

**REPORT AND RECOMMENDATIONS
RELATING TO ARTICLE 6
OF THE UNIFORM COMMERCIAL CODE**

**NEW JERSEY LAW REVISION COMMISSION
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Report and Recommendations

Concerning Repeal of Article 6 Bulk Transfers of the Uniform Commercial Code, 12A:6-101 et seq.

Bulk sales statutes were enacted in many states around the turn of the century to combat what had become, it was believed, a common phenomenon: the merchant who acquired retail stock on credit and then would close shop, sell the entire inventory in bulk and disappear with the proceeds. The merchant's creditors could sue on the debt and recover a judgment, but collection was often difficult because the creditor and the proceeds of the sale were difficult to trace. Creditors ordinarily had no recourse against the goods themselves because the sale was usually to a good faith purchaser who took the goods free of any claim by the merchant's creditors.

The drafters of the Uniform Commercial Code incorporated the common features of these bulk sales statutes into Article 6 Bulk Sales of the Uniform Commercial Code. As adopted in New Jersey, Article 6 covers sales "in bulk and not in the ordinary course of business" in enterprises whose "principal business is the sale of merchandise for stock." The transfer must be of "the major part" of the transferor's inventory. Transfers for security (i.e. the giving of a mortgage) are exempt. The seller in a bulk sale is required to notify all of its creditors of the pendency of a bulk sale and must distribute the proceeds to those creditors. The creditors which must be notified are "those holding claims based on transactions or events occurring before the bulk transfer," whether those claims are in contract or tort, and whether they are liquidated or unliquidated, secured or unsecured, contingent or fixed, due or undue. The proceeds of the bulk sale must then be distributed to the creditors. If the notice and distribution requirements of the bulk sales chapter are not complied with, the transfer is deemed "ineffective" against the creditors of the seller and the buyer is liable to the creditors.

Article 6 has engendered criticism and controversy continuously since its inclusion in the Uniform Commercial Code. See, e.g., Rapson, "U.C.C. Article 6: Should It Be Revised or 'Deep-Sixed'?" 38 Business Lawyer 1753 (1983). One of the difficulties in applying Article 6 Bulk Transfers is the confusion that has arisen over the interpretation of its provisions. For example, the article is applicable to the sale of "a major part" of the seller's inventory, yet there is no guidance as to how to measure what constitutes "a major part" in particular circumstances. The commentary to Article 6 suggests that more than 50% is a major part of inventory, yet it does not indicate whether the measurement should be of the number of items in inventory or the value of the items. While most courts have interpreted the provision to apply to 50% of the value of inventory, further questions have arisen in determining what constitutes the total inventory from which the calculation is made. The question has arisen in cases involving enterprises with more than one place of business within a state, or those with places of business both within and without the state.

Another interpretive difficulty in Article 6 involves the determination of the nature and amount of creditors' claims. The definition of a claim is very broad, and includes such things as unliquidated tort claims and contingent claims. The seller in a bulk transfer must therefore determine the kind and nature of such claims which might be asserted, and who might assert them, and then notify the potential claimants of the pendency of the bulk transfer. The requirement of notice to creditors may therefore trigger claims which might not otherwise have been made. The resolution of these types of uncertain legal issues adds to the cost of transactions which are, or arguably might be, covered by Article 6.

Even if the determination of the identity of creditors and the nature of the claims is itself straightforward, the cost of complying with Article 6 can be substantial. For example, even a small retail business may have hundreds of trade creditors, each one of which must be separately identified and sent a notice of the pendency of the bulk sale. In a small business transaction, the cost of extracting the names and addresses of these creditors and sending the required notice can add up rapidly and in some cases consume a significant portion of the proceeds of the sale itself. In this connection, the most consistent comment received by the Commission from New Jersey practitioners concerning the operation of the bulk sales law is that the law is waived in most transactions because compliance would add substantially to the cost and difficulty of completing the transaction. One New Jersey attorney commented to the Commission that in his 30-year experience in practice in the state, "in more cases than not, Article 6 has been waived by the parties. When a transaction was conducted in accordance with the requirements of Article 6, it added substantial expense, required cumbersome contract provisions and closing procedures, and did not appear to be giving substantial added protection to creditors."

The use of waivers of Article 6 in business transactions developed not only in response to the costs involved in compliance, but also in response to the concerns of both sellers and buyers that creditors would respond to the receipt of a notice of bulk sale by assuming that the seller was going out of business or was in financial difficulty. In these cases compliance with Article 6 would have the unsatisfactory result of impairing the financial reputation of a going business.

