U.C.C. Section 2-702(2): An Unsecured Seller's Right to Reclaim Goods

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I. INTRODUCTION

A continuing problem in commercial transactions is the situation in which, after shipping goods to a purchaser on credit, the seller discovers that the buyer is insolvent and unable to pay for the purchase. Even if the seller has no security interest, there is, under the Uniform Commercial Code, a possibility of recovering the goods. While not a perfect solution, it is better than the alternative of not recovering anything at all. This article will explore the rights and remedies available to sellers in these situations and examine the problems in enforcing those rights, including the history of Section 2-702(2), the many definitional problems with terms such as "insolvency" and "buyer in the ordinary course", and will discuss the problems courts have had in applying what appear to be fairly simple rules to the complex reality of the business world.

The first consideration is the location of the goods at the time the seller discovers that the buyer is insolvent. The Uniform Commercial Code states that, if the goods are in transit or in the hands of a bailee, the seller may stop delivery and demand that all shipments be paid in cash before delivery even though the seller may have a

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1. For a discussion of the method used to determine whether a sale is a cash sale or a credit sale, see Monsanto Co. v. Walter E. Heller & Co., 114 Ill. App. 3d 1078, 449 N.E.2d 993 (1st Dist. 1983) (the court held that the intent of the parties determines the nature of the sale).

2. U.C.C. § 2-702(2) (1972) (all references to the Uniform Commercial Code are from the 1972 amended version).


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contract with the insolvent buyer. However, at common law, if the buyer had received the goods, he became the owner of the goods even though he had not yet paid for them. The insolvent buyer was said to have voidable title. The goods were then treated as though they were assets of the buyer's estate and they could be claimed by any creditor having an interest in the estate unless the seller had a perfected security interest or a lien.

Thus, at common law, once a buyer had taken possession of the goods sold, they belonged to the buyer and, while the seller could always sue for the purchase price, the seller had no specific right to the return of the goods. Therefore, if a buyer filed bankruptcy before paying the seller, the goods either went to a secured party (who had a valid security interest in the buyer's inventory and equipment) or they went into the buyer's bankruptcy estate to be divided among all the unsecured creditors, including the seller. Neither of these alternatives were very palatable to the seller who, just before the buyer's bankruptcy, delivered valuable merchandise to that buyer.

Without a perfected security interest or a lien, the seller will be treated as a general creditor unless there is protection under some other law. The Uniform Commercial Code protects the seller by

5. U.C.C. § 2-702(1) (1972). See also Goldstein, Commercial Transactions Desk Book § 237.1, at 69 (1977) (Goldstein supports the proposition that a buyer's insolvency acts to void any credit agreements that were made between the parties). See generally R. Duesenberg & L. King, Sales and Bulk Transfers § 13.03(2), at 13-12 (1987) [hereinafter Duesenberg & King].


8. See generally Dusenberg & King § 13.03(4) supra note 5 at 13-20.


10. 3 Hawkland, Uniform Commercial Code Series § 2-702, at 243 (1984) (the common law held that some sellers on credit lost their liens, and the only way a seller could recover goods was to rescind the sale). See infra note 12. See generally In re Wetson's Corp., 17 U.C.C. Rep. Serv. (Callaghan) 423 (D.C. S.D.N.Y. 1975) (the reclamation right under § 2-702(2) is implicit in the definition of a lien and ends on tender of payment).

providing him or her an opportunity to avoid being treated as a general creditor as long as certain requirements are met. Section 2-702(2) of the Code states:

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.\(^{12}\)

II. PRE-CODE

The rights given the seller under section 2-702(2) find their origin in common law, where the seller's right to reclaim was based on fraud or imputed fraud of the buyer.\(^ {13}\) The seller would make the argument that the buyer did not have title to the goods since the seller could rescind the contract for sale,\(^ {14}\) and the rescission was based on the buyer's fraudulent misrepresentation to the seller regarding the buyer's solvency.\(^ {15}\)

In other words, in pre-Code Law, when a seller wanted to reclaim goods because of an insolvent or bankrupt buyer, his or her only real choices were to either file a claim in the bankruptcy proceedings, hope the debt could be collected with or without suit, or to attempt to rescind the sale. If the goods are the type that retain their sales value then reclaiming the goods would be the seller's first choice. Reclamation has the advantage of working even when the buyer has declared bankruptcy. If the contract could be rescinded because the

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14. Id.
15. Id. See also Bjornstad, Reclamation of Goods by Unsecured Sellers in Bankruptcy Proceedings, 24 DRAYE L. REV. 357, 358 (1975). The article sets out the elements required in various jurisdictions for the right to rescind a contract by a defrauded seller prior to the enactment of § 2-702. Some jurisdictions required active or tacit concealment of insolvency and a clear intent not to pay. Other jurisdictions required only an inducement to contract and then concealment of insolvency by the bankrupt without intent. Still other jurisdiction required a materially false representation of financial condition made in bad faith to induce a sale even though the debtor was not insolvent. And, lastly, some jurisdictions allowed rescission for innocent misrepresentation. Id.
buyer had been fraudulent concerning his or her solvency and ability to pay, then the trustee in bankruptcy would not get the buyer’s title in the goods and the seller could reclaim them.16

III. Code

It is evident that the drafters of section 2-702(2) considered pre-Code law important, because they stated “subsection (2) takes as its baseline the proposition 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.”17 With the adoption of section 2-702(2), the seller has the ability to reclaim the goods it sold to the insolvent buyer without unsecured creditors interference for a period of ten days.

There are two parts to section 2-702(2). The first deals with the situation where the buyer made no representation regarding solvency, but in fact was insolvent when the goods were received, and the second part deals with a situation where the buyer has made a misrepresentation of solvency. Only the first part will be discussed in this article.

Under the first part, there are three conditions which must be met before a seller can reclaim goods: first, the buyer must be insolvent;18 second, the insolvency must have existed at the time that the goods were delivered;19 third, the seller must demand return within ten days of receipt of the goods by the buyer.20 The section implies a time sequence: buyer is insolvent, the seller delivers the goods, and then the seller is made aware of the insolvency and demands return of the goods.21 Some courts have interpreted section 2-702(2) to require a fourth condition in order to establish a reclamation action, namely that the goods be in possession of the debtor on the day of demand and be identifiable.22

17. 3 HAWKLAND, UNIFORM COMMERCIAL CODE SERIES § 2-702, Comment 2, at 237 (1986). See also United States v. Wyoming National Bank, 505 F.2d 1064 (10th Cir. 1974) (court held that § 2-702 eliminated any common law claim by a defrauded seller for reclamation).
19. Id.
20. Id.
22. See infra notes 85-97 and accompanying text.
As noted above, for a seller to reclaim under section 2-702(2), he or she must prove\(^2\) that the buyer was in fact insolvent at the time the goods were received. Insolvency is defined in the U.C.C. in both an equitable\(^2\) and bankruptcy sense. Section 1-201(23) of the Uniform Commercial Code defines an insolvent entity as one "who either has 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."\(^2\) Therefore, there are essentially three definitions of insolvency: 1) ceasing to pay debts in the ordinary course of business; 2) inability to pay debts as they become due (equitable insolvency); or 3) insolvency as defined in the Bankruptcy Act. According to the U.C.C., the alternative tests must be approached from a commercial standard.\(^2\) The Bankruptcy Code, on the other hand, defines insolvency under Section 101(26) as follows:

> Insolvent means - (A) with reference to an entity other than a partnership, financial condition such that the sum of such entity's debts is greater than all of such entity's property, at a fair valuation, exclusive of (i) property transferred, concealed, or removed with intent to hinder, delay or defraud such entity's creditors; and (ii) property that may be exempted from property of the estate under section 522 of this title. . . \(^2\)

The definition of insolvency under the Bankruptcy Code has come to be known as the test for "balance sheet insolvency" because it described debts being greater than an entity's assets.

