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SECURITY DEVICES AS PREFERENCES UNDER THE BANKRUPTCY ACT

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The complete revision of our Bankruptcy Law in 1938 brought no more sweeping change than the entire recasting of the Section relating to preferences.[1] This change was wrought mainly by defining the time at which transfers made by the bankrupt were to be considered complete. Aiming at the hitherto commercially valuable doctrine of "relation back,"[2] the new Act states: ". . . a transfer shall be deemed to have been made at a time when it became so far perfected that no *bona-fide* purchaser from the debtor and *no creditor* could thereafter have acquired *any rights* in the property so transferred superior to the rights of the transferee therein. . . ."[3]

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1. Bankruptcy Act § 60, 52 STAT. 869 (1938), 11 U. S. C. § 96 (1940).

2. See *infra.*

3. Bankruptcy Act § 60, 52 STAT. 869 (1938), 11 U. S. C. § 96 (1940). Section 60 (a) in full states: "A preference is a transfer, as defined in this Act, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition in bankruptcy, or of the original petition under chapters X, XI, XII, or XIII of this Act, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class. For the purposes of subdivisions (a) and (b) of this section, a transfer shall be deemed to have been made at the time when it became so far perfected that no bona-fide purchaser from the debtor and no creditor could thereafter have acquired any rights in the property so transferred superior to the rights of the transferee therein, and, if such transfer is not so perfected prior to the filing of the petition in bankruptcy or of the original petition under chapter X, XI, XII or XIII of this Act, it shall be deemed to have been made immediately before bankruptcy."

In order to constitute a voidable preference it is necessary to satisfy § 60 (b) [52 STAT. 870 (1938), 11 U. S. C. § 96 (1940)]: "Any such preference may be avoided by the trustee if the creditor receiving it or to be benefited thereby or his agent acting with reference thereto has, at the time when the transfer is made, reasonable cause to believe that the debtor is insolvent. Where the preference is voidable, the trustee may recover the property or, if it has been converted, its value

Although not within the scope of this article a word should perhaps be said about an academic controversy that has arisen over the question of whether this Section (60 (a)), in effect, makes the trustee a *bona fide* purchaser, or just gives him the status of the same as a criterion for measuring his rights. It has been suggested, if not stated, by some of the most eminent authorities in this field[4] that the former is the case. Equally eminent authority[5] has held to the latter view. Acceptance of the former interpretation would be, to use the words of the latter authority, revolutionary and dangerous. "It would be revolutionary, because the trustee never enjoyed that status previously, and it would be dangerous because a statute that conferred upon the trustee the rights of an innocent purchaser for value would cut off outstanding equities in cases where reclamation or other equitable relief has hitherto been allowed against the estate as a matter of course."[6] The problem has not yet been passed upon by the Supreme Court.

The new Section seeks to strike down secret liens[7] and appears to be more comprehensive and more in accord with its contemplated purpose than any previously devised. Although the Constitution guarantees to Congress

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from any person who has received or converted such property, except a bona-fide purchaser from or lienor of the debtor's transferee for a present fair equivalent value: *Provided, however,* That where such purchaser or lienor has given less than such value, he shall nevertheless have a lien upon such property, but only to the extent of the consideration actually given by him. Where a preference by way of lien or security title is voidable, the court may on due notice order such lien or title to be preserved for the benefit of the estate, in which event such lien or title shall pass to the trustee. For the purpose of any recovery or avoidance under this section, where plenary proceedings are necessary, any State court which would have had jurisdiction if bankruptcy had not intervened and any court of bankruptcy shall have concurrent jurisdiction."

4. Mr. Hanna and Mr. McLaughlin have suggested the view that the new Act makes the trustee a *bona fide* purchaser, See HANNA AND MCLAUGHLIN, THE BANKRUPTCY ACT OF 1898 AS AMENDED INCLUDING THE CHANDLER ACT OF 1938 (1940); McLaughlin, *Aspects of the Chandler Bill to Amend the Bankruptcy Act* (1937) 4 CHI. L. REV. 369, 393; Note (1941) 29 GEO. L. J. 628. It is now clear that neither Mr. Hanna nor Mr. McLaughlin intended to propound such a view. See Hanna, *Some Unsolved Problems under Section 60A of the Bankruptcy Act* (1943) 43 COL. L. REV. 58, 64, n. 23.

5. GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES (rev. ed. 1940) § 488; Glenn, *The Chandler Act and the Trustee as a Bona Fide Purchaser, a Supplementary Note* (1939) 25 VA. L. REV. 885.

6. Glenn, *The Chandler Act and the Trustee as a Bone Fide Purchaser: a Supplementary Note* (1939) 25 VA. L. REV. 885 at 888-9. See also GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES (rev. ed. 1940) 193. "On the contrary, he takes the debtor's assets subject to outstanding equities; in other words, the trustee, like every other liquidator 'stands in the shoes' of the bankrupt as to everything except fraudulent conveyances and preferences."

7. See WEINSTEIN, BANKRUPTCY LAW OF 1938 (1938) at 120.

and consequently the federal judiciary, control of bankruptcy,[8] state law must be applied where the federal law fails to give adequate and complete coverage.[9] It is thus left to the individual states to define the various terms used but not explained in federal bankruptcy legislation, *i.e.*, when a transfer is perfected as against a *bona fide* purchaser.

CHATTEL MORTGAGES

Under the Bankruptcy Act, as it was construed prior to the Chandler Act, the recording within the four months of a chattel mortgage which had been executed before that period was held not to be a voidable preference in those states where the recording acts declared an unrecorded mortgage invalid only as against *bona fide* purchasers or lien creditors. By relating the recording back to the execution of the mortgage the transaction was removed from the operation of the law unless an individual creditor had fixed a lien on the property before the recordation date, in which case the trustee took the place of that creditor and thus could overthrow the mortgagee's claim.[10] In those states, however, where the recording acts were construed to give no effect to unrecorded chattel mortgages as against ordinary creditors, *i.e.*, those not having a lien, the recording within the four month period was held to constitute a voidable preference.[11]

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8. U. S. CONST. Art I, § 8. Globe Bank and Trust Co. of Paducah, Kentucky v. Martin, 236 U. S. 288 (1915) (provisions of the Bankruptcy Act regarding attachments and liens acquired under state law are superior to all state laws). *In re* Lindsay-Strathmore Irr. Dist., 25 F. Supp. 988 (S. D. Cal. 1939) (insolvency proceeding under state law is superseded by a proceeding under the Bankruptcy Act). See also 2 GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES (rev. ed. 1940) at 867.

9. Benedict v. Ratner, 268 U. S. 353 (1925) (assignment valid under state law); Sexton v. Kessler and Co., Ltd., 225 U. S. 90 (1912); *In re* De Luxe Oil Co., 36 F. Supp. 287 (D. Minn. 1940). *Cf.* Erie R. R. v. Tompkins, 304 U. S. 64 (1938).

10. Martin v. Commercial National Bank of Macon, Georgia, 245 U. S. 513 (1918) (decided under the Georgia Statute).

11. This construction was derived from the wording of § 60 (b) [36 STAT. 842 (1910), 11 U. S. C. § 96 (1934)] prior to the Chandler Act, under which the trustee could avoid, as a preference, a mortgage which was recorded within the four month period "if by law recording or registering thereof is required." Recording was held to be "required" only where the recording act of the state declared unrecorded mortgages to be invalid as against ordinary creditors, or those whose place the trustee was entitled to take. Martin v. Commercial National Bank of Macon, Georgia, 245 U. S. 513 (1918); Carey v. Donahue, 240 U. S. 430 (1916). For a discussion of this rule and the cases see Note (1933) 83 A. L. R. 1279.

