



Don't Believe the Florist When He Tells You That the Roses Are Free:
*Resurrecting UCC Article 6 to address bulk sales problems in the emerging
markets of post-communist countries*

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Abstract

This thesis discusses the need for bulk sales legislation in post-communist countries. It details how merchant scams which led to the United States adopting bulk sales law in the Uniform Commercial Code Article 6 as a means of showing similar conditions exist in current day post-communist countries. The peculiarity of the bulk sales problem as to other merchant fraud will be explained. It urges the need for better protection of creditors against merchants who deal in bulk goods. Evidence of elaborate creditor scams is presented and it is demonstrated that unsecured creditors in some post-communist countries are not protected from the possibility of bulk sales scams. The effects of leaving unsecured creditors unprotected are explored and the ramifications analyzed. The adoption of U.C.C. Article 6 type provisions is suggested as a means to thwart unscrupulous merchants from avoiding to pay back creditors. The flaws in current post-communist laws will be discussed and options to improve them are presented. Finally the benefits of implementing bulk sales law are pointed out.

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INTRODUCTION

In Chisinau, Moldova there is a flower market downtown which stays open twenty-four hours a day. I was once told by a resident that it was the largest in Eastern Europe. Regardless of if it is the largest or not, it is rather large and was open at 2 a.m. It is possible that one of the many flower sellers acquired her booth space and inventory completely through an unsecured creditor. Currently, there are no laws in Moldova which protect the creditors from the possibility that the flower seller will sell her entire floral enterprise to an unknowing aspiring flower dealer for less than half its value and move to Transnistria. If this were to happen, the unsecured creditor of the Moldovan flower stand will have no claim against the seller's assets because there was no fraud in the transaction. This problem is not unique to Moldova nor is it an invention of modern swindlers.

The collapse of communist governments in the late 1980's through the early 1990's left many countries excited about capitalism yet unaware of its pitfalls.¹ The purpose of this paper is to address the issue of one such pitfall, lack of bulk sales law in post-communist countries. By using the lessons learned in the United States and implementing U.C.C. Article 6 type bulk sales provisions, post-communist countries will make their economies more attractive to investors by establishing legislation that protects unsecured creditors from fraudulent bulk sales transactions. An unsecured creditor is defined as, "a creditor who, upon giving credit, takes no rights against specific property of the debtor."² Historically businesses have relied upon unsecured creditors and they are important to economic growth.³

The post-communist countries referred to in this paper are those which the European Bank for Reconstruction and Development (EBRD) work with: Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Estonia, FYR Macedonia,

¹ Rosa Lastra, Financial Law Reform in Emerging Economies, 23 J.I.B.L.R. 413 (2008).

² Black's Law Dictionary, *creditor*, (9th ed. 2009).

³ Morris G. Shanker, The Trashing of Article 6: Isn't There a Better Alternative?, 41 Ala. L. Rev., 653, 658 (1990).

Georgia, Hungary, Kazakhstan, Kyrgyz Republic, Latvia, Lithuania, Moldova, Mongolia, Montenegro, Poland, Romania, Russia, Serbia, Slovak Republic, Slovenia, Tajikistan, Turkey, Turkmenistan, Ukraine, Uzbekistan (hereafter post-communist countries).⁴ EBRD countries were used to define the post-communist countries in this article because the bank began its operations in 1991 to help transition countries from a communist to a capitalist economy which entails the revision of legislative frameworks.⁵ These countries all share a common history of the struggle to adopt a legal system tailored to a capitalist type economy while at the same time trying to attract investors.

Creditors' rights are fundamental to creating a legislative system that attracts and retains investment in businesses.⁶ In the United States these rights have developed over time, mainly through the development of bankruptcy laws and further strengthened through the development of bulk sales regulation.⁷ Many of the above listed post-communist countries adopted a German model civil law system to begin their new era as capitalist.⁸ Some of the legal concepts known and used in Western markets, such as bankruptcy, were completely new to the post-communist countries.⁹ Without a history of bankruptcy law, and then a reluctance to use it once they adopted it, the natural evolution of creditor protection, has stalled in some post-communist countries.¹⁰ This gap in legal development, created by the

⁴ European Bank for Reconstruction and Development Countries Page, <http://www.ebrd.com/pages/country.shtml> (last visited March 27, 2012).

⁵ European Bank for Reconstruction and Development History Page, <http://www.ebrd.com/pages/history.shtml> (last visited March 27, 2012).

⁶ See generally Garrard Glenn, *A Study in the Development of Creditors' Rights*, III, 14 Colum. L. Rev. 491 (1914).

⁷ Id.

⁸ Rafael La Porta et. Al, *The Economic Consequences of Legal Origins*, Vol. XLV J. Econ. Lit., 285, 290.I (June 2008), available at http://www.economics.harvard.edu/faculty/shleifer/files/consequences_JEL_final.pdf

⁹ Michael Kim, *When Nonuse is Useful: Bankruptcy Law in Post-Communist Central and Eastern Europe*, 65 Fordham L. Rev. 1043 (1996), available at <http://ir.lawnet.fordham.edu/flr/vol65/iss3/6>

¹⁰ Id.

importance which bankruptcy law devotes to creditors rights, has led to numerous creditor scams which deter foreign creditors.¹¹

This paper will prove that by protecting unsecured creditors rights in post-communist countries through the implementation of bulk sales laws similar to those in Article 6 of the Uniform Commercial Code in the United States that their economies will benefit by preventing merchant scams. First a history of unsecured creditor protection and bulk sales law from 13th century Europe through present day will first be addressed. This analysis beings by examining concepts used in early European trading collectives which later developed into fraudulent transfer laws in 16th century England, the invention of the chattel mortgage, and in the United States to individual state laws passed to combat scams, to the implementation of Article 6 of the Uniform Commercial Code, and concluding with the repeal of Article 6 due to the emergence of other methods which curbed the scams. By looking at the early history and later development of bulk sales law over the past hundred plus years, the application of similar provisions as a way to circumvent problems in post-communist emerging markets will be made clear.

Tracing the history of bulk sales legislation in the United States will illustrate how the US system has dealt with the problems facing unsecured creditors in bulk sales transactions. The unsecured creditor was the most frequent business lender in early US commercial

¹¹ A number of different tunneling scams in post communist countries have been documented in the following articles: Zdroj Ľuba Lesná & Jana Liptáková, Tunneling the Tunnel, Slovak Spectator, March 21, 2008, *available at* <http://www.vyvlastnenie.sk/clanok/a/tunnelling-the-tunnel/>; Stephen Castle, E.U. Cash Tunnel Ends in Slovakia, New York Times, Nov. 9, 2010, *available at* <http://www.nytimes.com/2010/11/10/world/europe/10slovakia.html?pagewanted=all>; Katerina Zachovalova and Roman Santur, A Leaky Vessel, Transitions Online, Aug. 23, 2001, *available at* <http://www.tol.org/client/article/1921-a-leaky-vessel.html> (last visited March 27, 2012); Fraud Flooding Slovenia, Slovenia Times, March 1, 2007, *available at* <http://www.sloveniatimes.com/fraud-flooding-slovenia>; Thierry Malleret, Corporate Governance in Central Eurasia: It May Come, Eurasianet.org, Sep. 5, 2000, *available at* <http://www.eurasianet.org/departments/business/articles/eav090600.shtml>; Chris Johnstone, Swiss File Charges Over Alleged Tunneling of Czech Coal Miner MUS, CzechPosition.com, Oct. 10, 2011, *available at* <http://m.ceskapozice.cz/en/business/companies/swiss-file-charges-over-alleged-tunneling-czech-coal-miner-mus>.

transactions; therefore they were instrumental in the development of creditor protection.¹² In the early 20th century in the United States, after turning its attention away from bankruptcy matters, the National Association of Credit Men, a creditor's lobby, turned their efforts toward the issue of bulk sales scams.¹³ This time period in US history will be expanded upon and the solutions explained, as it will provide answers for current post-communist countries who find themselves in a similar quagmire.

The scope of U.C.C. Article 6 will be discussed to frame the perimeters of the issue. An examination of the current fraudulent transfer laws and transfer avoidance laws in post-communist countries will reveal the shortcomings of such legislation when bulk sales scams occur. Pointing out the connection between passing legislation to strengthen unsecured creditors rights and the willingness of foreign creditors to invest in such a market, will illustrate the potential benefits post-communist countries to pass U.C.C. Article 6 type provisions.