There were no (or few) problems with the three different definitions of insolvency until 1978, when Congress enacted the new Bankruptcy Code. While the Code kept intact the prior definition of insolvency under the Bankruptcy Act, it added a new section, 546(c).\(^2\) It states:

> . . . [T]he rights and powers of the trustee under sections 544(a), 545, 547, and 549 of this title are subject to any

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25. U.C.C. § 1-201(23) (1972).
28. Section 546(c) was adopted by Congress in the Bankruptcy Reform Act of 1978 (Bankruptcy Code) in order to resolve the question of whether U.C.C. § 2-702 applies where the debtor files for bankruptcy.
statutory or common-law right of a seller, of goods that has sold goods to the debtor, in the ordinary course of such seller's business, to reclaim such goods if the debtor has received such goods while insolvent, but—(1) such a seller may not reclaim any such goods unless such seller demands in writing reclamation of such goods before ten days after receipt of such goods by the debtor; and (2) the court may deny reclamation to a seller with such a right of reclamation that has made such a demand only if the court—(A) grants the claim of such a seller priority as a claim of a kind specified in section 503(b) of this title; or (B) secures such claim by a lien.29

Although it has been held that section 546(c) is the exclusive remedy for a creditor's reclamation claim in a bankruptcy proceeding,30 the enactment of section 546(c) did not specifically eliminate section 2-702 in bankruptcy cases.31 In fact, the legislative comments indicate that section 2-702 was meant to be operative in bankruptcy although its involvement in bankruptcy actions is to be limited.32 It is also recognized that the drafters of section 546(c) left some definitional loose ends which the courts must resolve.33

A. DEFINING INSOLVENCY

It took several years before the courts were actually confronted with the issue of whether insolvency under section 546(c) should be defined under the bankruptcy definition which limits insolvency to a balance sheet standard, or the Uniform Commercial Code definition which includes a cash flow form of insolvency.

1. Balance Sheet Insolvency

A court addressed this issue in In re Furniture Distributors, Inc.,34 where the Massachusetts court held that the term "insolvent" as used

31. See id. (citing S. Rep. No. 989, 95th Cong. 2d Sess. 86-87, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 5872-5873, which stated that § 546(c) recognizes the "statutory or common law right of a seller, in the ordinary course of business, of goods to the debtor to reclaim the goods. . . . [Yet] [t]he purpose of the provision is to recognize, in part, the validity of Section 2-702 of the Uniform Commercial Code, which has generated much litigation, confusion and divergent decisions in different circuits.").
in section 546(c) must be interpreted according to the bankruptcy definition or "balance sheet" approach rather than the "equitable" insolvency approach of U.C.C. section 1-201(23). The court reasoned that, while the U.C.C. definition of insolvency would apply to U.C.C. applications, section 546(c) had several differences from that of section 2-702. Therefore, section 546(c) should be read so that all of its provisions and terms are meaningful. The court then jumped to the conclusion that the meaning of section 546(c) is clear and that the debtor must prove "balance sheet" insolvency. While this was one of the first cases to decide the solvency question, its use in determining which definition of insolvency to apply was limited since the court's decision did not rest on a determination of the insolvency issue by either definition.

A year later, the same issue arose in Colorado. The court, in In re Storage Technology Corporation, resolved the issue the same way it had been decided in In re Furniture. However, the court in In re Storage did acknowledge but did not adopt several persuasive arguments made by the seller favoring a standard of equitable insolvency

36. Id. The court in In re Furniture listed four important differences. The differences included the following. First: each statute [§ 2-702 and § 546(c)] starts from different points of reference. "Section 546(c) is a limitation on the avoiding powers of the trustee and, like all limitations, are generally strictly construed while 2-702 is intended as a liberal provision to aid the seller"; Second, a "demand for reclamation in bankruptcy must be made in writing..." There is no such requirement under 2-702; "Third, Section 546(c) has an ordinary course of business requirement." Lastly, § 546(c) requires that the goods be delivered when the buyer is insolvent, and this statement would be superfluous unless the words had a meaning different from those of the U.C.C. In re Furniture, 45 Bankr. 38, 42 (Bankr. D. Mass. 1984).
38. 45 Bankr. at 43. The court in In re Furniture reasoned that § 546(c) did not create any ambiguity so it was not at liberty to construe the meaning of the statute. The court supported its conclusion by stating that a two step process is necessary in determining the application of § 546(c). First, the Bankruptcy Act requirements must be met and then it is possible to look toward statutory or common law rights. Id. at 42.
39. Id. at 43. The court in In re Furniture limited its decision because neither insolvency in the bankruptcy sense nor insolvency in the U.C.C. sense was proved. Id.
41. See supra notes 34-39 and accompanying text.
instead of balance sheet insolvency. The arguments advanced by the seller included two policy arguments. First, that “balance sheet” insolvency is more difficult to prove than equitable insolvency, and thus the seller would be put at an unfair disadvantage by having to meet a heavier threshold. Second, the result of having to prove “balance sheet” insolvency would be more complex and lengthy litigation. While the court seemed sympathetic to the seller’s position, it held “that the provisions of the Bankruptcy Code are clear,” and it could not change them because of policy concerns.

The sellers in In re Storage, also advanced other arguments, such as, other terms in section 546(c) were defined by the U.C.C., such as “seller”, and “ordinary course of business” and “goods”; and that therefore, the U.C.C. definition should apply to insolvency. The sellers further contended that section 546(c) explicitly refers to state law and, therefore, the U.C.C. definition should prevail. The court dispensed with these arguments by stating that section 546(c) altered existing state and common law rights to reclaim goods, and “Congress did not intend to adopt 2-702 wholesale,” but rather only in part. While the court in In re Storage did decide the case in favor of the seller, it was evident that the court did not know exactly how to resolve the conflict. The arguments articulated by the seller would lay the path for future disagreement.

A later case in New York, In re Flagstaff Food Service Corporation, reached the same conclusion as In re Storage, but used different reasoning. The court in In re Flagstaff held that insolvency had to be defined according to the Bankruptcy Code’s “balance sheet” test, but stated that the Bankruptcy Code’s test is compatible with the U.C.C.’s definition. Such compatibility was possible since

43. Id.
44. Id. The court in In re Storage reasoned that there will be greater certainty in the law because one federal standard will apply instead of several state standards. The court inferred that states may have variations in their respective commercial code sections defining insolvency which would create greater uncertainty. Id.
45. Id. at 866.
46. Id. The court in In re Storage reasoned that § 546(c) and § 2-702 were designed to allow state and common law rights to be limited. Id.
49. See supra notes 42-47 and accompanying text.
section 1-201(23) of the U.C.C. provides for the balance sheet test as one of the three methods of determining insolvency. The court in *In re Flagstaff* also held that "[t]he [bankruptcy] definitional sections, absent clear indication to the contrary, are applicable to all provisions of the Bankruptcy Code." Thus, this court found it easier to hold that the definitions supplied, internally, by the Bankruptcy Code prevailed over definitions external to the Code.

2. **U.C.C.—Defined Insolvency**

With the exception of an unpublished opinion of a Texas court, *International Crude Corporation,* which held that the appropriate definition of insolvency under section 546(c) was the one contained in the Uniform Commercial Code, courts appeared to be uniformly using the Bankruptcy Code definition. However, in October of 1986, a New York court opted for the use of the Uniform Commercial Code's definition of insolvency. The court in *In re AIC Photo, Incorporated* held that "insolvency" was not intended to be defined exclusively by the Bankruptcy Code, but rather it was intended to be defined more generally under U.C.C. section 1-201(23). The court reasoned that, to hold otherwise would create the type of confusion that section 546(c) was enacted to dissipate. The court also realized that to require a seller to determine whether a debtor's liabilities exceed its assets is unrealistic due to the complexity involved in reaching such a determination. While this case appears to stand for the proposition that the term "insolvency" under section 546(c) can be defined by section 1-201(23) of the U.C.C., it should be noted that the parties stipulated that the meaning would be controlled by the U.C.C. definition of insolvency.

51. *Id.*
52. *Id.* at 905.
53. This unpublished opinion was cited in *In re Storage Technology Corp.*, 48 Bankr. 862, 865 (Bankr. D. Colo. 1985).
55. *In re AIC Photo, Inc.*, 57 Bankr. 56, 58-60 (Bankr. E.D.N.Y. 1985).
56. *Id.* at 59. The court in *In re AIC* reasoned that debtors often require extensions to complete bankruptcy schedules because of the difficulties encountered in trying to determine their own assets and liabilities. *Id.* The court further reasoned that it would be unfair to require a total stranger to attempt to determine the financial stability of the business by assessing excess liabilities over assets. *Id.*
57. *Id.* This case is important because the court held that the stipulated meaning of insolvency under § 1-201(23) of the U.C.C. was controlling without finding that the bankruptcy definition of insolvency was not controlling. *Id.* The court in essence adopted the position advocated by the seller in *In re Storage Technology Corp.*, 48 Bankr. 862 (Bankr. D. Colo. 1985). See also supra notes 42-47 and accompanying text.
As a result of the *In re AIC Photo* decision, it is uncertain what definition of insolvency will prevail in other jurisdictions. Although Colliers on Bankruptcy has taken the position that the appropriate definition is that contained in the Bankruptcy Code, it is this author's opinion that equity requires the use of the U.C.C. definition. The standard should be the same for both the bankrupt and non-bankrupt buyer.