In 1926 § 60 (a) [44 STAT. 666, 11 U. S. C. § 96, (a), (1934)] was amended to add the words "or permitted" to "if by law such recording or registering is required." Although the same words were not added to 60 (b) it was argued that the addition would be meaningless unless, construed with 60 (b), it intended to change the rule then prevailing so that recording within the four month period

The rewording of Section 60 (a) in the Chandler Act would certainly seem to make these transactions preferences. Yet in *Adams v. City Bank and Trust Company of Macon, Georgia,*[12] the court reached a decision, in no respect different from the holdings under the previous Act. The bankrupt had borrowed money from respondent bank on June 24, 1939, executing a bill of sale of a certain chattel as security.[13] In exchange for a further loan, the bankrupt on September 15, 1939, executed a bill of sale to the respondent of another chattel held by it. Recordation did not take place until December 18, 1939, at which time respondent had reasonable cause to believe the bankrupt was insolvent. Adjudication of bankruptcy followed on December 30, 1939. The trustee sold the goods in the belief that the recordation constituted a voidable preference and suit was successfully maintained for the proceeds by the bank. The court regarded the recording as only one step necessary to make the transfer binding as to the subsequent purchasers and creditors. The transaction, considered as a whole, could not be regarded as a preference because it was actually an exchange of equivalent considerations and not payment of an antecedent debt.

The Act's definition of a transfer[14] is broad enough to include the recordation of a mortgage, and, as it took place some time after the consideration had passed, it would seem that there has then been a transfer on account of an antecedent debt.[15] Before recordation the bankrupt had an interest in the particular property sufficient to pass title to a *bona fide*

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would constitute a voidable preference in whatever jurisdiction the recording took place. See Foltz v. Davis, 68 F. (2d) 495, 496 (C. C. A. 7th, 1934); *In re* Jackson, 9 F. Supp. 717, 723 (W. D. Ark. 1935). *Contra*: First National Bank of Lincoln, Nebraska v. Live Stock National Bank, 31 F. (2d) 416 (C. C. A. 8th, 1929); Bank of Wadesboro v. Little, 71 F. (2d) 513 (C. C. A. 4th, 1934); see *In re* Cunningham, 64 F. (2d) 296, 299 (C. C. A. 4th, 1933).

12. 115 F. (2d) 453 (C. C. A. 5th, 1940), *cert. denied,* 312 U. S. 699 (1941).

13. A bill of sale of goods, executed by a borrower of money in favor of the lender, and defeasible on the loan's repayment is held to be a chattel mortgage in the absence of a change of possession. 1 JONES, CHATTEL MORTGAGES AND CONDITIONAL SALES (6th ed. 1933) §§ 19, 22.

14. Section 1 (30) [52 STAT. 842 (1938), 11 U. S. C. § 1, (30), (1940)] defines transfer as including: ". . . the sale and every other and different mode, direct or indirect, of disposing of or of parting with property or with an interest therein or with the possession thereof or of fixing a lien upon property or upon an interest therein, absolutely or conditionally, voluntarily or involuntarily, by or without judicial proceedings, as a conveyance, sale, assignment, payment, pledge, mortgage, lien, encumbrance, gift, security or otherwise."

15. *In re* Quaker City Sheet Metal Co., 129 F. (2d) 894 (C. C. A. 3d, 1942) *aff'd sub nom.* Corn Exchange National Bank and Trust Co. v. Klauder, 11 U. S. LAW WEEK 4242 (U. S. 1943) (assignment of accounts receivable, no notice being given to the debtor, was a transfer for an antecedent indebtedness at the time made

purchaser or to have it subjected to the claims of a lien creditor. This interest of the debtor in the property is taken from him when the mortgage is recorded. The parting with such an interest would thus seem to constitute a transfer within the Act. A construction of the transaction as fixing a lien upon the property is also possible.[16] In any event, a transfer has been "suffered" for or on account of an antecedent debt. This conclusion is supported by the legislative history of the Act.[17]

The historical development of the preference concept is an interesting one, but beyond the scope of this article.[18] The legislative intent with respect to the Chandler Act seems, however, to be soundly premised on this historical development as well as on present policy. The doctrine of relation back is believed to have had its origin in the early theory of a preference, which was based upon an intent by the debtor to prefer one creditor over others.[19] No intent on the debtor's part was involved in the creditor's recordation of the instrument he held, thus no preference took place. Today intent on the part of debtor to prefer is of no consequence, the governing factor being the depletion, before bankruptcy, of that part of the insolvent's estate which could have been used to satisfy other creditors' claims. The recording of a mortgage within the four month period, there being no equivalent exchange at that time, deprives the debtor's estate of that much

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complete, immediately before bankruptcy, and other requisites being present a voidable preference. Court rejects interpretation of antecedent debt in *Adams* case.) *In re* Seim Construction Co., 37 F. Supp. 855 (D. Md. 1941). But *cf.* Associated Seed Growers, Inc. v. Geib, 125 F. (2d) 683 (C. C. A. 4th, 1942). *In re* Greenberg, 48 F. Supp. 3 (D. Mass. 1942) (loan made December, 1939, but chattel mortgage given in February, 1940 improperly recorded. Possession taken on December 4, 1940, a day before bankruptcy, constituted other requisites being present, a voidable preference). *In re* Markert, 45 F. Supp. 661 (D. Ct. Mass. 1942) (same situation under recorded *free handed* mortgage of merchandise). See also *In re* Aughenbaugh, 33 F. Supp. 671 (M. D. Pa. 1940) (mortgage executed before the four month period and recorded within it held not a preference on the ground that creditor, at time of recording, had no knowledge of debtor's insolvency; the language of the court implied that the other elements of preference were present). The Chandler Act would not seem to have been applicable as bankruptcy occurred before the Act became effective. The provisions of the Act were applied, however, the applicability of the Act seemingly not having been called in question. See 52 STAT. 940 (1938).

16. See *supra* note 14. An alternative construction would lead to the same result. "Parting with . . . an interest therein" or "fixing a lien upon property" is also broad enough to include the execution of a mortgage thereon.

17. H. R. Rep. No. 1409, 75th Cong., 1st Sess. (1937) 30; *Hearings before Committee on the Judiciary on H. R. 8046,* 75th Cong., 1st Sess. (1937) 120 *et seq.* See also McLaughlin *supra* note 4 at 392-3.

18. For an excellent treatment see 2 GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES (rev. ed. 1940) §§ 378 *et seq.*

19. Glenn *op. cit.* at §§ 278-9, 382.

in the way of assets that other creditors might have shared. This would enable one creditor to obtain a greater percentage of the debt owed him than his fellows, some of whom may have extended credit in reliance on the debtor's owning just that asset. Such reliance by other creditors is not necessary to have a voidable preference, but in most of the cases it is present. To allow him to better his position after he has reason to believe the debtor to be insolvent would be most unjust to other creditors where the means existed for him to safeguard his lien in sufficient time to avoid the prohibition of the statute.

The latter brings up the question of what should be regarded as sufficient time to avoid the prohibition of the statute. To put it another way, when should the transfer within the four month period be regarded as "made for or on account of an antecedent debt." Where recordation takes place the day following the execution of the instrument, it should not be regarded as a preference, since leeway must need be given as they both cannot take place simultaneously, and this is but a reasonable interval.[20] It would seem equally clear that the intervals of three and six months between the two dates in the *Adams* case are unreasonable and that the transfers constituted preferences. To temper the harshness latent in this Section the courts will undoubtedly have to expand or restrict their definition of "antecedent debt" to accommodate the equities of each case.[21]

Where the mortgagee is not in possession and has not recorded at the date of the filing of the petition, he will probably lose by operation of Section 70 (c)[22] without the necessity of the trustee proving a voidable preferance under Section 60.

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20. In the case of *In re* E. H. Webb Grocery Company, 32 F. Supp. 3 (M. D. Tenn. 1940), only one day separated the dates of execution and recordation. The latter date was within the four month period. Although holding that the transaction did not constitute a preference, the court erroneously relies on Martin v. Commercial National Bank of Macon, Georgia, 245 U. S. 513 (1918), which Section 60 of the Chandler Act was specifically intended to overrule. *Hearings before Committee on the Judiciary on H. R. 8046,* 75th Cong., 1st Sess. (1937) 124.

21. Matters that might well be considered in this connection are the length of the interval, the reason for the delay in recording, the existence or non-existence of intervening creditors, and the value of the consideration given for the lien.