In order to predict the future role that bulk sales problems will play if left unaddressed in the post-communist economies, a review of early 19th century US bulk sales case law will once again be used to shed light on the problem. Finally, it will be shown that by forming creditor unions, passing U.C.C. Article 6 type requirements, providing easy compliance, and insuring against creditor fraud, post-communist countries could efficiently and inexpensively solve bulk sales issues. Bolstering unsecured creditors rights with bulk sales legislation will be a signal to foreign creditors that the post-communist economies wish to continue creating an attractive environment for investment.

¹² See Shanker, *supra* note 3, at 658.

¹³ Thomas Clifford Billig, Bulk Sales Laws: A Study in Economic Adjustment, 77 U. Pa. L.Rev. 72, 83 (1928).

CHAPTER I. – HISTORY OF BULK SALES LAW

The history of bulk sales evolved due to the creativity of scam artists. Referred to as ‘tramp’ or ‘fly-by-night’ merchants, individuals who roamed from town to town taking advantage of buyers and leaving the area before individuals could enact any remedy, have plagued trader communities for hundreds of years¹⁴ First the early European trader communities will be examined to note how they dealt with ‘tramp’ merchants. Then turn of the 20th century US history will be fully explained to understand how modern bulk sales law came into being and its importance to current day post communist countries.

A. Early Creditors Rights

Bulk sales scams were not a pressing issue for 13th Century European traders. The early European traders handled “fly-by-night” merchants through the use of community responsibility.¹⁵ The trading communities entailed close relations between members, thus non-members were required to verify their personal and communal identity to the members before being able to join in any trading.¹⁶ There were also steep fees to join the trading communities, thus setting up a system where the investment of time (developing trust based on the establishment of personal relations) and money to join deterred the ‘tramp’ merchants.¹⁷ With the rise of powerful national governments able to enforce national legislation regarding trade practices, these communal checks and balances were replaced by a formal system enforced by the government.¹⁸

The transformation from community responsibility to national protection of unsecured creditors rights had a major advance in 1571 when the British Parliament passed the Statute

¹⁴ See Billig, *supra* note 13, at 78; Avner Greif, The Birth of Impersonal Exchange: The Community Responsibility System and Impartial Justice, 20 J. Econ. Perspective 221, 224 (2006).

¹⁵ See Greif, *supra* note 14, at 224.

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.* at 233-234.

of Fraudulent Conveyances.¹⁹ Fraudulent conveyance laws are the foundation from which bulk sales law would later be developed as they protected creditors from buyers and sellers who jointly agreed to perpetuate fraud and dupe creditors.²⁰ Parliament sought to protect unsecured creditors from the fraudulent dealings of its debtors and install ““true and plain dealing . . . between man and man.”²¹ The courts at the time were instructed to construe fraud liberally to give creditors greater protection.²²

Liberally construed fraudulent transfer laws were still not sufficient to protect unsecured creditors, so the 19th century saw the birth of chattel mortgage recording statutes.²³ The chattel mortgage was needed to prevent the debtor from getting a secret lien on property, which is encumbered with a chattel mortgage, from another creditor who had no notice.²⁴ The public notice requirement alerted potential creditors or unknowing buyers of any liens upon the land in question.²⁵ As described below, the same logic was then used in the early 20th century to solve bulk sales scams in the United States.²⁶

B. Brief history of U.C.C. Article 6 in the United States

US creditors in the late 1800's were regular victims of bulk sales scams which left them without legal recourse.²⁷ The typical scam would involve a merchant leasing a storeroom and fixtures then obtaining a great deal of stock via credit. Next the merchant would sell his merchandise in bulk to an unsuspecting good faith buyer at a substantial discount. The merchant would then leave town with all the proceeds and set up shop in

¹⁹ See Shanker, *supra* note 3, at 658.

²⁰ Peter Alces, The Confluence of Bulk Transfers and Fraudulent Disposition Law, 41 Ala.L.Rev. 821, 822-825 (1990).

²¹ See Shanker, *supra* note 3, at 658.

²² *Id.* at 658 n.21 *citing* Twyne's Case, 3 Coke Rep. 80b, 82a, 76 Eng. Rep. 809, 815-16 (Star Chamber 1601).

²³ See Shanker, *supra* note 3, at 659.

²⁴ *Id.*

²⁵ *Id.*

²⁶ *Id.* at 660.

²⁷ See Billing, *supra* note 13, at 76.

another part of the country to begin the process once again.²⁸ The creditor was left with little recourse as to the goods, unless he could prove that the sale fell under either a statutory or common-law fraudulent conveyance law.²⁹ Essentially, if the creditor could not prove that the buyer of the goods committed fraud then he had no recourse to recover lost assets.³⁰

Louisiana was the first state to take measures to curb this type of behavior.³¹ In 1894 the state passed a bill making this type of bulk sale scam a criminal offense and two years later they passed the Louisiana Bulk Sales Act of 1896.³² It is interesting to note that Louisiana, the first state to pass bulk sales laws, has a judicial and legislative system more closely resembling the European civil law system.³³ Thereafter many other states followed suit passing bulk sales laws of their own.³⁴ It wasn't until the 1952 when the Uniform Commercial Code was created with a section on bulk sales (Art.6) that all 50 states had an option of uniformity.³⁵

Although all 50 states eventually adopted Article 6, its effectiveness and advances in society ultimately eliminated its need. In the mid-1980's the American Bar Association published a report on the status of bulk sales regulation under Article 6 which led the National Conference of Commissioners on Uniform State Laws (NCCUSL) to revamp the

²⁸ See Billing, *supra* note 13, at 78 n.23 referring to a June 4, 1928 letter from William B. Layton, former counsel for the Portland (OR) Association of Credit Men, to Billing.

²⁹ See Alces, *supra* note 20, at 826.

³⁰ Lisa M. Bruno, *Is Bulk Sales Legislation Still Necessary?*, 1997 Det. C.L. Rev. 1091 (1997).

³¹ See Billing, *supra* note 13, at 81-82.

³² *Id.* Section 2 of the 1894 Louisiana bill stated: "whosoever shall purchase goods, wares or merchandise or other commodity on credit and shall sell, hypothecate, or dispose of the same out of the usual course of business and with the intent to cheat or defraud the seller or vendor, shall be guilty of a misdemeanor..." Section 3 provides: "whosoever shall purchase any goods wares or merchandise, or other commodity on credit and shall secrete himself, or abscond from the state for the purpose, and with the intent of cheating or defrauding the seller or vendor, shall be guilty of a misdemeanor..."

³³ University of California at Berkeley-School of Law Library website, *Common Law and Civil Law Traditions*, <http://www.law.berkeley.edu/library/robbins/CommonLawCivilLawTraditions.html> (last visited March 27, 2012).

³⁴ See Billing, *supra* note 13, at 85-88.

³⁵ Robert Baucher, *Legislative History of the Uniform Commercial Code*, 58 Colum. L. Rev. 798 (1958).

Article.³⁶ The NCCUSL's final proposal included an option for states to repeal or revise Article 6.³⁷ There was much discussion about the NCCUSL's proposals with some commentators welcoming the repeal, while others were skeptical of the fate of unsecured creditors in a United States without Article 6.³⁸

The Commissioners advanced three main reasons for advocating repeal: technological advances, long-arm statutes, and advances in secured transactions law.³⁹ Technological advances have made the exchange of communication easier than ever before and the NCCUSL noted the ease and speed at which credit reporting services could provide accurate credit histories at very little expense.⁴⁰ The second reason put forth by the NCCUSL was that all states had developed long-arm statutes which allowed them to obtain jurisdiction over a merchant who had fled to another state.⁴¹ Furthermore, with the passing of the Uniform Enforcement of Foreign Judgments in 1986, it allowed for nationwide collection of judgments.⁴² The final reason the NCCUSL stated was that with advances in secured transaction law, unsecured creditors could easily gain a secured interest by taking advantage of the purchase money security interest under Article 9-103(b) of the U.C.C..⁴³ By following the method to perfect a purchase money security interest in the inventory under U.C.C. Article 9, the unsecured creditor is able to recover if a debtor sells the inventory and absconds.⁴⁴

Due to the factors outlined above, the majority of states have opted for repeal and there are currently only three states (California, Georgia, and Maryland) and two federal

³⁶ Fred H. Miller, The Scope of Uniform Commercial Code Article 6: A Tale of Two Proposals, 41 Ala. L. Rev. 587, 590 (1990).

³⁷ *Id.* at 593-594.

³⁸ *See generally* Shanker, *supra* note 3; Acles, *supra* note 20, at 864-871; Miller, *supra* note 36.

³⁹ U.C.C. §6 Prefatory Note (1990).