One of the primary reasons cited by the National Conference of Commissioners on Uniform State Laws and the American Law Institute supporting the repeal of Article 6 is the change in the legal context of modern business transactions since bulk transfer laws were first adopted. First, the Conference and the Institute cited the ready availability to creditors of timely information to assist them in making decisions concerning the extension of credit. Second, the Conference and the Institute referred to the greater opportunities afforded creditors to collect debts under modern statutes. They cited, for example, the promulgation of state long-arm statutes, which give creditors the ability to more readily obtain personal jurisdiction over debtors, and the widespread adoption of the Uniform Fraudulent Transfer Act, which provides remedies in the case of a fraudulent bulk transfer. In addition, creditors are able to protect their interests at the time of extending credit by retaining an Article 9 security interest in the goods which are being sold.

The reasons supporting the retention of Article 6 are not compelling in comparison to the reasons supporting its repeal. While compliance with the provisions of Article 6 often results in the payment of creditors from the proceeds of a bulk sale, there is no evidence that the vast majority of these creditors would not have been paid in the ordinary course of a transaction in the absence of Article 6. Significantly, the remedy provided creditors by Article 6 is largely illusory, as creditors have only a ten-day notice of the pendency of a bulk transfer in which to take some action to protect their interests.

Generally, the remedies available to creditors in that short period of time are a levy on the inventory sold to the buyer, the issuance of a writ of attachment or *capias*, enjoining the transaction and seeking the appointment of a receiver, or the filing of an involuntary bankruptcy petition. The alternative of a levy is available only to a creditor who has a claim which has been reduced to judgment. The writs of attachment and *capias* require specific factual showings such as intent of the debtor to abscond or intent to defraud which are nonexistent in most cases or in any event, difficult to prove. The standards for obtaining appointment of a receiver or an involuntary bankruptcy petition are equally difficult to establish, and the proceedings are cumbersome. Moreover, the requirements of Article 6 are easily circumvented by those who do have an intent to defraud their creditors, by providing the bulk buyer with an affidavit indicating that they have no unpaid creditors.

In 1990 the National Conference of Commissioners on Uniform State Laws and the American Law Institute studied Article 6 and its relationship to other creditors' rights statutes. The Conference and the Institute jointly recommended that Article 6 be repealed in those states which have enacted it. Alternatively, they proposed a revised Article 6 for those states which perceive a particular problem with bulk sales in their jurisdictions. A copy of the recommendation of the Conference and the Institute is attached to this report as Exhibit A.

The Law Revision Commission received the recommendation of the Conference and the Institute and decided to seek comments concerning the advisability of repealing Article 6 in this state from members of the bar. The comments received by the Commission were uniformly in favor of repeal. The Commission has concluded that the remedies available to creditors in the ordinary course, either before extending credit or in pursuing an unpaid debt, are sufficient, and that the imposition of burdens on all transactions on the assumption that bulk sellers will not satisfy their creditors, are not justified.

Based upon the recommendation of the Conference and the Institute and on the confirmatory comments received from New Jersey attorneys, the Commission recommends that the New Jersey version of Article 6 of the Uniform Commercial Code, N.J.S. 12A:6-101 et seq., be repealed and not replaced.

UNIFORM COMMERCIAL CODE

THE AMERICAN LAW INSTITUTE
NATIONAL CONFERENCE OF
COMMISSIONERS ON UNIFORM
STATE LAWS

REPEALER OF ARTICLE 6 - BULK TRANSFERS

and

[REVISED] ARTICLE 6 - BULK SALES

(States to Select One Alternative)

(With Conforming Amendment to
Article 1)

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WITH COMMENTS

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UNIFORM COMMERCIAL CODE REPEALER OF ARTICLE 6 - BULK TRANSFERS and [REVISED] ARTICLE 6 - BULK SALES (States to Select One Alternative)

PREFATORY NOTE

Background. Bulk sale legislation originally was enacted in response to a fraud perceived to be common around the turn of the century: a merchant would acquire his stock in trade on credit, then sell his entire inventory ("in bulk") and abscond with the proceeds, leaving creditors unpaid. The creditors had a right to sue the merchant on the unpaid debts, but that right often was of little practical value. Even if the merchant-debtor was found, in personam jurisdiction over him might not have been readily available. Those creditors who succeeded in obtaining a judgment often were unable to satisfy it because the defrauding seller had spent or hidden the sale proceeds. Nor did the creditors ordinarily have recourse to the merchandise sold. The transfer of the inventory to an innocent buyer effectively immunized the goods from the reach of the seller's creditors. The creditors of a bulk seller thus might be left without a means to satisfy their claims.