22. Section 70 (c) [11 U. S. C. § 110, (c), (1940)] provides: ". . . The trustee, as to all property in the possession or under the control of the bankrupt at the date of bankruptcy or otherwise coming into the possession of the bankruptcy court, shall be deemed vested *as of the date of bankruptcy* with all the rights, remedies, and powers of a creditor then holding a lien thereon by legal or equitable proceedings, whether or not such a creditor actually exists; and, as to all other property, the trustee shall be deemed vested as of the date of bankruptcy with all the rights, remedies, and powers of a judgment creditor then holding an

Another problem presents itself with respect to the claims of artisans or other persons who are often preferred over the claims of a prior conditional sales vendor or chattel mortgagee despite recording or filing.[23] Such holdings are based upon an implied authority in the mortgagor or conditional sales vendee.[24] Other authorities refuse to find in the possession of the mortgagor or conditional sales vendee any authority from the lien creditor to subject the chattel in question to a lien for repairs or other services.[25] It would

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execution duly returned unsatisfied, whether or not such a creditor actually exists." This status given the trustee is not new but was substantially enacted in 1910. See 36 STAT. 840 (1910). Although an unrecorded mortgage on conditional sales contract is made complete as a transfer by virtue of Section 60 (a) "immediately before bankruptcy" this is only for the purposes of (a) and (b) of that Section. It is not complete as far as Section 70 (c) is concerned, and although the rights given there to the trustee do not arise until bankruptcy they will be superior if a lien creditor or judgment creditor, as the case may be, would have superior rights to an unrecorded mortgage or conditional sales contract. Among the recent cases see: *In re* Peairs Lynch Stone Co., 45 F. Supp. 992 (W. D. Mo. 1942) (trustee in possession of chattel superior right by virtue of Section 70 (c) to vendor under unrecorded conditional sales contract); *In re* Rigney, 45 F. Supp. 845 (W. D. Mo. 1942) (trustee with status as judgment creditor by virtue of 70 (c) superior right to mortgagee under unrecorded mortgage). Where a pledgee fails to take possession a similar result follows unless the pledgor was in possession for a limited purpose only at the date of bankruptcy. Taplinger v. Northwestern Nat. Bank, 101 F. (2d) 274 (C. C. A. 3d, 1938). See *supra* note 51.

23. Weber Implement & Automobile Co. v. Pearson, 132 Ark. 101, 200 S. W. 273 (1917); New Britain Real Estate and Title Co. v. Collington, 102 Conn. 652, 129 Atl. 780 (1925); Etchen v. Dennis & Son Garage, 104 Kan. 241, 178 Pac. 408 (1919); Meyers v. Neeley & Ensor Auto Co., 143 Md. 107, 121 Atl. 916 (1923); Guaranty Security Corp. v. Brophy, 243 Mass. 597, 137 N. E. 751 (1923); Broom & Son v. Dale & Sons, 109 Miss. 52, 67 So. 659 (1915); Reeves & Co. v. Russell, 28 N. D. 265, 148 N. W. 654 (1914); BROWN, PERSONAL PROPERTY (1936) 482, 483, 484. Section 67 [11 U. S. C. § 107] provides: "Every lien against the property of a person obtained by attachment, judgment, levy, or other legal or equitable process or proceedings within four months before the filing of a petition . . . shall be deemed null and void (a) if at the time when such lien was obtained such person was insolvent. . . ." By the provisions of (67) (3) the court may on due notice order any such lien to be preserved for the benefit of the estate. However, liens of the type here mentioned would seem to be protected for 67 (b) states: "The provisions of Section 60 of this Act to the contrary notwithstanding, statutory liens in favor of employees, contractors, mechanics, landlords, or other classes of persons, and statutory liens for taxes and debts owing to the United States or any state or subdivision thereof, created or recognized by the laws of the United States or of any state, may be valid against the trustee, even though arising or perfected while the debtor is insolvent and within four months prior to the filing of the petition in bankruptcy. . . ." Common law possessory liens would not seem to be within either of these sections and if contemporaneous transactions not preferences.

24. See cases cited *supra* note 22.

25. Campbell Motor Co. v. Stanfield, 214 Ala. 506, 108 So. 515 (1926); Ehrlich v. Chapple, 311 Ill. 467, 143 N. E. 61 (1924); Indiana Truck Corp. of Kentucky v. Hurry Up Broadway Co., 222 Ky. 521, 1 S. W. (2d) 990 (1928); Metropolitan Securities Co. v. Orlow, 107 O. S. 583, 140 N. E. 306 (1923); Hartford Accident & Indemnity Co. v. Spofford, 126 Me. 392, 138 Atl. 769 (1927); Small v. Robinson, 69 Me. 425, 31 Am. Rep. 299 (1879); Corinth Engine & Boiler

seem, however, that in jurisdictions implying such authority the creditor may run a greater risk. Although he has recorded or filed his lien according to state law four months before the petition or while the debtor was solvent, he may not have perfected the transfer, for Section 60 (a) does not regard the transfer as made until "*no bona-fide purchaser* from the debtor and *no creditor* could thereafter have acquired *any rights* in the property so transferred superior to the rights of the transferee therein. . . ."[26] If not "so perfected prior to the filing of the petition in bankruptcy . . . it shall be deemed to have been made immediately before bankruptcy."[27] In order that such a preference may be avoided, it is necessary that the creditor receiving it or to be benefited thereby have "at the time when the transfer is made, reasonable cause to believe that the debtor is insolvent."[28] He may, of course, not have such reasonable cause immediately before bankruptcy. To deprive a man of his lien when he has done everything possible except, in effect, to require a pledge by a transfer of possession would be an unjustified hardship and would probably cause the discarding of this security device in states

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Works v. Mississippi Central R. R., 95 Miss. 817, 49 So. 262 (1909); Whitlock Machine Co. v. Holway, 92 Me. 414, 42 Atl. 799 (1899); General Motors Acceptance Corp. v. Sutherland, 122 Neb. 720, 241 N. W. 281 (1932); Shaw v. Webb, 131 Tenn. 173, 174 S. W. 273 (1915); Holt v. Schwartz (Tex. Civ. App.) 225 S. W. 856 (1920); Beecher v. Thompson, 120 Wash. 520, 207 Pac. 1056 (1922); Scott v. Mercer Garage & Auto Sales Co., 88 W. Va. 92, 106 S. E. 425 (1921); BROWN, *op. cit.* at 485, 486.

26. 52 STAT. 869 (1938), 11 U. S. C. § 96 (1940) *supra* note 3. To the effect that the words "no *bona fide* purchaser and no creditor" in Section 60 are in the alternative see *In re* Seim Construction Co., 37 F. Supp. 855, 859 (D. Md. 1941); *In re* Quaker City Sheet Metal Co., 129 F. (2d) 894, 897 (C. C. A. 3d, 1942). The importance of this determination is obvious. There are many situations where the transfer would be perfected against one and not the other. It must be admitted that Section 1, which is concerned with definitions, contains no provision that conjunctive words may be interpreted as disjunctive and *vice versa* unless otherwise required by the context. Even assuming such a rule of construction it is still not free from doubt whether or not the context of Section 60a is meant to set up a conjunctive rather than an alternative test. The discussion in the text is premised on this alternative interpretation and should be kept in mind in the consideration given to each security device. As the basis for holdings giving artisans or mechanics superior rights is implied (often contrary to fact) authority from the mortgagee, it can be argued that this should not render his interest imperfect (for bankruptcy purposes) any more than if he personally hired the repair work.

27. *Ibid.* Bankruptcy with reference to time is defined thus: ". . . 'or bankruptcy,' with respect to time, shall mean the date when the petition was filed." Section 1 (13) [52 STAT. 840 (1938), 11 U. S. C. § 1 (13) (1940)].

28. 52 STAT. 870 (1938) 11 U. S. C. § 96 (b) (1940) *supra* note 3. It is there provided that a preference (under Section 60) may be avoided by the trustee if the creditor receiving it or to be benefited thereby has *at the time when the transfer is made* reasonable cause to believe that the debtor is insolvent. For a discussion of the meaning "reasonable cause" see GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES (rev. ed. 1940) § 409 and cases cited.

having such a rule. Either the federal courts should apply this Section with considerable latitude or such states should, it would seem, change their law on this point.