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² *Id.*

⁴³ *Id.*; U.C.C. §9-103 (1990).

⁴⁴ *Id.*

districts (Puerto Rico and the District of Columbia) that have not repealed Article 6.⁴⁵ The District of Columbia and California have both introduced legislation in 2012 to join the other 48 states in crossing bulk sales law off their books.⁴⁶ While the necessity of bulk sales legislation in the United States was diminished over time due to the combination of factors, such as the evolution of secured transaction law to include the purchase money security interest, inexpensive and readily available credit reports, the Uniform Fraudulent Transfers Act, and better insolvency laws, the current environment in post-communist markets have not enjoyed the same advancement, therefore they can benefit from Article 6 provisions.⁴⁷ The success of Article 6 can be seen in its repeal, we will now take a look at the inner workings to the act determine how they will help post-communist countries be successful in preventing bulk sales scams.

⁴⁵ National Conference of Commissioners on Uniform State Laws- Legislative Factsheet, [http://www.nccusl.org/LegislativeFactSheet.aspx?title=UCC%20Article%206,%20Bulk%20Sales%20\(1989\)](http://www.nccusl.org/LegislativeFactSheet.aspx?title=UCC%20Article%206,%20Bulk%20Sales%20(1989)) (last visited March 27, 2012)

⁴⁶ Id.

⁴⁷ Cale Battles, Legislature Makes Changes to Uniform Commercial Code Articles, St. Bar of Wis. website, June 23, 2010, http://www.wisbar.org/AM/Template.cfm?Section=Legislative_Advocacy&Template=/CM/ContentDisplay.cfm&ContentID=93844 (Last visited March 27, 2012).

CHAPTER II - Scope of US Bulk Sales Law

The development of the bulk sales law in the United States narrowed the scope to better protect unsecured creditors. The key to grasping the inner workings U.C.C. Article 6 is to understand what is considered a ‘bulk sale’ and what it protects. Then an explanation of how bulk sales laws were used to supplement the existing fraudulent transfer laws will better frame the scope of Article 6. A review of US case law will be utilized to explain the development of Article 6 as to which businesses are covered, what transfers fall within the regulations, the types of creditors protected, what sufficient notice entails, and what remedies are available to the creditors. Minding the lessons learned throughout history which led to unsecured creditors rights being protected against good faith purchasers in bulk sales transactions, emerging post-communist markets will stem the tide of scams that will inevitably wash upon their shores.

A. It Takes Three to Tango

The uniqueness of the bulk sales laws is that it allows a third party unsecured creditor to recover from a good faith purchaser, who would otherwise be immune from judgment absent fraud.⁴⁸ U.C.C. §1-201 (20) defines good faith as: “...honesty in fact and the observance of reasonable commercial standards of fair dealing.”⁴⁹ Good faith played a major role in early bulk sales disputes as unsecured creditors would be at the mercy of the courts to find fraud as it was their only chance of recovery on the goods.⁵⁰

An example of how early courts tried to find an equitable solution for creditors using fraud laws was the 1901 case, *Carter v. Richardson & Co.*⁵¹ In this case out of Kentucky, the Court was using 16th century British law, Statute of 13 Elizabeth, which required a showing

⁴⁸ See Billing, supra note 13, at 78-79. The facts of *Carter & Co. v Richardson & Co.* best serve to illustrate the courts early struggles with the presence of a good faith purchaser coupled with the absence fraud.

⁴⁹ U.C.C. §1-201(22) (1990).

⁵⁰ See Billing, supra note 13, at 78-79.

⁵¹ *Carter v. Richardson*, 22 Ky.L.Rptr. 1204, 60 S.W. 397 (Ky.App. 1901.)

of mutual fraud between the parties to resolve the issue.⁵² The defendant in this case had purchased goods in bulk from a vendor without notice through his agent.⁵³ The agent was told to pick up the goods in the night and move them through the back door of the business, which closed that day.⁵⁴ Here the *Carter* court, found that the agent knew or should have known of the vendors fraudulent intent therefore imputing the fraud to the defendant.⁵⁵

States within the US, with the encouragement of lobbyists, turned to bulk sales law to eliminate the need for courts to make the square pegs of bulk sale scams fit in round holes of fraudulent transfer laws.⁵⁶ The requirement that parties self-police the transaction eliminated the need to prove fraud.⁵⁷ The seller giving notice of all their creditors to the buyer of the goods removed the possibility of the buyer being unaware of claims.

Furthermore courts have held that parties in a bulk sales transaction are required to self-police the transaction regardless of the absence of intent to commit fraud. In *Danning v. Daylin, Inc.*, the United States Court of Appeals 9th Circuit, addressed the claim by defendants that the bulk sales provisions should not be applicable in cases where both parties acted in good faith and there was no fraudulent intent to defraud creditors.⁵⁸ The Court held that under the “evidence of good faith and the absence of fraudulent intent” is not a defense for a failure to comply with bulk sales provisions.⁵⁹ The parties must notify the seller’s creditors regardless of intent if the sale is within the scope of a bulk sale.

In the late 1980’s when Article 6 was being revised, there was debate as to expand the scope “to include all tangible and intangible personal property used in all types of businesses,” but ultimately this was not adopted.⁶⁰ Although this would have allowed for

⁵² Id.

⁵³ Id.

⁵⁴ Id.

⁵⁵ Id.

⁵⁶ See Billing, *supra* note 13, at 81.

⁵⁷ Id.

⁵⁸ *Danning v Daylin, Inc.*, 488 F.2d 185 (9th Cir. 1973).

⁵⁹ Id. at 190.

⁶⁰ See Miller, *supra* note 36, at 594

better coverage of bulk sales, the provision was nearing its lifespan in the United States thus the changes were seen to be unnecessary as they would have entailed additional expenses.⁶¹ These changes should be taken into consideration by post-communist countries when drafting bulk sales legislation as they may provide a better fit to combat the types of scams within their borders. The below section defines the language of bulks sales law under Article 6.

B. Speaking the Language of Bulk Sales

In understanding the workings of U.C.C. Article 6, a few of the terms must be defined. First of all one must understand what a bulk sale is. Under Revised Article 6 a bulk sale consists of either a sale in relation to auction and or liquidation proceedings, or any other sale “not in the ordinary course of business of more than half the seller’s inventory, as measured by value on the date of the bulk sale agreement, if on that date” the buyer, auctioneer, or liquidator “has notice or after reasonable inquiry would have had notice, that the seller will not continue to operate” a similar type of business after the sale.⁶² The Revised version of Article 6, completed in 1989, clears up the ambiguity in language as some states adopted “major part” or “substantial part” of sellers inventory instead of the easier-to-access half of the inventory.⁶³

Next one must understand what is considered inventory. Inventory under the provision includes goods which “are leased by a person as a lessor; are held by a person for sale or lease or to be furnished under a contract of service; are furnished by a person under a contract of service; or consist of raw materials, work in progress, or materials used or consumed in a business.”⁶⁴ Case law in the US has helped to distinguish what parts of a business are considered inventory and require compliance with the bulk sales provisions.

⁶¹ Id.

⁶² U.C.C. § 6-102 (1)(c)(i)-(ii) (1990).

⁶³ *Danning*, 488 F.2d at 189. Addressing California’s state U.C.C. and the U.C.C. differences between “substantial part” and “major part.”

⁶⁴ U.C.C. §6-102 (2)(c) (1990). Referring to the definition of “inventory” in Art. 9-102(48)(A)-(D).

In *H.L.C. Imports Corp. v. M & L Siegel*, the Court held the sale of all a jewelry store's office equipment was not considered a bulk sale because it was not a transfer in connection with the jewelry store's inventory.⁶⁵ Yet the Court in *Hyland Meat Co. v. Tsagarakis*, found that a bulk transfer existed when a partnership, whose partners were also operating incorporated restaurant business that used partnership assets, transferred real property, fixtures, and personal property used in connection with the restaurant.⁶⁶ Here the Court was able to see through the two organizations to determine that inventory of the partnership was the same as the restaurant.⁶⁷ The Courts in *H.L.C. Imports* and in *Hyland Meat*, were able to draw a line where the inventory started and ended by looking at the nature of the business and their daily operations.⁶⁸ However, there remained differences between states in the United States as to which enterprises had to comply with the provisions.