To a limited extent, the law of fraudulent conveyances ameliorated the creditors' plight. When the buyer in bulk was in league with the seller or paid less than full value for the inventory, fraudulent conveyance law enabled the defrauded creditors to avoid the sale and apply the transferred inventory toward the satisfaction of their claims against the seller. But fraudulent conveyance law provided no remedy against persons who bought in good faith, without reason to know of the seller's intention to pocket the proceeds and disappear, and for adequate value. In those cases, the only remedy for the seller's creditors was to attempt to recover from the absconding seller.

State legislatures responded to this perceived "bulk sale risk" with a variety of legislative enactments. Common to these statutes was the imposition of a duty on the buyer in bulk to notify the seller's creditors of the impending sale. The buyer's failure to comply with these and any other statutory duties generally afforded the seller's creditors a remedy analogous to the remedy for fraudulent conveyances: the creditors acquired the right to set aside the sale and reach the transferred inventory in the hands of the buyer.

Like its predecessors, Article 6 (1987 Official Text) is remarkable in that it obligates buyers in bulk to incur costs to protect the interests of the seller's creditors, with whom they usually have no relationship. Even more striking is that Article 6 affords creditors a remedy against a good faith purchaser for full value without notice of any wrongdoing on the part of the seller. The Article thereby impedes normal business transactions, many of which can be expected to benefit the seller's creditors.

For this reason, Article 6 has been subjected to serious criticism. See, e.g., Rapson, U.C.C. Article 6: Should It Be Revised or "DeepSixed"? 38 Bus. Law. 1753 (1983).

In the legal context in which Article 6 (1987 Official Text) and its nonuniform predecessors were enacted, the benefits to creditors appeared to justify the costs of interfering with good faith transactions. Today, however, creditors are better able than ever to make informed decisions about whether to extend credit. Changes in technology have enabled credit reporting services to provide fast, accurate, and more complete credit histories at relatively little cost. A search of the public real estate and personal property records will disclose most encumbrances on a debtor's property with little inconvenience.

In addition, changes in the law now afford creditors greater opportunities to collect their debts. The development of "minimum contacts" with the forum state as a basis for in personam jurisdiction and the universal promulgation of state long-arm statutes and rules have greatly improved the possibility of obtaining personal jurisdiction over a debtor who flees to another state. Widespread enactment of the Uniform Enforcement of Foreign Judgments Act has facilitated nation-wide collection of judgments. And to the extent that a bulk sale is fraudulent and the buyer is a party to fraud, aggrieved creditors have a remedy under the Uniform Fraudulent Transfer Act. Moreover, creditors of a merchant no longer face the choice of extending unsecured credit or no credit at all. Retaining an interest in inventory to secure its price has become relatively simple and inexpensive under Article 9.

Finally, there is no evidence that, in today's economy, fraudulent bulk sales are frequent enough, or engender credit losses significant enough, to require regulation of all bulk sales, including the vast majority that are conducted in good faith. Indeed, the experience of the Canadian Province of British Columbia, which repealed its Sale of Goods in Bulk Act

in 1985, and of the United Kingdom, which never has enacted bulk sales legislation, suggests that regulation of bulk sales no longer is necessary.

Recommendation. The National Conference of Commissioners on Uniform State Laws and the American Law Institute believe that changes in the business and legal contexts in which sales are conducted have made regulation of bulk sales unnecessary. The Conference and the Institute therefore withdraw their support for Article 6 of the Uniform Commercial Code and encourage those states that have enacted the Article to repeal it.

The Conference and the Institute recognize that bulk sales may present a particular problem in some states and that some legislatures may wish to continue to regulate bulk sales. They believe that existing Article 6 has become inadequate for that purpose. For those states that are disinclined to repeal Article 6, they have promulgated a revised version of Article 6. The revised Article is designed to afford better protection to creditors while minimizing the impediments to good-faith transactions.

The Official Comment to Section 6-101 explains the rationale underlying the revisions and highlights the major substantive changes reflected in them. Of particular interest is Section 6-103(1)(a), which limits the application of the revised Article to bulk sales by sellers whose principal business is the sale of inventory from stock. In approving this provision, the Conference and the Institute were mindful that some states have expanded the coverage of existing Article 6 to include bulk sales conducted by sellers whose principal business is the operation of a restaurant or tavern. Expansion of the scope of revised Article 6 is inconsistent with the recommendation that Article 6 be repealed. Nevertheless, the inclusion of restaurants and taverns within the scope of the revised Article as it is enacted in particular jurisdictions would not disturb the internal logic and structure of the revised Article.