There remain some difficult questions that arise when a mortgaged chattel is removed to a second state without the knowledge or consent of the foreign mortgagee.[29] As all but a very few jurisdictions[30] protect the interest of a foreign mortgagee against local attaching creditors of or *bona fide* purchasers from the mortgagor, his lien should be good as against the trustee of the bankrupt mortgagor.[31] However, in some jurisdictions where a mechanic's or materialman's lien is expressly given priority by local statute the lien is usually held to be superior to a foreign mortgagee's interest because of the added value to the chattel itself.[32] This might give the trustee of the mort-

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29. The same problem may exist where the removal is from one county to another county within a state. See UNIFORM CONDITIONAL SALES ACT § 14 and UNIFORM CHATTEL MORTGAGE ACT § 44.

30. RESTATEMENT, CONFLICT OF LAWS (1935), PA. ANNOT. (1936) § 268; TEX. ANNOT. (1935) § 268. Colorado adopting this minority view, has refused to enforce the claim of a vendor under a recorded, foreign conditional sales agreement as against a purchaser for value without notice [Turnbull v. Cole, 70 Colo. 364, 201 Pac. 887 (1921); Commercial Credit Co. v. Higbee, 92 Colo. 346, 20 P. (2d) 543 (1933)] but recognizes the validity of chattel mortgages recorded in other states. Flora v. Julesburg Motor Co., 69 Colo. 238, 193 Pac. 545 (1920). It has been suggested that the reason for this distinction may be the traditional judicial hostility toward the conditional sales contract. See Note (1934) 6 ROCKY MT. L. REV. 221, 222; HANNA, CASES AND MATERIALS ON SECURITY (2d ed. 1940) at 272.

31. Shepard v. Hynes, 104 Fed. 449, 453 (C. C. A. 8th, 1900); General Motors Acceptance Corp. v. Nuss, 196 So. 323 (La. Sup. Ct. 1940); Metro-Plan, Inc. v. Kotcher-Turner, Inc., 296 Mich. 400, 296 N. W. 304 (1941); Hart v. Oliver Farm Equipment Sales Co., 37 N. M. 267, 21 P. (2d) 96, 87 A. L. R. 962 (1933); Newsum v. Hoffman, 124 Tenn. 369, 137 S. W. 490 (1911); 2 BEALE, CONFLICT OF LAWS (1935) §§ 266, 268, 270, 271; GOODRICH, CONFLICT OF LAWS (2d ed. 1938) § 154; RESTATEMENT, CONFLICT OF LAWS (1935) § 268; ALA. ANNOT. (1939) § 268; CAL. ANNOT. (1939) § 268; LA. ANNOT. (1937) § 268; MO. ANNOT. (1937) § 268; MISS. ANNOT. (1935) § 268; MD. ANNOT. (1937) § 268; N. Y. ANNOT. (1935) § 268; OKLA. ANNOT. (1937) § 268; WASH. ANNOT. (1940) § 268; W. VA. ANNOT. (1937) § 268. Whether this protection of the mortgagee or security holder is a rule of common law or a rule of jurisdiction makes no difference, either way the "title" or interest of the mortgagee is protected. For two interesting cases reaching contrary holdings in a situation involving a triple situs see Fuller v. Webster, 5 Boyce (Del.) 538, 95 Atl. 335 (1915); Forgan v. Bainbridge, 34 Ariz. 408, 274 Pac. 155 (1928).

32. Willys Overland Co. of California v. Chapman, 206 S. W. 978 (Tex. Civ. App. 1918); Snyder v. Yates, 112 Tenn. 309, 79 S. W. 796 (1903); 2 BEALE *op. cit. supra* note 18, § 279.2 (stating that the determinant is the value added); JONES, CHATTEL MORTGAGES AND CONDITIONAL SALES (6th ed. 1933) § 474; RESTATEMENT, CONFLICT OF LAWS (1935) § 268, comment *d*; MD. ANNOT. (1937) § 268. Courts have with equal consistency denied priority where no value has been added to the chattel itself. Smith's Transfer & Storage Co. v. Reliable Stores Corp., 58 F. (2d) 511 (1932) (warehouseman's lien); Metzger v. Columbia Terminals

gagor the right to avoid the mortgagor's lien for here again the transfer was not so far perfected that no creditor could thereafter have acquired any rights in the property so transferred superior to the rights of the transferee therein.[33] It would seem that as the mortgagee had perfected the transfer, it should not be later considered imperfect for bankruptcy purposes simply because its removal (without his knowledge) caused it to be subject to this type of lien.[34] Previous reasoning would also apply. If by operation of Section 60 it is deemed perfected immediately before bankruptcy[35] then the requirement of "reasonable cause"[36] would appear almost insuperable, for a man who does not know of his debtor's removal from the state will generally not know of his insolvency. The same considerations apply where a chattel sold under a conditional sales contract is removed from the state without the consent or knowledge of the vendor.[37]

A harsh rule may be made even harsher in those jurisdictions that afford no protection to a mortgagee or conditional sales vendor whose chattel has been moved there without his consent.[38] Although he records within a reasonable time after knowledge it may be regarded as a preference if within the four month period. Removal under such conditions should not make a transfer once perfect imperfect within this Section. If the mortgage or contract is not recorded at the date of the filing of the petition, the trustee will generally prevail by virtue of the status conferred on him by Section 70 (c), and it would be immaterial whether or not a voidable preference existed under Section 60.[39]

Where a chattel is removed with the consent or knowledge of the mortgagee, either at the time of its removal or later, protection is denied against local attaching creditors of or *bona fide* purchasers from his debtor.[40] To regard the transfer that was once perfect as now imperfect by reason of

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Co., 227 Mo. App. 135, 50 S. W. (2d) 680 (1932) (carrier's lien). Alabama holds that until the thirty days allowed for recordation have elapsed the lien of the mortgagee shall be superior to all liens. RESTATEMENT, CONFLICT OF LAWS (1939), ALA. ANNOT. (1939) § 268. For a recent case subjecting a foreign mortgagee's interest (where there had been a removal from the state without his knowledge) to a tax lien in the second state, see First National Bank of Valentine, Neb. v. Peterson, 67 S. D. 400, 293 N. W. 530 (1940).

33. 52 STAT. 869 (1938) 11 U. S. C. § 96 (a) (1940) *supra* notes 3, 26.
34. See note 23 *supra.*
35. See note 3 *supra.*
36. See note 28 *supra.*
37. But see note 46 *infra.*
38. See note 30 *supra.*
39. See note 22 *supra.*
40. *In re* Peairs Lynch Stone Co., 45 F. Supp. 992 (W. D. Mo. 1942);

the failure to record within a reasonable period of time after knowledge seems fair enough under these circumstances. The establishment of a voidable preference under Section 60 will be unnecessary, however, where possession or recording does not take place before the petition is filed. The status given the trustee under Section 70 (c) will generally enable him to prevail in this situation unless, of course, bankruptcy ensues within such a short period of time after knowledge of removal that the creditor did not have a reasonable period of time to record.[41]

There thus remains the question as to what amount of time such a creditor should have in which to record (if necessary in the second state) where knowledge of removal is subsequently acquired. Under the Uniform Conditional Sales Act[42] and Uniform Chattel Mortgage Act[43] the creditor is given ten days after knowledge of removal to record, protection being extended meanwhile. Certainly some such reasonable time should be allowed. Failure to record before the elapse of this period should and does result in the loss of protection. As previously indicated, however, a recording after the elapse of this period but before bankruptcy will make it necessary for the trustee to resort to Section 60 unless there exists a creditor who had fixed a lien on the property before the recordation date, in which case the trustee can take his place and overthrow the claim.[44]

Universal Credit Co. v. Finn, 212 Wis. 601, 250 N. W. 391 (1933) (notice to creditor not equivalent to filing under § 14 of Uniform Conditional Sales Act); Thayer Mercantile Co. v. First National Bank, 98 N. J. L. 29, 19 Atl. 94 (1922); Banks-Miller Supply Co. v. Bank, 106 W. Va. 523, 146 S. E. 521 (1929) (notice to creditor equivalent to filing).

41. *In re* Peairs Lynch Stone Co., 45 F. Supp. 992 (W. D. Mo. 1942) (conditional sales vendor knew or later acquired knowledge of removal of crusher from Arkansas, where such contracts need not be recorded, to Nebraska, where recording is required. Held, having failed to record in Nebraska the trustee could assert a lien superior to seller's claim under contract. The court said the lien having been contracted four months before bankruptcy the vendor could have filed the contract for record in Nebraska within four months of bankruptcy. Presumably only a reasonable time would be allowed. The decision was properly based on the lien given the trustee by § 70 (c).). See note 22 *supra.*

42. § 14. The following jurisdictions have enacted the Uniform Act: Alaska, Arizona, Delaware, Indiana (substantially), New Jersey, New York, Pennsylvania, South Dakota, West Virginia, Wisconsin. HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS (1941) at 335.