C. For Whom the Bulk Sales Provisions Toll

The types of enterprises subject to bulk sales provisions of Article 6 were subject to debate amongst states. The revised Article 6 states that it is applicable if:

“the seller's principle business is the sale of inventory from stock; and on the date of the bulk-sale agreement the seller is located in this state or, if the seller is located in a jurisdiction that is not a part of the United States, the seller's major executive office in the United States is in this state.”⁶⁹

Most jurisdictions in the United States chose to limit the applicability of bulk sales provisions to just merchants whose principle business was the sale of inventory from stock, but not all states agreed.⁷⁰

Due to the fact that early bulk sales laws were challenged on constitutional grounds as unfairly discriminating against certain types of merchants, many states enacted changes to

⁶⁵ *H. L. C. Imports Corp. v M & L Siegel, Inc.*, 98 Misc 2d 179, (N.Y. Civ. Ct. 1979).

⁶⁶ *Hyland Meat Co. v Tsagarakis*, 202 App Div 2d 552 (N.Y. App. Div.1994).

⁶⁷ *Id.*

⁶⁸ *H. L. C. Imports Corp.* at 98 Misc 2d 179; *Hyland Meat Co.*, 202 App Div 2d 552.

⁶⁹ U.C.C. § 6-103(1)(a)(b) (1990).

⁷⁰ See Miller, *supra* note 36, at 593.

their state Article 6 provisions to include service industry merchants such as restaurants or bars.⁷¹ In 1990, twenty jurisdictions applied bulk sales laws to one or more of the following: bars, schools, restaurants, hospitals, and service establishments.⁷² The states with expanded the applicability of bulk sales provisions to the aforementioned argue that “purveyors of meats and produce to restaurants are entitled to just as much protection as sellers of clothing, hardware, or raw materials to merchants and manufacturers.”⁷³ Having resolved which industries are covered by bulk sales law, the matter of which transfers are subject to the Article 6 provisions will next be explained.

D. Transfers That Trigger Article 6

The types of transfers covered under U.C.C. Art. 6 are those which occur not in the ordinary course of the seller’s business and which consist of more than half of the seller’s inventory.⁷⁴ As stated before, the original provision resulted in states differing in terminology, some adopting ‘major part’ others ‘substantial part’ of inventory.⁷⁵ This change in the revised version of Article 6 drew a better line to measure which transfers fall within the scope of bulk sales legislation.⁷⁶

The first hurdle a court must clear when dealing with a bulk sales case is the applicability of the legislation to the transaction in question. In *Committee of Unsecured Creditors of Interstate Cigar Co. v. Interstate Distribution, Inc.* (hereafter *Unsecured Creditors*), the New York Supreme Court listed the following four factors to assess

⁷¹ Id. at 588 n. 27; See Billing, *supra* note 13, at 91.

⁷² Miller, *supra* note 36, at 588.

⁷³ See Miller, *supra* note 36, at 593.

⁷⁴ U.C.C. §6-102(1)(c)(1) (1990). For the purpose of this paper, provisions relating to auctions and liquidations will not be discussed.

⁷⁵ *Danning*, 488 F.2d at 189.

⁷⁶ Two early cases out of California which struggled with the amount of inventory required to meet the standard of state bulk sales law: *Reed v Anglo Scandinavian Corp.*, 298 F.Supp. 310 (DC. Cal 1969); *Danning*, 488 F.2d at 189; U.C.C. §6-103(3)(a)-(1) (1990). Presents an exhaustive list of exemptions to the narrow scope of transfers covered.

applicability and stated that all factors carry the same weight and all must be accessed to determine if the transaction falls under bulk sales law.⁷⁷:

- Was the transfer made to a secured creditor or nonsecured third party?
- Was the debt secured by the assets in default at the time of transfer?
- Was the entire value of the assets applied to the debt secured by the assets?
- Were assets transferred in addition to those which secured the debt?⁷⁸

In *Unsecured Creditors*, the defendant transferred a majority of its assets to another division of the company without complying with the notification requirements under New York's bulk sales laws.⁷⁹ The plaintiffs, a group of unsecured creditors of the transferred assets, contested the validity of the bulk sale due to defendant's non-compliance with the bulk sales notification requirement.⁸⁰ The Court found that the defendant's transfer of a majority its assets to another division meet the abovementioned factors and therefore the plaintiffs' were entitled to notice under the bulk sales laws of New York.⁸¹

While the Court in *Unsecured Creditors* listed the factors to determine applicability, the type of business subject to bulk sales regulation remained an issue.⁸² In *Kimberly Quality Care v. Eastern Star Nursing Home* (hereafter *Quality Care*), the Washington Court of Appeals was confronted with the issue of whether the transfer of a nursing home fell with its states bulk sales law.⁸³ The Court clarified the standard used to determine which industries fall within the bulk sales legislation as "an enterprise to which unsecured credit is commonly extended on the faith of its inventory."⁸⁴ Having explained which transfers trigger U.C.C. Article 6 provisions, we will now determine who benefits from the legislation.

⁷⁷ *Committee of Unsecured Creditors of Interstate Cigar Co. v. Interstate Distribution, Inc.*, 184 Misc.2d 774 (N.Y. Sup.Ct. 2000).

⁷⁸ *Id.*

⁷⁹ *Id.*

⁸⁰ *Id.*

⁸¹ *Id.*

⁸² *Id.*; *Kimberly Quality Care v. Eastern Star Nursing Home*, 62 Wash. App. 145 (Wash. Ct. App. 1991).

⁸³ *Kimberly Quality Care*, 62 Wash. App. at 145.

⁸⁴ *Id.*

E. All Creditors Take Notice

The types of creditors protected under the bulk sales laws of the U.C.C. were expanded over its lifetime to efficiently protect unsecured creditors. Originally, Article 6 protected creditors who had claims based on transactions or events before the transfer.⁸⁵ The revised Article 6 expanded the coverage and changed the terminology from ‘creditor’ to ‘claimant’.⁸⁶ The revised article defines a claimant as, a person holding a claim in the holder’s business, and requires the buyer to give notice to all the seller’s claimants at the time of the bulk sale agreement.⁸⁷ Despite the expansion, courts have held that landlords do not constitute creditors under the bulk sales laws of the U.C.C..⁸⁸ Thus, a lease is not considered a claim in the holder’s business, excluding the buyer from the landlord notice.⁸⁹ This raises the question of who the buyer must notify and what the remedies the unsecured creditor has under Article 6.

F. Requirements and Remedies

The buyer in a bulk sales transaction is placed with the burden of fulfilling the requirements under U.C.C. Article 6. Buyers in a bulk goods transaction must obtain a list from the seller of all of the seller’s creditors.⁹⁰ The seller must also disclose all names and addresses that he/she used within the previous three years.⁹¹ Then the buyer has to send notice to all of the seller’s creditors that the bulk sale transaction will be taking place on a specified future date (not more than 30 days from obtaining the list of creditors).⁹² These provisions place the responsibility of complying on the buyer, thus ensuring the buyer is

⁸⁵ U.C.C. §6-109(1) (1972).

⁸⁶ U.C.C. § 6-102 Official Comment (e)(f) (1990).

⁸⁷ U.C.C. §6-102(1)(e), 104(b), 105(1990).

⁸⁸ *Schlusell v Emmanuel Roth Co.*, 270 NJ Super 628 (N.J. 1994); *Sunrise Indus. Joint Venture v. Ditrac Optics, Inc.*, 873 F. Supp. 765 (E.D. N.Y. 1995).

⁸⁹ *Id.*

⁹⁰ U.C.C. § 6-104(1) (1990).

⁹¹ U.C.C. §6-104 (1)(a) (1990).

⁹² U.C.C. §6-105 (1), (2)(a)-(b), (5) (1990). If the seller has more than 200 creditors on the date of the bulk sale agreement then buyer may satisfy the notice requirement by filing a written notice of the bulk sale in the office of the Secretary of State.

aware of any fraudulent intent on behalf of the seller and it gives the creditor of the seller recourse if notice is not given.⁹³ The remedies available due to noncompliance allows for the creditor to seek damages against the breaching buyer.⁹⁴

The remedies afforded to unsecured creditors under US bulk sales laws are not excessive and would not be in conflict with the legal systems of post-communist countries. U.C.C. Article §6-107 addresses the liability of the buyer who fails to comply with the bulk sales provisions.⁹⁵ The non-complying buyer is simply liable to the seller's unsecured creditors "for damages in the amount of the claim, reduced by any amount that the creditor would not have realized if the buyer complied."⁹⁶ U.C.C. §6-107(4) clarifies the amount which the unsecured creditors may seek setting a maximum amount depending on if the assets are inventory and equipment or other property other than the aforementioned.⁹⁷ By setting limits on the amount of the non-complying buyer's liability the bulk sales laws in Article 6 would not offend the post-communist countries concept of acceptable damages.