B. OTHER DEFINITIONAL PROBLEMS

In addition to the bankruptcy/U.C.C. insolvency definitional conflict, there are, unfortunately, other conflicts as well. As already stated, section 2-702(2) imposes a requirement that the seller make a demand for the return of goods within ten days of receipt of the goods by the buyer. There is no requirement that the demand be in writing, so an oral demand is usually acceptable. A problem arises under section 546(c) which requires that the demand be in writing. The courts have yet to concur on where the law stands in determining whether oral demand made under U.C.C. 2-702(2) is sufficient when a buyer subsequently files bankruptcy. Authors suggest that the best

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58. *4 Colliers on Bankruptcy* § 546.04 at 546-15 (15th ed. 1979). That section in pertinent part states:

The seller's right to reclaim is not protected in all cases. The Code speaks of receipt of goods by the debtor 'while insolvent.' Section 101[(29)] defines 'insolvent' only in the bankruptcy sense (when the debtor's liabilities exceed its assets at a fair valuation). In many reorganization cases, however, the debtor may be insolvent in the equity sense (unable to pay its debts as they come due), but solvent in the bankruptcy sense. Such a debtor would thus not be insolvent within the Code definition and section 546(c) would not apply. (Footnotes omitted.)

*Id.*


60. *In re Daylin*, Inc. 596 F.2d 853 (9th Cir. 1979). The *Daylin* decision did not involve a bankruptcy action where courts have held § 546(c) requires demand to be in writing. See *infra* notes 61-63 and accompanying text.


62. United Beef Packers v. Lee, 14 Bankr. 27, 29 (Bankr. D. S.C. 1980) (the court held the seller did not have to comply with the writing requirements of § 546(c) since the seller had timely made demand before the bankruptcy had been filed); *In re Coast Trading Co.*, Inc., 31 Bankr. 667 (Bankr. D. Ore. 1982) (the court held that the seller must strictly comply with requirements of § 546(c) upon the buyer's filing
procedure is to always make a written demand, even if an oral demand was made which complies with section 2-702(2). In this way, the seller would be protected against a trustee trying to use their avoiding powers in the event of a bankruptcy.

Although both section 2-702(2) and section 546(c) require that demand be made within ten days after the debtor receives the goods, the sections do not define many of the terms. Consequently, the courts have been asked to determine such issues as what constitutes an effective demand, to whom must the demand be given, how is the ten day period computed, and what constitutes receipt of the goods. Additionally, the courts have had to determine when goods are identifiable and in possession of the debtor on the day of the demand.

1. Demand Requirement

The court in In re Marin Motor Oil, Incorporated, was presented with the issue of whether demand is effective on dispatch or only on receipt. In In re Marin, the seller alleged a proper demand had been made for the return of oil sold to the buyer. The seller contended that a Telex sent on the tenth day constituted a demand under section 546(c), and was sufficient demand even though the buyer's Telex machine was turned off so that the message was not received until the eleventh day. The court held that a demand is effective on dispatch, as long as it is made in a commercially reasonable manner. Serving written demand on buyer's attorney has been held to be commercially reasonable. The court in In re Marin went on to hold

of bankruptcy and therefore the demand must be in writing). See also In re Colacci's of Amer., Inc., 490 F.2d 1118, 1121 (10th Cir. 1974); In re Storage Technology Corp., 48 Bankr. 862, 866 (Bankr. D. Colo. 1985).


64. NORTON BANKR. L. & PRAC. § 31.05 at 31-16 (1981); 3 HAWKLAND, UNIFORM COMMERCIAL CODE SERIES, § 2-702:06 at 247 (1986).

65. 740 F.2d 220 (3d Cir. 1984).


67. Id. at 227-28. The court reasoned that a demand, effective upon dispatch in a commercially reasonable manner, comported with the "mailbox" rule in contracts. See also In re Flagstaff Foodservice Corp., 56 Bankr. 899 (Bankr. S.D.N.Y. 1986).

68. See, e.g., In re Flagstaff, 56 Bankr. at 907.
that the implementation of a state lawsuit by serving a summons and
complaint was not sufficient to constitute a demand under the stat-
ute.69 A seller has an obligation to make it clear that he or she is
demanding the return of goods.70

2. **Ten-Day Limitation**

The courts have also had to define what Congress intended by
the ten-day limitation.71 It is rather obvious that Congress did not
intend to protect a seller who makes a demand for reclamation more
then ten days after the receipt of goods by the buyer.72 When the last
day of the ten-day period falls on a Sunday, the period is extended
to the next day.73 In computing the ten-day period, the day the act is
done is excluded and the last day is included.74 The time limit is
strictly enforced and runs from the time of the buyer's receipt, not
the time at which the seller eventually discovers the buyer's insol-
vency.75 This will often be much later than the delivery of the goods.

3. **Receipt**

While the seller must make demand for reclamation within ten
days of receipt of the goods, some dispute has arisen as to what

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69. *In re Marin*, 740 F.2d at 224. The court reasoned that a complaint that
seeks only damages and a restraining order is insufficient to satisfy the demand
requirement of § 546(c). The decision does not really hold that all summons and
complaints would be insufficient. *Id.*

70. 3 HAWKLAND, *UNIFORM COMMERCIAL CODE SERIES* § 2-702, at 247 (1986).
A mere demand for payment of the purchase price will probably not be sufficient.
Ideally, the seller should state that he is demanding a reclamation of the goods
pursuant to § 2-702(2) of the U.C.C. *Id.*

71. *See supra* note 11. *See also In re First Software Corp.*, 72 Bankr. 403, 405-
07 (Bankr. D. Mass. 1987) (court held demand for reclamation untimely where the
installation of goods was completed less than ten days before buyer filed for
bankruptcy and demand was sent because the components had been shipped to buyer
at earlier date).

72. *See, e.g.*, *In re Pester Refining Co.*, 66 Bankr. 801, 814 (Bankr. S.D. Iowa
1986).

73. *See, e.g.*, *In re Dixie Enterprises, Inc.*, 22 Bankr. 855, 857-58 (Bankr. S.D.
Ohio 1982).

74. *See, e.g.*, *In re Dixie Enterprises, Inc.*, 22 Bankr. 855, 858 (Bankr. S.D.
Ohio 1982).

75. U.C.C. § 2-702 (1972), Comment 2, states . . . “This article makes discovery
of the buyer's insolvency and demand within a ten day period a condition of the
right to reclaim goods on this ground. The ten day limitation period operates from
the time of receipt of the goods.”
constitutes receipt. In *In re Maloney Enterprises, Incorporated,* a sportswear manufacturer brought suit against the debtor to reclaim sportswear sold to the debtor before he filed bankruptcy. The sportswear was shipped F.O.B. Seattle, Washington, and was received by the debtor in Kentucky. The day after the debtor received the sportswear, he filed bankruptcy. When the seller demanded that the sportswear be returned three days later, the buyer refused to comply with the seller's reclamation demand. The court held that, for purposes of defining receipt under section 2-702(2), receipt occurred when the debtor took actual physical possession of the sportswear and not delivery. Therefore even though title and risk of loss may have passed when the goods were given to the carrier, the ten days started to run when the goods were delivered.