43. § 44. Only Indiana has adopted the Uniform Act. HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS (1941) at 335.

44. Resort to § 60 was generally necessary also if possession was obtained by the mortgagee or vendor prior to the filing of the petition subject to the qualification above. For the right of the trustee to take the place of a creditor who had fixed a lien before this time see discussion *supra.*

CONDITIONAL SALES

Similar problems are presented with respect to conditional sales. In those states where such contracts are dealt with under the mortgage theory,[45] the same construction should apply to both mortgages and conditional sales. In those states which deal with them under the title theory, the effect of the Act remains unascertained.[46] Although title to the property has never resided in the debtor, he has the same interest in it before recordation of the contract as he has in the case of a mortgage. He may pass title to a *bona fide* purchaser,[47] and lien creditors are able to subject it to their claims.[48] Recordation of the contract would appear, then, to constitute a transfer of this interest or the fixing of a lien on the property. Where the contract was made some time before but not recorded until within the four month period, it would appear to be equally "for or on account of an antecedent debt," and the other requisites present a voidable preference. There is support for this in the legislative history of the Act.

EQUITABLE PLEDGE

Under the now outmoded "relation back" doctrine, an equitable pledgee[49] who took possession within the four month period was able to refer his pos-

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45. *E.g.* TEX. REV. STAT. (Vernon, 1925) Art. 5489; see Note (1933) 83 A. L. R. 1279.

46. Under the strict view, exemplified in Bailey v. Baker Ice Machine Company, 239 U. S. 268 (1915), the property never having been in the vendee a recordation within the four month period could not be a transfer of the bankrupt's property. If the doctrine of that case is applied to the new wording of the section, then conditional sales contracts will be excluded from its operation.

47. Practically all the states that require recordation protect a *bona fide* purchaser when the contract is not recorded. The state statutes are compiled in 3 JONES, *op. cit. supra* note 13, §§ 1008-1056; *Id.* (1940 Supp.) §§ 1008-1056. See also UNIFORM CONDITIONAL SALES ACT § 4.

48. Under the Uniform Conditional Sales Act, § 5, the creditor must levy on or attach the goods without notice of the terms of the sale before he can defeat the vendor's retained title. Filing within ten days protects the vendor against creditors of the vendee. Assuming that under state law an unfiled chattel mortgage or conditional sales contract is good except against attaching creditors and *bona fide* purchasers, an argument could be made that they may be perfected as statutory liens under 67 (b) within four months of bankruptcy or even after the filing of the petition. The legislative history of Section 60 (*supra* note 17) and the wording of Section 67 (b) (*supra* note 23) rather obviously indicates, however, that 67 (b) has no reference to security transfers. This inquiry is nevertheless suggested by White v. Karl Kiefer Machine Co., 127 F. (2d) 119 (C. C. A. 8th, 1942).

49. The equitable pledge is an outgrowth of the legal pledge, and differs only in that in the former possession is retained by the pledgor. It has found great favor with business men. RESTATEMENT, SECURITY (1941) § 10. A pledge imperfect due to want of delivery gives rise to an equitable lien. Goldstein v. Rusch, 56 F. (2d) 10 (C. C. A. 2d, 1932); Murry v. Central Bank, 226 Mo. App.

session back to the time of the original agreement.[50] This seems to have been but another example of the relaxation of the rule requiring possession or delivery for a valid pledge.[51] By this device an equitable pledgee who obtained possession within the period acquired a legal pledge as of the date of the agreement. Such interpretation expanded the ever increasing fields in which use of the equitable pledge was finding favor. The pledgee obtained all the protection of a valid pledge[52] without attendant difficulties. The debt was secured, and yet the debtor left the free use of the property by means of which payment was more readily assured. The business advantages to both were accordingly great. Another use to which this device was put was the taking of possession of a chattel before bankruptcy by a mortgagee who had failed to record.[53] By the new Act the date on which possession is obtained or when it will stand as against creditors and innocent purchasers governs rather than the time of the original agreement. If possession is not transferred then, the transfer is considered to have been perfected immediately before bankruptcy for the purposes of subdivisions (a) and (b) of Section 60.

400, 40 S. W. (2d) 721 (1931). An agreement that creates an equitable pledge must relate to specific property. Mechanics' and Metals' National Bank of the City of N. Y. v. Ernst, 231 U. S. 60 (1913); GLENN *op. cit. supra* note 8, § 483.

50. Sexton v. Kessler and Co., Ltd., 225 U. S. 90 (1912); Humphrey v. Tatman, 198 U. S. 91 (1905); Thompson v. Fairbanks, 196 U. S. 516 (1905); Tobin v. Insurance Agency Co., 80 F. (2d) 241 (C. C. A. 8th, 1935); Johnson v. Burke Manor Building Corp., 48 F. (2d) 1031 (C. C. A. 7th, 1931); Jordan v. Greenwood, 23 F. (2d) 506 (D. Me. 1928). *Contra*: *In re* Herkimer Mills Co., Inc., 39 F. (2d) 625 (N. D. N. Y. 1930).

51. Security Warehousing Co. v. Hand, 206 U. S. 415 (1907); Sammett v. Mayer, 108 F. (2d) 337 (C. C. A. 2d, 1939; *In re* Spanish-American Cork Products Co., 2 F. (2d) 203 (C. C. A. 4th, 1924). It was not long before the inexpediency of such a strict rule manifested itself, and as a result legal pledges of intangibles represented by indispensable documents were allowed. Goldstein v. Rusch, 56 F. (2d) 10 (C. C. A. 2d, 1932), *cert. denied*, 287 U. S. 604 (1932); Clarke v. Chapman, 215 Mich. 518, 184 N. W. 497 (1921). See Note (1937) 37 COL. L. REV. 621.

52. As long as it was simply an equitable pledge the pledgee assumed the risk of his rights being subordinated to an intervening *bona fide* purchaser from the pledgor or attaching or levying creditors who became creditors of the pledgor without notice of the equitable interest. RESTATEMENT, SECURITY (1941) § 10. There seems to be little authority that the levying creditor with notice will be subordinate to the pledgee. See Note (1937) 37 COL. L. REV. 621, 624, n. 21. Contrast the rule of the Restatement with the rule of the Uniform Trust Receipts Act § 8, subd. 3) and of the Uniform Conditional Sales Act (§ 5) protecting the entrustor or vendor as against levying or attaching creditors with notice.

53. Thus a conditional sales vendor or chattel mortgagee could head off creditors by taking possession of the security prior to an attachment or judgment. The transaction was then turned into a pledge, with pledgee in possession, and the security device lost its original nature and presented only the case of a contract terminated by repossession, or under modern statutes, the case of a pledge with pledgee in possession.

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Thus, to establish a voidable preference it would be necessary for the trustee to show the pledgee had "reasonable cause" to believe the debtor insolvent at the time the transfer was perfected. But if possession has not actually been transferred before the date of the petition, the trustee can probably prevail by virtue of his status under Section 70 (c) without resort to Section 60.[54] The validity of a pledge being solely a matter of state law, a statute passed by the state making an equitable pledge, in effect, a valid legal pledge as of the date of the original agreement or one limiting the rights of a *bona fide* purchaser and lien creditor against an equitable pledgee, would suffice to effect a reaffirmation of this device.

One other matter should be mentioned. The bankruptcy amendment will most effectually strike down a doctrine that heretofore has been capable of great elasticity according to the judicial inclination. The rule referred to is the one permitting a pledgor to have possession of the security for temporary and limited purposes, a rule which is so well settled that it found its way into the Security Restatement.[55] If the return of possession to the pledgor was kept well within the purpose of this rule, the pledgee was protected against attaching creditors of the pledgor and formerly, at least, against his trustee in bankruptcy.[56] Never, however, was such protection extended as against a *bona fide* purchaser from the pledgor.[57] It would cer-

54. See note 22 *supra.*

55. RESTATEMENT, SECURITY (1941) § 11. The purpose must relate to the maintenance of the value of the pledgee's interest and have to do with the protection, improvement or sale of the chattel, or where the chattel is an instrument or document, its handling or collection.