Mere compliance with bulk sales provisions does not preclude an unsecured creditor to seek damages as a result of fraud. This important distinction was highlighted in *Monastra v. Konica Bus. Mach.*, the defendants argued that their compliance with the bulk sales provisions excluded them from fraud charges.⁹⁸ The Court stated that if the defendant's claims were true then:

[I]f notice of a proposed bulk sale is published and recorded as required in the Act, the parties to the sale may, with complete impunity, place all of the seller's assets out

⁹³ Arthur Sabin, Pragmatic Aspects of Bulk Transfer Creditors' Rights, 74 Ill. B. J. 550 (1986).

⁹⁴ U.C.C. §6-107(1) (1990).

⁹⁵ U.C.C. §6-107 (1),(2) (1990).

⁹⁶ U.C.C. §6-107 (1)(a) (1990).

⁹⁷ U.C.C. §6-107(4) (1990). :

"In a single bulk sale the cumulative liability of the buyer for failure to comply with the requirements of Section 6-104(1) may not exceed an amount equal to:

(a) if the assets consist only of inventory and equipment, twice the net contract price, less the amount of any part of the net contract price paid to or applied for the benefit of the seller or a creditor; or

(b) if the assets include property other than inventory and equipment, twice the net value of the inventory and equipment less the amount of the portion of any part of the net contract price paid to or applied for the benefit of the seller or a creditor which is allocable to the inventory and equipment."

⁹⁸ *Monastra v. Konica Bus. Mach., U.S.A., Inc.*, 43 Cal.App.4th 1628, 1636(Cal. Ct. App. 1996).

of the reach of any creditor who is unwary enough to miss the single publication and the notice in the county recorder's office, and it makes no difference if this is done with the specific intent to defraud such creditor. We cannot accept this as a principle of law.⁹⁹

Hence by enacting bulk sales legislation in post-communist countries it would not preclude damages under pre-existing fraudulent transfer laws but instead prevent scams and provide an avenue for unsecured creditors to recover from the good-faith purchaser.

⁹⁹ *Monastra*, 43 Cal.App.4th at 1636-1637.

CHAPTER III. - Delimitation of Problems

The emerging markets of the post-communist countries in their rush to adopt modern commercial laws have failed to fully address the peculiarity of bulk sales scams. Bulk sales laws in the United States addressed scams involving ‘fly-by-night’ real estate salesmen, ‘tramp’ merchants, and basic creditor avoidance.¹⁰⁰ While the scams have advanced in sophistication over the years, unsecured creditors continue to face risks and suffer from scams in the emerging post-communist markets.¹⁰¹ The creditors’ remedy of fraud under civil or commercial law is not readily available without bulk sales law as the peculiarity of the scam involves a good faith purchaser without knowledge.¹⁰² The requirement of the buyer notifying the creditor addresses this overlooked area of post-communist legislation and can prevent the bulk sales scams for occurring.¹⁰³ The below sections look at the creditor rights laws offered under German law which served as a model in some post-communist countries and will reveal the need to adopt bulk sales legislation.¹⁰⁴ The adoption of bulk sales provisions in post-communist countries will create a safer lending environment.

A. Eliminating the Necessity to Prove Fraud

While there has been advancement in many areas of civil and commercial law in regards to creditor’s rights, post-communist countries have not fully addressed unsecured creditors rights against a purchaser in good faith. Many post-communist countries adopted

¹⁰⁰ See Billing, *supra* note 13, at 77-79.

¹⁰¹ See *supra* note 11.

¹⁰² See Billing, *supra* note 13, at, 78-79.

¹⁰³ Steven L. Harris, Article 6: The Process and the Product- An Introduction, 41 Ala. L. Rev. 549, 553-554 (1990). Stating that the notice requirement may even benefit the seller by allowing the creditor to participate in the negotiations and maximize proceeds.

¹⁰⁴ Bundesgesetzblatt [Insolvency Statute] ch. 3 §§129-147 (F.R.G.), *available at* <http://www.iuscomp.org/gla/statutes/InsO.pdf>; Gesetz über die Anfechtung von Rechtshandlungen eines Schuldners außerhalb des Insolvenzverfahrens (Anfechtungsgesetz -AnfG) [Law on the avoidance of acts of a debtor outside the insolvency proceedings] (F.R.G) *available at* http://www.gesetze-im-internet.de/anfg_1999/BJNR291110994.html; Civil Code Ch. 6 art. 59 (Mong.); Company Law Ch. 6 art. 49 (Mong.); The Law of Contracts and Torts ch. V art. 65 (Serb.).

laws that were based on the German legal system.¹⁰⁵ German law provides some remedy to creditors through the use of fraudulent transfer laws, civil contract law fraud, and avoidance laws.¹⁰⁶ However, these remedies only protect the unsecured creditor if fraud can be proven.¹⁰⁷ Cases in which the buyer is not a party to fraud leave unsecured creditors with little recourse to recover losses. This exact conundrum was what led the United States to adopt U.C.C. article 6.¹⁰⁸

Emerging post-communist countries reliance on German based legal remedies to bulk sales issues is reflective of early 1900 United States laws in its inability to protect unsecured creditors rights. The presence a bone fide purchaser frustrated the unsecured creditors' ability to prove fraud in the bulk sales scams and differentiated it from a basic fraudulent conveyance.¹⁰⁹ Late 19th Century case law was strewn with judgments where US courts worked hard to view the facts in a light likely to meet the "badges of fraud" requirement of fraudulent conveyances.¹¹⁰

¹⁰⁵ Mongolia adopted a Russian/German civil law system after the fall of communism. Anderson & Anderson, LLP, Mongolia Law Digest, <http://www.anallp.com/wp-content/uploads/downloads/2010/07/MONGOLIA-LAW-DIGEST.pdf> (late visited March 27, 2012). Slovakia also modeled their legal system after the German civil law system. Roman Majtan, The Slovak Legal System, <http://faculty.cua.edu/fischer/ComparativeLaw2002/roman/slovaklegalsystem.htm> (last visited March 27, 2012). Other post-communist countries influenced by German law include the Czech Republic, Greece, Hungary, and countries of the former Yugoslavia. Jonathan R. Hay et al, Toward a Theory of Legal Reform, 40 Eur. Econ. Rev. 559, 561(1996) available at http://www.economics.harvard.edu/faculty/shleifer/files/theory_legal_reform.pdf.

¹⁰⁶ Bundesgesetzblatt [Insolvency Statute] ch. 3 §§129-147 (F.R.G.), supra note 104; über die Anfechtung von Rechtshandlungen eines Schuldners außerhalb des Insolvenzverfahrens (Anfechtungsgesetz -AnfG) [Law on the avoidance of acts of a debtor outside the insolvency proceedings] (F.R.G), supra note 104.

¹⁰⁷ Id.

¹⁰⁸ See Alces, supra note 20, at 826.

¹⁰⁹ See Shanker, supra note 3, at 658-660. Tracing the history of unsecured creditors rights in the US from 1571 when the British Parliament passed the Statute against Fraudulent Conveyances to revised Article 6 of the U.C.C..

¹¹⁰ See Billing, supra note 13, at 78-81. Outlining the bulk sales case progression from the Statute of 13 Elizabeth, Carter & Co. v. Richardson & Co. (Kentucky), St. Louis Brewing Assn. v. Steimke(Missouri), Beels v. Flynn (Nebraska), and Manwaring v. O'Brien (Minnesota); Peter Winship, Lawmaking and Article 6 of the Uniform Commercial Code, 41 Ala. L. Rev. 673, 689-690 (1990).

The badges of fraud theory is best explained by the Court in the 1896 case *St. Louis Brewing Assn. v. Steimke*,

"It will be seen that there was substantial evidence of the following facts which might be considered by the jury as badges of fraud. Undue and unusual haste in the transaction of purchase. The purchase of the contents of a store in lump without detailed inventory and appraisal and with-out any satisfactory explanation why the goods were neither inventoried nor appraised. Gross inadequacy of price."¹¹¹

This is the type of logic where the court has to scrutinize each bulk sales transaction in dispute will be what post-communist countries will have to rely upon to protect the unsecured creditor in the absence of bulk sales legislation to address such issues as described below.

B. The Modern Post-Communist Schemester

Documentation of larger creditor fraud can be noted in the tunneling schemes and financial and real estate fraud prevalent in Eastern Europe and asset stripping in Central Asia.¹¹² The tunneling problems in the Czech Republic and the Slovak Republic have received more media coverage than other scams.¹¹³ Tunneling is the stripping of assets and profits from companies by their controlling shareholders.¹¹⁴ The courts in the emerging markets of the post-communist countries do not have the proper legislation to stop the looting, thus providing little protection to creditors.¹¹⁵ Without providing the remedies afforded under U.C.C. Art. 6 type legislation, these countries will remain risky for investors.