4. *Additional Requirement*

The courts have also implied a condition that the goods actually exist in an identifiable state and be in the possession of the buyer at the time of the demand. Although this seems to be a rather easy
requirement to meet, the courts have been presented with cases where
the goods have been commingled with other goods and found that
the commingled goods must be identifiable.85 While originally it
appeared that the courts would strictly apply the identification re-
quirement, that was not the case in In re Charter Company.86 In this
case, the seller delivered 3,986.25 barrels of crude oil to the buyer.87
The buyer transported the oil to two different facilities with storage
tanks. The tanks were directly connected to the Texas-New Mexico
Pipe Line. Automated pumps pushed the crude oil into the pipeline
which contained over 200,000 barrels of crude oil of like kind and
grade from over 80 other companies. The subject oil was pumped
into the pipeline two days before the seller sent the buyer a timely
notice of reclamation. The oil was located either in the storage tanks
or commingled with other crude oil in the pipeline.88

The court initially held that crude oil as a fungible good would
be subject to reclamation under section 546(c).89 It next undertook
the determination of whether the crude oil was sufficiently identifiable.
The buyer argued that the seller must identify the exact location of
every molecule in order to have a right to reclaim.90 The court held
that it would be impossible for the seller to identify the location of
each molecule since the crude oil was commingled with other crude
oil of like kind and grade within hours after it came into the buyer’s
possession.91 The court found that the identification requirement
mandated the sellers tracing the oil from its possession into an
identifiable mass and to show that the mass contains only crude oil
of like kind and grade.92 The court then held that, since the crude oil
is subject to the buyer’s control, it is both identifiable and in the
buyer’s possession.93

The court in Charter went on to try to distinguish In re Landy
Beef Company.94 The Landy Beef case involved a buyer who pur-
chased beef from various distributors.95 The beef was commingled

85. See, e.g., In re Charter Co., 54 Bankr. 91, 93 (Bankr. M.D. Fla. 1985), In
86. 54 Bankr. 91 (Bankr. M.D. Fla. 1985).
88. Id.
89. Id., at 92-93.
90. Id. at 93.
91. Id.
93. Id. at 93.
within three days of purchase and possibly sold to a third party. The seller demanded reclamation of its beef within the ten-day time frame, but after the three-day processing period. The court held that the meat was either non-identifiable, or sold to a third party and therefore not within the buyer's control. While it is possible that the meat was no longer within the control of the buyer, the distinction between commingled beef and commingled crude appears illusory.

Another Florida court, in Archer Daniels Midland Company v. Charter International Oil Company, addressed a similar issue regarding "ethanol" that had been sold to an insolvent buyer. The court held that the seller could only reclaim the amount of ethanol that was identifiable and in the buyer's storage tank at the time notice of reclamation was received. The other ethanol that the seller wished to reclaim had already been sold to a third party.

5. Third-Party Purchasers

A seller's right of reclamation becomes more complicated if a third party lays claim to the goods. Third party interests include: 1) a secured party of the buyer who claims the goods under an after-acquired property clause; 2) buyers of the goods who have acquired them from the first buyer; 3) the buyer's trustee in bankruptcy. Subsection 2-702(3) of the Uniform Commercial Code addresses these third party rights and makes a seller's right to reclaim goods subject to the rights of other parties, namely: 1) a good faith purchaser; 2) a buyer in the ordinary course of business; and 3) a lien creditor in a majority of states.

Subsection 2-702(3) provides as follows:

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96. Id. The court concluded that the meat that might have been in Landy's possession at the time of demand was non-identifiable because it had been processed (chopped up). The court also reasoned that it was possible that all the meat had already been sold and therefore no longer in Landy's control or possession. Id.

97. 60 Bankr. 854 (Bankr. M.D. Fla. 1986). In this case, Archer sold ethanol for use in gasoline to Charter. Charter became insolvent. The ethanol was stored in Charter's facilities at Houston and Jacksonville. However, only the ethanol in the Houston facility was still in storage when Charter received a notice of reclamation. Id.

98. Archer Daniels Midland Co. v. Charter Int'l Oil Co., 60 Bankr. 854, 856 (Bankr. M.D. Fla. 1986). This meant that only the ethanol contained in the Houston storage facility could be reclaimed. Id.

99. See 3 HAWKLAND UNIFORM COMMERCIAL CODE SERIES § 2-702, at 254 (1986) (discussion of the cut-off power of a good faith purchaser.)

100. Id. at 251 (discussion of the cut-off power of buyer in the ordinary course).

101. Id. at 257 (discussion of the cut-off power of lien creditor).
The seller's right to reclaim under sub (2) is subject to the rights of a buyer in the ordinary course or other good faith purchaser (or lien creditor) under 2-403. Successful reclamation of goods excludes all other remedies with respect to them.\textsuperscript{102}

This section has caused most of the problems for sellers wishing to exercise their rights under 2-702(2). Historically, a defrauded seller was provided the right to rescission and reclamation of goods.\textsuperscript{103} Now, however, the seller rights are subject to the rights of third parties.

In a credit sale, a seller would transfer all incidents of ownership, including title to an insolvent buyer, and the insolvent buyer could then transfer good title to any party that qualifies as a good faith purchaser.\textsuperscript{104} Subsection (3) thus severs the seller's right to reclaim when there has been a second sale to good faith purchaser. The definition of "purchaser" causes problems because the term good faith purchaser has been interpreted to include secured parties by most courts.\textsuperscript{105} This is true even if the secured party was simply obtaining additional security for a pre-existing debt.\textsuperscript{106} If a creditor takes a security interest in a seller's goods after the seller delivers the goods to an insolvent buyer, the secured creditor has "purchased" an interest in the goods. Then, under section 2-702(3), the secured creditors' claim to the goods takes precedence over the seller's right to reclaim. The courts have not agreed as to whether a secured creditor with a floating lien qualifies as a "purchaser."\textsuperscript{107}

\textsuperscript{102} U.C.C. § 2-702(3) (1972). The 1952 version of § 2-702(3) contained the words lien creditor. The words lien creditor were omitted in 1966 from the 1952 official edition of the Uniform Commercial Code. The omission was on the recommendation of the Permanent Editorial Board. See 6 U.C.C. Rep. Dig. (MB) § 2-702 (Drafting History) (1987) (for further discussion of the omission of the words "lien creditor" from § 2-702(3)).

\textsuperscript{103} See supra note 15. See discussion of cases in King, Voidable Preferences and the Uniform Commercial Code, 52 CORNELL L.Q. 925, 938 (1967).

\textsuperscript{104} See, e.g., In re Samuels & Co., Inc., 510 F.2d 139 (5th Cir. 1975), rev'd per curiam 526 F.2d 1238 (5th Cir. 1976).

\textsuperscript{105} See discussion of cases Warren, Gorham & Lamont, Quinn's Uniform Commercial Code Commentary and Law Digest, at § 2-261 (1986 Cum. supp. No. 1) (In re Sitkin Smelting & Ref., Inc., 639 F.2d 1213 (5th Cir. 1981); Kimberly & European Diamonds, Inc. v. Burbank, 684 F.2d 363 (6th Cir. 1982)).

\textsuperscript{106} U.C.C. § 1-201(44)(b) (1972).

\textsuperscript{107} The majority of courts have held that a seller's reclamation rights from an insolvent buyer were subordinate to the security interest of a good faith purchaser with an after-acquired property clause. See generally In re Misco Supply Co., 42 U.C.C. Rep. Serv. (Callaghan) 1662 (D.C. D. Kan. 1986); In re Furniture Distributors, Inc. 45 Bankr. 38 (Bankr. D. Mass. 1984); In re Bensar Co., Inc., 36 Bankr.
A creditor obtains a floating lien by inserting an after-acquired property clause in the security agreement that is executed when the creditor loans the buyer money. Usually the creditor designates that the loaned money be used to purchase inventory and by executing the security agreement, the creditor obtains an interest in the buyer’s future inventory. A majority of courts have interpreted the Uniform Commercial Code’s definition of purchaser to include creditors with floating liens. However, a court’s finding that a purchaser includes


A minority of courts have held for the seller over the rights of a party with an after-acquired property clause. See generally In re American Food Purveyors, Inc. 17 U.C.C. Rep. Serv. (Callaghan) 436, (Bankr. N.D. Ga. 1974); In re Emery Corp., 38 Bankr. 489 (Bankr. E.D. Pa. 1984) (the court in Emery held “that the term purchaser in § 2702(c) includes a secured creditor only to the extent that such creditor gives value to the debtor and receives a security interest thereon after the delivery of the goods and prior to the demand for reclamation”). In re Emery Corp., 38 Bankr. 489, 493 (Bankr. E.D. Pa. 1984) rev’d, Lavonia Manufacturing Co. v. Emery Corp., 52 Bankr. 944 (D. E.D. Pa. 1985) (the district court reversed the bankruptcy court decision and held that parties with a perfected security interest in an insolvent debtor’s after-acquired inventory were good faith purchasers under § 2-702 whose rights were superior to those of a seller attempting to reclaim goods sold to the debtor).


