales Act has been so interpreted by the Michigan Supreme Court.7

(4) “Sales by executors, administrators, trustee in bankruptcy, or any other public officer under judicial process.” This exception also currently appears in the Michigan Bulk Sales Act.9

(5) “Sales made in the course of judicial or administrative proceedings for the dissolution or reorganization of a corporation and of which notice is sent to the creditors of the corporation pursuant to order of the court or administrative agency.” There is currently no Michigan statute or decision covering this point but the exclusion makes sense because it can only exist where the creditors concerned have notice of the impending transfer and the opportunities for collusion regarding the sale between the transferor and the transferee are not present.

(6) “Transfers to a person maintaining a known place of business in this state who becomes bound to pay the debt of the transferor in full and gives public notice of that fact, and who is solvent after becoming so bound.” This provision is new. Comment Four to section 6-103 states, in part, “The purpose of this article on outright sales is to give the seller’s creditors a reasonable chance to collect their debts . . . If the buyer is willing to assume personal liability for those debts and is himself solvent after such assumption, there is no reason to subject the transaction to the delay and red tape which this article proposes.”

(7) “A transfer to a new business enterprise organized to take over and continue the business, if public notice of the transaction is given and the new enterprise assumes the debts of the transferor and he receives nothing from the transaction except an interest in the new enterprise junior to the claims of creditors.” It has been held that the Bulk Sales Act must be complied with when there is a sale of a partnership interest.13 The Code would avoid the necessity of compliance in this and other cases of change in business ownership if there was slight chance of injury to creditors. Creditors are protected by limiting this exclusion to those cases in which (a) the transferor and transferee are both liable for payment of the creditor’s claim, (b) the property transferred is still subject to the debt and (c) the transferor has received nothing in payment except an interest in the transferee business junior to the claim of his unpaid creditor.

(8) “Transfers of property which is exempt from execution.” This is in accord with the current interpretation of the Michigan Bulk Sales Act.15

Turning from the eight specifically excluded types of bulk transfers to the definition contained in section 6-102 of a transfer subject to the provisions of article 6, it should first be noted that definition of a bulk transfer is somewhat limited. First of all, a transaction in bulk is under the coverage of article 6 only if it is not “in the ordinary course of the transferor’s business.” This language is somewhat similar to that currently appearing in the Michigan sta-

5. U.C.C. § 6-103(2).
6. U.C.C. § 6-103(3).
8. U.C.C. § 6-103(4).
10. U.C.C. § 6-103(5).
11. U.C.C. § 6-103(6).
12. U.C.C. § 6-103(7).
14. U.C.C. § 6-103(8).
16. U.C.C. § 6-102(1).
The purpose of bulk sales legislation is to prevent sellers from either selling out at a fraudulently low price or leaving the state without paying off their creditors. Protection against this type of commercial fraud is secured through the notice requirement of the statute. Creditors do not need protection against sales customarily made by their debtors in honestly carrying on a business from day to day.

Section 6-102, which defines bulk transfers, would also clear up some troublesome definitional problems under the current statute. One problem is whether a sale by a manufacturer is subject to the Bulk Sales Act. In Frederick v. Dettary Engineering Co., a manufacturing corporation which sold its products directly to various customers, sold substantially all its assets without complying with the Bulk Sales Act. The Michigan Supreme Court held that the statute did not apply to sales by manufacturers but only to those who dealt in merchandise, e.g. did not manufacture goods. The difficulty with this decision under the present statute is that it proceeds on the assumption that a regulated bulk sale may never be found where both the activities of manufacture and merchandising are combined. A better test would seem to be whether the bulk seller mainly engages in a sales operation.

The test supplied by the Code is found in section 6-102(3):

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

Under the Code the Frederick case might be decided the same way but the reasoning would be different. Instead of excluding the sale from the operation of the statute because the seller was a manufacturer, the sale would be excluded because the principal business of the seller was not sale of merchandise from stock.

Assuming that the transfer in bulk is not one of the excluded types, is not in the ordinary course of the business of the transferor, and is made by one whose principal business is the sale of merchandise from stock, then article 6 applies to two types of transactions: (1) a transfer of a major part of the material, supplies, merchandise or other inventory of the transferor, and (2) a transfer of a substantial part of the equipment of the transferor but only when made in connection with the bulk transfer of inventory. Equipment as defined in section 9-109(2) can generally be considered as goods bought for use in a business such as stocks, machinery etc. This category of "equipment" would include those items now designated as "fixtures" under the Michigan Bulk Sales Act.