Slovenia has had a number of scams involving real estate in their recent past.¹¹⁶ These modern the reported scams resemble the ‘curb-stone’ real estate deals of early 19th century Iowa where ‘fly-by-night’ real estate men would trade a heavily encumbered property for

¹¹¹ See Billing, *supra* note 13, at 79.

¹¹² See *supra* note 11.

¹¹³ *Id.*

¹¹⁴ Simon Johnson et al, Tunneling, American Econ. Rev. Papers Proceedings, May 2000 pgs. 3-6 *available at* <http://mba.tuck.dartmouth.edu/pages/faculty/rafael.laporta/docs/publications/LaPorta%20PDF%20Papers-ALL/Tunnelling.pdf>.

¹¹⁵ *Id.*

¹¹⁶ See Fraud Flooding Slovenia, *supra* note 11.

goods in bulk.¹¹⁷ The early scam involved re-selling the bulk goods at auction and making away with the proceeds.¹¹⁸

In current day Slovenia the scam was slightly different, with the sellers taking advantage of the long wait on title procedures.¹¹⁹ One scam involved getting a mortgage on property which the individual already sold (due to the long title process, the former owner was still listed in the registry).¹²⁰ Another documented scam in Slovenia is when the seller files bankruptcy after selling the property, but due to the slow title registration process, the seller's creditors, believing that the seller is the proper owner, recover from property which was sold.¹²¹ While these scams do not involve bulk goods, with the loop hole left open, it will not take long for scam artists to employ the methods of the early Iowan 'curb-stone' real estate men.

In Central Asia, asset stripping is a major concern for potential investors. While this is predominately a problem of weak corporate governance pervasive in the region, bulk sales laws would at least curb a portion of this behavior providing the unsecured creditors with a remedy when the company sells its inventory in bulk.¹²² Without reassuring unsecured creditors with better protection, Central Asian countries are not encourage foreign investment in the region.¹²³ The benefits of bulk sales law include filling in the gaps of the post communist markets ineffective fraudulent transfer laws in bulk sales transactions.

There is an absence of empirical data reflecting the extent of bulk sales issues specifically in post-communist countries, evidence of its existence can be found in the more elaborate schemes used in these countries to dupe creditors. Lack of empirical data was also

¹¹⁷ See Billing, *supra* note 13, at 77.

¹¹⁸ *Id.*

¹¹⁹ See Fraud Flooding Slovenia, *supra* note 11.

¹²⁰ *Id.*

¹²¹ *Id.*

¹²² See Malleret, *supra* note 11.

¹²³ *Id.*

prevalent when the NCCUL set about revising Article 6 in the mid 1980's.¹²⁴ The drafting committee of Revised Article 6 determined that bulk sales risk still existed but did not need expanded coverage.¹²⁵ The post-communist countries continue to be victims of scams which were originally against the state but are now perpetrated against private creditors.¹²⁶ It can be inferred that the evidence of more elaborate schemes gaining media attention than the lesser publicized bulk sales issues exist in these countries as well. The frequency of bulk sales risk need not be quantified to protect unsecured creditors interest in bulk sale transactions, but as scams continue in the post-communist markets the laws in place are not sufficient.

C. Post-Communist Countries Take Heed

Despite the European 13th Century the solutions and the emerging national government attempts to protect unsecured creditors, their efforts have fallen short. Countries waking up from post-communist hangovers have made significant advances in secured transactions and fraudulent conveyance laws but they did not implement bulk sales laws.¹²⁷ Mongolia enacted legislation regarding the disposition of company property and civil law actions in regards to fraudulent transactions, but neither protect an unsecured creditor in a bulk sale transaction.¹²⁸ In March of 2009, European Bank for Reconstruction and Development report lauded the Slovak Republic as having “one of the most advanced EBRD countries of operation in terms of legal transition,” yet no bulk sales law.¹²⁹ These emerging

¹²⁴ See Miller, *supra* note 36, at 594.

¹²⁵ *Id.*

¹²⁶ See *supra* note 11.

¹²⁷ A March 2009 European Bank for Reconstruction and Development report lauded the Slovak Republic as having “one of the most advanced EBRD countries of operation in terms of legal transition.” European Bank for Reconstruction and Development, *Commercial Laws of the Slovak Republic: An Assessment by the EBRD* (March 2009) available at <http://www.ebrd.com/downloads/sector/legal/slovak.pdf>; CIVIL CODE CH. 6 ART. 59 (Mong.); COMPANY LAW CH. 6 ART. 49 (Mong.).

¹²⁸ CIVIL CODE CH. 6 ART. 59 (Mong.); COMPANY LAW CH. 6 ART. 49 (Mong.).

¹²⁹ EBRD, *Commercial Laws of the Slovak Republic: An Assessment by the EBRD*, *supra* 127.

economies will benefit from the bulk sales laws in the same way creditors in the United States did for more than 5 decades.¹³⁰

No current post-communist country has specifically addressed bulk sales in the same manner as the United States in enacting Article 6 of the U.C.C.. Some have enacted fraudulent transfer laws, while others still rely on civil laws to address this issue.¹³¹ These laws provide creditors with an avenue to recover some of the credit lent to the ‘tramp merchant,’ yet they fall short of the narrow scope of U.C.C. Article 6.¹³² Post-communist countries in particular are vulnerable to bulk sales problems as their commercial laws are not as developed and they were previously reliant on the state to commercial handle disputes.¹³³

Implementing bulk sales laws in the emerging markets of post-communist countries will provide benefits to unsecured creditors with little burden to the contracting parties. U.C.C. Article 6 provided a balance between unsecured creditors’ right to notice and the burden placed on the contracting parties.¹³⁴ These simple requirements provide protection for unsecured creditors while allowing for secured transactions laws to advance as evidenced in the United States.¹³⁵ Moreover, providing unsecured creditors with greater protection will lead to greater lending opportunities thus bolstering the economy in post-communist countries.¹³⁶ A closer inspection of the fraudulent transfer laws in a few of the post-communist countries will expose their inadequacies.

D. Not Seeing the Forest For the Trees

A glimpse at the current legislation in a couple of post-communist countries as well as some provisions in Germany, which served as their model, will prove that gaps exist in

¹³⁰ See Winship, *supra* note 110, at 688-689. Noting the balance of benefit for creditors and burden for contracting parties.

¹³¹ See *supra* note 104.

¹³² *Id.*; U.C.C. §6-102(1990).

¹³³ Anonymous, Comment, The Role of State Arbitrazh under the New Conditions of Economic Management in the Soviet Union, 116 U.Pa.L.Rev. 1285 (1968).

¹³⁴ See Winship, *supra* note 110, at 688-689.

¹³⁵ U.C.C. § 6 Prefatory Note (1990).

¹³⁶ See Shanker, *supra* note 3, at 656-657. Refuting the notion that unsecured creditors play a minimal role in modern lending practices.

unsecured creditors rights allowing for bulk sales scams to flourish. For example, the laws of Mongolia provide for remedies in civil law if an individual is cheated due to fraud or withholding information.¹³⁷ These articles in the civil code allows for an individual who has been cheated in a transaction to void the transaction.¹³⁸ The protection afforded by Mongolia's Civil Code only becomes effective after someone has been "cheated," whereas bulk sales provisions would require notice thus altering third parties of the terms of the sale.¹³⁹

The gaps in Mongolia's Civil Code in regards to bulk sales scams are not shored up in the nation's Company Law. Mongolian Company Law does address the disposition of a company's property in respect of creditors.¹⁴⁰ However, the provision only allows creditors to seek to void transactions where the company sells any property or property right below market value making the minimum capital fall below prescribed levels or the company to become insolvent.¹⁴¹ This remedy does little in regards to notifying the unsecured creditors of the sale, furthermore voiding the transaction after the company is insolvent and left town is not a suitable solution.

Serbia provides an additional example. The Law of Contract and Tort in Serbia also provide little remedy for unsecured creditors who fall victim to bulk sales scams. Under Serbian law individuals may avoid contracts for fraud; this is common amongst all legal systems.¹⁴² Creditors must also rely on fraud to recover from potential absconding debtors.¹⁴³ The burden of proving fraud was at the heart of bulk sales implementation in the United

¹³⁷ Civil Code Ch. 6 art. 59 (Mong.).