56. Sexton v. Kessler and Co., Ltd., 225 U. S. 90 (1912). As to judgment or attaching creditors, see Hulton v. Arnett, 51 Ill. 198 (1869); Hilliker v. Kuhn, 71 Cal. 214, 16 Pac. 707 (1886); Clare v. Agerter, 47 Kan. 604, 28 Pac. 694 (1892). As to trustee in bankruptcy, see Sexton v. Kessler and Co., Ltd., *supra*; Petition of Chattanooga Savings Bank, 261 Fed. 116 (C. C. A. 6th, 1919). In this connection the distinction between the temporary return for limited purposes of a pledged article to the pledgor and the surrender of possession by a possessory lienor should be noted. The lienor will generally retain a legal interest good against everyone if he is involuntarily deprived of possession while a voluntary surrender will destroy the lien so far as creditors and purchasers from the bailor are concerned. If surrendered under circumstances imposing an obligation on the bailor to return it, the lienor can recover the chattel from the bailor and others except a *bona fide* purchaser for value and an officer of the law who has levied on or attached the chattel at the instance of one who has become a creditor without notice of the lienor's interest. RESTATEMENT, SECURITY (1941) § 80.

57. RESTATEMENT, SECURITY (1941) § 11, comment c; Walker v. Staples, 5 Allen 34 (Mass. 1862); Stockyards Nat. Bank of St. Paul, Minn. v. First Nat. Bank of Towner, N. D., 249 Fed. 421 (C. C. A. 8th, 1918). If, however, the conjunctive "and" is given its literal interpretation, the return for the limited period would be good against creditors and hence the trustee. This is true, of course, of many of the situations discussed previously.

tainly seem, therefore, that under the new Act the pledgee will receive no protection as against the trustee in bankruptcy of the pledgor. The trustee will, however, have to establish "reasonable cause" on the pledgee's part at the time the transfer is perfected by the Act, immediately before bankruptcy. A state statute could, of course, by limiting the rights of a *bona fide* purchaser, reinstate the practice of returning goods for such purposes with as great a degree of protection as formerly had.

INTANGIBLES

There has long been a conflict in the states with respect to whether or not a subsequent assignee of an account receivable who first gives notice to the debtor will be preferred over a prior assignee. A long line of decisions has followed the English rule preferring the subsequent assignee in this situation[58] while many other jurisdictions have refused to do so.[59] The recent trend is probably toward the latter view.[60] In all jurisdictions the assignment is valid as between the parties without notice to the debtor. Under the old Bankruptcy Act it was, of course, immaterial which of these views was followed. The measurement of the trustee's rights by the status of a *bona fide* purchaser under Section 60 will now make an assignment not followed by notice until within four months of bankruptcy a preference in those jurisdictions having the English rule.[61] In jurisdictions not following

58. Dearle v. Hall, 3 Russ. 1, 38 Eng. Rep. 475 (Ch. 1827) is the leading case setting down this rule. The most recent decisions following it are: *In re* Quaker City Sheet Metal Co., 129 F. (2d) 894 (C. C. A. 3d, 1942) *aff'd sub nom.* Corn Exchange National Bank and Trust Co. v. Klauder, 11 U. S. LAW WEEK 4242 (U. S. 1943), and *In re* Seim Construction Co., 37 F. Supp. 855 (D. Md. 1941). See Notes (1934) 31 A. L. R. 876; (1937) 110 A. L. R. 774 for decisions in California, District of Columbia, Iowa, Maine, Maryland, Mississippi, Missouri, New Jersey, Ohio, Oklahoma, Pennsylvania, Tennessee, Vermont and Virginia.

59. Salem Trust Co. v. Manufacturers' Finance Co., 264 U. S. 182 (1924) (not controlling on states in view of Erie R. R. v. Tompkins). See Notes cited *supra* note 58 for decisions to this effect in Kentucky, Massachusetts, New York, Oregon, South Dakota, Texas, West Virginia and other federal courts. New Jersey and Iowa in later decisions repudiated the rule of Dearle v. Hall *supra* note 58, *e.g.*, Moorestown Trust Co. v. Buzby, 109 N. J. Eq. 409, 157 Atl. 663 (1932); Ottumwa Boiler Works v. O'Meara and Son, 206 Iowa 577, 218 N. W. 920 (1928). For an explanation of these opposing views, see Neuhoff, *Assignments of Accounts Receivable as Affected by the Chandler Act* (1940) 34 ILL. L. REV. 538; Hamilton, *The Effect of Section Sixty of the Bankruptcy Act upon Assignments of Accounts Receivable* (1939) 26 VA. L. REV. 168.

60. See Notes *supra* note 58. This is the view set forth in RESTATEMENT, CONTRACTS (1932) § 173.

61. *In re* Quaker Sheet Metal Co., 129 F. (2d) 894 (C. C. A. 3d, 1942) *supra* note 15; *In re* Seim Construction Co., 37 F. Supp. 855 (D. Md. 1941). In order to avoid the preference the trustee will have to show reasonable cause on the assignee's part to believe the assignor insolvent at the time of notice to the

the English rule it would seem necessary, however, for the first assignee, in order to preserve his rights, to give notice to the debtor because: "Whatever view may be entertained as to the English doctrine which prefers the assignee who first gives notice, the second assignee [assuming that he paid value in good faith for his assignment, or that if a volunteer, he took in good faith, and the first assignee also was a volunteer] is in several contingencies clearly entitled to supplant the first assignee, *e.g.*, (1) if acting in good faith he obtains payment of the claim assigned; or, (2) if he reduces his claim to a judgment in his own name; or, (3) if he effects a novation with the obligor, whereby the obligation in favor of the assignor is superseded by a new one running to himself, or, (4) if he obtains the document containing the obligation when the latter is in the form of a specialty. In all these cases, having obtained a legal right in good faith and for value, the prior assignee cannot properly deprive him of his legal right."[62]

Thus, irrespective of whether or not a jurisdiction adheres to the English view, it may be necessary for an assignee to give notice to the obligor. Otherwise jurisdictions recognizing any of these rules will prefer subsequent assignees who do those things, and this mere possibility may render an assignment imperfect right down to immediately before bankruptcy, at which time it is perfected by virtue of Section 60.[63] Being within the four month

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debtor, or if notice is not given when the transfer is perfected by Section 60, immediately before bankruptcy.

62. 2 WILLISTON, CONTRACTS (rev. ed. 1938) § 435, at page 1260. For authorities supporting these exceptions see cases cited by Williston in the notes to this quotation, and *Id.* (Supp. 1940) § 435. See also RESTATEMENT, CONTRACTS (1932) § 173. A recent case opposed to this view is State Factors Corporation v. Sales Factors Corp., 257 App. Div. 101, 12 N. Y. S. (2d) 12 (1st Dep't. 1939). (Failure of assignee of accounts receivable to give notice to debtor does not affect his right to recover from subsequent assignee who collected in good faith from debtors.) It must be admitted that the bankruptcy cases that have arisen involving such assignments have not considered these possibilities at all. See *In re* Quaker City Sheet Metal Co., 129 F. (2d) 894 (C. C. A. 3d, 1942) *aff'd sub nom.* Corn Exchange National Bank and Trust Co. v. Klauder, 11 U. S. LAW WEEK 4242 (U. S. 1943) cited *supra* note 15; Rockmore v. Lehman, 129 F. (2d) 892 (C. C. A. 2d, 1942); Schwartz v. Horowitz, 131 F. (2d) 506 (C. C. A. 2d, 1942); Associated Seed Growers, Inc. v. Geib, 125 F. (2d) 683 (C. C. A. 4th, 1942) cited *supra* note 15; Swetnam v. Wright Ginsburg Corp., 128 F. (2d) 1 (C. C. A. 2d, 1942) *cert. denied*, 63 S. Ct. 42 (1942); *In re* Seim Construction Co., 37 F. Supp. 855 (D. Md. 1941) cited *supra* note 15.