109. Id.

110. See generally, In re American Food Purveyors Inc., 17 U.C.C. Rep. Serv. (Callaghan) 436 (N.D. Ga. 1974) (creditor was a bank with a secured interest in after-acquired seafood in the inventory of a bankrupt buyer); In re Samuels & Co., Inc., 510 F.2d 139 (5th Cir. 1975) (creditor was a financing company with a secured interest in after-acquired cattle) rev’d per curiam, 526 F.2d 1238 (5th Cir. 1976), cert. denied sub nom. Stowers v. Mahon, 429 U.S. 834 (1976); United States v. Wyoming Nat’l Bank of Casper, 505 F.2d 1064 (10th Cir. 1974) (creditor was a bank with a secured interest in after-acquired steel in the inventory of a bankrupt buyer); In re McLouth Steel Corp., 22 Bankr. 722 (Bankr. E.D. Mich. 1982) (bank creditor had secured interest in after-acquired steel of bankrupt buyer); In re Bensar Co., Inc., 36 Bankr. 699 (Bankr. S.D. Ohio 1984) (secured creditor purchased an interest in the seller’s goods—which were in the buyer’s hands—through the floating lien it had acquired).
a secured creditor with a floating lien or after-acquired inventory does not mean that the seller is precluded from recovery in all instances. The seller can still argue that the secured party did not act in good faith, but the courts rarely make such findings.

There have been numerous opinions regarding the "appropriate" way to approach good faith purchasers rights. Several of these cases are set out in the following pages. It is evident from these cases that there really is not set pattern for reaching decisions regarding a good faith purchasers rights.

A meat packer in *In re Samuels & Company, Incorporated*, bought cattle from a seller while insolvent. When the seller discovered the meat packer's insolvency, he demanded return of the cattle.

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111. See, e.g., *In re* American Food Purveyors Inc., 17 U.C.C. Rep. Serv. (Callaghan) 436 (N.D. Ga. 1974) (seafood purchaser's failure to show "good faith" as a purchaser prevented it from prevailing over defrauded seller); Liles Bros. & Sons v. Wright, 638 S.W.2d 383 (Tenn. 1982) (purchaser had reason to believe property was stolen or fraudulently obtained, which prevented him from claiming "good faith purchaser" status); Monsanto Co. v. Walter E. Heller & Co., Inc., 114 Ill. App. 3d 1078, 449 N.E.2d 993 (1st Dist. 1983) (secured party not acting in good faith when it refused to cover buyer's checks for goods in question and refused to return the goods after taking over buyer's operation, given course of dealings between the parties and lender's direct involvement with the buyers operations).

112. 510 F.2d 139 (5th Cir. 1975), rev'd *per curiam*, 526 F.2d 1238 (5th Cir. 1976) (held provisions of § 2-401(1) did not apply to cash sale transaction and seller's unperfected security interest would not be subordinated by the financing company's security interest in buyer's after-acquired property) *cert. denied sub nom.* Stowers v. Mahon, 429 U.S. 834 (1976). In its original decision, the court of appeals, Judge Godbold dissenting, reversed the district court, which had upheld the claim of the sellers of livestock against a pre-existing security interest in the buyers inventory. Rehearing en banc was granted and the dissenting opinion of Judge Godbold adopted as the opinion of the majority of the court en banc in *In re Samuels*, 526 F.2d 1238 (1976).

113. *In re Samuels*, 510 F.2d 139, 143-44 (5th Cir. 1975), rev'd *per curiam*, 526 F.2d 1238, *cert. denied sub nom.* Stowers v. Mahon, 429 U.S. 834 (1976). The case involved a cash sale of cattle. But the buyer's check was dishonored so the seller tried to reclaim the cattle. *Id.* For further discussion of cash sale reclamation cases, see, e.g., *In re* Colacci's of Amer., Inc., 490 F.2d 1118 (10th Cir. 1974) (seller not a "reclaiming seller" where sale of bar equipment was made as cash sale with payment due on delivery, but seller acquiesced in debtor's retention of equipment for four months); Szabo v. Vinton Motors, 630 F.2d 1 (1st Cir. 1980) (court stated an auto paid for by a check that bounced could not be reclaimed by seller, since seller reclaimed more than ten days after buyer's receipt of goods); Genesee Merchants Bank & Trust Co. v. Tucker Motor Sales, 143 Mich. App. 339, 372 N.W.2d 546 (1985) (bank that floor-planned dealer's acquisition of new cars had superior security interest in dealer's inventory over cash seller's right to reclaim after dealer's check bounced). *See generally*, Mann & Phillips, *The Cash Seller Under the Uniform Commercial Code*, 20 B.C.L. Rev. 370 (1979).
However, the cattle could not be reclaimed because the meatpacker had already sold them. The seller then tried to reclaim the proceeds from the sale of the cattle. However, another party laid claim to the proceeds. The other party was a secured creditor who had an interest in the meat packer’s inventory. The secured creditor claimed that it was a good faith purchaser because of its interest in the cattle. The secured creditor claimed a superior interest in the proceeds because it had an after-acquired property clause in its security agreement which created a voluntary lien on the cattle as soon as the cattle were delivered to the buyer. Since the floating lien was a result of the voluntary transaction, the secured creditor argued that he was a purchaser under subsections 1-201(32) and (33) of the Uniform Commercial Code. The court later held, en banc, that the secured creditor was a purchaser. The court interpreted the Code’s definition of a purchaser to broadly encompass not only one who takes by sale, voluntary, mortgage, gift, pledge or lien, but also one with a secured interest.

The court went further to find that a secured creditor is a good faith purchaser under section 2-702(3), only if the creditor gives value for his interest in the buyer’s inventory. Value is spelled out in the

114. In re Samuels, 510 F.2d at 144.
115. Id.
116. Id.
117. Id.
118. In re Samuels, 526 F.2d 1238, 1241. See also In re Bowman, 25 U.C.C. Rep. Serv. (Callaghan) 738 (Bankr. N.D. Ga. 1978) (a secured creditor qualifies as a purchaser under § 1-201(32)); In re Emery Corp., 38 Bankr. 489 (Bankr. E.D. Penn. 1984) (a secured creditor qualifies as a purchaser under U.C.C.'s definition of purchaser). See also U.C.C. § 1-201 which provides:

Subject to additional definitions contained in the subsequent provisions of this title which are applicable to specific provisions of the title, the following words and phrases when used in this title shall have, unless the context clearly indicates otherwise, the meaning given to them in this section:

1-201(32) provides: "'Purchaser' includes taking by sale, discount, negotiation, mortgage, pledge, lien, issue or reissue, gift or any other voluntary transaction creating an interest in property.'"

1-201(33) provides: "'Purchaser', a person who takes by purchase.'"

U.C.C. § 1-201 (1972). See also No. 1 UCC - Digest, (1986 Cumm. Supp.) § 2-702[A][5][a]; Genesee Merchants Bank & Trust Co. v. Tucker Motor Sales, 143 Mich. App. 339, 372 N.W.2d 546 (1985) (the term purchase was held to include not only those who take by sale but also those who, like the bank in this case, take by lien).

119. In re Samuels, 526 F.2d at 1242.
120. Id. at 1245. See also Bryant, supra note 104, at 1354-55 (discussion of the In re Samuels decision).
Code as "consideration sufficient to support a simple contract." If a secured creditor has a lien on the buyer's present and future inventory because of an after-acquired property clause, then the secured creditor's interest automatically attaches to the goods as soon as the seller delivers the goods to the buyer.

Some courts suggest that it is necessary for a secured creditor to give new value to the buyer in order to purchase a valid interest in the buyer's incoming inventory. The court in In re Hayward Woolen Company, however, suggested that new value was not necessary, but yet went on to rely on a secured creditor's advancement of $25,000.00 to the buyer before the buyer bought some livestock in making its decision. In this case, an inventory lender with an after-acquired property clause sought goods that were delivered to the buyer while the buyer was insolvent. The court awarded the priority interest to the inventory lender.