¹³⁸ Civil Code Ch. 6 art. 59.1 (Mong.) reads: "If others are cheated with the purpose to conclude transaction, the cheated person shall be entitled to contend the transaction is void. In this case, considering the transaction void shall not depend on whether the person cheated had an intention to gain profit or do harm to the cheated person."

¹³⁹ Civil Code Ch. 6 art. 59 (Mong.); See Shanker, *supra* note 2, at 660

¹⁴⁰ Company Law Ch. 6 art. 49 (Mong.).

¹⁴¹ *Id.*

¹⁴² The Law of Contracts and Torts Ch. V art. 65 (Serb.).

¹⁴³ *Id.* at Ch.III Sec. 1 Subsec. 1 art.266(2) .

States.¹⁴⁴ By adopting a legal system based on German legal principles some post-communist countries protected unsecured creditors from obvious modern risks while neglecting to see those which were thwarted in the United States due to advanced legal principles.

Germany provided a familiar legal structure for post-communist countries to structure their laws but the ability to apply German based legal reasoning abroad is not as transferable. Germany has many provided post-communist countries with their basic legal structure, including the contract remedy of fraud and fraudulent transfer laws, allowing them to begin their transformation.¹⁴⁵ These remedies as proven above are not sufficient to stop bulk sales scams, yet German courts may construe their laws to cover such transactions.¹⁴⁶

An example of some post-communist countries inability to smoothly apply German based legal principles can be seen in the terms of bankruptcy. The World Bank, in its 2012 Doing Business Report, states that bankruptcy proceedings in Germany are resolved in just over a year.¹⁴⁷ Whereas, the average amount of years to resolve bankruptcy in Eastern Europe and Central Asia is just under 3 years.¹⁴⁸ Taking twice as long to resolve bankruptcy using what at one time was the same laws, shows that post-communist countries can struggle with applying German principles to their problems. Therefore, adopting bulk sales notice requirements would at least protect unsecured creditors rights until their laws and courts have had more time to resolve issues such as the ones detailed below.

¹⁴⁴ See Alces, *supra* note 20, at 827

¹⁴⁵ See *supra* note 104.

¹⁴⁶ INSOL Int'l, Avoidance Provisions in a Local and Cross-border Context: A Comparative Overview, Int'l Tech. Series Issue No. 7 pg. 10 §4.32 (Dec. 2008), *available at* <http://www.insol.org/TechnicalSeries/pdfs/TechnicalSeriesIssue7.pdf>.
stating "The general rule is stated in § 1 of the AnfG, namely that transactions by a debtor that prejudice the creditors may be subject to avoidance proceedings."

¹⁴⁷ World Bank, Doing Business in Germany 2012, *available at* <http://www.doingbusiness.org/data/exploreeconomies/germany?topic=resolving-insolvency#resolving-insolvency> (last visited March 27, 2012).

¹⁴⁸ World Bank, Doing Business in Eastern Europe and Central Asia 2012, pg. 91, Figure 11.2, *available at* <http://doingbusiness.org/~media/FPDKM/Doing%20Business/Documents/Profiles/Regional/DB2012/DB12-Eastern-Europe-Central-Asia.pdf>.

E. Missing out on the Benefits

Bulk sales regulation in post-communist countries which requires notice to be given to all the seller's creditors in advance of the sale will protect unsecured creditors rights and defeat the need to prove fraud. In evaluating the need for bulk sales laws in modern United States many commentators explained the past usefulness of bulk sales laws before other secured transaction provisions and emergence of readily accessible reliable credit reporting agencies extinguished the need.¹⁴⁹ The main benefit of bulk sales law is to protect unsecured creditors by giving them notice with very little detriment to the parties in the transaction.¹⁵⁰ The notice requirement under bulk sales legislation protects unsecured creditors much the same way that chattle mortgage statutes eliminated secret liens.¹⁵¹ Post-communist countries by simply requiring notice to the seller's creditors would eliminate the need to prove fraud or intent in bulk sale scams, preventing a potential looting of unsecured creditors by "tramp" merchants.

¹⁴⁹ See Alces, *supra* note 20 at 865-871; See Miller, *supra* note 36, at 590-592; See Shanker, *supra* note 3, at 661-665.

¹⁵⁰ See Shanker, *supra* note 3, at 660.

¹⁵¹ *Id.* at 659.

CHAPTER IV. - Future Trends

Looking into the future to predict the impact of bulk sales scams in post-communist countries, one only needs to look to the past. The legislation policing capitalism in the United States has had a natural progression from predominately unsecured credit based to secured credit based.¹⁵² The post-communist countries did not enjoy such a luxury as they went from state controlled economy to capitalism seemingly overnight.¹⁵³ The lack of a natural progression in legislation in the area of creditor's protection left post-communist countries susceptible to various creditor scams.¹⁵⁴ These unaddressed areas will continue to limit the credit available in these countries hurting their economic growth as credit lenders in Western Europe are now looking for safer investments.¹⁵⁵ By taking a step back and introducing bulk sales laws in post-communist countries unsecured creditors' loss will be minimized allowing for the other areas of commercial law to evolve and welcoming investors.

Post-communist countries which do not address bulk sales problems will increasingly become a risky investment causing their economy to lose access to credit which was previously available. In a shrinking European lending market, those countries with better creditor protection will attract more investors.¹⁵⁶ The statistics upon which post-communist countries can weigh the loss of annual revenue as a result of bulk sales scams is not available. However, it is logical to deduce that bulk sales scams are happening and will become more prevalent as they are not being addressed, which in turn, will cause assess to unsecured credit

¹⁵² Id. at 658.

¹⁵³ European Bank for Reconstruction and Development, Ten Years of Secured Transactions Reform, pg. 20, 21 (Autumn 2000) available at <http://www.ebrd.com/pages/sector/legal/secured.shtml>, stating in that in 1990 none of the 26 post-communist countries which they work with "had any workable laws permitting non-possessory security over movable assets." As of the report 22 countries had only basic laws in place- many still not efficiently working.

¹⁵⁴ See supra note 11.

¹⁵⁵ Agnes Lovasz, East European Deleveraging May Hurt Economic Growth, RBS Says, Bloomberg March 20, 2012 available at <http://www.bloomberg.com/news/2012-03-20/east-european-deleveraging-may-hurt-economic-growth-rbs-says.html>.

¹⁵⁶ Rafael La Porta et al, Law and Finance, J. Political Econ. (1998), available at <http://mba.tuck.dartmouth.edu/pages/faculty/rafael.laporta/docs/publications/LaPorta%20PDF%20Papers-ALL/Law%20and%20Finance-All/Law%20and%20Finance.pdf>.

to become more restricted. Lost funds could result in an unexpected alliance between unsecured creditors.

Unsecured creditors may be joining force to instigate bulk sales legislation by forming unions. This was one of the driving factors in getting legislatures in the United States to take notice and address bulk sales scams.¹⁵⁷ The unions, like in 1900 United States, would draft model law and then lobby their governments to pass bulk sales legislation. If the bulk sales laws are not addressed then the environment for an epidemic of bulk sales scams could reach levels in the post-communist countries which arose to in early 20th century United States that led to J . Henry Tregoe, first president of the National Association of Credit Men to proclaim:

"A favorite indoor sport of three decades ago with the fraudulently inclined debtor was to sell his stock in bulk, pocket the proceeds and laugh at his creditors. There was no way of reaching the debtor along criminal lines if he had broken no law, and the game could be played without fear of punishment whenever the debtor felt the urge of the deceitful method."¹⁵⁸

Another consequence of the lack of unsecured creditor protection in bulk sale transactions will be an increase in litigation. Late 19th –early 20th Century United States saw a plethora of cases involving the transfer of a merchant's entire stock to a bona fide purchaser, without the creditors knowledge.¹⁵⁹ If the post-communist countries judicial system fails the unsecured creditors, either proving too costly or inefficient, then they will turn to non-governmental bodies to deal with tramp merchants.¹⁶⁰ The consequences of ignoring the bulk sales issues are too extreme when balanced with the minimal requirements to prevent such problems. Post-communist countries currently find themselves in a preferred in a position to prevent bulk sales scams before the level of monetary losses forces legislation.

¹⁵⁷ See Billing, *supra* note 13, at 75.

¹⁵⁸ *Id.*

¹⁵⁹ See Billing, *supra* note 13, at 76 n.18. (*citing* more than 20 cases.)

¹⁶⁰ See Hay, *supra* note 105, at 561. Arguing that when a country has a dysfunctional court system, private parties will turn to the mafia to enforce the judgments.