63. The possibility also exists that a creditor of the assignor may garnishee the debt due from the obligor to the assignor. If notice of the assignment is not given to the obligor and he has no reason to know of it he will be discharged from his duty to the assignee if the creditor obtains judgment against him. RESTATEMENT, CONTRACTS (1932) § 172. This possibility of a creditor obtaining superior rights to the assignee would also seem to render the assignment imperfect.

period, and also for an antecedent debt, it will constitute a preference voidable by the trustee if the assignee at that time has reasonable cause to believe the assignor insolvent.

Other problems arise in the case of pledges of future accounts and in situations involving returned goods. With respect to the former it is clear that the substitution of one account for another is permissible.[64] The greatest problem seems to center around the use of the proceeds of the sale, or collection of the already pledged account.[65] Where the pledgor has been given absolute control over the use of the proceeds it has generally been held invalid as against the trustee in bankruptcy.[66] In New York some act must be done after the account comes into existence before the pledge is complete. In *Okin v. Isaac Goldman Co.*,[67] the court said "the rule[68] does not apply as against a trustee in bankruptcy or execution creditor to either personal chattels or to choses in action when they are subject to sale or use by the assignor in his business."

The collection of the proceeds by the assignor will not, however, invalidate the assignee's lien so long as an accounting is made to the assignee.[69] Heretofore the validity of the pledge of "returned goods" hinged on the extent of the power of the borrower to dispose of the goods or the proceeds of their sale and the necessity of consulting or accounting to the lender. Where returned goods are included in the agreement as part of the security there is a true equitable pledge.[70] These two fundamental security devices likewise face a material disembodiment in many states unless the "relation back" doctrine be in effect reestablished by new legislation.

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64. *E.g.*, Benedict v. Ratner, 268 U. S. 353 (1925); Okin v. Isaac Goldman Co., 79 F. (2d) 317 (C. C. A. 2d, 1935); Manufacturers Finance Co. v. Armstrong, 78 F. (2d) 289 (C. C. A. 4th, 1935); *In re* Vanity Fair Slippers, Inc., 4 F. Supp. 83 (S. D. N. Y. 1933). In New York such a lien is generally held to take effect when the future chose in action becomes the property of the promisor, Central Trust Co. of New York v. West India Improvement Co., 169 N. Y. 314, 62 N. E. 387, 391 (1901). *Cf.* Barnes v. Alexander, 232 U. S. 117 (1914).

65. Miller, *An Assignment of Accounts Receivable as a Security Device* (1937) 22 MARQ. L. R51. 28.

66. Benedict v. Ratner, 268 U. S. 353 (1925); Irving Trust Co. v. Finance Service Co., 63 F. (2d) 694 (C. C. A. 2d, 1933); Lee v. State Bank & Trust Co., 38 F. (2d) 45 (C. C. A. 2d, 1930).

67. 79 F. (2d) 317, 319 (C. C. A. 2d, 1930).

68. See note 64 *supra*.

69. Manufacturers Finance Co. v. Armstrong, 78 F. (2d) 289 (C. C. A. 4th, 1935).

70. Sammett v. Mayer, 108 F. (2d) 337 (C. C. A. 2d, 1939); Goldstein v. Rusch, 56 F. (2d) 10 (C. C. A. 2d, 1932); *In re* Bernard & Katz, Inc., 38 F. (2d) 40 (C. C. A. 2d, 1930).

Most American jurisdictions afford no protection to a mortgagee of a stock of goods where the mortgagor is allowed to retain possession and to offer them for sale in the usual course of business.[71] This holds true regardless of whether or not the mortgage is recorded.[72] The policy back of such stringency is the interest in protecting creditors who transact business with the mortgagor relying upon the mortgagor's possession of a stock of goods as security for the amounts due them. A minority of jurisdictions, following the lead of Michigan, accords fully validity and effect to stock in trade mortgages, holding superior the mortgagee's rights to the claims of creditors.[73] A few jurisdictions, however, take the position that the mortgage is ineffectual to create a lien only with respect to the stock acquired subsequent to execution of the mortgage, but that it is valid as to existing stock.[74] In a number of the states that hold such a mortgage is invalid as to creditors the courts have held that if the mortgagee obtains possession of the goods after default under the terms of the mortgage and prior to the acquisition of liens by creditors, his position is superior to that of general creditors.[75] Massachusetts has adopted a theory that such a device gives the mortgagee a right in the nature of an equitable lien and is valid provided possession is taken before bankruptcy or attachment.[76] Reposses-

71. See Cohen and Gerber, *Mortgages of Merchandise* (1939) 39 COL. L. REV. 1338.

72. *E.g.*, Freeman v. Rawson, 5 Ohio St. 1 (1855); Turk v. Kramer, 138 Okla. 35, 280 Pac. 266 (1929). See also Note (1939) 39 COL. L. REV. 1338, 1339 n. 5.

73. Gay v. Bidwell, 7 Mich. 519 (1859); Johnson v. Patterson, 13 Fed. Cas. 780, No. 7403 (C. C. N. D. Ga. 1875). See also Ga. Code (1933) §§ 67-103 and Note (1939) 39 COL. L. REV. 1338, 1342 n. 18.

74. Vogler, Wagner & Co. v. Smith, 10 Ky. L. Rep. 364 (1888) (valid as to existing stock); Sandy Valley Grocery Co. v. Patrick, 267 Ky. 768, 103 S. W. (2d) 307 (1937) (invalid as to after-acquired stock); Williams v. Noyes & Nutter Mfg. Co., 112 Me. 408, 92 Atl. 482 (1914); First Nat. Bank of Baltimore v. Lindenstruth, 79 Md. 136, 28 Atl. 807 (1894); Zartman v. First Nat. Bank of Waterloo, 189 N. Y. 267, 82 N. E. 127 (1907).

75. Kettenbach v. Walker, 32 Idaho 544, 186 Pac. 912 (1919); Southwestern Port Huron Co. v. Carraker, 133 Ill. App. 245 (1907); Barton v. Sitlington, 128 Mo. 164, 30 S. W. 514 (1895); Chaffee v. Atlas Lumber Co., 43 Neb. 224, 61 N. W. 637 (1895); Francisco v. Ryan, 54 Ohio St. 307, 43 N. E. 1045 (1896); Snow v. Cody, 96 Okla. 81, 220 Pac. 578 (1923); First Nat. Bank of Burns v. Frazier, 143 Ore. 662, 22 P. (2d) 325 (1933); Cook & Co. v. Corthell, 11 R. I. 482 (1877); Ayers, Weatherwax & Reid Co. v. Sundback, 5 S. D. 31, 58 N. W. 4 (1894).

76. Chase v. Denny, 130 Mass. 566 (1881). *In re* Markert, 45 F. Supp. 661 (D. Mass. 1942) (taking of possession of after-acquired property under recorded

sion in these latter states would not, it would seem, be related back to the date of the original agreement under present Section 60 of the Bankruptcy Act. State legislation could, as in the case of the pledge, relate possession back to the date of the original agreement. In the states that invalidate such a mortgage the Chandler Act makes no change, for the trustee always could recover the property. There is the additional difficulty in all these cases, however, that a *bona fide* purchaser in the ordinary course of business obtains good title to the goods. It is quite possible the Act might be so interpreted that such mortgages could never be perfected, for such goods are for sale and there can always be a *bona fide* purchaser who can obtain superior rights to the mortgagee.[77] A similar problem arises, of course, in the case of trust receipts where the goods can be sold by the trustee in the ordinary course of business.[78] It is reasonable, it would seem, to hold, however, that as the mortgagee or entrustor in these cases took his security with sales (in the ordinary course of business) in mind, what interest was conveyed to him (an interest subject to the rights of purchasers in the ordinary course of business) is perfected, and the possibility of a purchaser in the ordinary course of business obtaining the goods is irrelevant. It is otherwise, of course, where creditors or purchasers out of the ordinary business can obtain superior rights because here they are definitely infringing on the interest sought to be conveyed to him. In the latter situation the transfer is not perfected until it is good as against such parties.

After-Acquired Property

The operation and validity of an after-acquired property clause in a mortgage has been the subject of countless discourses and numerous articles.[79] Equity at an early date permitted such mortgages.[80] Today such

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free handed mortgage on stock of merchandise by mortgagee two days before bankruptcy constituted, other requisites being present, a voidable preference). It has been pointed out that in Massachusetts possession under such a mortgage must be taken by the mortgagee to perfect his title as against attaching creditors and purchasers.