The court in In re American Food Purveyors held that a secured creditor is not a purchaser under section 2-702(3) and therefore a seller could recover his goods under 2-702. The court held that section 2-702(3) was not designed to protect secured creditors, it was only intended to protect Article Two purchasers. The court disregarded the argument that the U.C.C. definition of purchaser is broad enough to include a secured creditor. The court's decision is a radical departure from most cases which hold that a secured party takes

121. U.C.C. § 1-201(44)(d) (1972).
122. See supra note 118.
126. Id.
127. Id. at 1111-12.
129. Id. The court reasoned that U.C.C. § 2-403 and § 2-702(3) were not meant to protect a secured creditor to the detriment of the unpaid seller. Id.
130. Id. The court in In re American Food Purveyors, Inc., realized that the definition of purchaser in the Uniform Commercial Code was sufficiently broad to encompass a secured party, but felt that it would be a miscarriage of justice to allow the secured party to reap a benefit when it had taken no action to protect itself. Therefore, a "purchaser" in § 2-702(3) must exclude Article 9 secured parties. Id.
priority over the seller. However, it should be noted that the court was probably decision orientated. In *In re American Food Purveyors, Inc.*, the court was presented with the determination of whether a secured party who had prior notice of the buyer’s insolvent condition and did nothing to protect is position, could prevail over an innocent seller.\(^{131}\) The court relied on equity principles to hold that a secured party should not be able to reclaim over a seller where it had not exercised good faith.\(^{132}\)

Most courts would agree with the decision in *In re Bensar Company, Inc.*,\(^{133}\) that a secured creditor with a floating lien has priority over a reclaiming seller. In *In re Bensar Company, Inc.*, the sellers tried to argue that the right to reclaim under section 2-702(2) is like a security interest.\(^{134}\) The seller argued that, under section 9-113\(^ {135}\) of the U.C.C., a creditor can enforce a security interest under Article Two without filing a financing statement or obtaining possession of the goods as long as the debtor did not lawfully obtain possession of the goods.\(^ {136}\) The sellers stated that the buyer did not lawfully obtain possession of the goods because the buyer received the goods while insolvent. The court said the language of section 2-702(2) does not create a security interest as defined in the Code.\(^ {137}\) It also said that the presence of a secured creditor with a floating lien


\(^{132}\) *Id.* at 441-44.


\(^{135}\) *Ohio Rev. Code Ann.* § 1309.11 (Anderson 1979) provides:

A security interest arising solely under section 1302.1 to 1302.98, inclusive, of the Revised Code is subject to the provisions of section 1309.01 to 1309.50, inclusive, of the Revised Code except that to the extent that and so long as the debtor not have or does not lawfully obtain possession of the goods:

(A) No security agreement is necessary to make the security interest enforceable; and

(B) No filing is required to perfect the security interest; and

(C) The rights of the secured party on default by the debtor are governed by sections 1302.01 to 1302.98 inclusive, of the revised Code.

\(^{136}\) 36 Bankr. at 702.

\(^{137}\) *In re Bensar Co., Inc.*, 36 Bankr. 699, 702 (Bankr. S.D. Ohio 1984) (the sellers tried to argue that the right of reclamation established in the U.C.C. § 2-702 is equivalent to the right of a defrauded seller to repossess goods under the common law, and as a matter of equity such a right is superior to that of the secured creditor holding a perfected security interest. The court stated that there was no evidence that the parties intended to create a security interest.)
on the buyer's inventory put a stop to the seller's reclamation right against the insolvent party and against any other party.\(^\text{138}\)

*United States v. Westside Bank*\(^\text{139}\) is a case in which the court decided that a seller's reclamation right is secondary and subordinate to the rights of a secured creditor with a floating lien, but which may survive the presence of a floating lien.\(^\text{140}\) After the secured creditor is made whole, the seller may satisfy his interest in the buyer's inventory prior to other general creditors of the buyer.\(^\text{141}\) Thus, the court in *Westside Bank* held that the seller could reclaim after the secured creditor had satisfied his interest.\(^\text{142}\)

The court in *Westside Bank* classified the reclamation right as a security interest.\(^\text{143}\) This is inconsistent with the Code's requirements for a security interest. Section 9-102(1)(a)\(^\text{144}\) states that a security interest is a transaction "intended to create a security interest." A seller's reclamation right would not qualify as a security interest unless the seller enters a transaction intending to create a security interest. If a seller enters a transaction with the buyer to retain a security interest in goods, then the seller has taken a purchase money security interest in the goods, and that would then defeat the floating lien creditor.\(^\text{145}\) If, in fact, the seller had a security interest (a perfected purchase money security interest in goods) he then would not need to use the section 2-702 reclamation right to recover his goods.\(^\text{146}\) If the courts classify a seller's right to reclaim as an unperfected security interest, then another creditor will defeat a reclaiming seller. The rights of creditors with an unperfected security interest are secondary to rights of lien creditors whose lien attached before the creditor had perfected a security interest. To protect his or her interest, a seller

\(^{138}\) Id. at 703.

\(^{139}\) 732 F.2d 1258, 1265 (5th Cir. 1984).

\(^{140}\) United States v. Westside Bank, 732 F.2d 1258, 1265 (5th Cir. 1984).

\(^{141}\) Id. (The court allowed the seller of goods who diligently asserted its right of reclamation, to obtain a priority status against the buyer's general unsecured creditors, where the prior lienholders have been fully satisfied).

\(^{142}\) Id.

\(^{143}\) Id. The court in *Westside Bank* reasoned that a reclaiming seller should also be entitled to a priority claim against the proceeds of a sale of goods. The court felt that allowing a seller a priority claim was wholly consistent with the "preferential treatment" allowed by § 2-702 comment 3 of a seller as "against the buyer's general unsecured creditors." Id.

\(^{144}\) U.C.C. Section 9-102(1)(a) (1972).


\(^{146}\) See, e.g., U.C.C. § 9-503 (1972).
should obtain and perfect a purchase money security interest.

Even though most courts favor an inventory lender over the seller, the seller may not be completely precluded from recovery because of treatment as an unsecured creditor if the buyer filed bankruptcy. The bankruptcy court may treat the seller's claim as an administrative expense or a lien under the Bankruptcy Reform Act.\textsuperscript{147} It should be noted that the seller who is forced to take an administrative priority or a lien may end up with less than what would have been received if the goods had been returned.\textsuperscript{148} If the seller had been able to get his goods back right away there is the possibility of him holding an immediate sale and the seller would have had the use of the proceeds from that sale.\textsuperscript{149} The courts have taken numerous positions in deciding whether a seller should be granted an administrative expense or a lien under the Bankruptcy Code.

In \textit{In re Lawrence Paperboard Corporation}\textsuperscript{150} the court was presented with the issue of whether a seller should be granted an administrative expense or a lien which, due to the Bankruptcy Code, would be subordinate to a bank with an after-acquired property clause in its security agreement. The court held that the banks after-acquired property clause extinguished a seller's right to reclaim.\textsuperscript{151} The court reasoned that, since section 546(c) only permits the granting of an administrative expense if the seller has a valid right to reclaim,\textsuperscript{152} and the right to reclaim was extinguished, the seller had

\textsuperscript{147} 11 U.S.C. § 546 (c) (2) (A) and (B) (1982).

\textsuperscript{148} Many times bankruptcy cases have no assets for distribution, so it would not matter that a seller has obtained an administrative priority or lien. One cannot squeeze money out of a bankruptcy estate where there is no money. Therefore, a seller would be better off to reclaim the goods.

\textsuperscript{149} See Marshack, \textit{supra} note 11 at 202.


\textsuperscript{152} 52 Bankr. at 911 (citing Action Industries, Inc. v. Dixie's Enterprises, Inc. 22 Bankr. 855 (Bankr. S.D. Ohio 1982) which held if a seller does not have a legal basis for reclamation under the U.C.C., then there is no legal basis for granting an administrative expense). \textit{See generally In re Griffin Retreading Co.}, 795 F.2d 676 (8th Cir. 1986) (court held that since seller had a right to reclaim, he should be entitled to an administrative expense even though the buyer was not in possession of goods. The buyer disposed of good to third party even though there was a timely demand).
no right to an administrative claim or lien. The court also noted that the security agreement had to be executed before the sale of goods or the seller's right would not be cut off. The court further stated that the result would definitely be different if the goods were sold to the insolvent buyer after the filing of a bankruptcy petition. In that event, the debtor would not be subject to the lien resulting from a security agreement entered into before the filing of the bankruptcy petition.

An opposite result was reached in *In re FCX, Inc.* where the court held that the rights of a reclaiming seller are not automatically cut off merely because of the presence of a secured creditor with a superior interest. The court held that, for a right to an administrative expense or a lien, the seller must have a right to reclaim. That way, the right to an administrative expense or a lien is in lieu of the right to reclaim. However, the court still recognized the power of certain third parties to supersede the rights of the seller to reclaim and even cut off the rights of a seller's administrative lien. It did this by stating that a seller's lien would exist only to the extent that the value of the asset secured by the prior lien holder exceeded the amount of

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153. *Id.* at 911.
154. *Id.*
156. *Id.* at 912 (the court cited 11 U.S.C. § 552(a) (1979) which provides: "property acquired by . . . the debtor after the commencement of the case is not subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case." 11 U.S.C. § 552(a) (1982)).
157. 62 Bankr. 315 (Bankr. E.D. N.C. 1986). The court in *In re FCX* in reaching its decision that the rights of reclaiming sellers are not automatically extinguished simply because of the presence of a secured party, cited *In re Wathen's Elevators, Inc.*, 32 Bankr. 912, 923 (Bankr. W.D. Ky. 1983) which stated:

... to say that reclamation is "subject to" superior claims is neither to deny the validity of the sellers' rights nor to bar their claims. Rather the effect of this language is to eliminate their first position and relegate the sellers to some less commanding station.