CHAPTER V. - Recommendations

Post-communist countries should adopt bulk sales legislation similar to the provisions of U.C.C. Article 6. Unsecured creditors should band together to form a collation and present the benefits of bulk sales legislation to their respective governments. As discussed above, pre-U.C.C. bulk sales law provided a number of different options which post-communist countries could consider to better fit their existing legislation.¹⁶¹ Finally, post-communist countries should work to make the implementation and compliance with bulk sales requirements simple to benefit both unsecured creditors and the parties to the transaction. By taking the steps necessary to prevent bulk sales issues from reaching the level of an “indoor sport,” post-communist emerging markets will have a greater opportunity to attract more creditors.

A. Collation of the Lending

Creditors across the post-communist countries should join together to draft model legislation and share ideas about how to implement bulk sales legislation in their countries. As mentioned earlier, the National Association of Credit Men formed to lobby for bulk sales legislation.¹⁶² This credit association was so influential that in a mere 19 years after forming every state had passed a bulk sales law which eventually were made uniform in Article 6 of the Uniform Commercial Code.¹⁶³ If creditors in the post-communist countries and across Europe and Central Asia would structure themselves in a similar manner then their influence over the region would be significant enough that the national governments would need to take notice. The creditors are in the best position to determine which provisions to implement to best mesh with the laws of their perspective country.

¹⁶¹ See Billing, *supra* note 13, at 72-75, 81-82. Explaining the New York form, Pennsylvania form, Montana law, Connecticut law, and Louisiana Bulk Sales Act of 1896.

¹⁶² See Billing, *supra* note 13, at 75; See Bruno, *supra* note 30, at 1092.

¹⁶³ National Association Credit Management Timeline Page, <http://history.nacm.org/1896-1920.shtml> (last visited March 27, 2012).

B. Finding the Bulk Sales Slipper That Fits

In selecting a type of bulk sales legislation post-communist countries should implement the requirements for self-policing and notice in U.C.C. Article 6. As described, initially there were a number of slightly different bulk sales statutes throughout the United States.¹⁶⁴ The common denominator in all the laws were the requirement that the parties self-policing of the transaction by requiring the seller to give the buyer a list of creditors, thus alerting the buyer of any fraudulent intent.¹⁶⁵ The buyer's requirement to give notice to all the seller's creditors should also be retained to facilitate an effective bulk sales law.

The benefits of retaining self-policing and notice include saving countries money in litigation costs, better protecting unsecured creditors, and potential for a higher recovery on debt by unsecured creditors in cases of an insolvent seller. Placing the burden on the contracting parties to police the sale saves cost for the state in future litigation.¹⁶⁶ Additionally, by giving the unsecured creditor better protection against an absconding debtor, creditors will be willing to lend to more individuals.¹⁶⁷ The notice requirement not only alerts the creditors of a potential bulk sales scam but in situations where the seller is insolvent, it invites the creditors into the negotiations where they can seek a higher price for the goods.¹⁶⁸ The benefits which will be bestowed upon post-communist countries by protecting unsecured creditors by enacting bulk sales legislation any inconvenience placed upon the transacting parties.

Outside the two provisions of self-policing and notice in U.C.C. Article 6, post-communist countries should feel free to look to other early bulk sales law to find one that fits best with their current legislation. U.C.C. being a creation of a common law system should

¹⁶⁴ See Billing, *supra* note 13, at 72-75, 81-82.

¹⁶⁵ U.C.C. § 6-104(1990); See Billing, *supra* note 13, at 72-75; William D. Hawkland, Compliance with Revised Article 6 of the Uniform Commercial Code, 41 Ala. L. Rev. 605, 618 (1990).

¹⁶⁶ See Shanker, *supra* note 3, at 669.

¹⁶⁷ *Id.*

¹⁶⁸ See Shanker, *supra* note 3, at 655.

not hinder its use in civil law jurisdictions. The first state to pass bulk sales law was Louisiana which has a civil law system influenced by the French and Spanish systems.¹⁶⁹ Furthermore, the bulk sales law in force in pre-U.C.C. Pennsylvania (the Pennsylvania form) made non-compliance with the notice and self-policing provisions “fraudulent and void,” which allowed for the fraudulent transfer laws to be applicable.¹⁷⁰ Ironing out the details of a bulk sales provision should be left to the individual country as to best serve the system in place, as long as it includes notice and a burden on the contracting parties to self-police the transaction, it will be effective. Easy compliance with whatever bulk sales provisions are adopted will encourage parties to use the laws to their benefit.

C. If It Don’t Make Dollars, It Don’t Make Sense

It is important for post-communist countries to make compliance with the provisions of bulk sales legislation easy to comply with for the mutual benefit of unsecured creditors and the contracting parties. Article 6 provided a sample form for the contracting parties to use as a model when entering into a bulk sale.¹⁷¹ With the technological advances and abundant availability in all corners of the planet, post-communist emerging markets should utilize the internet and create online line data bases on their government website to facilitate compliance. The seller could keep a running list of her creditors on a secured database which could be shared with parties of her choosing. In turn the creditors should also have the option to be listed on the site with an email address to help facilitate quick notice by the buyer upon receipt of the list from the seller. The cost and time of compliance with Article 6 was a frequent argument in the United States, these simple steps would speed up the bulk sale transactions and cut costs for everyone involved.¹⁷²

¹⁶⁹ See supra note 33; See Billing, supra note 13, at 81-82.

¹⁷⁰ See Billing, supra note 13, at 73.

¹⁷¹ U.C.C. §6-105(7) (1990).

¹⁷² See Shanker, supra note 3, at 655.

D. Insuring Tramp Merchants Are Kept Off the Playing Field

An alternative avenue for post-communist countries to explore is to require the parties to the bulk sale to obtain insurance or put aside funds in escrow on behalf of the unsecured creditors. This theory was put forth by Morris Shanker in his 1990 law review article, *The Trashing of Article 6: Isn't There a Better Alternative?*, dealing with the revision of U.C.C. Art. 6.¹⁷³ Shanker sought to address the critics who claim that the cost of compliance and determination if a sale falls within the provisions of bulk sales law causes a “chilling effect” on those who may want to enter a bulk sale.¹⁷⁴ He reasons:

“The essence of my idea is to seek to devise a remedy that more directly meets the specific problem facing the creditors and which is triggered only when the problem actually arises; that is, where creditors actually suffer loss due to their debtor's inappropriate actions.”¹⁷⁵

This notion of insurance for the unsecured creditor coupled with notice and self-policing could eliminate the ability of tramp merchants to play their indoor sport.

¹⁷³ Id. at 670-671.

¹⁷⁴ Id. at 671.

¹⁷⁵ Id.

CONCLUSION

The onslaught of tramp merchants have yet to descend upon the flower markets in Chisinau, but the absence of bulk sales legislation only invites their presence. Having thoroughly evaluated the history of bulk sales issues in the United States which led to the passing of U.C.C. article 6, a framework to prevent bulk sales scams in the post-communist countries has been presented. Requiring the buyers in a bulk sales transaction to notify the creditors of the seller will eliminate any ambiguity about the parties fraudulent intentions, provide unsecured creditors with a remedy, and signal to investor that the post-communist markets are safe for foreign investors.

The lack of statistical data of the frequency of bulk sales scams in the post-communist countries is not representative of their existence. The existence of more elaborate creditor scams in the post-communist countries, proves that they exist and are not reported or at least that the environment for their emergence is ripe.¹⁷⁶ Self-policing by parties in a bulk sales transaction and notifying the seller's creditors will serve to fill in the gaps missing in current post-communist commercial law.

Post-communist countries should not be dissuaded by U.C.C. Article 6 being repealed in most of the United States. In fact, it should serve as an example of how the implementation of bulk sales law will lead to the advancements in other areas of law. Advancements in secured transaction law, bankruptcy law, and efficiency of credit reporting procedures were allowed the time to evolve in the United States because of the Article 6 bulk sales laws.¹⁷⁷ Unsecured creditors were able to continue extend credit to merchants in the beginnings of US capitalism with the security of knowing they were protected. A similar effect awaits post communist countries once they adopt bulk sales provisions.

¹⁷⁶ See supra note 11.

¹⁷⁷ See Battles, supra note 47.

The implementation of U.C.C. Article 6 type provisions in post-communist countries would not only protect unsecured creditors but also provide a favorable lending environment for its citizens. Encouraging the formation of creditors unions to draft model bulk sales law, working with governments to mesh the provisions with existing law, and insuring the provisions are easy for all parties to comply with, the post communist countries can efficiently prevent bulk sales scams in their countries. As Benjamin Franklin stated, “an ounce of prevention is worth a pound of cure.”

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