The functioning of this two-fold classification can best be demonstrated by looking at the facts of Elliott Grocer Co. v. Fields Pure Food Market Inc. In that case a corporation made a bulk sale of some of its fixtures and it was held that a creditor of the transferor could reach the goods because of a failure to comply with the statute. The question which the court answered in the affirmative was whether the statute applied to a sale of fixtures alone, not accompanied by a sale of inventory. Under the Code the opposite result would be reached. Although the fixtures in the Elliott case would qualify as equipment, the sale would not fall within article 6 because of the absence of an accompanying bulk transfer of inventory.

If it is found that the transfer is subject to article 6, then certain steps must be taken to protect creditors of the transferor. The Code parallels current law in requiring that the transferee obtain a sworn list of creditors from the transferor together with an inventory of

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17. 1948 CL 442.1, MSA 19.361 (1959). "...[O]therwise than in the ordinary course of trade and in the regular and usual prosecution of the business of the seller..."
19. U.C.C. § 6-102(1).
20. U.C.C. § 6-102(2).
the property. The inaccuracy of the list of creditors does not affect the transferee unless he has shown to have knowledge of it. A new requirement is that the list of creditors and inventory must be preserved by the transferee for six months and, unless recorded in a specified public office, these documents must be available for inspection by creditors at reasonable hours. In addition, the transferee must give listed creditors ten days notice before taking possession of or paying for the transferred goods. The current notice period is only five days. The longer time required by the Code is designed to make the opportunity to investigate the sale a more meaningful one for creditors.

Currently the notice to be given creditors is merely that a sale will take place. Under the Code there are two types of notice. If the debts of the transferor are to be paid as they fall due, a fairly brief notice can be used. A more lengthy and detailed notice is required if the debts are not to be paid as they fall due or if the transferee is in doubt on that point. This is an attempt to cut red tape where the transaction should not involve much risk to creditors.

Auction sales receive special treatment under article 6. The duty to secure a list of creditors and inventory is placed upon the auctioneer and not upon the bidders. On one hand, it would be unfair and impractical to require that bidders comply with the Bulk Transfer Act. On the other hand, auction sales could not be omitted from the coverage of article 6 without leaving a big gap in the protection afforded creditors. Therefore, the sanctions for failure to comply with the provisions of the article on bulk transfers fall upon the auctioneer if he knew that the sale constituted a bulk transfer but in no event does the non-compliance affect the validity of the sale to the particular bidders.

The sanction for non-compliance is familiar. The transfer is ineffectiveness against any creditor of the transferor except in the case of auction sales as noted above. Thus the goods may be reached in the hands of the transferee. This is in accord with current Michigan law. Second, article 6 contains an optional provision requiring the bulk transferee to apply the proceeds of the sale to payment of the listed debts. The theory of this optional provision is that if payment of a new consideration is involved, the transferor’s creditors will more probably get their money if it comes directly to them from the transferee instead of being channeled through the transferor. This provision is thought to be one on which uniformity is not essential and a decision as to its inclusion is left to the individual states adopting the Code.

Two other provisions of the Code have no current Michigan counterpart and are worthy of note. Section 6-110 states that a purchaser for value without notice from the transferee of an improperly conducted bulk transfer takes free of any defect in the bulk transfer. This is in line with the Code’s tendency to protect bona fide purchasers whenever possible. Conversely, a purchaser with notice or who does not pay value takes subject to claims of the transferor’s creditors. Finally, section 6-111 limits creditors rights under article 6 to six months after the transferee takes possession of the goods or six months after the transfer is discovered if it has been concealed by the parties to it.

Article 6 is the shortest article of the Uniform Commercial Code and the changes embodied in it do not appear to be controversial. On the other hand, it provides a workable framework within which bulk transfers may be conducted with fairness to all parties concerned and a minimum amount of red tape.

23. U.C.C. § 6-104(3).
24. U.C.C. § 6-104(1)(c).
25. U.C.C. § 6-105.
27. U.C.C. § 6-107.
29. U.C.C. § 6-104(1).
31. U.C.C. § 6-106.