*Id.*
159. *Id.* (citations omitted).
160. *Id.* at 323. The court in *In re FCX* reasoned that, if a prior third party's lien security interest exceeded the value of the security, the seller's lien would have no value and would be "cut off." Therefore, an administrative expense or lien would only be granted where the good sold has some value above that of the secured party's after acquired property interest.
that claim.\textsuperscript{161} If the prior lien creditor's debt is not fully satisfied by the value of the collateral, the seller as a new lien holder would receive nothing.\textsuperscript{162}

Still another court, in \textit{In re Misco Supply Company},\textsuperscript{163} reached yet a different result. As in \textit{In re FCX}, the court held that the seller must have a right to reclaim before the court will grant a seller an administrative priority or lien.\textsuperscript{164} However, the court concluded that, if a seller has a right to reclaim, the seller should be "entitled to an administrative priority or lien on all of the bankrupt's unsecured assets . . .", subject to the secured parties interest.\textsuperscript{165}

The \textit{In re Misco} decision differs significantly from the \textit{In re FCX} decision in that \textit{In re FCX} granted the seller an administrative claim or lien only to the extent that the prior lienholder's collateral exceeded the amount of the prior lienholder's claim and the court in \textit{In re Misco} extended the seller's interest to all the bankrupt's unsecured assets.\textsuperscript{166}

As mentioned earlier, the courts have allowed a seller who diligently asserts his rights to reclaim and who meets all the requirements of section 2-702, to obtain a priority status against the buyer's general unsecured creditors. The priority status is in the nature of an administrative expense or lien.\textsuperscript{167} But, what right does a seller have to the proceeds of his or her goods that were sold? Traditionally, the courts had held that the right to reclaim did not extend to proceeds.\textsuperscript{168}

\footnotesize{161. \textit{Id.}  \\
162. \textit{Id.}  \\
165. \textit{Id.} at 1667.  \\
166. \textit{Id.} at 1666-67. The court in \textit{In re Misco} commenting on § 546(c)(2) of the Bankruptcy Code stated: "The Bankruptcy Court may deny a seller's right of reclamation only if it gives the seller an administrative priority or a lien on all of debtor's unsecured assets." \textit{Id.}  \\
167. \textit{See generally In re Griffin Retreading Co.}, 795 F.2d 676, 680 (8th Cir. 1986) for further discussion of a seller's right to an administrative expense or lien. The court in \textit{In re Griffin} held that, since a seller had met all the requirements of § 546(c) to assert it's right to reclamation, even though the goods were sold in the ordinary course of business, the seller should be afforded the protection of an administrative expense or lien. The court was sympathetic to the seller because the buyer had sold the goods after the seller asserted its right of reclamation. The written demand for reclamation was simply ignored.  \\
However, in *United States v. Westside Bank*, 69 a Texas court held that, if section 2-702 was properly exercised, the seller's right to reclamation would extend to traceable proceeds if all prior interests in those goods have been satisfied. 70 The court in *Westside Bank* recognized that the seller's interest is subject to that of a lender with an after-acquired property clause. 71 Then, by noting that section 2-702 was intended to provide seller's priority over unsecured creditors, the court decided that allowing sellers a claim to the proceeds of the goods sold would not frustrate the intent of the Legislature. 72 It is important to note that this case did not involve a bankruptcy action as did prior cases which did not allow the seller to recover proceeds.

6. *Buyer in the Ordinary Course*

Turning now to the question of a buyer in the ordinary course of business, 73 pursuant to subsection 2-702(3). As noted earlier, the buyer in the ordinary course has the power to cut off a reclaiming seller. To qualify as a buyer in the ordinary course, the buyer must buy only goods sold by persons in the business of selling those kinds of goods. 74 It means a buyer must purchase from a person who deals

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169. 732 F.2d 1258 (5th Cir. 1984).
171. *Id.*
172. *Id.* The court in *Westside Bank* reasoned that, since § 2-702 was intended to create a preferential treatment in favor of the seller over that of the buyer's other creditors, there must be a secondary priority status in the seller to the proceeds of a sale of his goods. The Texas court relied on Texas U.C.C. § 9.504(b), comment 2, which provides: "'[W]here the secured party knows that the collateral is owned by a person who is not the debtor, the owner of the collateral and not the debtor is entitled to any surplus.'" Thus, the seller should receive the proceeds. *Texas Business and Commerce Code Ann.* § 9.504 comment 2 (Vernon Supp. 1989).
173. U.C.C. § 1-201(9) (1972) defines a buyer in the ordinary course of business to be:

... a person who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods buys in the ordinary course from a person in the business of selling goods of that kind but does not include a pawnbroker. All persons who sell minerals or the like (including oil and gas) at Wellhead or Mineralhead shall be deemed to be persons in the business of selling goods of that kind. "Buying" may be for cash or by exchange of other property or on secured or unsecured credit and includes receiving goods or documents of title under a pre-existing contract for sale but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt.
174. *See e.g.,* United States v. Westside Bank, 732 F.2d 1258, 1263 (5th Cir. 1984).
in goods of the kind purchased. It is clear from the wording of subsection 2-702(3) that a party who buys goods from another party who had obtained the goods while insolvent would have a priority interest in the goods over that of the seller. This issue was dealt with in *English v. Ralph Williams Ford*, where the court was presented with an automobile dealer who sold an automobile to another dealer while that dealer was insolvent. The automobile was subsequently purchased by another party. The court held that, since the insolvent automobile dealer was dealing in goods of that kind, there could be no reclamation by the original seller because its rights were subject to the buyers in ordinary course of business. The lesson to be learned is that a seller must be very careful when selling goods to a buyer who deals in goods of like kind. The result otherwise could be to give the buyer viable title upon which the seller's interest would be lost if the goods were to be transferred to a buyer in ordinary course of business.

Another problem term is "lien creditor" which is referred to in subsection 2-702(3). The subsection states that a seller's right to reclaim is subject to the rights of lien creditors. There has been controversy just who constitutes a lien creditor. Much confusion arose over whether the seller's right to reclaim was subordinate to the claim of a trustee in bankruptcy. Some courts have resolved this

178. See supra note 102 and accompanying text.
179. U.C.C. Section 2-702(3) (1972).
issue in favor of the trustee, while other courts have held in favor of the seller.

In 1966 the Uniform Commercial Code omitted the words "lien creditor" from the official text. However, a majority of states have not adopted the 1966 amendment. To date, twenty-two states have amended their statutes to omit the words "lien creditor". New Jersey's rationale for this deletion was typical in that it reasoned:

The intention of the draftsman was to give the seller somewhat greater rights than he had under the Uniform Sales Act. The New Jersey Study of the Uniform Commercial Code indicates on page 176 that there is a danger that 12A: 2-702 will run afoul of the Bankruptcy Act. This danger really stems from the fact that 12A: 2-702(3) permits a 'lien creditor' to cut off the seller's right of reclamation. Since a trustee in bankruptcy is a hypothetical lien creditor under section 70-C of the Bankruptcy Act, it is possible to argue that 12A: 2-702 destroys the seller's former right to reclaim goods in bankruptcy upon showing that the sale was fraudulently induced by a misrepresentation of solvency. This was surely not the intention of the section.

New York, in making their change, reasoned: "The omission in the first sentence of subsection (3) of 'or lien creditor', which words appear in the official text of the sponsors of the Uniform Commercial Code, follows the code as enacted in Illinois and is designed to prevent the frustration of the seller's rights to reclaim the goods when the buyer becomes bankrupt as in In re Kravitz 278 F.2d 820."