77. Of course for the purposes of subdivisions (a) and (b) of § 60 it will be perfected immediately before bankruptcy.

78. The Uniform Act provides a thirty day period of validity for the entrustor's security interest without filing (§ 8 (1)) but, irrespective of filing, full protection is accorded a "buyer in the ordinary course of trade" (§ 9 (2) (a)).

79. See Note (1935) 7 Rocky Mt. L. Rev. 264, n. 1.

80. Holroyd v. Marshall, 10 H. L. Cas. 191 (1861); Mitchell v. Winslow, 17 Fed. Cas. 527, No. 9673 (C. C. D. Me. 1843).

a mortgage, if recorded, is superior to the claims of subsequent purchasers[81] and creditors[82] in some states. In some states possession by the mortgagee before the claims of purchasers or lien creditors accrue will be superior, but otherwise the mortgagee will not be protected even though he has recorded.[83] Under this rule the Chandler Act would make preferences the title of mortgagees who have taken possession within four months of the petition.[84] As the great majority of jurisdictions do not protect the mortgagee even when the mortgage is recorded as against one or the other of these groups, it would seem that as to after-acquired property the security will not be perfected (in the absence of possession being taken) for the purposes of Section 60 until immediately before bankruptcy.[85] If possession has been taken and there is no lien creditor whose place the trustee is entitled to take, the trustee must rely on Section 60. If possession has not been taken and such clauses are no protection against creditors, the trustee will prevail by virtue of the status conferred on him by Section 70 (c).[86]

Trust Receipts

The general rule, in jurisdictions not having the Uniform Act, upholds the validity of only the tripartite arrangement without the necessity of filing.[87] A few jurisdictions require recording of both bipartite and tripartite trust transactions.[88] In some jurisdictions the status of the trust receipt still remains undetermined.[89] The Uniform Act validates both tripartite and

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81. Loupee v. Mich. Cent. R. R., 243 Mich. 144, 219 N. W. 727 (1928); Bonneville Lumber Co. v. Peppard Seed Co., 72 Utah 463, 271 Pac. 226 (1928).

82. Waters v. Ellington & Co., 289 S. W. 417 (Tex. Civ. App. 1926); Smithhurst v. Edmunds, 14 N. J. Eq. 408 (Ch. 1862).

83. *E.g.*, Wasserman v. McDonnell, 190 Mass. 326, 76 N. E. 959, 960 (1906). See also Cohen & Gerber, *The After-Acquired Property Clause* (1939) 87 U. of Pa. L. Rev. 635, 639.

84. Assuming of course a lapse of time sufficiently great between the loan and taking possession so as to make it a transfer for an antecedent debt.

85. And then only for the purposes of this Section.

86. See note 22 *supra.*

87. 1 Jones, Chattel Mortgages and Conditional Sales (6th ed. 1933) § 33e, p. 60. See also Note (1933) 17 Minn. L. Rev. 790, 792 n. 9.

88. Michigan, Wisconsin and Kentucky have held that trust receipts should be recorded as chattel mortgages: Motor Bankers' Corp. v. C. I. T. Corp., 258 Mich. 301, 241 N. W. 911 (1932); Matter of Lee, 6 A. B. R. (N. S.) 437 (Dist. Ct. Wis. 1923); General Motors Acceptance Corp. v. Sharp Motor Sales Co., 233 Ky. 290, 293 (1930). In some instances they have been held to be conditional sales, and to require filing as such: General Motors Acceptance Corp. v. Mayberry, 195 N. C. 508, 142 S. E. 767 (1928); Central Acceptance Corp. v. Lynch, 58 F. (2d) 915 (C. C. A. 6th, 1932); Industrial Finance Corp. v. Capplemann, 284 Fed. 8 (C. C. A. 4th, 1922).

89. *E.g.*, Missouri. See Note, *Trust Receipts in Missouri* (1942) 7 Mo. L. Rev. 302.

bipartite trust receipt transactions but requires filing in case the goods are to be held by the borrower for substantial periods of time.[90] To the extent that recording is required the transaction will be governed precisely the same as chattel mortgages or conditional sales contracts discussed previously. However, even under the Uniform Act a purchaser in the ordinary course of business from a borrower with unlimited power of sale gets title free of the trust receipt, regardless of filing.[91] And even though the sale violates the limited authority of the borrower, only actual knowledge of the limitation on the part of the purchaser will affect his title.[92] In these situations it is accordingly possible for a *bona fide* purchaser to obtain superior rights to the entrustor, and a literal interpretation of Section 60 might render the entrustor's security imperfect down to immediately before bankruptcy. It is possible to argue that as the interest conveyed to the entrustor did not seek to embrace protection against such purchasers, the probability of such purchasers is irrelevant as they do not divest and render imperfect an interest he did not have or intend to have. Where the trustee has no such power of sale and a purchaser nevertheless obtains superior rights, this argument would not apply. An interpretation of the Chandler Act to invalidate these transactions would seem undesirable but in any case would leave the way open for appropriate state legislation changing the status of the entrustor in these situations.

CONCLUSION

No attempt has been made to cover all the situations in which different security devices may be jeopardized with respect to bankruptcy because of the possibility that the transfer will not be regarded as complete as against

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90. By § 8 (1) the lender is protected in his trust receipt security for thirty days without filing. After thirty days the trust receipt is invalid against lien creditors who have obtained a lien without actual notice if (a) the trust receipt was not filed or (b) the lender did not take possession before the acquisition of the lien (§ 8 (2)). Creditors who have acquired their claims by processing, warehousing or shipping goods held under a trust receipt are superior to the lender to the extent of their liens (§ 11). A purchaser out of the ordinary course of business, including a chattel mortgagee, a pledgee, a buyer in bulk, takes subject even to an unfiled trust receipt, except in the case of a mortgagee or pledgee for new value who obtains possession prior to filing (§ 9 (2) (b)). See HANNA, CASES AND MATERIALS ON SECURITY (2d ed. 1940) 237. The following jurisdictions have adopted the Uniform Act: California, Connecticut, Illinois, Indiana, Maryland, Massachusetts, Nevada, New Hampshire, New Jersey, New York, Oregon, Pennsylvania, Tennessee. HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS (1941) at 339.

91. Section 9 (2) (i).

92. Section 9 (2) (ii).

creditors and *bona fide* purchasers. A sufficient number have been indicated to show that a strict interpretation of Section 60 may endanger the usefulness and value of many of them perhaps not contemplated by the framers of the Act. It has been pointed out in this connection, however, that while the American Bar Association members and bankers' counsel, who might have been expected to guard the rights of secured creditors, were represented at the National Bankruptcy Conference, the actual drafting of the Act was entrusted to a group little inclined by predilection or self-interest to a sympathetic understanding of the legitimate protection to which security interests are entitled in bankruptcy.[93] It should not be forgotten that the constitutional authority of Congress in bankruptcy matters is itself subject to the Fifth Amendment.[94] Since an interpretation of an ambiguous statute is favored which keeps it within constitutional limits, it is possible that this consideration will influence the courts in restricting the scope of the literal words of Section 60. Then, too, the interpretation to be ascribed to the word "and" may assume decisive importance.[95]

If a literal interpretation of the Act is regarded as unduly destructive of legitimate security interests, as it would seem, it would probably be more desirable to have the Act amended rather than to await a slow and tedious construction of the Act by the Supreme Court. Even under a literal interpretation, however, it is still open to the states to declare their own social policy by defining the status of creditors and *bona fide* purchasers. State action will probably await construction of the Act by the Supreme Court.

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93. Hanna, *Some Unsolved Problems under Section 60a of the Bankruptcy* Act (1943) 43 COL. L. REV. 58, 60.

94. In Louisville Joint Stock Land Bank v. Radford, 295 U. S. 555 (1935), the Supreme Court decided the interests of a secured creditor had been unconstitutionally invaded because the first Frazier-Lemke Act sought to take from it substantive interests in specified property acquired by the creditor under the law of Kentucky. The constitutionality of the second Frazier-Lemke Act was sustained in Wright v. Vinton Branch of the Mountain Trust Bank of Roanoke, 300 U. S. 440 (1937).

95. See *supra* note 26.