The In re Kravitz decision is probably the best known of Code reclamation cases. It involved a reclamation proceeding in which the seller attempted to reclaim goods sold to the bankrupt buyer from

182. See, e.g., In re Kravitz, 278 F.2d 820 (3d Cir. 1960).
188. 278 F.2d 820 (3rd Cir. 1960).
the trustee in bankruptcy. Radios had been sold on credit by Wilcox-
Gray Corporation on January 16, 1958. The goods were delivered
to Lincoln Tire the next day. On January 20th, an involuntary petition
in bankruptcy was filed against Lincoln Tire. On January 21, the
seller made the necessary "demand to rescind" the sale. It was
necessary to find enough evidence to prove that the buyers knew at
the time of the purchase and delivery that they were insolvent and
couldn’t pay for the merchandise, and that they deliberately concealed
their insolvency from the seller. The district court had found that
there was insufficient proof of misrepresentation. The court of
appeals adopted the bankruptcy referee's approach and ruled, how-
ever, that the issue of misrepresentation was immaterial since, under
the Bankruptcy Act, the trustee in bankruptcy was made a lien creditor
and a lien creditor has a higher claim than a defrauded seller in
Pennsylvania. The seller's right to rescind was subject to the rights
of lien creditor. Therefore, the seller's right was subject to the trustee's
because lien creditor includes a trustee in bankruptcy. Lien creditor's
rights were determined by state law. The Permanent Editorial Board
for the Uniform Commercial Code recommended that the words "lien
creditor" be deleted because the result in Pennsylvania made the right of reclamation granted by the Code
almost entirely illusory. Thus the 1966 amendment to the U.C.C.

190. Id.
191. Id. at 822.
192. Id.
193. Id.
the Permanent Editorial Board of the U.C.C. recommended that the words "lien
creditor" be deleted. It explained its position as follows:
The cross-reference is confusing, since the only reference to 'rights of a lien
creditor' found in Section 2-403 is a further cross-reference to Articles 6, 7
and 9 and the relevance of those articles is not apparent. In re Kravitz . . .
held that the pre-Code law of Pennsylvania was carried forward by the
Code, that under that law a defrauded seller was subordinated to a lien
creditor who extended credit to the buyer after the goods were delivered to
him, and that the buyer's trustee in bankruptcy as an "ideal lien creditor"
had the rights of such lien creditor. The result in Pennsylvania is to make
the right of reclamation granted by this section almost entirely illusory. In
most states the pre-Code law was otherwise, and the right of reclamation
seems to be fully effective . . . Six states have resolved the problem by
deleting the words 'or lien creditor' from this section, and there seems to
be no other practicable route to uniformity among the states.

Id.
has been adopted by a number of states to overrule the *In re Kravitz* decision cited above. Its purpose is to reverse that decision by deleting the words “lien creditor” from the Code.\textsuperscript{195}

As noted earlier, there are still a considerable number of states that have retained the words “lien creditor.” However even in these states there is much debate as to whether the seller’s right to reclamation is subordinate to that of the trustee since if the trustee prevails over the seller, the seller becomes nothing more than an unsecured creditor.\textsuperscript{196} In this event, the seller will generally get far less value for his or her claim against the buyer than if he or she could recover his or her goods.\textsuperscript{197} Courts have settled this dilemma by utilizing two approaches. Some courts have chosen to look at pre-code law, which defines the rights of the trustee.\textsuperscript{198} In most of these states pre-code law favored the seller over the trustee.\textsuperscript{199} As noted, contrary to the majority, *In re Kravitz*, applying pre-code law, found that under Pennsylvania common law the trustee prevailed over a defrauded reclaiming seller. The seller lost to the trustee in bankruptcy.

The second approach adopted by some states is to look exclusively at section 2-702(3) which expressly subordinates the seller to a lien creditor.\textsuperscript{200} Under this approach, it is not necessary to turn to pre-code law. The trustee is likely to receive priority over the seller under this construction and interpretation of section 2-702(3).\textsuperscript{201}

Although most judicial decisions were finding in favor of the trustee, the court in *In re Daylin, Inc.*\textsuperscript{202} permitted the reclamation even though Section 2-702(3) subjected the seller’s rights to a “lien creditor.” In this case the seller was confronted with the trustee in bankruptcy. The insolvent buyers were located in states with and without the modified version of 2-702(3).\textsuperscript{203} The Ninth Circuit was

\begin{flushright}
\textsuperscript{195} Id.
\textsuperscript{196} Id.
\textsuperscript{197} See DUSENBURG & KING, supra note 4, § 13.03(4)(a) at 13-20 (1987).
\textsuperscript{198} See *In re Federal’s, Inc.*, 553 F.2d 509 (6th Cir. 1977); *In re P.F.A. Farmers Market Assoc.*, 583 F.2d 992 (8th Cir. 1978).
\textsuperscript{199} See, e.g., *In re Federal’s Inc.*, 553 F.2d 509, 512 (6th Cir. 1977).
\textsuperscript{200} See Mann & Phillips, *In re Federal’s, Inc., Another Round in the Battle Between the Reclaiming Credit Seller and the Bankruptcy Trustee*, 46 FORDHAM L. REV. 641 (1978) [hereinafter Mann & Phillips]. See also *In re Metal Tech Manufacturing, Inc.*, 27 U.C.C. Rep. Serv. 701, 707 (D.C. Utah 1979) (the court felt that a reversion to pre-Code law violated the spirit and purpose of the Code. The court held that a trustee as a lien creditor would take priority over the reclaiming seller. The court noted that the seller could have secured its position.).
\textsuperscript{202} 596 F.2d 853 (9th Cir. 1979).
\textsuperscript{203} *In re Daylin, Inc.* 596 F.2d 853, 855 (9th Cir. 1979).
\end{flushright}
able to get around the "lien creditor" language implicit in section 2-702(3) by claiming that it was an historical outgrowth of the pre-Code rescission theory. If that was the case, a buyer could only acquire "voidable title." According to section 2-403(1), voidable title can only be cut off by a good faith purchaser for value. Certainly a trustee in bankruptcy was not a good faith purchaser for value, so the trustee was left with no recourse against the reclaiming seller. Hence, the seller could seek a retroactive reversion of title.

Although a trustee was a "lien creditor" under the language of section 2-702(3), the court dispensed with the argument that a lien creditor had a superior interest over the seller by calling the "lien creditor" language "mere surplusage." The court's logic is shaky, but regardless of that fact, the court reached the decision it desired.

In a later case, Citizens Bank of Roseville v. Taggart, the court was presented with a bank who, as a lien creditor, was trying to obtain the status of a good faith purchaser for value. The case involved conflicting claims of a cash seller and a bank as lien creditor on a defaulted loan. A car was sold on May 20, 1982. It was paid for with a check which bounced after the buyer had received the car and a certificate of ownership. The bank obtained a judgment and caused the sheriff to levy on the purchased car in early September 1982. The seller of the car filed a third party claim on September 10, 1982. The court held that the bank had not given value for the automobile nor had it relied on the ostensible ownership or voidable title of the debtor to the vehicle. The court, therefore, gave the reclaiming seller priority over the lien creditor.

IV. CONCLUSION

In conclusion, it is fairly clear that a seller, in attempting to reclaim goods, will be in third place behind a buyer in the ordinary

204. Id. at 856 (discussing In re Telemart Enterprises, Inc., 524 F.2d 761, 765 (9th Cir. 1975)).
205. Id. See also In re Emery Corp., 38 Bankr. 489, 491 (Bankr. D. Pa. 1984).
206. In re Daylin, Inc., 596 F.2d at 856.
207. Id. at 856. See also Archer Daniels Midland Co. v. Charter International Oil Co., 60 B.R. 854, 856 (Bankr. D. Fla. 1986) (The court adopted In re Daylin, 596 F.2d 853, 855-56 and agreed with its decision to subordinate a trustee lien creditor to the seller. In adopting the In re Daylin rationale, the court cited to U.S. v. Westside Bank, 732 F.2d 1258 (5th Cir. 1984) as further support for its decision).
210. Id. at 320, 191 Cal. Rptr. at 730.
course and a good faith purchaser, including a secured lender. The seller's rights, however, will vary depending on how courts interpret the language of 2-702. Whether the seller slips to fourth place behind a lien creditor (trustee) will depend on the state in which the issue arises. Unfortunately, there are still a number of courts that give the trustee priority. Hopefully, the increased adoption by states of the 1966 amended version of section 2-702(3) will result in the uniformity of law\textsuperscript{211} that prompted the development of the Uniform Commercial Code.

It is clear that the courts have been unable to reach a consensus on many of the issues involving this section of the Code. This author is of the opinion that it makes no sense to have one definition of insolvency for the buyer who has not filed bankruptcy and a different one for the buyer who has filed bankruptcy. At the time of the sale, the merchant clearly believes that the buyer is paying its bills. It will be difficult enough for a seller within ten days of delivery of the merchandise to determine that the buyer is insolvent in the equitable sense, but it would take someone clearly clairvoyant to determine within those ten days that the buyer is bankrupt in the balance sheet sense. The purpose of the section is to give some small protection to the seller and there is no logic in giving it with one hand and taking it away with the other.

\textsuperscript{211} Id.